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A FREE MARKET APPROACH TO FEDERAL CONTRACTING: THE FAIR COMPETITION ACT OF 1998 AND THE COMPETITION IN COMMERCIAL ACTIVITIES OF 1998

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, RESTRUCTURING, AND THE DISTRICT OF COLUMBIA

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

AND THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

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U.S. SENATE,
OVERSIGHT OF GOVERNMENT MANAGEMENT, RESTRUCTURING AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE, OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS, JOINT WITH U.S. HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY, OF THE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT.
Washington, DC.

The joint hearing met, pursuant to notice, at 2:11 p.m., in room SD–342, Dirksen Senate Office Building, Hon. Sam Brownback, Chairman of the Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, presiding.

Present: Senator Brownback and Representatives Horn, Sessions, Maloney, and Kucinich.

OPENING STATEMENT BY SENATOR BROWNBACK

Senator BROWNBACK. The hearing will come to order.

Thank you all for joining us today. I want to welcome you to our joint hearing examining the Fair Competition Act of 1998 and the Competition in Commercial Activities Act of 1998. I would especially like to welcome our colleagues from the House Subcommittee on Government Management, Information, and Technology, Congressman Horn who is present, and I would particularly like to note his leadership on this topic. For all the years I have been in Congress, the House and the Senate has been a leader on this topic, and we are moving forward with something positive, and I am glad to be associated with him.

Our Subcommittee held a hearing in June of last year on the previous version of S. 314, the Freedom from Government Competition Act, and listened very carefully to industry and Federal Government representatives testify about the strengths and the weaknesses of our legislation. Since then, we have been redrafting the legislation to accommodate various concerns, and I believe we have come a long way to move this bill toward enactment.

The reason for the legislation, I think is clear. The current Federal competition policy, also known as OMB Circular A–76—that is quite a title—is not working. A–76 provides guidelines for a com-

petition process, but Federal agencies are not required to follow these guidelines, and as a result, many agencies simply ignore them.

Last year, OMB asked Federal agencies to provide the number of Federal employees currently performing commercial activities in-house. The results varied widely. For example, the Department of Defense follows the OMB competition guidelines under A–76. DOD acknowledged that about 59 percent of their employees engaged in non-inherently government or commercial activities. Other Federal Cabinet agencies, however, claimed that on average approximately 5 percent of their employees are performing commercial activities. Two agencies, the Department of Commerce and the Department of State, chose not to respond to the OMB survey at all. I hope that these responses are not indicative of an attitude of resistance to competition in these Federal Cabinet agencies, and I also hope that this discrepancy between the Department of Defense and the rest of the Federal agencies will be explained by some of our witnesses today.

In redrafting this legislation, representatives from the Federal Employees Union and private industry made it clear that OMB Circular A–76 does not work because Federal agencies ignore it. We have got a little cartoon graphic here for that.

As a result, on one side of the table, private industry says that Federal employees are favored because the agency chooses to keep these functions in-house, and on the other side of the table, the unions say Federal agencies choose to immediately contract out commercial functions without giving Federal employees a chance to compete for these functions.

In order to address these concerns from the Senate Subcommittee at the last hearing, the new bill implements a competitive process which includes both the private industry and the Federal employees. Both sides have an opportunity to compete on a level playing field.

Another concern raised at our Subcommittee's last hearing is the need for flexibility in determining an inclusive competition policy.

In addition, the unions expressed the need for cost comparisons to be included when determining whether the functions should be performed by the Federal Government or the private sector.

Since then, all sides on this issue have acknowledged that fair competition between the Federal agencies and private industry is essential to ensure that the Federal Government is getting the most for each taxpayer dollar spent on these non-inherently governmental functions. As a response, we have redrafted S. 314 to create a level playing field for fair competition to take place between a private sector and the Federal agencies. The Fair Competition Act addresses all of these concerns. The ongoing discussions with representatives from all sides of this issue are very important to redrafting this bill. We are very serious about moving this legislation through Congress this year, and I look forward to working with our colleagues in the Senate and the House and the administration to make this happen.

With that, I want to acknowledge Congressman Horn for an opening statement and again state how pleased I am to be associ-

ated with him on this effort that he has focused so much intensity on in moving this issue forward.

Congressman Horn.

OPENING STATEMENT OF STEPHEN HORN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. HORN. I thank you, Mr. Chairman. We are delighted to be with you. We have learned to appreciate your expertise and knowledge and commitment in the House. We are sorry you went over here, where you have all this space and beautiful hearing rooms, but it is nice to be on your turf.

Today, we are examining a policy in the area of commercial activities performed by the Federal Government. Current policy is governed by the Office of Management and Budget Circular A–76, something I remember well, I happened to be in the Eisenhower administration, which says: one, that agencies ought to rely on private sources for commercial activities, and on government sources for inherently governmental activities; two, that agencies should not start new commercial activities if they can get a contractor to perform the activity; and, three, that agencies will subject their in-house commercial activities to competition.

According to information provided by the Office of Management and Budget, not one single agency, outside of the Department of Defense, uses A–76 competitions. The Department of Defense does follow the circular, largely because there is an implicit agreement that savings will go to other agency programs—namely, force modernization.

We have an administrative policy promulgated by the President through OMB that is simply not followed. It is into this vacuum between policy and practice that the current legislative proposals seek to fill.

This policy dates from 1954, as I noted, President Eisenhower's first term, when Congress passed a version of H.R. 9835, legislation establishing a policy of relying upon the private sector sources for commercial activities. H.R. 9835 passed the House by a voice vote, was amended in the Senate, but never became law. We have seen that happen a few times in our careers.

Resistance to the current proposals sounds eerily familiar to objections heard 40 years ago. In the House debate, then-Representative Tip O'Neill, Jr., Massachusetts, argued for retaining the plant in Massachusetts that made rope for the Navy. Others discussed the Federal operations making coffee roasters, dentures, sleeping bags, and even iron and steel plants. Most of these operations are now defunct, and we have contracted with private vendors to make dentures, and the coffee to stain them, with specialized firms that have those functions as their core missions. In response, the Bureau of the Budget promulgated a bulletin on this issue, which evolved into OMB Circular A–76.

In the private sector, specialization and competition have reduced costs and improved performance and consumer choice. The most competitive sectors of the economy are also the most innovative. Federal antitrust policy is designed to ensure competition, so that customers do not get gouged. We need an antitrust policy for

the Federal Government, to ensure that competition brings benefits to taxpayers.

My own view is that some agencies already have the most experienced and efficient people doing the job. But other agencies do not, especially as buyouts have removed some of the most capable performers. Competition can be a spur to improve performance in either case. According to the General Accounting Office, Congress' audit arms that program in money, competition can reduce the cost of government by an average of 20 to 35 percent. That is real money.

I know that there are vendors who have been harmed by government competition. I also know that there have been Federal employees harmed by contracting out. There have been spectacular failures by contractors, equally spectacular failures in government agencies in functions performed by Federal employees. But our primary purpose here today is to focus on good government demanded by the taxpayers who sent us here, and who ultimately pay the bills of not only Congress, but the Executive Branch.

Today, we will hear from the sponsor of the bill, my next-door neighbor my first year in Congress, Senator Craig Thomas of Wyoming, a very distinguished, dedicated Member. Our witnesses represent some of the best minds in this area at the Federal, State, and local levels, and at the employee as well as employer levels, and we look forward to their testimony.

I want to add that the staff has received several unsolicited statements for the record of this hearing. The Subcommittee would like to encourage additional thoughts on this issue, and we will hold open the testimony for 3 weeks for any person to provide a statement. We do not mean to close the door to any point of view, and we encourage healthy debate.

Thank you very much, Mr. Chairman.

Senator BROWNBACK. Thank you very much.

We would like to invite to the table, Senator Craig Thomas, the sponsor of the Fair Competition Act of 1998. We were going to have Congressman John Duncan, but his plane has been delayed. So he will not be able to be with us.

Senator Thomas, I would note at the outset, after your presentation and the questions, you would certainly be welcome to join us on the dias if you would like to. I may have to slip out at one point for an amendment that I have on the floor during this hearing. So that may be something that has to take place.

Welcome. I know you have been doing a lot of work on this act, and please fill us in.

TESTIMONY OF HON. CRAIG THOMAS, A U.S. SENATOR FROM THE STATE OF WYOMING

Senator THOMAS. Thank you very much, Mr. Chairman. Mr. Chairman, Steve, nice to see you.

I appreciate very much your having the hearing today. I have appeared before both of you in the recent past. We have made subsequent changes to the legislation, as you know, with your cooperation and your involvement. So I appreciate the opportunity to testify.

I also thank Congressman Duncan, my colleague, for his hard work, and I am sorry he could not be here today.

For over 40 years, it has been the administrative policy of the Federal Government to rely on the private sector for its commercial needs, a policy that is now found in OMB Circular A–76. The basis, of course, for this legislation is that A–76 is a fundamentally flawed process that is basically ignored.

For example, OMB estimates there are nearly 500,000 Federal employees who are doing commercial work. OMB acknowledges that this is a conservative estimate because two Cabinet agencies and a host of smaller agencies did not even bother to respond and turn in a commercial inventory. What can OMB do about it? Nothing.

The fact is CBO has estimated that well over a million Federal employees do commercial work. Even those agencies that do compile a commercial inventory maintain a government monopoly by keeping commercial work in-house and refuse to conduct A–76 cost comparisons.

Because A–76 is an administrative policy, there is little OMB or the private sector can do to challenge these anti-free market practices. In fact, under reinventing government initiatives, agencies not only in-source without competitions; they also market their services to the private sector. This is such a big problem that all three sessions of the White House Conference on Small Business rated unfair competition as one of the top concerns to small entrepreneurs.

But, OMB lacks important data on the commercial work of the Federal Government. OMB does not know the dollar value of commercial activities the Federal Government conducts. It does not know how much reimbursable work Federal agencies do for one another. It does not know how much work the Federal Government does for State and local governments.

In fact, in a recent article, the *Washington Times* named A–76 as one of the seven worst regulations in America. It said, "Circular A–76 has raised so many obstacles and regulatory impediments to market reforms at the Defense Department, it is having the opposite effect of its original intentions." A–76 studies often take more than 2 years to complete. The cost comparison under A–76 are like comparing apples and oranges. A level playing field does not exist due to differences in public and private sector accounting structures, work organizations, and budgeting processes, but the worst part of the whole A–76 mess is that the American taxpayer gets shortchanged.

Studies by OMB, DOD, and GAO show that the government can save 20 to 30 percent or more when services are competed. That means the Federal Government could get better goods and services and actually save billions of dollars annually, but since A–76 is not fair and is not used, the taxpayers never get the benefits of those improved goods and services or the cost savings associated with competition.

To inject free-market competition into government monopolies, for the past several years, I have been the Senate sponsor of the Freedom of Government Competition Act. Previous versions of the bill would have codified the 40-year-old administrative policy of re-

liance on the private sector. However, the new and improved bill we are talking about today has been significantly restructured, and I want to stress this point. No longer does the bill require outsourcing to the private sector. Instead, it replaces the one-side cost comparison found in A–76 with a competitive process, which will allow Federal employees and private sector businesses to compete on a level playing field.

The redraft provides for simple and fair process. It requires a list of non-inherently governmental activities. It requires activities on the list to be subjected to competition. It provides for a challenge process to these decisions. This bill avoids the pitfalls of A–76, which is unfair, unused, and unenforceable.

OMB will say the bill is not needed; that it is doing a good job of implementing A–76. The fact is that an administrative policy does not work and has not worked, and the time has come for a statutory requirement that is, in fact, enforceable.

OMB also will say that the judicial review portion of the bill will tie up agencies' decisions in courts, and I share OMB's dislike for litigation, but I do not think that a taxpaying citizen should lose his job because the Federal Government ran him out of business without giving him a chance for some kind of judicial recource. The fact is judicial review has been part of many other government reform laws.

Further, legislation introduced in the past by congressional Democrats to ban contracting out included judicial review. So there seems to be bipartisan agreement that some kind of redress is appropriate.

OMB will, no doubt, criticize some other details of the bill. Reasonable people can, in fact, disagree, and I appreciate OMB's willingness to discuss these issues.

As I indicated to OMB in a meeting the other day, I am not necessarily tied to this approach on how we get there. I think the goal—which is fair competition and to allow the private sector to participate on a fair playing field, and how we get there is something that we can all talk about. I am more interested in the results than the process, and the fact is that A–76 is not producing the results.

In the past, unions have endorsed public-private competition. This bill empowers Federal employees. They complain that agencies are contracting without using A–76. They feel that they do not have the opportunity to compete. They ought to endorse this legislation. It allows them to compete on a level playing field. Where they stand on this bill remains to be seen.

This legislation has been fundamentally rewritten. Is it perfect? No, but that is why we are here, and I am willing to work with anyone that has an interest in this matter.

As I said before, I am not so concerned about the details as I am in the outcome. Saving American taxpayers money, creating a Federal Government that works better and costs less, that is the goal.

So Chairman Brownback, and Chairman Horn, I thank you so much for the opportunity, and I look forward to working with you as we seek to perfect this legislation.

Senator BROWNBACK. We look forward to working with you, and we appreciate you bringing this bill forward. It is my hope that we

can move it forward this session of Congress through the Subcommittees, the Committee, and onto the floor for a successful vote, and hopefully get it to the President's desk.

I noted with interest your point of OMB's estimate that 500,000 Federal employees are doing private sector type of work. That is a significant number and a conservative estimate. We really need to get at that, so that the Federal taxpayer or the taxpayers in the country can get their money's worth.

I appreciate the Senator's work, what he is doing on this, and we will look forward to working with you as this process moves on forward.

Senator THOMAS. Thank you very much.

Senator BROWNBACK. Congressman Horn.

Mr. HORN. Senator, I am curious if you can sum up in a couple of sentences how your apparatus would work compared to A–76, so we do not have the dilly-dallying we have had since the Eisenhower administration.

Senator THOMAS. Steve, no one can sum up in the Senate in a couple of sentences. No, I am kidding.

Mr. HORN. Well, I am a college professor. I am use to 50-minute dialogs, also.

Senator THOMAS. I think your question is valid, you can do different things. The key to it is that it is a statutory requirement, currently it is not. So we have had this in place, as you mentioned, since the Eisenhower administration. It has been there. It has been the concept. It has been the notion. It has been the policy, but it does not have any enforcement. So what we are seeking to do, I think, basically is to accomplish the same goal, but we have found that it does not work, and it is the old saying, if you want different results, you cannot keep doing the same thing. So I do not think we can keep doing the same thing and expect the results to be different.

Mr. HORN. Well, if it is statutory, which it would be if we passed it, what are the sanctions if they do not do it? There is a lot of laws that the Executive Branch, regardless of party, seems to have a great knack for not following.

Senator THOMAS. Well, first, the responsibility would be more ours (Congress) to ensure that it happened. After all, if we put it into statute, then we have some responsibility to ensure that it happens, as with any other law. I think that is also why there is some opportunity for some sort of judicial review. There should be some kind of a way to test that statute and see that it works. I am certainly not one that encourages litigation, but that is as fair here as it is everywhere else.

Mr. HORN. Should there be some kind of base closure mandatory mechanism that each year an agency would have to put certain things on the chopping block, and then that would be looked at by an independent commission? Does that make any sense?

Senator THOMAS. I do not know. I frankly do not think it would be that hard to enforce if, in fact, it were a statute, if, in fact, agencies went through and did the listings with respect to the various commercial activities, and I am sure that you and I, for example, would get reactions from people at home, in the private sector, and probably some reactions from people in government if they did not

think this was working, and there would then be pressure to do something about it.

So I think it would be enforced if it were a statute, and I believe that is what we ought to do.

Mr. HORN. Recently, we reviewed strategic plans from the various agencies. Should we make this a fundamental element of a strategic plan? That is also one way to deal with it.

Senator THOMAS. Yes, absolutely.

Mr. HORN. That would force at least yearly goal-setting and looking at a situation within a particular area.

Senator THOMAS. As you said, we are in the process. I am Chairman of the Subcommittee on Parks. In fact, that is where I am supposed to be right now. We are trying to do some things on management there, and we are pushing for a strategic plan at the agency level, a strategic plan at the various park levels, plans that include measurable results.

We have found through GAO studies that quite often the budget proposals that are submitted by agencies for the activities listed are not the activities that the money was spent for. So I think you are exactly right. I think there ought to be in the strategic plan and in the management plan some measurable kinds of results, so that you could look at them very easily, and this could be one of those.

Senator BROWNBACK. Thank you very much, Senator Thomas.

Senator THOMAS. My pleasure. Thank you.

Senator BROWNBACK. We appreciate it. We look forward to working with you.

Mrs. MALONEY. Good to see you again, Senator Thomas.

Senator THOMAS. Thank you. Nice to see you.

Mrs. MALONEY. We miss you in the other body.

Senator THOMAS. Well, I miss being over there, as a matter of fact.

[The prepared statement of Senator Thomas follows:]

OPENING STATEMENT OF SENATOR THOMAS

Chairman Brownback, Chairman Horn, Members of the Subcommittees, thank you for the opportunity to testify before you today regarding the important issue of direct Federal Government competition with the private sector. I especially want to thank both Chairmen for their hard work and continued interest in this matter. I also thank Congressman Duncan, the primary sponsor of this legislation in the U.S. House, for his dedication to this topic.

Need for Legislation: A–76 is Fundamentally Flawed and Routinely Ignored

For the past four decades, it has been the administrative policy of the Federal Government to rely upon the private sector for its "commercial" needs. This policy was originally issued in 1955 during the Eisenhower Administration in reaction to a bill very similar to the original version of this legislation that was moving through Congress at the time. However, Congress relented when President Eisenhower agreed to solve the problem administratively. This policy is now found in Office of Management and Budget (OMB) Circular A–76. Basically, it requires Federal agencies to submit a list of commercial activities and the number of Federal employees engaged in those activities to OMB. A–76 lays out a process for dealing with these activities, namely cost comparisons between public and private sources for the right to provide a good or service. Unfortunately for the American taxpayer, that policy is fundamentally flawed and routinely ignored.

For example, OMB estimates that there are nearly 500,000 Federal employees currently doing work that is commercial in nature. Over 90 percent of these employees are in the Department of Defense. OMB acknowledges that this is a conservative estimate because the Department of Commerce and the State Department

didn't bother to submit commercial inventories to OMB. Further, most other smaller Federal agencies declined to file a commercial inventory with OMB. In fact, CBO has estimated in the past that well over one million Federal employees are engaged in commercial work. And even in those agencies that do file commercial inventories with OMB, they keep commercial work in-house and maintain their government monopolies by refusing to conduct A–76 cost comparisons. Because A–76 is an administrative policy, there is little OMB can do to make agencies change their current monopolistic practices.

But that's only part of the story. OMB has no idea what the dollar value is of commercial activities the Federal Government engages in, how much reimbursable work Federal agencies do for each other, or how much work the Federal Government does for State and local governments. Further, OMB and other Federal agencies ignore an existing Executive Order that requires each agency to compete 3 percent of its commercial activities each year.

A recent article in the *Washington Times* named A–76 as one of the seven worst regulations in America. The article states, "Alas, Circular A–76 has raised so many obstacles and regulatory impediments to market reforms at the Defense Department it is having the opposite effect of its original intentions." For example, A–76 studies routinely take over 2 years to complete and at best allow for apples to oranges comparisons between public and private sector capabilities. A level playing field does not exist due to differences in public and private sector accounting structures, work organization and budgeting processes.

It is unfortunate that A–76 is broken and ineffective because the net effect to the American taxpayer is billions of dollars wasted each year. Activities ranging from the mundane to the high-tech, from laundry services to information technology are performed by government monopolies, even when they can be obtained more cost effectively from the private sector at equal or higher quality.

Studies by OMB, the Department of Defense (DoD) and the General Accounting Office (GAO) show that the government saves 20 to 30 percent or more when services are competed. Similar savings were found when the private sector was utilized in several State and local governments in the United States and throughout the world. Later today, Mayor Goldsmith of Indianapolis will explain in detail the success he has had in providing his constituents with better services at lower costs by utilizing competitive market forces.

However, under the Clinton Administration's "reinventing" government initiatives, agencies not only engage in commercial activities for their own use (or so called in-sourcing), but have become entrepreneurial and are marketing their services to other government agencies and the commercial marketplace. In many cases, they are displacing private sector firms, a number of which are small businesses. In fact, the problem has become so pervasive that all three sessions of the White House Conference on Small Business ranked unfair competition from government and government supported entities as one of the biggest concerns to small entrepreneurs.

Legislation Has Been Significantly Re-Drafted

To inject market competition into government monopolies in Washington, for the past several years I have introduced the Senate version of the "Freedom from Government Competition Act." Its main premise was based on the 40-year-old policy that the Federal Government should rely on the private sector for its commercial needs. However, this legislation before you today has been fundamentally restructured. Based on input from many parties, including OMB, GAO, private industry and labor unions, this legislation has been re-drafted to establish a simple and fair process.

For example, the bill no longer requires outsourcing all Federal commercial functions. Instead of the one-sided cost comparison that favors government production of commercial goods and services now found in OMB Circular A–76, this legislation will allow Federal employees and private sector businesses to compete on a level playing field. This change will guarantee the American taxpayer will get the highest quality goods and services for the lowest possible prices.

Basically, the re-drafted legislation does three things: (1) It requires Federal agencies to compile a list of "non-inherently governmental activities;" (2) It requires those agencies to run competitions for those activities within a specific time frame; and (3) It provides a process for both the public and private sector to challenge agency decision. By narrowing the focus of the bill and stripping it down to a simple process, this legislation avoids the pitfalls of A–76, which is unfair, unused and unenforceable.

Criticism of Re-Drafted Legislation

OMB will testify today that this bill is not needed. My testimony has already documented OMB's inability to enforce A–76. The fact of the matter is that an administrative policy has been in place for over 40 years and it has not worked. The time for a statutory provision has come.

Another objection OMB will make today is that passing this legislation will invite lawsuits from private sector businesses and labor unions that will tie up the process indefinitely. While I share OMB's dislike for lawsuits, I do not share the belief that a tax paying citizen should lose his job because the Federal Government ran him out of business without giving him the ability to go to court. The fact is that judicial review has been a part of several recently enacted laws like the Regulatory Flexibility Act and there have been few problems. Further, legislation introduced in the past by congressional Democrats (Rep. Kanjorski for example) to ban contracting out has included judicial review as a vital component, so there seems to be bipartisan agreement that judicial review of some sort is appropriate.

No doubt OMB also will offer some criticisms of how the re-draft is structured and how it would be implemented. Reasonable people can disagree about some of these details. And I appreciate OMB's willingness to discuss these issues. But what's inarguable is that the American taxpayer is being shortchanged by the current system.

Even Federal employee labor unions think the current process has problems. They complain that A–76 isn't used and that agencies contract out regardless of cost or performance. Quite frankly, the labor unions ought to endorse this legislation, because it provides Federal employees the opportunity to compete with private sector businesses on a level playing field. this bill would empower Federal employees. In the past, the unions have said that they strongly endorse competition. Where they stand on this bill will see if their actions match their rhetoric.

Conclusion

This legislation has been fundamentally re-written. Is it perfect? No. But that's why Congress has the committee process. I am willing to work with anyone, with any group that has an interest in this matter. Quite frankly, I am not so concerned about the details as I am about the outcome—saving taxpayers' money and creating a Federal Government that works better and costs less.

Again, I thank Chairman Brownback and Chairman Horn for their continued interest in this issue. I also salute my colleague, Congressman Duncan for carrying the banner on the House side for many years now. I look forward to working with you and this Committee to enact this good government, common sense reform.

Mr. HORN. Yes, sir.

Senator BROWNBACK. Congresswoman Maloney and Congressman Kucinich, do you have any questions of this witness?

Mrs. MALONEY. I just, in the interest of time, would like to know if my opening statement could be put in the record as read.

Senator BROWNBACK. Absolutely, without objection.

Mr. KUCINICH. Mr. Chairman, I would like to do the same. Thank you.

Senator BROWNBACK. Absolutely.

[The prepared statements of Hon. Carolyn B. Maloney, Hon. Dennis J. Kucinich, Hon. John J. Duncan, Jr., and Hon. Steny H. Hoyer follows:]

PREPARED STATEMENT OF HON. CAROLYN B. MALONEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Thank you, Mr. Chairman. And welcome Representative Duncan and Senator Thomas.

I look forward to today's hearing on the "Freedom from Government Competition Act," the "Competition in Commercial Activities Act," and the "Fair Competition Act." These bills go to the heart of the debate about the nature and proper role of government. Which functions should government perform and which functions should the private sector perform.

Privatization, or contracting out, is not a cure-all for government problems. But if implemented wisely, contracting out can be a useful tool in providing services for the American public more economically and efficiently. However, we must remember

that it is just one tool. Empowering workers through training, treating them as assets, and striving to improve management techniques are all great examples of tools we will need in government for the next century.

The Federal Government relies on commercial contractors for $120 billion annually in needed goods and services. The legislation we will talk about today is designed to substantially expand that amount. However, contracting out raises a number of difficult and contentious issues, which we should discuss here today. Cost accounting standards, contract management controls and job placement and training for displaced workers are but a few.

We must also be cautious that contracting out a service doesn't end up costing us more in the long run, because once turned over to the private sector, it is often difficult and expensive for the government to regain control. For example, private trash hauling in New York City costs five times what it does in San Francisco. The Los Angeles school district wound up a few years ago with a $3 million bill for deficits run up by a contractor hired to run the school food services. On the other hand, New York City gave park service workers greater control over their jobs and found that they could operate more efficiently than private contractors. In a 1992 experiment, the cost of tree removal in Queens and the Bronx by city workers was thousands less than a contractor would have charged.

Contracting out is a process which needs to be carefully scrutinized. First, we need accurate and complete information on what is to be privatized and why. Second, we must insist on sound contracts that incorporate incentives for cost savings including severe penalties for failure to perform. Finally, we should have a strong and effective job placement program for displaced workers.

Thank you, Mr. Chairman, I look forward to hearing from our witnesses.

PREPARED STATEMENT OF HON. DENNIS J. KUCINICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Thank you, Mr. Chairman. I would also like to thank Chairman Horn for agreeing to hold this hearing at my request. The issues raised by this legislation are fundamental ones. How they are settled will have a profound and lasting impact on the structure of the Federal Government, on Federal employees, and on the American public. A full and fair discussion of these issues is vital to the legislative process, so I appreciate this opportunity, and the Majority's willingness to take into account our views on what would constitute a balanced panel of witnesses.

That being said, I must also frankly state that I have serious concerns about this legislation as currently drafted. I'm sure that every Senator and Representative here today believes that our job is to constantly strive for a more efficient and cost-effective Federal Government. The current administration has made great strides in that effort through the longest-running government reform effort in America's history. The policies have already saved American taxpayers over $130 billion dollars. The size of the Federal workforce has been reduced, through attrition and buyouts, by over 300,000 employees. We now have the smallest Federal workforce since John F. Kennedy was President.

This legislation seems to proceed from the premise that the Federal Government is not contracting out enough, despite the fact that we already spend more on the contracting of services—about $114 billion in fiscal year 1997—than we spend on pay and retirement for the entire civilian workforce. In fact, some of the more-recently created Federal agencies like the Department of Energy, NASA and EPA have relied from the start on contracting out for services rather than performing them directly. Critics of the current process as embodied in OMB Circular A–76 maintain that only the Defense Department is actively pursing public-private competitions, yet almost 40 percent of the $114 billion in service contracting comes from the civilian agencies.

So we are already spending vast amounts of money on services contracts. Unfortunately, in many cases that money is probably being poorly spent. According to both OMB and the General Accounting Office, contract administration is one of the highest risk activities the government engages in. Examples abound: Senate hearings uncovered $27 billion a year in contractor Medicare fraud; in 1995, $25 billion in payments to defense contractors could not be matched invoices, and in many cases DOD relies on the contractors themselves to identify overpayments; at one DOE site, a contractor poured toxic and radioactive waste into the ground, and stored more in leaky drums.

Whether from outright theft, charges of unallowable costs, lack of top-level management attention to contract management, or ineffective contract administration and auditing, the Federal Government is losing billions of dollars a year. It seems

to me that this bill puts the cart before the horse. If we are truly interested in a more cost-effective government, we should drastically improve contract management before moving to contract out billions more in services. Yet the legislation before us is silent on these vital issues.

The legislation before us also seems to me to have a one-sided approach which favors the contractors, at the expense of Federal employees and the American public. The bill requires Federal agencies to create an inventory of functions which are not inherently governmental. It then allows "interested parties" to challenge omissions from this list—but not inclusions. Parties with a direct economic interest in particular activities could, under the Senate draft, sue in Federal court to challenge an omission. Affected public interest groups, employees organizations and the general public are given no similar standing if they feel a particular activity is an inherently governmental function and should not be contracted out. In addition, the bills seem to prohibit contracting in. Denying agencies the ability to compete and bring certain functions back in-house is inherently unfair to government employees. It also works against the very efficiency and cost-effectiveness the bill is supposed to achieve.

Finally, Mr. Chairman, we need to establish a truly level playing field if we are to embark on the course this bill envisions—including comparable pay, benefits and working conditions between Federal employees and contractor employees. The authors of this legislation claim it will save substantial sums of money. I am not convinced that is the case, but any savings must not be on the backs of American workers, and dedicated Federal workers should be held harmless if they lose their jobs.

I welcome our witnesses and thank you Chairmen.

PREPARED STATEMENT OF HON. JOHN J. DUNCAN, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Chairman Horn, Chairman Brownback and Members of the House and Senate Subcommittees, it is my pleasure to appear before you today. As the sponsor of H.R. 716, the Freedom From Government Competition Act, I am delighted that the Subcommittee is conducting this hearing to explore legislative strategies that could and should be implemented to save tax dollars, empower the private sector, eliminate unfair government competition with and duplication of private firms, focus loyal and hardworking Federal employees on those important functions that only the government can and should perform, and to truly have a government that works better and costs less.

As you know, Senator Thomas has introduced the Senate companion bill to H.R. 716. I would like to thank him for his work on this legislation. Our bills have bipartisan support with 66 cosponsors in the House and 14 in the Senate. In addition, this legislation has been endorsed by a number of organizations including the U.S. Chamber of Commerce, the National Federation of Independent Business, and many others.

I think the legislation that I have introduced with Senator Thomas is a very modest proposal. It does not require the Federal Government to contract everything out. We recognize that there are things that the government does best and there are functions that only the government should do. This bill does not require the government to contract out functions that are related to national security or those things that are related to the core mission of an agency. It requires only that the Federal agencies look at those things they do which are commercial in nature.

The history of government competition is a long one. Based on my research, it is my understanding that legislation like mine was first introduced in Congress in 1954. Faced with the prospect of enactment of such a bill, the old Bureau of the Budget in the Eisenhower Administration issued a policy statement on reliance on the private sector. A bill was reported by the House Government Operations Committee, passed the House and was reported by the Senate Governmental Affairs Committee. The Executive Branch argued that legislation was not necessary, that it inappropriately would inject the Legislative Branch into the legitimate management functions of the agencies. So, in lieu of that legislation, an Executive policy was issued. And over the past 40 years, Federal agencies have grown, the expanse of agency performance of commercial activities has proliferated, and the extent to which government activities duplicate, and indeed, compete with the private sector has become extensive.

In fact, the genesis of contracting out legislation dates back even further. The history of government competition is best described by Dr. Allan V. Burman, President Bush's Administrator of the Office of Federal Procurement Policy. In testimony be-

fore the Subcommittee on Human Resources of the Committee on Post Office and Civil Service, on January 25, 1990, he said:

> "As far back as 1932, a Special Committee of the House of Representatives expressed concern over the extent to which the government engaged in activities which might be more appropriately performed by the private sector. The first and second Hoover Commissions expressed similar concern in the 1940's and recommended legislation to prohibit government competition with private enterprise. However, there was no formal policy until 1955, when Congress introduced legislation to require the Executive Branch to increase its reliance on the private sector. Finally action was dropped only upon assurance from the Executive Branch that it would implement the policy administratively. Bureau of the Budget Bulletin 55–4 . . . was issued in 1955 prohibiting agencies from carrying on any commercial activities which could be provided by the private sector. Exceptions were permitted only when it could be clearly demonstrated in specific cases that the use of the private sector would not be in the public interest."

On January 15, 1955, the policy directive issued by President Eisenhower stated:

> "The Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels."

Dr. Burman told the Subcommittee:

> "Since 1955, every Administration has endorsed the general policy of reliance on the private sector to provide commercial and industrial services."

Unfortunately, that policy has not been implemented. It is estimated that as many as one million Federal employees are engaged in commercial activities. While this policy has been endorsed by every Administration, Republican and Democrat, since 1955, enforcement has been poor.

This Federal policy is now found in Office of Management and Budget Circular A-76. This circular is a miserable failure. It is completely up to the agencies to decide if they want to convert their in-house activities to contract. It is up to the agencies to decide if they want to do an A-76 study. It is up to the agencies to decide whether to perform an activity in-house or by contract.

It is my view that legislation is both necessary and desirable. It is desirable because it has been estimated enactment of this bill could result in as much as $9 billion per year in savings without cutting services. It is necessary because the experience of the past 40 years has shown that without a legislative mandate, agencies will not take this action on their own. Numerous organizations have conducted studies on contracting out. In 1984, the Grace Commission recommended contracting out and estimated that $4.6 billion a year could be saved by using private contractors to perform the commercial activities currently accomplished in-house by Federal employees, while at that time OMB estimated the savings at up to $3 billion annually.

In 1995, the Heritage Foundation issued a report, "Cutting the Deficit and Improving Services By Contracting Out" which stated:

> "Contracting out government services to the private sector offers the new Congress the winning opportunity to make substantial cuts in Federal spending as much as $9 billion per year—without reducing essential constituent services."

The 1995 report of the Commission on the Roles and Missions of the Armed Forces, known as the "White Commission" indicated that in the Department of Defense

> "at least 250,000 civilian employees are performing commercial-type activities that do not need to be performed by government personnel . . . we are confident our recommendations for greater use of private market competition will lower DoD support costs and improve performance. A 20 percent savings from outsourcing the Department's commercial-type workload would free over $3 billion per year for higher priority defense needs. . . . We recommend that the government in general, and the Department of Defense in particular, return to the basic principle that the government should not compete with its citizens."

In 1980, the first White House Conference on Small Business made unfair competition one of its top issues. It said:

"The Federal Government shall be required by statute to contract out to small business those supplies and services that the private sector can provide. The government should not compete with the private sector by accomplishing these efforts with its own or non-profit personnel and facilities."

The issue of government competition with the private sector has become so pervasive that the 1986 White House Conference on Small Business adopted as one of its leading planks:

"Government at all levels has failed to protect small business from damaging levels of unfair competition. At the Federal, State and local levels, therefore, laws, regulations and policies should . . . prohibit direct, government created competition in which government organizations perform commercial services New laws at all levels, particularly at the Federal level, should require strict government reliance on the private sector for performance of commercial-type functions. When cost comparisons are necessary to accomplish conversion to private sector performance, laws must include provision for fair and equal cost comparisons. Funds controlled by a government entity must not be used to establish or conduct a commercial activity on U.S. property."

The 1995 White House Conference on Small Business, again made this issue one of its top priorities. Its plank read:

"Congress should enact legislation that would prohibit government agencies and tax exempt and anti-trust exempt organizations from engaging in commercial activities in direct competition with small businesses."

The National Policy Forum, said:

"In reducing the size and scope of government, it is time for Washington to learn from the lessons of the State and local governments. In Indianapolis, Jersey City, Dallas, Charlotte and Philadelphia, city governments under Democrat as well as Republican administration are turning to privatization to do more with less. In some cases, governments are getting out of the business of doing things they never should have done in the first place. In other cases, private companies compete with public employees to provide service at the highest quality and the lowest cost.

* * *

"The Federal Government can learn much from the new breed of mayors and governors who are responding to the call from their friends and neighbors to put government back in the hands of the people who found it, to rethink the role of government; to get out of businesses it doesn't belong in. . . ."

My bill, H.R. 716, the "Freedom from Government Competition Act" and S. 314 by Senator Thomas, would require each agency of the Federal Government to obtain goods or services from the private sector through ordinary and appropriate Federal acquisition processes if a competition between the government agency and the private sector results in a better value in contractor performance. I want to make that clear. In past sessions of Congress, my bill followed the old 1955 policy that the government should not compete. Senator Thomas and I modified our bills in this Congress to inject the concept of competition between the government and private sector on a level playing field. This was suggested by GAO, OMB, government employee unions and many others. The concept of public-private competitions is also championed by the books "Reinventing Government" and "Banishing Bureaucracy" by David Osborne, and in the Administration's National Performance Review. So there should be bipartisan support for this idea.

Our bill, as well as your committees' draft substitutes, establish important exemptions, including activities where:

- in-house performance is necessary for national defense,
- the activity is so inherently government in nature that it is in the public interest to require performance in-house,
- a declared national emergency, or
- there is no capable private source.

When we look for ways to cut the size of government, we should look first at those activities which can be done by the private sector. There is no reason for Federal employees to design roads and buildings or do surveying and mapping when there are architecture engineer firms and other private sector professionals that can do

this work by contract. There is no reason for agencies to operate motor pools when maintenance of cars can be done by private contractors. There is no reason for the government to operate laboratories or computer centers, when the private sector can do it more efficiently. There is no reason for the taxpayers to pay the salaries of Federal employees to operate cafeterias, guard posts, perform janitorial services, painting, printing, electrical work, and scores of other activities that can be obtained from the private sector, including and especially small businesses, woman-owned businesses and minority enterprises, if those services can be performed better, cheaper and faster in the private sector.

I believe we can and should enact H.R. 716. I believe that when private enterprise is permitted to compete in the marketplace for the right to win a contract to perform a commercial-type service or provide goods for the Federal Government, that competition will result in the best value for money. And that is what the taxpayers demand and deserve.

I commend you for the leadership you have shown. I appreciate this hearing. I strongly support the direction you are going in improving the bill I first introduced. You are making it a better bill.

Let me end with a story. As you know, I have the honor of chairing the Aviation Subcommittee of the House Committee on Transportation and Infrastructure. Fixed wing air flight began with the Wright Brothers in 1903 in Kitty Hawk, North Carolina. Airplanes developed in the ensuing years and air flight became an important part of World War I. The Post Office Department realized the benefits of air flight and worked with the Army Signal Corps to test the concept of air mail service. In 1910, Congress enacted the Air Mail bill to determine the feasibility of scheduled air transport of mail. The tests were a success. By 1918, it was recognized that this was a civilian, not military function, and the service was transferred to the Post Office. In 1925, Congress looked forward to turning Post Office air mail routes over private operators—I do not think the words privatization or contracting out or outsourcing were used in those days. But legislation known as the Kelly Act was passed to authorize the Post Office to negotiate the transfer of air mail routes to commercial operators through competitive bidding. A man named Walter Varney operated a small air-taxi operation known as Varney Air Lines. He bid on a contract to carry mail by air between Elko, Nevada and Pasco, Washington via Boise, Idaho. He won the contract and successfully operated the route. Another route was won by Eddie Hubbard and Philip Johnson. Those experiments in government contracting not only established Air Mail as a service, but gave way to the creation of America's great private airline and aircraft industries. You see, Varney Air Lines is now known as United Air Lines and Mr. Hubbard and Mr. Johnson joined with a Seattle businessman named William Boeing to become officers of the Boeing Corporation.

Mr. Chairman, how many innovative, risk-taking small business men and women are there across America just waiting for the chance to grow, flourish, create jobs and become the future United Air Lines and Boeings. It can all start with a single government-contract. Our predecessors in Congress had the vision to contract for air mail service. I hope we will have the vision to create thousands of new opportunities for a new generation of Americans in the new millennium. That is what this legislation is all about.

PREPARED STATEMENT OF HON. STENY H. HOYER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MARYLAND

Chairman Brownback, Chairman Horn, Ranking Member Lieberman, Ranking Member Kucinich and Members of the Joint Subcommittees, I want to thank you for the opportunity to address you this afternoon.

As a Member of Congress who represents nearly 60,000 Federal employees I have some serious concerns with the House draft legislation entitled "Competition in Commercial Activities Act" and its Senate counterpart the "Fair Competition Act."

I'd like to take just a few moments to point out some problems I see with the draft legislation.

My first concern is that the premise of both bills is that there are too many Federal employees and that the private sector is being unnecessarily excluded from work currently being performed by the public sector. Both these premises are false.

Since the enactment of the Workforce Restructuring Act the government has eliminated 320,000 positions. The Federal Government is the smallest since the Kennedy administration. Additionally, as a percentage of the total workforce, the Federal component is the smallest since 1931.

The second premise that the private sector is being shut out is also false. The fact is that the Federal Government already contracts out with the private sector at

least $120 billion a year; fully $12 billion more than the entire Federal payroll including pay and benefits.

In fact, according to OMB in its 1994 report on contracting practices, it found that the acquisition of services from the private sector is the "fastest growing area of procurement."

Clearly this legislation would cause a significant increase in the amount of Federal activities performed by, and money spent on, contractors. Unfortunately, contract oversight is currently not being managed as well as it should.

According to OMB's testimony before the Civil Service Subcommittee this January, we have no idea how many contractors the Federal Government employs, which agencies they work for, where they work, or how much they are paid.

Both OMB and GAO have been very critical of the Federal Government's contract management. Just last week, DOD's Inspector General testified before the Senate Armed Service Committee that DOD paid $76.50 each for nearly 2,000 screws that usually sell for only 57 cents a piece at a hardware store.

I'm sure that Bobby Harnage, Bob Tobias and Mike Styles can provide you with even more examples of poor oversight and abuse.

The legislation would also require agencies to create a "contractor catalogue" at taxpayer expense. Any function not deemed inherently governmental would be reviewed for contracting out with 5 years.

Aside from the tremendous expense and effort this would require, the bills allow contractors as "interested parties" to challenge omissions from the list of commercial activities.

Regrettably, public interest groups, unions, and the general public are not allowed to challenge an agency's decision to list an inherently governmental function on the commercial activities list.

The Senate draft would go even further. It gives contractors the right to challenge omissions in the U.S. Court of Federal claims. This provision has the potential of hamstringing agencies under a mountain of contractor lawsuits.

Notwithstanding my ardent support of Federal employees and the outstanding service they perform. I recognize that the private sector can, and often does, perform some work at less cost and better quality than the public sector.

However, contracting out is not a panacea and this legislation is a solution in search of a problem.

Competition is already taking place. It needs to be conducted in a manner that provides the taxpayer with the best value while allowing Federal employees to compete on a level playing field.

Senator BROWNBACK. Our first panel of witnesses will be Ed DeSeve, OMB Acting Deputy Director for Management; Skip Stitt, former Deputy Mayor of the City of Indianapolis, who is here to testify on behalf of Mayor Steven Goldsmith. They will be our two panelists on this next panel.

I believe the House has them sworn in.

Mr. HORN. Unlike the Senate, our tradition is to give the oath to all witnesses, except Members, gentlemen. Do you swear the testimony you are about to give these joint Subcommittees is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. DESEVE. I do.

Mr. STITT. I do.

Mr. HORN. The clerk will note that both voted in the affirmative.

Senator BROWNBACK. Thank you very much, gentlemen, for joining us today. We appreciate your willingness to come here and testify on your concerns and interests and, hopefully support, ultimately for this bill.

With that, Mr. DeSeve, I would be happy to give you the floor. Thank you for joining us.

TESTIMONY OF G. EDWARD DeSEVE,[1] ACTING DEPUTY DIRECTOR FOR MANAGEMENT, U.S. OFFICE OF MANAGEMENT AND BUDGET

Mr. DESEVE. Thank you, Mr. Chairman. I am glad to be back.

I am here to discuss proposed revisions to S. 314, currently being cited as the Fair Competition Act of 1998, and to H.R. 716, currently being cited as the Competition in Commercial Activities Act of 1998.

We share with you the goal of seeking the most efficient and cost-effective source for the provision of commercial support activities required by the Federal Government.

Five years ago this month, the President announced and the Vice President led an effort to fundamentally change the way government operates. At the time, it seemed almost impossible. Red tape, poor financial management systems, rigid hierarchies, poor performance incentives, a procurement system in desperate need of repair, systemic problems in our ability to acquire and integrate information technology and senseless rules and procedures separated Federal employees from managers, separated managers from their missions, their responsibilities and their employees, and separated the taxpayer from their government. Today, reinventing government is the longest-running, most dramatic and most successful government reform effort in our history. Together, with you, we have streamlined our infrastructure, eliminated business lines, created partnerships with our employees to contribute to reform, eliminated red tape, changed business practices, eliminated duplication, and, yes, opened our commercial support activities to significantly expanded levels of competition.

As of the end of fiscal year 1997, the administration had cut the civilian Federal work force by over 316,000 employees, creating the smallest Federal work force in 35 years, and as a share of total civilian employment, the smallest Federal work force since 1931.

Almost all of the 14 Cabinet departments have cut their work forces. Only Justice and Commerce have growing work forces. Through these and other reinvention efforts, the administration has saved $137 million over these past 5 years.

The key to this success in working together with you, because many of these were legislative accomplishments, not simply administrative accomplishments, has been our ability to overcome the rhetoric and work together to identify needed reforms. In our view, the House and Senate drafts contain a number of important improvements over last year's Freedom from Government Competition Act. We appreciate that the revised bills no longer center on who may or may not be eligible to perform Federal work. Nothing is more "unfair" than to limit or otherwise arbitrarily exclude a viable offerer, public or private, from the competitive process. Each of us seeks to expand the level of competition for both in-house and contracted work in an effort to improve quality and reduce the cost of services to the taxpayer.

This process works. The differences that remain are not about goals, but, rather, are about how best to achieve them. Contracting

[1] The prepared statement of Mr. DeSeve appears in the Appendix on page 65.

out is a tool, a tool for downsizing, a tool for streamlining, and a tool for better performing work.

In the Defense Department, for example, over 150,000 full-time-equivalent employees have been scheduled for competition with the private sector over the next 5 years. DOD has realized that given its budget pressure and the need to continue its mission that it is going to significantly utilize the A–76 process during this period. Any legislation should contribute to this process and move it forward.

Since we do not have a single bill to react to, let me discuss some of the fundamental principles that a final bill should embody, including some aspects that we hope could be avoided.

First, the government must be permitted to choose the alternative, public or private, which is most cost effective, and in the best interest of the taxpayer.

Second, any legislation should avoid judicial involvement in management decision regarding whether or not to out-source.

Third, the management documentation, employee participation, costing, and source selection rules for the competition must be well understood and able to be enforced and impartial.

Fourth, source selection processes must permit efficient and effective competitions between public and private offerers for work presently being performed by the government or by a private contractor.

Fifth, when an activity currently being performed in-house is converted to performance by contract, the in-house employees must be afforded the opportunity to compete to retain the work.

Finally, we must acknowledge that out-sourcing is just a tool along with other reinventing and management improvement initiatives. It is not an end in itself, and we must not let out-sourcing delay or cause unnecessary administrative burdens on agencies who are using a variety of tools to meet their management challenges.

We would also have concerns with legislation that required the head of an agency to undertake competitions in accordance with a schedule mandated in law. This is not a good idea. We are concerned that such schedules could be unduly burdensome and may preclude agencies from considering a mix of reinvention, reengineering, consolidation, privatization, evolution, and cost comparison efforts.

In conclusion, I have tried to point out some of the principles that we would all want to draw on. We do not believe the proposed revisions to S. 314 and H.R. 716 will achieve the quality improvement or cost reduction goals that I know you are seeking.

Federal employees are some of our Nation's most highly trained and dedicated employees. They operate within a complex system of rules, regulations, and laws. They respond to a vast array of missions, public concerns, and operational requirements. They deserve, as does the private sector, the opportunity to compete for their jobs on a fair and level playing field. This means that the managerial complexities of a public-public and public-private competition need to be recognized. We do not believe that this legislation meets that requirement. We are concerned that the proposed revisions can result in higher costs to the taxpayer.

Thank you very much, and I would be happy to answer any questions that you might have.

Senator BROWNBACK. If I am understanding you, you say you have got a list of criteria that you think need to be met in this bill, but you do not think they are in this bill. You are willing to work with us on seeing if some of these items can be put in, and then you could be supportive of this bill. Is that right, Mr. DeSeve?

Mr. DESEVE. Yes, sir. I think at this point, we oppose the bill, but we think that the ideas embodied in the bill are subject to being able to be worked together with you.

Senator BROWNBACK. OK. And have there been ongoing discussions at this point in time?

Mr. DESEVE. Yes. Senator Thomas alluded to one even last week where we met with the Senator and his staff for that purpose.

Senator BROWNBACK. Good. Glad to hear that those are taking place.

Mr. Stitt, thank you very much for joining us, and the microphone is yours.

TESTIMONY OF SKIP STITT,[1] FORMER DEPUTY MAYOR, CITY OF INDIANAPOLIS, TESTIFYING ON BEHALF OF HON. STEVEN GOLDSMITH, MAYOR, CITY OF INDIANAPOLIS

Mr. STITT. Mr. Chairman, Chairman Horn, and Members of the Subcommittee. My name is Skip Stitt, and I am here today on behalf of the Indianapolis Mayor, Steven Goldsmith.

For most of the last 6 years, I had the privilege of managing the Mayor's Competitive Government Initiative in Indianapolis. I am pleased to provide this testimony to the Subcommittee as part of its consideration of the Fair Competition Act of 1998.

When the Mayor was elected 6 years ago, he ran on an aggressive platform of privatization. Over the years, we have modified that preliminary platform into a rigorous public-private competition model. The model requires head-to-head competition between public and private sector providers. In Indianapolis, services that have been subjected to competition include the operation of the Indianapolis International Airport, our wastewater treatment plants, and our sewer collection system, fleet service operations, printing, copying, filling potholes and solid waste collection.

After 75 competitions, these efforts have generated savings of nearly $420 million. The number of city workers, excluding police officers and firefighters, has been reduced dramatically in Indianapolis. Nonetheless, no union employees have lost a job as a result of our competition efforts. Employee grievances in several competed areas have actually fallen by as much as 90 percent, and workplace injuries in several competed areas have been reduced dramatically as well.

We believe the central focus of this bill, that focus being competition, is appropriate. We have found no better tool to help control the cost to government services, while at the same time ensuring their quality in Indianapolis.

[1] The prepared statement of Mr. Goldsmith submitted by Mr. Stitt appears in the Appendix on page 72.

We would also concur with your efforts to break up the Federal monopoly on service provision, but to still let Federal employees compete for that work.

As someone who has been in the trenches of the competitive government effort for 6 years at the municipal level, let me make a few general comments about the bill.

We operate on the assumption and the belief in Indianapolis that government is full of very good people, most of whom are caught in very bad systems. The regulations that will inevitably be promulgated to implement this bill will need to be very simple, very concise, and focus on results rather than processes.

By reducing the rules and regulations, while simultaneously increasing the decisionmaking authority and flexibility of your talented employees, we believe you will see enormous benefits, irrespective of whether the work is ultimately provided privately or by incumbent employees.

Second, this bill and your efforts will likely be in vain unless there is a very strong commitment at the top of your organization to competition and smaller government.

We have studied many, many competition efforts around the world and have yet to find one that has been successful without strong leadership at the top. To fulfill that need and to serve as an adjunct to the efforts outlined in this legislation, Congress may even consider developing its own list of activities for competition.

This bill also specifically addresses the need to develop systems that support the make-or-buy decisionmaking process. Doing this correctly will be essential to your progress. These systems will likely include activity-based costing or a similar costing methodology, as well as rigorous performance measurement systems that focus on quality and quantity goals for services.

Next, be sure to recognize that your incumbent employees are a tremendous and extraordinary resource. We would encourage you to be very thoughtful, where transitions occur, to pay attention to employee needs, to salary ranges, to benefits, and similar activities.

In Indianapolis, we also found that it was important to reward employee performance when they produced, competed, and won. Nothing got city employees more focused on the bottom line and on serving customers than when we implemented an incentive pay plan funded with operating savings they had identified.

Next, we would encourage you to connect these cost-saving and service-enhancement efforts to positive outcomes. In Indianapolis, we used the savings from our competition efforts to lower our property tax rate and put more police officers on the street.

I anticipate you will find, as we did, that most citizens care very little about the concept of competition, but they care a lot about safe streets, low taxes, and high-quality government services.

Next, I would encourage you not to get caught in the intellectual trap that lowing the cost of services will necessarily lead to lower quality. Our experience with competition in Indianapolis, when it is done right, has indicated that it is possible in some circumstances to spend less and still get more.

Next, this bill excludes activities involving fewer than 10 full-time employees. I understand and appreciate your emphasis on larger budgets. However, one of the most productive byproducts of

our competition effort was the positive effect it had on small, minority and women-owned businesses who competed for and won many of these contracts. We would encourage you to consider ways to extend more Federal market opportunities to these small businesses.

Early on, some Indianapolis vendors confidentially expressed concerns about our process. Many of these concerns were eliminated once the vendor community saw our commitment to continual, open, rigorous, fair, and comprehensive competition. Although I do not have an answer for how you might protect against this, I would anticipate that some Federal service vendors might likewise be reluctant early on to challenge an omission from the list of activities open to competition.

There may also be a concern over the increase in the number of bid protests that would result from an increased number of competitions. As you think both about this bill and about the regulations that will be promulgated to implement it, I would encourage you to focus very carefully on creating an open and public process that maximizes competitive opportunities, minimizes disputes, and eliminates politics from the decisionmaking process.

We also believe it is important to separate staff procurement decisions from staff production decisions. Our experience has shown that it is very difficult for an incumbent administrator to remain unbiased in a make-or-buy procurement decision when their organization both consumes and produces the good or service.

The final point is a comment with respect to A–76. The bill discusses exempting certain A–76 cost comparisons from this process. While we would not argue with that exemption, we feel that A–76 more often frustrates competition than facilities competition. Our experience in successfully privatizing the Indianapolis-based Naval Air Warfare Center, which was done outside of the A–76 process, generally supports that conclusion.

We believe the Fair Competition Act of 1998 is one preliminary step in the process of improving the quality of government services, while at the same time lowering the cost. As a companion effort, we would suggest that it is important to identify the other legal, systemic, cultural, and organizational barriers that exist to improving further governmental efficiency.

To that end, Mayor Goldsmith has previously suggested to the House leadership that a commission be formed specifically to identify obstacles to fair and open competition.

We thank you for the opportunity to be here today and would be happy to answer any questions you may have.

Senator BROWNBACK. Thank you very much, Mr. Stitt, and thank you for coming out from Indianapolis to testify at the Subcommittee.

What we will do is we will run the time clock on a 5-minute basis, and bounce back and forth, if that is all right. We will have another panel that will follow this one as well. So, if we can get the clock ticking here, we will make sure to keep it tight on time.

Mr. DeSeve, I really appreciate you coming here, and your statement earlier that you would be willing to work with us on getting this pulled together. It strikes me that we are talking about the number of employees here involved, 316,000 fewer civilian employ-

ees that you have already worked with, and, yet, half-a-million that are doing commercial type of work or non-inherently governmental work. We have got even some further distance to go along the track and the goal that you have, and certainly that this Congress would like to see taking place. So I think it really is important, if we can, to get this moving on forward and us collectively working together.

The working days that we have in this Congress are not going to be long at length. So we need to really get this moving forward, if you folks can see fit to helping us out on that, or if the figures that Senator Thomas put together is fairly accurate of half-a-million employees involved.

Mr. DESEVE. I think it is 475,000 at the last count in 1996. We will do another inventory this year, probably starting in about 30 days and lasting through the fall.

You have to take out of that the number that the Defense Department is currently putting up for conversion or for review for competition at this point. So we will not know until we get the numbers back in October.

People have always felt it was a conservative estimate, that is, on the low side, but you do have the DOD proposal to review for competition. We want to be very clear. We favor competition and reviewing these jobs for competition. At the end of the day, I think as Mr. Stitt has indicated, some of them may be retained in-house. About half the time when the jobs are competed, they are retained in-house. So what we want is a level playing field for competition on commercial activities.

Senator BROWNBACK. My concern was in looking through those numbers is that the Department of Defense—that one would think of as having generally a higher percentage of jobs that are inherently governmental—is the one that comes up with this enormous number of jobs that they say are not inherently governmental, and, yet, all these other agencies didn't come up with very many. I mean, it struck this observer of that information that the others really were not too forthcoming on their internal analysis. If you do not have the leadership at the top pushing it, it is going to be a tough row to hoe.

Mr. DESEVE. Sure.

Senator BROWNBACK. So we are really going to need your help not only with the legislation, but with the implementation as this moves on forward.

Mr. DESEVE. Yes. We will be happy to push it, as I say, during the inventory this year.

One of the things about DOD, because they provide housing, because they provide commissary services, because they provide other forms of PX and other services, they kind of handle the soldier from beginning to end. They do a lot more things that are, in essence, commercial than a lot of the other civilian agencies. So you are right. You would expect more of the civilian agencies, but DOD is always going to be the leader in this because of their beginning-to-end service to the soldier.

Senator BROWNBACK. Don't you suspect that some of the other agencies did not quite look very sharply on some of these? We had a couple that did not even participate. So I would hope you would think so in those areas.

Mr. DESEVE. I hate to guarantee you anything, but we will certainly heavily encourage 100-percent participation in the survey this time.

Senator BROWNBACK. I do not know if my time is up or not. It is like running a basketball game without a clock, but we will move on to the next one.

Mr. Kucinich.

Mr. KUCINICH. Thank you very much, Mr. Chairman. Mr. Horn, it is a pleasure to join you and Mrs. Maloney here. I am grateful to have a chance to be on this Subcommittee and to have the opportunity now to serve as the Ranking Member of the Government Management, Information, and Technology Subcommittee. I know how important the issues are which come before this Subcommittee, and I also know that part of the great debate which is reflected in this legislation here is considered to be pretty much over.

Listening to the testimony of Mr. DeSeve, quoting you, it is really not about goals, but how to achieve them; that Federal employees are some of the Nation's most highly trained and dedicated employees. They operate within a complex system of rules, regulations, and laws. They respond to a vast array of missions, public concerns, and operational requirements. They deserve, as does the private sector, the opportunity to compete for their jobs on a fair and level playing field.

I really understand where that is coming from, and because I do, I would like to pose this question, Mr. Chairman, just to everyone here, for that matter. You can all answer in the silence of your manifest positions.

I do not think the debate is over, with all due respect, Mr. DeSeve. I say that with 30 years of involvement in public life, off and on as an office-holder. I do not think the debate is over.

So let me bring the ants to the picnic. You talk about it is not about goals, but how to achieve them. I think that there needs to be a debate again about what the proper role of government is because I would contend that the role of government is distinct from the role of the private sector. The role of government is to provide a service, and taxpayers pay a lot of money to make sure they get service. The role of the private sector is to make a profit.

Now, I am sure in some unique situations, those two goals may be mutually inclusive, but often we will find that they are not. We see in the GAO's report on the Department of Energy's contract management which put them in 1990 at the high-risk series. We know the Department of Energy contracts out 91 percent of over $19 billion in obligations in the 1995 fiscal year. We have got the Department of Defense contract management, same thing, high-risk series. We have got the Committee on Government Operations in 1991 issuing a report on major aerospace contractors, problems with falsification and fraudulent testing.

Now, my background is in municipal government, and I know that people want to make sure that the garbage is picked up, that the potholes are filled, that the police respond when people call. Those are all things that people expect from government, and when we start contracting out services wholesale, it is illusory to think that suddenly we are going to see an increase in service at a reduced cost. What is more likely to happen and what is a more in-

structive paradigm is the HMO paradigm. Whereas, we transmitted to HMOs in medical care, services have been cut and then profits of the industry have gone up.

Now, I think there is a legitimate role in some places for the private sector in participation with government, but when we start from a presumption that it is not about goals, but it is about how to achieve them, you are leaping over this whole debate about what the purpose of government is.

Frankly, Senator Brownback, my feeling is that when we view government as the enemy here, government's bad politics, bad public employees, we are missing an opportunity to refresh ourselves about the purpose of government in itself, which is to provide service and it is to be responsive and it is to have the public have direct control.

Privatization changes all that, and so I make that as a statement. You have already answered my question. I know how you feel about it. I know what your goals are. I understand the Indianapolis model, but I am letting you know there is at least one Member of the House of Representatives who thinks differently on this, and I will be continuing to provide you with a challenge to show me—and I am not from Missouri, I am from Ohio—to show me as to where the benefits are because I remain unconvinced, and I am not convinced that this just is not another way to relieve the American people of the assets of their government and increase the price they pay for it. So I thank you for listening to me.

Thank you. I yield back.

Senator BROWNBACK. Congressman Horn for 5 minutes.

Mr. HORN. Let me ask the gentleman from OMB, Mr. DeSeve, how do you feel about the Defense programs in a number of areas? For example, should they be contracting out things that relate directly to the readiness of the fleet? Should they be handling critical ammunition? Where would you draw the line over there in defense?

Mr. DESEVE. We actually try to let the Defense experts draw the line, Mr. Chairman. We ask them to distinguish between inherently governmental functions and those functions which are essentially commercial activities.

There are some functions which the Defense Department deems as core to their mission, which they do contract out in a commercial way as well, but we do not try in an A–76 to come in and say this one is and this one is not. We try to leave that to the folks at the Defense Department.

Mr. HORN. How would you feel as a citizen if apparently OMB is not going to review judgments in the Defense Department when you have got ships of the Pacific Fleet that need new ammunition supplies? Do you want them contracted out to a private agency where the employees could go on strike at any time?

Mr. DESEVE. I guess, again, even as a private citizen, I would look to my admirals and generals to try to do the thing that they thought best along the way. I would not try to second-guess them.

Wellington said, "I can either fight a war or report to the clerks in London," and Wellington did a pretty good job in the war that he fought. So I use the judgment of the admirals and the generals and those who are entrusted with making those decisions and rely upon them, even as a citizen.

Mr. HORN. Well, ultimately, the commander-in-chief is responsible, not the admirals and the generals. Now, you happen to be in the agency that handles the budget, and hopefully one of these days will handle the management of the Executive Branch of the Federal Government. Now, it seems to me, you are working for the President, not the generals and admirals, and that is as it should be in a constitution that provides for civilian authority over the generals and the admirals.

Mr. DESEVE. Correct. And one of the things you have told me, sir, is that I will never get along very well unless I delegate. I have heard that from your own lips in another room.

So what we try to do is say to Secretary Cohen, to Deputy Secretary Hamre, to Controller Lynn and others who are the civilian oversight, make sure that, as the generals and admirals make these decisions, you provide oversight.

We will certainly comment if they come to us and say we would like to do this, we would like to do that, and so, in a specific situation, we certainly give them guidance, but, as a general matter, we do not go in and oversee those decisions.

Mr. HORN. One of the criterion in this whole discussion for 40 years has been what is inherently governmental and what is not inherently governmental.

Mr. DESEVE. Correct.

Mr. HORN. Now, I would say that when you are handling nuclear weapons and when you are handling ammunition that might explode everywhere, if you do not have skilled people doing it, I do not understand why that is not considered inherently governmental.

Mr. DESEVE. I want to go to your "have skilled people doing it." I think skilled people could be either contractors or public employees. There is no skill in handling either ammunition that is certainly made by private contractors or nuclear weapons that are made by contractors.

It is very often the case, if you go to NASA where rockets are launched, but it is difficult to tell the skills of the contractors from the skills of the public employees.

Mr. HORN. Well, public employees and private employees all need a lot of training to do their job.

Mr. DESEVE. Correct.

Mr. HORN. I guess my question is, when you have people that have dedicated 10, 20, or 30 years of their life and they have had no accidents that would explode and blow up a city near it, that would be a pretty good record, wouldn't you say?

Mr. DESEVE. Yes, sir, and we want to make sure that those public employees have every availability to continue that good record of service to their government. We feel very strongly about that.

And the bills before us limit that ability. If there is work that is currently in the private sector, a public offeror would not be able to make a bid on that work, even though they had traditionally done that work. We think that is wrong. We think those public employees in those circumstances should be able to bid.

Mr. HORN. One of the things government employees—and I realize this has been intruded upon at the municipal level—do not do is strike, and that is very important. It seems to me, when you are

waging a war and you have ships of all varieties come in to get ammunition put on or to get it taken off if they have to be repaired, since you could not have people with welding and all the rest that goes on, on a ship, and having charged ammunition in storage there. Wouldn't that kind of situation concern you?

Mr. DESEVE. It certainly would, and we would hope that the contract, if it were a contract item, would absolutely preclude that sort of thing for national defense purposes.

Mr. HORN. Well, I hope when you go back to your office in my favorite building in Washington, which is the Executive Office Building, built under Ulysses Grant's administration and a great building—and any of you that have not seen it, you can tour it on Saturday now and you will see Mr. DeSeve and all the Presidential assistants in very nice areas over there—we hope it promotes thinking.

Mr. DESEVE. We try not to work Saturday, but we usually fail. We usually fail.

Mr. HORN. We hope it promotes thinking, but when you go back there, you might ask the U.S. Navy why are they trying to contract out at the Seal Beach Ammunition Depot, and by what standard of safety and concern do they have to do it. I think that is a typical example of where some people finally get around to doing something and then they do the wrong thing, not the right thing.

[The information referred to follows:]

INSERT SUPPLIED FOR QUESTIONS

1. The Navy announced a competitive A–76 study of Ocean Terminal operations at Naval Ordnance Center Seal Beach on 15 January 1998.

2. A Naval Ordnance Center is full service activity for the storage, assembly and maintenance of Naval ordnance. A Naval Magazine is a smaller facility principally used for storage of ordnance. As a general matter, neither a navel ordnance center or a naval magazine is considered an inherently government operation. As these types of ordnance, including our nuclear arsenals, are manufactured and delivered to us by contractors, the handling of such materials has not been a safety issue nor is it considered inherently governmental.

3. This effort is similar to the A–76 conversion of the Ocean Terminal functions at Naval Magazine, Leuleulei, Hawaii to contract performance. A contract operation was put in place in 1985. This function has remained in the private sector since then.

4. There have been concerns expressed regarding contract performance of these kinds of activities. The Navy remains satisfied, however, with the contract work at Naval Magazine Leuleulei, During Operation Desert Storm the Naval Magazine at Leuleulei, like other mobilization and shipping points in the military infrastructure, was at it's busiest level in memory. One of the numerous ships the Leuleulei Naval Magazine contractor was tasked with loading was the "Cape Judy." This was a break bulk ship which was to be loaded with 5"/54 gun ammunition. This ship was delayed approximately 2 weeks beyond it's scheduled sailing date. This was the only significant delay during this period at Leuleulei.

To load this ship the contractor had to clean the ship to the cleanliness standards required for ordnance since the ship had previously carried a cargo of rice which had spilled everywhere. The contractor then had to remove temporary bulkheads within the cargo holds and build new ones which were suitable for ordnance. Then, finally, the ship had to be loaded with the ammunition. The contractor did not pay a performance penalty for this delay as it was caused principally by the Navy setting an overly optimistic schedule for the load. The Navy actually paid the contractor a $126,000 adjustment as compensation for the additional work and materials used building up the interior bulkheads.

Mr. DESEVE. And I would be delighted to go back and look at that. I have heard about that today for the first time, and I will be delighted to address that concern. And we will formally give you an answer as to what is going on there as quickly as we can.

Mr. HORN. Good. Thank you very much.

Senator BROWNBACK. Thank you.

Congresswoman Maloney.

Mrs. MALONEY. Thank you very much.

I would like to ask Mr. DeSeve—you have testified about the success of Vice President Gore's Reinventing Government, where we now have the smallest work force since 1931 with a savings, you said, of $137 billion and a reduction in our work force of 316,000 people. I would like to ask you and Mr. Stitt how did you achieve this, and is the method that you are doing, which is really the goal that Mr. Stitt mentioned, is we need a smaller, more accountable, professional work force that gets the job done professionally? Just comment on your approach and Mr. Stitt's approach, both of you. How did you believe this success, and do you need a competitive bid to make it happen?

And, second—you obviously do not because you already made it happen—I would like to touch on the question that was raised by Mr. Kucinich which is really quality control.

One thing with Federal workers, you have control over the quality of work that is coming out of them, their honesty, the way they treat people, the way they get their job done, and how do you control that with a private contractor? And I think that all of us bring to this table some of our past experiences in government.

I recall in New York City, we at one point trying to drive up our collections, something that Chairman Horn and I have worked on, a debt collection, we contracted out to private contractors, and they used such extreme cruel methods that really violated the sense of decency, even for New Yorkers, that we had to curtail that, and we now have a lot of debate now in Congress with Vice President Gore and Mr. Clinton talking about a consumer bill of rights so that HMOs don't go over that fine line, and, truly, when you have a government worker, you can control the end product. So how do you control that if you are going to a contracted-out type of situation? So those two questions, I would like you both to comment on them.

Mr. DESEVE. OK. Let me take them in order. First, one of the things we tried to do in reinventing government was to decide what things we needed to do.

If you are going to contract something out, if you really do not need to do it at all, you have achieved a significant savings by not doing it. What do I mean? If we look at the investigations function in OPM, we decided that that was not inherently governmental. We did not even need to be in that business anymore. Training was the same way. We did not need to be in the training business. There are a lot of people at the Cato Institute, the Brookings Institution, and colleges and universities who can do training. There are private sector offerors who can conduct investigations as they are needed. So we did not need to be in that business. We simply got out of the business; in one case, through an ESOP, which Chairman Horn and Mr. Mica were very helpful in creating. In the second case, we simply divested the training function. It was picked

up first by the U.S. Department of Agriculture, and now I guess others are doing that as well.

So we went through—we identified those things which we did not need to do anymore, and also those things which we could do with fewer people, whether those people were in-house or outside the house, contracted out, whether it is the Department of Housing and Urban Development, GSA. We could go down the whole list. There are fewer people because we do not need——

Mrs. MALONEY. So, if I could just—so you really were accomplishing the intent of this bill by self-determining those places where you feel could be contracted out or done cheaper, but the difference is this bill would force you possibly to contract out in areas that you do not think it would be a cost benefit or result benefit for the American taxpayer. Is that a correct——

Mr. DESEVE. It would take away the discretion of a manager, to some extent, and force him by using valuable staff time to conduct according to a schedule, a set of cost comparisons and out-sourcings. He would have less time to spend in the other kind of reengineering that we believe has already yielded savings.

Mrs. MALONEY. So it would force the out-sourcing, whereas you have already been doing it. I think we have $900 billion in procurement now with the Federal Government? It is a huge number.

Mr. DESEVE. Yes, it is.

Mrs. MALONEY. And—so go on.

Mr. DESEVE. So what we tried to do is by reengineering and getting rid of some of the old functions and even devolving some of the functions to State and local governments. They have picked up a significantly greater role in combatting food stamp fraud, and they were happy to do that because they knew that they could prosper along the way.

So EBT, which we have also talked about, electronic benefit transfer, enabled them to do things better and enabled us to eliminate certain kinds of functions we did not need to do.

The second question you asked was about——

Mrs. MALONEY. Could I ask, what are your further plans for reinventing government? Are you continuing to do this, or have you met your goals?

Mr. DESEVE. No, we are continuing to do it. We are continuing to streamline. The President's Management Council, in its April meeting, will be talking about internally the various streamlining efforts.

We have heard today that the Defense Department has, indeed, decided to contract out, or at least to expose to competition—not to contract out, but to expose to competition, and that is the thing we think is core. Other agencies are likely to make that same judgment. Once they have gotten down to the right functions, then they have to decide how to best perform those functions, and we are getting closer and closer to the right functions.

Mrs. MALONEY. Now, you mentioned that government had grown in two areas. One was Commerce, which is hiring really for the Census——

Mr. DESEVE. That is correct.

Mrs. MALONEY [continuing]. Which is once every 10 years. What was the other area you mentioned?

Mr. DESEVE. The Justice Department. Both the Bureau of Prisons——

Mrs. MALONEY. The Justice Department.

Mr. DESEVE [continuing]. And the FBI have grown significantly——

Mrs. MALONEY. I know.

Mr. DESEVE [continuing]. And the Immigration and Naturalization Service.

Mrs. MALONEY. Right, and we hired 100,000 additional police officers, too.

Mr. DESEVE. Right.

Why don't I let Mr. Stitt comment on the first question, and then we will do the second.

Mr. STITT. The first question I had down: Is competition necessary? In Indianapolis, at the municipal level, we felt that it was. I have debated this issue for 6 years with both managers and my AFSCME colleagues. We have not found a tool that has been as effective as competition.

We had a longstanding TQM program at the city for many years, which essentially yielded no results. So we think it was helpful in our community.

Mrs. MALONEY. May I ask for a clarification?

Senator BROWNBACK. Well, if we could get the witnesses to directly, quickly respond to your two questions, and then I think we will have to move it on.

Mrs. MALONEY. All right. Are you alone in this——

Senator BROWNBACK. If you would like to change the question, we can——

Mrs. MALONEY [continuing]. Or are there many——

Senator BROWNBACK [continuing]. We can do it that way, then.

Mrs. MALONEY [continuing]. Municipalities doing the same thing that you are doing?

Mr. STITT. There are a number of municipalities around the country that are looking at the concept of managed competition. I think Indianapolis has probably done more, and done it more quickly than other communities. But it is something that we are seeing more and more at the municipal level, particularly in utility service areas.

Mrs. MALONEY. What about quality control?

Senator BROWNBACK. Well, let us go back to another round of questions.

Mrs. MALONEY. OK.

Mr. HORN. Yes. I would like to get into it at some time.

Senator BROWNBACK. I want to go to Congressman Horn and then we will go back to Congressman Kucinich and then back to you again for questions.

Mr. HORN. Let me ask you. You mentioned, Mr. DeSeve, that there were two agencies that did not file a plan because they have not had a cut in civilian employment, and that was Justice and Commerce?

Mr. DESEVE. That was not the reason they did not file. Those are happenstances.

Mr. HORN. And they have a growing work force, you said?

Mr. DESEVE. They have a growing work force, but that does not relate to their not filing a plan.

Mr. HORN. Well, I assume Justice's growing work force is based on all the independent counsels that have been appointed by the court. So I can understand that one.

I look at NOAA, which is 60 percent of the budget of the Department of Commerce, which I still want to get rid of—not NOAA, just the rest of the Department—put it out and privatize a lot of it, which reminds me of the Coast and Geodetic Survey; 35 or 40 years ago when I was on the Senate staff, I remember we had—and this is before the Eisenhower—yes, it was a little after the Eisenhower Declaration. It was 1960, 1962. We were after the Coast and Geodetic Survey to contract things out because they were simply duplicating which was already being done by the private sector. The map-makers would remember the firm. I think it is Jepson in Denver, Colorado. And the reason we got into it, it was a subsidiary of the *Los Angeles Times*. That was my first taste of where government employees were doing work that is not inherently governmental; that can be done just as well in the private sector, and it was not being done. I just wonder if the OMB has looked at Commerce, when they do not file any plans, and say, "Hey, the little bit you have got left around here, there are some things that could be contracted out."

Mr. DESEVE. I want to assure you that I will work very hard, and we will ask Secretary Daley to make sure that a plan is filed in this round of evaluations.

Mr. HORN. Thank you.

Senator BROWNBACK. Mr. Kucinich.

Mr. KUCINICH. I would like to use this time to continue my homily about the importance of democratic control of the process as exemplified by the systems of service which government delivers.

The whole concept in this country of a United States presupposes there is some unity in the States, and we were brought together out of a community of interest. I mean, I happen to believe that we, in fact, have an American community.

Government systems at every level reflect the needs of the community. That is why those systems of support are organized to extend services. The ability of government to control those services is the ability of government to make sure that its structures maintain democratic values.

We cannot look to the corporate world for democratic values, even though we may have many fine leaders in the corporate world who may practice democratic principles in their daily life. We cannot look to the corporate sector to secure democratic values. We have to look to the government and the execution of the laws and the political process to do that.

So, when we have drawn an equivalency here between the public sector and the private sector and, in effect, the equation has put us in a position where we have equated the work of the public sector and the work of the private sector, we are basically ignoring that they have two separate goals that are often mutually exclusive as opposed to what I said earlier, where there might be some areas where their goals might be inclusive mutually.

This is about goals, and you may have your plans to go ahead and execute private contracts, but to tell government employees that they have to start competing for their jobs is in and of itself threatening not to just those employees and their jobs, but it threatens the entire democratic system of which they are a part.

I view public employees in a slightly different way. I do not see them as widgets in some kind of autonomic machinery. I see government employees as being an extension of democratic values. We then have some control over that system.

Now, the honorable gentleman from Indianapolis mentioned the contracting out of utility services. I will tell you, and remind you, that there are over 2,000 municipally owned utilities in this country, and one of the reasons we have that is not only so people can have lower electric rates, which they do, without any exception, and in those cases where they do not have lower rates, it is usually because of the interference of the private sector, but also because they have some control over the system. They have the ability to be able to have input in the process.

This whole idea of privatization, I would suggest to you, notwithstanding the urgings of the administration, needs to be looked at again in terms of the implication it has for democratic values.

In the last few decades, there has been an attack on government to cause people to be estranged from their government, but if this is, in fact, a government of the people, by the people, and for the people, as Lincoln's prayer was so many years ago, then, in fact, when we attack government, we are attacking ourselves. And unlike the challenge of Poto that we have met the enemy and he is us, it is up to us to recognize that this is our government. We can make it work, not by dismantling it piece by piece, but by finding ways for those systems to work in order to get the people to do their job better, not by threatening them with loss of their job, but by showing them how their jobs are essential to the unfolding of the democratic process.

As a Member of this Subommittee and as a Member of the Congress, I am going to continue to insist that we review again and again the underlying premises which promote wholesale privatization in the government because, in a democratic society, government has to be there to protect democratic values. We cannot look to the corporate sector to protect democratic values.

I yield back.

Senator BROWNBACK. Thank you very much.

I would note that the bill has nothing to do with the role of government. It is just that if there are activities which could be done by a contractor, the agency should determine how to get the best deal, is what the structure of the bill has tried to be. So I am hopeful we are being sensitive to your point of view on this, and that we are just trying to get the best deal we possibly can here.

Congresswoman Maloney.

Could this be our last question? We have a huge panel after this one.

Mrs. MALONEY. Back to my last question, quality control, how do you maintain quality control with a private contractor?

Mr. STITT. I can only speak to our experience in Indianapolis, and as we have been visited over the years by many folks who talk

about our competition initiative, one of the things we have told them is that it is not a cookie-cutter approach. What worked in Indianapolis may not work in Miami or the Twin Cities.

We inherited a system in Indianapolis that, although it was regarded as one of the country's most well-run cities, it had some pretty serious challenges. There was no effective quality assurance, quality control mechanism over local government when we got there. There was very, very little performance data, and as I talked with municipalities and, quite frankly, State employees around the country, that is common. They do not know how much they produce or the quality of it in many circumstances.

We set about developing a rigorous performance measurement system that asked those questions, what did we produce, what do our customers expect, and what is the quality we produce. We have used that as we have gone into the marketplace to ask employees and vendors to compete for that work.

Our experience has been that post-competition, whether provided by public employees or a vendor, we generally see improvements in the quality of those services. And in cases where employees continue to provide that service, we established quality benchmarks, much like we would in a private vendor's contract. Today, we track on a monthly basis about 250 performance measures in our community.

Mrs. MALONEY. Could you cite some examples of services you contracted out that the employees, the government employees won?

Mr. STITT. Probably, the example that I am proudest of involves the Indianapolis Fleet Services Garage, a group of employees who maintain our 2,000-vehicle fleet. We asked them to go head-to-head with the best vendors in the country. They said, "We will do that, but you have got to get some of these bureaucratic structures off our back. We cannot be in a system where it costs us more to buy a battery than it does the private vendor or it takes longer to get training done or a new employee brought in or the legal department will not let us do anything creative and entrepreneurial." They competed and won a 3-year contract to provide that service. They barely won that contract, I might add, and as part of their proposal to us, they asked us to implement an incentive plan that said if they out-perform that contract, they could share in the savings. We agreed to that, and the results were really quite remarkable.

Grievances fell by about 80 percent. Time lost to injuries fell from about 6,000 hours a year to about 200 hours a year. Customer complaints dropped dramatically. We saw an increase in the number of line employees relative to managers. Productivity grew by several hundred hours per employee, and I have had the privilege of handing out incentive checks between $600 and $1,100 a year to that employee group, while still generating several million dollars of savings for taxpayers.

Mrs. MALONEY. It seems, Mr. Chairman, that both have very similar plans, with the only difference is that you are forcing—or this bill would force a competition whether or not there was a management decision, whether it was necessary or not. Is that correct? You are forcing a competition on everything that is "commercial"? Whereas, Mr. DeSeve, if I heard you correctly, you are making de-

cisions over what is, you think, something that can be reduced or contracted out or kept with government?

So, in a sense, the bill could cost more money by forcing a competition if there is a belief that it should not take place or is not necessary. Is that an accurate statement, Mr. DeSeve, or not?

Mr. DESEVE. I think that is what we have testified. We are concerned, especially with some of the rules and regulations that are inherent in the bill and the nature of judicial review of management decisions that we could end up in that kind of a situation.

Mrs. MALONEY. Do you agree, Mr. Stitt?

Mr. STITT. We did not implement a legislative or rulemaking system. We were a billion-and-a-half dollars in the hole and had a mayor who had promised not to raise property taxes. So we were pretty aggressive about this approach because we did not have another choice.

We would prefer to create systems that drive performance.

Mrs. MALONEY. When did you start this approach?

Mr. STITT. Six years ago.

Mrs. MALONEY. Six years ago.

Mr. STITT. We preferred to change the systems in which employees work rather than legislate it; employee incentive plans, pay for performance, incentive pay, rigorous performance measures, and regular, routine and open public competition, with the exception of those areas that we deemed to be inherently governmental at the municipal level.

Mrs. MALONEY. Mr. DeSeve, you have had an outstanding success, reinventing government. I think it has not received the attention it should, from the public. I think it has been a tremendous success, and I know that OMB has really been the implementer in that program.

Do you support this bill? Do you think this bill is helpful, or do you think it would be costly and problematic? What is your feeling on it, based on your years in government?

Mr. DESEVE. First of all, I want to say that we really did try to form a partnership. Dr. Kelman is with us today, and will be testifying a little later with these Subcommittees, the Subcommittees we are before today. FASA, FARA, ITMRA, the Debt Collection Act, and GPRA are all cases. GMRA, which I will testify on next week in Mr. Horn's Subcommittee—they are all partnerships. So, we oppose elements of the bill as it stands today. We support the idea of competition, and when I refer to a goal, the goal I was referring to was on the first page of my statement. We share the goal of seeking the most efficient and cost-effective sources for the provision of commercial support activities required by the Federal Government to get the best deal for the taxpayer. That is what we are seeking to do, and we think that the way that the bill is structured, providing this kind of a legislative framework does not do that.

Mrs. MALONEY. Do you see a problem with quality control?

Senator BROWNBACK. We are at 5 minutes. So, if we could answer that one, and then let us go on from there.

Mrs. MALONEY. OK.

Mr. DESEVE. What we try to do is we try to implement what are called performance-based service contracts, very similar to the no-

tion that Mr. Stitt had, that it is inherent in the contract itself to specify the level of performance.

We see recently, for example, the Department of Education competed a set of data centers and reduced their cost by more than 50 percent from the prior contract. It had been a private contractor. It stayed a private contractor, but the performance-basing made the difference.

Mrs. MALONEY. OK, thank you.

Senator BROWNBACK. Thank you both, gentlemen, very much for coming here.

Mr. DESEVE. Thank you, Mr. Chairman.

Senator BROWNBACK. We look forward to working with you.

Mr. STITT. Thank you, Mr. Chairman.

Senator BROWNBACK. If we could call up our third panel: Bryan Logan, Chief Executive Officer of Earth Data International; Larry Trammel, Corporate Vice President and General Manager, Science Applications International Corp.; Douglas K. Stevens, Jr., Partner of Information Technology Services Group, under Grant Thornton, LLP, representing the U.S. Chamber of Commerce; Dr. Steve Kelman, Weatherhead Professor of Public Management, Harvard University; Robert Tobias, National President, The National Treasury Employees Union; Bobby Harnage, President of the American Federation of Government Employees; and Michael Styles, National President of Federal Managers Association. So the rest of the room is up and testifying.

Could the witnesses all stand to be sworn in, please?

Mr. HORN. Mr. Chairman, before I swear them in, let me just put two documents in the record with the previous portion. One is a letter from David M. Gentry, American Federation of Government Employees, AFL–CIO, at the Weapons Support Facility in Seal Beach. Since I raised the question of Seal Beach, I would like his letter by unanimous consent to be at the end of my question to Mr. DeSeve on that topic.

The letter referred to follows:

DRAFT LETTER FROM MR. GENTRY

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES
AFFILLIATED WITH THE AFL–CIO
16 March 1998

Local 2161, Weapons Support Facility
P.O. Box 2340, Seal Beach, CA 90740

DEAR

We would like to communicate to you our concerns on the decision to open the Navy Ordnance Receipt, Storage, Segregation and Issue (RSS&I) Core functions for Commercial Activities (CA) Study, which consistently has been an inherently governmental function. As tax payers and Federal employees we understand the initiative to streamline government through competition with the private sector. However, we must register strong opposition to recent efforts by the Navy and Congress to outsource (contract out) critical core logistics capabilities. It is essential for the national defense that these capabilities be conducted by government personnel to ensure effective and timely response to a mobilization, national defense contingency situation and other emergency requirements. By contracting these capabilities out the United States Defense is vulnerable to contractor default, strike, or non-response.

The Weapons Support Facility Seal Beach provides critical core logistics to the fleet. Specifically, we directly support the fleet by loading Naval ships with ordnance or munitions, such as Tomahawk weapons, at our facilities at Seal Beach, Port

Hadlock, Concord and Fallbrook. The Nation cannot afford to become vulnerable because this capability is contracted by the private sector. The necessity to provide this critical service in the safest and most efficient manner for the Navy and the surrounding Community is the guiding principle that the employees of the Weapons Support Facility Seal Beach and its detachments have lived by for the past 50 years.

History has shown that specific depots which were outsourced to contractors, failed to answer the bell when called upon during times of national defense. One such installation was the Naval Magazine located at Leuleulei, Hawaii. During Operation Desert Storm, the contractor at Leuleulei agreed to pay fines to the Navy, rather than load the ships destined for the Persian Gulf, in a timely, as scheduled manner. Leuleulei's "economic" decision adversely impacted the Navy's ability to prevail in the Persian Gulf crisis. At the same time, other Naval Weapons Stations operated by government civil service workers met the challenge, carried their load and aided the Navy in completing its mission.

In addition to the Weapons Support Facility Seal Bach providing the Fleet critical core logistics, we continually strive to provide our services to the fleet in the most cost effective manner possible. We regularly bench mark our functions with the private industry and systematically look for ways to re-engineer our processes. We are a Naval working capital funded business oriented activity. As such, we have conducted re-engineering processes. Over the past 10 years we have re-engineered, streamlined, benchmarked, and implemented productivity improvements.

As a government civil service manned activity, Weapons Support Facility Seal Beach is recognized as one of the "best of class" in Malcolm Baldridge National Quality Award criteria. Seal Beach, consecutively achieves the highest level of Safety and Customer Service during its years of operation. In addition, Seal Beach has achieved numerous citations and awards, the following are just a few:

1995 Hammer Award, Vice President Gore's Reinvention of Government
1995 Bronze Eureka Award, California equivalent of the Malcolm Baldridge Award
1996 Hammer Award
1996 Silver Eureka Award
1997 Silver Eureka Award
Munitions Carrier's Superior Achievement Award

We feel that this type of dedication, service, and integrity cannot be achieved by Outsourcing. A contractor will *only* provide *minimal* requirements and service at best. We strive for *excellence.* With your continued support of Federal employees we will assure that the Navy can meet its challenges today, tomorrow and in the future.

We would like to extend an invitation to you to come and visit our world class facility. You will have an opportunity to see a streamlined government manned, operation. We would like to make an appointment to see you in the near future at your office if convenient.

Sincerely,

DAVID M. GENTRY

Mr. HORN. The other matter just came to my attention, which I find an excellent document. This is the Procurement Roundtable,[1] and it happens to be chaired by a person we all respect, regardless of party, Elmer B. Stats, former Controller General of the United States, former member of the Old Bureau of the Budget, who knows more about government than, I guess, the next 20 people in this town. This document is also prepared under the acting chairmanship of the Procurement Roundtable, Frank Horton, a very distinguished former Member of Congress from New York. I would like unanimous consent to have this published at the end of the first panel.

Senator BROWNBACK. Without objection.

Mr. HORN. It has some excellent ideas, and we will use them.

[1] The document referred to above appears in the Appendix on page 346.

Gentlemen, our tradition in the House is to swear all witnesses under oath. If you would, raise your right hands. Do you swear the testimony you are about to give the joint Subcommittees is the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. LOGAN. I do.

Mr. TRAMMELL. I do.

Mr. STEVENS. I do.

Mr. KELMAN. I do.

Mr. TOBIAS. I do.

Mr. HARNAGE. I do.

Mr. STYLES. I do.

Mr. HORN. I will note that the seven witnesses have affirmed, and the clerk will enter that in the record.

Senator BROWNBACK. Thank you all very much for joining us. We will be on a 5-minute time frame. We have lights here. So the yellow light comes on when you have 1 minute left to go.

There has been a request by Congresswoman Maloney that we have Dr. Kelman go first, as she has to leave and wanted to make sure—not that everybody's testimony isn't very important and needed, but she had a particular request for that.

Mrs. MALONEY. And we had not received his prepared statement in advance, so I do not know what he is going to say.

Senator BROWNBACK. So we have decided to go ahead and concede with that. It will be a 5-minute testimony, and then we will go ahead and start down the line.

Welcome, all of you. I hope you do not feel slighted for us jumping out of order on this. We would like to keep your testimony pretty tight. We can take the full testimony into the record. So you can summarize, if you would like. Thank you very much for joining us.

Dr. Kelman.

TESTIMONY OF STEVE KELMAN,[1] Ph.D., WEATHERHEAD PROFESSOR OF PUBLIC MANAGEMENT, HARVARD UNIVERSITY

Mr. KELMAN. You are putting a lot of pressure on me, but, all right, I will do my best.

Actually, I apologize I do not have a formal statement. The logistics are a little more complicated now. Back in academia, I am now answering my own telephones, and I have one-third of a staff-assistant time, stuff like that. So the logistics are a little bit more difficult. So I apologize. It is very nice to be back in front of the Subcommittee again.

With any luck, I will do this in less than 5 minutes. I had just two big-picture messages that I wanted to try to communicate today regarding this bill and regarding the whole issue of competition and out-sourcing. The first is that I really do think that it is time to lower the level of rhetoric about out-sourcing and contracting out. I really do not believe that this is about do you like big government or do you like small government. It is not a question of big government or small government, whether the payroll checks for soldiers and other employees of the Defense Department are cut by government employees or by private sector employees. Nor is it

[1] The prepared statement of Mr. Kelman appears in the Appendix on page 81.

a question, I think, of do you like or do not like the Federal work force.

Luckily, I was in town today to be able to come and testify before the Subcommittee. I spent the morning interviewing front-line procurement professionals at the Census Bureau in the Department of Commerce for some research I am doing on procurement reform, and those folks I spoke with this morning, the front-line procurement professionals, are the kinds of people I got to know while I was in government. We have a fantastic Federal work force, and this is not about do you like Federal workers or don't you like Federal workers.

I mean, the fact is the vast majority of out-sourcing that takes place in the United States takes place between business firms. It is commercial to commercial out-sourcing within the commercial world, not even involving government, where one commercial firm out-sources some work to another commercial firm, that is growing extremely rapidly in the private sector.

If you read investment analysts, one big investment theme in the stock market right now is investing in companies that are in out-sourcing businesses, that out-source functions to other commercial companies, and the reason that out-sourcing is growing so rapidly commercial to commercial, again, just not involving the government, is managers. Executives of firms have increasingly realized that it is good management practice to stick as much as you can to your own core competency as an organization, to keep management time focused as much as possible on your core mission and your core responsibilities, and let the non-core responsibilities be taken over by other organizations who themselves have as a core competency in payroll, check-cashing, or things like that, which are not in the core competency or core mission of the organization that is doing the contracting out.

So, for years, obviously—and we do not even think of this as contracting out—most commercial firms have contracted out writing advertising, and a lot of their legal services. These have taken place for decades, and in recent years, the amount of contracting out and out-sourcing within the commercial world has expanded dramatically.

Let us take one very mundane example, and I take it because it involves a company that does not even do business with the Federal Government. There is a company called Carabiner International. It is very rapidly growing, publicly traded company. The mission of their company is to out-source meetings and conferences for private organizations, Ford Motor Company, or whatever. And what they do is they go to those organizations and say, "Your core business is not running meetings and running conferences. That is what we specialize in. That is what we are good at," and, again, this company does, so far as I know, no business with the Federal Government. That is a very rapidly growing business. So the first point is this is about good management, and it should not be seen, in my view, as an ideological issue.

Second, without having considered every word of the proposed bills as they have been revised, it does seem to me that the two bills, by and large, have done a good job walking a tightrope and

walking a line between various bookend or extreme positions on this issue.

I think that it is good that the revised bills make it possible for Federal workers to compete for these jobs. I think they should be allowed to compete for these jobs.

I believe that when Federal workers compete, we do need to worry, and I think OMB's Circular A–76 revisions a few years ago made some progress on this, about proper accounting for indirect costs. I believe that the past performance of government entities should be taken into consideration in these competitions.

One feature from a quick read that I do not like in the bill—and I agree with my former colleague, Ed DeSeve, on this—is the various judicial review provisions. I do not think it is necessary to have these management decisions second-guessed by any sort of judicial review.

Last point, and I will be under the red light, I hope, is that we really need to make an effort as government and private, whether private business or private trade union folks, to try to manage this transition, as I think they have tried to do in Indianapolis, that when something is out-sourced, to hold the existing Federal work force harmless insofar as possible, through right-of-first-refusal provisions and other kinds of things. That is one area that I hope the Executive Branch, as the Executive Branch starts doing more out-sourcing, will continue to pay attention to.

Thank you for your attention.

Senator BROWNBACK. Thank you very much, Dr. Kelman, and we will look forward to, hopefully, some questions and thoughts for you, well recognized in this field.

Bryan Logan, Chief Executive Officer, Earth Data International.

TESTIMONY OF BRYAN LOGAN,[1] CHIEF EXECUTIVE OFFICER, EARTH DATA INTERNATIONAL

Mr. LOGAN. Mr. Chairman, Mr. Horn, and Members of the Subcommittee, I would like to put my full statement in place on the record.

Senator BROWNBACK. Without objection.

Mr. LOGAN. One thing that is said—and I have 5 minutes here—today we are going to try to put some high tech into my 5-minute speech here. So I will ask you to don some glasses in a moment or two and dim the lights.

Senator BROWNBACK. There will be no cameras in the audience when we put these glasses on.

Mr. LOGAN. Right. [Laugher.]

The other thing is that a photograph says a thousand words, and as I am restricted to 5 minutes, I am hoping this is going to help my testimony.

As the past president of the Management Association of Private Photogrametric Surveyors, MAPPS, a national association of private mapping firms, I was also a delegate to the 1986 White House Conference on Small Business, where the problem of government competition was a major issue both in 1980 and 1986 and 1995. I, today, would just like to focus on the fact that what we are looking

[1] The prepared statement of Mr. Logan appears in the Appendix on page 84.

for in our particular field is free and fair competition, and we do not believe that that exists at this point in time.

If you want to look at an area where free and fair competition does not work, we need to look at the mapping industry and the GIS profession. As early as 1933—yes, 1933—a report of a special House committee found the mapping business subject to unfair government competition by government. For years, government studies have found that an accomplished and qualified private sector in surveying and mapping exists, and recommended increased contracting.

In fact, in 1973, OMB reports said private cartographic contract capability is not being used sufficiently. OMB's fiscal year 1990 budget said specific areas where the government could place greater reliance on the private sector providers include map-making activities. That statement was intended to target the surveying and mapping of OMB Circular A–76 studies. Since the mapping initiative was included in fiscal year 1990 budget, not a single Federal agency has conducted an A–76 review for surveying and mapping activities.

Recently, OMB has changed A–76 to actually permit agencies to do work for other agencies without conducting a cost comparison, and that is what has led to Senator Thomas' floor amendment to the Treasury Appropriations bill in 1996 and 1997.

Why has contracting out of mapping not increased significantly? I believe it is because the principal tool for moving services from government performance to the private sector is OMB A–76, and the decision on whether or not A–76 studies are actually undertaken rests with the agencies.

What we have today is a monopoly, and I would like to say that there were some people on the Hill a few weeks ago in the software industry who would think that 95 percent of the business undertaken in the mapping business, undertaken by the government would be a monopoly even in their terms. That is about the number right now. There is $1 billion a year spent by Federal agencies on surveying and mapping activities. There is about 6,000 employees involved in that, and the private sector gets about $58 million worth of business per year from that. About 5.8 percent of the work that the Federal Government requires for surveying and mapping is actually done by the Federal Government itself.

What we would like to see is that the Federal Government rides the wave rather than makes the wave. There is no need any longer for the wave to be made by the Federal agencies. The private sector can certainly do that for them.

I would rather not have to compete against the government. I would rather have a true, free system where we can, in fact, look at individual projects that the government is undertaking and put forward a proposal to undertake that work. That is happening, I must add, with a number of agencies, such as the Army Corps of Engineers, the Air Force, and the Navy. They have traditionally contracted out, and, in fact, are contracting out more.

In recent years, the USGS and NIMA, the new National Image and Mapping Agency, have launched new programs for the private sector.

As a result of that, we have moved quite a considerable amount of work to the private sector, and my firm alone has employed in the last few years over 20 Federal employees from NIMA, TVA, USGS, and the Corps of Engineers and the military.

Presently, we have more than 40 positions in the firm that can be filled by Federal employees who wish to move to the private sector, and we will do so, should out-sourcing by NIMA and NOAA and other agencies come to fruition. If this bill is enacted and we, in fact, do get free and fair competition, I think we will triple that number again.

I see my orange light has come on. So I would quickly like—if we could bring the lights down—and I have got Nick Palatiello over here who is on his out-to-work day from school, who is going to make this all happen for us.

The first image here shows a comparison. The image on the left is a government satellite, an older technology, 30-meter resolution. In other words, any point on the ground 30 meters or greater can be seen. The image on the right is going to be a new private sector satellite that will be put into service this coming year where we can see 4-meter resolution. As you can see, the private sector here is certainly leading the technology with regard to the image quality. Next slide, please.

This is a typical map from the U.S. Geological Survey. It is a somewhat static map, and on average, they tend to be out of date by sometimes up to as much as 35 to 40 years.

The next image is a project that we are presently doing for the District of Columbia and NCPC, a Federal agency, and if we had time today, we could zoom in on the Capitol Building there and see the actual tourists on the front steps of the Capitol. This database is being built on which all the utilities, etc., for the District Government will be handled in due course. Next slide, please.

This is a NOAA chart, and, again, you can see from this chart, it is fairly basic, but if we look at the next slide, we can see the detail of the same area, and this detail will allow us to hide buildings and obstacles that would be potential air obstacles for aircraft and/or sea obstacles for shipping and navigation.

And the last slide, which we are going to move into, is when we need the glasses, and if you look at this image here, with your glasses on, please, you will actually see, I hope, that the image turns into a three-dimensional model. For the rest of the audience, you will not see that, but that three-dimensional model is produced by technology that we have in the private sector and have developed, admittedly with help of R&D from Federal agencies, but what I would like to see is that this technology that we have spent a considerable amount of time on being replicated with the Federal agencies, State, and/or local government agencies.

So, again, this technology is what we are bringing forward. It shows that we can compete, and to summarize what we really want today is to be in a position where we can compete for this type of work and move people from government into the private sector where they can have first-rate jobs with great benefits and a great picture.

Thank you, Mr. Chairman.

Senator BROWNBACK. Thank you, Mr. Logan.

Next will be Larry Trammell, Corporate Vice President and General Manager, Science Applications International Corp. Mr. Trammell, welcome.

LARRY TRAMMELL,[1] CORPORATE VICE PRESIDENT AND GENERAL MANAGER, SCIENCE APPLICATIONS INTERNATIONAL CORP.

Mr. TRAMMELL. Thank you. I am pleased to be here today to speak on behalf of industry groups, and I thank you very much for your invitation, Mr. Chairman, and Subcommittee Members.

By way of introduction, I am employed by Science Applications International Corp. to manage its services company. SAIC is primarily a scientific and information technology company who has provided services to the Federal Government for almost 30 years. We are members of many industry associations, including several of those represented today. From this perspective, I will be providing my views on the Federal Government marketplace.

In order for Congress to require agencies to meet its balanced budget requirements, we believe there must be legislation that supports the concepts embraced in the bills before us today. We know that efficiency is required for survival in the competitive private sector. Likewise, government agencies owe it to the American taxpayer to be efficient.

My discussion today is going to focus on six key principles pertinent to this legislation, and they are provided on the board to your right for reference.

On the first point, let me say that industry supports the OMB guidance of what is and is not inherently governmental, and we acknowledge the need to retain core capabilities in the government. We in industry want smart, capable, and well-informed customers to ensure that we meet the right objectives to accomplish their mission. Our government partners must have the capability to conceive and oversee the work to accomplish its core mission.

We also believe that there is no place for an agency to compete in the public market. As an industry, it is important for each agency to focus on its core mission and to procure from other sources those items which are non-governmental.

We believe fundamentally that work which is not inherently governmental should be performed by industry. However, we concede to enter into a competition with the government activity for these non-core functions.

On item two, industry's perspective on the current process for identification and selection of the right source is cumbersome and inefficient. It unfortunately focuses only on low cost. We understand that this legislation phases out these procedures in favor of a best-value selection of the right source to perform required services.

In regard to item three, competition, even public-private competition, promotes general efficiencies and ultimately the most efficient organization. We know that quality is the key to effective and efficient performance, and higher quality may be worth a higher price. We need legislation to allow latitude to purchase at other than low

[1] The prepared statement of Mr. Trammell appears in the Appendix on page 88.

price, and we are pleased to see the emergence of this concept in this legislation in order to assure that the American taxpayer receive the best value for the tax dollar.

Item four, as mentioned, we advocate best-value awards and seek to ensure a level playing field for evaluation. The current approach does not require all costs of an activity to be reflected in the public estimate of a cost. We need a common approach to cost collection and reporting for both government and private sectors. Government has already embraced this concept, and industry supports that position.

It will be a challenge for government to adapt to activity-based costing as it has been for our industry, but we are pleased to see the emergence of this concept in this and in previous legislation in order to assure a level evaluation.

Item five, sometimes what we do not know can hurt us. This is the case with the current process in contracting out. There is no current requirement for an agency to identify all its opportunities to compete for efficiency. Industry supports this legislation which does require evaluation of all agency functions for competition.

And, last, we understand that this will be a program which must have a time-phased implementation, and we believe the schedule set forth in the legislation is fair and reasonable to accomplish this important mission.

Having made these key points, I would like to commend you and your Subcommittee for hard work on this important and long-needed legislation, and I offer our continued support.

That concludes my remarks. I thank you again for this opportunity and stand ready to address any questions.

Senator BROWNBACK. Thank you very much, Mr. Trammel. We appreciate your being here, and I am certain we will have some questions.

Douglas K. Stevens, Jr., Partner of Information Technology Services Group, under Grant Thornton, LLP, representing the U.S. Chamber of Commerce. Mr. Stevens, thank you for joining us.

TESTIMONY OF DOUGLAS K. STEVENS, JR.,[1] PARTNER OF INFORMATION TECHNOLOGY SERVICES GROUP, UNDER GRANT THORNTON, LLP, REPRESENTING THE U.S. CHAMBER OF COMMERCE

Mr. STEVENS. Thank you, Mr. Chairman. I have submitted written testimony, and would just like to make some brief comments, hopefully not too redundant with some that we have heard previously.

Senator BROWNBACK. Your testimony will be a part of the record.

Mr. STEVENS. I would like to comment on three very important points: First, very briefly on the state of the language of the draft bills that we have reviewed; second, on some of the problems with the current version of OMB Circular A–76; and, finally, on the activity-based costing language that is included in the House version of the draft bill.

The current bills include two very major, very substantial changes from previous bills. The first is the addition of language

[1] The prepared statement of Mr. Stevens appears in the Appendix on page 91.

about management competition, including the incorporation of activity-based costing, and the second is the inclusion of out-sourcing reporting requirements under the Government Performance and Results Act.

The addition of the managed competition language should remove, in our view, previous objectives by the various players in this process, including the GAO, the OMB, and the Federal employees and their unions who wanted an opportunity to compete for work currently performed by the public sector and designated as commercial, rather than automatically awarding the work to a private sector organization.

The inclusion of agency reporting requirements under the Performance Act is a critical mechanism, in my view, for proper congressional oversight of the conversion process without creating an entirely new reporting burden on the agencies.

In the area of the problems with the current A–76 circular, the first problem that the proposed legislation addresses is the fact that the A–76 competition process is converted from a voluntary activity to a mandatory one.

Chairman Brownback has heard testimony before his Subcommittee on this bill that government managers who have voluntarily decided to perform A–76's have found that a career-ending move. Therefore, government managers tend to avoid conducting A–76 competition and use excuses like lack of staff, budget time, or resources.

Since the legislation before us not only makes the competitions for the agencies mandatory with the force of law, but it also provides reporting under the Performance Act, we believe that under the legislation, agencies will no longer be able to make excuses to Congress, and, very importantly, government managers will have the cover of a statutory mandate to perform the A–76 competitions.

Second, the current version of A–76 allows for, but does not require a standard cost-accounting methodology such as activity-based costing. Thus, historically, agencies have had the option to adjust numbers to arrive at a desired outcome by using a different accounting system than the private sector organization competing is forced to use.

The legislation before us requires that the agency consider as many as possible of the same cost that a private sector bidder would consider in a competition, and, really, it goes a long ways toward leveling the playing field in an A–76 competition.

The third problem with the existing legislation that we see is the inadequate inventory of commercial activities that is maintained by OMB, and the business community applauds the legislation's requirement that agencies prepare, maintain, and publish in the Federal Register a catalog of all the commercial work being done in-house.

Finally, about activity-based costing and cost accounting, the House and Senate draft language on the issue of cost accounting is very different, and my comments pertain to the draft language from the House. We urge that the House language be incorporated in the Senate bill to make sure that the playing field is, indeed, level, and this opportunity to adjust cost figures is eliminated.

The point of using activity-based costing is to ensure that any comparable analysis between a government bid and a private sector bid used a comparable and comprehensible cost-accounting methodology. While there are a number of cost-accounting methodologies that could be used, we believe that activity-based costing provides the easiest method for obtaining similar information from both parties and information that can be easily understood.

A couple of, perhaps, technical points. We believe that the cost-accounting standards board ought to be included in the commenting process on the bill. The cost-accounting standards board is the entity that governs cost-accounting standards for private sector companies, and, therefore, ought to have a legitimate role because it makes the rules that oversee the government contractors that will be bidding.

Finally, there is an issue about recognizing the cost of taxes in a private sector bid, and our approach is to simply recommend that both the government and private sector bids not include taxes as a cost item, so that the measurement is straightforward.

Thank you.

Mr. HORN [presiding]. Well, we thank you for that excellent statement. I particularly appreciate you tying it into the actual legislation and what should be incorporated and moved wherever.

We now begin with the various employee groups. Robert Tobias is president of the National Treasury Employees Union. Mr. Tobias.

TESTIMONY OF ROBERT M. TOBIAS,[1] NATIONAL PRESIDENT, THE NATIONAL TREASURY EMPLOYEES UNION

Mr. TOBIAS. Thank you, Mr. Chairman.

NTEU is very concerned that the legislation we are here to discuss today represents a philosophical predisposition, rather than a data-driven decisionmaking process concerning who can deliver products to the taxpayers faster, better, and cheaper. There is no data. There is no evidence that the private sector is automatically better just because it is the private sector. Rather, there is a great deal of evidence that just the contrary is true.

It is also important to keep in mind that contracting work to the private sector does not make it private sector work. It remains government work performed by the private sector under the supervision of the government for the benefit of the public.

The issue is who will perform the work and at what cost, not whether the work will be performed. Therefore, the appropriate question is who can perform the work faster, better, and cheaper.

It is not as though the Federal Government does not use contractors with the private sector, $108 billion is spent in salary and benefits for Federal employees, and the minimum amount spent on private sector contracting is $120 billion, and some estimate it is three times that amount.

And we know that the current contracts have led to astronomical amounts of waste and fraud that have been well documented by both GAO and OMB. The GAO has brought to Congress' attention

[1] The prepared statement of Mr. Tobias with attachments appears in the Appendix on page 97.

examples of millions of dollars of missing government property that has been turned over to contractors, and they admit their numbers are probably understated by millions of dollars. They have documented instances of unallowable and questionable overhead costs, and they have suggested that this matter is a significant and widespread problem, costing Federal agencies and the American taxpayers potentially hundreds of millions of dollars annually.

I have with me today just a few of the relevant GAO and OMB documents on this topic, and I ask that they be made part of the record.[1]

Mr. HORN. Without objection, so ordered.

Mr. TOBIAS. They raise serious issues, and they cannot be ignored.

Both GAO and OMB have repeatedly pointed out that the Federal Government is unable to adequately supervise all the contracting it undertakes now. They have provided detailed examples of contracts where the Federal Government could save roughly 50 percent by performing the work in-house. They highlight contract cost overruns, poor or nonexistent oversight, lax management of contracts, as well as outright fraud and abuse in the billions of dollars.

Some of these reports are more than 5 years old. Some are relatively new. Yet, nothing has been done to address the problems they highlight. Contract management and oversight are not only within the jurisdiction of these Committees, they are part of the names of these Subcommittees. Yet, when we ask why the abuse and waste detailed in these studies is not addressed in this legislation and why procedures are not put in place to prevent such abuses in the future, we have been told simply that this is beyond the scope of this bill.

We believe that contract reform must start with reform of the oversight of the existing contracts before there is any consideration of additional contracting out. This legislation would also do away with A–76 which currently governs contracting out. We fear that this will only lead to more contracting with less cost comparisons.

Currently, 40 percent of contracts are let without competition and cost comparisons. We need more competition, not less. Congress should mandate the use of A–76 before any contract is considered, not eliminate A–76.

This legislation would effectively remove congressional oversight, allow work performed by the U.S. Government to be done in foreign countries, and contains no safety net for current Federal workers who might lose their job.

Finally, the legislation does not allow the Federal Government to compete for the work once it is contracted out.

Administrations come and go. Congresses, too, come and go. I suggest that we do not want the spirit of public service to come and go. There are many services the public sector provides that it should provide. We should not, on a political whim, decide that our sons and daughters will be forced to depend on a succession of private sector contractors to provide government services, maybe reasonably, maybe not, maybe more efficiently, maybe not. This legis-

[1] The documents submitted by Mr. Tobias appear in the Appendix on pages 116–275.

lation would truly shut down the Federal Government, not all at once as legislation eliminating Federal agencies would do, but, over the long term, the effect would be the same.

The system in place now may not be perfect, but it is accountable, and contracting out Federal services must continue to be evaluated on a case-by-case basis. To do otherwise ignores the problems pointed out time and again by GAO, OMB, and the many private organizations who have completed their own studies. I encourage the Members of the two Subcommittees present today, as well as this Congress, to reject the legislation that is before you.

Thank you very much.

Mr. HORN. Thank you very much.

Our next witness is Bobby Harnage, the president of the American Federation of Government Employees. Your statement will be automatically included in the record.

TESTIMONY OF BOBBY L. HARNAGE,[1] PRESIDENT, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES

Mr. HARNAGE. Thank you, sir.

Chairman Brownback, Chairman Horn, and Members of the Senate and House Government Management Subcommittees, I want to thank you for allowing me this opportunity to give AFGE's views on the latest version of the Freedom of Government Competition Act.

Chairman Brownback, my predecessor, the late John Sturdivant, testified before your Subcommittee last year on this legislation, and he later told me, after he appeared at your Subcommittee, that you did conduct a very fair hearing on the legislation, even though you happened to be one of the co-sponsors, and I thank you for that, as well as the insights that the Majority staff on the full Committee have shared with AFGE prior to this hearing.

Senator BROWNBACK. I remember him as just an outstanding, wonderful member, a person with this great soul, too. He was a wonderful man.

Mr. HARNAGE. Yes. We miss him.

And, Chairman Horn, let me thank you for your willingness to work with AFGE on your recent travel card legislation, as well as the interest you have shown in making child care more affordable for lower-income Federal employees.

When AFGE last testified on the legislation that we are concerned with today, we had several constructive suggestions: Improving OMB Circular A–76 and requiring cost comparisons for all service contracting; lifting arbitrary personnel ceilings which cause wasteful contracting out; developing a better understanding of the contractor work force; improving contract administration; ending contractor's incentive to avoid unions and shortchange workers on their pay and benefits; and encouraging labor-management partnerships to make the government even more effective.

I regret to report today that not even a single suggestion AFGE has made managed to sneak into the draft legislation we are considering today. Consequently, I am baffled that this legislation is actually being characterized as a compromise.

[1] The prepared statement of Mr. Harnage appears in the Appendix on page 276.

I am even more baffled to hear contractors continue to complain about not getting enough taxpayer dollars. The government already contracts out for services in excess of $110 billion annually, an arbitrarily low number which does not come close to indicating the private sector's deep involvement with the Federal Government.

With an administration that has consistently racked up the highest service contracting-out bills in the Nation's history and a series of Congresses that cheer on privatization more so than anyone which preceded them, contractors should be celebrating their good fortune in grand style.

Attributing the failure of contractors to dig even deeper into Treasury to a conspiracy not to use A–76 often enough to suit the private sector, the legislation under consideration today includes provisions that would put most of the government up for sale over 5 years. Contractors are obviously frustrated at the increasing success of Federal employees in competition under OMB Circular A–76. Formerly, Federal employees lost 7 out of 10 competitions. Now we are winning 50 percent of those competitions. This is not the result of unfair competition for the contractors. It is the result of reinvention-of-government initiatives and MEOs. Contractors want to junk OMB Circular A–76 in favor of a more pro-contractor framework. This is not about saving taxpayers' dollars. It is about privatization at any cost.

It is said that this legislation simply establishes a process by which the Executive Branch can create a fair system for public-private competition. Since the framework which would succeed A–76 itself is not yet formed, the legislation sponsors are imploring a don't-worry-be-happy strategy. To Federal employees, your concerns will be dealt with later. Well, I was taught at a very early age not to buy a pig in a poke. I am not about to change my way this late in life.

Federal employees are justifiably apprehensive at the prospects of a competitive framework that politicians and contractors might devise in place of A–76. At a time when some politicians' minds are impaired by notions that the public sector can do nothing right, now is not the time to rewrite the rules for Federal service contracting, public-private competitions, if we truly want to save money for the taxpayers and ensure that inherently governmental services continue to be performed by Federal employees. And the often one-sided approach of this legislation providing detailed instructions about how to calculate in-house overheat, but conspicuously solid on contracted in and the most efficient organization process, it only increases our suspicions.

Let us talk about the most important reason why this legislation is not designed to ensure fair competition, its complete and total failure to even address in-house personnel ceilings that force agencies to contract out work, even at higher costs because of shortage of Federal employees, a practice which has been extensively documented by GAO, OMB, and other agencies.

Finally, I note that this legislation does absolutely nothing about the dismal state of Federal contract administration. The details are provided in my testimony, but, clearly, there is no doubt that we are losing billions of dollars every year because of waste, fraud, and abuse in Federal contracting. Lawmakers considering this legisla-

tion need to ask themselves a very simple question. If it is manifestly clear that the taxpayers are being billed for billions of dollars in contractor waste, fraud, and abuse every year as a result of the $110 billion in service contracting currently undertaken, just what sort of extraordinary budget-busting losses will we see when over a 5-year period the total Federal Government is put up for bid?

Mr. Chairman, I appreciate the opportunity to appear before you today, and I look forward to answering your questions.

Mr. HORN. Well, we thank you for that very full statement, and we appreciate the timeliness with which you could deliver it. I have never seen a panel so good as all of you that have come within the 5-minute side, and it is sort of ironic. We are in Senate territory, and on the House territory, I can never get you to stop, but we thank you all for what you have done on this.

We now have our last panelist, and then we will have questions. Michael Styles is the national president of the Federal Managers Association. Mr. Styles, it is a pleasure to have you here.

TESTIMONY OF MICHAEL B. STYLES,[1] NATIONAL PRESIDENT, FEDERAL MANAGERS ASSOCIATION

Mr. STYLES. Thank you, Mr. Chairman.

In an effort to stay within the 5 minutes, I would like to just comment briefly on the statement and some of the comments that were made here today by other presenters.

One thing I would like to say, I am sorry that Congresswoman Maloney left because I was born and raised in the Bronx, and current privatization and contracting-out policies have offended my sensibilities as well.

And I also think that Congressman Kucinich said it best when he said "of the people, by the people, and for the people." That is what government is all about, and I think what we have now is a misconception.

What we are talking about with the right-sizing of government, we say that we are shrinking the size of government. The American taxpayer believes that as we shrink the Federal work force, we are actually shrinking the size of government, and my premise is this, that moving work from one sector to another does not, in fact, shrink the size of government. It just moves the work from one sector to the other.

I believe that there are more than 1.8 million people working for the Federal Government. I believe there are approximately 10 million people. I do not know for sure, but I think it is something that we should look to because everyone who has contracted or had contracted work with the Federal Government works for the Federal Government.

A question was asked earlier about reinventing government. I remember that we went through this in several phases. The first phase was to say let us cut 272,900 Federal employees. That was an arbitrary number that was brought about by the administration to go out and cut Federal employees. The second phase said to go up into the 400,000 range, and along with the second phase, people said, "And, by the way, let us take a look at the agencies that these

[1] The prepared statement of Mr. Styles appears in the Appendix on page 337.

people work for and consider their mission." I think we had it kind of backwards, and I think what we are responsible for is providing the best service, the best quality service for the lowest price to the American taxpayer.

If you take a look at some of the organizations that we have downsized to date, recently at a National Partnership Council meeting at our national convention, we had a presentation that was made by NAVAIR. In that presentation, we talked about cutting the infrastructure by 56 percent, cutting the work force by 49 percent, and most people would say to you that we were shrinking the size of government, becoming more efficient, quite the contrary in the sense that we are now contracting out more of the services that were performed at those installations, and, more importantly than that, we have undermined our ability to provide immediate response capability and surge capacity in those arenas.

I think that as we look at the overall issue of contracting out, we have to look at some of the challenges that face us. There are two primary concerns that FMA has. One is the fact that contractor strikes can be imminent. We have in our testimony several examples of that, but I would like to share with you one on a personal note.

I went to an FMA–FAA conference-convention, and while we were there, we were given a presentation by Airways Corporation of New Zealand, and they talked about the privatization of the New Zealand FAA. It was quite an impressive presentation. When I asked of the presenter whether the now-privatized New Zealand FAA controllers could go on strike, he said sure. I said, "Well, what happens if they do?" He said, "They are above that."

Well, that was in October of that year, and I got a Christmas card which I brought with me, which I thought is kind of neat because it was approximately 2 months later. It says, "Mike, you may have heard that the New Zealand controllers went on strike over the conditions for their contract. It is a long story with many interesting features and some personal agendas. I will be writing to Bill," and blah, blah, blah, "to let you know how it comes out."

I think it is important for us to take a good look, a good hard look at what it means to have a very competent skilled work force working for us that is a strike-free work force.

Another point that we have issue with is the fact that we do not very effectively track the cost of contracting. In our recommendations, and I will get to them in a little bit, we do recommend that we track the cost of contracting, and I believe Congressman Cummings has put forth a bill before the House to do exactly that.

Along with this, I believe that if you take a look at Seal Beach Weapons Station—I was going to call them "Chapter 55." I apologize. The situation that you mentioned earlier when you talked about the weapons station at Seal Beach is a very important one. We talk about the skilled labor that we have within the Federal work force, and if you take a look at the awards that have been won by the managers and supervisors at that installation and the employees, you are talking about the Government Hammer Award in 1995 and 1996, the Bronze Eureka Award, California's equivalent to the Malcolm Baldridge Award in 1995, and the Silver Eure-

ka Award in 1996 and 1997, and they have just recently learned that they will be a part of this process.

Now, I realize that you have excluded the depots from this process, and we appreciate that very much, but we are worried about those other military entities as well who fall within that definition that I provided before about immediate response capability and surge capacity. I think these are issues that we must look to, and I hope that we do in the future.

Thank you very much.

Mr. HORN. Well, we thank you.

I am now going to yield my time, 5 minutes, to the Vice Chairman of the House Subcommittee on Government Management, Information, and Technology, Mr. Sessions of Texas.

Mr. SESSIONS. Thank you, Mr. Chairman.

Dr. Kelman, I would like to address some of my questions to you, if I could, first. I heard your testimony and have read part of what you provided here. I think you were talking about a balance in order to achieve this legislation.

I have heard from people here who are also equally on both sides of this issue. Can you play out for me to the benefit of the taxpayer—you have served on both sides, academic and within the administration—what you believe those advantages and/or disadvantages, once again, both sides could be?

Mr. KELMAN. Yes. I think that we do need to keep in mind the big picture, which is that the overwhelming amount of evidence, both at the Federal level, the State and local level, and even, again, the private-to-private level, to the extent we have evidence. Is that when you subject activities such as these to competition, costs tend to go down, typically quite dramatically, 20-percent declines are not at all uncommon, and quality tends to get better?

I mean, the idea of competition, which is the base on which our marketplace system functions, also has its place in the public sector in non-core functions.

I agree with Congressman Kucinich, there are core government functions, core missions, decisions that we make as a people democratically that should be implemented by Federal employees, but that does not apply to grounds operations, payroll checks, a lot of the medical services that are delivered in-house by the Defense Department, and lots of the commercial activities that are currently delivered in-house without competition do not fall within that category. So I think the benefits of competition are pretty straightforward.

I guess I was surprised to hear from some of my colleagues, the union witnesses, these statements about the Federal Government is unable to oversee these contracts. I am surprised that they have such a disparaging view of Federal workers. I believe that our Federal work force is perfectly capable of overseeing these contracts. They are overseeing the contracts. I am also surprised to hear cited a number of IG and GAO investigations. These are exactly the kinds of studies that when they are done about Federal programs, friends of appropriate government, friends of government say, correctly, these are extreme examples, these are unusual examples, do not assume they are typical, the sort of thing that is on "Fleecing

of America" that many of us, I assume, the union witnesses and I, often blanche at seeing.

I am somewhat surprised and disappointed to hear some of the union witnesses cite similar kinds of "horror stories" with reference to contract oversight. Almost all of those examples of problems in contract oversight that were cited by some of the earlier witnesses involve some of the more esoteric kinds of contracts, often sometimes sole source for various reasons. These are not the mainstream of commercial activities, which it is very, very feasible using performance-based contracts, gain-sharing, fixed-price contracting. There are well-known techniques that the administration has been promoting as part of procurement reform that allow us perfectly well to oversee these contracts.

Mr. SESSIONS. Thank you.

Mr. Stevens, there were some discussions, and I believe it was Mr. Logan who talked about the mapping. Was it you, Mr. Logan?

Mr. LOGAN. That is correct.

Mr. SESSIONS. Can you please tell me some of those functions that might mean to you—what were they? Core and out-sourcing? Not referring to Mr. Logan, but Dr. Kelman. Was it the core?

Mr. KELMAN. Yes, core and non-core.

Mr. SESSIONS. OK. Can you tell me in your opinion what might be core and not core, just in a brief minute or so, please? Then, Mr. Styles, I would like to ask that you and Mr. Harnage answer that also, please.

Mr. STEVENS. I really would rather not comment on that. I am here largely as a technician and simply can tell you that once those things are defined, if the playing field is level and the proper methodologies are used, the competition will be fair.

Mr. SESSIONS. Because, evidently, the agencies will be determining these things.

Mr. Harnage, do you have any comment on that, or concerns?

Mr. HARNAGE. What was your question again?

Mr. SESSIONS. Well, essentially, in this legislation, there will be a determination made of what is core and then, in essence, what is for competition. I have heard you talk about the concerns that you have. Do you have any concerns about that utilization or how that would be used that might be to a disadvantage for a government employee?

Mr. HARNAGE. Well, I think our first concern was going to be the amount of litigation that this bill is obviously going to create whenever that can be challenged. What is decided to now be inherently government is now subject to the courts of where it is not before, and, oddly enough, the only thing that can be challenged is when it is not decided to be contracted out. It cannot be challenged if it is decided to be contracted out. I think that is a very unfair advantage to the contractor or disadvantage to the Federal employees, but we are not about more litigation. We do not think this belongs in the courts. We think this belongs in the upper management decisions. We think this belongs in Congress and in making their decision and passing the laws that look into these matters. I just do not agree that litigation is the process.

Mr. SESSIONS. Mr. Styles.

Mr. STYLES. Yes, sir.

Mr. SESSIONS. Mr. Chairman, if I might——

Mr. HORN. Yes. As long as you ask the question in the time period in which you did, we let anybody that wants to answer it, and we will do the same with the gentleman from Ohio.

Mr. STYLES. I thank you very much.

U.S. law, Title X, Subtitle A, Part 4, Chapter 146, specifically designates,

> The necessity of the Department of Defense to keep core logistics functions within the U.S. Government. It is essential for the national defense that the Department of Defense maintain a core logistics capability that is government-owned and government-operated (including government personnel and government-owned and government-operated equipment and facilities) to ensure a ready and controlled source of technical competence and resources necessary to ensure effective and timely response to a mobilization, national defense contingency situations, and other emergency requirements.

When I talk about immediate response capability and surge capacity, I am talking about the men, the women, the machines, and the drydocks. All of those things are essential to the readiness of this Nation.

So, when we talk about core, we are talking about all of those entities. When you downsize and not right-size, when you contract out—and I will use an example here. I will use the shipyards, which is a good example. When we lost Brooklyn Navy Shipyard, let us say, all of those resources were given to the private sector. What happened was the drydocks and other things went into decay. We lost a resource.

Now, understandably, we are in a new era. What we have to do, though, I believe, is as we are downsizing or right-sizing, as I would like to see it, when you talk about competition, I believe the public sector should be able to compete with work in order to maintain the skill levels at their depots and other organizations so that they do not lose that force and readiness at time of need.

Mr. TOBIAS. Mr. Sessions, I think that the issue that we are talking about here is who defines "core government function," and what this legislation would do would be to allow the courts to define "core government function" in the context of litigation, as opposed to the Federal Government and the Executive Branch defining "core government function." I do not think that the courts ought to be defining what is a "core government function," and this legislation would allow that to occur.

Second, in response to Mr. Kelman, who was surprised about these horror stories——

Mr. SESSIONS. Mr. Tobias, I asked that question, and I would not like to engage in anything that would be considered pitting one Member of this panel against another. And I do appreciate your comments. I would be pleased to hear that when we get finished, that you may give that to me, but I would——

Mr. TOBIAS. Thank you.

Mr. SESSIONS. Thank you.

Mr. HORN. Well, for the next round. I now yield 5 minutes to the gentleman from Ohio, Mr. Kucinich.

Mr. KUCINICH. Mr. Chairman, thank you very much.

In reviewing this testimony, I am struck by what I would call the epistemology of privatization, and, certainly, Dr. Kelman, as a Har-

vard professor, understands the connotative as well as the denotative meanings of words and phrases.

I was struck by your assertion that this is a non-ideological profession, and, yet, when I see language which speaks of the marketplace, leveling the playing field, downsize, that certainly carries with it a particular and peculiar kind of logic. How do you stand on your assertion that this is not ideological, when, in fact, it seems to be replete with references to a more corporate approach toward interaction?

Mr. KELMAN. I agree with your concern about what words connote as well as what they denote. With Professor Horn in the audience, you should maybe continue——

Mr. KUCINICH. I have done a little teaching myself.

Mr. KELMAN. I understand. So we have three teachers here.

Here is what I would say. What I would say is—I am here speaking for myself—I care very deeply about the ability of government to work effectively because I believe that government performs some very crucial roles in our society.

If you look at the polls, the biggest threat to the standing of government in the eyes of the American people—if you ask the American people—and you see all these polls about the high level of public dissatisfaction with government. If you look at the most recent Pew Foundation poll that was on the Federal page of the *Washingotn Post* a few weeks ago, what you will find is most Americans agree with the goals, more or less, that government is undertaking, but believe that government wastes a lot of money and is not managed effectively.

I believe that we need to concentrate the effort of our Federal executives and leaders on taking overall responsibility for the core policy-making and policy implementation tasks of government.

I believe that through increased use of out-sourcing, just as is done commercial-to-commercial in the commercial world, we can get government to be more effective, more efficient, and save and turn around the reputation of government in the minds of the American people.

So I believe, actually—I say this not to be ideological because people who do not share my ideology might favor this for other reasons—but, speaking for myself, as a friend of government, as a former government employee, and as somebody who is teaching kids who are going to work in public service, who have chosen not to go to a business school, they have chosen to study public policy and to work in public service, that is what I have sort of devoted my life to. I care about these things.

I believe that the appropriately increased use of out-sourcing even from an ideological perspective—this is not an ideological issue, but from my ideology, I would say that it is an important way to salvage the standing and status of government in the minds of taxpayers.

Mr. KUCINICH. I would like to ask you, Doctor. You spoke earlier about holding government employees harmless in a period off privatization. Could I ask you, does that go to supporting government employees, if they are in a transition, to a privatized function, having the same level of benefits, the same level of wages, the same pension rights? Do you support that?

Mr. KELMAN. That is a fair question to ask me.

Mr. KUCINICH. Do you support it?

Mr. KELMAN. Hold on. I think that has to be looked at on a case-by-case basis. Keep in mind that when——

Mr. KUCINICH. OK. I just want to point this out. Reclaiming my time, with all due respect, Doctor.

Mr. KELMAN. OK.

Mr. KUCINICH. On the one hand, one of the witnesses—I think it was Mr. Logan—said go to the private sector, get a great job. Well, terrific, let us do it, but if we are going to make that transition to the private sector, as Mr. Logan advocates—thank you—then your profession is that we want to hold—your words—hold harmless the government employees. Then why can't they have the same wages and same benefit levels and same pension levels?

And I will tell you why they do not, because that takes the profit out of the deal. If you do that, there is no profit. So the profit here in privatization comes from the wages, the benefits, and the pensions of public employees, and a consequent service reduction. I mean, I have seen that happen in local government. So I just wanted to point out why it is very vexing for such an esteemed professor and doctor as you are, and you are, to be able to answer without qualification the question about what would happen with respect to government employees. It is a very difficult issue, Doctor.

Mr. KELMAN. No, I agree it is a difficult issue, and I think there are all sorts of pluses and minuses that might come to employees when they move into the private sector. They get part of a larger firm with more promotion opportunities and so forth.

Mr. KUCINICH. You are right. Doctor, the red light is on.

Mr. KELMAN. Fine.

Mr. KUCINICH. But may I say that, to use another private sector euphemism, it is called the bottom line.

Mr. LOGAN. I would like to take exception with that. It was I who said there were opportunities in the private sector. I have employed people recently at higher wages and better medical benefits joining our firm from Federal agencies.

And one thing that I would like to say is if we knew a better way to understand the Federal employees, knew a better way to understand what their various pension rights and whatnot are—and I should be promoting a program called Soft Landing that—that we would be able to get more people to leave the government and join the private sector, but there is confusion in that area right now, and I think there should be some help to the employees, the government employees, to help them come across to the private sector. But I must re-assert that those people are leaving the government and coming into my profession at higher salaries, with better benefits than they had when they left the government, or why else would they have voluntarily left the government?

Mr. KUCINICH. That is a fine example you are setting for the rest of the private sector.

Mr. LOGAN. And I think that is not alone. I can tell you right now that there are 118 firms in my association, and there are Federal employees who could get jobs with all of them right now, in almost 50 States of this Union, if they wanted to go there and have a better career path than they had with government, and they will

actually tell you that, if you sometime want to take time and come out and talk to some of my ex-Federal employees.

Mr. KUCINICH. I am impressed with your presentation, and I look forward to you setting the standards for the rest of the private sector. Thank you.

Mr. HORN. I believe Mr. Trammel wanted to answer your question, also, and that is fair game.

Mr. TRAMMELL. I would just like to make a comment in regard to what Mr. Logan was just talking about. We, too, have one of the Soft Landing contracts from the government, which brings some of the Federal employees into the private sector, and I have had the exact same experience at our company (SAIC) as he just described in regard to being able to provide equal or greater-than benefits in every area, including vacations and holidays and health and welfare benefits, etc.

Also, I would like to interject that our industry is governed by certain laws, including the Service Contract Act, which mandates certain wages to be paid to hourly employees, and contractors take that law very seriously.

In fact, we can be debarred from doing any government business for not being in compliance with that law. I assure you that government service contractors take that law very, very seriously. In our associations, for instance, the Contract Services Association has developed a specific training course in consonance with the Department of Labor. Actually, Department of Labor officials teach that course twice a year here in the D.C. area. Every time we teach that course, we have an overflow of contractors and government employees which attend those sessions.

Mr. TOBIAS. Mr. Kucinich.

Mr. HORN. Excuse me. Mr. Tobias, and then Mr. Styles.

Mr. TOBIAS. GAO's follow-up with employees who have been involuntarily separated or went to work with contractors reveal that over half received unemployment compensation or public assistance.

Mr. KUCINICH. Over half or under half?

Mr. TOBIAS. Over half. Moreover, 53 percent who went to work for contractors said they received lower wages with most reporting that contractor benefits were not as good.

Mr. KUCINICH. What are you saying? Lower wages?

Mr. TOBIAS. Moreover, 53 percent who went to work for contractors said they received lower wages with most reporting that contractor benefits were not as good. That is a GAO follow-up with work that is contracted out.

Mr. KUCINICH. I think the panel has established there are some people who want to pay people more, but we have to also establish for the record that there are some people who want to pay less.

Mr. LOGAN. I would like to just say that I also disagree with your comment that the profit comes from paying people less. I believe the profit comes from better utilization of hardware or software, in our case, and better utilization of the work force.

When we started to do some work for some Federal agencies, those specs we were given were maybe 2-foot high. We have reduced that now to two pages of everybody's effort, including the

team from the government side, and we are able to produce data faster, better than ever before.

Mr. KUCINICH. Sir, if I may, you have acquitted yourself quite well as to what you do.

Mr. LOGAN. I am not asking of myself personally.

Mr. KUCINICH. But when you show us these pictures—what altitude are they taken from?

Mr. LOGAN. Well, which ones are you referring to?

Mr. KUCINICH. The one where you—the picture of the White House.

Mr. LOGAN. That one was taken at 8,000 feet.

Mr. KUCINICH. OK. Well, when you show us those pictures that are taken at 8,000 feet and you give us testimony that you are providing a soft landing for your employees, I just wonder if there are some people who are being dropped from 8,000 feet or we have people who are making—53 percent making less money. They are not landing soft. They are landing with a thud. So we have to distinguish between people like you who are testifying as to your sincerity to make sure that your employees are going to be given top-notch treatment, and, that is the right thing to do, and I congratulate you for that.

And, on the other hand, Mr. Tobias produces a GAO report which says not working for everyone. So just comparing records——

Mr. HORN. Mr. Styles.

Mr. STYLES. There are two things that I would like to reflect on here. One, we keep coming back to this thought or notion that the Federal managers themselves are not doing a fine job in effecting the best quality service for the American people.

Our work force, if anybody wants to take a look at it, is the finest work force assembled in the history of the world, and all we have done is berate and belittle that work force. Quite frankly, in public and in this House, I think we should show great respect for the things that are done on a daily basis by the American people working for the public sector.

A little earlier, also, a Senator made a comment that we had to—the taxpayer. Well, guess what? All of us who work for the Federal Government are taxpayers as well.

And I would also say that on those instances where we do pay more or pay a decent wage to our folks who are being privatized or contracted out, if you take a look at Louisville, Naval Weapons Station, or you take a look at Newark Air Force Base, then you look at the privatization aspect of it, and now it costs $40-something-million a year more to operate those facilities. So who is getting the biggest bang for the buck? Are the American people getting the biggest bang? Not hardly.

Mr. HORN. OK. I thank you.

Mr. KUCINICH. Mr. Chairman, I must——

Mr. HORN. Your time has long since expired.

Mr. KUCINICH. It has, and I understand that. I want to thank the Chair for his generosity and for helping to create the circumstances for this hearing.

I have to go to another meeting right now, but I want to thank you for what you have done to create this moment, and also thank

all the Federal employees who are out there for the work that they do. Thank you.

Mr. HORN. I thank the gentleman and wish him well. I now yield to the Vice Chairman, the gentleman from Texas, Mr. Sessions.

Mr. SESSIONS. Well, thank you, Mr. Chairman.

The part of the discussion that has invoked my brain into asking questions that are probably off the legislation—and I do not know whether there is anybody that would object to the germaneness of this discussion, but the question begs to me, is there something that the Federal Government should do to help this Soft Landing? You are looking at a person who spent 16 years working for a private firm, who left. I was not able to take my benefits with me, chose not to accept the government—and I do not know which side this is trying to help, but did not accept the health care that the government offers from the House of Representatives because it was worse than what I had in the free market, and have chosen to continue buying that, but are there things that we can do, Mr. Tobias, Mr. Harnage, and Mr. Styles, to make this Soft Landing easier within how the government treats a departing employee that we should look at? Mr. Tobias.

Mr. TOBIAS. I think the answer to that is yes, Mr. Sessions. I think that, certainly, no employee who loses a job with the Federal Government is——

Mr. SESSIONS. Through no fault of his own, especially, or her own.

Mr. TOBIAS. Through no fault of his own, loses his or her job, is not entitled to pay at a level that is equivalent to the pay received in the Federal Government, is not entitled to benefits equivalent to the benefits of a Federal employee, and, in fact, is not entitled to a job at all.

Some employees may be offered a job, but others not, at the discretion of the private sector employer. So there is no real safety net for folks who do lose their jobs as a result of contracting out.

Mr. SESSIONS. I guess my question is, is there something inherently involved with employees who default the Federal Government, that we could change those circumstances that make it better and easier for them, unrelated to where they are going, but from what they are departing, from what they had? So I guess I am really talking about benefit plans, things that they had earned while in the government that they could begin taking advantage of earlier.

Mr. Harnage.

Mr. HARNAGE. Well, there probably are some, but I think if we get into that area, you are going to have two arguments, and we have argued about this fairness for years. And I do not know that we will ever agree on it, but if you are talking about being able to carry some benefits into the private sector, you are doing one of two things. Either the contractor is going to be arguing that it is no longer fair because they are incurring that additional cost that they otherwise would not, or the government is going to have to be subsidized. In that case, the taxpayer is paying for it, anyway, so why don't we go to the private sector to start with.

Congress has been very good in the past in those areas of downsizing, reinventing government, developing Soft Landings, in

the BRAC shutdowns, and retaining Federal employees. It has done well in that area, but it has done absolutely nothing when it comes to contracting out. I think we need to look at those experiences in reinventing government and downsizing to draw information from what can the government do.

Mr. SESSIONS. Good. Mr. Styles.

Mr. STYLES. I think that especially in the Department of Defense, they have done well as far as placing people, training people, ensuring that there is a smooth transition for them. I think other agencies have to learn a lot from that. I think that cross-agency placement is essential if we are going to be successful, but I also think that what Mr. Harnage just said is something to look at.

Contracting out should not be mandated. Contracting out should be a management tool to ensure the provision of the finest services to the American people. When we talk about what should be and what should not be contracted out, I think that should be a management decision within an organization.

When I told you earlier that the NAVAIR organizations were cut 56 percent in infrastructure and 49 percent in personnel, they are still being mandated to contract out. Now, there is something wrong with that because, as I said before, you are now drifting past that point of no return.

When the skills within the work force are gone, what you talked about, core is no longer with us, and that goes across the board throughout all of the agencies, if you will. Once you get past that, you cannot compete.

Mr. SESSIONS. Mr. Chairman, I would like to state that for the people who are gathered before us, not only in panel, but also these people who are in this room, that I do believe that this hearing today has been very good. I believe that there are Members of this Committee and Subcommittee who will take very seriously the remarks that have been made today. I think the things that you have seen, the vigorous discussion that we have had, obviously, does ensue privately with us behind closed doors, and that I have great respect for each and every part of the testimony that has been made today.

With that, I will tell you that I am through with my questions. Thank you, Mr. Chairman.

Mr. HORN. Well, we thank you very much. We appreciate the testimony all of you had.

Let me ask just one last question. Is there anything that you would like to get on the record in response to what any of the other witnesses said, just to clarify the situation? I believe in giving witnesses who spend their time coming here from a long ways—I believe in giving you everything you can to get in the record.

So, Mr. Tobias, anything getting you in the craw that you heard and did not like that we have not covered?

Mr. SESSIONS. And, Mr. Chairman, let me state, and I said it a minute ago, I had written Mr. Tobias a note here, presumably to allow him now this opportunity on the record. So thank you.

Mr. TOBIAS. Thank you very much, Mr. Chairman.

I do have a little bone to pick with Professor Kelman.

Mr. HORN. That will teach you to leave the government, Steve. [Laughter.]

Mr. TOBIAS. I am surprised at Professor Kelman's testimony that this represents a middle ground. There is no question that the issue of competition is an important one. The issue that competition lowers costs is an important idea and a well-recognized idea and an idea that I accept, but what I do not accept is the fact that under this legislation that the private sector defines core government functions; and the court defines core government functions.

I do not accept the idea that the Federal Government now knows how to manage and does effectively manage the work that is contracted out. You can cast that as if I am disparaging Federal employees, but, rather, I am disparaging the system that is in place today to manage the work of the—some of the work of the private sector that GAO has reported.

Finally, I do not think that I am referring to horror stories, but, rather, when GAO is asked to look at transactions—and they are not exceptions—what is found is that the private sector costs more, and part of that is because there have not been competitions, and the competitions that have been run have not been run well. So I think all of those are issues that have to be addressed, and many of them are not addressed in this legislation.

Finally, I think that the idea that somehow a core government function can be, once and for all, defined over time is wrong. The government performs the work it is performing because people at one time decided that it ought to perform that work, and the idea that somehow all of those decisions were wrong and that over the next 5 years we are going to bid all of that work just because we ought to, I think, is a wrong-headed approach, both to government and managing the government.

Mr. HORN. Mr. Logan.

Mr. LOGAN. I just wanted to close by saying that A–76, and that has been core to this legislation, does not give or allow decisions either on the core aspect of government because it is in the hands of the agencies, and the agencies make the decision as to whether A–76. In our case, they are just not doing that.

It strikes me as strange that some agencies do contract out exactly the same services that other agencies say cannot be contracted out. They are saying this because they say only the government can do it. Yet, we see from agency to agency the same services in our particular field, one saying one thing, one saying the other.

I would also like to just comment on the $600 hammer that has come up again today. I believe a lot of that has happened because of mil-specs by the government requesting very, very unique services, and when you request very unique services and, as I have said, with 2-foot-thick specifications, you will end up with $600 hammers, but when you get it down to buying cots—and I have to thank Steve Kelman for promoting this very successfully—we have a situation with one agency right now who, when we started to do work, they said that our costs compared to their costs were approximately one-third more because we were in a learning curve, too. Within a year, they have pointed out that we are producing work for less than they can do in-house, but I come back to the A–76 program. It does not work because there is no incentive to make it work.

Thank you very much.

Mr. HORN. Thank you.

Mr. Trammell.

Mr. TRAMMELL. Thank you. I will make a few quick comments on key points from an industry perspective in relation to this legislation. Industry is most interested in having an opportunity to compete for the most efficient organization. We do, indeed, believe that this competition does increase efficiencies. However, we also should be provided a level playing field in evaluation for these opportunities.

The last comment that I would like to make is from both the perspective of my company—and industry. As we team with a number of private sector companies as well as with the government—my company and our industry endeavors to engage in a partnership with the government when we perform activities under contract to the government. We take that relationship very seriously. We promote it. We believe that our government counterparts embrace this concept. That is what I want to leave you with; that industry promotes that partnership.

Mr. HORN. Thank you. I am going to skip Mr. Kelman and bring him in last in case the other three are going to attack him. I wanted to get you all in one place.

Mr. Stevens.

Mr. STEVENS. Thank you, Mr. Chairman.

Again, from an industry perspective, I want to underline that we believe that the draft legislation is a substantial improvement over the existing A–76 process. It corrects a lot of flaws, provides language that from a common-sense perspective ought to be acceptable to most, if not all, of the parties involved, and a warning that as in many things, the devil is in the detail, and one needs to pay good attention to how costs are calculated and measured and how they figure into the competitive process.

Mr. HORN. Mr. Harnage.

Mr. HARNAGE. Yes. Rather than trying to add more testimony, I think the opportunity was to address anything that may have been said by other witnesses that may have taken exception to, and what I would like to clarify, a previous witness talked about the statements made by the late John Sturdivant concerning AFGE's position on competition. I want that understood.

When AFGE developed its policy on competition, I was chairman of AFGE's Privatization Committee of the Executive Board, which developed that policy. So I am very, very familiar with that policy.

We were talking about in the context of reinventing government where we were playing a role, a partnership role, in trying to make the government the most efficient, the most effective government. We were also participating in a downsizing of the government as a result of the end of the cold war, and, again, we were talking about the soft landings and taking care of our people the best we could, recognizing that there had to be some downsizing of government, and also recognizing in today's world, there had to be better efficiencies developed.

At the same time, we were participating in the revision of OMB Circular A–76. We did not get all that we wanted, any more than the contractors got all that they wanted, but at least we were al-

lowed to participate, and we wanted to send the message clear to both Congress and to the administration that we were not fighting competition; that we wanted it fair, and we wanted it reasonable, and we wanted what was best for the taxpayers. And that was our interest.

I now say that because we may appear to be changing our position on competition, it is like comparing me if I was to go out here in the Reflection Pool of the Lincoln monument in a rowboat and get out and say, "Everybody ought to go rowing," and then somebody wants to know why I do not take a kayak down the rapids. That is about the same comparison as me saying I support competition with this bill as opposed to saying we support the competition under the A–76 process, which is as fair as we have been able to get it today. And we recognize—we recognize that competition does bring about efficiencies, and we would not be acting in the best interest of the taxpayers if we totally opposed competition.

I do have a problem. I do not agree that competition is right in all forms. I am a veteran, and I am very patriotic. I love this country, and I am very concerned about the most powerful government in the world, the leader of the free world, being a government for profit. I have a real concern with that, and at the same time, I am very concerned about the support of our war fighters, the support of our war fighters, our national security being subject to the low bidder.

I have a problem with that, the same as Senator John Glenn had when they asked him how did he feel when they lit the fuse on that first rocket that he took, and he said he was thinking about that it was built by the low bidder. Well, I have that same concern when it comes to national security.

So, please, nobody misunderstand us. We are not in favor to competition in every case, and never will be, but we are not opposed to competition in every case either.

Mr. HORN. We thank you on that, and as a former State official, I certainly had my fill of low bidders that later tried to jack the price up a million ways.

Mr. Styles.

Mr. STYLES. Yes. Thank you, sir.

If there was anything that was said today that I took offense to, I think it was the fact that perhaps the government workers and managers do not do the job as efficiently as their counterparts in the private sector.

Experience has shown me that we not only can compete, but we have won competitions consistently against the private sector, and I think when we do compete in the arena—and I will use an example here. I know that Warner Robbins Air Logistics Center in Georgia won a contract for the C–5 Galaxy transport, and they beat out Boeing and Lockheed Martin, and the closest private sector bid was $22 million more than the one turned in by Warner Robbins. I think that is pretty efficient management and effective workmanship.

When I was in the Experience with Industry Program, I spent a year working with the private sector, and I will not mention the corporation I worked with, but while I was there, they were developing their total quality management philosophy, if you will, and

putting it in place. We were using the North Island Rework Facility in San Diego, a Federal installation as an example for them to put in place their total quality management program.

I also, by the way—and I wanted to bring this in, and it kind of works in here. We are talking about the biggest bang for the buck for the American people. When I was with that particular organization, I came across their pay schedule, and for several weeks, I was very disturbed because I knew I had thrown away my career because I was working for the wrong group of folks. This is a 1988, March 5, pay schedule from that private sector organization, and if you compare it to the Federal Almanac's pay schedule for our Federal employees who are very competent and equal at the task, that 1988 schedule has higher salaries than ours do today.

So I think we should applaud the Federal employee and the Federal manager for the incredible job that they do day in and day out for our Nation, and I do not think the American people should ever be given a picture of us as being less than our counterparts on the other side of the fence.

Thank you.

Mr. HORN. We thank you. And now, Dr. Kelman?

Mr. KELMAN. Let me first just back up what Mr. Styles said at the end. I, too, have an enormous—as a taxpayer and as a teacher, an enormous appreciation for the Federal work force and for the qualities and public spirit and devotion to the public good of our Federal work force.

I do not see that as being the issue here. It may be the issue for some idealogues who want to berate the Federal work force.

Mr. Tobias asked why I felt the bill was a compromise. I see it as a, by and large, reasonable compromise because it incorporates a principle that was not in the bill as introduced last year, namely the ability of our Federal workers to compete for those activities that are competed.

I agree with Mr. Tobias. The one provision, looking at the bill, that I do not like is the judicial review. I do not think that we should be having judicial challenges of these decisions about whether something is inherently governmental. I would want to keep that out of the courts.

But to me, the only ideology—and I will not impose it on everybody else, but the ideology that I bring to this is an ideology that says government needs to be managed better, to restore the faith of the American people in the ability of government to do its important missions.

Commercial companies themselves have found that significantly increased out-sourcing promotes their abilities as private firms to do their missions as private firms. I believe the same will occur if we encourage greater competition for more non-core government jobs.

Mr. HORN. Well, I thank you all, and just to reflect on a little of this, I certainly agree with the point that has been made by both private sector representatives and public sector representatives that we have some excellent people, some very fine people, dedicated civil servants and public servants in government. As I listen to some of you and as we looked at the number of years people had served in various capacities, I noted that over the 40 years that I

have worked, I spent 35 as either a Federal official or a State official, and I spent 4½ years with non-profit institutions known as Brookings and American University. I spent half-a-year working my way through college pumping gas for the Standard Stations, Inc., all jobs I happen to have enjoyed, and I certainly would agree that we want the best civil service we have. But I also agree with you, and you said it, in both the public and the private sectors, that competition can be a good thing for both Federal workers and the taxpayers and the Federal workers are paying as much taxes as anybody else, since we in the middle class are the ones that pay the bills.

The poor, we took out in 1986, and the rich can find ways to get around the tax laws. So most of us in this room are the ones contributing to the salaries of everybody else in the room, and I want to thank you all for coming.

We want to leave the record open for any of you that have any other comments to say. We will leave it open for about 3 weeks, and we would welcome that, and we would welcome anybody else in the audience and any other groups that we have not had a chance to put at this table. We would certainly appreciate the comments because we do want to get together with the Senate and work out what makes sense and what will get the job done.

I think the only alternative I can see to the court aspect, which is not in the House bill, it is in the Senate bill, is that you have a very strong office of management, which I am going to be proposing as opposed to an office of what is really budget not management, and they would have to, then, on behalf of the President, whoever that is at any point in time—they would have to be giving some of the direction and analysis on behalf of the President in his role as commander-in-chief, as well as his role as domestic general manager, to a degree, and assure that the various Cabinet Departments do take seriously that basic policy of competition in some areas.

With the fleet control, for example, that the Army used in Europe, they saved millions of dollars in that. GSA has saved millions of dollars by careful bidding of a number of things, and those were Hoover Commission reports, essentially, of 1949, 1952, that charged up the Executive Branch to take a look at some of these things. I think your testimony has been very helpful.

I also recall that we are working on the commendation and appropriate salary to go with it for a procurement corps, and praise was given by one of the witnesses here today on the outstanding people we have in acquisition and procurement. Well, a lot of those people are being bought off by the private sector. We know we cannot keep everybody, but while the salaries might be lower in some of the public sector in relation to the private sector, you also have to look, to be fair about this, at the benefits that come with various types of public service that might not also come in the private sector.

So, just as Mr. Sessions noted that he thought the House package on health care, which is exactly what the Federal Civil Service has, was not as good as what he had in the private sector, I know what that is. It was not as good as what I had in California State Government either. So there is a lot of competition going on for

good people, and the government needs to keep up, and good people need to get involved.

I have been very pleased with the excellent suggestions that have come from Members of the panel, and I look forward to working with you on this side. I am sure Chairman Brownback will be glad to work with you on the Senate side.

Let me thank now the staff that has gone into having this excellent group and this dialog this afternoon. On behalf of the House Subcommittee on Government Management, Information, and Technology, our Staff Director and Counsel, J. Russell George, who has been sitting over there by the phone because I thought I would have to leave for a vote, but Mr. Shuster used his usual charm, and, unanimously, everybody reported out the bill, and I could stay here. Mark Brasher, our Senior Policy Director, behind me, worked very hard on this particular hearing, as did John Hynes, a professional staff member. Matthew Ebert, our clerk, worked very closely with the Senate clerk on this, and David Coher, our intern from USC has been helpful in that area. Mark Stephenson for the Minority has been his usual able self, and so has Dr. Julie Moses of Mr. Kucinich's staff, and Chris Bitsko, who is the court reporter. Also Earley Green, Minority Staff Assistant.

Now we get to the Senate Subcommittee on Government Management, Restructuring, and the District of Columbia. We have Michael Rubin, Staff Director; Marie Wheat, Deputy Staff Director; Tom Palmieri, professional staff member; Joyce Yamat, professional staff member; Pete Rowan, staff assistant, and Esmeralda Amos, chief clerk for the Senate Subcommittee.

With that, I will bring down this hearing at about exactly 5 o'clock. Thank you.

[Whereupon, at 5:04 p.m., the joint hearing was adjourned.]

APPENDIX

STATEMENT OF
G. EDWARD DESEVE
ACTING DEPUTY DIRECTOR FOR MANAGEMENT
OFFICE OF MANAGEMENT AND BUDGET

BEFORE THE JOINT HOUSE AND SENATE
HEARING
ON
PROPOSED REVISIONS TO

S. 314/H.R. 716, "THE FREEDOM FROM GOVERNMENT COMPETITION ACT"

March 24, 1998

INTRODUCTION

Thank you Chairman Brownback and thank you Chairman Horn. I am here to discuss proposed revisions to S. 314, currently being cited as the "Fair Competition Act of 1998," and to H.R. 716, currently being cited as the "Competition in Commercial Activities Act of 1998."

We share the goal of seeking the most efficient and cost-effective source for the provision of commercial support activities required by the Federal Government. Five years ago this month, the President announced and the Vice President led an effort to fundamentally change the way Government operates.

At the time it seemed almost impossible. Red tape, poor financial and management systems, rigid hierarchies, poor performance incentives, a procurement system in desperate need of repair, systemic problems in our ability to acquire and integrate information technology, and senseless rules and procedures separated Federal employees from managers; separated managers from their missions, their responsibilities and their employees; and separated the taxpayer from their Government. Today, reinventing Government is the longest running, most dramatic and most successful government reform effort in our history. Together, we have streamlined our infrastructure, eliminated business lines, created partnerships with our employees to contribute to reform, eliminated red tape, changed business practices, eliminated duplication and, yes, opened

our commercial support activities to significantly expanded levels of competition. As of the end of FY 1997, the Administration had cut the civilian Federal workforce by over 316,000 employees, creating the smallest Federal workforce in 35 years and as a share of total civilian employment, the smallest Federal workforce since 1931. Almost all of the 14 Cabinet Departments have cut their work forces; only the Justice and Commerce work force is growing. Through these and other reinvention efforts, the Administration has saved $137 billion over the last five years.

We have worked with you to improve our financial and management systems through the implementation of the Chief Financial Officers Act. We have worked with you to improve our performance standards through the Government Performance and Results Act. We have worked with you to reduce the burdens, delay and costs associated with the Federal procurement system through the Federal Acquisition Streamlining Act and the Clinger-Cohen Act. And, we worked with you to expand the opportunities for public-public and public-private competition through the March 1996 OMB Circular A-76 Revised Supplemental Handbook and the Government Management Reform Act. We recognize that continued efforts are required in each of these areas and have begun initiatives to better integrate budgeting with performance planning and reporting.

The key to this success has been our ability to overcome the rhetoric and to work together to identify needed reforms. In our view, the House and the Senate drafts contain a number of important improvements over last year's "Freedom from Government Competition Act." We appreciate that the revised bills no longer center on who may or may not be eligible to perform Federal work. Nothing is more "unfair" than to limit or otherwise arbitrarily exclude a viable offeror (public or private) from the competitive process. Each of us seeks to expand the level of competition for both in-house and contracted work in an effort to improve quality and reduce the cost of services to the taxpayer. This process works. The differences that remain are not about the goals, but rather how to best achieve them.

The process outlined by the March 1996 OMB Circular A-76 Revised Supplemental Handbook was developed through more than 40 years of give and take and currently represents the input of the agencies, employee groups, large and small businesses and congressional sources. It was also developed in conjunction with the other management, budgetary and procurement improvement initiatives noted above. In the Department of Defense, over 150,000 FTE have been scheduled for competition with the private sector over the next five years. This would be the largest number of in-house FTE ever placed under review for competition and we expect that this number will grow, both in Defense and within the civilian agencies, over the next few years.

Any legislation should contribute to this process and move it forward. We are concerned that rather than build on what we have, many of the proposed revisions try to modify and create an overly simplistic process by creating new rules for what should be inventoried, creating mandatory competition schedules, creating new prohibitions regarding agency competitions for contracted work, broadly defining new costing requirements, promulgating new rules for the operation of interservice support agreements, and imposing significant new levels of administrative, Inspector General, Government Accounting Office and even judicial oversight.

FUNDAMENTAL PRINCIPLES

Since we do not have a single bill to react to, let me discuss some of the fundamental principles that a final bill should embody, including some aspects that we would hope could be avoided.

First, the Government must be permitted to choose the alternative -- public or private -- which is the most cost effective and in the best interest of the taxpayer. In so doing, the process must be fair and equitable to all interested parties. The customer agency, the reimbursable public offeror, the employees and the private sector should all have access to a level playing field to

compete for the performance of all Federal commercial support requirements. We do not care who does the work! We do care, however, that the decision process is fair, reasoned and that it results in lower costs to the taxpayer. Legislation must not restrict the opportunities for public offerors to participate in the process or distort the level playing field. Work must be able to be converted both from in-house to contract and from contract to in-house performance.

Second, any legislation should avoid judicial involvement in the management decision regarding whether or not to outsource. This includes avoiding giving jurisdiction to the United States Court of Federal Claims to render judgement on omissions from the list of commercial activities. In addition to raising a number of questions regarding the authority to determine what is inherently governmental, we believe that the proposal will result in a large number of legal filings and delays to the development of inventories, schedules, and existing and prospective competitions. While we do not think it appropriate to provide for judicial review of omissions from, or inclusion on, commercial inventories, it certainly would be inappropriate to allow contractors to challenge omissions while not allowing employees to challenge the inclusion of their work on the list. No legislation should allow the courts to enter into a review of the managerial, cost accounting and procedural aspects of an agency's implementation procedures.

Third, the management documentation, employee participation, costing and source selection rules for the competition must be well understood so as to be enforceable and impartial. Generalities in these areas are not helpful. In addition, the cost comparison process itself should be efficient.

For example, public-private competitions should not require the inclusion of all "direct and indirect costs" in the public offer. There are many overhead costs that will not change regardless of whether the work is performed by in-house or contract employees. Where various costs would not be affected by a conversion to or from in-house or contract performance, they should be excluded from the cost comparison. Detailed, consistent and balanced managerial and costing guidance is already provided by Circular A-76. In our view, the inclusion of "all direct

and indirect" costs biases the decision to result in a conversion to contract, without any savings to the taxpayer and may result in higher overall costs. Competitions should be based on the inclusion of all "*comparable* direct and indirect costs." Cost is not the only issue here. Nevertheless, leaving the detailed management restructuring, costing and administrative review procedures up to each individual agency or to the courts is not recommended.

Fourth, source selection processes must permit efficient and effective competitions between public and private offerors for work presently being performed by the Government or by a private contractor. We will continue to make available to agencies techniques -- including best value competitions -- that are impartial and build on the important acquisition reforms which your Committees have helped to bring about. We would have concerns about including internal management issues in the Federal Acquisition Regulation, such as documentation requirements, internal employee participation, and the development of the Government's most efficient organization. In addition, employees must be assured that they can fully compete to keep their jobs. We would have concerns with any legislation that excludes Federal offers.

Fifth, when an activity currently being performed in-house is converted to performance by contract (including contracts awarded by another Federal agency) the in-house employees must be afforded the opportunity to compete to retain the work. Permitting conversion without competition reduces the number of viable competitors, may adversely affect small business, creates new and inappropriate incentives on reimbursable activities to outsource, and restricts an agency's ability to select the most effective source.

Finally, we must acknowledge the other reinvention and management improvement initiatives that are ongoing and not must delay or cause unnecessary administrative burdens upon the agencies. For example, the exemptions from the competition requirements should be comparable to those currently provided in Circular A-76. Exemptions do not exist in the drafts to permit the conversion of work to preference eligibles without a competition, nor do grant agreements or other non-profits appear to be excluded, as a matter of law.

We would also have concerns with legislation that required the head of each agency to undertake competitions in accordance with a schedule mandated in law. We are concerned that such schedules could be unduly burdensome and may preclude agencies from considering a mix of reinvention, re-engineering, consolidation, privatization, and cost comparison efforts. For those agencies which may have large inventories of commercial activities performed by Federal employees, such as DOD, VA, USDA, and Interior, compliance with the schedule requirements of the House and Senate bills will require additional staffing and contract resources. As agencies seek lower costs and best value support service offerors, they will test and improve their in-house, contract, and franchise (cross-servicing) support mix. Rather than mandating cost comparison schedules, we recommend that we allow the forces of declining budgets and the market to require that these competitions are conducted. This approach too is reflected in the current Circular A-76.

CONCLUSION

In conclusion, I have tried to point to some of the principles that we would all want to draw on. We do not believe that the proposed revisions to S. 314 and H.R. 716 will achieve the quality improvement or cost reduction goals that I know you are seeking. In our view, we should not treat competition as a variable independent from our other reinvention and management improvement efforts. Any legislation addressing the provision of commercial support activities through public-private competitions must build on our accomplishments to date (including the important acquisition reforms that we have achieved with your help) and help us to develop long-term incentives to keep the agencies reinventing themselves and searching for more effective service providers. Proposed legislation that would establish a new model of Federal management, must not be so general as to be meaningless to Federal managers or so specific as to be inflexible and result in additional administrative burdens and delays. That will be a very difficult thing for legislation to achieve in this area.

Federal employees are some of our nation's most highly trained and dedicated employees. They operate within a complex system of rules, regulations and laws. They respond to a vast array of missions, public concerns and operational requirements. They deserve, as does the private sector, the opportunity to compete for their jobs on a fair and level playing field. This means that the managerial complexities of a public-public and a public-private competition be recognized. We do not believe that this legislation meets that requirement and we are concerned that the proposed revisions could result in higher costs for the taxpayer.

Chairman Brownback, Chairman Horn that concludes my prepared statement. I would be happy to address any questions that you might have.

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A Free Market Approach to Federal Contracting: The Fair Competition Act of 1998

Testimony on Behalf of Mayor Stephen Goldsmith -- City of Indianapolis, Indiana

Testimony before the U.S. Senate
Committee on Governmental Affairs
Subcommittee on Oversight of Government Management
March 24, 1998

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Mr. Chairman and Members of the Subcommittee:

I am pleased to provide testimony to the Subcommittee as part of its consideration of The Fair Competition Act of 1998. As stated in the section-by-section analysis, the purpose of this legislation is to "require a Federal agency to use competitive procedures in selecting a source to perform activities for the agency which are not inherently governmental." While there are substantive exceptions, the bill levels the playing field between the Federal government and the private-sector marketplace regarding "make-or-buy" decisions for services. This same sentiment was expressed previously by Thomas Jefferson who noted that "[i]t is better for the public to procure at the common market whatever the market can supply; because there it is by competition kept up in its quality, and reduced to its minimum price."

In the City of Indianapolis, we support the focus of the bill and the issues it addresses. Sometimes when government preempts the private sector from participating in the service delivery process, it does so to the detriment of not only private business but also taxpayers. This bill, in its effort to level the playing field between public and private providers, addresses a number of the systemic problems with government procurement. This bill recognizes that sometimes the process by which government produces services itself rather than buying them has little to do with competition. Competition entails an open marketplace where producers understand what it costs to produce a good as well as the prevailing market standards for quality. Many governmental entities, including Indianapolis several years ago, have no idea what it costs to produce a service. They also have little

sense of the quality and performance standards that govern the production of the service and they rarely subject themselves to the rigors of a competitive marketplace. The current system in much of government today is characterized by monopoly control over production, performance standards, and purchasing. The Fair Competition Act of 1998 recognizes this and begins to address a number of challenges. I believe that our experience in Indianapolis with some of these same issues will be helpful as you consider this bill.

I was elected Mayor of Indianapolis six years ago. I ran on a platform of rigorous public-private competition. At that time, I was not alone in the competitive government effort. David Osborne and Ted Gaebler had just written Reinventing Government and other reform-minded leaders like Mayor Norquist and Mayor Rendell were using the specter of private sector competition to spur improvements in services then provided by government employees. It was clear then, and it remains clear today, that there are enormous barriers to any efforts to reform government. That is particularly true when discussing privatization, outsourcing, or even public-private competition. The federal barriers, which are too numerous to mention, include section 13(c), which effectively prohibits cities from reforming urban mass transit into systems that can effectively serve low-income, transit-dependent citizens. Although there has been some improvement in the last two years, we also ran into barriers with I.R.S. revenue rulings when we originally examined options for privatizing, selling, or contracting out the management of our wastewater treatment plants and our sewer collection system. While cities are being asked to spend billions of dollars on environmental infrastructure, the existing rules retain strong incentives to use public capital rather than available and sometimes more effectively managed private capital.

Notwithstanding these barriers, we have had some modest success in Indianapolis in moving government services into the competitive marketplace. Our model required head-to-head competition between the public and the private sector. As part of that effort, we created real competition, used actual cost and performance data and created open markets. In addition, we separated governmental production efforts from governmental procurement efforts. We also created real financial and career advancement incentives for employees to make sound business decisions and to find the highest quality and lowest priced services. Finally, our starting point for head-to-head competition was not the range of services then provided by the private sector, but the services then provided by government employees. Services subjected to competition included the operation of the Indianapolis International Airport, our wastewater treatment and collection systems, fleet service operations, printing, copying, pothole filling and solid waste collection.

After seventy-five head-to-head competitions and six years of work, we have generated some positive results. To date, the City has saved nearly $420 million. The number of City workers, excluding police officers and firefighters, has dropped by nearly 45%. Nonetheless, no union employee has lost a job as a result of our efforts. Employee grievances have fallen by as much as 90% and workplace injuries have fallen by as much as 80%. The City's fund balance has quadrupled, license and permit fees have been dramatically reduced, and our third property tax rate reduction was recently approved by our local legislature.

Now, let me focus on The Fair Competition Act of 1998 and make several observations. We believe this bill has correctly focused on using competition as a tool to improve service quality and to control costs. In our experience, no other tool is as powerful and productive in improving the service

we provide to citizens. We would also concur with your efforts to reduce the Federal government's monopoly power while still permitting the Federal government to compete in a more structured format. In that way, the bill is similar to the Indianapolis model as we have developed it over time. My specific observations include:

- We believe that government is full of great people who are caught in bad systems. As you debate this bill, I would urge you to make it as straightforward as possible. Public managers need to understand their goals clearly and then be given the freedom and flexibility necessary to achieve them. The regulations that will be promulgated to implement this bill also need to be simple, concise, and focused on results rather than processes. In Indianapolis, much of our success has been due to a very simple system with clearly defined objectives and fully empowered employees. In the end, reducing the rules and regulations while increasing the decision-making authority of your talented employees will yield enormous benefits.

- This bill and your efforts will likely be in vain unless their is a strong commitment at the top of the organization to reduce the cost of government services. In our study of competition efforts around the world, we have not seen a successful initiative where there was not a political champion in a leadership role. To fulfill that need, and to serve as an adjunct to the efforts required by this legislation, Congress may want to develop its own list of activities for competition.

- The bill addresses the need to develop systems that support the make-or-buy decision-making process. Doing this correctly will be essential to your success. These systems will likely include activity based costing (or a similar cost accounting methodology) and a rigorous performance measurement system that focuses on quality and quantity goals for services. These cost accounting and performance measurement systems should have applicability both to existing governmental processes as well as any newly privatized functions. These systems need not be complex or cumbersome, however.

- Be sure to recognize that your incumbent employees are a tremendous resource. You should work hard to smooth the transitions that will inevitably be necessary for your employees. At the same time, you should identify and pursue opportunities to use financial and career development incentives to help drive performance. In Indianapolis, nothing got city employees more focused on the bottom line than an incentive pay plan funded with operating savings they had identified. Also, work diligently to identify opportunities for creating goal congruence between the interests of taxpayers, employees, and managers.

- Connect these cost-saving and service enhancement efforts to positive outcomes. In Indianapolis, we used the savings from our competition efforts to reduce previously unfunded liabilities, lower the property tax rate, increase minority and women-owned business contracting, complete the largest infrastructure program in the City's history, and put more police officers on the street. Connecting our reform efforts to these initiatives helped maintain support when it came time to make the more difficult

decisions. I anticipate that you will find, as we did, that most citizens care little about privatization or competition but they care a lot about safe streets, working sewers, low taxes, and well-maintained parks.

- I would encourage you not to get caught in the erroneous intellectual trap that lowering the cost of services will lead to lower quality. Unfortunately, that premise underlies much of our political debate -- and have found that it is generally wrong. Our experience in Indianapolis has indicated, almost without exception, that the rigors of competition not only drive down the cost of services but also, at the same time, drive up the quality. Our initiative has consistently shown that spending less can and will get you more.

- The bill excludes activities involving fewer than ten full-time employees. I understand the desire to focus on larger issues and bigger budgets. One of the most productive by-products of our competition effort, however, was the positive effect it had on small, minority and women-owned businesses. As we moved more and more services into the competitive marketplace, these small businesses were very successful in winning contracts. We have not found any better way to support small business growth and development than by creating market-based business opportunities through competitive contracting. We would encourage you to consider ways to extend more Federal market opportunities to small, minority and women-owned businesses in this manner.

- Early on, some Indianapolis vendors confidentially expressed concern about our process for selecting areas to compete. Those concerns were eliminated once the vendor

community saw our commitment to continual, open, rigorous, fair, and comprehensive competition. Some Federal service vendors might likewise be reluctant early on to challenge an omission from the list of activities open to competition. They may fear that if they challenge an omission, they will be effectively barred from winning when the service is eventually competed.

- There may also be concern over an increase in the number of bid protests or similar administrative proceedings that result from an increased number of competitions. The bill appears to address some of these issues. I would encourage you, however, to focus very carefully on creating an open and public process that maximizes competitive opportunities, minimizes disputes, eliminates politics from the decision-making process, and defers to qualified and unbiased staff to make final decisions.

- With respect to staff participation, we also believe that it is important to separate staff procurement decisions from staff production decisions within the service procurement system. Our experience has shown that it is difficult for an administrator to remain unbiased in "make-or-buy" procurement decisions when their organization serves as both the producer of the service and the ultimate consumer of the service.

- The bill also discusses exempting certain A-76 cost comparisons from this process. While I would not argue with that exemption, our sense is that A-76 more often frustrates competition than facilitates competition. Our experience in successfully privatizing the

Indianapolis-based Naval Air Warfare Center, which was done outside of the A-76 process, generally supports that conclusion.

The Fair Competition Act of 1998 is a step in the process of improving the quality of government services while at the same time lowering the cost. As a companion effort, I would suggest that it is important to identify the other legal, systemic, cultural, and organizational barriers that exist to improving further governmental efficiency. These barriers exist not only at the federal level, but also at many state and local levels. To that end, I have suggested to the House leadership that a commission be formed specifically to identify obstacles to competition and, where appropriate, privatization. Identifying and eliminating those barriers will augment the good work that the caucus has already undertaken under the leadership of Senator Brownback.

Thank you for the opportunity to be here today.

ISSUES TO BE RAISED IN TESTIMONY BY STEVEN KELMAN, WEATHERHEAD PROFESSOR OF PUBLIC MANAGEMENT, HARVARD UNIVERSITY, JOHN F. KENNEDY SCHOOL OF GOVERNMENT

Outsourcing often makes good business sense. Management experts have increasingly come to believe that it is best for organizations to concentrate on their core competencies and contract peripheral activities out to other firms, for whom the contracting organization's peripheral activity is a core competency. Thus, for example, there exists a successful commercial firm called Caribiner International that specializes in outsourcing conference and meeting management for large corporations. Ford's core competency isn't organizing meetings; Caribiner's is.

Because it so often makes good business sense, I am convinced outsourcing, sooner or later, will increase in the federal government. But the politics of the transition is tough and contentious. Legislative remedies should be judicious.

De-emphasize ideology. This is not about big government vs. small government or about whether you like government workers. Most outsourcing in the world takes place commercial-to-commercial. For years, private companies have outsourced much of their advertising and legal work. Firms that outsource not only conference management but areas such as employee benefits management or accounts payable to commercial firms are booming. This is about improving the management of the public sector.

Don't overreach. I was disturbed by the request some time ago from the State of Texas (eventually turned down by the federal government) to outsource benefits determination decisions for welfare recipients. Such decisions involve authoritative social

– and, ultimately, moral – judgments about how we as a society treat disadvantaged individuals. Social decisions such as these should be made by representatives of society, not employees of private firms. Furthermore, such determinations are part of the core mission of welfare organizations. Overreaching only hurts the strong case for outsourcing other activities.

Public-private competitions are inevitable. Steve Goldsmith, the privatizing Republican mayor of Indianapolis, has allowed city employees to bid on outsourcing deals, and often they've won. Instead of engaging the quixotic and inappropriate fight of trying to prevent government employees from competing, we need to pay serious attention to "level playing field" issues involving scoring past performance and accounting for indirect costs.

Try to hold government employees harmless. Outsourcing a previously governmental activity to a commercial firm creates benefits for taxpayers. Those benefits to the extent possible shouldn't be at the cost of existing federal workers. Contractors should be prepared to offer government employees a right of first refusal – either in the existing operation or somewhere else within the company's local activities – if they take over an in-house function. For many workers, actually, the move to a firm that specializes in the worker's area of expertise will be a plus, because internal promotion opportunities are no longer limited to the small pond of the agency's own activities in the area, but now include the company's whole base of operations. (A government employee who gets transferred to working for the systems integrator that has taken over an agency data center is no longer limited to that data center, but gets the opportunity to advance within the integrator's entire organization.)

Follow developments in commercial-to-commercial outsourcing. Readers of the commercial IT press will be aware that commercial IT outsourcing (some of the big mega-contracts where integrators take over a company's IT operations) is no bed of roses. Some customers are dissatisfied; a few contracts have even been canceled. Turning a blind eye to these problems will not enhance the credibility of would-be federal IT outsourcing vendors. Vendors should be in touch with their commercial colleagues about steps underway to deal with complaints and lessons learned from commercial experience. Maybe the federal government can benefit from the experience of commercial guinea pigs.

**Management Association
for Private
Photogrammetric Surveyors**

Testimony of Bryan Logan
Before a Joint Hearing of the
House Government Reform and Oversight Committee
Subcommittee on Government Management, Information and Technology
and the
Senate Governmental Affairs Committee
Subcommittee on Oversight of Government Management,
Restructuring and the District of Columbia

on House and Senate drafts of H.R. 716/S.314
originally known as the "Freedom from Government Competition Act."

March 24, 1998

Chairman Horn, Chairman Brownback and members of the subcommittees, I am Bryan Logan, Chief Executive Officer of Earth Data, International. We are a small but fast growing business headquartered in Gaithersburg, MD with offices and affiliates in Herndon and Richmond, Virginia; Branchburg, New Jersey; Hagerstown, Maryland; High Point, North Carolina; Albuquerque, New Mexico, and San Francisco and Fresno, California. I am a past president of the Management Association for Private Photogrammetric Surveyors, MAPPS, a national association of private mapping firms. MAPPS is pleased to be part of the Coalition for Taxpayer Value, a broad based group of more than 70 companies and associations that support the legislation before you today. I was also a delegate to the 1986 White House Conference on Small Business, where the problem of government competition was a major issue of the 1980, 1986 and 1995 sessions.

Earth Data and the other member firms of MAPPS are in the business of providing earth information, most commonly portrayed through the making of maps from aerial photography, satellite images and other sources. We provide data and solutions to pubic and private clients for new methods to control floods, detect agricultural blight, manage wetlands, achieve more precise engineering designs or comply with more stringent environmental regulations. Our goal is consistently to provide the high-quality spatial data our clients need in a form that is easy to use.

If the committee wants to look at a case study on how OMB Circular A-76 does NOT work, and why the legislation before you is critically needed, consider mapping.

John M. Palatiello, Executive Director
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As early as 1933 a report of a special committee of the House identified the mapping business as one subject to unfair competition by the government. For years, study after study -- by OMB, by Congressional Committees, the National Academy of Sciences and others, found that an accomplished and qualified private sector exists in surveying and mapping and suggested that these capabilities be more significantly utilized.

In fact, in 1973 an Office of Management and Budget report of the Task Force on Mapping, Charting, Geodesy and Surveying found "private cartographic contract capability is not being used sufficiently. We found this capacity to be broad and varied and capable of rendering skilled support ... Contract capability is a viable management alternative ... Its use should be encouraged in lieu of continued in-house build-up."

In the Budget of the United States for Fiscal Year 1990 submitted to Congress, OMB said, competitive contracting "is an important management tool to raise productivity, cut costs and improve the quality of Government services." It went on to discuss the advantages of utilizing the private sector, such as "efficiency, quality and innovation in the delivery of goods and services." It concluded that "specific areas where the Government could place greater reliance on private sector providers include ... map-making activities."

What was announced was a pilot program to take aim at surveying and mapping for OMB Circular A-76 studies. OMB Circular A-76 is a Federal directive that has been on the books since the Eisenhower Administration, but is NOT based on any statutory requirement. Most heads of Federal agencies with surveying and mapping activities have refused to conduct A-76 studies on these functions. Some simply do not want to go through the burdensome process. Others claim that only the government can capably map. Many want to protect turf. Since the mapping initiative was included in the FY90 budget, not a single Federal agency has conducted an A-76 review of a surveying or mapping activity.

With regard to surveying and mapping, the Clinton Administration is in agreement. In its National Performance Review, the Administration said, "The National Oceanic and Atmospheric Administration (NOAA) will experiment with a program of public-private competition to help fulfill its mission ... The experience of the U.S. Army Corps of Engineers, which contracts out 30 to 40 percent of its ocean floor charting to private firms, shows that the private sector can and will do this kind of work. Competition among private companies for these services also might reduce costs... (The Administration will) issue a new order, establish a policy supporting the acquisition of goods and services in the most economical manner possible. OMB will review Circular A-76, which governs contracting out, for potential changes that would simplify the contracting process..."

With regard to NOAA, Chairman Brownback, as you know, that agency has not implemented the Vice President's initiative. I was honored to testify before this Subcommittee last spring regarding NOAA's contracting, and as you know, NOAA began contracting only when Congress attached language to its appropriations bill.

The Administration has NOT issued a new order establishing a policy supporting acquisition in the most economical manner possible. OMB's recent changes to A-76 actually PERMITS agencies to

do work for other agencies WITHOUT conducting a cost comparison. That is what led to Senator Thomas' floor amendments to the Treasury Appropriations bills in 1996 and 1997.

Despite these admonishments from Presidents Reagan and Clinton, many agencies have continued to follow the status quo. Why? Because the principle tool for moving services from government performance to the private sector is OMB Circular A-76 and the decision on whether to do an A-76 study rests with the agencies. What we have today is a monopoly. Some Federal agencies have a lock on their work. They also have the ability to perform work for other federal agencies and for State and local government and even foreign governments. And they do not have to compete. I had my first meeting with OMB on this issue in 1988. In that meeting and in every meeting with OMB since that time, under Administrations of both parties, I have been told, "we can't force the agencies to do an A-76." That was repeated by an OMB official to a MAPPS meeting as recently as earlier this month.

OMB has estimated that $1 billion a year is spend by Federal agencies on surveying and mapping activities. OPM figures shows there are more than 6,000 Federal employees engaged in these functions. But in fiscal year 1996, only $58 million or 5.8 percent of the $1 billion was contracted to the private sector, according to data from the Federal Procurement Data System. Mr.Chairman, when one entity dominates 95% of a market -- that is monopoly even Bill Gates would envy.

When OMB recently asked agencies to volunteer how many of its employees were engaged in commercial activities, the agencies reported just 622 in surveying and mapping -- less than 10 percent of the OPM total.

All we want, Mr. Chairman, is a chance to compete. If the private sector cannot provide a better, fastest and cheaper service than the government agencies, we do not believe we should be dong this in the first place. That is what the legislation before you would do -- give both the government and the private sector a chance to compete -- on a level playing field. It gives the taxpayers the chance to realize the best value for their tax dollars. It sets in statute a requirement that agencies provide the opportunity to compete, a chance to see if the competitive forces of the market provide more efficiency than the government monopoly.

Since 1995, the amount of Federal mapping performed by the private sector has been increasing. Is that because of "management decisions" by the agencies? No. Is it because A-76 has been applied to mapping? No. This contracting has been mandated by this Congress, primarily though the appropriations process. The Corps of Engineers, Air Force and Navy have traditionally contracted, and in recent years the USGS and National Imagery and Mapping Agency have launched new programs using the private sector.

As a result of the work that has moved to the private sector, my firm has hired over 20 former Federal employees. These individuals came from NIMA, TVA, USGS, the Corps of Engineers and the military. Presently, we have more than 40 positions in my firm that can be filled by Federal employees who wish to move to the private sector, and we will do so should outsourcing by NIMA, NOAA and other agencies come to fruition and if this bill is enacted.

Pick up any newspaper today and you will see articles about the critical labor shortage in technology businesses. Mapping is such an industry. We are providing and will continue to private a soft landing for former Federal employees. MAPPS has begun a feature on its web site to post employment opportunities in its member firms. The association has particularly worked to help provide a soft landing for Federal employees making the transition to the private sector.

I can say without equivocation that there should be no concern on the part of Federal employees or their representatives as to a soft landing in the private sector. There are good paying, professionally challenging, personally rewarding jobs in mapping and other technology industries in the private sector. As an employer, I have found it is difficult for Federal employees to move to the private sector. Information about their benefits is scarce. There is trepidation on the part of workers. I would hope Congress and the agencies would help give Federal employees all the information they need to make informed decisions about whether they can take advantages of opportunities in the private sector.

In summary, this legislation is vitally needed. It is needed because there is no statutory basis for the 40+ year old Federal policy of relying on the private sector. It is needed because when left to management decisions in the agencies, agencies will not perform A-76 reviews and will not look for the potential efficiencies of contracting out. It is needed in order to give the private sector, particularly small business, a chance to compete. It is needed to provide a more level playing field. It is needed to prevent the government from actually competing with the private sector by doing work for other Federal agencies and state and local government based on non-competitive, sole source deals. It is needed to assure the taxpayers the best value for their hard-earned tax dollars.

I thank you for the opportunity to testify and congratulate you for considering this important legislation.

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Putting the private sector to work...
for the public good.

STATEMENT OF
Larry Trammell, Corporate Vice President and General Manager
Technology Services Company, Science Applications International Corporation
on behalf of:
Contract Services Association,
Professional Services Council,
American Consulting Engineers Council,
American Council of Independent Laboratories, and
The Coalition for Taxpayer Value

BEFORE
The Senate Government Affairs Committee
Subcommittee on Oversight of Government Management, Restructuring and the District of Columbia
The House Government Reform and Oversight Committee
Subcommittee on Government Management, Information Technology

HEARING ON:
Competition in Commercial Activities Act of 1998
Fair Competition Act of 1998

Mr. Chairman and Members of the Subcommittees:

I am pleased to appear before you today speaking on behalf of the Coalition for Taxpayer Value, a group of companies and trade associations, including several associations SAIC is affiliated with, such as the Contract Services Association, The Professional Services Council, American Council of Independent Laboratories, and the American Consulting Engineers Council. Collectively this coalition represents thousands of employers and tens of thousands of government contract employees. Thank you for your invitation.

By way of introduction, I am employed by Science Applications International Corporation to manage its services company. SAIC is primarily a scientific and information technology company. We have provided information technology and functional systems integration services to the federal government, state and local governments, commercial and foreign customers for nearly 30 years. SAIC is an industry leader in development of strategic relationships to provide effective and efficient solutions to a vast array of customer requirements. SAIC is an employee owned company with over 30,000 employees.

Speaking on behalf of our industry coalition, let me stress that, while we have significant philosophical reservations regarding public-private competition -- indeed, we feel that it is not in the best interest of the taxpayer for the federal government to compete directly with its citizens -- we recognize the broad based support for public-private competition on the part of the government and given that near term reality, we strongly support this legislation as a rational, appropriate, and measured step towards achieving the proper balance between public and private sector resources. To that end, I applaud and encourage the committees to continue their efforts to pass legislation embodying a number of key concepts.

The language before you today represents important progress and opportunities on many fronts:

- **Inherently versus Non-Inherently Governmental Functions**

  The legislation clearly delineates between activities identified as inherently governmental versus non-inherently governmental and reiterates a long standing policy of the federal government to rely on the capabilities of the private sector. It emphasizes that the federal government should focus on its core missions and responsibilities and not attempt to perform functions which are non-governmental in nature. Furthermore, it strengthens the integrity and success of current efforts to streamline the federal government by providing an incentive for agencies to seek new ways to leverage private sector expertise in meeting their congressionally mandated missions.

- **Sunsets A-76 Cost Comparisons**

  This legislation eliminates the current flawed methodology which does not reflect all of the true costs related to carrying out a government activity. The current methodology makes it impossible for the government to determine who legitimately can provide the best value to the American Taxpayer.

- **Best Value Methodology**

  This legislation strongly endorses the notion of best value competition as superior to the current straight cost comparison process. A best value methodology is vital to attaining long term efficiencies and cost savings for the taxpayer. It incorporates, in addition to cost and price factors, a number of non-cost/non-price factors, such as considering the quality of past performance.

- **Activity Based Costing Structure**

  This legislation also provides a groundwork for a government accounting structure more closely aligned with standard industry practices. This will allow the government to more accurately determine all of its costs, both direct and indirect. The ability of federal agencies to meet the tough budgetary and mission targets that Congress has set

for them hinges, in large part, on the degree to which an agency can account for the total costs of the performance of an activity. Activity based cost accounting is critical to allowing efficiency and true cost savings to be realized through the competition process.

- **Sunshine Governmental Activities**

  This legislation will ensure a process that can throughly identify and categorize all of the activities currently being performed by the federal government. Activities determined to be commercial in nature and not inherently governmental should and will be subject to competition.

- **Competitive Process Phase In**

  This legislation also includes a reasonable timetable for phasing in the competitive process. This is designed to ensure that no significant disruptions to the government's ability to carry out its missions occurs and forces a legitimate discipline in carrying out the intent of this legislation.

The legislation being considered creates an environment that promotes efficiency and encourages cost savings. Most importantly however, it frees agencies to focus on their core missions rather than ancillary support activities. It requires the government to do what businesses and individual taxpayers do every day: find the best value for the goods and services it needs.

The legislation offers Congress and the American taxpayer an extraordinary opportunity to put real teeth and momentum behind a policy that was first issued by President Eisenhower, but which today, remains largely ignored. The ability of Federal agencies to meet the tough budgetary and mission targets that Congress has set for them hinges, in large part, on the degree to which they open their commercial activities to competition. Furthermore, it strengthens the integrity and success of current efforts to streamline the federal government by providing an incentive for agencies to seek new ways to leverage private sector expertise in meeting their congressionally mandated missions. Again, I commend you Mr. Chairman as well as Senator Thomas, Congressman Duncan and your staffs, for all of your hard work in crafting this long needed legislation. And I offer our continued support. That concludes my remarks. I stand ready to answer any questions you may have.

Thank you.

STATEMENT

on

H.R. 716 & S. 314

FORMERLY KNOWN AS

THE FREEDOM FROM GOVERNMENT COMPETITION ACT

before the

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,

INFORMATION AND TECHNOLOGY

of the

HOUSE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

and the

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT,

RESTRUCTURING AND THE DISTRICT OF COLUMBIA

of the

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

for the

U.S. Chamber of Commerce

by

Douglas K. Stevens, Jr.

March 24, 1998

Good afternoon. I am Doug Stevens. I am the Partner in charge of the Management Consulting Group in Washington, D.C. for Grant Thornton L.L.P. which is a member of Grant Thornton International. Grant Thornton is a limited liability partnership of accountants, tax professionals and management consultants. My

responsibilities include coordinating all commercial, Federal, and State and Local government projects for the firm. My practice group includes the Privatization and Government Contract Services Group headed by Steve Sorett and our Activity Based Costing Practice Group headed by Joe Donlon - both of which have been active members of the U.S. Chamber's Privatization Ad Hoc Group, since its creation over two years ago.

The U.S. Chamber of Commerce is the world's largest business federation, organizations representing more than three million businesses and professional organizations of every size, in every business sector, and in every region in the country. More than 90% of our members are small businesses.

Grant-Thornton has consulted on numerous privatization projects, at all levels of government including work on cost and pricing matters, claims, contested audits, and advice on compliance with federal laws, regulations, policies, and guidelines including cost principles, cost accounting standards and general procurement issues such as OMB Circular A-76, outsourcing, managed competition, and cost comparison methodologies.

I. INTRODUCTION

Chairman Horn and Chairman Brownback, I am pleased to testify before your respective subcommittees on the discussion draft language provided to me by your staff. I understand that when this language is finalized, it may be the Chairman's substitute for H.R. 716 and S. 314, The Freedom From Government Competition Act. As you know, the U.S. Chamber has led business community efforts on this legislation and ranks this bill's passage as the top priority for the Chamber's Privatization Ad Hoc Group.

The Chamber submitted testimony for the record to both subcommittees regarding their hearings last year on the government competition issue. In that testimony, the Chamber outlined why passage of this legislation is so important: (1) It reduces the size of the federal bureaucracy by an estimated 1.4 million employees through limitations to performing core federal mission functions with an inconsequential displacement of federal employees; (2) It saves an estimated $10.4 billion in federal budget dollars without reducing services; and (3) It prohibits new and drastically reduces existing government competition with the private sector. The support for these three points was elaborated on in the previous testimony.

Mr. Chairman, while I am prepared to discuss either of the draft versions at length, you have asked me to focus my statements on three very important points: the chronology of the compromise of the language, the problems with the current version of OMB Circular A-76, and the Activity-Based Cost Accounting language.

II. CHRONOLOGY OF COMPROMISE

I believe that a chronology of the evolution of the language before us today is as persuasive and refreshing to the subcommittees as reiterating the reasons above for why the business community supports the language.

During the last several sessions of Congress, Representative Duncan and Senator Thomas introduced companion bills called the Freedom From Government Competition Act. In those previous versions, the agencies were required to identify their commercial activities and then outsource them to the private sector. However, the bills as introduced this year were drastically different from their predecessors by the same name. For the first time, this Congress' version of the Freedom From Government Competition Act contained two major changes: (1) The addition of managed competition with the incorporation of activity-based cost accounting (ABC) language and (2) The inclusion of the outsourcing reporting requirements under the Government Performance and Results Act (GPRA).

The addition of managed competition language removes previous objections by various players in this process including the General Accounting Office (GAO), the Office and Management and Budget (OMB), and the federal employees and their unions who wanted an opportunity to compete for work currently performed by the public sector designated as "commercial," rather than automatically awarding the work to the private sector. The inclusion of agency reporting requirements under GPRA is a critical mechanism for Congressional oversight of the conversion process without creating an entirely new reporting burden on the agencies.

I believe that Representative Duncan and Senator Thomas redrafted this version of the Freedom From Government Competition Act to address the testimony from OMB, GAO and the public sector unions. The inclusion of the ABC and GPRA language addressed individual problems outlined by OMB and GAO. In fact, GAO stated, "We testified in the 104th Congress on a predecessor to S. 314. The revisions incorporated in this new bill respond to a number of our suggestions, including provisions relating to the use of best value as a criterion for contracting decisions, allowing for situations where private sector sources are inadequate to meet the government's needs, and recognizing that the identification of inherently governmental functions is somewhat situational."

Similarly, the inclusion of managed competition language was to address the concerns of OMB and the federal unions. In fact, OMB stated, "To its credit and like the current Circular A-76, H.R. 716 does not require the Federal Government to contract-out everything nor does it require the conversion of work from in-house to contract performance in accordance with some specified or otherwise arbitrary time-line." On September 24, 1996, the late John Sturdivant, President of the American Federation of Government Employees stated at a Senate hearing on this bill, "Mr.

Chairman, you have often heard me say that Fed employees are not afraid of competition. If we cannot provide the services better, faster and cheaper than our private-sector competition, then we do not deserve to perform the work in the first place."

Thus, to the dismay of some members of the business community, a compromise was drafted to allow the government to compete with the private sector on existing activities to keep the commercial work in house where it makes sense. Interestingly, while much of the business community has softened its position in order to incrementally move the issue forward, the public sector unions refuse to reciprocate.

III. PROBLEMS WITH A-76

Mr. Chairman, legislation similar to that before us was originally contemplated by Congress during President Eisenhower's Administration. However, the Administration of that time convinced Congress to back off because they would come up with an "administrative solution" to the government competition issue. Over the years, that "administrative solution" has evolved into OMB Circular A-76. However, there are many shortcomings with the current A-76 and as a result we need the legislation before us to correct these problems.

The Administration and the public sector unions claim that A-76 is working just fine. However, of the 434 issues to be discussed, the 1,800 elected and appointed delegates to the June 1995 White House Conference on Small Business found that unfair government competition was one of their top fifteen issues. Therefore, if A-76 is working so well, why is government competition a priority issue for the business community? The answer is not only is A-76 flawed, but almost no civilian agency is currently using A-76.

The legislation before us today corrects the three largest flaws of A-76. First, the legislation changes the A-76 competition process from a voluntary activity to a mandatory one. As you know, A-76 is not a statute or even a regulation, but is merely a guidance document. Currently, an agency may perform an A-76 competition, but often chooses not to because the government manager may be forced to downsize his/her agency if the private sector demonstrates that it is more cost effective. Additionally, under the current version of A-76, any savings from the competition go to the Federal Treasury, so the government manager who tries to save money through contracting out is not rewarded with a financial incentive. Thus, very few civilian agencies are choosing to perform A-76's competitions, in contrast to the Department of Defense (DoD), which has a separate agreement that provides for a financial incentive.

In fact, Chairman Brownback heard testimony before his subcommittee on this bill that government managers who voluntarily decided to perform A-76's found it to be career ending. Therefore, government managers hide behind reasons for not

conducting A-76 competitions such as lack of staff, budget, time, or resources. Since the legislation before us not only makes the competitions for the agencies mandatory with the force of law, but also provides for a schedule under GPRA. Thus, the agencies will no longer be able to make excuses to Congress; and the government managers will have the cover of a statutory mandate to perform the competitions.

Second, the current version of A-76 allows for, but does not require, activity-based-cost accounting. Thus, an agency may choose to "adjust" the numbers to arrive at a desired outcome by designating a different accounting system than the Generally Accepted Accounting Principles (GAAP) that the private sector must use. The legislation before us today requires that the agencies consider as many as possible of the same costs that a private sector bidder would consider in a competition under a Request For Proposal. Therefore, this legislation levels the playing field between the public and private sectors for these competitions. This language was the only way that the business community would support the managed competition concept.

Third, the legislation corrects the inadequate inventory of commercial activities maintained by OMB. Currently, the A-76 supplemental handbook states that, "...agencies **may** be asked by OMB to report on their inventories of commercial activities... Therefore, agencies **should** maintain an annual inventory of all commercial activities performed by in-house FTE..." The key words in that quote are *may* and *should*. These should be changed to *will* and *must*. Both the Senate and House hearings on this bill submitted questions to OMB on how many commercial activities are being performed in the federal government. OMB could not answer the question, because the inventory was incomplete. The business community applauds the legislation's requirement that the agencies prepare, maintain, and publish in the Federal Register a catalogue of all commercial work being done in-house.

IV. THE ABC LANGUAGE

As I mentioned above, currently the playing field under A-76 for public-private competitions is not level. Senator Thomas and Representative Duncan began to level that playing field in the legislation introduced this Congress through the incorporation of ABC language. GAO, OMB and the private sector agree that this language is critical for the implementation of the competition process to be successful.

The House and Senate draft language on the issue of costs including Activity Based Cost Accounting is very different. The comments below only assume the House language. I recommend that the Senate incorporate the House language on the costing issue because the omission of this language may result in similar issues to those discussed above in reference to the agencies being able to "adjust" the cost figures under A-76 to arrive at a desired outcome.

Section 102(b)(3) of the House language did a good job in trying to identify many of the direct and indirect costs that a private sector source must consider when bidding on a RFP. However, I would make the following recommendations in order to make the review process on the accounting methodology stronger and make the playing field between the public and private sector more level.

First, Section 102(b)(3)(A)(iii) should also include the Cost Accounting Standards Board (CASB) in the commenting process. CASB is the entity that governs cost accounting standards for private sector companies who perform significant amounts of government contract work. Public-private competitions necessarily create a collision between governmental and private sector accounting methodology. Thus, it makes sense to involve not only the public sector accounting oversight bodies, but also the oversight body for the government contractors.

Second, after the listed entities have commented on the proposed cost accounting regulations and they are ready for release in final form, they should be approved by the House Government Reform and Oversight Committee and the Senate Governmental Affairs Committee before they are issued as final regulations. The rationale for this provision is because the listed entities can only provide comment under the Administrative Procedures Act and the ultimate language will be chosen by the government agencies. Therefore, it is best that the Congress should provide a check on the government agencies to prevent slanting the regulations in their favor. The business community commends the House for including those entities already listed.

Third, one significant cost that the House language omitted from the language is that the private sector will have to consider Federal, State and Local taxes. While I am not contending that the Federal government should have to pay taxes to itself, I would suggest that the legislation allow for an adjustment for taxes for proposal review purposes only. This can be accomplished by specifically authorizing the evaluators of private sector proposals not to consider the cost of taxes in conducting the cost analysis. The rationale for this is that while the cost of taxes is an expense against the ledger of the agency that pays for the private sector contract – should the private sector win a given competition, the taxes paid will go back to the government. Therefore, the cost of federal taxes would be "a wash," which should not work to the disadvantage of the private sector.

As a final matter, one source of difficulty has been the inconsistent way that the private sector "challengers" to the incumbent government most-efficient-organization (MEO) are evaluated on a "best value" basis, but then ultimately subjected to a low bid competition against the MEO. Our position is that the challenging private sector firms and the government MEO should be subjected to a constant set of evaluation factors and selection methodology so that the ultimate award decision to go with an outside contractor or an inside MEO is made on a common and consistent basis throughout the process. It appears that the language in Section 102(b)(3)(B) addresses the consistency for evaluation factors, but does not go far enough in providing consistency in procurement methodology.

V. CONCLUSION

Mr. Chairman, that concludes my prepared statement. I would be happy to address any questions that you might have.

TESTIMONY OF

ROBERT M. TOBIAS

NATIONAL PRESIDENT

NATIONAL TREASURY EMPLOYEES UNION

ON

THE FAIR COMPETITION ACT OF 1998

AND

THE COMPETITION IN COMMERCIAL ACTIVITIES ACT OF 1998

BEFORE

THE SENATE SUBCOMMITTEE ON OVERSIGHT AND GOVERNMENT MANAGEMENT

AND

THE HOUSE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT

MARCH 24, 1998

2:00 pm

342 DIRKSEN SENATE BUILDING

901 E Street, N.W. • Suite 600 • Washington, D.C. 20004-2037 • (202) 783-4444

Chairman Brownback, Chairman Horn, Members of the Subcommittees:

I am Robert M. Tobias, National President of the National Treasury Employees Union. I appreciate this opportunity to share the views of the more than 150,000 federal employees represented by NTEU on legislation before you today that seeks to turn over large segments of the federal government to the private sector.

NTEU has several serious objections to this legislation which I will discuss in detail today. These include:

1) Contract competition, management and oversight of the $120 billion in annual contracts currently in place must be reformed first.

2) Rather than eliminate Circular A-76, Congress should require that its provisions be followed whenever a function is reviewed for contracting out.

3) Inherently governmental functions must be clearly spelled out and the federal government must be the final authority. Private contractors should not be provided an unprecedented right to challenge the government's authority in this area.

4) Private sector companies competing for federal government work should be required to provide employees with pay and benefits substantially equivalent to those received by federal workers. They should be required to maintain previously federal functions in

current locations. Work should not be allowed to leave the country.

5) Retraining, relocation assistance and other protections presently provided under A-76 to federal employees whose positions are contracted to the private sector should be maintained.

6) If the goal is to provide fair competition between the public and private sector for goods and services in appropriate circumstances, agencies must be permitted to hire additional employees for the purpose of performing work in-house. To do otherwise insures the transfer of functions to the private sector with no honest opportunity for the work to ever again be performed by the federal sector -- even if that work can be accomplished at a dramatically reduced cost.

The Washington Post (February 26, 1998) reports that a group of 70 trade associations and businesses have formed a coalition to work with Congress to "force federal agencies to turn more of their work over to private industry". And why shouldn't they -- clearly there are profits out there to be made at the expense of the U.S. taxpayers.

Just six days ago today, the Defense Department Inspector General reported to Congress that the Pentagon is still in the $640 toilet seat business. This time, they are purchasing 57 cent screws for $75.60 a piece! This latest fiasco serves to underscore one of the points I want to make today. You cannot slash the number of purchasing and contract personnel at federal agencies -- as the Defense Department has done -- while simultaneously turning the keys over to the private sector. The tax dollars saved by this

exercise are simply swallowed up by the black hole of private contracting.

I have testified before Congress at least half a dozen times in the last three years on the subject of contracting out. Each time, I have raised issues that are central to any discussion of contracting out of federal services and each time, these issues have been ignored. The draft legislation under consideration today again ignores many of the key issues raised by not only this Union, but the General Accounting Office (GAO) as well as the Office of Management and Budget (OMB).

Contracting out is not a panacea. It is not even an end in itself. It is a process. One that, in fact, has been used with alarming frequency in recent years as evidenced by the vast sums of money the federal government spends on contract services each year. It has led to documented waste, fraud and abuse and has, more often than not, been accomplished absent the most basic checks and balances.

It is difficult not to view this legislation as a reckless attempt to accomplish what some in Congress have been unable to do through shutting down the federal government and legislation to eliminate federal departments. The end result would be the same -- an end to most federal services and a private sector that has been "governmentalized" with no oversight and no accountability to Congress or the American people.

Despite rhetoric to the contrary, the public sector serves several important functions. It is accountable to Congress and to

the American people. It is not always perfect, but it is always accountable. When Congress has concerns about the direction of a federal agency, it holds the power to demand answers or even a fundamental change of course. When contractors are running America's public service programs, where will that accountability lie? In light of the very well documented examples of waste and fraud that have occurred in federal contracting, and are yet to be corrected, Congress' interest in abandoning its oversight responsibility at this particular juncture is peculiar at best.

The questions Congress should be asking are what are the most efficient methods for delivering services to the American people? Who should be performing what services and how can those services be provided most effectively, most efficiently and at the least cost? Some in Congress display a predisposed view that the private sector can always perform better. There is no evidence to bear that out. House Majority Leader Dick Armey recently stated, "The federal government can become smaller and smarter by transferring activities to the more efficient private sector." There is little question that the federal government can be made smaller by transferring its functions to the private sector. However, there is no evidence I know of to support the supposition that the private sector is always either smarter, cheaper or more efficient.

Today, the federal government is the smallest since 1964, having shrunk by more than 340,000 employees in the last several years. The same cannot be said of the contractor workforce that

has already grown exponentially to take its place. The annual federal payroll including pay and retirement benefits is $108 billion while the federal government's contracting budget is at least $120 billion and has been estimated to be much higher. Because contracts are often let without the benefit of a cost-benefit analysis and because so little Congressional or Executive branch oversight of current contracting exists, the total contracting budget could well be twice that amount.

We have no idea how many contract workers the federal government employs, or which agencies they work for. In responding to questions on contracting from the House Civil Service Subcommittee, OMB stated in January of this year, "There is currently no system of reports that will identify or aggregate contract employees by contract type, location or contract number." In a system where we know precisely how many federal workers are employed by the federal government at any point in time, it is curious that we have so little interest in knowing how many contract workers the federal government also employs through tax dollars.

Not only do we have no idea how many contract workers the federal government employs, we have no idea how much they are paid or what benefits they receive. Federal agencies are required to live within congressionally mandated salary and expense account limits which dictate the number of workers they employ. No similar accounting exists for agency contracting budgets. Moreover, at least one Member of Congress has explained to this Union that

increased contracting out is occurring because the government finds itself increasingly unable to hire the expertise it requires at the salary levels it is willing to pay!

What we do know is this. Poor management and ineffective federal oversight of these contracts has led to astronomical amounts of waste and fraud that has been well documented by both GAO and OMB. The GAO has brought to Congress' attention examples of millions of dollars of missing government property that has been turned over to contractors. And, they admit their numbers are probably understated by millions of dollars. They have documented instances of unallowable and questionable overhead costs and they have suggested that this matter is a "significant and widespread problem--costing federal agencies and American taxpayers potentially hundreds of millions of dollars annually." (GAO/T-NSAID-94-132) I have with me today just a few of the relevant GAO and OMB reports on this topic and I ask that they be made part of today's hearing record. They raise serious issues that are too important to continue to be ignored.

Despite these facts, some in Congress seem poised to begin a wholesale shutting down of the federal government as well as an abdication of most federal responsibility by allowing contractors to assume the oversight authority that properly belongs with elected officials. Call it what you will -- monitoring, oversight, management, evaluation of performance in delivering services to insure that the government's interests are fully protected -- whatever you call it, it is missing.

As the GAO and OMB reports highlight ad nauseam, monitoring contractor's performance is the weakest link in the privatization process. Both GAO and OMB have repeatedly pointed out that the federal government is unable to adequately supervise all the contracting it undertakes now. They have provided detailed examples of contracts where the federal government could save roughly 50 percent by performing the work in-house. They highlight contract cost overruns, poor or nonexistent oversight, lax management of contracts as well as outright fraud and abuse in the billions of dollars, yet this legislation is silent on these issues. Contract administration is one of the costs of doing business with contractors. It not only must be done, it must be included in cost comparison analyses. Often, however, oversight of contractor performance becomes a peripheral concern, with the bulk of efforts being focused on the awarding of contracts and the obligation of funds.

In its December, 1992 report entitled Federal Contracting: Cost Effective Contract Management Requires Sustained Commitment (GAO/T-RCED-93-2), GAO concluded the following:

"With the budget deficit and other financial commitments that the federal government faces, it cannot afford to ignore the potential cost of poor contractor oversight. For many years federal agencies have increasingly relied on contractors to carry out needed activities. Unfortunately, in all too many instances, federal agencies have abdicated to their contractors the responsibility for ensuring that contractors perform quality work

cost effectively."

The Office of Management and Budget, in its January, 1994, Summary Report of Agencies' Service Contracting Practices, again addressed the problems quite clearly. OMB stated, "The acquisition of services is the fastest growing area of government procurement." Despite this, they add, "Cost analyses and independent government cost estimates are not performed by many agencies prior to the renewal, extension, or recompetition of existing contracts. In some instances, cost estimates are not prepared prior to entering into new contracts." OMB goes on to highlight problems they have uncovered including cases where contractors perform inherently governmental functions such as writing "the opening statement that a Cabinet Secretary was to give to a Congressional committee." OMB cites conflicts of interest where contractors hired by the federal government simultaneously work for other, competing interests as well. And, they cite numerous instances where the federal government "has not obtained full value for its contracting dollars."

Some of these reports are more than five years old; some are relatively new, yet nothing has been done to address the problems they highlight. Contract management and oversight are not only within the jurisdiction of your Subcommittees, they are part of your names -- the Senate Subcommittee on Oversight of Government Management, and the House Subcommittee on Government Management. Yet, when asked why the rampant waste and abuse detailed in these studies is not addressed in this legislation and why procedures are

not put in place to prevent such abuses in the future, we have been told simply, that this is beyond the scope of this bill.

The fact of the matter is that what commonly passes for "bad government", is often "bad contracting". That needs to be pointed out and addressed by these Subcommittees. Several prominent examples of contract waste, fraud and abuse bear repeating today.

Medicare is a good example. The program is almost entirely run by private medical equipment suppliers, hospitals, insurance companies and "fiscal intermediaries" -- the people deciding who, what and when to reimburse. They do such a poor job that recent Senate hearings found **$27 billion** a year in annual fraud. (The Perils of Privatization, The Washington Monthly, May, 1995)

Moreover, the inherent superiority of the private sector can neither be assumed or defended. "If that were the case, the Department of Energy (DOE) would have the finest record in the federal government. It relies more heavily on the private sector than any other agency...It has only 20,000 civil servants and anywhere from 7 to 10 times that number of employees on private contract...But DOE contractors have a miserable record...while officials looked the other way, Rockwell poured toxic and radioactive waste into the ground, and stored more in leaky metal drums. It eventually left 108 separate waste dumps and toxic solvents in the earth at 1,000 times the acceptable concentration...GAO now estimates that cleaning the pond will take until 2009, **at a cost exceeding $170 million."** (The Perils of Privatization, The Washington Monthly, May, 1995)

In 1995, GAO issued its series of High Risk (GAO/HR-95-1) reports which discussed the massive amount of contractor waste and abuse in federal service contracting, including the "disbursement of **$25 billion** to (defense contractors) that cannot be matched to supporting documentation...". In its 1997 follow-up High Risk Series (GAO/HR-97-1), GAO announced that little had changed. In fact, GAO said, the crisis in the federal government's contract administration had grown even more severe.

A Department of Defense (DOD) Inspector General report estimated that DOD agencies could **save about $26 million** from fiscal years 1992 to 1996, by gradually reducing their service contracts by 60 percent. The report further estimated that contracting costs were between 21 and 40 percent higher than in-house performance. Another study of 11 DOE service contracts estimated that the Department could have achieved savings ranging from 3.1 to 55.4 percent, with an average of 25.4 percent if the work were done in-house. (Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees (GAO/GGD-94-95))

In this same report, the GAO found that the federal government could save millions of dollars by performing functions directly rather than allowing them to be performed by private contractors. GAO reviewed nine previous studies comparing the cost of using contractors rather than federal employees to perform necessary government functions. The findings were alarming. For example, an audit of Air Force service contracts disclosed that the Air Force paid **$4.7 million in additional costs** for certain contractor work

in fiscal year 1990, and could have **saved up to $6.2 million** if the work to be performed under the optional years of the contracts reviewed were performed in-house.

None of this is to say that there are not instances where the government does not have the necessary expertise to accomplish a job and should seek that assistance from the private sector. However, the federal government should not abdicate its responsibilities and rely on contractors to carry out their own oversight. This is akin to encouraging federal employees to write their own performance evaluations. Surely, the members of this body would find that practice inappropriate.

What the legislation before you today does do is propose elimination of OMB Circular A-76 which contains the federal policy regarding the performance of commercial contracting activities. The stated goal of the Circular is to achieve economy and enhance productivity by using established guidelines for conducting public-private competitions where appropriate. It requires agencies to conduct a cost analysis to determine the most cost effective approach for providing services. As we know, agencies sometimes disregard the rule. As much as 40% of the contracting out that is currently underway appears to be done without the benefit of any cost comparisons or Congressional or Executive branch oversight. Rather than throw A-76 out, however, I suggest that Congress mandate its use before contracts are let.

By suggesting that Circular A-76 be eliminated, the legislation, at a minimum, weakens current prohibitions against

contracting out inherently governmental functions. This is unacceptable to this Union. The detailed examples provided in Circular A-76 must be maintained. Their omission brings further into question the purpose of this legislation. If Congress believes the A-76 process is inadequate because some agencies ignore it, Congress has the power to require federal agencies to use it whenever they make a determination to contract out a particular service. NTEU neither sees a need for, nor supports the view that the A-76 process must be replaced. Moreover, this legislation is excessively vague in stating what might replace the current A-76 process. It provides little guidance other than to suggest that parts of the Federal Acquisition Reform Regulations would apply, that the Administration would likely have a hand in determining A-76's replacement and that the private sector would also share in the drafting process. This "replacement mechanism" is not only unnecessary, it is unacceptably vague.

Equally suspect is the procedure dictated in the Senate version of this legislation for allowing private sector challenges to services federal agencies determine are rightful, inherent governmental functions. The legislation envisions agencies preparing lists of services they provide that, if not inherently governmental, must therefore be commercial and subject to private sector bidding. Omissions from that list would be open to challenge by private contractors. As was explained to this Union, the challenger has the right to define the battlefield.

While federal agencies, federal employees, and federal

employee representatives may well be interested in challenging items on these "commercial contracting lists", no right to challenge inclusions on the list of commercial activities is provided. Yet, private sector contractors would have the right to not only challenge agency determinations of inherently-governmental functions, if agencies failed to respond to their challenges within 10 days, an item omitted from the list because the federal government believed it constituted an inherently governmental function, would suddenly, and without further thought, be added to the list of commercial activities available for private contract.

For the first time, the federal government would be forced to defend itself and its right to make inherently governmental decisions against private sector contractors. This level of both micromanagement and politicalization of the process is without precedent. Private sector contractors would have the right to take the federal government to the Court of Claims for a final determination of whether or not a function constituted an inherently governmental function. Federal employees and their representatives would not have that right. More surprisingly, beneficiaries of federal programs and customers of federal agencies would also not have that right.

Several years ago when Congress considered closing many rural and small town post offices, members of the public swarmed Capitol Hill with their fears that private contractors would not be interested in providing similar levels of service to them at similar costs. Congress agreed, and responded by requiring the

Postal Service to maintain most post offices in their present locations. If private sector contractors are allowed to take over federal functions, customers in rural and small town locations in particular will have every bit as much reason for concern that these services may either disappear from their current locations or become prohibitively expensive. If private sector contractors are given the right to challenge federal government interpretations of inherently governmental functions, beneficiaries of these programs should have the same rights to challenge whether or not they believe it is in their best interests for the federal government to maintain these functions.

Not only may contracting out on the level envisioned by this legislation remove any Congressional or Executive branch accountability that currently exists, it may very well leave constituents unable to obtain needed services as the federal presence in Congressional districts dwindles. Jobs may disappear entirely as private companies winning contracts to perform activities for the federal government have shown they are under no obligation to continue to perform services in current locations.

Moreover, private contractors may well successfully underbid the federal government on a particular function with the idea that they will perform it in another, less costly part of the country, or even outside of the United States. Nothing in this legislation prevents contractors from taking jobs outside of their current locations, current states, or even out of the country. Examples already exist where private contractors have successfully bid for

federal government work and that work is today not even being performed by American citizens. Rather, the jobs have been exported to Canada.

The annals of contracting out are replete with examples of contracting out being done to avoid Unions, to undermine pay and benefits of employees and generally shortchange workers. Nothing in this legislation sets a floor for wages or benefits or even provides any right of successorship for federal unions who may attempt to follow the work once it is contracted out to the private sector.

It is ironic that many in Congress are quick to talk about the Federal Employees Health Benefits Program (FEHBP) as a model that should be emulated. Legislation abounds to expand the FEHB's boundaries to include military retirees, children without health care, active duty military, etc. Yet, this legislation does not even require that federal employees who lose their jobs to private sector companies be recompensed with a similar set of benefits. More than 90% of the federal government's workforce is able to afford health coverage under the FEHB program. Almost every employee is offered it. It's a standard that the private sector should emulate.

However, findings recently released by the National Employer Health Insurance Survey show that workers, especially in poor or rural areas, are offered health benefits coverage less than 50% of the time. Even in the Washington, D.C. area, only 57% of Maryland's private sector employers provide health benefits coverage. In

Virginia, that percentage is 56%. Studies such as this reflect the reason why the federal government continues to search for ways to extend health coverage to more Americans and why it is one of the leaders in this field. Forty-one million people in the United States are uninsured. The role of employers in health coverage is significant -- more than two-thirds of all health insurance in this country is received through an individual's employment. This legislation represents another step backward as private contractors would certainly have at least an incentive to limit benefits they provide their employees in order to obtain greater amounts of federal government work.

It is also telling that current A-76 regulations providing federal employees adversely affected by contracting out with priority consideration for available positions within their agency, reasonable costs for training and relocation assistance and a very narrow right of first refusal for the newly contracted work, would all disappear with the elimination of Circular A-76. In testimony before Congress in March of 1995 (GAO/T-GGD-95-131), GAO presented a snapshot of what happens most often to federal employees when their jobs are replaced by contractors. "...although our earlier reports indicated that a significant number of displaced workers found employment in another government job, the current downsizing environment may not provide the same opportunities." GAO's follow-up with those employees who had been involuntarily separated or went to work with contractors revealed that over half received unemployment compensation or public assistance. Moreover, 53

percent who went to work for contractors said that they received lower wages, with most reporting that contractor benefits were not as good.

An additional questionable feature of the legislation is its provision for recompetition of work once the work is let to the private sector. The legislation would require a demanding and continuing level of review of the government by itself. Legislation of this magnitude is unprecedented and I question how federal agencies, already having been downsized in many cases beyond acceptable levels, would accomplish this workload. They are unable to monitor the contracting that is done now. While the legislation would apparently permit the government to compete for work that has been contracted out when those contracts expire, it is difficult to imagine the government ever having the ability to reassemble the necessary staff, train them, and be prepared to compete once again for the work. Personnel restrictions alone would prevent this "recompetition" from occurring. However, there is nothing in this legislation to permit agencies to hire additional employees for the purpose of performing work in-house, even when the government can clearly show it can perform the work more efficiently and at a lower cost.

In reality, the legislation provides for recompetition in name only. Once something is contracted out to the private sector, it is likely to remain there. Any future competitions would be essentially meaningless and absent long overdue contract management reform, the federal government will be powerless to prevent private

contractors from continuing to hoist incredible levels of waste and fraud upon the federal government and federal taxpayers -- all in the name of competition.

Administrations come and go. Congresses, too, come and go. I suggest that we do not want the spirit of public service to come and go. There are many services the public sector provides that it should provide. We should not, on a political whim, decide that our sons and daughters will be forced to depend on a succession of private sector contractors to provide government services, maybe reasonably, maybe not. Maybe efficiently, maybe not. This legislation would truly shut down the federal government. Not all at once, as legislation eliminating federal agencies would do, but over the long term, the effect would be the same.

The system in place now may not be perfect, but it is accountable and contracting out federal services must continue to be evaluated on a case by case basis. To do otherwise, ignores the problems pointed out time and again by GAO, OMB and the many private organizations who have completed their own studies. I encourage the members of the two Subcommittees present today, as well as the Congress, to reject the flawed legislation before you.

United States General Accounting Office

GAO

High-Risk Series

February 1995

An Overview

GAO/HR-95-1

Six Categories of High-Risk Focus

1. *Providing for Accountability and Cost-effective Management of Defense Programs*
2. *Ensuring All Revenues Are Collected and Accounted For*
3. *Obtaining an Adequate Return on Multibillion Dollar Investments in Information Technology*
4. *Controlling Medicare Claims Fraud and Abuse*
5. *Minimizing Loan Program Losses*
6. *Improving Management of Federal Contracts at Civilian Agencies*

Providing for Accountability and Cost-Effective Management of Defense Programs

While our military capabilities are unparalleled in the world today, Defense cannot accurately account for its more than $250 billion annual budget and over $1 trillion in assets worldwide. It also has been unable to adequately fix well-known areas of major vulnerability. These include

- holding inventory, valued by Defense at $36 billion, that is no longer needed for current operating requirements;
- disbursing $25 billion to vendors that cannot be matched to supporting documentation to determine if payments were proper;
- relying on contractors to voluntarily return hundreds of millions of dollars in overpayments; and
- paying billions of dollars in added costs when acquiring weapons systems.

These poor practices are draining resources that could be used to further enhance military readiness. At the heart of these problems is a long-standing culture that has not valued good financial management. No military service or major Defense component has been able to obtain a financial audit opinion because of hundreds of billions of dollars in assets not accounted for and countless failures in performing the most rudimentary bookkeeping tasks. The Secretary of Defense said it well: "We need to reform our financial management. It is a mess, and it is costing us money we desperately need."

Effective implementation of the landmark Chief Financial Officers Act throughout the Department of Defense is critical. We have

made numerous recommendations to strengthen Defense accountability and management. While Defense has acknowledged the severity of its financial management problems and established goals to correct them, it still lacks the realistic plans and expertise needed to accomplish those goals. These issues are discussed in more detail on pages 38 to 44.

Ensuring All Revenues Are Collected and Accounted for

Although responsible for collecting 98 percent of the government's revenues—currently $1.25 trillion annually—the Internal Revenue Service (IRS) has not kept its own books and records with the same degree of accuracy it expects of taxpayers. For the last 2 years, we have been unable to express an opinion on IRS' financial statements due to serious accounting and internal control problems.

In response to our audit reports, IRS has expressed its commitment to develop meaningful and reliable financial information and establish sound internal controls. However, IRS' financial management weaknesses are pervasive, have been repeatedly reported, and warrant prompt attention. IRS' financial systems are out of date, produce unreliable data on tax

Problems in this area are discussed on pages 54 to 59.

Controlling Medicare Claims Fraud and Abuse	Medicare is undermined by flawed payment policies, weak billing controls, and inconsistent program management. Instances of scams, abuses, and fraud abound in the $162 billion program. Insurers have owed Medicare millions of dollars for mistaken payments. Moreover, to maximize profits, providers continue to exploit loopholes and billing control weaknesses. Under current policy, the Congressional Budget Office projects Medicare payments will reach $380 billion a year by 2003. The Health Care Financing Administration has moved to counteract the program's abuses, but its overall management of these activities is not sufficient. Stronger controls are essential to deter a drain on taxpayer funds. See pages 60 to 63.
Minimizing Loan Program Losses	The federal government provides this country's largest source of credit. The government managed direct loan portfolios of $155 billion and had guaranteed loans totaling $699 billion at the end of fiscal year

- The Department of Housing and Urban Development (HUD), which insures some $400 billion in housing loans, guarantees more than $400 billion in outstanding securities, and spends $25 billion a year on housing programs, is currently the subject of numerous "reinvention" proposals; however, the agency must address fundamental internal control, management, staffing, and systems problems regardless of what changes are made. See pages 68 to 69.

Improving Management of Federal Contracts at Civilian Agencies

Civilian agencies rely on contractors to provide goods and services costing tens of billions of dollars a year. It is critical to ensure that the government gets what it pays for and that contractors' work is done at reasonable cost. But this has not always been the case.

- The Department of Energy has allowed its management and operating contractors extensive latitude in spending $15 billion annually, and it has not required contractors to have financial audits despite continuing disclosures of abuse and poor management. As a result, the government is not adequately protected. See pages 70 to 72.
- Ineffective oversight by the National Aeronautics and Space Administration

(NASA), which spends about $13 billion a year under contract, has resulted in cost growth and schedule slippage in completing large space projects. See pages 72 to 73.

- Contract management problems in the Environmental Protection Agency's (EPA) multibillion dollar Superfund hazardous waste cleanup program have provided contractors too little incentive to control costs. See pages 74 to 75.

High-Risk Program Successes

In 15 of 18 high-risk areas we have followed, there has been progress in attacking root causes of problems. In 5 areas, enough progress has been made to remove their high-risk designation, although we will continue to monitor their status.

United States General Accounting Office

GAO

High-Risk Series

February 1997

An Overview

GAO/HR-97-2

Providing for Accountability and Cost-Effective Management of Defense Programs

The Department of Defense (DOD) has had some success in addressing its inventory management problems, is working to reform its weapon systems acquisition process, and has recognized the need for infrastructure reductions. However, much remains to be done to resolve DOD's five high-risk areas.

First, DOD's lingering financial management problems—among the most severe in government—leave the Department without accurate information with which to manage its vast resources, which in fiscal year 1996 included a budget of over $250 billion and over $1 trillion in assets worldwide. Financial audits have highlighted significant deficiencies in every aspect of DOD's financial management and reporting, resulting in failure of any major DOD component to receive a positive audit opinion. The deficiencies identified prevent DOD managers from obtaining the reliable financial information needed to make sound decisions on alternate uses for both current and future resources. DOD's financial management leaders have recognized the importance of tackling these problems and have many initiatives underway to address widespread financial management problems. Fixing DOD's financial management problems is also

critical to the resolution of the Department's other high-risk areas. See page 33.

Also, because of fundamental control deficiencies in contract and inventory management systems and procedures, DOD is vulnerable to billions of dollars being wasted on excess supplies and millions of dollars in contractor overpayments. Improvements are necessary to maintain appropriate controls over DOD's centrally managed inventories valued at $69.6 billion in fiscal year 1995 and contracts now costing about $110 billion annually. See pages 35 and 36.

In addition, despite DOD's past and current efforts to reform its acquisition system, wasteful practices still add billions of dollars to defense weapon systems acquisition costs, which are about $79 billion annually. DOD continues to (1) generate and support acquisition of new weapon systems that will not satisfy the most critical weapon requirements at minimal cost and (2) commit more procurement funds to programs than can reasonably be expected to be available in future defense budgets. Many new weapon systems cost more and do less than anticipated, and schedules are often delayed. Moreover, the need for some of these costly weapons, particularly since the collapse of

poses the high risk that computer systems throughout government will fail to run or malfunction because computer equipment and software were not designed to accommodate the change of date at the new millennium.

For example, IRS' tax systems could be unable to process returns, which in turn could jeopardize the collection of revenue and the entire tax processing system. Federal systems used to track student education loans could produce erroneous information on their status, such as indicating that an unpaid loan has been satisfied. Or the Social Security Administration's disability insurance process could experience major disruptions because the interface with various state systems fails, thereby causing delays and interruptions in disability payments to citizens. See page 62.

Controlling Fraud, Waste, and Abuse in Benefit Programs

The Congress and the President have been seeking to introduce changes to Medicare to help control program costs, which were $197 billion in fiscal year 1996. At the same time, they are concerned that the Medicare program loses significant amounts due to persistent fraudulent and wasteful claims and abusive billings. The Congress has

passed legislation to protect Medicare from exploitation by adding funding to bolster program safeguard efforts and making the penalties for Medicare fraud more severe. Effective implementation of this legislation and other agency actions are key to mitigating many of the inherent vulnerabilities that make Medicare, the nation's second largest social program, a perpetually attractive target for exploitation. See page 65.

The Supplemental Security Income (SSI) program is another new high-risk area. SSI, which provided about $22 billion in federal benefits to recipients between January 1, 1996, and October 31, 1996, is at high risk of overpayments, which have grown to over $1 billion annually. One root cause of these overpayments is the difficulty the Social Security Administration has in corroborating financial eligibility information that program beneficiaries self report and that affects their benefit levels. Determining whether a claimant's impairment qualifies an individual for disability benefits can often be difficult as well, especially in cases involving applicants with mental impairments and other hard-to-diagnose conditions. See page 68.

- Since our last high-risk report series, the Congress has enacted legislation to make fundamental changes in the farm loan programs' loan-making, loan-servicing, and property management policies. The Department of Agriculture is in the process of implementing the new legislative mandates and other administrative reforms to resolve farm loan program risks. The impact of these actions on the $17 billion farm loan portfolio's financial condition will not be known for some time. See page 72.

  The Debt Collection Improvement Act of 1996 also was enacted to expand and strengthen agencies' debt collection practices and authorities. Implementing the act's provisions can improve agencies' lending program performance.

Improving Management of Federal Contracts at Civilian Agencies

With government downsizing, civilian agencies will continue to rely heavily on contractors to operate programs. While this approach can help to achieve program goals with a reduced workforce, it can also result in increased vulnerability to risks, such as schedule slippages, cost growth, and contractor overpayments, as we have seen with the weak contract management

practices of some of the government's largest contracting agencies.

- Most of the Department of Energy's (DOE) $17.5 billion in annual contract obligations is for its management and operating contracts. DOE has made headway to overcome its history of weak contractor management through a major contract reform effort that has included developing an extensive array of policies and procedures. Although the Department recently adopted a policy favoring competition in the award of these contracts, in actual practice most contracts continue to be made noncompetitively. See page 79.

- The National Aeronautics and Space Administration (NASA) has made considerable progress in better managing and overseeing contracts, for which it spends about $13 billion a year. The improvements have included establishing a process for collecting better information for managing contractor performance and placing greater emphasis on contract cost control and contractor performance. Our most recent work, however, identified additional problems in contract management and opportunities for improving procurement oversight. See page 81.

- For the past several years, the Environmental Protection Agency (EPA) has focused attention on strengthening its management and oversight of Superfund contractors. Nonetheless, EPA remains vulnerable to contractor overpayments. At the same time, the magnitude of the nation's hazardous waste problem, estimated to cost hundreds of billions of dollars, calls for the efficient use of available funds to protect public health and the environment. See page 82.

Planning for the 2000 Decennial Census

A new high-risk area involves the need for agreement between the administration and the Congress on an approach that will both minimize risk of an unsatisfactory 2000 Decennial Census and keep the cost of doing it within reasonable bounds. The longer the delay in securing agreement over design and funding, the more difficult it will be to execute an effective census, and the more likely it will be that the government will have spent billions of dollars and still have demonstrably inaccurate results.

The country can ill afford an unsatisfactory census at the turn of the century, especially if it comes at a substantially higher cost than previous censuses. The census results are

United States General Accounting Office

GAO

Testimony

Before the Committee on the Budget
United States Senate

For Release
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OVERHEAD COSTS

Unallowable and Questionable Costs Charged by Government Contractors

Statement of David E. Cooper, Director, Acquisition Policy, Technology, and Competitiveness Issues, National Security and International Affairs Division

GAO/T-NSIAD-94-132

Mr. Chairman and Members of the Committee:

It is a pleasure to be here today to discuss the results of our reviews of contractor indirect costs, or "overhead" as it is commonly known.

Over the years, our office has issued numerous reports on contractor overhead costs. Our reports have examined overhead costs billed by contractors and universities doing business with the Departments of Defense and Energy, the Environmental Protection Agency, and by hospitals claiming reimbursement through the Medicare program. Our work and the audits of the Defense Contract Audit Agency and the Inspectors General shows that unallowable and questionable overhead costs are a significant and widespread problem--costing federal agencies and American taxpayers potentially hundreds of millions of dollars annually. Appendix I lists some of the overhead reports we have issued.

To illustrate the types of problems we have found, I would like to focus my comments today on our recent work at eight defense contractors. The eight contractors included (1) six small contractors with annual government sales that ranged from $11 million to $107 million and (2) two major contractors each with annual government sales that exceeded $1 billion.

In examining overhead costs at these contractors, we sampled only a few accounts, concentrating on areas that we believed were most vulnerable to overbilling. These areas included expenditures for alcoholic beverages, personal use of automobiles and boats, travel, business meetings, and entertainment.

The Federal Acquisition Regulation requires contractors to identify and exclude unallowable costs from their overhead claims. Contractors are also required to certify that, to the best of their knowledge, their overhead claims do not include unallowable costs.

The Defense Contract Audit Agency audits contractors' costs, identifies costs that are questionable, and reports such costs to government contracting officers. Government administrative contracting officers are responsible for negotiating and administering contract costs, including overhead, and for applying penalties required by law, as appropriate.

UNALLOWABLE AND QUESTIONABLE OVERHEAD COSTS AT EIGHT DEFENSE CONTRACTORS

We found that all eight contractors had included unallowable and questionable costs in their overhead claims. For example, in addition to almost $1 million in costs identified by the Defense Contract Audit Agency at the six small contractors, we identified about $2 million more in overhead costs that was either expressly unallowable or questionable.[1] Similarly, at the two large contractors, we identified about $4.4 million in unallowable or questionable overhead costs.

The government will not necessarily bear the burden for all of the unallowable or questionable costs we identified. The government's portion depends on the mix of defense versus commercial business performed by the contractors and the types of contracts being used.

I would like to discuss some of the examples of unallowable and questionable overhead costs we identified at the eight contractors.

ALCOHOLIC BEVERAGES

The FAR states that alcoholic beverage costs are expressly unallowable as a charge against government contracts. Yet, at six of the eight contractors, we found about $26,000 in overhead charges for alcoholic beverages. For example, one contractor included $1,621 for a Saturday evening "working" dinner attended by 21 employees and consultants at a cost of $77 per person. The contractor included the entire bill, even though it included $745 for alcoholic beverages and a bar fee, a cost of $35 per person. Another contractor included over $2,100 in its overhead charges for alcohol consumed at a conference for the company's lawyers, at an employee's farewell dinner, and at the private residence of a company employee.

PERSONAL USE OF AUTOMOBILES AND BOATS

Although costs for the personal use of company automobiles are expressly unallowable under the Federal Acquisition Regulation, five of the six small contractors we visited included about $173,000 in their overhead costs for expenses involving employees' personal use of company automobiles. We likewise found that one of the major contractors charged about $28,000 in its overhead claims for employees to use company-furnished vehicles for personal use.

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[1]Expressly unallowable costs are those costs that are specifically stated to be unallowable under the provisions of an applicable law, regulation, or contract. Questionable costs, generally, are those costs for which the contractor was unable to provide adequate support or where the nature, purpose, and reasonableness of the expenditure is in question.

We also found that one contractor included $62,000 in its overhead expenses over a 2-year period for employees to use the company's boat for personal matters. According to contractor representatives, the boat, a 46-foot sportfishing vessel, was used for product testing as well as entertainment.

TRAVEL

Airfare costs are limited to the cost of the lowest standard commercial airfare, according to the FAR. However, one contractor included the full cost of two chartered aircraft flights in its overhead claim. These chartered flights, costing about $19,300, is significantly more than standard commercial airfares. For example, in June 1989, three company executives chartered an aircraft for a trip to a conference. The trip cost $13,019, or about $4,340 per person. If standard commercial airfares for these executives had been used, the allowable cost would have been about $11,000 less.

BUSINESS MEETINGS

Federal regulations allow contractors to charge the government for costs associated with business meetings. However, we found some contractors charged the government for a number of trips to resort locations outside the United States. For example, one contractor included about $50,000 in its overhead costs for travel expenses associated with its annual management meeting held in Bermuda for 40 employees and a consultant. Thirty-six spouses and guests went on the trip at their own expense.

Another contractor, over a 2-year period, included about $333,000 in its overhead costs for travel to Mexico, Jamaica, and the Grand Cayman Island for annual management and business meetings. For example, the contractor charged about $102,000 to its overhead costs for 151 employees (over one-third of its employees) to travel to Jamaica to attend its annual business meeting. The employees brought 112 spouses or guests, mostly at their own expense.

According to the contractor, the purpose of the trip was to review operating policy and marketing strategy and serve as a stockholders meeting. Company officials advised us that such meetings are:

> ". . .intended to promote a corporate 'cohesiveness' via both social and business interaction. . . and . . . combine business and fun via an opportunity to extend to a low cost vacation (at personal expense) in a resort area. Employees are encouraged to bring their spouses or families."

The company claims that the additional costs of meetings in resort areas are a form of incentive compensation.

We do not question the need to have legitimate business meetings. However, we do question whether the government should pay for

events that have the character of a vacation, especially in tropical resorts outside the United States.

ENTERTAINMENT

The Federal Acquisition Regulation does not allow contractors to charge the government for entertainment costs involving social activities and tickets to sporting events and shows. However, the regulation on entertainment costs refers, without any explanation, to the cost principle on employee morale and welfare costs, which are generally allowable. Because of this reference, some contractors maintain that entertainment-type expenses for employees are an allowable cost of maintaining employee morale and welfare and included such costs in their overhead claims. For example, over a 2-year period, one contractor included $14,000 in its overhead costs for tickets and parking for professional sporting events (Boston Red Sox and Boston Celtics games), $10,000 for schooner rentals for 40 employees and their guests, $5,800 for running shoes for employees, and about $12,000 for cable television charges for retirees.

Using the regulation on employee morale and welfare costs to claim costs for social activities and tickets to sporting events and shows is questionable, we believe, because the Federal Acquisition Regulation on entertainment specifically disallows these costs.

Another contractor included about $10,600 in its overhead costs for a Christmas party for about 104 of its Washington, D.C., area employees and their guests. The party cost about $102 per person, which included costs for decorations and flowers, a disc jockey, and a magician. Also included in the overhead charges was the cost of lottery tickets given to employees and their guests as Christmas party prizes.

One contractor charged over $14,500 to overhead for entertainment. The charges included

- -- $3,411 for a banquet for the company's lawyers (identified on the conference agenda as a reception, dinner, and social event);
- -- $2,482 to entertain 76 bankers;
- -- $2,184 for a hospitality suite at the 1991 Tailhook convention; and,
- -- $2,900 for various social activities, including a chili cook-off, an Italian-American dinner, golf outings and greens fees, and the tickets to the Philadelphia Philharmonic.

ACTIONS NEEDED TO SOLVE THE PROBLEM

Over the years a number of actions have been taken in an attempt to address the problem of unallowable costs. In 1985, the Department of Defense started requiring contractors to certify that their overhead claims excluded unallowable costs. Penalties were also legislated by the Congress as a deterrent against unallowable overhead costs.

Despite such actions, however, we continue to see unallowable and questionable overhead costs charged to government contracts. There is no magic solution to this persistent and widespread problem, but we believe improvements are possible if the government would take the following actions.

-- Clarify the regulations, especially for selected types of overhead costs, like entertainment and employee morale and welfare.

-- Explore innovative approaches to reimbursing contractor overhead costs such as capping the expenses that can be charged for selected types of overhead costs.

-- Increase the purchase of commercial products as provided for in current acquisition reform proposals as a way to move away from cost-based contracting toward market-determined prices.

We also believe contractors must do their part. Company executives must send a clear and strong message that unallowable costs are not an acceptable cost of doing business with the government. Likewise, company managers at all levels must pay more attention and place more emphasis on unallowable costs.

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Mr. Chairman, that concludes my statement. I will be pleased to answer any questions that you or other committee members may have.

United States General Accounting Office

GAO

Testimony

Before the Environment, Energy, and Natural Resources Subcommittee, Committee on Government Operations, House of Representatives

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MANAGING DOE

Government Property Worth Millions of Dollars Is Missing

Statement of Victor S. Rezendes,
Director, Energy and Science Issues,
Resources, Community, and Economic
Development Division

GAO/T-RCED-94-309

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss property management at Department of Energy (DOE) facilities. As you know, we have issued several reports on DOE's property management, including two recently issued reports for your Subcommittee. The first of those two reports, issued in March 1994, was an in-depth examination of property management problems at DOE's Rocky Flats Plant.[1] The second report, issued in April 1994, provided summary details regarding the property management activities of 20 major DOE contractors, including the contractor at Rocky Flats.[2]

Our property management work has led us to several observations. First, a substantial amount of DOE's property is missing, probably more than the $74 million identified in our April 1994 report.[3] Second, numerous weaknesses exist in DOE contractors' property management systems. Those weaknesses include inadequate property-tracking data bases and a lack of physical protection of DOE's property from theft. Third, DOE has not provided sufficient oversight of the contractors' property management activities. For example, many contractors do not have approved property management systems. We recognize that DOE has taken, and is in the process of taking, steps to improve property management. Given the number of problems DOE faces as well as the complexity of those problems, it will take years of continual management attention for DOE to address all of the problems. At this time, I would like to discuss each of our observations in greater detail.

A SUBSTANTIAL AMOUNT OF DOE'S PROPERTY IS MISSING

DOE's contractors are required, by departmental regulations, to periodically inventory and report on government-owned property in their possession. In our April 1994 report, we presented information on DOE's most recent inventory reports from 20 of its major contractors. These reports, which were completed over the last few years, showed that government-owned property worth approximately $74 million was missing. The items of missing property span a wide variety of equipment categories. They include computer equipment, such as monitors and keyboards; shop

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[1]Department of Energy: The Property Management System at the Rocky Flats Plant Is Inadequate (GAO/RCED-94-77, Mar. 1, 1994).

[2]Department of Energy: Status of DOE's Property Management Program (GAO/RCED-94-154FS, Apr. 7, 1994).

[3]DOE has accumulated more than $12 billion in property, most of which is in the possession of its contractors.

equipment, such as lathes and drill presses; office equipment, such as desks and typewriters; electronic equipment, such as radios and pagers; and photographic equipment, such as cameras. Finally, some heavy equipment such as forklifts and a semi-trailer are also missing.

Let me emphasize that while the $74 million worth of missing property is high, this amount represents only what the contractor reported to DOE as missing. We believe that the $74 million figure probably understates the actual amount of missing property, particularly in light of our detailed review of property management at the Rocky Flats Plant. In that review, we found that in addition to the nearly $13 million worth of missing property reported by the contractor, the contractor could not physically locate another $16 million worth of property. The contractor said that it had documentation indicating what happened to this property. However, we found that much of the documentation was incomplete and that some of that property may have to be classified as missing. We also noted that the contractor, during a 1-year period, inappropriately deleted over 500 items from the property-tracking data base without maintaining any historical record of the items' existence. Some of these deleted items may have been lost or stolen and DOE would never know that that occurred.

CONTRACTORS' PROPERTY MANAGEMENT SYSTEMS HAVE NUMEROUS WEAKNESSES

Over the years, we have pointed out weaknesses in DOE contractors' property management systems. DOE has also found weaknesses in its own review of contractors' property management operations. Some of these weaknesses have persisted for years. The latest DOE reviews of the 20 contractors included in our April 1994 report identified over 400 weaknesses requiring corrective action.

The weaknesses identified by DOE relate to nearly every element considered critical to an effective property management system. They include the following:

-- Lack of operating procedures. For example, at one site, DOE found that the contractor did not have policies and procedures for the plant that address the responsibility of employees to ensure the proper control, use, and protection of government property.

-- Inadequate employee training. For example, one DOE contractor review sampled the training records for selected property management personnel and determined that none of the individuals had ever attended formal inventory management training.

-- Incomplete reporting of property. For example, at one DOE site, there were significant errors in the property inventory reports to DOE and a significant overstatement of the value and volume of personal property in the possession of the contractor.

-- Inadequate storage of property. At some sites, heavy equipment, office furnishings, materials, and machines not designed for outside use were being left outside unprotected from the elements.

-- Physical inventories not being conducted on time. At some sites, an inventory of special equipment such as office equipment, photographic equipment, radio equipment, and automotive equipment had not been conducted on schedule, and some inventories were conducted years late.

-- Lack of physical security. For example, at one site, DOE reported that the significant losses of sensitive items such as computers and photographic equipment, indicate a lack of adequate physical protection or responsible oversight.

-- Improper utilization and disposal of equipment. One DOE contractor review showed, for instance, that items such as copy paper, fluorescent light bulbs, and truck mufflers were being scheduled for surplus sale while the contractor was buying new, similar items from vendors.

In our work at DOE's Rocky Flats Plant, we found another significant weakness--the contractor's property-tracking data base was incomplete because some property was never entered into the data base. In addition, the data base contained inaccurate serial numbers for some property, such as fire trucks, which made locating them for inventory purposes difficult. Further, inappropriate changes have been made to certain data in the data base, including the erasure of evidence that some property ever existed at the plant. Without a well-maintained and properly working data base, good property management control is impossible.

Because of reports of theft at the Rocky Flats Plant, our Office of Special Investigations has begun looking into the matter. Both DOE and contractor officials have confirmed that the theft of government-owned property has occurred and has contributed to the contractor's inability to account for millions of dollars worth of missing equipment. This investigation has also surfaced a possible instance of bid-rigging on the purchase of automotive parts. When completed, the results of our investigation will be forwarded to the appropriate agency for further investigation and possible prosecution.

DOE'S OVERSIGHT OF CONTRACTORS' PROPERTY MANAGEMENT SYSTEMS HAS NOT BEEN SUFFICIENT

In addition to weaknesses in contractors' property management systems, we believe that DOE has not provided sufficient oversight. In this regard, DOE has not reviewed and approved contractors' property management systems as required by departmental regulations. Further, DOE has not ensured the timely correction of contractors' property management weaknesses identified in DOE reviews. Insufficient oversight, in our view, is a strong indication that DOE has not given property management the necessary attention.

DOE regulations require the Department to review and approve or disapprove a contractor's property management system within the first year of the contract and every 3 years thereafter. DOE's approval represents a determination that the contractor's system will adequately protect, maintain, utilize, and dispose of government property in accordance with federal and DOE property management regulations. Of the 20 contractors included in our April 1994 report, only 7 had DOE-approved property management systems. The situation at the Rocky Flats Plant, we believe, illustrates the inadequate attention that DOE has given to approving contractors' property management systems. In our March 1994 report, we noted that DOE was required to review and approve or disapprove the contractor's property management system by the end of 1990 but still had not done so by the time we issued our report--more than 3 years later. In September of this year, DOE disapproved the Rocky Flats contractor's property management system.

DOE's oversight in ensuring that property management problems are corrected is also weak. For instance, our March 1994 report noted that DOE had not required the contractor to implement timely corrective action on problems DOE identified during the Department's previous review of property management at the plant. Some problems have remained unresolved for years. DOE has also not required the contractor to take adequate corrective action in response to DOE-identified problems. For example, in a February 1993 report to DOE, the contractor claimed to have ensured that (1) all necessary property had been tagged and that serial numbers were recorded in the property data base and (2) all property management, accounting, and other personnel directly involved in property management-related activities had been properly trained. However, as our March 1994 report discusses, serious deficiencies continued to exist in these areas.

DOE HAS UNDERTAKEN NUMEROUS INITIATIVES TO IMPROVE CONTRACTORS' PROPERTY MANAGEMENT

In response to our work, DOE officials commented that the Department is committed to improving its controls over contractors' property management systems. According to these officials, evidence of DOE's commitment can be seen in the June 1992 establishment of the Office of Contractor Management and Administration in headquarters to tighten DOE's stewardship over contractors' property management systems and to undertake numerous initiatives. Those initiatives have included the following: (1) headquarters' independent property management reviews of selected projects, (2) strengthened DOE surveillance of contractors, and (3) a centralized personal property tracking system to catalog the findings from each DOE review and to track corrective actions. DOE officials also commented that the increased emphasis that the Department has placed on property management and the need for its contractors to establish reliable property data bases may have contributed to the significant amount of missing property shown in our April 1994 report.

SUMMARY

In summary, by all indications, a substantial amount of DOE property is missing, probably more than the $74 million worth identified in our April 1994 report. The apparent reason why property is missing is that contractors' property management systems contain numerous weaknesses and DOE has provided inadequate oversight. DOE is in the process of making numerous changes. While we believe that these changes may help, it will take the Department many years of continual management attention to adequately address all of the complex property management problems it faces.

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This concludes our testimony. We would be pleased to respond to any questions that you or the members of the Subcommittee may have.

(302134)

United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Human Resources, Committee on Government Reform and Oversight, House of Representatives

October 1997

SOCIAL SERVICE PRIVATIZATION

Expansion Poses Challenges in Ensuring Accountability for Program Results

GAO/HEHS-98-6

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United States
General Accounting Office
Washington, D.C. 20548

Health, Education, and
Human Services Division

B-276630

October 20, 1997

The Honorable Christopher Shays
Chairman, Subcommittee on Human Resources and
Intergovernmental Relations
Committee on Government Reform and Oversight
House of Representatives

Dear Mr. Chairman:

Political leaders and program managers are responding to calls for improved service delivery and reduced costs by rethinking the role government plays in providing services. Even though governments have for decades privatized a broad range of government social services, interest has been renewed in privatization as a means of coping with constraints on public resources. Moreover, recent changes in federal welfare legislation have focused attention on privatizing, or contracting out, social services, in particular. Four social programs affected by this legislation—child care, child welfare, child support enforcement, and new block grants to assist needy families—constitute a large share of the nation's welfare system. Together these programs serve millions of children and families, and in 1996, the federal government provided states with about $20 billion to administer them and to provide a diverse array of services. Debate has focused on whether privatization improves services and increases efficiency and on what the appropriate role of the federal government is. Yet little is known about the extent and policy implications of privatizing these social services.

This report, which responds to your request that we examine issues related to social service privatization, focuses on the following three key questions: (1) What is the recent history of state and local government efforts to privatize federally funded social services? (2) What are the key issues surrounding state and local privatized social services? (3) What are the federal policy implications of state and local social service privatization? To answer these questions, we reviewed and synthesized selected studies and articles on social service privatization. In addition, we interviewed state and local officials in five states that have gained some experience in the privatization of social services (California, Massachusetts, Texas, Virginia, and Wisconsin), as well as officials from the Department of Health and Human Services (HHS), national associations and advocacy groups, unions, and contractors. We focused on the four social service programs mentioned above. HHS establishes policies and

oversees state administration of all four programs. Appendix I contains a more complete discussion of our scope and methodology.

Results in Brief

Since 1990, more than half of the state and local governments we contacted have increased their contracting for services, as indicated by the number and type of services privatized and the percentage of social service budgets paid to private contractors. The Council of State Governments corroborated this trend in a 1993 national study that reported that almost 80 percent of the state social service departments surveyed had expanded privatization of social services in the preceding 5 years. Moreover, many experts we consulted expect privatization to expand further. Our own research found that the recent increases in privatization were most often prompted by political leaders and top program managers, who were responding to an increasing demand for public services and a belief that contractors can provide higher-quality services more cost-effectively than can public agencies. In attempts to provide more cost-effective services, for example, more states are contracting out larger portions of their child support enforcement programs. In addition, state and local governments are turning to contractors to provide some services and support activities in which they lack experience or technical expertise, such as large management information systems or systems to pay program benefits electronically.

State and local governments face several key challenges as they plan and implement strategies to privatize their social services. First is the challenge to obtain sufficient competition to realize the benefits of privatization. While there is some disagreement among experts, some believe that the unique nature of social services may limit the number of contractors able or willing to compete. The results of the few studies that examine this question are inconclusive. Most state and local program officials we contacted reported that they were satisfied with the number of qualified bidders in their state or locality. However, some of these officials expressed concern about an insufficient number of qualified bidders in rural areas or in contracts requiring highly skilled staff. Second, state and local governments often have little experience in developing contracts that specify program results in sufficient detail to effectively hold contractors accountable. Third and finally, it can be particularly difficult for states to monitor performance in some social service programs, whether provided directly by the government or through a contract. Weaknesses in monitoring contractor performance make it difficult to ensure that all intended beneficiaries have access to services and to determine whether

private providers achieve desired program goals and avoid unintended negative consequences.

Increased privatization raises questions about how HHS will fulfill its obligation to ensure that broad program goals are achieved. Assessing program results presents a significant challenge throughout the government, yet it is an important component of an effective system for holding service providers accountable. The difficulties the states have in monitoring privatized social services focus attention on the need to improve accountability for results. Some of the state and local officials we interviewed believe that, to help ensure that privatized social services are effective, HHS should clarify its program goals and develop performance measures states can use to monitor and evaluate contractor efforts. The Government Performance and Results Act of 1993 requires federal agencies like HHS to focus their efforts on achieving better program results. While focusing on results can be complex and challenging for any organization, HHS' practice of holding states accountable primarily for compliance with statutes and regulations may make the transition particularly difficult. However, promising approaches are available within HHS in moving to a program results orientation, such as some recent efforts by the federal Office of Child Support Enforcement.

Background

The four social service programs included in our review—child care, child welfare services, child support enforcement, and the Temporary Assistance for Needy Families (TANF) block grant—provide a broad range of services and benefits for children and families. While each program is administered by HHS' Administration for Children and Families, primary responsibility for operating these programs rests with state governments. Within many states, local governments operate social service programs with considerable autonomy. The major goals, services, and federal funding for the four programs are described below.

Child Care

Federally funded child care services consist primarily of subsidized care for children of low-income families while their parents are working, seeking work, or attending training or education. Other subsidized child care activities include providing information, referrals, and counseling to help families locate and select child care programs and training for child care providers. State child care agencies can provide child care directly, arrange for care with providers through contracts or vouchers, provide

The Privatization of Public Service

Lessons From Case Studies

by Elliott Sclar

Economic Policy Institute

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Professor Sclar contributed one of the lead papers on the economic importance of central cities to the book *Interwoven Destinies: Cities and the Nation* (1993), edited by Henry Cisneros, and has co-authored two previous studies for the Economic Policy Institute: *The Emperor's New Clothes: Transit Privatization and Public Policy* (1989) and *Does America Need Cities?* (1992), prepared for the U.S. Conference of Mayors. His article, "Public Service Privatization — Ideology or Economics?" appeared in the summer 1994 issue of *Dissent*. Among his more recent works are *Neighborhood Change and the Future of the City*, to be published in 1998 by Columbia University Press.

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To the extent that this work has merit it reflects the kind help each of these individuals extended to me. Any errors of fact that remain are mine. More importantly, the work reflects my opinions and not necessarily those of anyone mentioned above.

Portions of this work will appear in my larger study of this subject, *Selling the Brooklyn Bridge: The Economics of Public Service Privatization*, to be published by the Twentieth Century Fund early next year.

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EXECUTIVE SUMMARY

This study reports on three case studies of public service reorganization in the United States. Although only two entailed the transfer of responsibility for service delivery from the public to the private sector, all have at one time or another been characterized as "privatization."

Each case covered at least four years, so the findings are less likely to be affected by temporary "start-up" factors. Selection of the cases was based on the availability of information—public documents, newspaper accounts, and personal interviews. Each appeared to be a strong candidate for privatization, since they all involved physical, "blue collar" work that is thought to be the easiest type of service to deliver through contracting. The types of tasks involved are also routinely performed in the private sector.

This study reports on three case studies of public service reorganization in the United States.

In the case of vehicle maintenance in Albany, N.Y. and state highway maintenance in Massachusetts, the privatization was carried out as its advocates initially planned. In Indianapolis, privatized vehicle maintenance was abandoned in favor of internal reorganization.

As for Albany and Massachusetts, there was no evidence that contracting saved money or improved service quality. In Indianapolis, however, substantial savings and an improvement in the quality of work can be documented.

In Albany, the best estimate is that the city is overspending by at least 20% under privatization, not counting the added costs of contract auditing and supervision. By contrast, Indianapolis can document savings in the range of 8-29%. It is not possible to estimate the true costs (or benefits) in the Massachusetts case, although the loss probably ranges from 9% to 27.5%.

Why did things not turn out as well as the privatization advocates predicted? For one thing, the tasks that make up the bulk of public service are often more complex than privatization advocates maintain, and the complexity translates into extra costs to administer the contracting process, monitor work, and evaluate performance. These can easily outweigh savings from lower production costs. Private organizations themselves often find that the administrative costs of performing tasks in-house are less than the transaction costs of using the market when key elements of their mission are at stake.

When any private or public organization decides to buy rather than make, it must go shopping. It either shops in what could be called a spot market or in a contract market. Spot markets are akin to "buying off the rack," while contract markets are like custom tailoring. Spot markets typically offer standardized products; examples include office supplies and motor vehicles. Some services that organizations

can readily provide for themselves also fit in the spot market category. A business firm might use its own bookkeepers to prepare its payroll or it might hire an outside service. A periodicals publisher might process its own subscriptions and mail its own journals, or it might hire an outside fulfillment company.

Where the choice is between spot purchases of standardized products or internal production, the decision depends on a comparison of production costs. Typically products available in spot markets are available from many sellers, and product quality is relatively obvious. Competition maintains downward pressure on prices and focuses average quality to suit the tastes of buyers.

In much of the privatization debate, transaction costs are typically ignored.

In contract markets, the choice of sellers is usually more limited. Product quality and prices are not as easily observed and compared. Consequently, decisions to contract out involve specification of the product, negotiation of prices, close monitoring of quality, and anticipation of contingencies. The decision to make or buy involves not only analysis of the comparative production costs typical of spot markets, but also the transaction costs of contract design and monitoring when much relevant information is nonexistent or only available at significant cost.

In much of the privatization debate, transaction costs are typically ignored. The product is routinely treated as if it is sold in a spot market, as if all one needs to do is announce the availability of the contract, specify the relevant conditions and terms, and wait for bidders to beat a path to the door.

The appealing simplicity of privatization through competitive contracting should be examined in light of experience and in comparison to alternative methods of improving public sector efficiency. A prominent option is the refashioning of labor-management relations, typified by the Indianapolis story.

Enhancing efficiency in public service provision may be possible without the participation of business firms. Given the transaction costs involved in a changeover to contracting, labor-management consultation could provide an economical shortcut. From this standpoint, it ought to be the option of first resort.

Public services can be complex to perform and administer. While contracting will always have a role to play, experience and analysis, rather than ideology, must be brought to bear to achieve the best balance of public and private participation. These cases analyzed here point up the hazards of premature conclusions as to what is easy to contract out. Problems of accountability and control can be daunting. The findings in this study do not augur well for decisions to expand the scope of contracting to ever-larger and more complex public services.

INTRODUCTION

The old New York County Courthouse in Lower Manhattan, which opened its doors in 1872, is an impressive building. A facade of Massachusetts marble, a grand staircase, and a soaring rotunda mark it as an outstanding example of Victorian architecture. Commissioned in 1858 by the New York Board of Supervisors, the project began with an initial appropriation of $250,000. But by the time the majestic edifice was completed 14 years later, the cost had ballooned at least fifty-fold: historians estimate the final figure at $12-15 million in late-19th century dollars. Adjusting for inflation, an equivalent building today would start with an initial estimate of about $40 million and a final cost of over $2 billion.

Although no longer used to dispense justice, the building is being restored as a civic monument. Its architectural merits aside, the structure would still survive in modern folklore as a cautionary tale of how easily the public treasury can be plundered by skilled practitioners. This story and others like it (the Pentagon's notorious $600 toilet seats provide another striking example) capture the public's attention with their mind-boggling numbers. But when stripped of their large price tags, such tales are unremarkable in terms of what they tell us about the contracting process. For the generation of political reformers who came to power in reaction to the scandals of Boss Tweed and his counterparts, the lesson was clear: the nation needed a cadre of public employees unbeholden to political powerbrokers to carry out the people's business. Public contracting was a necessary evil to be contained.

In the ensuing years we have learned ways to limit the abuse of public contracting, but we have failed to solve its inherent problems. Because public money belongs to all in principle, it belongs to no one individually, thus inviting schemes to lay claim to these public revenues. As quickly as one contracting abuse is exposed and patched over with a new layer of red tape, another appears. As a result, public contracting will always be an imperfect instrument for carrying out the public will.

We have learned ways to limit the abuse of public contracting, but we have failed to solve its inherent problems.

A LOOK AT THE NEW RECORD

Despite the long and problematic record with public contracting as an instrument of public service, the past two decades have witnessed an upsurge in advocacy for its extensive use. Relabeled "privatization" by its conservative advocates, the drive has achieved enough success that there is now a sufficient track record to see if, as its proponents claim, privatization is truly an advance in public management or merely a relabeling of an old idea in the service of an ascendant political ideology. This report summarizes an evaluation of three in-depth privatization case studies. To be considered for inclusion, each case had to meet two principal criteria. The first demanded that each privatization case had to have been in place long enough to ensure that observed outcomes could be fairly considered a result of managerial transformation and not merely a reflection of startup difficulties. To this end, each of the three privatization cases examined in this study is at least four years old. The second criterion concerned the availability of sufficient evidence in the form of public documents, newspaper accounts, and individual interviews necessary for constructing an adequate factual record. The three cases selected provide adequate evidence of these types for this study's evaluation.

There is now a sufficient track record to see if privatization is truly an advance in public management or merely a relabeling of an old idea.

Two of the cases selected involved vehicle maintenance, while the other involved highway maintenance. The public services in all three cases were strong *a priori* candidates for privatization for two reasons. First, each case involved the type of "blue-collar" work that is presumed easiest to administer via private contract because of the observable nature of the output. Unlike social services or education, in which actual output is more difficult to identify or evaluate, it presumably takes little effort to know if a car's oil has been changed in a timely manner or grass has been properly mowed. Hence, the administrative costs of effective contract management in these cases were assumed to be low. Second, the public services examined in these cases can also be commonly found in the private sector. All three services pass what privatization advocates call a "yellow pages" test for the existence of a competitive market: If one were to consult the phone book, a significant number of small and presumably competitive providers could easily be found to perform the needed tasks. Such cannot be said for more complex services like education and child welfare, but the three cases chosen for this study are easily placed in the context of a competitive market, providing a fair test for evaluating claims that private-sector competition can reform the public sector.

The privatization of vehicle maintenance took place in Indianapolis, Ind. and Albany, N.Y., while the privatization of state highway maintenance occurred in Massachusetts. In two of the cases (Albany and Massachusetts) the privatization

took the form initially envisioned by its proponents, but, in Indianapolis, the original plan for privatization was replaced by an innovative internal restructuring of the work arrangement that had been slated for outsourcing. As a result, we are not only able to compare privatization with public service, but we can also compare it with internal reorganization.

PUBLIC MANAGEMENT BY REMOTE CONTROL

Despite the rich, well-documented history of public contracting's shortcomings over the past two decades, a political consensus has emerged that regards the privatization of public services as "the key to better government" (Savas 1987). This view's adherents argue that the last generation of reformers got it wrong. Inefficiency, ineffectiveness, and corruption are endemic to *public* service. These critics argue that private markets are paradigms of efficiency and effectiveness. If only private markets could be put to use in public service, we would then witness a revolution in the proper use of the taxpayer's money. This adoption of contracting is labeled "privatization" by its devotees, and they have exalted it as the ultimate public management tool.

The case for public contracting rests upon the belief that competition is the answer to public service's failings.

The case for public contracting rests upon the belief that competition is the answer to public service's failings. Privatization advocates rule out the notion that it is possible to correct the flaws of direct public service. They argue that the flaws relate to endemic organizational inefficiency and unresponsiveness to the needs of service users. Private marketers also claim that managerial reform is impossible to achieve because public managers and public employees are paid from budgets that are rarely, if ever, justified by the yardstick of market costs. As a result, public workers have enjoyed a *de facto* monopoly as the suppliers of public goods, and this monopoly generates organizational laxity and high costs.

Viewed from this perspective, privatization is essentially a process of remote organizational reform, offering a quick, easy solution to all that ails the public sector by sidestepping the messy issues of the politics of contracting and the effectiveness of public-sector leadership and management. Privatization's proponents argue that the threat of competition will compel public employees to either figure out on their own how to reorganize themselves efficiently or forfeit their work to more competent and competitive private providers.

From this analysis flows the well-known mantra of privatization, repeated on all occasions in which contracting is questioned: It is not a matter of public versus private, but one of monopoly versus competition. Although such sloganeering has some appeal, it is an oversimplification that fails to accurately reflect the reality of public work or public contracting. Lost in the zeal to privatize increasing amounts of public work is any understanding of the systemic and largely economic forces that actually shape contemporary public work. These forces are illustrated and examined in detail in the following case studies.

THE ALBANY DEPARTMENT OF PUBLIC WORKS

In January 1992, the Albany, N.Y. Department of Public Works (DPW), which is responsible for the maintenance of most municipal vehicles, replaced its entire in-house motor vehicle maintenance operation with contracted work performed in local repair shops. The stated rationale was that contracting out would save the city money and provide better services. Although the hourly repair charges at these outside shops (about $30 per hour) was approximately 50% higher than the $20 per hour of wages and fringes paid to municipal mechanics and assistants, the city would not have to pay the full 40-hour-a-week salary enjoyed by municipal workers. In theory, the city would pay only for the hours the vehicles were actually being serviced. The DPW commissioner at the time, George Nealon, estimated that the change would lead to an ongoing savings of $100,000-$200,000 a year.

In its report to the city, the consulting firm concluded that Albany was overspending for fleet maintenance by about 20%.

The privatization of Albany's vehicle maintenance was scrutinized in two outside reviews. Both reviews indicate that the city is overpaying for vehicle maintenance. The city retained David M. Griffiths & Associates, a nationally recognized management consulting firm in the field of vehicle maintenance, to undertake an extensive management audit of its fleet maintenance program. In its December 1995 report to the city, the consulting firm concluded that Albany was overspending for fleet maintenance by about 20%: in 1994 the city spent about $1.6 million when it should have spent around $1.3 million. According to the consultant, the "city has not been able to take advantage of economies of scale achievable in more centralized approaches."

Representing the displaced mechanics and helpers, the American Federation of State, County, and Municipal Employees District Council #61 and Blue Collar Workers Union Local 1961 undertook two small investigative studies. The first was conducted immediately after the privatization was announced in early 1992. The second was undertaken in 1993, a year into the privatization. The first study analyzed past city practices with regard to the contracting out of vehicle maintenance work. The second looked at the current privatization experience. The methodology in both cases was the same, with the unions examining and analyzing bills submitted by the contractors and paid by the city. Both studies found numerous ongoing instances of double billing and overcharging for work and parts. The findings bear out much that is generally suspected about the ways in which contractors abuse contracts. Some typical examples, taken from the report, include the following:

One contractor charged the city $80 to check all the lights on a Sanitation vehicle and replace broken marker lights. Two weeks later, after traveling only five miles, the same repairs were once more performed on the same vehicle at a cost of $128.

Another Sanitation vehicle was brought to a local shop to have a hydraulic leak repaired. The necessary work was done. In addition, the hydraulic oil was checked, the brakes adjusted, all lights were checked, bad bulbs and bad marker lights were replaced and necessary wiring repairs were performed for $183. Three weeks later the vehicle returned to the same shop. This time the hydraulic oil was topped off, the brakes were adjusted again, and all the lights and wiring were once again judiciously repaired. This time the city was charged $203.

A police car was brought into a local dealership with faulty parking lights. In order to solve this problem the dealership mechanic examined the entire wiring system before locating a pinched wire behind the back seat. The former municipal mechanics charge that this was an inefficient approach to the problem. But the city was forced to pay $489.07 for this repair. The cost broke out into $9.07 for parts and $480.00 for labor. (AFSCME 1993)

The comptroller pointed out that the necessary close auditing of contracts and services is cumbersome under the city's present accounting system.

Prompted by the revelations contained in these union reports, the city comptroller independently evaluated the DPW's vehicle maintenance contracts. In April 1995 the comptroller's office announced that, as a result of its investigation, the City of Albany reduced its 1994 vehicle maintenance spending by $240,295 in the public works and police departments (in which vehicle maintenance had been contracted out since 1992). That savings represents an 18% drop from the amount spent in 1993. The magnitude of the savings is in line with Griffiths' estimate.

The bulk of the savings resulted from more aggressive supervision of contractors' bills and closer monitoring of the service rendered. This finding, too, was consistent with those of the union reports. But such savings come at a high price. The comptroller pointed out that the necessary close auditing of contracts and services is cumbersome under the city's present accounting system, and that the city

TABLE 1
City of Albany
Selected Costs of DPW Operations and Contracts
1990 and 1993

	1990	1993	Absolute Change	Percentage Change
Central Garage	$906,319	$184,501	($ 721,818)	- 80 %
Departmental Contracts	$478,066	$1,229,893	$ 751,827	+122 %

Source: 1992 and 1995 budgets of the City of Albany.

would have to "re-engineer" its voucher and data processing system in order to maintain the needed vigilance. While the red tape associated with better and more expensive audit procedures will help reduce the risk of exploitation, it will not be enough to optimize the city's costs. Auditors can only question the validity of the bills; in the end, it still takes expert mechanics to judge the necessity for repairs and the quality of completed work.

To the extent that there was any money saved from shutting down the city's maintenance garages, these savings were more than offset by an increase in contract spending (Table 1). Ultimately, contracting did not prove to be the competitive, money-saving process hoped for by the former department of public works commissioner. It is not possible to definitively identify the full fiscal impact of contracting out vehicle maintenance because of the highly decentralized system in place in Albany. At best, by 1994, the situation did not get worse, but only due to significant oversight efforts by the comptroller to catch fraud and double billing. Over time, this sort of outside auditing becomes an inefficient and expensive way in which to manage an operation. For an agency to be most effective, the cost-control mechanism must be internal to its day-to-day operations. External audits are, at best, a fiscal safety net.

* Key, again

INDIANAPOLIS FLEET SERVICES

If any city was likely to mimic the privatization in Albany, N.Y., it was Indianapolis. But despite the staunch pro-privatization leanings of Indianapolis Mayor Stephen Goldsmith, a far different arrangement eventually emerged. In fact, the city's internal reorganization of vehicle maintenance negotiated by the employees of Indianapolis Fleet Services (IFS) (led by union Local 3131, AFSCME District Council 62) has proven to be an important national model for public-sector restructuring. The fleet maintenance employees successfully forged an alliance with their direct managers and jointly convinced the mayor that restructuring was superior to privatization. Over time, as the more controversial municipal privatizations popularly associated with Goldsmith began to unravel, this particular restructuring became a point of special pride for the mayor and his administration.[1]

The city's internal reorganization of vehicle maintenance has proven to be an important national model for public-sector restructuring.

When Goldsmith originally ran for mayor, he did so on a highly visible, pro-privatization platform. His well-publicized one-time remark that he could run the entire city with only four contract managers quickly became widely quoted as his signature stand on municipal management. Although his statement was a bit of an exaggeration, he did intend to reduce the city payroll (excluding public safety services) by 25% in his first term. During his campaign, he often cited the IFS as an exemplary candidate for privatization.

Goldsmith's electoral victory coincided with a time of change within the IFS. When Goldsmith first took office, the IFS administrator had an antagonistic relationship with both his workforce and the municipal departments who were his customers. He soon retired, though, and his deputy, John McCorkhill, stepped in to run the agency until the new mayor could decide its future. Although McCorkhill was instructed by the outgoing mayor not to make any changes in the fleet services, he did strive to improve moral and the working atmosphere. No significant structural changes occurred during 1991, but improved day-to-day relations fostered a harmony between labor and management that later provided the groundwork that made the present reorganization possible. Arranged in negotiations between McCorkhill and Local 3131's former president, Dominic Mangine, some of these changes included more flexible work scheduling and cooperation around repair protocols. The experience of cooperation convinced both the line workers and their immediate superiors that a new day in labor-management relations was possible.

While the relationship between the IFS and the city was critical to the eventual outcome, other forces also shaped the end result. District Council 62, the AFSCME umbrella organization that includes Local 3131, had made it clear that it was prepared to use all its resources to fight any of the city's privatization efforts. The council's

resolve shaped the atmosphere in which the IFS restructuring occurred—a factor that should not be underestimated.

The hostility between the new administration and the unionized workforce continued at a fever pitch for the first four to six months of the new administration. After a particularly bitter round of contract negotiations, the director of the department of transportation approached District Council 62's executive director and asked to pursue a more conciliatory path of negotiations on privatization matters. He offered them a genuinely "level playing-field" for city teams to compete against private vendors. While the unions always thought they could win in such a context, they were also concerned about the larger implications of yielding ground in the philosophical debate over privatization. After much internal deliberation, AFSCME agreed to go forward, setting four preconditions on its participation:

After all contract proposals were submitted, the IFS proved to be the lowest-cost bidder.

- The right to participate from the beginning of the process, and name the employee team members.
- Provision by the city for advance training for those participating, and the opportunity to submit several practice proposals prior to actually bidding.
- The right to look not only at personnel but also at all aspects of a job, including overhead, and redesign it as the team saw fit.
- Assistance by the administration in freeing up union members from the bureaucracies that stymied their ability to provide services competitively.

By the time a formal request was made for fleet maintenance contract proposals in January 1995, the municipal operation shrank itself (with full support from the Goldsmith administration) from 119 workers down to 84. All of the jobs eliminated were in middle management and among clerical workers. Beyond this attrition, no jobs were lost on the shop floor.

After all contract proposals were submitted, the IFS proved to be the lowest-cost bidder. From the IFS' point of view, the process confirmed that it knew how to run the operation. Its proposed staffing of 84 employees was almost identical to the staffing proposals made by the outside competitors.

Under the terms of their proposal the employees agreed to forego a previously negotiated 3% pay increase. In exchange they were granted 25% of any first-year savings below the proposal price and 30% of any savings in the second and third years of the contract. These incentives were to supplement their regularly scheduled pay increases. In the spring of 1996, the IFS staff received $75,000, representing its share of the first eight months of savings incentives.

The success of the restructuring can best be judged by its outcomes. The data in **Table 2** are IFS budget comparisons for the years 1991-96.

On an unadjusted basis, between 1991 and 1996 total costs have fallen about $1.1 million, or around 8%. When the budget costs are adjusted to reflect the added activity, the underlying costs fell $3.8 million, or about 29%. (These figures are not inflation corrected, so inflation-adjusted savings would actually be somewhat larger). Nor have these savings been at the expense of service quality, but rather a reflection of an improved work environment. The data in **Table 3** illustrates this point.

On an unadjusted basis, between 1991 and 1996 total costs have fallen about $1.1 million, or around 8%.

While most of this table is self-explanatory, some categories would benefit from further explanation. "Customer Meetings" refer to a proactive policy that has become a strong part of the IFS service program. In 1991, the IFS instituted a series of regular meetings with the operating departments that are essentially IFS customers. The purpose of these meetings is to obtain customer feedback on service-related issues. Starting in 1991, about two meetings per week were held, but, by 1995, the average number of meetings increased to over three per week. These meetings constitute an important link in the ongoing reorganization that IFS has initiated.

It is also noteworthy that, in the first year of restructured operation, under-8-hour turnaround time improved by about 10%—from about 72% to 80%. Not only has service turnaround time improved, but the city is also getting more service from each of its vehicles at a lower cost per vehicle. This savings is reflected in both the decline in the cost of tires despite an increase in the number of miles driven per vehicle and the fact that miles driven per vehicle has increased even as the overall operating service costs have been decreasing.

TABLE 2
Indianapolis Fleet Services
Comparative Budgets, 1991-96
(In Thousands)

	1996	1995	1994	1993	1992	1991
Unadjusted Budget	$12,578	$12,192	$12,561	$13,997	$13,854	$13,688
Less New Costs						
Since 1991						
Belmont Garage	($1,147)	($1,242)	($1,230)	($1,232)	($ 342)	($ 233)
Fire Dept. as Customer	($1,133)	($1,062)	($1,058)	($1,121)	($ 209)	($ 209)
Added Cost of IPD Take Home	($ 862)	($ 610)	0	0	0	0
Total Adjustments	($3,142)	($2,915)	($2,288)	($2,352)	($ 551)	($ 442)
Adjusted Budgeted Costs	$9,437	$9,278	$10,273	$11,645	$13,302	$13,246

Source: Indianapolis Fleet Services.

TABLE 3
Indianapolis Fleet Services
Performance Indicators
1990-95

	1995	1994	1993	1992	1991	1990
Fleet Size	2,202	2,104	1,967	1,969	2,043	2,153
Number of Employees	81	84	93	109	119	113
Written Complaints	7	5	6	24	30	149
Customer Meetings	185	192	156	139	81	N.A.
% Under 8 Hr. Turnaround	80%	72%	72%	70%	71%	71%
Indirect Labor as % of Cost	33%*	31%	35%	38%	40%	40%
Lost Hrs. - Worker Comp.	1,119	4,062	2,619	3,903	6,040	4,933
Miles Driven	25,388,700	20,991,900	18,534,800	N.A.	N.A.	N.A.
Miles Driven per Vehicle	11,530	9,977	9,423	N.A.	N.A.	N.A.
Tire Expense	$840,000	$684,800	$837,300	$830,000	$787,000	$728,700
Net Auction Proceeds	$1,300,000	$1,113,500	$1,378,900	$826,100	$1,432,200	$315,600

Source: Indianapolis Fleet Services.
* Increase due to use of union group leaders instead of mechanics and managers or contractual janitorial firm to perform cleaning services.

MassHighway

As was demonstrated in Indianapolis, the goal of genuine organizational reform should be permanently improving the operation of the public sector. Because of the public sector's many stakeholders and the multifaceted nature of public power, such reform must, at its core, be a consensus-building process. Reform efforts should include a range of innovative techniques for restructuring public service. In Massachusetts, Governor William Weld's administration took a different approach to making changes to the state's public services. That administration's efforts can be characterized as a headlong rush to contract out as much public-sector work as possible. The centerpiece of Weld's 1990 gubernatorial campaign was his promise to establish "entrepreneurial government" in Massachusetts. As coined by David Osborne and Ted Gaebler in their widely read book, *Reinventing Government*, the phrase "entrepreneurial government" strives to evoke an image that is in sharp contrast to the popular conception of government as sluggish bureaucracy.

The Weld administration's efforts can be characterized as a headlong rush to contract out as much public-sector work as possible.

One of the first public services Weld attempted to privatize via contracting was highway maintenance. In addition to working with outside contractors, MassHighway (the state highway maintenance agency) also encourages its unionized workers to submit bids. After receiving bids for its highway maintenance jobs, MassHighway then disperses the work on a 50-50 basis, half going to its own state workers and half to outside contractors.

The Weld administration hailed the arrangement as a success in terms of both cost savings and enhanced work quality. Two independent outside examinations, one prepared by the House Audit and Oversight Bureau of the state legislature and the other by the Office of the State Auditor (OSA), call this success into question. Both examinations' findings are based upon a thorough review of the initial privatization effort in Essex County, which began in fall 1992.

The bureau concluded that the Essex County contract, as written, failed to provide for regular and continuous district maintenance. In fact, the contract provided incentives to both the state and the contractor to engage in deferred maintenance. For the state the goal was to keep costs below the contract price. The flexibility of the arrangement permitted the contractor to perform the most profitable rather than the most useful work. The bureau's onsite inspections revealed that even the supervision that the state was supposed to supply was lax (House Audit and Oversight Bureau 1994). Much of the work allegedly done was either done poorly or not at all. The small amount of work that was undertaken was carried out by state employees, not the contractors.

OSA's investigation compared the costs of in-house production with those of

privatization, with the result shown in **Table 4**.

OSA estimates that as a result of the privatization the department actually *lost* approximately $1.4 million before an adjustment for equipment savings and $1.1 million after that adjustment, for a total loss of 27.5% of service costs. MassHighway contested these findings, and asked its privatization consultants, Coopers and Lybrand (C&L), to respond to the OSA investigation. C&L concluded that not only did the state not lose money on the privatization but actually saved $2.5 million. **Table 5** summarizes the C&L analysis.

The major discrepancies between the two estimates involve the manner in which pre-privatization personnel costs and actual contract costs were calculated. C&L estimates pre-privatization personnel costs at about $5.6 million, while OSA estimates these costs at about $3.3 million. C&L puts the final contract cost at $2.6 million, but OSA estimates $3.7 million.

In its haste to move the privatization forward, the state never undertook a definitive cost accounting of the way in which state employee time was actually spent.

In its haste to move the privatization forward, the state never undertook a definitive cost accounting of the way in which state employee time was actually spent. OSA attempted to overcome this deficiency by using the W-2s of employees attached to the privatized unit to determine actual personnel costs. It then reviewed time sheets to estimate the proportion of time spent on the tasks that were privatized.

The C&L analysis concluded that pre-privatization personnel costs were higher

TABLE 4
Comparative Analysis of In-House and Privatized Costs of Essex County Highway Maintenance

Cost Item	In-House	Privatization	Difference
Salaries	$2,920,467	$1,078,524	$1,841,943
Overtime	266,705	150,000	116,705
Police	200,000	210,000	(10,000)
Materials	24,975	6,000	18,975
Vehicle Maintenance	91,520	26,415	65,105
Administrative Costs	257,700	183,925	73,775
Contract Costs	419,709	3,687,158	(3,267,449)
Contingency	-	250,000	(250,000)
Subtotal	$4,181,076	$5,592,022	$(1,410,946)
Equipment Savings	-	255,000	255,000
Total Costs	$4,181,076	$5,337,022	$(1,155,946)

Source: State Auditor's Report on the Privatization of the Maintenance of State Roads in Essex County, October 7, 1992 to October 6, 1993, Report No. 93-5015-3, July 19, 1995.

TABLE 5
Comparison of Pre-Privatization (FY92) and Privatization (10/92-10/93)

Direct Costs	Pre-Privatization	Privatization 10/92-10/93	Savings	% Cost Difference
Personnel	$5,581,738	$1,552,191	$4,029,546	-72.2%
Materials	24,974	0	24,974	-100.0%
Contractor Compensation	419,709	2,605,719	(2,186,010)	520.8%
Other Direct Costs	1,135,808	545,204	590,604	-52.0%
Total	$7,162,229	$4,703,114	$2,459,114	-34.3%

Source: Coopers & Lybrand, "Independent Assessment of Massachusetts Highway Maintenance Privatization Program," prepared for the Executive Office of Transportation and Construction, June 1996.

than those OSA found. C&L used a longer list of workers than was initially claimed by MassHighway to have been working in Essex County. C&L further raised the pre-privatization personnel cost by failing to adjust its estimate to exclude time spent working on tasks other than those privatized. These liberties and oversights indicate that OSA used the correct procedure to estimate the pre-privatization personnel costs of the work that was later contracted out.

A second disparity between the two studies involved the actual cost of contracting. C&L used the final contract cost of $2.6 million in its study, but OSA used the initial bid price of $3.7 million to estimate the cost of the contract. Because C&L overstated the pre-privatization personnel cost and OSA overestimated the true final contract cost, it is difficult to distinguish the true cost of this privatization from these two studies.

Evaluating the effectiveness of this arrangement becomes even more difficult when trying to gauge the extent of service delivered. C&L's finding of an actual contract cost below the original estimate is consistent with the legislature's finding of a low level of compliance with the contract terms. MassHighway's original internal price estimate for the needed work was $4 million. The winning bid was $3.7 million, but the final price was $2.6 million, with any savings seemingly achieved through attenuation in the amount of service actually purchased. Since the state never undertook a careful pre-privatization cost accounting and permitted the intermingling of state workers and equipment with contractor employees and equipment, it is difficult to know who is actually responsible for the cost and quality outcomes or what those outcomes actually are.

The state is now evenly divided into 14 highway maintenance districts — half are maintained by state workers and half by private contractors. The unions believe they have proven that they provide a better product for less, but the Weld administration contests the claim. Given the inherent vagueness in much of the work, the lack of strong contract supervision, the use of state workers to perform work for the private contractors, and the contractor's ability to defer maintenance, efforts to gauge the success of this arrangement are difficult at best. Certainly the evidence in Essex County indicates that the state is more than likely losing money or services, but these losses have yet to cause a cash hemorrhage. Further evidence, however, points to the possibility that the state has created a losing proposition. Table 6 compares union bids with the lowest outside bids in the latest round of proposals for maintenance contracts in 12 districts.

The unions believe they have proven that they provide a better product for less, but the Weld administration contests the claim.

The unions were the lowest bidders in nine of the 12 districts. Their bids were, on average, 9% less than that of the outside bidders. In absolute terms, the difference is $2.6 million, an amount sufficiently large to suggest that, in the end, the administration favors privatization, not efficient service.

Judging by the public employees' willingness to work with the state on restructuring in Indianapolis, these numbers make a strong case that far more innova-

TABLE 6
Comparison of Union Bids and Lowest Contractor Bids
Massachusetts Highway Maintenance
June 1996

District	Union Offer	Lowest Contractor	Difference
2A	$1,420,480	$2,132,970	50%
2B	$1,420,480	$2,009,769	41%
3A	$1,360,480	$2,059,300	51%
3B	$1,400,480	$1,515,575	08%
3C	$1,375,480	$1,617,290	18%
4A	$1,743,500	$1,961,339	11%
4B	$3,174,720	$3,527,164	11%
4C	$3,211,800	$4,118,646	28%
4D	$4,836,880	$5,169,442	07%
5A	$3,224,366	$2,174,350	-33%
5B	$4,250,880	$3,858,008	-09%
5C	$2,040,104	$1,968,758	-03%
Total	29,459,650	32,112,611	09%

Source: SEIU Local 285.

tive labor-management incentive arrangements could be put into place. The governor's office continues to approach such possibilities with great diffidence. In terms of Massachusetts' future, it appears that a more likely scenario is one in which MassHighway is nothing more than a contract manager for a rotating group of suppliers.

These numbers make a strong case that far more innovative labor-management incentive arrangements could be put into place.

Although talks between the state government and the unions continue to address maintaining "the partnership that has been established between labor and management," state administrators warn that they "will no longer be able to provide the slack [they] have given the union workers" (Kostro 1995). Neither side harbors any pretense that the present situation is about working toward improving the quality of public sector work. Instead, the union is presently resigned to the fact that it will almost automatically be given one-half of the work, regardless of the merits of its bids, while the other half will be contracted out. But this is only a stopgap measure—both the unions and the governor's office know they are involved in a waiting game. The remaining workers are aging, and though some new equipment has been purchased, the state has no intention of remaining in the highway maintenance business. Indeed, the Massachusetts executive secretary for transportation and construction, James Kerasiotes, has said as much:

> The unions must also recognize that hiring new employees and purchasing large quantities of new equipment is not realistic under the present fiscal circumstances, *circumstances that are not likely to change in the foreseeable future* [emphasis added]. If the present trends continue...over time and through attrition the unions are going to find their employees replaced by private contractors. Making their workers competitive with private contractors will, at the very least, slow this trend. (Kerasiotes, 114)

The secretary makes it clear that the best unions can hope for is that employee acquiescence to privatization will earn them a slower rate of downsizing.

LESSONS FROM EXPERIENCE

The three experiences summarized in this study, in and of themselves, neither "prove" nor "disprove" anything. They do, however, illustrate several major pitfalls that must be carefully considered if privatization via public contracting is to be adopted (as its advocates hope) as routine and widespread public policy. On a general level, these experiences cast doubt on whether the fundamental and historic accountability problems of public contracting have been solved. These cases also force us to more carefully question the belief that private contracting will enhance the public sector's performance by placing it in competition with the private market. These issues, and many others, require more thoughtful and careful reflection if we hope to truly improve the public sector.

These experiences cast doubt on whether the fundamental and historic accountability problems of public contracting have been solved.

'Moral Hazards' and 'Principal-Agent' Problems

We must avoid the temptation to base public policy on generalized personal observations. In both Albany and Indianapolis, local officials considered privatizing municipal fleet maintenance after observing vehicle repair facilities whose customers typically owned only one or two family vehicles—a far cry from the challenges of maintaining a fleet of municipally owned vehicles. There are two problems between these very different kinds of services: one concerns the nature of property ownership and the other the dynamics of delegated public responsibility.

Private automobile owners have obvious proprietary incentives to safeguard both their vehicles and their checkbooks. Public contracting, by contrast, always involves "moral hazard," which arises in any situation in which the best economic interest of at least one of the parties to a transaction can be better served by dereliction of duty or outright dishonesty. In public contracting, these problems can arise on both sides of the deal. The officials charged with responsibility for motor vehicle or highway maintenance are not the beneficial owners of the equipment or infrastructure, since these things belong to "the public." Public officials are essentially third-party agents, and it is easy to envision situations in which these officials experience pressure to perform in a less than diligent manner in supervising the maintenance of the public's property. Private contractors have obvious temptations to serve their own interest rather than those of a nebulous "public" for whom they ostensibly work. As is evident from our case studies, this abuse can involve performing either more (as in the case of Albany) or less (as in the case of Essex County) than an adequate amount of work, or even billing for work never performed (Albany).

Secondly, the degree to which these dilemmas can be avoided depends greatly upon the degree to which the public sector is prepared to add layers of bureau-

cratic oversight to establish accountability. To avoid—or at least minimize—the extent to which moral hazard becomes out-and-out theft, government is forced to impose increasingly elaborate oversight and audit systems. When confronted with the evidence of over- and double-billing, the Albany comptroller's decision to devise a more stringent auditing procedure for the privatized vehicle maintenance program is typical of what a responsible public official will do. One only needs to examine the federal government's long, expensive, and well-documented attempts to control these problems in its defense contracting programs. Such an examination would illustrate this approach's ever-growing supervisory costs and consistently diminishing benefits. Unfortunately, once government commits itself to privatization, it seems there is no turning back.

Privatization advocates frequently underestimate the sizable administrative costs of maintaining a contractual service-delivery system.

Transaction Costs and Organizational Size

In their ideological haste to convert public service to privately contracted arrangements, privatization advocates frequently underestimate the sizable administrative costs of maintaining a contractual service-delivery system. Not only do these costs never disappear, but, more importantly, they are often substantial. One need only consider the use of contracting by private-sector businesses.

The critical issue in private-sector firm size, and by extension public agency size, relates to organizational mission. Unlike political leaders who chase policy trends, business executives are more apt to assess the size of their organization in relation to that organization's or department's function. Private-sector firms are keenly aware that contracting out work to meet organizational goals costs money. Only when direct-contract costs are less than the costs of in-house activity do firms outsource jobs. These same financial considerations should also inform government agencies when considering privatization.

There are times, however, when identical services do exist in both the private and public sector. If, instead of considering maintenance services that typically dealt with single car-owning customers, Albany and Indianapolis had compared private-sector fleet maintenance services with its municipally owned fleet service, then the decision becomes more difficult. It makes economic sense for a person owning a single car to occasionally hire a specialist to maintain and repair that vehicle. But the economic considerations become more complex when considering a fleet of sufficient size that will likely require almost daily attention. There is admittedly no universally correct choice, but traditionally this kind of fleet maintenance has most often been performed by the fleet's owners. Economic theory helps explain why.

Economists have long been concerned about the factors that influence the way organizations make decisions about their size. When is it less expensive to

expand the size of an organization to accomplish tasks necessary to its mission and when is it more economical to purchase needed goods or services from outside vendors? Together these questions make up the essence of what is known as "the make-buy" decision. When a service is an integral or routine element to a private organization's mission or daily operation, organizations almost invariably find that the internal bureaucratic costs accompanying larger size are less than the external transaction costs of using the market.

Last year's Valu-Jet tragedy in Florida transformed the mundane "make-buy" business determination into front-page news. In Valu-Jet's drive to establish itself as a low-price, low-cost air carrier, it relied heavily on a strategy of outsourcing as much of its operation as possible in order to avoid high fixed overhead. The idea was to allow ticket prices to closely match its low direct operating costs. To that end, aircraft maintenance (an expensive part of daily operation and a task vital to the organization's mission), was outsourced. The Federal Aviation Administration has determined that the crash was caused by the explosion of spent oxygen cylinders improperly placed into the cargo hold by the aircraft maintenance contractor. Under the FAA rules, such a shipment is prohibited, but in the day-to-day rush of activity between Valu-Jet and its contractor, careful tracking of these kinds of important details can fall between the cracks. Each party now blames the other for the mix-up, as the heirs of the crash victims make their way into court to collect liability damages. The crash might well have been avoided if Valu-Jet had spent more money on supervising its contractor, but incurring such overhead costs would have stood in the way of the company's goal of maintaining low ticket prices. Because maintaining high aircraft performance standards also requires high levels of diligence, large airlines find it less costly to maintain their own aircraft. Similarly most large transportation companies find that the internal bureaucratic costs of supervising a maintenance staff is less than the transaction costs of hiring and correctly supervising an outside contractor.

When a service is an integral part of an organization's mission, the organization almost invariably finds that the internal bureaucratic costs accompanying larger size are less than the external transaction costs of using the market.

When an organization decides to buy a service rather than make one, it must go shopping. It either shops in a spot market or a contract market. Spot markets are akin to a pre-existing product, like buying a suit off the rack, and contract markets are similar to custom tailoring. Spot markets are typically used to acquire products such as office supplies and motor vehicles, items that come in sufficiently standardized forms that commercial vendors routinely maintain them in inventories and are virtually impossible for firms to make themselves. But some long-term services that organizations can readily do themselves also fit in this spot market category. A business firm might prepare its payroll internally, in its own bookkeeping office, or it may hire an outside payroll service. A periodical publisher

could process its own subscriptions and mail its own journals, or it could hire an outside fulfillment company.

In instances in which the choice is between spot purchases of standardized products or internal production, decisions are essentially a matter of comparative direct-*production* cost analysis. The organization must compare its internal production costs with the cost of the outside purchase. The standardized nature of "spot market" products and services usually results in virtually no transaction costs. Learning a product's price is often little more than two or three phone calls worth of effort. Typically, goods available in spot markets are sold in competitive environments in which many sellers participate (like the aforementioned "yellow pages" test). Product quality is usually obvious to buyers and sellers, and, as a result, competition ensures that retail prices stay low and average quality suits the taste of average buyers.

The standardized nature of 'spot market' products and services usually results in virtually no transaction costs.

Such simplicity does not characterize "make-buy" decisions that involve contracting for ongoing specialized services. The choice of sellers can be much more limited, and both product quality and cost is only vaguely governed by market competition. Consequently, decisions to contract out usually involve complex transaction costs related to product tailoring, price negotiations, close monitoring of quality, and unanticipated contingencies. In such cases, managerial decisions must involve both an analysis of the comparative *production costs* and consideration of inherent *transaction costs*, such as contract design and project monitoring. Much of the relevant information needed to wisely decide whether to purchase these specialized goods or services is either nonexistent or available only with significant investments of time and money.

The experience with privatization of highway maintenance services in Massachusetts illustrates the types of problems that can arise when government attempts to take a "spot market" approach to contract specialized services. Even though many of the individual tasks that made up the highway maintenance contract (grass mowing, etc.) are commonplace and easily fit within the confines of the spot market, some tasks such as bridge washing are unique to public service and unavailable in the spot market. Thus, the bidders on the privatization were themselves not firms providing standardized products but instead a consortium of subcontractors. Typically the lead contractor was a highway construction firm that had strong familiarity with the rules of the contracting game in state highway departments (even though the project was for ongoing maintenance). Furthermore, the "yellow pages" test played no part in creating the pool of bidders. To make matters even more complex, the state also supplied some of the equipment and personnel to fulfill the outside contractor's mission. As the legislature's Post Audit Bureau report revealed, much of the work was never done. As mentioned earlier, of the work that was completed, a significant por-

tion was done by state employees. Given the complex coordination involved among subcontractors and the Weld administration's goal to keep the final price at or below the contract price, the state must have absorbed its transaction costs through the contractor's failure to provide the promised service.

In much of the privatization debate, such costly transactional complexity is typically ignored when tallying the costs of privatization. The contracting process is treated as if it were a trivial modification in what is essentially a spot market. Accordingly, all one need do is announce the availability of the contract through a request for proposals, specify the contract's contingencies and terms, and allow the bidders to set the price competitively, with the lowest bid typically winning. To the extent that the process is truly that simple and straightforward, the use of contracting for product acquisition in the long term becomes identical with spot market purchasing. However, when contracts are sought for less standardized services with less readily discernible quality and under conditions of greater uncertainty, a more complex managerial calculus is needed. All of these factors typically come into play with public contracting, and the Massachusetts highway maintenance experience is rich in instances of this transactional complexity.

When contracts are sought for less standardized services with less readily discernible quality and under conditions of greater uncertainty, a more complex managerial calculus is needed.

It is also important to remember that privatization via contracting relies heavily on the belief that most contracts can be made self-enforcing. But the impulse to create a written agreement arises because the parties to a transaction have reason to believe that they might be at risk of the other party not meeting its contractual obligation. Thus, contracts contain descriptions of both party's future obligations and the sanctions to be imposed in the event that either party fails to hold up its end of the bargain. Such contractual agreements, often crafted in an atmosphere of uncertainty, creates a far different relationship than those found in the cut-and-dried transactions of either the spot market or the idealized contract market envisioned by privatization advocates. The extent of this divergence between the two market types is critical in determining the comparative efficiency of privatization.

Comparative Costs

The bottom line argument often made for privatization via contracting is that it is cheaper than direct public service provision—yet in the three situations we examined this was never true. In Albany, the best estimate was that the city pays a price premium of at least 20% to its contractor. This figure is undoubtedly too low because it does not account for the increased transaction costs of contract auditing and supervision that has been forced upon the city. As for Indianapolis, its decision to forego precisely such expensive contracting in favor of internal restructuring has resulted in the city enjoying savings of between 8% and 29%. In Massachusetts,

however, the hasty, complex, and undocumented privatization by MassHighway has made it impossible to estimate the true costs to the state. The best that can be said is that the loss is likely somewhere between 9% (the amount by which the unions underbid the outside contractors on average) and 27.5% (the loss the state auditor found in the Essex County situation).

Economics and Politics

While public provision of services is seldom without flaw, its problems can be addressed by more sophisticated and incremental methods of change.

Why did things not turn out as well as the privatization advocates predicted they would? The problems ranged from ethical difficulties of accountability (as was prevalent in the local repair work in Albany) to the more complex failure to perform contracted work (as was exemplified in Essex County). Underlying these problems are even larger dilemmas related to the nature of public work and contracting in general.

With all of the public sector's problems, there is more economic wisdom in the operation of public work than privatization advocates understand. While public provision of services is seldom without flaw, its problems can be addressed by more sophisticated and incremental methods of change. The evidence presented here suggests that all-or-nothing privatization approaches have made little progress in reforming the public service system's flaws, and this is a result of a failure to appreciate the complexities of this situation.

The essential reason that public service privatization is of limited value is that the bulk of public services are more complicated and unique than most services readily available in the spot market. As a result, the effort needed to orchestrate and oversee these kinds of services is a more costly undertaking than privatization advocates realize. The transaction costs of administering the contracting process and monitoring the contractor's work typically outweigh the savings gained from lower internal costs.

In addition to the ordinary operation of marketplace economics, it is important to remember that municipal service contractors are also political players. They use every lobbying and campaign-financing ploy they can to remain in the good graces of state and local decision makers. One of countless examples of this practice can be easily cited from an incident in Hartford, Conn. By the time the Hartford School Board awarded a contract to Education Alternatives Inc. (EAI) in an ill-fated attempt at complete public school privatization, EAI was already an important local political participant. The company had spent two years laying the local political groundwork for its contract through public relations work and community involvement (Reuters News Service 1994). Once a contract is secured and large sums of money are at risk, contractors will become more embroiled in local politics.[2]

From Competition to Monopoly

Public contracting is a dynamic political process that typically moves from a competitive market structure toward a monopolistic one. Even if the first round of contract bidding is genuinely competitive, the very act of bestowing a contract transforms the relative market power between the one buyer and the few sellers into a bilateral negotiation between government and the winning bidder.

The simple textbook models of competition so prized by privatization advocates provide no guidance to what actually occurs when public services are contracted. Over time, the winning contractor moves to secure permanent control of the "turf" by addressing threats of potential returns to insourcing or from other outside competitors. To counteract the former threat, contractors move to expand their political influence with the local officials in positions of power. To thwart the latter threat, they move to neutralize competition, most typically through mergers and market consolidation among public contractors. This trend helps to explain why two-thirds of all public service contracts at any time are sole-source affairs (California State Auditors 1996).

Competition provides no protection because the government can sever its tie to its present contractor only at a high cost.

Critical Assets

It is one thing to hire a contractor using its own staff and equipment to wash the windows in city hall. The tools, equipment, and low-skilled labor employed are obtainable from a range of providers. It is another to hire a firm to staff a county's fire houses with skilled fire fighters and purchase highly specialized equipment. Once the contractor controls these valuable critical assets, the public sector is at a distinct market disadvantage when conditions change. Competition provides no protection because the government can sever its tie to its present contractor only at a high cost. The best that the public sector can do in practice is determined by its bilateral bargaining strength relative to that of its supplier.

An example of this situation can be found in Scottsdale, Ariz., which has had a private, for-profit fire company since 1948. The same company has always had the work, and there is no competitive bidding process. Costs are negotiated each year between the municipality and the fire company. The practice has scarcely spread beyond Scottsdale. Indeed, some locales near Scottsdale, after trying the service, have elected to switch to municipal service in order to save money.

New York City's experience with school bus contracting provides a similar example. The city contracts with private companies for school bus service. The critical asset, the fleet of buses, is owned by the companies, not the city. Although the system is supposed to be competitive, that pretense was abandoned long ago. Instead, the contracts are granted on a continuous basis to the same companies for

the same service. Since labor is the largest individual item of cost, it tends to drive the price of the overall contract. Under the cost-plus market-sharing arrangement that the city and its contractors agreed upon, there is no incentive on the part of the contractors to hold down costs. To the contrary, their profit is effectively a mark-up on the absolute level of cost, including the wages and fringe benefits of their employees. The city's need for service is so large that every possible competitor already has a piece of the system. The city consequently ends up with little room to maneuver in contract negotiations—the contractors are fully aware that the city has no place else to buy the service. The city can't even change its route structure when it needs to without compensating the contractors for any loss they might incur. In this case, public operation would have been a more desirable managerial strategy.

Four factors are crucial in determining whether contracting can provide an economic alternative to improving internal organization.

Guidelines for Public Contracting

In general, four factors are crucial in determining whether contracting can provide an economic alternative to improving internal organization. They are:

- the centrality of the task to the agency's mission,
- the frequency of the transactions,
- the uncertainty and complexity surrounding the product or service, and
- the asset-specificity of the inputs needed to produce it.

Even though it is easier to conceive of ways to contract out the operation of the school cafeteria than of teaching in the classrooms, theory suggests that it is not automatically better just because the first task is simple and routine. With regard to classroom teaching, the theory suggests that, because of the complexity of the task and the uncertainty of the environment and outcome, the more likely it is that privatization via contracting will fail to produce cost-effective results. Finally, the more specific the physical and human assets needed for the service, the more efficient internal reorganization will be over external contracting. Highly skilled workers using highly complex pieces of equipment will perform in approximately the same manner regardless of who pays them. The relevant question then concerns the degree of direct managerial control the organization has over the work. In many public service cases, contracting is an awkward third-party arrangement. Attempts in both the public and private sector makes this exceedingly clear.

Consequently, as serious attempts are made to enhance government operation, the more it will be necessary to reform public work operations rather than

contract them out. The successful reorganization of vehicle maintenance in Indianapolis makes this clear. The appealing simplicity of privatization through competitive contracting is proving to be no match for the dauntingly complex problems of achieving cost-effective public service delivery. The less glamorous work of refashioning labor-management relations, now taking place quietly across America, will prove to be the more important revolution.

CONCLUSION

The reality of public work is that it is complex both to perform and to administer.

A self-enforcing and competitively renewable contract to perform work for the public sector is like the notion of the perfectly competitive market—just an ideal. The reality of public work is that it is complex both to perform and to administer. While contracting will always have a role to play in public service, the insights we can glean from economic experience must be brought to bear, balancing the role of public contracting with an investment in the development of good public management. Privatization is not a successful method for ensuring that citizens get the services they require from government in a cost-effective manner. The lesson of these three experiments in privatization makes this especially clear. These cases represent the types of services thought to be the easiest to privatize, yet problems of accountability and control still proved quite difficult. These cases' results do not augur well for calls to privatize the larger and more complex of our public services.

ENDNOTES

1. See, for example, the January 13, 1997 memo from Debra Wilson, deputy commissioner, to Commissioner Curt Wiley, Indiana Department of Transportation, which concludes that as a result of transit privatization "operating expenses are up 34.5%."

2. See, for example, Richards, Shore, and Sawicky 1996.

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GOVERNMENT CONTRACTORS

An Overview of the Federal Contracting-Out Program

Statement of L. Nye Stevens
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GAO/T-GGD-95-131

GOVERNMENT CONTRACTORS
AN OVERVIEW OF THE FEDERAL CONTRACTING-OUT PROGRAM

Summary of Statement by
L. Nye Stevens
General Government Division

GAO has done a large body of work on federal contracting-out and has drawn on this work to (1) provide a brief history of the contracting-out program, (2) discuss the effect of contracting-out decisions on federal employees, (3) examine the effectiveness of contracting-out decisions, and (4) describe legislative or any other impediments to the program's ability to promote the effective and efficient operation of government agencies.

Office of Management and Budget Circular A-76 is the federal policy that governs how contracting-out decisions are made in the government. The 40-year policy encourages government agencies to rely on the private sector for commercial goods and services. Since 1967, the objective of the A-76 program has been to achieve efficiencies by encouraging competition between the federal workforce and the private sector for providing commercial services. More recent revisions to the circular and other actions have more clearly detailed how cost studies were to be carried out, specified activities that were "inherently governmental" and should only be performed by federal employees, and extended the cost study requirement for advisory and assistance services.

Circular A-76 offers a number of provisions designed to protect the rights of federal employees adversely affected by contracting-out decisions, such as requiring that federal agencies exert maximum effort to find other jobs for these employees. GAO notes that while its earlier reports found that a significant number of displaced federal workers found employment in another government job, the current downsizing environment may not provide the same opportunities.

GAO found that evaluating the overall effectiveness of A-76 decisions and verifying the estimated savings reported by agencies is extremely difficult. GAO cannot prove or disprove that the results of federal agencies' A-76 decisions have been beneficial and cost-effective.

The A-76 program has never been adopted legislatively. In fact, Congress has enacted many restrictions on A-76 studies and on contracting out jobs presently held by federal employees. These restrictions generally fall into one of the following three categories: prohibitions on contracting out specific activities, minimum staffing requirements, and restrictive requirements regarding cost studies. Personnel ceilings imposed during the budget process are sometimes an impediment to choosing the option of federal performance when that is more cost-effective.

Mr. Chairman and Members of the Subcommittee:

Thank you for this opportunity to testify on the Subcommittee's oversight of federal contracting-out policies and their implementation over the years. You asked us to (1) give a brief history of the contracting-out program, (2) discuss what problems have surfaced among federal employees affected by contracting-out decisions, (3) examine the basis for measuring the performance of the contracting-out program, and (4) describe any legislative or other impediments to its success at promoting effective and efficient operations of government agencies.

We have done a large body of work on contracting-out. The attachment to my statement lists some of the most relevant products we have issued since 1981. I will draw on this body of work to respond to your questions.

History of the Contracting-Out Program

The federal government contracts for a wide variety of goods and services over the course of a year. Approximately $108 billion per year is spent for service contracts. The practice of entering into service contracts that are the result of decisions to convert work performed by federal employees to contract is commonly known as contracting-out.

Office of Management and Budget (OMB) Circular A-76 is the policy that governs how contracting-out decisions are made in the federal government. As a general policy, presidential administrations since 1955 have encouraged federal agencies to rely on the private sector for commercial goods and services. Since 1967, the objective of the A-76 program has been to achieve efficiencies by encouraging competition between the federal workforce and the private sector for providing commercial services needed by government agencies. Subsequent revisions to the circular and other actions have more clearly detailed how cost studies were to be carried out; specified activities that were "inherently governmental" and should be performed only by federal employees; and through a rescission of Circular A-120, which covered the provision of advisory and assistance services, extended to them by implication the cost study requirement.

As Congress considers the proposals of the Contract With America and of the National Performance Review (NPR) to downsize the federal government, contracting issues have assumed renewed prominence since the use of contractors may be a substitute for government employment. We believe that contractors can provide valuable services to the government. We have long held that the concept of encouraging competition is a sensible management objective that can contribute to more efficient and effective government operations and potentially result in significant savings. However, despite its appeal on a conceptual level, the

A-76 program has suffered from a number of implementation problems that raise questions on the amount of savings actually achieved and that prevent governmentwide acceptance.

The A-76 program has been and continues to be controversial. In more than 100 reviews we and others have done, managers accepted its objectives of seeking efficiencies and cost savings, but they also said that the program is time-consuming, difficult to implement, disruptive, and threatening to both managers and employees.

Effects on Employees

The circular contains a number of provisions designed to protect the rights of federal employees affected by contracting-out decisions. First, unless a waiver is received, any activity consisting of more than 10 full-time equivalent jobs (FTE), must undergo a cost study, and the study's results must indicate that contracting-out would result in more than 10 percent savings over comparable in-house costs before the activity can be converted. Federal employees may appeal these decisions to the agency performing the cost study if they believe that the cost study was faulty.

Secondly, under A-76, once the decision to contract out is made, federal agencies must exert maximum effort to find other jobs for

adversely affected employees. These efforts include giving them priority consideration for available positions within the agency, establishing reemployment priority lists, paying reasonable costs for training and relocation, and coordinating with the Office of Personnel Management (OPM) to provide access to governmentwide placement programs. The winning contractor must also give adversely affected employees the right of first refusal for positions for which they are qualified.

These policy provisions were strengthened by the Federal Workforce Restructuring Act of 1994 (P.L. 103-226). This act prohibits agencies from increasing the procurement of service contracts in order to achieve the personnel reductions mandated by the act, unless an A-76 cost study shows that the contracts would be to the financial advantage of the government.

Despite these protections, the A-76 program adversely affects workers' morale and productivity. Our work has shown that because employees affected by an A-76 study are uncertain about their current employment, employee anxiety can begin as soon as the study is announced. Some affected employees begin to look for new jobs, reducing individual and organizational productivity and frequently resulting in the loss of good employees.

The cost studies required by Circular A-76 are in practice mostly done by managers and operational workers rather than trained management analysts. They are required to develop detailed work statements and analyses--tasks they are often not skilled in, may never do again, and frequently are assigned as extra duties. The absence of workload data and adequate cost accounting systems makes the task all the more difficult. The time it takes to do A-76 studies has contributed to disruption in the workplace. Cost studies completed by the Department of Defense (DOD) between 1978 and 1986 took an average of 2 years to complete. When we checked DOD's database in 1989, we found 940 cost studies in process. Of these, 411, or 44 percent, were started in 1983 or earlier and had been in process at least 6 years.

We have not done any recent work on the question of what happens to displaced federal workers under the A-76 program. However, several reports that we did in the 1980s may provide some insight. For example, in a 1985 report on the program's impact in DOD,[1] we found that the majority of federal workers whose jobs had been contracted out obtained other federal employment, most often at the same installation. We found that of 2,535 DOD employees we sampled who worked in activities that were contracted out in fiscal year 1983, 74 percent had found other government jobs, most often at the same installation; 7 percent

[1]DOD Functions Contracted Out Under OMB Circular A-76: Contract Cost Increases and the Effects on Federal Employees (GAO/NSIAD-85-49, Apr. 15, 1985.

went to work for the contractor; 5 percent were involuntarily separated; and most of the remaining 14 percent resigned or retired. Of those who obtained other government positions, about 56 percent received lower grades, and about 44 percent received the same or higher grades.

In early 1985, we followed up by questionnaire with those employees who had been involuntarily separated or had gone to work for contractors. Of those respondents who were involuntarily separated, over half were reemployed with the federal government. Over half also said that they had received unemployment compensation and/or public assistance. Fifty-three percent who went to work for contractors said they had received lower wages, and most reported that contractor benefits were not as good as their government benefits.

It is worth noting, however, that although our earlier reports indicated that a significant number of displaced workers found employment in another government job, the current downsizing environment may not provide the same opportunities. For example, OPM operates an interagency placement program to assist separated employees. Under this program, agencies are required to give priority to separated employees when filling positions through competitive appointments. According to OPM, between the program's inception in December 1993 and September 16, 1994, from an inventory of 2,018 registrants, agencies made 204 job offers.

Among other things, OPM attributes the low number to the fact that agency downsizing has substantially reduced the number of vacancies.

Effectiveness of A-76 Decisions

During the long history of our work in this area, we have consistently found that evaluating the overall effectiveness of contracting-out decisions and verifying the estimated savings reported by agencies is extremely difficult after the fact. As a result, we cannot convincingly prove nor disprove that the results of federal agencies' contracting-out decisions have been beneficial and cost-effective.

In previous reports, we expressed concerns about the implementation of A-76 and the lack of complete and reliable data on the extent to which estimated savings have been realized.[2] For example, our 1990 evaluation of DOD savings data showed that neither DOD nor OMB had reliable data on which to assess the soundness of savings estimates or knew the extent to which expected savings were realized. At the time of our reviews, DOD did not routinely collect and analyze cost information to monitor actual operations after a cost study had been made. In addition,

[2]See, for example, Achieving Cost Efficiencies in Commercial Activities (GAO/T-GGD-90-35, Apr. 25, 1990) and OMB Circular A-76: DOD's Reported Savings Figures Are Incomplete and Inaccurate (GAO/GGD-90-58, Mar. 15, 1990).

DOD's database on costs contained inaccurate and incomplete information. If contracts were subsequently modified, or in-house organizations were revised from the configurations used in the comparison of government and contractor costs, this information was not available for post-study analysis. Poor contract administration, including poorly worded performance work statements, contributed to contract revisions and cost escalations that quickly outdated comparisons with the precontract performance of the functions.

In an attempt to address some of the broader performance questions, we began looking at the overall contracting experience of the General Services Administration (GSA) at the request of Senator James Inhofe. GSA began systematically reviewing its real property services in 1982 using the guidelines in Circular A-76. In a report released last year,[3] we were able to report on the overall extent of contracting-out by the agency and to identify the results of individual contracting decisions and the reported savings. However, for the reasons that follow, we have, thus far, not been able to provide a clear assessment of whether GSA has realized the expected savings and benefits from the activities contracted out or retained as a result of this process.

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[3]Public-Private Mix: Extent of Contracting Out for Real Property Management Services in GSA (GAO/GGD-94-126BR, May 16, 1994).

There is no common baseline available to evaluate subsequent performance of either contract or in-house services. As a result, we have not been able to compare the actual costs of these activities with what could have been the cost if other options had been chosen. However, even if such baseline data were available, we found that post-decision comparisons would be extremely difficult, if not impossible in some cases, because most activities do not remain static over time.

While Circular A-76 contains a list of typical commercial activities and requires agencies to compile an inventory of all government activities that are commercial in nature and could be contracted out, these listings or inventories are not current and may not be comprehensive. To our knowledge, no comprehensive inventory exists that identifies activities for which government agencies compete with private contractors or identifies which agencies perform these activities in-house and which perform them through contract.

It would be ideal for cost comparison purposes, Mr. Chairman, if an inventory existed of activities performed both under contract and by federal employees under similar conditions, with good cost data on each. Such an inventory could be the basis for establishing cost and performance benchmarks to evaluate the effectiveness of contracting-out decisions and, perhaps, even streamlining the A-76 process. However, such an inventory could

be compiled only if similar activities were performed in both the public and private sectors. In addition, it could be costly and difficult to maintain.

In isolated cases, we have been able to (1) obtain good cost data for similar activities performed by both government employees and private contractors under similar conditions and (2) perform equitable post-decision cost comparisons. For example, in 1992 we reviewed the Postal Service's initiative to procure postage stamps from the private sector and determined that the private sector was a lower cost source than the Bureau of Engraving and Printing for seven of the eight pairs of postage stamps we examined.[4] In this review, we were able to control for such factors as stamp size, printing method, and quantity produced and compare government and private sector costs. The cost comparison revealed that except for one case, private sector-produced stamps ranged from 6.8 to 62.4 percent lower than the cost of government-produced stamps.

Legislative Impediments

Observing the absence of definitive evidence to support projected cost savings and management improvements and being frequently contacted by constituents upset by the process, Congress

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[4]Postage Stamp Production: Private Sector Can Be a Lower Cost Optional Source (GAO/GGD-93-18, Oct. 30, 1992).

generally has been concerned about the impact of contracting-out on agency operations and skeptical of efforts to accelerate contracting out activities being done by federal employees. The A-76 program has never been adopted legislatively. In fact, over the years, Congress has enacted many restrictions on A-76 studies and on contracting-out jobs presently held by federal employees. While we could not find a comprehensive list of these restrictions, the restrictions generally fall into one of three categories:

-- Prohibitions on contracting-out specific activities. For example, GSA is prohibited from contracting out for custodians, guards, elevator operators, and messengers unless the contract is to a sheltered workshop employing the severely handicapped. Similarly, the Farmers Home Administration is prohibited from contracting with private debt collection firms to collect delinquent payments. The Department of Commerce is prohibited from contracting out any part of the National Technical Information Service or from selling, leasing, or transferring any part of the weather satellite system.

-- Minimum staffing requirements. Minimum staffing requirements create a level that effectively restricts contracting-out if contracting-out would cause the agency to fall below that level. Minimum employment levels exist at

the Department of Agriculture's Stabilization and Conservation Service, and its Soil Conservation Service.

-- Restrictive requirements. For example, DOD may not use its funds to complete any A-76 cost study that is more than 24 months old and involves a single activity or that is more than 48 months old if it involves multiple activities.

It is worth noting that in addition to restrictions on contracting-out, there can be similar restrictions on performing activities in-house. For example, we have found that the personnel ceilings set by OMB frequently have the effect of encouraging agencies to contract out regardless of the results of cost, policy, or high-risk studies. Many of the examples of this phenomenon are in the newer, more scientifically oriented agencies such as the Environmental Protection Agency, National Aeronautics and Space Administration, and the Department of Energy,[5] rather than in old-line agencies whose organizational principles and base employment levels were established before aggregate federal employment became a sensitive national issue.

[5] Federal Contracting: Cost-Effective Contract Management Requires Sustained Commitment (GAO/T-RCED-93-2, Dec. 3, 1992); Government Contractors: Are Service Contractors Performing Inherently Governmental Functions? (GAO/GGD-29-11, Nov. 18, 1991); Energy Management: Using DOE Employees Can Reduce Costs for Some Support Services (GAO/RCED-91-186, Aug. 16, 1991).

Competition and Flexibility
to Manage the Government's Work

As I have mentioned, the goal of the A-76 program is to achieve efficiencies by encouraging competition between the federal workforce and private sector for providing services needed by government agencies. This goal, I believe, is shared by both political parties and recently endorsed by the NPR which, among other things, advocated

-- exposing agency operations to competition--with other agencies and private companies and

-- providing agencies with the flexibility to obtain services from the best possible source.

To achieve the A-76 program's goal, our work has shown that once agencies consider the comparative costs of contracting-out versus using in-house personnel and relevant noncost factors, the agencies then need to have the flexibility to have the work performed in the most cost-effective manner.[6] Because of the federal downsizing in progress, agencies may lack the necessary flexibility to perform activities in the manner that is most

[6] Government Contractors: Contracting-Out Implications of Streamlining Agency Operations (GAO/T-GGD-95-4, Oct. 5, 1994).

beneficial to the government. The NPR also recognized this lack of flexibility and suggested eliminating personnel ceilings and allowing federal managers to manage to their budgets--using ceilings on operation costs to control spending. The NPR recognized that personnel ceilings could cause agencies to contract out work that could be done more efficiently in-house.

As Congress and the executive branch continue to revisit issues associated with contracting-out and Circular A-76, we should not lose sight of the underlying objectives of seeking greater effectiveness and efficiency in government operations. Despite the problems experienced in the implementation of Circular A-76, the basic policy of relying on competition to guide procurement decisions in those markets where competition exists makes sense and is generally accepted. We also need to recognize the importance of the A-76 policy in encouraging agencies to systematically review the potential costs of their activities and to consider alternatives. Any prospective revision of Circular A-76 and federal contracting policies should seek to preserve the benefits of fair competition while addressing the concerns of all parties--managers, federal employees, contractors, and taxpayers--about the impediments to its effective implementation.

This concludes my prepared statement, Mr. Chairman. I will be pleased to answer any questions you or the Members of the Subcommittee may have.

RELATED GAO PRODUCTS

Government Contractors: Contracting-Out Implications of Streamlining Agency Operations (GAO/T-GGD-95-4, Oct. 5, 1994).

Air Traffic Control: Status of FAA's Plans to Close and Contract Out Low-Activity Towers (GAO/RCED-94-265, Sept. 12, 1994).

Navy Maintenance: Assessment of the Public and Private Shipyard Competition Program (GAO/NSIAD-94-184, May 25, 1994).

Public-Private Mix: Extent of Contracting-Out for Real Property Management Services in GSA (GAO/GGD-94-126BR, May 16, 1994).

Department of Energy: Challenges to Implementing Contract Reform (GAO/RCED-94-150, Mar. 21, 1994).

Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees (GAO/GGD-94-95, Mar. 10, 1994).

Energy Management: Improving Cost-Effectiveness in DOE's Support Services Will Be Difficult (GAO/RCED-93-88, Mar. 5, 1993).

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OMB Circular A-76: Expected Savings Are Not Being Realized in Ft. Sill's Logistics Contract (GAO/GGD-91-33, Feb. 11, 1991).

Government Printing Office: Monopoly Status Contributes to Inefficiency and Ineffectiveness (GAO/GGD-90-107, Sept. 28, 1990).

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A-76 Program Issues (GAO/T-GGD-90-12, Dec. 5, 1989).

Civilian Agency Procurement: Improvements Needed in Contracting and Contract Administration (GAO/GGD-89-109, Sept. 5, 1989).

Army Procurement: Fort Benjamin Harrison's Commercial Activity Study Should Be Redone or Updated (GAO/NSIAD-89-90, Feb. 24, 1989).

Federal Productivity: DOD's Experience in Contracting-Out Commercially Available Activities (GAO/GGD-89-6, Nov. 28, 1988).

Army Procurement: No Savings From Contracting for Support Services at Fort Eustis, Virginia (GAO/NSIAD-89-25, Oct. 31, 1988).

Air Force Contracting: Contracting For Maintenance of Training Aircraft at Columbus Air Force Base (GAO/NSIAD-88-136BR, Apr. 6, 1988).

Federal Productivity: DOD Functions With Savings Potential From Private Sector Cost Comparisons (GAO/GGD-88-63FS, Apr. 8, 1988).

Contracting-Out for Commercial Activities and Services Under OMB Circular A-76 (GAO/T-GGD-88-7, Jan. 7, 1988).

Federal Workforce: Provisions for Comparing Government and Contractor Retirement Costs Should Be Changed (GAO/GGD-88-25, Dec. 17, 1987).

Federal Productivity: Potential Savings From Private Sector Cost Comparisons (GAO/GGD-87-30, Dec. 31, 1986).

DOD Functions Contracted Out Under OMB Circular A-76: Costs and Status of Certain Displaced Employees (GAO/NSIAD-85-90, July 12, 1985).

Information From Previous Reports On Various Aspects of Contracting-Out Under OMB Circular A-76 (GAO/NSIAD-85-107, July 5, 1985).

DOD Functions Contracted Out Under OMB Circular A-76: Contract

Cost Increases And The Effects On Federal Employees (GAO/NSIAD-85-49, Apr. 15, 1985).

Increased Use of Productivity Management Can Help Control Government Costs (GAO/AFMD-84-11, Nov. 10, 1983).

Synopsis of GAO Reports Involving Contracting-Out Under OMB Circular A-76 (GAO/PLRD-83-74, May 24, 1983).

Review of DOD Contracts Awarded Under OMB Circular A-76 (GAO/PLRD-81-58, Aug. 26, 1981).

GSA's Cleaning Costs Are Needlessly Higher Than in The Private Sector (GAO/AFMD-81-78, Aug. 24, 1981).

Civil Servants and Contract Employees: Who Should Do What for the Federal Government? (GAO/FPCD-81-43, June 19, 1981).

Factors Influencing DOD Decisions To Convert Activities From In-House to Contractor Performance (GAO/PLRD-81-19, Apr. 22, 1981).

(966648)

United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Federal Services, Post Office and Civil Service, Committee on Governmental Affairs, U.S. Senate

March 1994

GOVERNMENT CONTRACTORS

Measuring Costs of Service Contractors Versus Federal Employees

GAO/GGD-94-95

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-256459

March 10, 1994

The Honorable David H. Pryor
Chairman, Subcommittee on Federal Services,
Post Office and Civil Service
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This report responds to your request that we review various reports and testimonies[1] that have been made over the past few years comparing the cost of using contractors versus federal employees to perform services. Your request identified several of these reports and testimonies and asked us to determine whether any others existed. As agreed, we commented on the methodologies used in these documents and identified many of their strengths and weaknesses, and summarized the results.

Background

The federal government spent almost $12 billion in fiscal year 1992 for advisory and assistance service contracts. These contracts include professional, administrative, and management support services and special studies and analyses. The contractors who provide these services can play a valuable role in government, supplying expertise that agencies may not have in-house or may not need on a permanent basis. In addition, these contractors can enable agencies to obtain up-to-date expertise in rapidly changing fields and explore a wide range of knowledgeable viewpoints on controversial issues. Agencies may also find using contractors to be more economical than using federal employees to perform certain services.

Until December 1993, advisory and assistance services were subject to Office of Management and Budget (OMB) guidance under Circular A-120, Guidelines for the Use of Advisory and Assistance Services. This circular established policy, assigned responsibilities, and set guidelines to be followed for determining and controlling the appropriate use of advisory and assistance services. In November 1993, OMB issued Policy Letter No. 93-1, which rescinded Circular A-120. The requirements of A-120 were incorporated into the new policy letter and other policy documents. The policy letter became effective 30 days after issuance.

[1]Throughout this letter we refer to the identified reports and testimonies generically as "studies."

The new policy letter provides more detailed guidance on managing and controlling the use of service contracts including advisory and assistance contracts. The guidance includes issues for responsible management officials to address in analyzing contract requirements. For example, agency officials must ensure that agency requirements are met in the most cost effective manner, considering quality and other relevant factors. While the policy letter emphasizes the cost effectiveness of service contracts, it does not require agencies to develop a cost comparison between contractor and in-house performance.

Federal policy regarding the performance of commercial activities—as opposed to advisory and assistance activities—was established by Circular A-76. This circular requires that cost comparisons be made to determine whether agencies should use contractors or government employees to perform commercial activities, such as automatic data processing, guard and protection services, and maintenance and repair services. An A-76 cost study involves comparing estimated contract and in-house costs for the specific work to be performed to determine the more cost effective approach.

OMB's Cost Comparison Handbook, a supplement to the circular, furnishes the guidance for computing cost comparison amounts. The agency is to prepare a document containing the government's estimate of the lowest number and types of employees required to do the work described. From these data and other estimated costs, the agency is to prepare a total estimated cost for in-house performance. To estimate contractor performance costs, the selected bid or offer is added to other estimated costs, such as contract administration, to develop a total projected cost for contracting out. The circular requires comparisons of the two estimates for the agency to determine which alternative is more cost effective.

Results in Brief

In contrast to the A-76 requirements covering commercial activities, which require cost comparisons, agencies are not currently required to conduct cost comparisons in determining whether to contract for advisory and assistance services. However, our analysis of studies made by GAO, the Department of Energy (DOE), and the Department of Defense (DOD) suggest that cost comparisons can be a useful management tool for assisting government agencies in deciding how to acquire needed services in the most cost effective manner.

In addition to the five studies identified in the Chairman's request, we identified four more. We reviewed all nine. Although the nine studies indicated that savings may be available in certain situations if services were performed by federal employees rather than by contractors, all of the studies had limitations. For example, none were sufficiently large or comprehensive to permit generalization to other situations in the government as a whole, or even within the agencies in question.

The studies also varied in the extent to which they incorporated all possible cost factors. Because Circular A-76 contains an extensive list of items to consider—most of which, we believe, would be equally applicable to advisory and assistance services—we believe it could serve as a useful source of criteria for studies such as these. One study of seven headquarters' administrative, management, and technical support contracts used substantially all of the extensive cost elements contained in OMB Circular A-76. Four additional studies used some, but not all, of these cost elements. The remaining four studies limited their methodologies to determining or estimating direct labor costs and comparing them to contract labor costs.

In addition to cost, we believe agencies would also need to consider other factors in deciding whether to contract out for advisory services. For example, if the advisory services sought were short-term and nonrecurring in nature, it might make sense for an agency to contract out even if it might be less expensive to hire staff to do the work in-house. An agency would also need to consider quality and timeliness of the services required. This would involve determining whether available federal employees had the necessary technical skills or knowledge.

OMB is considering revising its A-76 guidance. This could include extending the cost comparison requirement to include advisory and assistance services. In this regard, we believe OMB should also consider the additional noncost factors discussed in this report.

OMB should also consider the proposals of the National Performance Review (NPR) to encourage competition between the public and private sector in obtaining needed services for the government. However, as it considers revisions to its cost comparison guidance, OMB will need to resolve a potential conflict between the NPR's objective of providing agencies greater flexibility in accomplishing their missions and the current efforts to downsize the government. On one hand, the NPR has advocated (1) giving managers the flexibility to obtain needed services from the best

possible source and (2) eliminating personnel ceilings and permitting managers to manage to budget. On the other hand, the administration has also stated its commitment to reducing the federal workforce by 252,000 employees. Such downsizing could, in effect, create new personnel ceilings rather than eliminate them, with agencies finding themselves in a position of having to contract out to meet the downsizing goal regardless of what cost comparison studies show. The administration and Congress will need to address this apparent contradiction to avoid sending conflicting messages to federal agencies.

Scope and Methodology

To identify the universe of recent cost comparison studies, we conducted an extensive literature search covering the period from fiscal years 1988 to 1993 and made inquiries of OMB, Congressional Research Service (CRS), National Academy of Public Administration (NAPA), DOD, DOE, American Federation of Government Employees (AFGE), a service contractor, Dan Gutman (author of The Shadow Government), and the Professional Services Council (an organization representing the interests of advisory and assistance service contractors). We identified nine reports and testimonies—one report prepared by the DOE's Inspector General (IG), three prepared by the DOD's IG, and two we prepared; two testimonies presented by DOE and DOD officials; and one review we made of our own use of contractors. The reports and testimonies identified are listed in appendix I.

To review the studies' methodologies, we used OMB's A-76 cost elements plus other noncost factors we deemed critical, such as quality and timeliness of services, the availability of federal employees, and whether the work was short-term and nonrecurring or longer term and recurring. We chose the A-76 cost factors because they are comprehensive, reflect the fully allocated cost to the government, and generally include a broad range of cost factors, such as personnel costs, materials and supplies, overhead, contract price, and contract administration. Our study did not include a determination of the accuracy of the agency cost data used. We were concerned primarily with the extent to which the studies' methodologies incorporated the cost elements suggested by OMB.

To review the status of current efforts to improve the way federal agencies obtain needed services, we (1) held discussions with congressional staff with responsibilities related to government contracting activities and OMB officials and (2) reviewed OMB documentation, White House news releases, and newspaper articles. In addition, we reviewed the NPR report, since it

addressed how federal agencies obtain needed services to accomplish their missions.

As requested by the Subcommittee, we did not obtain official agency comments. However, we discussed the results of our work with knowledgeable officials from OMB, DOE, and DOD. Their comments are summarized on pages 12 and 13. We did our review in Washington, D.C., between April 1993 and January 1994 in accordance with generally accepted government auditing standards.

Several Studies Followed A-76 Cost Comparison Principles

Circular A-76 and its Cost Comparison Handbook provide instructions for agencies to consider in developing fair and equitable costs of both government and contract performance. Five of the studies included some of the relevant cost elements in A-76 (see app. III).

The other four studies limited their methodologies to determining or estimating direct agency labor costs and comparing them to contract labor costs. In our view, the five studies that included some of the A-76 cost elements represent a more comprehensive cost comparison methodology. Although the studies illustrate that the A-76 methodology can be used and serve as a useful management tool in deciding how best to obtain needed services, it should be noted that all of the studies have limitations. For example, none was designed to be sufficiently large or comprehensive to permit generalizing to other situations in the government as a whole, or even to the agencies in question.

Appendix II lists the suggested A-76 elements for agencies to consider in developing these costs. For government performance, such costs include direct labor costs, indirect labor costs (such as health and retirement benefits), supplies, and overhead. Contract costs include the contract price and the cost to the government for contract administration.

To illustrate how a study could incorporate such cost elements, we have summarized the study done by DOE's IG. Discussions of each of the nine studies we reviewed are included in appendix IV.

The DOE IG looked at seven headquarters support service contracts that were active as of November 1989, each with an annual cost of over $1 million or required the services of at least 10 full-time equivalents. The seven contracts selected for detailed review were taken from a universe of 54 contracts with an average cost of over $1 million each. The IG

considered all of the cost elements suggested by OMB and used actual contract costs. The IG used the contractor's organizational structure in developing an in-house labor cost estimate. Specifically, with the assistance of a personnel classifier, the IG identified comparable federal positions requiring the same personnel skill levels as the contractor staff. Other in-house expenditures were based on costs stipulated in OMB Circular A-76 or actual agency cost experience.

In addition to personnel costs, the IG's report considered other in-house performance costs suggested by OMB. It included material and supply costs, overhead costs, and one-time costs such as employee recruitment and/or relocation expenses necessary to convert a contract function to government performance. For contract performance, the IG report considered contract costs suggested by OMB, such as the contract price and the cost of contract administration by the government. The contract costs were reduced by the estimated amount of federal income tax the contractors would pay since that amount would be returned to the federal Treasury.

Before approving a conversion from contract to in-house performance on the basis of costs, OMB Circular No. A-76 has established cost margins that must be exceeded. The cost margin is equal to 10 percent of the government personnel-related cost and 25 percent of the acquisition cost of new capital assets—i.e., assets not currently owned by the government and used solely by the in-house operation. DOE's study included this requirement and added these costs to the cost of in-house performance. (See p. 19).

In our view, the DOE IG report illustrates that the A-76 guidance can be applied to support service contracts such as advisory and assistance services and that such a cost comparison can serve as a useful management tool to assist agencies in deciding how to acquire needed services. Among other things, the cost elements contained in A-76 are extensive; by considering all those relevant to support service contracts, agencies should be able to develop comprehensive cost estimates.

With one exception, we have not noted major concerns or criticism of the cost elements contained in A-76. The one concern was raised by the Professional Services Council, which represents the interests of advisory and assistance service contractors. It believes the A-76 guidance is defective in that it does not include all possible costs in the agency overhead cost category.

Currently, OMB Circular A-76 considers overhead to include two major categories of cost—operations overhead and general and administrative overhead. Operations overhead is defined in the Circular as those costs incurred by the first supervisory work center one element above and in support of the function under study. General and administrative overhead is defined as all support costs, other than operations overhead, incurred in support of the function under study.

According to the Circular, a portion of the support costs incurred above the installation level would be theoretically attributable to the function under study. However, for purposes of a cost comparison, the Circular requires the inclusion of only those government support costs that would be eliminated in the event that the function is contracted. This decision is based on the conclusion that costs involved in funding, policymaking, long-range planning and direction would continue and be equally applicable to both in-house or contractor performance.

We agree with OMB's conclusion, and we question (1) the practicality of allocating all possible overhead costs to specific support services under consideration and (2) whether the inclusion of these costs would markedly affect the outcome of a cost comparison analysis. However, we recognize that differences of opinion can occur. As we discuss on page 9, OMB is considering revisions of A-76 and extending the cost comparison requirement to advisory and assistance services. When it proceeds, OMB, in accordance with its normal practice, will likely provide an opportunity for public comment on its intentions, which would provide the Professional Services Council and others an opportunity to voice any concerns they might have.

Noncost Factors That Also Need to Be Considered

For a cost comparison of contracting out versus using federal employees to be a useful management tool for agency decisionmakers, OMB also needs to consider other noncost factors. These include the difference between the quality of services offered by federal versus contractor employees; the timeliness of services available; the availability of federal employees to do the work; the value of flexibility in responding to variable work requirements; and whether the services needed are short-term, nonrecurring in nature, or of a longer term and recurring.

Of the nine cost comparison studies we reviewed, only one addressed noncost factors in the actual analysis. Some of the other studies referred to the factors, but did not include them in the analysis. In the former case,

the agency evaluated the quality and the timeliness of services provided by the contractor on a short-term, "test" contract to determine the feasibility of future reliance on contracting out for certain tasks. The agency used three methods to evaluate the quality of contractor work—peer review of contracted work; external expert ratings of comparable tasks done by agency and contracted staff; and in the case of one type of work, the correction of control errors by the contractor. The contractor's performance was considered to be acceptable in terms of quality. However, in terms of timeliness, the contractor was not able to deliver the needed services as quickly as agency personnel.

In commenting on the DOE IG's study, a DOE official also raised the issue that noncost factors need to be considered. The Director of DOE's Office of Administration and Human Resource Management pointed out management's belief that a process for review and approval of agency requests for support services should also document, as appropriate, factors other than cost that create mitigating circumstances for permitting contracting when a cost comparison shows savings projected for in-house operation. Such factors included the mix of technical skills of required employees, the duration of the work to be done, and the availability of funding. The Director pointed out that without considering these factors, the agency may not be able to contract out work even when it is in its best interests to do so.

An OMB official held similar views. He suggested that under certain circumstances, such as where the work requirements were short-term and nonrecurring, the results of a cost comparison may be a secondary issue. He believed that under these conditions a cost comparison may not be needed.

We agree that such noncost factors should enter into the decisionmaking process. For example, unlike many commercial services currently subject to A-76 guidance that are generally long-term and recurring in nature, advisory and assistance service needs can also be time-critical, nonrecurring, or intermittent in nature. If an agency were faced with such circumstances and did not have federal employees with the necessary technical knowledge and skills, the relative cost of contracting out or hiring additional employees might not be of overriding importance. In our view, however, such decisions would need to be made on a case-by-case basis and properly justified and documented.

OMB Is Considering Requiring Cost Comparisons for Advisory Services

OMB recognizes the importance of obtaining needed federal services at the most reasonable cost to the taxpayers and has emphasized this need in its November 19, 1993, Policy Letter No. 93-1, Management Oversight of Service Contracting. In addition, OMB is considering expanding A-76 cost comparison requirements to include advisory and assistance services as part of an ongoing effort to revise its governmentwide cost comparison guidance and consider the recommendations of the NPR.

OMB's reconsideration of its A-76 guidance is due in part to past criticisms of the program. For example, in December 1989 we testified that in more than 100 reviews, we and other agencies had found that managers generally agreed with the A-76 concept of government/private sector competition, but said that the program was time-consuming, difficult to implement, disruptive, and perceived as threatening to the jobs of federal managers and employees.[2] In revising its A-76 guidance, OMB is considering addressing these issues. It will also consider the results of a comprehensive governmentwide study of contracting policies it conducted. The resulting report entitled Summary Report of Agencies Contracting Practices was issued in January 1994.

Although OMB's observations did not specifically address the issue of performing cost comparisons between in-house and contractor performance, it addressed some related issues. For example, the report said that many agencies do not routinely perform independent cost analyses of the market reasonableness of contractor bids before the renewal, extension, or re-competition of existing contracts. In some cases, cost analyses are not prepared before entering into new contracts.

The report concluded that agencies often assume that additional government personnel will not be authorized and, therefore, the only alternative is to contract for needed services. The report indicated that several agencies requested that they be given more budget flexibility with respect to determining whether work should be performed by agency or contractor staff.

OMB's intention to address these problems when reconsidering its guidance is timely in that it is in accord with many of the concepts advocated in the NPR. Among other things, the NPR has advocated the following:

- Individual agencies should compete with other agencies and private companies to provide support services.

[2] A-76 Program Issues (GAO/T-GGD-90-12)

- Agency managers should have flexibility to obtain services from the best possible source.
- Personnel ceilings should be eliminated and federal managers should be permitted to manage to budget using ceilings on operating costs to control spending. The report recognized that personnel ceilings could cause agencies to contract out work that could be done better and cheaper in-house.

The NPR findings corresponded with our previous observations that federal managers should have the authority and flexibility to obtain services for the government in the most cost effective manner. For example, in our Transition Series Report, The Public Service (GAO/OCG-93-7TR, Dec. 1992), we reported that federal managers have often not had sufficient flexibility to choose between hiring employees or contractors because of restrictive personnel ceilings imposed by OMB or Congress. As a result, agencies frequently used contractors even when they believed it might be more appropriate to use federal employees because of the nature of the work involved or because it would be less costly.

Providing agencies with the needed flexibility to choose between using employees or contractors, however, will be a particularly sensitive issue in light of the administration's overall goal of downsizing the federal workforce by approximately 252,000 positions. Unless agencies are specifically authorized to hire needed federal employees in circumstances where a meaningful cost comparison indicates that in-house performance is desirable, agencies could be in a position of having to contract for services regardless of what a cost comparison study shows. OMB and Congress will need to reconcile this potential conflict as they implement the NPR recommendations.

Conclusions

Although agencies have not been required to make cost comparisons for advisory and assistance services, studies made by us, DOD's IG, and DOE's IG have indicated that cost comparisons can be a useful management tool.

OMB is considering revising its A-76 guidance to address many of the procedural problems and concerns we and other agencies have identified over the past several years. It also plans to consider extending the cost comparison requirement to include advisory and assistance services. OMB's consideration of extending Circular A-76 requirements to include advisory and assistance services is both timely and in harmony with the objectives of the administration's NPR to provide quality service to the public at the

most reasonable cost. Applying a cost comparison requirement to advisory and assistance service would be another step forward in a disciplined approach to ensuring that the government gets the most for its money.

OMB will need to be sensitive to, and allow for, such noncost factors as quality, timeliness, the technical skills of federal employees, and the duration of the work to be done. In addition, OMB and Congress need to be aware that a potential conflict exists between the administration's objectives of (1) giving federal managers the flexibility to obtain needed services from the best possible source and (2) downsizing the federal workforce.

Matter for Consideration by Congress

Congress may want to explore with OMB the best way to reconcile the administration's objective of downsizing the government with the objective of providing federal agencies the flexibility to accomplish the government's work in the most cost effective manner including, where needed, increased competition between the public and private sectors.

Recommendations

We recommend that the Director, OMB, take the following actions:

- As part of its overall effort to improve the procurement of services, OMB should extend a cost comparison requirement to advisory and assistance services. As part of its guidance to agencies in preparing cost comparisons for advisory and assistance services, OMB should recognize that noncost factors also need to be considered and specify any circumstances that might exempt an agency from the cost comparison requirement. However, if a decision is made not to conduct a cost comparison, such a decision should be adequately justified and documented.
- OMB should work with Congress to explore ways to meet the administration's workforce reduction objective and provide agencies with sufficient authority and flexibility to accomplish the government's work in the most efficient and effective manner—either by using government employees or by contract, or some combination of both.

Agency Comments

As requested by the Subcommittee, we did not obtain official agency comments. However, we discussed the results of our work with knowledgeable officials from DOE, DOD, and OMB.[3]

DOE and DOD officials commented on our summaries of their respective agency's cost comparison studies. They generally agreed with our presentation of the studies and provided several suggestions for greater clarity. We have incorporated their suggestions where appropriate.

OMB officials commented on and were in general agreement with the preliminary findings and conclusions in the draft report. They reiterated their intent to consider extending the cost comparison requirement to include advisory and assistance services.

The officials noted that it may not be necessary or practicable to require cost comparisons for all types of advisory and assistance services. In particular, they suggested that in certain circumstances, such as those involving activities where the work requirements are of a short-term and nonrecurring nature, cost comparisons would not be necessary. They suggested that these and other noncost factors be considered before a decision is made to conduct a cost comparison.

We agree that it would be reasonable to first require consideration of noncost factors before making a cost comparison for advisory and assistance services. As we stated earlier in this report, such noncost factors need to be considered and specifically included in OMB guidance. We believe, however, that OMB should require agencies to adequately justify and document decisions not to conduct cost comparisons and not allow agencies to use these factors solely as a basis for avoiding the comparisons.

OMB officials offered the opinion that consideration of the comparative costs of contracting versus in-house performance should relate not only to those activities that may be performed by contractors but to those activities already being performed by the government as well. The officials also expressed concern that to be fully reliable, contractor cost estimates should reflect the best prices available in the market place—obtainable

[3]We discussed the draft with the Director, Management Systems, DOE, and two other DOE officials. We met with a Procurement Analyst from the Office of the Secretary of Defense, DOD, and twelve other DOD officials. We also met with an OMB Policy Analyst from the Federal Services Branch and two other OMB officials. The Analyst said that although the matters discussed in the draft report were under the Analyst's area of responsibility, the Analyst was not able to speak officially for OMB without having the draft report submitted to the agency for formal comment.

through the competitive process. They said that existing advisory and assistance contracts may not have always incorporated the most efficient practices and, as a result, may not reflect the best price of contract services available to the government. We believe OMB's comments have merit and expect that OMB will consider these matters as part of its reconsideration of the A-76 process.

The OMB officials provided other comments of a technical nature that have been incorporated where appropriate.

We are sending copies of this report to the Director of the Office of Management and Budget and the Secretaries of the Departments of Defense and Energy. We are also providing copies to the ranking minority member of the Subcommittee on Federal Services, Post Office and Civil Service, Committee on Governmental Affairs, and other appropriate congressional committees. Copies will be made available to other interested parties upon request.

The major contributors to this report are listed in appendix V. If you have any questions about this report, please call me on (202) 512-5074.

Sincerely yours,

Nancy Kingsbury
Director
Federal Human Resource Management
Issues

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Abbreviations

AFGE	American Federation of Government Employees
CRS	Congressional Research Service
DOD	Department of Defense
DOE	Department of Energy
EPA	Environmental Protection Agency
IG	Inspector General
NAPA	National Academy of Public Administration
NPR	National Performance Review
OMB	Office of Management and Budget

Appendix I

Reports and Testimonies Reviewed by GAO

1. Department of Energy Office of Inspector General: Audit of the Cost-Effectiveness of Contracting for Headquarters Support Services (DOE/IG-0297, Aug. 30, 1991).

2. Department of Defense Office of the Inspector General: Audit Report on Contracted Advisory and Assistance Services Contracts (No. 91-041, Feb. 1, 1991).

3. GAO: Energy Management: Using DOE Employees Can Reduce Costs for Some Support Services (GAO/RCED-91-186, Aug. 16, 1991).

4. Testimony of Donna R. Fitzpatrick, Assistant Secretary for Management and Administration, DOE, before the Subcommittee on Federal Services, Post Office and Civil Service, Senate Committee on Governmental Affairs, September 6, 1989.

5. Testimony of Ambassador Henry F. Cooper, Director, Strategic Defense Initiative Organization, DOD, before the Senate Committee on Governmental Affairs, July 24, 1992.

6. GAO: Letter from the Comptroller General to the Chairman, Legislative Subcommittee, House Committee on Appropriations, on the expanded use of contractors to help with GAO's audit and evaluation work, February 28, 1991.

7. GAO: Government Contractors: Are Service Contractors Performing Inherently Governmental Functions? (GAO/GGD-92-11, Nov. 18, 1991).

8. Department of Defense Office of the Inspector General: Audit Report on Consulting Services Contracts for Operational Test and Evaluation (No. 91-115, Aug. 22, 1991).

9. Department of Defense Office of the Inspector General: Audit Report on Selected Services Contracts at Wright-Patterson Air Force Base (No. 92-128, Aug. 17, 1992).

OMB Circular No. A-76 Cost Comparison Criteria

OMB's Circular No. A-76, Cost Comparison Handbook provides detailed instructions for developing a comprehensive comparison of the estimated cost to the government of acquiring a service by contract and of providing the service with in-house government resources. The specific cost elements that agencies need to consider are illustrated in table II.1.

Table II.1: OMB Circular A-76 Cost Comparison Criteria—Expansions, New Requirements, and Conversions to In-House Performance

In-house performance costs
Personnel costs[a]
Material & supply cost
Other specifically attributable costs[b]
Overhead cost[c]
Cost of capital[d]
One-time conversion cost[e]
Additional costs[f]
Total in-house costs
Contract performance costs
Contract price
Contract administration[g]
Additional costs[h]
One-time contract conversion costs[i]
Gain or loss on disposal/transfer of assets[j]
Federal income tax deduction[k]
Total contract costs
Decision
Conversion differential[l]
Total
Cost comparison
Cost comparison decision (check block) / / Accomplish in-house / / Accomplish by contract

(Table notes on next page)

GAO Notes:

[a]Personnel costs include 29.55 percent for retirement, life insurance, health insurance, and miscellaneous benefits.

[b]Include depreciation, rent, maintenance and repair, utilities, and insurance (the government is self-insured and must pay for each loss incurred).

[c]Operations overhead and general and administrative overhead.

[d]New investment in facilities and equipment.

[e]Office and plant rearrangements; employee recruitment, training, and relocation; and expenses resulting from discontinuing an existing contract or expanding the in-house operations.

[f]Any government costs not classified by other cost elements resulting from unusual or special circumstances.

[g]Costs incurred by government to ensure execution of contract.

[h]Costs for unusual or special circumstances such as transportation or purchased services.

[i]Based on government discontinuing an existing activity and obtaining a service by contracting.

[j]Based on reduction in government assets.

[k]Revenue from contractor that reduces net contract costs.

[l]Total in-house costs must be increased by certain differential costs for personnel and overhead before they are compared to the total contract costs.

Source: OMB Circular No. A-76, Cost Comparison Handbook

Extent to Which DOE IG, DOD IG, and GAO Studies Used OMB Circular A-76 Cost Comparison Criteria[a]

OMB A-76	DOE/IG-0297	DOD/IG-91-041	GAO/RCED-91-186	DOD/IG-91-115	DOD/IG-91-128
In-house performance costs					
Personnel costs	x	x	x	x[e]	x[g]
Material & supply	x				
Other specifically attributable costs	x			x[e]	
Overhead costs	x				
Cost of capital	x				
One time conversion cost	x		x		
Additional costs	x		x		
Total in-house costs	x		x	x[e]	
Contract performance costs					
Contract price	x[b]	x[c]	x[bd]	x[f]	x[c]
Contract administration	x				
Additional costs	x				
One-time contract conversion costs	x				
Gain or loss on disposal/ transfer of assets	x				
Federal income tax deduction	x				
Total contract costs	x				
Decision					
Conversion differential	x				
Total	x	x	x	x	x
Cost comparison	x	x	x	x	x

Legend

x equals the criteria that were met

Notes:

[a]This analysis is based on the five studies that used all or some of the A-76 cost elements.

[b]Based on actual expenditures for contractor's work.

[c]Based on contract labor rates and hours.

[d]Certain items, such as federal income tax, were considered but not included.

[e]Based on hourly costs, including salary, fringe benefits, office space, and miscellaneous costs.

[f]Based on hourly costs, including labor, overhead, general and administrative expenses, and profit.

[g]Based on hourly costs, consisting of hours times the rate per hour.

Appendix IV

Summary of Reports and Testimonies Reviewed

We reviewed nine reports and testimonies that compared costs of performing advisory and assistance type support services with contractor and in-house resources. Five used some of the cost elements suggested in OMB's Circular No. A-76. The remaining four limited their discussion to actual or estimated labor costs. We have summarized all nine.

The five studies that most closely followed the A-76 cost comparison criteria were done by the Inspectors General at DOE and DOD, and by us.

Audit of the Cost Effectiveness of Contracting for Headquarters Support Services (DOE/IG-0297)

This report to the Secretary of Energy contained the results of an audit of contractor costs for support services at DOE Headquarters by the Department IG. It most closely followed OMB's A-76 criteria and used all of the prescribed OMB cost comparison elements.

The study was based on cost comparisons for seven headquarters' support service contracts dealing with management, technical, and administrative assistance that were active in November 1989. Overall, it cited estimated average savings of 40 percent through government performance of these activities, ranging from 26 to 53 percent.

An example of the cost comparison made for one of the contracts in the study is shown in Table IV.1.

Table IV.1: Example of Cost Comparison Used in DOE IG Report (DOE/IG-0297)

In-house performance costs	
Personnel costs	$231,045.51
Material & supply	2,062.50
Other specifically attributable costs	10,463.09
Overhead costs	
Personnel	45,515.96
Operations	0.00
Cost of capital	21.00
One-time conversion cost	6,875.00
Additional costs	0.00
Total in-house costs	**$295,983.06**
Contract performance costs	
Contract price	$460,200.30
Contract administration	26,608.30
Additional costs	0.00
One-time contract conversion costs	0.00
Gain or loss on disposal of assets (expansion)	0.00
Federal income tax (deduct)	(8,283.60)
Total contract costs	**$478,525.00**
Decision	
Conversion differential	$ 27,661.40
Total	**$323,644.46**
Cost comparison	$154,880.54 32.366%
Cost comparison decision (check block) /x/ Accomplish In-House / / Accomplish by Contract	

Source: DOE IG workpapers for audit report, DOE/IG 0297.

Audit Report: Contracted Advisory and Assistance Service Contracts, DOD IG Report, (No. 91-041)

This report to DOD officials contained the results of an audit of contracted advisory and assistance services. The primary objective of the audit was to determine the adequacy of management controls. The IG also considered, however, the cost effectiveness of contracting for services.

This study was based partially on OMB A-76 criteria and examined four long-term work requirements for contract obligations in fiscal year 1987. Work performed under each contract had continued for more than 5 years. According to the IG, the cost comparisons did not include facilities and

additional administrative costs that might be required if the services were performed in-house.

Contract costs consisted of actual contract labor, travel, and miscellaneous costs. Other OMB-specified costs, such as government contract administration, conversion costs, and gain or loss on disposal of assets, were not included. Also, a deduction for federal income tax was not made. The government costs were limited to labor plus fringe benefits and did not include material and supply costs, other specifically attributable costs, overhead, capital costs, and one-time conversion costs. The work did not require specialized skills and, as a result, the IG said it was possible to identify the Civil Service equivalent of the contractor employees.

The IG cited a range of 37 percent to 51 percent in estimated savings for the four work requirements reviewed through in-house performance.

An example of the cost comparison for one of the contracts involving administrative and technical support services is shown in table IV.2.

Table IV.2: Example of Cost Comparison Used in DOD IG Report (No. 91-041)

Government GS/contractor equivalents	GS-9/5 Engineer Assistant	GS-10/5 Junior Engineer	GS-12/5 Senior Engineer	GS-13/5 Project Engineer
Government GS base salary (1987)	$25,454.00	$28,028.00	$36,911.00	$43,891.00
Hourly rate	$14.60	$16.07	$21.16	$25.17
OMB A-76 benefit cost factors				
Retirement at 21.70 percent	3.17	3.49	4.59	5.46
Medicare at 1.45 percent	.21	.23	.31	.36
Life & health insurance at 4.70 percent	.69	.76	.99	1.18
Miscellaneous fringe at 1.80 percent	.26	.28	.38	.45
Government rates with benefit costs	$18.93	$20.83	$27.43	$32.62

Contract labor categories	Contract rate	Contract hours	Total contract costs	Government rates x contract hours	Government cost	Savings - in-house
Project engineer	$48.44	3,180	$154,039.20	32.62 x 3,180	$103,731.60	$ 50,307.60
Senior engineer	41.75	17,810	743,567.50	27.43 x 17,810	488,528.30	255,039.20
Junior engineer	35.68	19,995	713,421.60	20.83 x 19,995	416,495.85	296,925.75
Engineer assistant	30.50	14,410	439,505.00	18.93 x 14,410	272,781.30	166,723.70
Travel, miscellaneous			24,711.54		22,824.00	1,887.70
Total cost			**$2,075,244.84**		**$1,304,361.05**	**$770,883.79**[a]

[a]Percentage of savings if performed in-house is 37 percent.

Energy Management: Using DOE Employees Can Reduce Costs for Some Support Services (GAO/RCED-91-186, Aug. 1991)

This report to Senator David H. Pryor contained the results of cost comparisons made at his request of twelve support service contracts.

The study was based partially on OMB A-76 criteria and considered twelve contracts that were active in fiscal year 1990. Overall, our methodology tended to overstate the cost of federal performance so the comparison would not be biased in favor of the federal sector.

We compared contract performance costs to in-house performance costs that consisted of labor costs, fringe benefits, one-time costs to convert activities to in-house performance, and training costs. For the most part,

contractors were using government space and equipment. Therefore, these costs were not added to either side of the equation.

In the interest of conservatism, in estimating labor costs for in-house performance, we used the top salary level for each position, rather than the middle level specified in the OMB guidance. We also did not add the cost of DOE's contract administration to the contract costs. This tended to understate the cost of contractor performance so there would not be a bias in favor of the government.

We did not subtract the contractor's potential income tax payment from the contractor's cost because we believed the amount would be minimal for the contracts reviewed.

Overall, we estimated that DOE could have achieved savings for 11 of the contracts we reviewed, ranging from 3.1 to 55.4 percent, with an average of 25.4 percent if the work were done in-house.

The study results were not generalizable because the selection methodology favored contracts that agency officials suggested could be performed less expensively by federal personnel.

For one of the contracts we reviewed, the in-house performance costs were estimated to be 9 percent higher than the contract performance costs. An example of our analysis for one contract we reviewed is shown in table IV.3.

Table IV.3: Example of Cost Comparison Used in GAO Report (GAO/RCED-91-186)

Contract performance costs	$5,398,000
In-house performance costs	
Labor costs	$3,000,449
Fringe benefits	886,633
One-time costs to convert to in-house performance	231,200
Training costs	32,500
Total in-house performance costs	$4,150,782
Difference	$1,247,218[a]

[a]Estimated percentage of difference to in-house performance costs is 30 percent.

Audit Report: Consulting Services Contracts for Operational Test and Evaluation, DOD IG Report, (No. 91-115)

This report to DOD officials summarized the results of an audit requested by Congresswoman Barbara Boxer. The report addressed advisory and assistance services contractors that participated in the development, production, testing, and evaluation of major defense systems. One objective of the study was to determine whether using services contractors to provide support for operational tests was more cost effective than developing a capability to perform the work in-house.

The report stated that the military departments' operational test agencies used repeated and extended service contracts that were not as cost effective as developing an in-house capability to perform the work. The report estimated that the agencies could save about $26 million from fiscal years 1992 to 1996, by gradually reducing their service contracts by 60 percent. The report further estimated that contracting costs were between 21 and 40 percent higher than in-house performance.

The report compared contractor total hourly costs with estimated hourly costs for various levels of civilian government personnel. Total contractor hourly costs included such factors as hourly labor costs, overhead, general and administrative expenses, and profit. Government hourly costs included salary, retirement, medicare, life and health insurance, fringe benefits, office space, and other miscellaneous costs.

An example of the cost comparison for one of the contracts is shown in table IV.4.

Table IV.4: Example of Cost Comparison Used in DOD IG Report (No. 91-115)

Labor category	Hourly cost of contractor services	Equivalent government grade	Hourly cost of government employees	Difference between in-house costs and contracted services	Percentage difference between in-house costs and contracted services
Management	$82.19	GM-15/5	$51.01	$31.18	37.94
Research staff member	62.63	GS-14/5	42.77	19.86	31.71
Editors and miscellaneous	39.50	GS-13/5	35.88	3.62	9.16
Graduate students, research assistants, and program analyst	34.62	GS-09/5	21.61	13.01	37.58
Support staff	22.78	GS-05/5	14.91	7.87	34.55
Total	**$241.72**		**$166.18**	**$75.54**	**31.25**

Calculation of hourly costs for contractor services

Labor category	Hourly rate	Overhead rate at 48 percent	Fringe benefits of 42 percent	General and administrative at 6.8 percent	Profit at 4.25 percent	Total hourly cost
Management	$38.85	$18.65	$16.32	$5.02	$3.35	$82.19
Research staff member	29.61	14.21	12.43	3.83	2.55	62.63
Editors and miscellaneous	18.68	8.96	7.84	2.41	1.61	39.50
Graduate students, research assistants, and program analysts	16.37	7.86	6.87	2.11	1.41	34.62
Support staff	$10.77	$5.17	$4.52	$1.39	$0.93	$22.78

Audit Report: Selected Service Contracts at Wright-Patterson Air Force Base, DOD IG Report (No. 92-128)

This report to DOD officials, concerning eight specific support service contracts at Wright-Patterson Air Force Base valued at about $132 million that were active during fiscal years 1986 to 1991, summarized the results of an audit requested by Senator David H. Pryor. One issue covered in the audit was to determine whether the cost of contracting was greater than the cost of in-house performance.

The report concluded that the Air Force paid $4.7 million in additional costs for certain contractor work in fiscal year 1990 and could save up to $6.2 million if the work to be performed under the optional years of the contracts reviewed were performed in-house. The report recommended that the Air Force eliminate personnel ceilings, require managers to justify the most cost-effective mix of in-house or contractor personnel, evaluate

support service contracts for cost effectiveness, and make budget adjustments to shift funds from contracts to civilian manpower.

The audit report identified Air Force civilian job categories that were comparable to the skill and experience levels of contract employees. The study compared the contractor amounts billed with the total hourly costs for government civilian employees.

An example of the comparison made for one of the contracts is shown in table IV.5.

Table IV.5: Example of Cost Comparison Used in DOD IG Report (No. 92-128)

Labor category	Hours	Rate	Amount billed	GS equivalent grade level	GS equivalent category	GS total rate per hour	GS total hourly annual cost[a]	Excess cost[b]
A	50	$19.79	$ 990	04/03	A-1	$11.48	$ 574.00	$ 416.00
B	247	25.43	6,281	04/10	B-1	15.24	3,764.28	2,516.72
C	162	37.05	6,002	06/10	C-1	18.53	3,001.86	3,000.14
D	140	73.33	10,266	13/10	D-1	40.88	5,723.20	4,542.80
E	50	60.25	3,013	13/10	E-1	39.52	1,976.00	1,037.00
F	320	64.46	20,627	12/10	F-1	34.68	11,097.60	9,529.40
G	725	54.59	39,578	12/10	G-1	33.32	24,157.00	15,421.00
H	315	49.18	15,492	12/03	H-1	28.80	9,072.00	6,420.00
I	295	53.46	15,771	13/03	I-1	33.88	9,994.60	5,776.40
J	200	34.88	6,976	07/01	J-1	16.11	3,222.00	3,754.00
K	73	55.59	4,058	07/10	K-1	20.38	1,487.74	2,570.26
L	450	70.88	31,896	13/10	L-1	40.88	18,396.00	13,500.00
Total[c]			**$160,950**	**Total[d]**			**$92,466.28**	**$68,483.72**

[a]GS total hourly annual cost equals hours times the GS total rate per hour.

[b]Excess cost equals amount billed minus GS total hourly annual cost.

[c]Labor dollars per contractor.

[d]GS cost comparison and cost differential.

Other Testimonies and Reports

The following four testimonies and studies also addressed contractor versus in-house costs, but in a less detailed manner.

DOE Testimony: Use of Consultants and Contractors by the Environmental Protection Agency and the Department of Energy

In testimony on September 6, 1989, before the Subcommittee on Federal Services, Post Office and Civil Service, Senate Committee on Governmental Affairs, the Assistant Secretary for Management and Administration, DOE, cited estimated savings through in-house performance versus contractor performance of 20 to 25 percent for support services.

According to DOE officials, no specific study was conducted to support this estimate. The Assistant Secretary was responding to a question raised at the hearing. The Assistant Secretary also said, however, in responding to questions that were based solely on direct salary costs, excluding benefits and overhead, DOE would pay a GS-15 government employee about $67,000. The comparable private sector employee would be paid between $77,000 and $100,000. (The mid-point between these amounts would be about $89,000. The difference between $89,000 and $67,000 is $22,000, equal to about 33 percent higher than the federal salary.)

DOD Testimony: The Star Wars Program and the Role of Contractors

In testimony on July 24, 1992, before the Senate Committee on Governmental Affairs, the Director of the Strategic Defense Initiative Organization, in discussing the role of contractors, cited estimated savings through in-house performance versus contractor performance for certain agency work of about 33 percent or $15 million.

We were advised by an official of the Ballistic Missile Defense Organization (the organization that replaced the Strategic Defense Initiative Organization) that the Director's testimony was based on information being developed for a study on the agency's manpower requirements.

The study, Strategic Defense Initiative Organization: Manpower Requirements Proposal for FY 93-95 was issued in October 1992. The study did not discuss specific savings estimates for in-house performance, however, the study discussed the reallocation of funded resources from contractor support services to government personnel. The study stated that additional government personnel would result in a more efficient and effective management program and ensure that inherently governmental functions and suitable program oversight were always performed by government personnel. The study proposed increasing government staff by 453 positions from fiscal year 1993 to 1995. We were advised by responsible agency officials that 100 additional positions were authorized

for fiscal year 1994, and that 100 additional positions were being requested in the President's Budget for fiscal year 1995.

GAO Letter From the Comptroller General to the Chairman, Legislative Subcommittee, House Committee on Appropriations (February 28, 1991)

In response to a request from the Chairman, Legislative Subcommittee, House Committee on Appropriations, we reported on February 28, 1991, on the expanded use of contractors to help with our audit and evaluation work. We discussed the results of a study of 78 tasks, of which 56 were contracted out and 22 were done in-house. In addition to cost, our study also considered the timeliness and quality of the work in question.

We did not make full cost analyses, but we did compare negotiated contract labor charges with estimated in-house labor costs, including fringe benefits, for seven specific tasks. We estimated the average hourly cost to accomplish each type of work. The cost of in-house performance was estimated to be close for four and lower for three of the seven types of work considered—such as mailing, telephone surveys, individual or group interviews, data collection instrument design, statistical analysis, and referencing (checking facts in GAO products). Costs were the same for the seventh type of work considered—database management. We found that contractor costs were estimated to be higher because in virtually all cases, the contractor either assigned more senior staff to the task than GAO did or the contractor paid comparable staff higher salaries.

We also noted that with some variation across the different kinds of work we contracted, contractors' products typically were not delivered at the specified time, and GAO staff reported doing similar work somewhat faster internally. We noted, however, that the quality of contractors' work was generally acceptable, with simpler tasks completed more successfully than more complex tasks.

GAO Report: Government Contractors: Are Service Contractors Performing Inherently Governmental Functions? (GAO/GGD-92-11)

We discussed, among other things, a DOE effort to replace certain contract personnel with government personnel. One DOE component—the Western Area Power Administration—estimated it could save about $4.5 million annually through the conversion of 105 positions that were then held by contractors to federal positions. The services involved included such work as construction inspections, engineering surveys, environmental support, and design and system studies. This work did not involve inherently governmental functions or work so intimately related to the public interest that it must be administered by government employees.

These estimated savings were based on a comparison of the cost of converting the higher cost contract personnel to lower cost federal staff. The federal costs were based on an estimate that the cost of federal employees at the GS-12 level, plus their applicable fringe benefits, would be substantially less than the cost of a comparable number of contractor personnel. These calculations were made for seven contracts.

Appendix V

Major Contributors to This Report

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SUMMARY REPORT OF AGENCIES' SERVICE CONTRACTING PRACTICES

Office of Management and Budget
Office of Federal Procurement Policy

January 1994

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EXECUTIVE SUMMARY

INTRODUCTION.

Service contracts, as distinguished from contracts for supplies and equipment, are designed to be used by agencies to acquire knowledge and skills that are either not available in the government or that are available in the private sector at a lesser cost. Service contracts are also used by agencies and departments to fulfill temporary or intermittent needs and requirements of the government. The acquisition of services is the fastest growing area of government procurement and accounted for $105 billion of the government's $200 billion FY 1992 procurement program.

On March 15, 1993, Office of Management and Budget (OMB) Director Leon Panetta requested that 17 major Executive branch agencies and departments review their service contracting programs. The purpose of the review was to determine (1) if the service contracts were accomplishing what was intended; (2) whether the contracts were cost effective, and (3) whether inherently governmental functions were being performed by contractors. The results of the agency and departmental reviews were reported to OMB in July 1993. This report provides an overview of the reports submitted to OMB by the agencies and departments.

RESULTS OF THE REVIEWS.

The reports submitted in response to Director Panetta's request indicate that contracting practices and capabilities are uneven across the Executive branch. Most agencies conducted thorough, critical analyses of their programs. The reports submitted by these agencies tended to note that significant improvements are needed to ensure that the government is getting its money's worth from service contractors. Other agencies submitted less critical reports, and it is difficult to assess whether the contracting programs of these agencies are indeed better managed or whether their reviews were less candid.

In spite of the unevenness in the quality of the agency contracting programs and of the reviews, several consistent findings and themes were presented in almost all of the agency reports. These findings are:

- Government reliance on contracted services is increasing and many agencies are being required to do more with less staff.

- Contracting personnel concentrate on the award of contracts and the obligation of funds. Contract administration, particularly in most civilian agencies, is conducted by agency program staff and not by contracts personnel. The program staffs are often ill-trained in contract administration.

- Cost analyses and independent government cost estimates are not performed by many agencies prior to the renewal, extension, or re-competition of existing contracts. In some instances, cost estimates are not prepared prior to entering into new contracts.

the bank — we're still spending the $, just on more-exp. outside help — reduce 252 pos w/out tight restricts here, the use of contract (history shows no) will go ↑.

- Agencies often assume that additional government personnel will not be authorized and, therefore, there is no alternative but to contract for needed services. Several agencies requested that they be given more budget flexibility with respect to determining whether work should be performed by agency or contractor staff. Examples were reported where the government (based on the agencies' projections) could save several millions of dollars by performing functions directly rather than having them performed by contract.

- The contracting process is viewed by both contracting and program personnel as being overly burdensome, complex and time consuming. As a result, agencies are increasing their reliance on task order contracting instruments, and in many cases orders are often placed without the benefit of open competition or market research. In addition, the services are not always reviewed prior to acceptance or payment.

Furthermore because burdensome, even more sloppy in awarding

- The statements-of-work used to describe the specific tasks or services to be procured by contract are frequently so broad and imprecise that vendors are unable to determine the agency's requirements. As a result, competition is limited and performance cannot be assessed.

CORRECTIVE ACTIONS.

All of the agencies made recommendations and proposed various actions to address the above problems. Director Panetta has requested OMB's Office of Federal Procurement Policy (OFPP) to oversee the implementation of the corrective actions. Actions planned by OFPP to address the problems include:

- Convening an interagency work group to develop solutions and appropriate policies covering requirements for cost estimating, cost analysis and the preparation of work statements;

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- Issuing new guidance on how to administer contracts including the imposition of minimum qualification and training requirements for contract administrators, and

- Convening a high level OMB-led committee to oversee implementation of recommendations made in a December 1992 report for improving contract audit practices within the government.

I. INTRODUCTION

Services contracting is the fastest growing area of Government procurement and has increased to the point where contracts for services now account for 53 percent of Executive agency procurement expenditures -- over $105 billion in Fiscal Year 1992. As shown in Figure 1, below, service contracts now account for over 90 percent of the procurement dollars in some agencies.

Figure 1

VOLUME OF SERVICES CONTRACTING
FY 1992

AGENCY	SERVICE $'S*	% OF CONTRACT $'S
Agriculture	$712,375	19.2%
Commerce	$318,495	42.9%
Defense	$60,872,999	45%
Education	$279,256	92.6%
Energy	$18,360,275	98.7%
HHS	$2,119,934	68.6%
HUD	$197,198	93.7%
Interior	$1,305,041	67.6%
Justice	$1,054,493	50.7%
Labor	$732,886	92.2%
State	$592,339	61.8%
Transportation	$1,971,754	60.7%
Treasury	$705,818	38.9%
Veterans Affairs	$1,532,384	37.7%
EPA	$1,199,240	89.3%
GSA	$1,987,268	34.1%
NASA	$9,067,782	73.1%
OTHERS	$2,249,275	
TOTAL:	$105,258,812	52.6%

* in thousands of dollars

Source: FPDS

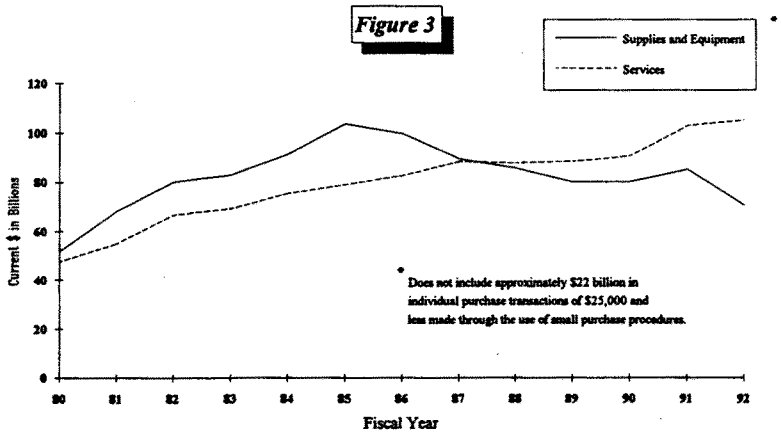
The types of services acquired by contract range from routine maintenance and security services to contracts for basic research and applied engineering. An illustrative list of the different types of services acquired by one major department (the Department of Energy) is shown in Figure 2. Figure 3 illustrates the growth in service contracts over the period beginning with FY 1980.

Figure 2

Illustrative List of the Types of Services Acquired under Contract

Computer Modeling	ADP Support	Engineering Analysis
Janitorial Services	Asbestos Removal	Security/Guard Services
Environmental Services	Systems Engineering	Facility Operations
ADP Maintenance	Software Services	Architect-Engineering Services
Analytical Services	Economic Analysis	Data Collection/Analysis
Legal Services	Network Management	Oil and Gas Market Analysis
Audit Services	Quality Assurance	Environmental Restoration
Educational Services	Safety and Health	Financial Analysis
Staffing Assessments	Operations Research	

Figure 3



With the increase in dependency on contracted services, associated abuses and problems have also increased. Senator Pryor, Congressman Dingell, the Inspectors General, and the General Accounting Office (GAO) have all expressed concerns with certain aspects of contracting for services.

Examples of problems frequently highlighted in the various Congressional hearings, press accounts, and GAO and Inspectors General reports include:

- Contractors Performing Inherently Governmental Functions. Until recently, there was no clear guidance to distinguish between functions that contractors may appropriately perform and inherently governmental functions; i.e., functions that must be performed by Government personnel. One of the more publicized instances of an inherently governmental function being performed by a contractor related to a situation where a contractor wrote the opening statement that a Cabinet Secretary was to give to a Congressional committee.

- Conflicts of Interest. Persons providing advisory and assistance services to the Government are especially vulnerable to conflicts of interest. A prior instance was reported where a contractor, hired to provide assistance in securing passage of the U.S.-Japan Nuclear Non-Proliferation Treaty, also had an affiliate in Japan whose clients included the Japanese Ministry of International Trade and Industry.

- Failure to Obtain Fair Value. Numerous instances have occurred over the last several years where the Government has not obtained full value for its contracting dollars. Recently publicized instances of this problem relate to the Hubble Telescope and to over spending associated with the Superconducting, Super Collider.

To help correct the above problems, the Office of Federal Procurement Policy (OFPP) issued several new policies over the last several years. Those policies are:

1. OFPP Policy Letter 89-1, Conflict of Interest Policies Applicable to Consultants (December 8, 1989);

2. OFPP Policy Letter 91-2, Service Contracting (April 9, 1991);

3. OFPP Policy Letter 92-1, Inherently Governmental Functions (September 23, 1992); and

4. OFPP Policy Letter 92-5, Past Performance Information (December 30, 1992).

In addition to the policy actions, OFPP led a major review during the Summer of 1992 to examine and assess contract administration and contract auditing practices in 12 major civilian agencies. This review was conducted by interagency "SWAT Teams" and resulted in a comprehensive report issued in December 1992. The SWAT report identified the need for additional policy and regulatory changes that are now in the process of being implemented. These changes primarily relate to the clarification of the unallowable cost principles contained in Part 31 of the Federal Acquisition Regulation (FAR); changes in how civilian agencies have contract audits performed, and changes in contract administration practices.

In recognition of the need to involve the new Administration in service contracting reforms, and in an effort to identify possible budget savings opportunities, Office of Management and Budget (OMB) Director Leon Panetta, in March 1993 asked 17 of the largest departments and agencies to review their service contracting programs and to report their findings to OMB by June 30, 1993. These agencies and departments represent over 90 percent of all Government procurement expenditures and each was requested to answer the following three questions:

1. Are your existing contracts accomplishing what was intended?

2. Do you have adequate procedures in place to monitor such services to evaluate their cost effectiveness, to hold such contractors accountable for results, and to ensure the Government gets what it is paying for?

3. Are you certain that the services being performed by contractors are not "inherently governmental?"

Reports have now been received from the 17 agencies and departments that were tasked by Director Panetta to make the service contracting "self assessments." The findings from these reports with respect to the substantive questions asked by Director Panetta are summarized in Chapters 2, 3, and 4 of this report. An overview of the methods used by the agencies in conducting their reviews is shown in Appendix 1. The recommendations made by the agencies to correct the various problems identified during their reviews are listed in Appendix 2. Chapter 5 provides a discussion of the major recommendations.

II. ACCOMPLISHMENT OF INTENTIONS

Contracts are awarded to help accomplish authorized mission needs of the awarding agencies. The extent that contractors accomplish mission objectives is influenced primarily by the agencies in preparing for, awarding and administering contracts, and secondly, by the contractors in performing contract tasks. The reports submitted by the agencies indicate that contractors are generally delivering what the contracts intended. It is clear, however, that there are problems in several agencies. These problems begin with the development of the statements-of-work (SOW) and run throughout the administrative process including the actual oversight and monitoring of contractor performance.

AGENCY FINDINGS.

All 17 agencies responded that their contracts were accomplishing what they intended. However, in almost every case, the agencies stated that there was room for improvement. Several concerns of the agencies identified during the reviews are:

- Inability to Write Adequate Statements-of-Work. Several agencies found serious deficiencies in their ability to develop adequate statements of work (SOW). Agriculture, Education, Interior and others found several instances where the SOWs were too vague or too broad. The State Department indicated that in-house capability to develop adequate SOWs is so lacking that they now find themselves in a position where they have to resort to contracting for such services. State says they would prefer to do SOWs in-house, but do not have trained personnel in-house to perform this function.

- Complexity of the Procurement Process. In several instances, the problems experienced by agencies are closely related to the time which it takes to complete a procurement action. Education stated that, "by the time we get what we ask for, it may no longer be what we need." An office's needs evolve over time, and Education stated that a less complicated system for awarding contracts is needed to accommodate the changing demands of their program offices.

- Failure to Communicate Between the Contracting Officer's Technical Representative (COTR) and the Contracting Officer. The Department of Defense cited two instances where contract files indicated contractor performance problems. According to their review, one of the contracts did not adequately communicate the criteria that the contractor was expected to meet. In

another situation, there was a general failure to perform part of the contract. In this situation, the contracting officer was not aware that the COTR had been attempting for almost a year to resolve problems that appear to have breached the contract. The contractor had failed from the outset to provide the number and kind of personnel required by the contract, to deliver satisfactory reports and in many cases had not delivered reports at all. Although the COTR had actively attempted to resolve the problems, failure to communicate the extent of the problems to the contracting officer precluded the Government's ability to exercise its rights under the contract. Such examples of poor communications between COTR's and contracting officers are not considered to be unique to DOD.

- Poor Management. The Justice Department found numerous and recurring problems stemming from a failure to properly implement established policies. Justice found deficiencies in areas that include oversight of contractor performance, the use of untrained COTRs, and a failure to follow-up on contract terms and conditions. Justice states that despite all the policies and procedures that are in place, more active, aggressive oversight is needed. Furthermore, the report stated, "in our view, the root of the problem lies in poor management and the lack of accountability for the failure to perform the required oversight functions." Justice intends to establish appropriate standards and incorporate them into the individual work plans of all procurement personnel.

CONCLUSION.

Although the agencies indicated few specific instances of contractors not accomplishing contract intentions, the reports clearly show that there is room for improvement in this area. The Justice Department's assessment that the primary root of the problems is poor management could be applied to deficiencies found at several of the agencies.

III. COST-EFFECTIVENESS

This chapter focuses on the cost-effectiveness of service contracts, given that an agency will in fact be contracting for a specific service. Resolving the issue of whether agencies should perform specific tasks or programs (i.e., work that is not inherently governmental) by contract or with Federal employees is not an objective of this report.

Pre-award Cost Reasonableness

Cost-effectiveness of contracts is both a pre-award and a post-award issue. In the pre-award phase, agencies are expected to validate that the Government would be contracting for services at a fair and reasonable price. This necessitates that agencies go beyond mere acceptance of the contractor's cost estimate as the true cost of the service to be rendered. Agencies are best-equipped to make fair and reasonable price determinations when there is competition and when they do independent Government cost estimates, i.e., when the Government estimates the contractors cost of providing the required services.

Several agencies raised issues regarding independent Government cost estimates. The Department of Transportation found that detailed Government estimates often were not included in the contract files it reviewed. The Department of Education expressed concerns that both its program office staff and contracting office staff lack adequate expertise to effectively evaluate costs. The Department of Interior found inadequate cost or price analysis documentation, and the Department of Agriculture could not establish that contract proposals were fair and reasonable because its contracting personnel were not adequately complying with procedures or documenting the basis for decisions reached in contract negotiations.

The Department of Agriculture provided an example that shows the importance of addressing pre-award cost reasonableness issues. According to the USDA report, "When a USDA contracting officer asserted a request for cost and pricing data, a single letter request produced agreement to submit the data and a unilateral offer reduction of $9 million over the contract life." When the data were received, an additional unilateral $10 million reduction was made from the original offer of $70 million.

The Department of Commerce, as a result of its services review, has decided to require that agency COTR's prepare independent Government cost estimates, based on bottom-up requirements analyses, for all contractor work prior to any proposal submissions (including task orders) by the contractor. The Environmental Protection Agency has decided to require similar independent Government cost estimates.

Some agencies assert that they can be assured of the cost reasonableness of their service contracts by virtue of the fact that they are using competitive procedures for most of the contracts. However, another agency stated that the market does not seem to be working to control contractor costs or labor rates. Obviously, something more than a market check is needed.

Post-Award Contract Administration

On the post-award side, most agencies report that the Government is getting what it is paying for and that the agencies have adequate procedures in place to effectively monitor contractor performance. For the most part, they conclude that service contracts are, therefore, cost-effective. However, several agencies reported inadequate compliance with policy and procedures within their respective agencies. The Department of Justice, for example, stated that its review found " . . . numerous and recurring problems that result from failure to properly implement these policies and procedures." As a result, Justice indicated that it does not have complete assurance that the Department monitors and evaluates the cost-effectiveness of service contracts, that it holds contractors accountable for results, or that it ensures that the Government is getting what it pays for.

Most agencies, including the Departments of Justice and Energy cited deficiencies including inadequate oversight and monitoring of contractor performance by the contracting officer and contracting officer technical representatives (COTR). The Department of Commerce expressed concern over the inadequate involvement of its contracting personnel in cost control. The Department has now emphasized to contracting officers and COTRs the importance of reviewing contractor financial reporting, invoices and vouchers, but Commerce remains concerned about the adequacy of contracting resources for review and monitoring in this area. The Department of Interior found that work in progress was being monitored satisfactorily, but remaining costs to be incurred to complete performance under the same contract were not being monitored with the same level of intensity, an essential step to avoid cost-overruns.

A number of agencies expressed concern that it was difficult to evaluate cost-effectiveness without visiting contractor work sites to observe work in progress, but travel funds were not available for this purpose. A few agencies cited additional problems such as payments for services that were never received, not covered under the contract, were made in spite of unsatisfactory performance or at rates exceeding contract prices. For example, EPA, relies heavily on level-of-effort, cost-reimbursement contracts. EPA interprets this to mean that all that is required is the contractors' best effort. When a best effort is sufficient, then the contract may be cost-effective.

However, EPA indicates that sometimes deficiencies in quality occur and the agency pays the contractor more money for the contractor to revise the work.

CONCLUSION.

On a macro level agencies consistently returned to the theme that they have inadequate resources to undertake effective contract administration. Agencies would like to see FTE barriers eliminated or at least made more flexible.

At a micro level, on the pre-award side, inadequate attention is given to the issue of cost-reasonableness. Agencies are making up-front commitments to pay more for contracts for services -- to ensure that they obtain what they view as an essential mission service-- than they might otherwise pay if they had done an independent Government cost estimate.

On the post-award side, agencies are not devoting enough attention to the cost-effectiveness side of contract administration. Agencies believe they are contracting for mission-essential services. As a result, most of their contract administration efforts focus on ensuring that they receive the required services, with cost sometimes becoming a secondary matter. This is further exacerbated because most of the contract administration is done by the program offices, which need the services, rather than the contracting offices.

IV. INHERENTLY GOVERNMENTAL FUNCTIONS

As a matter of policy, an "inherently governmental function" is one that is so intimately related to the public interest as to mandate performance by Government employees. These functions include those activities that require either the exercise of discretion in applying Government authority or the making of value judgments in making decisions for the Government. Examples are set forth in OFPP Policy Letter 92-1, "Inherently Governmental Functions" (September 23, 1992); they include the determination of agency policy and the determination of Federal program priorities or budget requests.

Contractor Performance of Inherently Governmental Functions.

As part of the services contracting program review, the 17 agencies were asked "Are you certain that the services being performed by contractors are not "inherently governmental?" Eleven of the agencies replied that their reviews had disclosed no instances of inherently governmental functions being performed by service contractors. Of the remaining agencies, most found only isolated cases where the reviews indicated that service contractors were performing inherently governmental functions. All had or were taking action to remedy the violations.

DOD found two contracts out of forty-two reviewed where the statements of work included what appeared to be inherently governmental functions. In one instance, the contract is for the management and operation of a mission support facility, and the contractor is responsible for the information/public affairs program, which includes meeting the press. DOD observed that this could put the contractor in the position of performing an inherently governmental function. In the other instance, the contract requires the contractor to work under the direction of a person who is himself the employee of another contractor. The responsible DOD components are being asked to submit corrective action plans.

Another example is the Department of Commerce, which found two contracts (out of thirty reviewed) where contractors were performing inherently governmental functions. One contract is for architect-engineer and program management services, and the other is for on-site long-term technical support services. For the A/E contract, the reviewers found there was over reliance on a very general statement-of-work; failure to negotiate new or redirected work or obtain audits of increased cost; lack of monitoring, and inappropriate use of the contractor for personal services and inherently governmental functions.

On the contract for "long-term technical support services" DOC found that there was over-reliance on the contractor; less

than an arms length relationship between the Government and contractor staff; inadequate monitoring of performance or cost, and possible performance of personal or inherently governmental functions.

NASA also found instances of inherently governmental functions being performed by contractors. NASA reported that "floor checks" of 28 on-site contractor employees found situations which appeared to reflect personal services conditions and contractor performance of inherently governmental functions. (A personal services contract is one which by its express terms, or as administered, makes contractor personnel appear, in effect, Government employees. Personal service contracts are prohibited by regulation.) These instances have been referred to the responsible contracting officers for further research and resolution, and the program organizations are being asked to take corrective action.

Other agencies that identified contracts where contractors were performing inherently governmental functions are Interior, DOE, and EPA. Those agencies, however, did not elaborate on the specific types of functions being performed by the contractors.

AGENCY PROCEDURES.

All of the 17 agencies surveyed had procedures in place to safeguard against the performance of inherently governmental functions by service contractors. Several agencies found that improvements in these procedures were needed, and are taking action to implement the necessary changes.

For instance, NASA is issuing guidelines entitled "Distinguishing and Separating Civil Service and Support Service Contractor Functions". The new guidance will require that all COTRs receive training on inherently governmental functions, and calls for an agency-wide review of current support service contracts to ensure proper utilization of support services. Interior plans to include a section in its Acquisition Management Review Handbook on inherently governmental functions, and to require that acquisition planning documents include questions addressing inherently governmental functions as well as documentation of a review under OFPP Policy Letter 92-1.

Other agencies pointed out examples where their procedures had prevented performance of inherently governmental functions by contractors. Justice, for example, noted that its components perform supervisory reviews of solicitations prior to issuance to ensure compliance with OFPP Policy Letter 92-1 and FAR Part 37, "Service Contracting." As a result, the Procurement Executive recently disapproved a proposed award for the new "Asset Forfeiture Program Support Services Contract" because he was not

convinced that it adequately guarded against contractor performance of inherently governmental functions.

DOE has a formal support services review and approval process that includes approval by an independent Headquarters organization of all support services contracts over $1 million. DOE's review of 53 support services contracts revealed that, as a result of the review and approval process, statements of work under four contract requests were revised to remove requirements that could have been perceived as being inherently governmental.

Conclusion.

The 17 agencies generally have procedures in place to safeguard against the performance of inherently governmental functions by service contractors. Nevertheless, some agencies' reviews did disclose instances of inherently governmental functions being performed by contractors. These agencies have taken corrective actions, including the improvement of their procedures. Other agencies have also improved their procedures as a result of the review even though no violations of the policy on inherently governmental functions were discovered.

V. SUMMARY OF MAJOR RECOMMENDATIONS

The 17 agencies and departments made approximately 40 Government-wide and 70 agency specific recommendations for improving service contracting practices. The recommendations and changes proposed by each agency are listed in Appendix 1. This Chapter discusses the major recommendations made in the agencies' reports. The recommendations have been grouped into the six primary categories shown in Figure 4.

Figure 4

Major Areas Covered by Agency Recommendations

Agency	*Budget Flexibility/ Cost Issues*	*Improve Contract Administration*	*Better Statements of Work*	*Procurement Simplification and Reform*	*Clarify Policy on Task Order Contracts*	*Implement OFPP Policy Letters*
Agriculture	X	X	X			
Commerce		X				
Defense				X	X	X
Education	X	X	X	X	X	X
Energy	X	X	X			
HHS	X	X				X
HUD	X	X	X	X	X	
Interior	X	X	X	X	X	X
Justice	X		X	X		X
Labor		X				
State	X		X			X
DOT	X	X		X	X	X
Treasury	X	X		X	X	
Veterans						
GSA	X	X	X	X	X	
EPA	X		X	X		
NASA	X	X				X

COST ISSUES.

The agencies made two basic recommendations pertaining to cost issues. The first recommendation (made by USDA, HHS, HUD, State, Education, Treasury, and EPA) is that agencies should be given more flexibility with regard to using their budget resources. EPA, summed up this recommendation by stating:

> "We, therefore, would advocate that OMB grant agencies authority to determine the appropriate allocation of resources between extramural and intramural budgets and make changes to the associated full time equivalent ceilings, when necessary. Efforts to reinvent government should not attempt to address problems associated with performance of the civil service and contractors as distinct entities, but as two pieces of the same puzzle."

The other agencies' recommendations were variations of this theme with all advocating that they be given the flexibility to use "contracting funds" for FTE purposes when they can show that the hiring of additional FTE's will result in the "best business decision," i.e. less overall cost to the government. OMB encourages agencies to include specific conversion proposals in their annual budget submissions. Cognizance of existing FTE ceilings, however, must be maintained and efforts should be made to accomplish such proposals by shifting internal resources.

The second most common recommendation relative to cost effectiveness pertains to independent government cost estimates and the need for better cost and price analyses. Recommendations in this area were made by USDA, GSA, HUD, Transportation, and Education. While these agencies indicated that existing policies and regulations relative to cost estimating and cost and price analyses were adequate, implementation of the existing procedures was considered inadequate. Several of the agencies indicated a need for additional training in cost and price analyses. One agency (Transportation) stated that the respective responsibilities of the program and contracting offices for making itemized government estimates needed to be clarified. Transportation proposes to assign this responsibility to their program offices.

To assure that problems involving cost estimates and analyses are addressed, OFPP will establish an interagency working group. The group will review "best practices" now employed in various agencies as well as existing FAR provisions, agency regulations and training requirements. The group will issue practical "trick of the trade" guidance for agencies use and determine what other specific governmentwide actions are needed. This effort will be completed by July 1, 1994.

CONTRACT ADMINISTRATION.

OMB and the agencies have been working over the last several months to address contract administration problems, and many of the contract administration recommendations are duplicative of the recommendations contained in the December 1992 SWAT Report on Civilian Agency Contracting Practices. Specific contract administration recommendations made in the agency reports include:

- A need for more travel monies to fund site visits. Several agencies made the point that it is difficult to monitor contractor operations without visiting the site where the work is being performed.
- The need for adequate contract audit resources.
- Increased training for voucher review. As noted in the preceding chapters, numerous instances of faulty review practices were encountered during the reviews.
- Physical separation of contractor and government staff or at least a consistent approach for clearly distinguishing contractor personnel from government staff. Several instances were noted where contractor staff were perceived as government employees.
- The importance of training for contracting personnel, and particularly for COTR's, was continually emphasized. The need for COTR training was referred by DOT, State, Labor, Interior, Energy, Education, and Commerce.

OMB is presently taking 3 specific actions to help implement the above recommendations. The actions are:

Civilian Agency Contract Administration. Most of the agencies recommend that OMB proceed with its work under the Civilian Agency Contract Administration Task Force. This Task Force, established in March 1993, completed its work in November 1993 and OFPP will monitor the implementation of the Task Force's recommendations.

Contract Audit Improvements. The importance of audits to the contracting process was previously reviewed in OMB's December 1992, "Interagency Task Force Report on the Federal Contract Audit Process." OMB has established an Interagency Contract Audit Oversight Committee to oversee the implementation of the recommendations in that report. The Committee, established in July 1993, will where appropriate promulgate "best practices."

Improved Policy Guidance. Another action being taken by OFPP is the revision of its March 1991 policy guidance on Contract Administration. Presently, OFPP is developing revised guidance to place greater emphasis on the roles and responsibilities of contracting officers and COTRs; procedures for the voucher review process, detailed guidance on administration of various types of contracts, and guidance on minimum requirements for contract administration data.

STATEMENTS-OF-WORK.

Recommendations pertaining to the need to improve statements-of-work were made by Interior, Agriculture, Energy, GSA, EPA, and State. Three agencies' recommendations (GSA, EPA, and State) are considered to be representative and are reviewed here.

GSA stated:

> "Across organizational lines, there is a definitive need for more discipline in the development of formal, measurable performance standards and surveillance plans to facilitate the assessment of contractor performance. Preparers of statements of work need to ensure that performance standards are identified and included in the contract."
>
> "Heads of Central Office Services should instruct preparers of guide/model statements of work to revise existing guides/models to include formal measurable quality assurance requirements. New guides/models should include similar information when issued."
>
> "Central Office activities issuing guide or model solicitation/specifications for services should also develop model quality assurance plans to be used in conjunction with the guide/model solicitation/specifications."

EPA in commenting on statements-of-work recognized the direct connection between the adequacy and quality of work statements and the use of past performance in source selections.

EPA stated:

> "While it is important to ensure that there is no undue bias for incumbents in competitive procurements, often the past performance of contractors does not get full consideration when it is only considered as part of the contracting officer's responsibility determination. Many times too, agencies are reluctant to take time to provide complete disclosure when it will have minimal impact on the

procurement, coming at the end of the process. It is of importance that the quality, timeliness, and cost-effectiveness of past performance be considered as a possible indicator of future performance.

EPA requested that OMB continue its efforts to promote:

"Use of past performance to a greater extent through more formal evaluation schemes than as a measure for responsibility."

In comparison to the EPA and GSA approaches, the Department of State recommended that:

"OMB should issue new guidance to all agencies on preparing statements of work, including handbooks.

"Expand current training requirements for Contracting Officer's Representatives, to include preparation of effective, measurable statements of work."

The need for additional guidance on how to prepare statements-of-work will be considered by the task group established to review cost issues. The work group will review existing statements-of-work guidance materials, including the content of current class room courses, before determining if new guidance is needed. The work group will complete its review by July 1994. Pending the completion of the work group's review, agencies are encouraged to consider the GSA approach for developing model statements-of-work, including performance standards. The models are useful as guides and can be tailored to meet specific service requirements.

SIMPLIFICATION.

Numerous agencies (Education, EPA, Justice, Interior) recommended that procurement reform and simplification efforts be continued. Specific recommendations received in this area include:

- Encouraging purchases of commercial products or services,
- Simplifying and streamlining acquisition procedures,
- Raising the small purchase threshold to $100,000,
- Using electronic data interchange for small purchases,

- Expanding authority to pilot test streamlined procedures,
- Extending Defense streamlining to civilian agencies, and
- Requiring prompt dismissal of frivolous, bad-faith and unmeritorious protests."

OFPP supports the specific reforms listed above.

TASK ORDER CONTRACTS.

HUD, GSA, and Education all made recommendations with respect to the need for better controls on task order contracts. FAR coverage of task order contracts is presently regarded by many as inadequate. Education's recommendation, which is consistent with others, is:

> "OFPP should ask the FAR Councils to issue guidance on task order contracts as soon as possible. OFPP is coordinating an interagency group that is working on developing guidance on task order and related contracts. Some agencies call these master contracts or have another name for them. The feature they have in common is an umbrella contract under which the agencies can place orders or make small awards quickly. Most agencies recognize the difficulties in assuring adequate competition, evaluating proposals and establishing prices, but find task order contracts necessary to handle quick turn around requirements of small to moderate size. Until the Federal government develops a new, more effective contracting vehicle, agencies must continue to rely on task order contracts. Until then, FAR guidance will help reduce the risks."

OFPP concurs in the need for better guidance on task order contracts and plans to work to increase the value of this contracting method -- including guidance to encourage the use of fixed price and multiple award task orders. This effort is scheduled for completion in 1994.

IMPLEMENT OFPP POLICY LETTERS IN FAR.

HHS, Education, DOD, and State recommended that OFPP Policy Letters 91-2, Service Contracting; 92-1, Inherently Governmental Functions, and 92-5, Past Performance be implemented in the FAR. OFPP concurs in this recommendation and will continue to actively pursue FAR implementation of the Policy Letters. Most agency recommendations also strongly supported issuance of the then proposed OFPP Policy Letter on "Management Oversight of Service Contracts." This Policy Letter was issued in November 1993.

With respect to inherently governmental functions, most agencies indicated that OFPP Policy Letter No. 92-1, Inherently Governmental Functions, was a major step forward in distinguishing functions that are inherently governmental from those that are appropriate for performance by a contractor. The primary recommendation was that the Policy Letter be included in the FAR. In addition to the FAR amendments, two agencies (GSA and HUD) stated that their internal policies are being amended to clarify "when" and "who" should make the decision as to whether a specific service is inherently governmental. Several agencies have established committees to review and clear contracts for "Contracted Advisory and Assistance Services." These committees are being used in some instances to make decisions as to whether specific services are inherently governmental. All agencies should have clear procedures that identify specific responsibilities for making decisions regarding whether specific services can be acquired by contract. These agency specific regulations should be referenced in agency FAR supplements.

APPENDIX 1

OMB did not prescribe a specific methodology to be followed by the agencies in conducting the service contracting reviews. Instead, discretion was left to each agency. Prior to starting the reviews, however, the agencies were required to meet with OFPP Administrator Allan Burman and discuss their approach and review plans.

While the review processes used by the agencies differed, most agencies established interdisciplinary teams of agency personnel consisting of representatives from their contracting, Inspectors General, and program offices. The teams were then responsible for conducting file reviews, staff interviews, and reviews of prior GAO and IG reports. In addition, many of the teams developed survey questionnaires and solicited written comments from various agency components. The chart below, shows the review techniques used by each agency and the number and dollar value of contracts included within the review.

Summary of Review Techniques

Agency	*No. of Contracts Reviewed*	*Dollar Value of Contracts (Millions)*	*IG Participation on Team*	*Review Prior GAO & IG Reports*	*Use of Formal Questionnaire*	*Customer Program Office Interviews*
Agriculture	33	18	✓	x	x	x
Commerce	30	N/A	x	x	✓	✓
Defense	42	1,200	*	✓	x	x
Education	N/A	N/A	✓	✓	✓	✓
Energy	53	N/A	x	✓	✓	x
Health	18	124	✓	✓	✓	✓
Housing	20	80	✓	✓	✓	✓
Interior	33	60	✓	✓	✓	✓
Justice	36	289	✓	✓	✓	x
Labor	62	409	x	x	✓	✓
State	45	1,000	x	x	x	x
Transportation	66	2,100	✓	✓	✓	✓
Treasury	120	1,700	x	x	x	x
Veterans	N/A	620	x	x	✓	✓
Environment	300	N/A	✓	✓	x	x
General Services	103	650	x	✓	x	x
NASA	130	N/A	✓	✓	✓	✓
TOTALS	1,091	8,250				

N/A = Not Available
x = No
✓ = Yes
* = IG Submitted Separate Report

APPENDIX 2

LISTING OF AGENCY RECOMMENDATIONS

Department of Agriculture

Agency-specific.

1. Request the agency administrator to pursue a comparative cost analyses for chemical residue testing.

2. USDA should emphasize the need to document price and cost analyses, as applicable, before awarding negotiated procurements in excess of $100,000, including noncompetitive actions and modifications that increase or decrease the contract price.

3. Require reviews of all pre-negotiation and price negotiation memorandums to ensure they are completed in the level of detail required by the FAR prior to contract action.

4. Expand the current scope of Procurement Management Reviews (PMR's) to emphasize adequacy of the SOW. The PMR manual should, at a minimum, reference or paraphrase the information contained in the March 15, 1991, OMB memorandum "Government-Wide Guidance on Contract Administration," Section IV - Development of Clear Statements of Work and Selection of Contract Type."

5. Contracting personnel should he reminded that contract files must contain detailed rationale on factors considered during the source selection process. The file also must provide rationale on how the selection process met each condition outlined in FAR 15.804-3(b) for "adequate price competition," including the difference in cost.

Department of Commerce

Agency-specific.

1. Sufficient resources need to be applied to contract management on both the contracting and program side. Our COTRs need to be trained to understand the limits of their authority and the importance of adhering to contractual terms and conditions. Structured approaches to contract management need to be developed, and program personnel need to understand that contractors cannot be treated as extensions of their own staffs. We need to ensure that we are not contracting out our expertise and eroding essential in-house capability to perform the mission. Contracting and

program personnel need to be viewed as partners in the process of contract management and a mindset of mission over management needs to be changed.

We think such change needs to start at the highest levels of management within the organization.

Governmentwide.

1. As a result of this review, we consider two of the initiatives stemming from the SWAT review to be of particular importance. One is the study of contract administration practices. The other is the study of procurement staffing levels. We look forward to the results of both of these initiatives.

Department of Defense

Agency Specific.

1. The military departments and defense agencies responsible for the contracts under which deficiencies were found will be asked to submit corrective action plans.

2. All military departments and defense agencies will be tasked to review their procedures that:

   - Competition is not restrained through improper use of task order/delivery order contracts and cost type, level of effort contracts with broad work statements.

   - Contracts or orders, as appropriate, include detailed descriptions of tasks to be performed and specific performance criteria that the contractor is expected to meet.

   - Procedures for monitoring contractor performance specifically include communicating any performance problems of the contracting officer.

3. DOD will conduct a follow-up review in approximately 24 months to determine the extent to which corrective action has been effective.

Governmentwide.

1. Our review disclosed no systemic deficiencies. Actions contemplated in paragraph 5 should correct improper execution of established policies and procedures, and failure to effectively utilize the tools that are currently available to insure that service contracts are necessary,

cost-effective, and accomplishing what was intended Implementation of OFPP Policy Letter 91-2, "Service Contracting" and Policy Letter 92-1, "Inherently Governmental Functions" into the FAR should serve to reemphasize sound procurement practices with regard to these and future contracts.

Department of Education

Agency-specific.

1. ED should institute its proposed training and certification program for contracting staff, including team-building workshops that focus on sharing goals with program offices. In developing the training program, GCS and the Horace Mann Learning Center (HMLC) should consider the suggestions from respondents to the survey. In particular, the program should include adequate training in evaluating cost effectiveness and in team-building. Both contracting staff and COTRs should participate in the team-building workshops.

2. ED clearance offices should review their procedures to see if they can be simplified, eliminated or improved. Each clearance office listed in Exhibit 3 of the ACS Directive, "Acquisition Planning," should be required to review its clearance procedures and report to the Deputy Secretary whether the clearance can be simplified, eliminated or improved.

3. ED should strengthen its COTR training courses. GCS and HMLC should consider the responses to the survey and incorporate them into its planning for the next cycle of courses. In particular, the program should improve training in evaluating cost effectiveness.

Governmentwide.

1. OFPP should issue its draft policy letter on "Management Oversight Of Service Contracting" promptly. The draft policy letter provides valuable guidance for both COTRs and contracting staff. It highlights potential risk areas and suggests ways to avoid or reduce the risks. It would supersede OMB Circular A-120, "Guidelines for the Use of Advisory and Assistance Services." The difficulty of applying the Circular's definition of advisory and assistance services has diverted attention from the potential risks of contracting for services. OFPP's draft policy letter refocuses attention on the potential risks.

2. OFPP should ask the FAR councils to issue guidance on task-order contracts as soon as possible. OFPP is coordinating an interagency group that is working on developing guidance on task-order and related contracts. Some agencies call these master contracts or have another name for them. The feature they have in common is an umbrella contract under which the agencies can place orders or make small awards quickly. Most agencies recognize the difficulties in assuring adequate competition, evaluating proposals and establishing prices, but find task-order contracts necessary to handle quick-turnaround requirements of small to moderate size. Until the Federal Government develops a new, more effective contracting vehicle, agencies must continue to rely on task order contracts. Until then, FAR guidance will help reduce the risks.

3. OFPP should continue its support for procurement reform. In his May 25, 1993 testimony before the Subcommittee on Legislation and National Security of the House Committee on Governmental Affairs, OFPP Administrator Allan Burman outlined his support for several procurement reform efforts. Reform efforts discussed by Dr. Burman included:

   - Encouraging purchases of commercial products or services,
   - Simplifying and streamlining acquisition procedures,
   - Raising the small purchase threshold to $100,000,
   - Using electronic data interchange for small purchases,
   - Expanding authority to pilot test streamlined procedures,
   - Extending Defense streamlining to civilian agencies, and
   - Requiring prompt dismissal of frivolous, bad-faith and unmeritorious protests.

4. OFPP should propose a new, quick and simple procurement vehicle for moderately sized purchases. The current negotiated procurement process no longer works for most moderately-sized procurements. Sometimes agencies are forced to spend more than the value of the contract on conducting the competition. Some potential contractors choose not to compete for moderately-sized contracts because proposal and negotiation costs may exceed potential profits. The Federal Government desperately needs a better way to make purchases above the small purchase threshold up to about $1,000,000. The new procurement process should allow

agencies to make awards within one to two months. A new vehicle for quick turnaround work will greatly reduce the need for agencies to rely on task-order contracts.

OFPP may want to consider incorporating a preference for commercial products and services into the new system. An idea that has been circulating through the procurement community recently is to allow agencies to use small purchase procedures to buy commercial products and services up to $1,000,000. An effective way to encourage agencies to buy more commercial products and services is to make it easier for agencies to do so.

5. The Federal Government should raise the small purchase threshold to $100,000. As already noted, the negotiated procurement process is not functioning for most moderately sized procurements. Raising the small purchase threshold will take some pressure off and will reduce the need for agencies to rely on task-order contracts. Raising the threshold could be accomplished this year. Draft legislation (The Federal Acquisition Improvement Act of 1993) already contains a provision for raising the small purchase threshold.

6. OFPP should ask SBA to consider developing a limited competition system for 8(a) contracts. Under the current system, an agency selects an 8(a) firm by reviewing capability statements and promotional pamphlets and conducting interviews. The agency then requests proposals on a sole-source basis. As this report notes, ED staff are not satisfied that this method is working. Another consideration is that the current system does not teach 8(a) firms to compete. Price competition should not be overlooked. An 8(a) firm that does not learn to control costs will not survive once it graduates from the 8(a) program. SBA may wish to consider a tiered system, e.g.:

   - For new firms, sole-source awards,
   - For second-tier firms, mini-competitions using simple procedures limited to three 8(a) firms, and
   - For firms nearing graduation, full competition among 8(a) firms.

7. Agencies should have more flexibility with regard to using their resources. Reductions by Congress of funds for advisory and assistance services make flexibility all the more important. Multi-year budgets and flexibility in using funds for contracts and government staffing are essential tools for managers. Otherwise, contracts are awarded but funds are not available to use them.

Department of Energy

Agency-specific.

1. The following areas will be reviewed as part of the Contract Reform Team established by the Secretary:

   - contractor oversight/adequacy of staffing resources;
   - role of the contracting officer;
   - training for contracting officer representatives in the administration of services contracts, particularly in the areas of inherently governmental functions, use of management information, and quality control;
   - strengthened review requirements for contract services statements of work and support services requests to ensure that requirements are adequately and precisely expressed, have mission relevance, and are properly justified;
   - policies, procedures, and guidance concerning the acquisition of services that are clear, relevant, and reflect good business practices;
   - development of statements of work;
   - development of performance measurement criteria for support services contracts; and,
   - selection of appropriate contract types and methodology.

Governmentwide.

2. We recommend that the Office of Management and Budget consider ways to strengthen agency budgets for audit support.

Department of Health and Human Services

Agency-specific.

1. Regulatory Coverage: The HHSAR should be clarified to require that program and contracting offices jointly make these decisions as early as practicable in the budget, program and acquisition planning process; and should be revised, as needed, to implement any new governmentwide regulations on the subject. Also, decisions that proposed contracted services are cost-effective and are not

inherently governmental should be documented in the individual acquisition plan and RFC.

2. Human Resources Planning: The Team believes that HHS should explore the feasibility of formally and permanently integrating the workforce decisionmaking process with HHS's program, management and budgetary planning process. In this way, human resource planning can feed into, or influence the budget process, rather than be driven by it. (It should be noted that one OPDIV (SSA) has already implemented the recommendation through the use of its unified budget process). This will help the Department to: avoid costly FTE imbalances; apply human resources to high-priority agency activities; effectively manage the performance of required services; and meet its overall mission, as well as make sound business decisions on specific program and budget matters.

3. Contract Administration Resources: Under the auspices of OMB's Civilian Agency Contract Administration Task Force, the Department and its OPDIVs should explore alternative approaches to contract administration, including: the re-allocation of existing FTEs; the allocation of additional FTEs dedicated to this function; or the reimbursement of the Defense Contract Management Command (DOD's key contract administration organization) for selected supplemental contract administration tasks that it may perform for appropriate contracting activities within HHS.

4. Contract Audits: Under the auspices of HHS's Contract Audit Users Work Group and its "Long-term Plan to Allocate Contract Audit Resources," the Department should continue its current initiatives of: working with its OIG to try to earmark additional funds for contract audits; exploring the feasibility of changing the HHS appropriations process to allow for the use of program funds for this purpose; and working with the OPDIVs to better allocate scarce contract audit resources.

5. Project Officers: Program offices should be encouraged to delegate "cradle to grave" project responsibility to designated project officers. HHS should explore the feasibility of establishing a permanent cadre of highly qualified HHS project officers for FIP systems maintenance or similar projects having repetitive requirements. (It should be noted that one OPDIV has already developed a Project Officer cadre for FIP maintenance). Also, the Team suggests that HHS continue to improve the training of, and strengthen the close coordination among, HCFA Peer Review Organization (PRO) regional project officers, to enhance the reliability of project officer review and advice nationwide.

Governmentwide.

6. OMB's Draft Policy Letter 92-2: Please see Appendix J for the HHS Contracted Service Team's recommended changes to OMB's draft Policy Letter No. 92-2, as well as an estimate of the costs associated with the implementation of the current version of the Policy Letter. Also, OMB may wish to consider streamlining and strengthening the provisions of its A-76 Circular that speak to the conversion of contracted services to in-house services.

Department of Housing and Urban Development

Agency-specific.

1. Enforce existing requirements regarding government cost estimates.

2. Develop guidance for contracting staff for those cases which deal with unit costs.

3. Provide written guidance and train staff on cost and price analysis.

4. Staff resources should be made available for proactive contract administration.

5. Guidance should be developed on use of alternate contract management reporting systems.

6. Develop guidance on ordering controls/management. This guidance should describe the characteristics of an adequate tracking system and provide examples suited to different situations.

7. Develop a certification for solicitations for services which requires the offeror to disclose names, former agency affiliation and dates of separation from Federal employment of former Federal employees who will be involved in contract performance. Because this has governmentwide application, it should be incorporated into the FAR.

8. Develop a plan for increasing competition for the reprocurement of this service. (A service where the SOW was so poorly developed that competition could not be obtained).

9. There should be further analysis of the 22 services to quantify the cost-effectiveness of doing the work in-house. Where in-house cost-effectiveness is supported by this analysis, a presentation should be made to Congress, through

the budget process, recommending the conversion of contract dollars to FTE.

10. HUD should ensure that statements of work developed by program offices require contractors to take into account program manpower and funding limitations when developing recommendations, when such restrictions are appropriate.

11. HUD should ensure that the Contract Management Committee (CMC) is apprised of any proposed program changes that may impact the study.

12. The Department should reexamine its requirements for using the Management Studies Contracts, establishing criteria against which the CMC would review requests for contracted management studies.

13. Once the criteria are established, HUD should review its procedures for requesting contracted management studies to ensure the information necessary to justify using the Management Studies Contracts is available to the CMC when it evaluates requests for services.

Department of the Interior

Agency-Specific.

1. Include a section in the Department's AMR Handbook to evaluate the application of service contracting policies, specifically relating to "inherently governmental" functions, quality assurance plans and COTR and CO training in FY 94;

2. Require the bureaus/offices to include questions in their acquisition planning documents on "inherently governmental" functions. Require documentation of review for OMB Circular A-76, Performance of Commercial Activities and OFPP Policy Letter 92-1, "Inherently Governmental Functions" with specific reference to service contracting as part of an acquisition planning process in FY 94.

3. Require minimum/mandatory COTR training.

4. Update the Department's COTR Handbook in FY 94;

5. Request the bureaus offices to focus more attention on developing quality assurance plans in accordance with FAR Part 46 in FY 94.

6. Request the bureaus/offices to examine the need for policy and guidance in the area of incurred cost monitoring to complement work progress monitoring.

7. Request through the annual Department budget formulation adequate funding and management support, where cost justified, for COTR, interns, contracting officers certifications, and CO warrant training to strengthen contract administration functions;

8. Evaluate the potential of developing a contractor performance database so CO's can electronically access contractor performance evaluations.

Governmentwide.

1. OFPP should update its guidance on "Writing Performance Work Statements for Service Contracts" issued in 1980;

2. OMB needs to review the cost effectiveness of bringing contracted work in-house when there aren't sufficient Full Time Equivalents (FTE) to perform the work. More flexibility with the budget limitation on FTEs is necessary when it can be demonstrated through studies that it would be less expensive to perform the work in-house but government personnel ceilings prevent that decision.

3. OMB should continue to actively sponsor civilian agency workforce improvement efforts which, patterned after the DOD acquisition workforce improvement act, expand the field of personnel who require procurement training to include COTRs and others;

4. OMB should actively promote simplification of the acquisition process through increasing the small purchase threshold, and by making special efforts to raise other thresholds for application of labor laws like, i.e., Davis-Bacon and Service Contract Act. The NASA pilot to use electronic bulletin boards versus Commerce Business Daily publication is an attempt to streamline the acquisition process and if successful should be adopted in some situations governmentwide. OMB should charge OFPP with looking at procurement statutes, the FAR, OFPP Policy Letters and overall acquisition guidance to eliminate any unnecessary requirements redundancies and overlaps in the acquisition process and in-keeping with Vice President Gore's Reinvent the government initiative and the Department of Defense, Acquisition Law Advisory Panel (Section 800 report).

Department of Justice

Governmentwide.

1. OMB should give more consideration to authorizing Full Time Employees (FTE) to perform some of the services described herein as opposed to contract dollars. When determination is made by a component that it is more cost effective to do a service in-house, rather than contract it out, the OMB should authorize the positions so that the service can be brought in-house to be performed by government personnel. The OMB should develop policy and a mechanism for authorizing the necessary FTEs if it is more cost effective to the government.

2. Further, contracts for common services could be centralized in order to consolidate efforts. Examples of such services are employee drug testing and employee relocation cervices. Because most of these services apply governmentwide, a central government contract would be more efficient than the existing individual department component contracts. Also, a more concerted effort could be made to research visible alternatives to how these services are currently being provided.

3. In conducting our review of the service contracts, we were told by many members of the acquisition work force that the procurement system needs to be simplified because it is composed of too many procedures and policies.

4. The same recommendation may be made regarding the program detailed in OFPP Policy Letter 92-3. Although we fully support the intent of the policy letter (i.e. to establish a governmentwide standard for skill-based training in performing contracting and purchasing duties), the means of fulfilling its purpose could be simplified. The current program, which lists seventy-eight Units of Instruction that are to be incorporated in the specific courses in order for them to qualify as competency based, could be reduced to a listing of courses and hours of each type of course an individual must complete. This way the objective of training the staff will be achieved without creating a complicated system that may interfere with accomplishing the desired results. Further, the requirements of the policy letter should be analyzed in light of budget cut-backs.

Department of Labor

Agency-specific.

1. Although there are no findings which require governmentwide solutions, the Department intends to continue to place an emphasis on improved and more frequent training of current COTR staff to further enhance DOL's capability to monitor contractor performance. The effectiveness of DOL's current contract administration activities minimizes the likelihood of substantial cost savings from implementation of this action.

Department of State

Agency-specific.

1. Revise current procedures on contract administration and implement in-house training;

2. Consider supplementing the current organization or examining alternate approaches for contract administration in the Department's largest contracting activity to shift more emphasis toward greater quality in contract administration for services; and

3. Reconstitute the goals of the Department's Advisory and Assistance (AAS) Coordinating Committee, making it an organization for the management of contracted services to bring top management's attention to bear on high dollar-value service acquisitions and on requirements that closely resemble inherently governmental functions.

Governmentwide.

1. OMB should issue new guidance to all agencies on preparing statements of work, including handbooks;

2. Expand current training requirements for Contracting Officer's Representatives, to include preparation o effective, measurable statements of work;

3. The Federal Acquisition Regulation should be revised to provide specific guidance and forms that will enable agencies to implement performance-based contracting in accordance with OFPP Policy Letter 92-5 and permit the Department to assess more accurately whether contracts are accomplishing what was intended.

4. ✓OMB should develop a methodology for determining, on an ongoing basis, the cost-effectiveness of contracted services

so that the Department will be able to decide when services should be acquired by contract versus direct hire. This guidance must be less cumbersome and time-consuming than OMB Circular A-76 in order to be effective. Where the analysis shows that in-house performance will be less costly or provide greater control over inherently governmental functions, agencies should be granted the flexibility to convert contract dollars to funding for direct-hire positions.

5. The Federal Acquisition Regulation should be revised to provide specific, practical, easily implemented guidance on performance-based contracting and monitoring of contractor performance.

6. OMB should replace Circular A-120 to provide better guidance to agencies on the controls necessary for the use of contracted services. As a corollary effort, OMB should consider sponsoring appropriate legislative changes to 31 U.S.C. 1114.

7. The Federal Acquisition Regulation should be revised to identify clearly which functions are considered "inherently governmental."

8. OMB should ensure that agencies are meaningfully involved in any efforts to restrict contracting out of support services of an arguably "governmental" nature while at the same time restricting the expansion of direct-hire personnel to perform currently contracted out requirements. To the extent that any reductions require the elimination of current work, final decision authority should reside with the agencies. OMB should support and facilitate agreement by Congress, particularly where legislative relief is appropriate or necessary.

9. OMB should replace Circular A-120 with a final version of OFPP Policy Letter 92-2 as soon as possible. Draft OFPP Policy Letter 92-2 should be revised to focus on larger dollar value acquisitions--over $500,000. The high level controls in the current draft should apply only to services --that affect government decision-making, support or influence agency policy development, or affect program design and implementation (these types of services tend to border on inherently governmental functions and are more susceptible to abuse than "blue collar" services).

Department of Transportation

Agency-specific.

1. Amend the Transportation Acquisition Manual (TAM) to include Uniform requirements for preparation and processing of invoices.

2. Amend the TAM to include the requirement for preparation of a detailed, itemized government estimate by the requisitioning office.

3. Issue a notice to the operating administrations reminding them of the need to review all proposed services contracts against the requirements of OFPP Policy Letter 92-1, Inherently governmental Functions.

Governmentwide.

1. The Federal Acquisition Regulation should be revised to provide specific guidance and forms that will enable agencies to implement performance-based contracting in accordance with OFPP Policy Letter 92-5 and permit the Department to assess more accurately whether contracts are accomplishing what was intended.

2. OMB should issue new guidance to all agencies on preparing statements of work, including handbooks.

3. Expand current training requirements for Contracting Officer's Representatives, to include preparation of effective, measurable statements of work.

Department of the Treasury

Governmentwide.

OMB should issue a comprehensive, coordinated policy on service contracting that integrates the budget and management concerns. Existing guidance is fragmented in several OMB Circulars, OFPP Policy Letters, Handbooks and existing procurement regulations. This fragmentation frequently creates the appearance that these policy statements are in conflict and makes them extremely difficult to administer. Further, not integrating these policy statements into the Federal procurement regulations has also complicated full compliance. We suggest that a single document be prepared that would, at a minimum, include the following:

- OMB Circular A-76, Policies for Acquiring Commercial or Industrial Products Needed by the government;
- OFPP Policy Letter 92-1, Inherently Governmental Functions;
- Draft OFPP Policy Letter 92-2, Management Oversight of Service Contracting (including incorporation of OMB Circular A-120, Guidelines for the Use of Advisory and Assistance Services); and
- OFPP Policy Letter 89-1, Conflict of Interest Policies Applicable to Consultants.

A single service contract policy document would greatly assist proper application of service contract policy.

Environmental Protection Agency

Governmentwide.

1. OMB grant agencies authority to determine the appropriate allocation of resources between extramural and intramural budgets and make changes to the associated full time equivalent ceilings, when necessary. Efforts to reinvent government should not attempt to address problems associated with performance of the civil service and contractors as distinct entities, but as two pieces of the same puzzle.

2. OMB consider the following reforms to streamline the procurement process in order to maximize industry involvement, cost-savings and participation by small and small-disadvantaged businesses:

   - reexamine the procedural requirements of competition currently in the Competition in Contract Act. This would involve changing the standard for competition, the time frames for and steps of the procurement process.
   - sponsor an effort to reduce regulatory and administrative barriers that prevent the efficient award of new contracts. An OFPP-sponsored project from 1984, entitled "Simplified Competitive Acquisition Technique" might serve as a prototype for such an effort.
   - review recommendations of the Department of Defense's Section 800 report for adoption whenever possible to achieve economies and efficiencies in the procurement process.

- continue efforts to increase governmentwide the small purchase threshold from $25,000 to $50,000/$100,000.
- increase the threshold of applicability for acquisitions under the Service Contract Act from $2,500 to $100,000.
- develop streamlined and simplified solicitation and contract documents for mid-range acquisitions ($100,000 to $10,000,000).

3. OMB should amend the procurement regulations for competitive acquisition of microcomputer hardware and software to enable the government to take advantage of the rapid technological changes and intense competition for these products.

4. OMB should develop more uniform protest procedures for consideration by the GSBCA and GAO.

5. OMB should continue its efforts to promote use of past performance to a greater extent through more formal evaluation schemes than as a measure for responsibility determinations.

General Services Administration

Agency-specific.

1. The head of the contracting activity for the National Capital Region should ensure that adequate controls are put in place in the PBS when it is necessary for construction quality management contractors to be physically located in government controlled space.

2. Central Office activities issuing guide or model solicitation/specifications for services should also develop model quality assurance plans to be used in conjunction with the guide/model solicitation/specifications.

3. The Associate Administrator for Administration should revise GSA's guidelines implementing A-76 to make it clear that responsibility for monitoring the cost effectiveness of continuing to contract out services should be assigned to the applicable program offices.

4. The Commissioner of Public Buildings Service should make an assessment of the cost effectiveness of contracting out construction quality management services and take appropriate action to implement the results of the assessment.

5. The Central Office Service Commissioners should establish a mechanism for redistributing FTE and/or requesting additional FTE so that program managers can provide for the performance of services (in-house vs. contract) in the most cost effective manner.

6. The Associate Administrator for Acquisition Policy should consider amending the current guidance on preparing procurement requests to add a requirement that requesting offices include a statement on the procurement request when submitting it to the contracting office indicating whether consideration was given to in-house capability was available to perform the services.

7. The Commissioner of PBS should establish procedures to ensure that a cost effectiveness assessment is made before making a decision to bundle services in a commercial facility management contract.

8. The head of the contracting activity for the National Capital Region should require PBS activities in the region to implement procedures to ensure statements of work are prepared and included in task orders placed against construction quality management contracts.

9. Heads of Central Office Services should instruct preparers of guide/model statements of work to revise existing guides/models to include formal measurable quality assurance requirements. New guides/models should include similar information when issued.

10. The Commissioner of PBS should survey contracting activities engaged in contracting for commercial facility management services to obtain an overall assessment on the use of incentive provisions as a mechanism for motivating quality performance. Results of the survey should be provided to the Associate Administrator for Acquisition Policy so that the information may be considered in establishing policy on the use of firm-fixed-price-award-fee contracts.

11. Heads of contracting activities should ensure that contracting personnel use cost proposals to assess offerors understanding of the government's requirements when using source selection procedures.

12. The Associate Administrator for Acquisition Policy should emphasize the need to consider cost proposals to assess offerors understanding when conducting future training course C3 source selection procedures.

13. The Associate Administrator for Acquisition Policy should continue to issue "Lessons Learned" and other similar

publications to aid contracting personnel in effectively conducting procurements using source selection procedures.

14. Heads of contracting activities should ensure that the agency maintains a cadre of well trained and qualified employees to perform contract administration functions.

15. Heads of contracting activities need to ensure that when contractor personnel are required to perform work at the government facility sufficient controls are in place to separate contractor employees from GSA staff.

16. The Commissioner of PRS should obtain procedures used by FPSD in the National Capital Region and the guide and training video from the Contracts Division in Region 7 and share the materials with other regions.

NASA

Agency-specific.

Accordingly, the task team's recommendations included the following:

1. The Agency should adopt a policy, flexible enough to accommodate varying Center missions, which should identify services appropriate and not appropriate for contracting out;

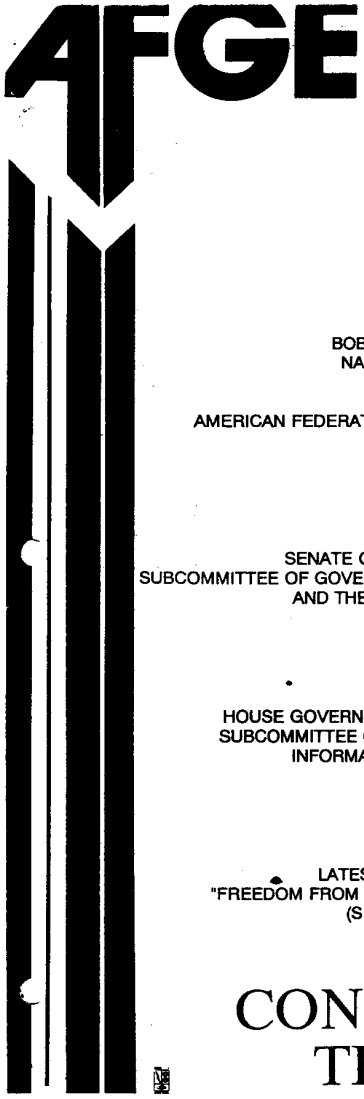
2. The Agency should examine its functional activities and define which are inherently governmental functions; or which are core to its mandated research, development, and management responsibilities; or which are of such a nature that they should be performed only by civil service employees;

3. Each Center and Headquarters should review its mission and workforce; take necessary actions to ensure that functions which are inherently governmental or defined to be in the core of its responsibilities are retained for civil service personnel; and develop plans for the transition of its workforce so that those functions are performed by civil service personnel;

4. The Agency should continue seeking additional FTE positions with an offsetting reduction in the number of support service contractors;

5. An appropriate senior Agency official should be assigned responsibility for overseeing the implementation of the policy contained in the task team's report; and

6. Another *NASA* contract management initiative aims to improve the training provided to NASA Contracting Officer's Technical Representatives (COTRs). Existing training, as provided by individual NASA Field Installations, is inconsistent in depth, content, and quality. NASA Headquarters is currently developing a list of Agencywide "minimum" areas of discussion that must be taught in any NASA COTR training course. This list of topics will include several related to service contracting, such as inherently governmental functions, personal services, and the role of the COTR in proper management and oversight of Service contracts. NASA also plans to issue a revision to the NASA Federal Acquisition Regulation Supplement that will impose a requirement that COTR training be mandatory.



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STATEMENT BY

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AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES,
AFL-CIO

BEFORE THE

SENATE GOVERNMENTAL AFFAIRS
SUBCOMMITTEE OF GOVERNMENT MANAGEMENT, RESTRUCTURING
AND THE DISTRICT OF COLUMBIA

AND THE

HOUSE GOVERNMENT REFORM AND OVERSIGHT
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY

ON THE

LATEST VERSIONS OF THE
"FREEDOM FROM GOVERNMENT COMPETITION ACT"
(S. 314 AND H.R. 716)

MARCH 24, 1998

CONGRESSIONAL TESTIMONY

INTRODUCTION

Chairman Brownback, Chairman Horn, members of the Senate Governmental Affairs Oversight of Government Management Subcommittee and the House Governmental Reform and Oversight Subcommittee on Government Management, Information and Technology, thank you for allowing me this opportunity to offer AFGE'S views on the latest versions of the Freedom From Government Competition Act (S. 314, H.R. 716).

Chairman Brownback, my predecessor, the late John Sturdivant, testified before your subcommittee last year on this legislation. He told me after his appearance that you had absolutely no trouble conducting a fair hearing on the legislation even though you happen to be one of its co-sponsors. I thank you for that as well as the insights that majority staff on the full committee have shared with AFGE prior to this hearing. Although I suspect that we will continue to disagree on the merits of the legislation, I hope that we can continue at least to discuss our differences.

Chairman Horn, let me thank you for your willingness to work with AFGE on your recent travel card legislation as well as the interest you have shown in making child care more affordable for low-income federal employees. Although we also may disagree on the merits of this legislation, it is my sincere hope that we can continue to work together on issues of concern to federal employees.

Finally, let me thank Senator Craig Thomas, who testified earlier today in support of his legislation, and his very capable aide for maintaining a dialogue with AFGE and listening to our concerns.

When AFGE last testified on this legislation, we had several constructive suggestions: improving OMB Circular A-76 and requiring cost comparisons for all service contracting, lifting arbitrary personnel ceilings which cause wasteful contracting out, developing a better understanding of the contractor workforce, improving contract administration, ending contractors' incentives to avoid unions and short-change workers on their pay and benefits, and encouraging labor-management partnerships to make the government even more effective.

I regret to report that not even a single suggestion AFGE has made managed to sneak into the draft legislation we are considering today. Consequently, I am baffled that this legislation is actually being characterized by some as a "compromise."

Much is now being made of the contractors' calculated acknowledgement that public-private competition is not really an abomination after all. Contractors may have changed their public position on the appropriateness of public-private competition, but I have little doubt that they will continue to use their considerable financial power and political might to frustrate contract administration reform and make sure the successor to A-76 is even more pro-contractor.

Typical of their actual position is what five of the most powerful contractors' groups[1] wrote in a confidential letter to John Koskinen, then Deputy Director for Management at the Office of Management and Budget, just over two years ago, in an attempt to scuttle provisions in the revised Circular that would ensure strong public–private competition:

> "We believe that the...A–76 public/private competition/cost comparison approach is bad public policy...At the most fundamental level, the federal government should not be in the position of competing with the private sector. It is simply not the American economic model and tradition and it is not in the interest of the U.S. taxpayer."

I'm a religious man, Chairmen Brownback and Horn, and I believe in redemption, but I'm not so foolish as to believe that federal service contractors have changed their "fundamental" opposition to federal employees' providing anything but the most narrowly–defined inherently governmental work––especially when we've become so competitive.

Whether or not contractors acknowledge the right of federal employees to exist, we will continue to strive every day, in government offices and plants across the nation, to be the world's greatest service providers.

The legislation under consideration today is built on so many flawed premises, I'm not sure where to begin.

Flawed Premise #1: The federal government is not contracting out enough

Wrong. The government already contracts out for services in excess of $110 billion annually, according to the Office of Management and Budget (OMB).[2] That is actually an arbitrary figure since it doesn't include such things as payments to Medicare providers. Moreover, it doesn't include the billions of dollars the federal government spends annually on goods made by private sector firms. Even at the artificially low level of $110 billion, the federal government spends less annually on pay and retirement for its entire civilian workforce of 1.8 million employees ($108 billion) than it does on service contracting.[3]

Professor Donald Kettl of the University of Wisconsin and the Brookings Institution reminds us how much of the federal government's responsibilities have been contracted out and devolved down to state and local government already:

> "Beyond the privatization debates, however, lurks a little-recognized truth: the federal government has in fact already privatized many goods and services. In fact, in fiscal year 1993, half of all discretionary federal spending went through contracts and grants to state and local governments...
>
> "(T)o those who argue that the federal government ought to devolve power to state and local governments and the private sector, the answer is that it already has, to a far greater degree than often recognized."[4]

To assert that contractors are being unfairly deprived of business by the federal government is an absurdity.

Contractors complain that OMB Circular A-76, the administrative framework governing public-private competitions for commercial work which originated in the Eisenhower-era and has been endorsed by every Republican and Democratic Administration since, isn't being used often enough. Oh, they'll admit that it's being employed extensively by the Department of Defense. But pointing to a chart listing, agency by agency, the number of competitions under OMB Circular A-76 carried out over the last several years, they assert--correctly--that the Circular is not being used very often outside of DoD.

Contractors think this proves that work is not being contracted out in agencies other than DoD. But is that true? Of course not. Approximately 40% of the more than $110 billion in service contracting billed to the taxpayers every year is done by agencies other than DoD, according to OMB.[5] The problem is that it's probably not being done under the cost-comparison process required under OMB Circular A-76. That is: contractors are getting this work without having to compete against federal employees.

It's not clear under what authority this approximately $40 billion worth of federal service contracting occurring outside of DoD is undertaken. Sometimes, agencies don't use cost comparisons because they lack sufficient in-house staff to perform the work. Since there is no public competition, this type of contracting out usually costs more than if agencies could have done the work in-house. Sometimes, agencies come up with or are given by the Congress their own alternatives to OMB Circular A-76 that don't ensure genuine public-private competition.[6] Officials at the Department of Housing and Urban Development, for example, haven't used OMB Circular A-76 for years, but still manage to contract out much of the department's work. The Department of Veterans Affairs was allowed to opt out of OMB Circular A-76 last year.[7]

That so much contracting out is perpetrated without the benefit of rigorous cost comparisons is a problem the lawmakers assembled here today ought to be addressing. Instead, we're considering legislation which would junk OMB Circular A-76 in favor of a more pro-contractor system.

Flawed Premise #2: The commercial sector is feverishly outsourcing and the federal government ought to slavishly mimic the private sector.

Wrong. An increasing number of business publications are questioning the outsourcing fad of the 1980s because firms are finding that the loss of quality control and the onerous demands of contract administration more than offset any anticipated savings.

For example, take the field of information technology. According to InformationWeek,

> "After years of big promises and even bigger deals, the IT (information technology) outsourcing backlash has arrived. Many users say wholesale outsourcing hasn't lived up to its promise. Some are so frustrated that they're canceling long-term deals and going through the painful processing of rebuilding their in-house IT operations.
>
> "'I don't think we would ever, in the foreseeable future, entertain any ideas of large-scale outsourcing again,' says E.P. Rogers, CIO at MONY. The New York insurer this month finished rebuilding its in-house IT structure after terminating a $210 million contract with Computer Sciences Corp. in May, less than half-way through its seven-year term.
>
> "Other organizations apparently feel the same way. LSI Logic, which late last month cut short a five-year outsourcing contract with IBM Global Services, is rehiring IT staff and implementing core business applications itself. 'The linkage between technology and business processes is so tight that when you outsource, somehow you get dysfunctional,' says Lam Truong, CIO at the Milpitas, Calif., chipmaker.
>
> "Companies bring work back in-house for any number of reasons. Among them to regain control and to react more quickly to rapid business change. 'Outsourcing didn't work for us, a Silicon Valley company, because we change our mind all the time,' says Truong."[8]

In fact, the problems have gotten so bad that firms now have to hire contractors to watch their contractors.

> "'Outsourcing deals are inherently not fluid enough,' says Howard Rubin, a professor of computer science at New York's Hunter College who has done consulting...'Business environments change, technology changes, people change. A lot of outsourcing deals are going to blow up.' The result is yet another consulting business. Think of it as consultants to watch the consultants."[9]

Moreover, as Americans have learned to their sorrow, corporate outsourcing has in some instances been so reckless as to call into question the whole fad. For an example, take a look at Valu–Jet, the notorious cut–rate airline.

> "In Valu–Jet's drive to establish itself as a low–price, low–cost carrier, it relied heavily on a strategy of outsourcing as much of its operation as possible in order to avoid high fixed overhead. The idea was to allow ticket prices to closely match its low direct operating costs. To that end, aircraft maintenance (an expensive part of daily operation and a task vital to the agency's mission), was outsourced.
> "The Federal Aviation Administration has determined that the (Florida) crash was caused by the explosion of spent oxygen cylinders improperly placed in the cargo hold by the aircraft maintenance contractor...The crash might well have been avoided if Valu–Jet had spent more money supervising its contractor, but incurring such overhead costs would have stood in the way of the company's goal of maintaining low ticket prices.[10]

The use of outsourcing in the private sector has yielded mixed results and offers little guidance to lawmakers in establishing policy for the federal government.

Flawed Premise #3: Federal agencies are not subject to sufficient competition.

Wrong. It is a fallacy to think that federal agencies are not subject to competitive pressures. As Professor Charles Goodsell of the Virginia Polytechnic Institute and State University notes,

> "To suggest that bureaucracies are unexposed to a harsh external environment is to confess ignorance about the nature of the public sector. Government agencies are faced with long-standing rivalries, periodic turf battles, continuous budget competition over scarce resources, frequent audits and investigations by skeptical outsiders, and pugnacious press scrutiny at any hint of embarrassment or scandal. Indeed, the bureaucratic environment contains plenty of performance-demanding compulsion..."[11]

Moreover, champions of privatization

> "ignore the checkered record of private enterprises. Giant firms fail to pay their taxes, cheat on government contracts, bilk their customers, make false advertisements, and more. Nor are private corporations perfect models of efficiency. The business pages are full of tales of waste and mismanagement at companies like GM and IBM--despite the intensely competitive terrain on which they must operate.[12]

As Harvard Professor John Donahue reminds us,

> "There is a large element of nonsense in the privatization debate. Proponents are fond of invoking the efficiency that characterizes well-run companies in competitive markets and then not troubling with any intervening logical steps, trumpeting the conclusion that private firms will excel in public undertakings as well. To go from the observation that private companies tend to do what they do better than public agencies, to the assertion that companies should take over the agencies' duties is rather like observing that the clients of exercise spas are healthier, on average, than the clients of hospitals, and concluding from this that workout coaches should take over for doctors. Public tasks are different, and mostly harder."[13]

Flawed Premise #4: There is a secret conspiracy to prevent OMB Circular A-76 from being used with even greater frequency.

Wrong. Contractors insist that the reason more of the federal government's work hasn't been contracted out is that federal managers have entered into a vast conspiracy to abuse their discretion under OMB Circular A-76 not to initiate public-private competitions.

In fact, when GAO conducted a comprehensive review of the General Services Administration's use of OMB Circular A-76, Congress' auditors gave that agency's leadership the thumbs-up.

> "The cost comparison, performance evaluation, and historical tracking data we reviewed for 54 sample activities indicated that GSA's decisions to retain individual activities in-house or contract them out were sound. Post-decision analyses and evaluations by GSA generally showed that GSA was obtaining services at a reasonable cost and at an acceptable level of performance, and GSA made relatively few reversals from its original decisions."[14]

The fears and anxieties which inspire the contractors' conspiracy theory may be helpful when writing scripts for "The X-Files," but, as the comments of Professor Elliot Sclar of Columbia University indicate, it is of no help when dealing with complicated public policy realities.

> "Some argue that the lack of privatization progress to date is not a sign of economic weakness in the case. Rather it reflects a lack of political power on the part of those who would implement public sector reform through privatization...
>
> "The essential reason why privatization will be so limited is that the nature of the services which comprise the bulk of public spending are so complex to create and so complex to evaluate, that the transaction costs--the costs of administering the contracting process and monitoring the work of contractors--which privatization engenders will far outweigh the savings from lower internal bureaucratic costs of direct service provision."[15]

Attributing the failure of contractors to dig even deeper into the treasury to the managers' conspiracy, the legislation under consideration today includes provisions that would put the government up for sale over five years. The contractors would thus eliminate managers' discretion not to subject work to public-private competition when they are satisfied with in-house performance.

Let's look more closely at the contractors' conspiracy theory, which essentially alleges that any commercial service performed by the federal government which has not been contracted out or at least currently subject to public–private competition is inherently suspect.

The problem with this theory is that managers who abuse their discretion not to subject work to an A–76 competition when in–house performance is unsatisfactory are accountable to both political appointees and lawmakers.

Over the past seventeen years, federal agencies have been run by political appointees who have been more open to contracting out and privatization than all of their predecessors combined. The profound contempt of most Reagan–Bush Administration political appointees for the public sector was matched only by their deep reverence towards the private sector. And Clinton Administration political appointees are even more pro–privatization, having consistently racked up the biggest service contracting bills of all time.

At the same time, the Congress has been controlled by lawmakers who are more partial to contracting out and privatization than ever before. Indeed, they have played crucial roles in helping contractors perform even more work for the federal government.

There are powerful checks on the discretion of managers, most notably from the pro–privatization political appointees and mostly pro–privatization lawmakers. It is simply unreasonable to argue that the reason more work hasn't been contracted out or subjected to competition is because of a conspiracy of managers not to initiate OMB Circular A–76 competitions when in–house performance is unsatisfactory.

In fact, some lawmakers have actually written into law requirements that OMB Circular A–76 studies be conducted for certain commercial services. Because AFGE represents 300,000 DoD employees, we follow the defense authorization process very closely. Often, as part of that process, lawmakers, particularly those on the House National Security Committee, pass judgment on the decisions DoD's managers and political appointees make with respect to OMB Circular A–76.

Sometimes they disagree with DoD's decisions not to use the Circular, examine what they consider to be a commercial service, determine––perhaps on the basis of GAO and IG reports––that they aren't getting good value for money, conclude that the private sector is capable of competing for this work––perhaps after determining whether a competitive market exists––and then write a provision into the defense authorization bill which requires that an A–76 competition be conducted for that commercial service. Other times, lawmakers simply require that DoD privatize particular services.

While AFGE does not always agree with such decisions, that active and more well-informed approach towards requiring public-private competitions makes considerably more sense than blindly subjecting every single agency in the federal government to costly and disruptive public-private competitions over a five-year period.

The sponsors of the legislation we are considering today know they simply can't make the case that in-house performance is unsatisfactory for most commercial services---even though the lawmakers and political appointees who are ultimately responsible for making those competition decisions are generally very favorably inclined towards contracting out. But rather than accept the fact that federal employees generally deliver services the government's customers need at the prices taxpayers can afford, contractors instead demand that the federal government be put up for sale.

Flawed Premise #5: This legislation is about competition.

Wrong. As we have testified in the past when earlier versions of this legislation were under consideration, AFGE fully supports the use of public–private competitions within the context of OMB Circular A–76. Clearly, work should not be contracted out without the benefit of public–private competition. And just as surely as OMB Circular A–76 gives managers the discretion to subject commercial work to public–private competitions, it also gives managers the discretion not to compete work when federal employees are doing their jobs satisfactorily.

No businesses like competition and contractors are no exception.[16] If contractors were truly interested in competition, they wouldn't be pushing legislation which eliminates OMB Circular A–76. Contractors are obviously frustrated at the increasing success of federal employees in the Circular's competitions. Formerly, federal employees lost seven out of ten competitions. Thanks to reinvention efforts and A–76 efficiency and competitiveness training by federal employee unions, in–house bids are now winning 50% of the competitions. But rather than go through the effort of reinventing themselves, contractors want to junk OMB Circular A–76 in favor of a more pro–contractor framework.

Contractors, federal employee unions, and Administration officials worked hard to revise OMB Circular A–76 two years ago to make it a more fair and equitable system. Like the contractors, AFGE has its own complaints about the Circular, principally that exemptions and waivers allow for too much work to be contracted out without giving federal employees fair opportunities to compete.[17]

It is inevitable that the public sector and the private sector will find fault with OMB Circular A–76. Big money is at stake for the contractors. It's been said that democracy is a terrible way to govern, but it's better than the alternatives. The same can be said of OMB Circular A–76. Neither side managed to achieve all of its objectives during the A–76 revision process. Contractors and their political benefactors need to learn that compromises must be made when competing interests are at stake.

It is said that this legislation simply establishes a process by which the executive branch can create a fair system for public–private competitions. Since the framework which would succeed A–76 is itself unformed, the legislation's sponsors are employing a "Don't worry, be happy" strategy. "Federal employees, your concerns will be dealt with later." Well, I was taught at a very early age not to buy a pig in a poke, and I'm too old to change my ways now.

Federal employees are justifiably be apprehensive at the prospect of a competitive framework that politicians and contractors might devise in place of A–76. At a time when some politicians' minds are impaired by notions that the public sector can do nothing right, now is no time to re–write the rules for federal service contracting public–private competitions---if we truly want to save money for the taxpayers and ensure that inherently governmental services continue to be performed by federal employees. And the often one–sided approach of this legislation only increases our suspicions.[18]

For example, certain features of A–76 are necessary if federal employees are to be allowed to compete:

> The most–efficient organization (MEO) process allows an agency to reshape itself, often by reinventing how it delivers services and sometimes by reducing its workforce, and thus allows agencies to provide the private sector with strong competition during an A–76 study.
>
> The recent revision to the Circular also allows for work to be brought back in–house when taxpayers and agencies' customers would be better served by using federal employees.

Because both features ensure strong public–private competition, they are reviled by contractors. Neither feature is recommended by the legislation for inclusion in the successor to A–76. It was explained by Senate majority staff that the intent of this legislation was not to micro–manage, but rather to let the Administration use existing statutes as models to devise a fair source selection system.

I don't believe that explanation stands up to scrutiny. For example, both the House and Senate drafts prescribe in some detail---the House provisions are more than two pages long---the procedures for calculating in–house overhead---a perennial obsession of the contractors.

Clearly, the legislation we are considering today is very responsive to contractor concerns and very unresponsive to federal employee concerns in how it directs the process by which the successor to A–76 is to be shaped. To pretend otherwise is disingenuous. That is why we say and will continue to say that this legislation is designed to ensure a pro–contractor successor to A–76. No, I am not buying this pig in a poke.

Let's now turn to the blatant political set-aside in both drafts which exempts defense depots from the legislation's scope entirely. If the provisions in the bill are good enough for the rest of the government, why exempt parts of DoD? The obvious answer: internal Republican politics. If the individuals who crafted this legislation truly had the courage of their professed convictions they would have written it to cover all parts of the government---those they liked and those they didn't like. That they didn't is yet another example of the special interest politics spurring this legislation forward.

AFGE is proud to count thousands and thousands of depot employees as members. This union has played a leading role in preventing the Clinton Administration from eliminating the federal depots, working closely with our friends in the House Depot Caucus, and we obviously do not support including depot maintenance work within the scope of this legislation. At the same time, we oppose including the rest of the government within the scope of this legislation. After all, what's bad for depots is bad for the rest of the government---from veterans' care to contract administration.

But the best---or the worst---is yet to come. Both drafts would allow challenges to agencies' determinations as to which services are commercial. Interested parties could protest when they felt agencies had *omitted* commercial services from the contractor catalogues they would be required to submit to Congress and publish in the Federal Register. This process appears to be designed to allow contractors to bully agencies into putting work which is inherently governmental up for bid.

However, among the interested parties who could issue such challenges are federal employee unions. Are we likely to use a process that would subject even more work to public-private competition? It's safe to say that the answer is no. When AFGE asked Senate majority staff why federal employee unions could not challenge *inclusions* as well as omissions---that is, when agencies mistakenly put inherently governmental services on its list of commercial activities, we were told that it was not possible for "chain-of-command" reasons.

Of course, federal employee unions are often forced to take action in accord with the law in defense of their members' interests---even when it means challenging management decisions. Indeed, that is why unions exist. And challenging inclusions would be no different.

Moreover, if federal employee unions could challenge agencies' decisions to omit services without interfering with "chain-of-command," just why is it that we would run afoul of "chain-of-command" if we challenged agencies' inclusions?

Also, why restrict this protest process to federal employee unions and contractors? When AFGE asked if ordinary Americans who depend on agencies for services could protest agencies' decisions to shift work from inherently governmental to commercial, we were told that that, too, was impossible.

Why? Take the Social Security Administration, for example. If the agency shifted a service---say the 800 number which is commonly-recognized as the best in the world, public or private---from inherently governmental to commercial, but the agency's customers were fearful that contracting out might result in inferior service, why shouldn't they be allowed to protest SSA's decision? Surely a group of concerned Social Security recipients, whose lives literally depend on effective service, have more interest in this process than a contractor, who simply wants a contract.

The same can be said of federal food inspectors and federal workplace safety inspectors. Individuals who believe that their lives might be jeopardized by the contracting out which could occur as a result of agencies misclassifying inherently governmental functions as commercial should be allowed opportunities to participate in this process. Why are their legitimate interests so unimportant? And why are the mercenary interests of the contractors so paramount?

Both the House and Senate bills allow contractors to challenge agencies' source selections in the federal claims court if they lose their bids. The Senate bill would also allow contractors to take agencies' determinations of what's an inherently governmental function to federal claims court. OMB Circular A-76 does not allow for such litigation. Obviously, the intent of the legislation is to allow deep-pocketed contractors to threaten to bury agencies in expensive, protracted lawsuits in order to force as much work to be contracted out as possible---regardless of the rules and regulations developed for the successor to A-76 that are supposed to usher in a new dawn of "fair competition" in federal service contracting.

Considering all of the litigation these provisions would generate, I can see the day when contractor executives would not raise their sons and daughters to be contractor executives like their parents. Rather, they would be groomed to become contractor executives' lawyers. After all, that's where the real money would be. I must say that I am intrigued to see the party of tort reform become the party of non-stop, special interest contractor litigation. Would the Congress pass a special tax increase on the American people to pay the bills for defending the government against all of these contractor lawsuits?

Needless to say, federal employee unions are not allowed to contest agencies' inherently governmental determinations or award selections in federal claims court. I suppose this could be a "chain-of-command" thing. Or it could be another example of just how uninterested in fair public-private competition supporters of this legislation really are.

AFGE is proud to have many Republican members and of our relationships with many Republican lawmakers, particularly on DoD issues. We're also proud to be thoroughly "Republican" when it comes to determining which services are inherently governmental and which source selections are appropriate. We believe in decentralization of this power, instead of investing it in the hands of a few insiders who are far removed from the

scene. While we don't always agree, agencies' managers are ultimately the ones best-equipped to make those decisions. They're the ones out in the field, closest to the action, who know what their agencies need to do and who should perform that work.

They're far from perfect and their decisions merit scrutiny from all of us, but managers are infinitely more expert and trustworthy than political appointees in some OMB Privatization Office, in Washington, DC (a feature in most previous versions of this legislation); federal claims court judges; contractors and their high-priced lawyers; and politicians trying to please contractor constituents.[19]

Chairman Brownback, Chairman Horn, I respectfully suggest that you follow the lead of the American people. They understand that it's federal employees, rank-and-file workers and managers, who are the ones really looking out for their interests.

> "Despite substantial distrust of the federal government, Americans show more confidence in federal employees than in their elected officials to do the right thing, according to a survey of public attitudes towards Washington. The survey, conducted by the Pew Research Center for the People and the Press, found more trust in civil servants than politicians, by 67 percent to 16 percent. Sixty-nine percent also reported holding a favorable opinion of government workers."[20]

Finally, let's talk about the most important reason why this legislation is not designed to ensure fair competition: its complete and total failure to even address in-house personnel ceilings that force agencies to contract out work--often at higher costs--because of shortages of federal employees.

The wastefulness of in-house personnel ceilings has been extensively documented:

> As far back as 1991, GAO reported that personnel ceilings were forcing agencies to contract out work at higher costs. For example, "Few of the DoE contracts for support services we reviewed were awarded on the basis of comparisons between federal and contract costs. DoE officials said they did not compare costs since they could not get additional staff to perform the work in-house because of personnel ceilings...Some DoE support service contracts cost substantially more than would using additional federal employees for the same work. Eleven of the 12 support service activities for which we conducted cost comparisons were, on average, 25% more costly."[21]
>
> In early 1994, the Office of Management and Budget (OMB) admitted that several agencies--including the Departments of Agriculture, Health & Human Services, Housing & Urban Development, State, Education and Treasury, as well as the Environmental Protection Agency--said that they each could have saved several million dollars by performing functions directly rather than having them performed by contractors but did not do so because either their requests to OMB to take on

the necessary full-time equivalents were refused or the agencies were so sure such requests would be refused that they were not even submitted.[22]

On March 16, 1995, the personnel directors of the four branches of the armed forces told the Senate Armed Services Personnel Subcommittee that civilian personnel ceilings, not workload, cost, or readiness concerns are forcing them to send work to contractors that could have been performed more cheaply in-house.

Also in March 1995, GAO reported "that the personnel ceilings set by OMB frequently have the effect of encouraging agencies to contract out regardless of the results of cost, policy, or high-risk studies."[23]

The DoD Inspector General noted, in a 1995 report, "the goal of downsizing the federal workforce is widely perceived as placing DoD in a position of having to contract for services regardless of what is more desirable and cost effective."

Independent experts like the National Association of Public Administration also verify that agencies are using in-house personnel ceilings to contract out work at higher costs. Noting the pernicious practice at a particular agency, NAPA reported that "(b)ecause of staff shortages, HUD has relied on contractor assistance in instances where considerations of efficiency and economy would favor performance in-house."[24]

We shouldn't be surprised that contracting out occurring because of personnel ceilings is wasteful. After all, there's no public-private competition. Federal employees aren't given the opportunity to compete--simply because there aren't enough of them to do the work. Clearly, agencies should be required to manage by budgets. If they have work to do and money is authorized and appropriated to do that work, then agencies should be able to use federal employees if in-house performance is to the benefit of warfighters, customers, and taxpayers. We all know that the federal government's in-house workforce is going to get smaller. We all know that there is going to be more contracting out. But agencies should not be imposing arbitrary personnel ceilings and foreclosing the option of in-house performance of important work, especially if contractors are less efficient.

Despite testimony by AFGE and other federal employee unions at hearings on previous incarnations of the legislation we are considering today, the issue of in-house personnel ceilings is still unaddressed. How can lawmakers profess to support the principle of public-private competition and then endorse legislation that does nothing to ensure that federal employees are actually able to compete? I understand that supporters of the draft bills say that dealing with in-house personnel ceilings is beyond the scope of this legislation. Come again? Taking steps towards actually ensuring fair public-private competition is beyond the scope of legislation ostensibly designed to ensure fair public-private competition?

Flawed Premise #6: The public sector's performance is inferior to that of the private sector.

Wrong. As GAO points out,

> "During the long history of (its) work in this area, (GAO has) consistently found that evaluating the overall effectiveness of contracting-out decisions and verifying the estimated savings reported by agencies is extremely difficult after the fact. As a result, we cannot convincingly prove nor disprove that the results of federal agencies' contracting out decisions have been beneficial and cost-effective."[25]

That is, after years and years of billions and billions of dollars in contracting out, the Congress' auditors cannot say that the taxpayers have been well-served. Yet, some lawmakers are prepared to jettison OMB Circular A-76 in favor of a more pro-contractor framework and then contract out expansively-defined commercial activities on a heretofore unimagined scale.

In 1994, GAO determined that savings would have been available in all nine contracting out studies it reviewed if work had only been kept in-house.[26] Does this mean that federal employees are always more efficient than contractors? Of course not. Does this mean that contractors who declare that the private sector is better than the public sector are talking rubbish? Of course.

Pro-privatization politicians often use examples from state government to buttress their case that the federal government should contract out even more work. Upon closer inspection, these examples don't appear to be very helpful to their cause.

In Private Practices: A Review of Privatization in State Government, a comprehensive study released earlier this year by the Council of State Governments (CSG), whose President is Governor George Pataki (R-NY), it was noted that "(t)hough officials privatize services to save money, the figures reported by survey respondents do not indicate impressive savings. This is due at least in part to the difficulty in calculating how much money is saved by providing services privately rather than publicly. Indeed, a majority of state respondents could not estimate the percentages of cost savings from privatization. Of those providing a percentage, most indicated less than five percent savings to state government."[27]

Let's put those meager "savings" into perspective. The estimates themselves come from state officials who obviously feel compelled to justify their contracting out decisions; and apparently most of them are making their estimates up out of thin air. As CSG notes elsewhere in its report, "some states and agencies (22.4 percent and 24.8 percent, respectively) use a formal decision-making process for privatization projects. Overall, however, they initiate privatization projects without standard decision-making, monitoring

or evaluation processes."[28]

Moreover, these "savings" don't take into account the costs of transitioning work to the private sector; administering the contracts; losses incurred due to waste, fraud, and abuse; and any diminution in cost-saving public-private competition for work when the contracts come up for renewal.

After a lengthy survey of reports comparing the effectiveness and efficiency of the public sector and the private sector, Professor Charles Goodsell, in his influential treatise on government, asks,

> "What generalizations do we draw from these data? One is that evidence for superior efficiency in the private sector as against the public sector is by no means unambiguous. The meta-analyses that summarize the literature are themselves unclear. They differ among each other in the tenor of their overviews and often exhibit differences among the findings reported. In the fields where we reviewed the literature ourselves, we also found divided findings, as in garbage collection, municipal water supply, and hospital costs.
>
> "A second generalization is that some of the comparative data reveal no significant difference between the sectors. This is the case in garbage collection in small towns (and the public's perception of it), the quality of service in large hospitals, and airline efficiency in Australia and railroad efficiency in Canada...
>
> "A third generalization is that while the private sector seems superior in economic efficiency in some instances, adverse side effects can also arise from this attribute. Examples are lower service effectiveness in bus transportation, poorer-quality service in day care centers, and greater equipment excess in nuclear medicine."[29]

Flawed Premise #7: This legislation will make the federal government more responsive to the American people.

Wrong. There are reasons why the federal government has a civil service. There are reasons why the federal government employs impartial individuals who follow established rules and procedures in order to serve the American people with favoritism towards none.

There are reasons why the federal government establishes offices throughout the nation so that all of the American people may be served---regardless of race, religion, or class. Since contractors follow profits---whether for more docile labor markets or because they must consolidate after mergers or because they would prefer not to serve low-income, high demand areas---lawmakers, particularly those who represent poor urban areas or predominantly rural areas, should consider whether enactment of this legislation would leave their districts with a minimal federal presence--or perhaps none at all--and what consequences that might have for their constituents.

There are reasons why we ensure that agencies and their employees are fully accountable to both lawmakers and their constituents. And there are reasons why we need a federal government that thinks of the long-term and the public interest instead of the short-term and private gain.

> "For politicians, contracting out frequently decreases government accountability and provides insulation from the kind of media scrutiny and citizen feedback that enhances democratic participation...(C)itizens feel far more ownership, and therefore demand far greater responsiveness, from a public agency than from a private business...
>
> "Contracting out lets political leaders evade the anger people feel when government fails them. The media show far less zeal in tracking down private contractors and scrutinizing their operations; private firms' proprietary information is much more difficult and expensive to investigate...
>
> "Conversely, there is much to be said for the accountability and durability of public sector service providers. Their books must be open, and they must abide by a set of procedures designed to discourage corruption, favoritism, prejudice, arbitrariness. They cannot go out of business overnight, leaving customers dangling. They can provide continuity of knowledge and skill, and they have structural incentives to plan better for the long term. Private sector contractors eyeing the bottom line are less apt to perform well on these criteria."[30]

Flawed Premise #8: Enactment of this legislation will result in savings for the taxpayers.

Wrong.

> "(I)n many government programs, competition frequently does not exist or is hard to stimulate...Much of what government does it does because there are few suppliers of quality goods at reasonable prices. In the absence of an effective market, turning these tasks over to the private sector might only worsen the very problems that citizens originally came to government to solve."[31]
>
> Professor Donald Kettl
> University of Wisconsin

The rationale for the endless series of costly and disruptive contracting out competitions mandated by the legislation is that savings to the taxpayers would be generated. But the absence of public–private competition and the relative absence of genuine private–private competition when contracts come up for renewal makes it likely that any savings generated by the initial public–private competitions---which have not been eaten up by contract administration or waste, fraud, and abuse---will be lost when the contracts are recompeted in a considerably less competitive environment.

With in–house personnel ceilings and funding shortfalls, the chances are remote to nil that the federal government's in–house capability will ever be recapitalized and the necessary staff assembled and trained after that work has been contracted out. That means there will be no public–private competition when most of these contracts come up for renewal.

The loss of public–private competition notwithstanding, will the level of private–private competition be strong enough when contracts come up for renewal to ensure that taxpayers won't be stuck with sole–source contractors? Research at local, state, and federal levels of government indicates that's simply not the case. As Representative Norm Sisisky (D–VA), a businessman prior to public service, said at a recent House National Security Committee hearing: "If you kill the public sector, you kill competition."

> "Contracting out is no guaranteed formula for efficiency. In most cases, only a small number of bidders compete, creating a less than fully competitive situation and vast potential for monopolistic profits. Absent considerable rigor, the potential for bid–rigging[32] and other forms of corruption remains. Total costs to the public sector may actually rise, because private contractors demand profits and even 'steering' still costs the government money."[33]

Here's a sampling of moderate, conservative, and liberal thought on how privatization turns into profitization:

> "The expansionary appetites and resistance to cutbacks of bureaucratic organizations are classic conservative laments. But profit-seeking organizations are usually at least as eager and at least as able to affect the public spending agenda.[34] The same features of private institutions that concentrate incentives for efficiency provide for a similarly concentrated interest in exercising political influence. Those who fear the political might of civil servants and prescribe wholesale privatization as a corrective have not thought things through."[35]
>
> Professor John Donahue
> Harvard University

> "It would be difficult to argue that savings (from contracting out) have been translated into reductions in total expenditure. As we have seen, contracting out is the least favored tool of the most vigorous promoters of privatization, precisely because there are no guarantees that total expenditures will be reduced. Quite the contrary, it is expected that expenditures will be maintained by self-aggrandizing bureaucrats, by a Congress whose members and constituents focus on their own net benefit (income or services from particular expenditure programs minus the shared costs), and an expanding group of contractors who can be expected to lobby for increased expenditures."[36]
>
> Stuart Butler
> Heritage Foundation

> "Public contracting is a dynamic political process that typically moves from a competitive market structure toward a monopolistic one. Even if the first round of contract bidding is genuinely competitive, the very act of bestowing a contract transforms the relative market power between the one buyer and the few sellers into a bilateral negotiation between the government and the winning bidder.
>
> "The simple textbook models of competition so prized by privatization advocates provide no guidance to what actually occurs when public services are contracted. Over time, the winning contractor moves to secure permanent control of the 'turf' by addressing threats of potential returns to insourcing or from other outside competitors. To counteract the former threat, they move to neutralize competition, most typically through mergers and market consolidation among public contractors. This trend helps to explain why two-thirds of all public service contracts at any time are sole-source affairs (California State Auditors 1996)."

"It is one thing to hire a contractor using its own staff and equipment to wash the windows in city hall. The tools, equipment, and low-skilled labor employed are obtainable from a range of providers. It is another to hire a firm to staff a county's fire houses with skilled fire fighters and purchase highly specialized equipment. Once the contractor controls these valuable critical assets, the public sector is at a distinct market disadvantage when conditions change.[37]

"Competition provides no protection because the government can sever its ties to its present contractor only at a high cost."[38]

Professor Elliot Sclar
Columbia University

Let's now look at research about the consequences of monopolies and sole-sourcing on savings from the initial public-private competitions. When touting the benefits of privatization, advocates only discuss whatever savings may be available after the initial public-private competitions when work is contracted out. As Professor Janet Rothenberg Pack of the Wharton School of Management, University of Pennsylvania, notes, privatization research

"has not usually been concerned with the longer term evolution of contracting relationships. For the most part, it concentrates on comparisons of private and public production costs at a moment in time."[39]

Here is her summary of one of the three long-term studies she reviewed for a 1991 paper:

"One study that does take up the question of how contracting arrangements develop over time examines a small, diverse group of contracts, including intermediate service inputs like vehicle maintenance, data processing, and housekeeping functions, as well as final service outputs like street cleaning, trash pickup, and fire and ambulance services.

"It provides some evidence that initial savings are not indicative of longer term outcomes. Of twelve agencies for which a comparison of costs in 1987 and 1983 was made, *only half claimed that their private contracts continued to provide services at lower costs. In most of these cases estimated savings had substantially decreased over the four years. Two agencies still contracting with private firms believed that their own costs would have been lower than current contracts, but cited political obstacles to reversing the contracting decision. In three other cases, production had reverted to the public agency...*"[40]

Professor Elliot Sclar of Columbia University looked at three different contracting out cases to determine the reliability of claims that privatization saves money in the long-term.

> "Each case covered at least four years, so the findings are less likely to be affected by temporary start-up costs...Each appeared to be a strong candidate for privatization, since they all involved physical, 'blue collar' work that is thought to be the easiest type of service to deliver through contracting. The types of tasks involved are also routinely performed in the private sector.
>
> "In the case of vehicle maintenance in Massachusetts, the privatization was carried out as its advocates initially planned. In Indianapolis, privatized vehicle maintenance was abandoned in favor of internal reorganization.
>
> "As for Albany and Massachusetts, there was no evidence that contracting saved money or improved service quality. In Indianapolis, however, substantial savings and an improvement in the quality of work can be documented.
>
> "In Albany, the best estimate is that the city is overspending by at least 20% under privatization, not counting the added costs of contract auditing and supervision. By contrast, Indianapolis can document savings in the range of 8-29%. It is not possible to estimate the true costs (or benefits) in the Massachusetts case, although the loss probably ranges from 9% to 27.5%.
>
> "*Why did things not turn out as well as privatization advocates predicted? For one thing, the tasks that make up the bulk of public service are often more complex than privatization advocates maintain, and the complexity translates into extra costs to administer the contracting process, monitor work, and evaluate performance. These can easily outweigh savings from lower production costs. Private organizations themselves often find that the administrative costs of performing tasks in-house are less than the transaction costs of using the market when key elements of their mission are at stake.*
>
> "*These cases point up the hazards of premature conclusions as to what is easy to contract out. Problems of accountability and control can be daunting. The findings in this study do not augur well for decisions to expand the scope of contracting to ever-larger and more complex public services.*"[41]

In his report on Denver's ill-fated effort to privatize its buses, Professor Sclar noted that

> "*(t)ypically, it is the case (with privatization) that even if some initial incremental savings are found, they average somewhere around 10 percent. However, by the second round of contracting, even they disappear.*[42]

> "...*Lower costs only translate into public savings if there is competition to force the issue. But contracting for the direct provision of a public service is only competitive, if at all, in the first round. At that time, there is often mild competition for the first contracts. However, once the operation gets underway, the unique nature of the service is usually such that the contract evolves into a de facto monopoly favoring those who won the first round bid.*[43]

GAO recently reported concern over the likelihood of limited private–private competition for social service contracting at the state and local levels of government.[44]

> "State and local governments face several key challenges as they plan and implement strategies to privatize their social services.
>
> "First is the challenge to obtain sufficient competition to realize the benefits of privatization. While there is some disagreement among the experts, *some believe that the unique nature of social services may limit the number of contractors able or willing to compete. The results of the few studies that examine this question are inconclusive...(S)ome (state and local) officials expressed concern about an insufficient number of qualified bidders in rural areas or in contracts requiring highly skilled staff.*
>
> "Second, *state and local governments often have little experience in developing contracts that specify program results in sufficient detail to effectively hold contractors accountable.*
>
> "Third and finally...*weaknesses in monitoring contractor performance make it difficult to ensure that all intended beneficiaries have access to services and determine whether private providers achieve desired program goals and avoid unintended negative consequences.*"

The three privatization pitfalls described by GAO at the state and local levels—insufficient private–private competition, poor contract administration, and unreliable contractor performance—are even steeper at the federal level.

Let's look at two agencies which annually contract out billions of dollars in goods and services to the private sector, DoE and DoD.

In 1994, DoE officials became alarmed at skyrocketing service contracts. Noting that only seven contracts had been put up for bid over the last 25 years when an incumbent contractor wanted to stay on, DoE officials put their collective foot down and said that service contracts would no longer be automatically renewed.

What was the response from DoE contractors? "The 'specter of competition' led some contractors, including Westinghouse Electric Corp...to offer to reduce costs by 15 percent to 20 percent. 'If implied competition will do that, imagine what real competition will do,' quipped (a DoE official)."[45]

Is this that rarest of things--a contract administration success story? Unfortunately not. Although recompeting contracts seemed so simple a solution, by 1997 it was clear that this reform effort was not going to have a happy ending.

> "The Energy Department continues to make noncompetitive awards for management and operating contracts despite having changed its policy and having adopted competitive contract awards as the standards for these contracts, according to a General Accounting Office report.
>
> "Of 24 M&O contracts awarded between July 1994 and August 1996, DoE awarded 16 noncompetitively. Also, DoE decided not to compete three major contracts before it renegotiated the terms of the contract renewal--a practice that is contrary to contract reform."[46]

Turning to DoD, a recent article in The New York Times noted the virtual monopoly of contractors supplying the Pentagon with new military hardware:

> "(T)here are now significantly fewer Pentagon contractors bidding on any given military contract. The three prime contractors now represent about two-thirds of all military product sales. The price of this change, industry analysts say, is the potential for less innovation in the design of military products, and less control by the Pentagon over its suppliers, in times of peace as well as in war, because the Pentagon has less financial clout over them."
>
> Even the rabidly pro-contracting out Defense Science Board expressed fears that "monopolistic practices could be 'harmful to defense product cost, quality or performance' and that reduced competition could depress innovation, especially among smaller military suppliers."[47]
>
> "Power has shifted from the Defense Department to the defense contractors," said one congressional military analyst, who spoke on condition of anonymity. "The Pentagon has less leverage when there are fewer places to go to fill mission needs. Companies have fiduciary responsibilities to shareholders."[48]

The consequences of this shift in power were reported in an earlier article in The Washington Monthly:

"Lack of competition is why the Pentagon often countenances corruption. In 1986, when 45 of the Pentagon's top 100 contractors were under criminal investigation, a general explained to The New York Times, "It would be swell if I could say, 'You're a naughty boy and I'm going to cast you into oblivion.' But if I do where am I going to buy the submarines and tanks that I need?' Competition is sometimes so scarce that the Pentagon contracts for goods it admits are unnecessary, just to keep a contractor in business."[49]

Ominously, the same contractors who use their monopoly power to dictate to the Congress and the Pentagon how much taxpayers will have to pay for new weapons systems are now moving into social services.

"By the year 2000, America's largest weapons manufacturer, Lockheed Martin, may be as familiar to mothers on welfare and social service bureaucrats as it is to the Pentagon's top brass. If the company's strategy succeeds, Lockheed Martin will be not only be a major aerospace manufacturer but also a leading dispenser of food stamps, Medicaid, and other public assistance programs to America's neediest citizens.

"...(A) new company 'welfare reform' division is busy gobbling up contracts to run job-placement offices and automated kiosks for the distribution of food stamps and cash assistance in dozens of states and localities.

"Unfortunately, the move from warfare to welfare is not an exercise in beating swords into plowshares; rather it is part of Lockheed Martin's grand strategy to grab as many taxpayer dollars as possible.

"Beyond the $12 billion it continues to rake in annually from the Pentagon, Lockheed Martin now receives $6 billion to $8 billion in nonmilitary funds from federal agencies as diverse as the Department of Energy, the Federal Aviation Administration and the Census Bureau. And that doesn't even include the corporation's growing empire of state and local government business...Now that new block grants have ceded to states control over an annual $17 billion in welfare funds, Lockheed Martin is betting that public assistance will be its next big prize."[50]

If the legislation under consideration today is enacted, will contractors like Lockheed Martin be able to use their extraordinary political clout and awesome financial resources to reduce private-private competition in these new markets as effectively as they have in weapons procurement? Of course.

Flawed Premise #9: Effective contract administration is outside the scope of this legislation.

Wrong.

> "(O)f course, the federal government has already painfully suffered the cost of failing to learn the real lessons of privatization. The most egregious cases of fraud, waste, and abuse in the 1980s were of contracting out gone awry, of the failure of the Pentagon, in particular, to pay careful attention to its contractors. Management problems at HUD in the late 1980s put billions of dollars at risk, while inadequate oversight of a major Hubble space telescope contractor led an expensive 1994 mission to repair major faults. Add to that the failure to detect fraud in the Medicare program, the costly failure to detect and prevent the thrift crisis of the 1980s while the problems were embryonic, and the international scandal that flowed from the BCCI case of the late 1980s, and one message is clear. The potential for private distortion of the public interest is huge."[51]
>
> Professor Donald Kettl
> University of Wisconsin

We all know that those who don't learn from history are doomed to repeat their mistakes, but are we so foolish as to intentionally repeat those mistakes on an almost infinitely grander scale?

> "The conclusion that public goods are produced most efficiently when they are produced by the government is first and foremost an empirical, not a theoretical, conclusion. It was arrived at in spite of an ideological commitment to contracting out. It is unclear why we seem to want to unlearn that which we have already learned conclusively and at a very high cost."[52]
>
> Professor Moshe Adler
> Rutgers University School of Management

Even though it comes within the scope of the two subcommittees which have convened today's hearing, it is said that contract administration is outside the scope of the legislation. In fact, the legislation we are now considering not only fails to address the existing crisis in contract administration but would actually make it far worse by completely overloading that broken and busted system.

Lawmakers need to ask themselves a very simple question:

> If it is manifestly clear that the taxpayers are being billed for billions and billions of dollars in contractor waste, fraud, and abuse every year as a result of the $110 billion in service contracting currently undertaken, just what sort of extraordinary budget-busting losses will we see when, over a five-year period, the federal government is put up for bid?

Because, Chairmen Brownback and Horn, your subcommittees are responsible for providing effective oversight of the federal government's contract administration, I know that I am posing that question to the right people.

Why is so much federal service contracting so rife with so much corruption? As two eminent social scientists point out, corruption is to contracting out what peanut butter is to jelly. Consequently, corruption must be counted as one of the many significant hidden costs of contracting out that ultimately make in-house performance of government services the superior option.

> "In much of the privatization debate, transaction costs are typically ignored. The product is routinely treated as if it is sold in a spot market, as if all one needs to do is announce the availability of the contract, specify the relevant conditions and terms, and wait for bidders to beat a path to the door.
>
> "Public contracting...always involves `moral hazard,' which arises in any situation in which the best economic interest of at least one of the parties to a transaction can be better served by dereliction of duty or outright dishonesty. In public contracting, these problems can arise on both sides of the deal.
>
> "Private contractors have obvious temptations to serve their own interest rather than those of a nebulous `public' for whom they ostensibly work.
>
> "To avoid--or at least minimize--the extent to which moral hazard becomes out-and-out theft, government is forced to impose increasingly elaborate oversight and audit systems...One only needs to examine the federal government's long, expensive, and well-documented attempts to control these problems in its defense contracting programs. Such an examination would illustrate this approach's ever-growing supervisory costs and consistently diminishing benefits. Unfortunately, once government commits itself to privatization, it seems there is no turning back."[53]

Professor Elliot Sclar
Columbia University

"The current advocates of privatization contend that (past) failures actually teach us a way to make `outsourcing' work. What is new in the current efforts, according to Professor E.S. Savas of Baruch College, a consultant to governments here and internationally, `is introducing competition into the delivery of public services.' The fastest privatizer in the country, Mayor Stephen Goldsmith of Indianapolis, has argued that the past failure of privatization was due to monopolization.[54]

"There is only one problem with these ideas: measures to make outsourcing competitive already litter the history of private-sector provision of public services and all have failed. If there is a lesson, it is that the incentives for a public servant who hires a contractor are inherently different from the incentives for a private entrepreneur who hires a contractor. The entreprenuer is interested in performance and nothing else. The public servant may trade performance for a personal gain. *In the end, governments have proved to be the most efficient when their services are produced by public employees rather than private contractors.*"[55]

Professor Moshe Adler
Rutgers University School of Management

AFGE is proud to represent federal employees who perform procurement work--from the Government Printing Office to the Defense Logistics Agency. These workers are hidden heroes who often go unappreciated by the taxpayers, customers, and warfighters whose interests they serve with such diligence. Every year, they ferret out hundreds of millions, perhaps even billions, of dollars in contractor waste, fraud, and abuse. But they're understaffed and underresourced. Moreover, they're burdened with bad contract administration systems foisted upon them by successive Congresses and Administrations. Finally, they're powerless to act when senior managers, military personnel, and political appointees send contracts towards politically-well connected firms--which sometimes then hire those very same senior managers and political appointees upon their retirement.

"Government's record of buying smart is not strong. Government regulations sometimes force decision makers to focus obsessively on obtaining the lowest price regardless of quality or performance. No smart private sector corporation would operate that way; reliable delivery of quality parts would loom large in their decisions. But government workers are often not allowed to make such judgments and, when they are, they typically are ill-equipped and under-staffed to do the job. The current move to slash the federal workforce even further[56] risks undermining the government's ability to do the job."[57]

Professor Donald Ketti
University of Wisconsin

Putting the government up for sale over five years is obviously unprecedented, so one can't say for sure just how disastrous the legislation's enactment would be. Therefore, it would be instructive to look at three parts of the federal government that have already been substantially contracted out. In other words, if you like what you see in Medicare, the Department of Energy, and the Superfund program, you'll just love what would happen to the rest of the government as a result of this legislation.

As a journalist writing in The Washington Monthly points out,

> "much of what commonly passes for 'bad government' is actually bad contracting. Medicare is a fine example. The program is almost entirely run by private medical equipment suppliers, hospitals, insurance companies, and 'fiscal intermediaries'--the people deciding who, what, and when to reimburse. They do such a poor job that recent Senate hearings found $27 billion a year in annual fraud."[58]

He notes how pro-privatization politicians brag about the inherent superiority of the private sector and insist that all of government's ills would be cured if more work were turned over to the private sector.

> "If that were the case, the Department of Energy would have the finest record in the federal government. It relies more heavily on the private sector than any other agency, paying about 80 to 90 percent of its budget to such corporate giants as General Electric and Martin Marietta. It has only 20,000 civil servants and anywhere from 7 to 10 times that number of employees on private contract...
>
> "But DoE contractors have a miserable record. Take the plant built in Rocky Flats, Colorado, to produce plutonium triggers for hydrogen bombs. In theory, the contractor, Rockwell International, followed orders from civil servant plant managers. But while officials looked the other way, Rockwell poured toxic and radioactive waste into the ground, and stored more in leaky metal drums. It eventually left 108 separate waste dumps and toxic solvents in the earth at 1,000 times the acceptable concentration.
>
> "The problem, DoE's inspector general found in 1991, was the government's attitude: 'stay out of Rockwell's business and let them run the show.' This held true even after DoE was alerted to the trouble. In many cases it even relied on the criminals to clean up the crime scene. At Rocky Flats, DoE officials gave Rockwell $27 million to clean up five 'ponds' of radioactive and hazardous waste that it had helped create. But Rockwell bungled the complicated procedure--supervisors caught their error, but not before the 'cleanup' was nearly complete--and GAO now estimates that cleaning the pond will take until 2009, at a cost exceeding $170 million. The DoE's market-driven response: From 1986 to 1988, when Rockwell's performance was dismal, it received a rating of 90 out of 100--and $26.8 million in bonuses.

"Rocky Flats is hardly unusual. DoE presides over 14 major nuclear facilities and is, (according to one prominent social scientist), 'an administrative shell over a vast empire of contractors.' 'Shell' is right. The department's management is so thin and the burden of oversight so heavy that there is virtually no accountability...

"As DoE shows, when the government contracts out, the lack of qualified managers—or sheer incompetence—often leads to a surrender of authority to the shadow government. With time, as contractors make the crucial decisions and develop expertise and authority, the government starts working for the contractor instead of the other way around. Decisions that should be the province of elected officials fall into the hands of hired guns."[59]

The consequences of that surrender of authority is manifestly clear when we consider the Environmental Protection Agency's Superfund program.

"Superfund, designed to clean up especially noxious waste sites, is often cited as a prime example of government ineptitude. But the 1980 law that established the program was a privatizer's dream. It placed a tight limit on EPA's administrative budget, forcing it to rely heavily on contractors. In theory, government would make the decisions and contractors would do the work.

"In practice, though, the government has run Superfund in name only: 'Nearly all the important information, the analyses and ideas come from consultants and contractors,' reported the Office of Technology Assessment. For-profit contractors decided which sites to clean up, how to do so, and what constituted success. They drafted regulations, standards, and congressional testimony. Contractors even trained other contractors and evaluated their performance.

"Abuse has been rampant. Many of the contractors have worked simultaneously for both the EPA and the industries that had created the waste they were cleaning up. With few of the resources needed to keep contractors honest, EPA has paid millions in bogus charges. One company, the engineering firm CH2M Hill, billed the government for use of the firm's private jet, alcohol for employee parties, and tickets to Denver Nuggets basketball games."[60]

It's not like any of this information should be new to lawmakers, especially those responsible for oversight of the government's contract administration efforts. But over the last ten years, the contract administration alarm has gone off several times—only for successive Congresses and Administrations to push the snooze button again and again.

"In a 1989 Office of Management and Budget study, half the programs at high-risk for abuse relied on contractors, and 80 percent had some tie with the private sector."[61]

"In 1992, OMB "swat teams" found massive abuses by contractors, and a House committee concluded that 'ineptitude, poor planning and inadequate auditing' and 'venality and corruption...cost taxpayers billions of dollars in faulty procurements each year.'"[62]

Also in 1992, discussing civilian agency contracting generally, GAO urged the Congress to address ineffective contract administration, insufficient oversight of contract auditing, and lack of high-level management attention to and accountability for contract management.

"At the core of contracting problems, (GAO has) found a lack of senior-level management attention to agencies' contracting activities. In some cases, senior officials have remained blissfully ignorant of waste and abuse because agencies do not have management information systems that 'flag' contracting problems. In other cases, senior officials have not made managers accountable for effective contract administration, nor have they made a sufficient commitment to correct contract problems that have surfaced."[63]

In 1994, OMB issued one of the most damning assessments of the federal government's contract administration efforts ever written.

> "Contracting personnel concentrate on the award of contracts and the obligation of funds. Contract administration, particularly in most civilian agencies, is conducted by agency program staff and not by contract personnel. The program staffs are often ill-trained in contract administration.
>
> "Cost analyses and independent government cost estimates are not performed by many agencies prior to the renewal, extension, or recompetition of existing contracts. In some instances, cost estimates are not prepared prior to entering into new contracts.
>
> "Agencies often assume that additional government personnel will not be authorized and, therefore, there is no alternative but to contract for needed services. Several agencies requested that they be given more flexibility with respect to determining whether work should be performed by agency or contractor staff. Examples were reported where the government...could save several millions of dollars by performing functions directly rather than having them performed by contract.

"The contracting process is viewed by both contracting and program personnel as being overly burdensome, complex and time consuming. As a result, agencies are increasing their reliance on task order contracting instruments, and in many cases orders are often placed without the benefit of open competition or market research. In addition, the services are not always reviewed prior to acceptance or payment.

"The statements–of–work used to describe the specific tasks or services to be procured by contract are frequently so broad and imprecise that vendors are unable to determine the agency's requirements. As a result, competition is limited and performance cannot be assessed."[64]

In 1995, GAO issued its series of high–risk reports which discussed the massive amount of contractor waste, fraud, and abuse in federal service contracting,[65] including the

"disbursement of $25 billion to (defense contractors) that cannot be matched to supporting documentation to determine if payments were proper...

"reliance on contractors to voluntarily return hundreds of millions of dollars in added costs when acquiring weapons systems.[66]

undermining of Medicare "by flawed payment policies, weak billing controls, and inconsistent program management. Instances of scams, abuses, and fraud abound in the $162 billion program. Insurers have owed Medicare millions of dollars for mistaken payments. Moreover, to maximize profits, providers continue to exploit loopholes and billing control weaknesses."

reliance by civilian agencies "on contractors to provide goods and services costing tens of billions of dollars a year. It is critical to ensure that contractors' work is done at reasonable cost. But this has not always been the case...At the core of contract management problems, we have found a lack of senior–level management attention to agencies' contracting activities."

allowance of "extensive latitude" to DoE contractors to the tune of $15 billion annually, and failure to "require contractors to have financial audits despite continuing disclosures of abuse and poor management. As a result, the government is not adequately protected."

"ineffective oversight by the National Aeronautics and Space Administration, which spends about $13 billion a year under contract, that has resulted in cost growth and schedule slippage in completing large space projects."

"contract management problems in the Environmental Protection Agency's multibillion dollar Superfund hazardous waste cleanup program (which) have provided contractors too little incentive to control costs."

In 1997, GAO followed up on its reports from two years before and announced that little had changed.[67] In fact, the crisis in the federal government's contract administration had grown even more severe.

Defense Contract Management: "Improvement and simplification of the Department of Defense's contract payment system is imperative. If DoD does not achieve effective control over its payment process, DoD's Defense Finance and Accounting Service will continue to risk overpaying contractors millions of dollars. Further, failure to reform the payment system perpetuates other financial management and accounting control problems and increases the administrative burden of identifying and correcting erroneous payments and their associated costs...

"DoD has established a voluntary disclosure program to encourage defense contractors to report potential civil or criminal procurement fraud to the government. However, contractors' participation in the program has been relatively small and the dollar recoveries modest...As is the case with many other elements of defense, contract administration and audit resources have been reduced, and further reductions are planned...(Nevertheless,) DoD continues to look to additional outsourcing opportunities, and it plans to increase its procurement budgets significantly in the coming years."

Environmental Protection Agency: "(A)lthough EPA has been addressing the weaknesses in contract management, the agency remains vulnerable to overpaying its contractors and not achieving the maximum cleanup work with its limited resources. EPA needs to better estimate the costs of contractor's work, use the estimates to negotiate reasonable costs, provide contractors with appropriate incentives to hold down their administrative expenses, and increase the timeliness of contract audits."

Department of Energy: "When we recently completed a review of the status of all of DoE's contract reform actions, we noted that competition now may be the rule but that DoE has a long way to go before it realizes the benefits of competition. Most of DoE's contract decisions continue to be noncompetitive. In addition, we found that problems are emerging in early implementation. For example, the contracts' goals are not always linked to those of the Department. Given the magnitude of these reforms, implementation problems are to be expected. However, they must be identified and corrected for contract reform to succeed. "Also, it is critical that DoE not lose its momentum and priority in implementing contract reform. Therefore, continued high-level monitoring and oversight by DoE will be needed to identify problems, standardize the best practices, and make

needed corrections as DoE makes it way through these changes.

"DoE also needs to make the specific changes we identified in our recent review of its early implementation of contract reform. For example, DoE should competitively award its management and operating contracts to the greatest extent possible and link the contractors' goals to DoE's strategic goals."

Defense Weapons Systems Acquisition: "DoD is pursuing a number of positive initiatives that should, over time, improve the cost-effectiveness of its acquisition processes and is reporting some success in terms of cost savings or avoidance and other benefits. However, it may take several years of continued implementation before tangible results can be documented and sustained.

"While these initiatives are commendable, DoD continues to (1) generate and support acquisitions of new weapons systems that will not satisfy the most critical weapon requirement at minimal cost and (2) commit more procurement funds to programs than can reasonably be expected to be available in future defense budgets. The fundamental reforms needed to correct these problems have not yet been formulated, much less instituted by DoD and the Congress."

Medicare: "Since the first report in the series, the Health Care Financing Administration, the Department of Health and Human Services' agency responsible for running the Medicare program has made some regulatory and administrative changes aimed at curbing fraudulent and unnecessary payments. However, in recent years, sizable cuts in the budgets for program safeguards, where most of the funding for the fight against abusive billing is centered have diminished efforts to thwart improper billing practices...

"Problems in funding program safeguards and HCFA's limited oversight of contractors continue to contribute to fee-for-service program losses...In addition, the managed care program suffers from excessive payment rates to HMOs and HCFA's weak oversight of the HMOs it contracts with. These flaws leave beneficiaries without information essential to guide their HMO selection and without assurance that HMOs are adequately screened and disciplined for unacceptable care...

"Many of Medicare's vulnerabilities are inherent in its size and mission, making the government's second largest social program a perpetually attractive target for exploitation. That wrongdoers continue to find ways to dodge safeguards illustrates the dynamic nature of fraud and abuse and the need for constant vigilance and increasingly sophisticated ways to protect against gaming the system."

When GAO's 1997 reports were submitted to the Congress, a conscientious House lawmaker expressed frustration that so many items on the original list of high-risk programs were still designated as such, despite numerous recommendations from GAO and legislation passed by Congress to establish broad management reforms and improve the government's fiscal management. "I think that something needs to be done to ensure that federal agencies make at least some sort of effort to comply with laws the Congress passes," (this lawmaker) said. If they do not, then the Executive Branch is really out of control."[68]

That conscientious lawmaker--who happens to be none other than Chairman Horn--was dead-right when he said that things were "out of control."

So why are we considering legislation today which would almost exponentially exacerbate that chaos and corruption?[69]

And why is it that every service contracting reform effort--whether sincere or half-hearted--ends in abysmal failure and the crisis in contracting out grows worse and worse?

Is it because contractors use their considerable political leverage to foil reform efforts?

Is it because the "moral hazard" inherent in government contracting makes such astounding amounts of waste, fraud, and abuse inevitable? Or is it both factors?

And why, as GAO points out, is the Congress throwing out of their jobs employees who perform contract administration work when their skill and industry are more needed on behalf of the taxpayers than ever before?

In any event, the appropriate response to the crisis in contracting is clearly not more contracting out, let alone putting an average of one-fifth of the government up for bid every year.

Now that we've reviewed the "big picture" of contract administration, let's look at six different types of contract administration scandals:

1. Stealing Government Property
GAO reviewed several contracts in DoE after learning of reports that millions and millions of dollars in government property was missing.[70]

> "(GAO's) property management work has led (GAO) to several observations. First, a substantial amount of DoE's property is missing, probably more than the $74 million identified in (GAO's) April 1994 report. Second, numerous weaknesses exist in DoE's contractors' property management systems. Those weaknesses include inadequate property-tracking data bases and a lack of physical protection of DoE's property from theft. Third, DoE has not provided sufficient oversight of the contractors' property management activities...Given the number of problems DoE faces as well as the complexity of those problems, it will take years of continual management attention for DoE to address all of the problems."
>
> "The items of missing property span a wide variety of equipment categories. They include computer equipment, such as monitors and keyboards; shop equipment, such as lathes and drill presses; offices equipment, such as desks and typewriters; electronic equipment, such as radios and pagers; and photographic equipment, such as cameras. Finally, some heavy equipment such as forklifts and a semi-trailer are also missing.
>
> "*Let me emphasize that while the $74 million worth of missing property is high, this amount represents only what the contractor reported to DoE as missing. We believe that the $74 million figure probably understates the actual amount of missing property*, particularly in light of (GAO's) detailed review of property management at the Rocky Flats Plant. In that review, we found that in addition to the nearly $13 million worth of missing property reported by the contractor, the contractor could not physically locate another $16 million worth of property...(GAO) also noted that the contractor, during a 1-year period, inappropriately deleted over 500 items from the property-tracking data base without maintaining any historical record of the items' existence. Some of these deleted items may have been lost or stolen and DoE would never know that that occurred."
>
> Among the problems GAO identified were lack of operating procedures, inadequate employee training, incomplete reporting of property, inadequate storage of property, physical inventories not being conducted on time, lack of physical security, and improper utilization and disposal of equipment.

I would be negligent if I failed to remind lawmakers that the astounding losses in this report were from just a few contracts at a single agency. DoE all by itself, as GAO noted ominously, "has accumulated more than $12 billion in property, most of which is in the possession of its contractors."

Moreover, the then House Committee on Government Operations reported several years ago that more than $40 billion worth of materials and equipment purchased by the federal government for use by contractors in the performance of their services was still in the possession of those contractors.[71] The report noted that, in many cases, contractors had improperly used this federal government property to perform commercial work unrelated to the contract. In addition, according to the report, some of that property had even been sold back to the government. Perhaps these two subcommittees could combine forces to address this problem. As the GAO report on DoE indicates, this problem has likely gotten worse.

2. Charging Taxpayers for Unallowable Overhead Costs

> "(GAO's) work and the audits of the Defense Contract Audit Agency and the Inspectors General shows that unallowable and questionable overhead costs are a significant and widespread problem—costing federal agencies and American taxpayers potentially hundreds of millions of dollars annually..."
>
> "To illustrate the types of problems," GAO looked at the bills of just eight contractors, "sampling only a few accounts." (GAO) found that all eight contractors had included unallowable and questionable costs in their overhead claims."
>
> For example, alcohol is never allowable as a charge against government contracts. But six out of the eight contractors surveyed charged in excess of $25,000 to the government for booze.
>
> One contractor charged the taxpayers $62,000 for the use of a 46–foot sportfishing vessel, claiming that it was used for "product testing."
>
> Instead of taking the required lowest standard commercial airfare, one contractor charged the taxpayers the full cost of two chartered aircraft flights, costing the government $11,000 more in unnecessary charges.
>
> Another contractor charged the taxpayers $333,000 in overhead for trips to Mexico, Jamaica, and the Grand Cayman Island for annual management meetings. On the Jamaican junket, 151 contractor employees—most of them accompanied by their spouses and significant others—were involved. "According to the contractor, the purpose of the trip was to review operating policy and marketing strategy and serve as a stockholders meeting. Company officials advised (the GAO) that such meetings are: "...intended to promote a corporate `cohesiveness'

via both social and business interaction...and...combine business and fun..."

Displaying a wry sense of humor not normally associated with GAO auditors, the report noted that the Congressional investigators didn't "question the need to have legitimate business meetings. However, (the GAO did) question whether the government should pay for events that have the character of a vacation, especially in tropical resorts outside the United States."

Contractors also stuck taxpayers with the bills for their entertainment, including sports tickets, schooner rentals, running shoes, cable television, lottery tickets, hospitality suites at the 1991 Tailhook convention, golf outings and greens fees, chili cook-offs, and orchestra tickets.[72]

3. Bonuses for Contractors Who Do Bad Work

Often, agencies' contract administration systems are so bad and contractors are so in control of the contracting out process that some contractors get bonuses even when they do bad work.[73]

"(GAO) found that EPA had granted interim award fees to contractors whose performance was rated as less than satisfactory at the end of the contract." Previous reports disclosed that 6 EPA contractors in a sample size of only 11 had received less than satisfactory overall performance ratings but somehow managed to get between 29 and 45 percent of the available award fees.

In another report discussing six DoE award-fee determinations, the contractors' environmental performance was rated as satisfactory or better. "As a result, these contractors received the majority of the available award fees even though they had been cited for repeated Resource Conservation and Recovery Act (RCRA) violations. For example, one of these contractors was cited by EPA and a state for 17 RCRA violations yet received an 'excellent' rating for environmental management."

In the report's conclusion GAO forlornly reminded agencies that if bonuses "are awarded automatically, they reduce the contractor's incentive to provide timely, high-quality work."[74]

4. Billing Defense Contractor Executives' Pay Directly to the Taxpayers

AFGE has consistently opposed the efforts of defense contractor kingpins to extract even more money from the nation's taxpayers for their personal benefit. Up until last year, defense contractor executives had been prevented from directly billing the taxpayers for more than $250,000 annually for their salaries. As a result of a provision in last year's defense authorization bill, that cap has been lifted to $340,000 annually. The Administration had proposed that the pay cap be set as high as $4,000,000 for contractor executives in large firms. Because the contractor executives were demanding that the

pay cap be lifted entirely, the Administration's proposal was considered by some to be a reasonable in-between position.

It is likely that the contractor executives will come back again this year in hopes of eliminating the cap. The Congress should turn back this raid on the treasury and instead reduce the cap to $150,000. Those firms which want to pay their executives in excess of that amount would be free to do so but would have to use corporate profits. That is, they'd have to take the money from their shareholders instead of the taxpayers.

5. Endangering the Health and Safety of Contractor Employees

> "Federal contracts have been awarded to employers who have violated safety and health regulations issued under the Occupational Safety and Health Act. For fiscal year 1994, we found 261 federal contractors who were the corporate parent companies with worksites at which OSHA assessed proposed penalties of $15,000 or more for violations of federal safety and health regulations...In fiscal year 1994, the 261 federal contractors received $38 billion in contract dollars, about 22 percent of the $176 billion in federal contracts of $25,000 or more awarded that year."[75]

Clearly, the government has more than ample reason to make sure that taxpayers do not reward employers who disregard their employees' health and safety with public contracts.

6. Violating Contractor Employees' Right to Organize and Collectively Bargain

> "Federal contracts have been awarded to employers who have violated the National Labor Relations Act. (GAO) found that 80 firms had violated the act and received over $23 billion, about 13% of the $182 billion in federal contracts awarded in fiscal year 1993...
>
> "The Board cases that (GAO) examined indicate a range of violations. The cases also show that the Board had ordered various remedies relating to the unlawful activities by firms that discouraged workers from exercising their right to bargain collectively. For example, as a remedy, the Board ordered firms to reinstate or restore workers in 35 of 88 cases (some of the 80 firms were involved in more than one case) in which workers were unlawfully fired, transferred, or not hired in the first place because of activities for or association with a union. Other remedies, such as restoring lost wages and benefits or demanding that the firm stop threatening workers with job loss, were also ordered by the Board in many of these 88 cases. Altogether these remedies affected nearly 1,000 individual workers as well as thousands of additional workers represented in 12 bargaining units.

"Fifteen violators (almost 20 percent of the 80 firms) might be considered more serious violators. These firms, for example, had been ordered to reinstate or restore more than 20 individual workers each or had been issued a broad cease and desist order by the Board. Of these 15 violators, (GAO) also found some that have a history of violating the act."[76]

Again, the government has more than ample reason to make sure that taxpayers do not reward employers who discriminate against employees exercising their right to organize and collectively bargain with public contracts.

7. Discriminating Against Employees

Contractors have repeatedly been cited for violating federal rules requring them to observe pay equity for employees and to avoid discriminating on the basis of sex, race or age. Here are a few examples:

In January 1998, a computer services contractor agreed to pay $400,000 to settle Labor Department charges that it paid female employees less than their male counterparts doing the same work.[77]

In November 1996, a bank in Cincinnati that served as an issuing agent for U.S. savings bonds (and thus was considered a contractor) agreed to pay $887,000 to resolve allegations that it discriminated against job applicants who were African-American or members of other minority groups.[78]

In June 1996, a supplier of medical equipment to the federal government agreed to pay back wages and make salary adjustments to settle Labor Department charges that the company paid minority and female managers and supervisors less than their male counterparts.[79]

Flawed Premise #10: To the employee, there's no difference between working for a contractor and working for the government.

Wrong.

> "A decade ago, collecting garbage (in New Orleans) was a job on the lower rung of the middle class, paying today's equivalent of roughly $9 an hour plus health and other benefits. But over the years, the city privatized the service, and the contractor turned to temporary workers. Now it is mostly a day job, with base pay of $5 an hour, little safety gear and no health insurance."[80]

Champions of contracting out say that private sector firms generate savings for taxpayers by devising more efficient ways of delivering services. However, much contracting out is actually done to shortchange employees on pay and benefits. Often, contracting out is done to avoid unions. Chairman Horn, you are to be commended for bringing this important issue to the forefront at the earlier hearing you conducted on this legislation.

However, despite the suggestion included in AFGE's previous testimony, nothing in the legislation we are considering today would force contractors to devise better ways of delivering services and thus reduce their incentives to provide substandard wages and benefits. I suppose that supporters might say such issues are beyond the scope of this legislation. However, privatization advocates often talk about the importance of incentives. Well, if they mean what they say it's incumbent upon them to give contractors the right incentives.

> "Just as with corporate outsourcing, 'the big savings in (public sector) outsourcing are from wages,' says James Mercer, president of the Mercer Group..."[81]

Referring to "living wage" statutes--which merely set minimum wages for contractor employees that are not much higher than the federal government's own minimum wage--in Baltimore, New York City, and Los Angeles, a prominent contracting out consultant admitted that "these laws dramatically reduce potential cost savings, and discourage a lot of private firms from competing."[82]

These false "savings" come at a considerable cost.

> "'Everyone sees outsourcing as a way of gaining for the government the advantages and flexibility of the private sector, but this creates problems for society,' says Frank McArdle, managing director of the General Contractors Association of New York. 'When you drive down wages through outsourcing, you

undermine your tax base and you add to the burden on government services."[83]

"What's more, contracting out often offers a way to bypass fair standards. Minority groups and public sector unions have helped create a workforce that has a higher proportion of women and minorities than the private sector; that pays a living wage; offers reasonable, if moderate, health care and pension benefits; and is protected against arbitrary firings.

"Increasingly, private sector firms whose aims are securing public sector contracts are relying on low-wage, no-benefit policies to give them the competitive edge. As privatization increases, it could well have even wider impact, serving to sanction labor force practices that reinforce private companies' efforts to cut labor costs and renegotiate the social contract."[84]

That doesn't even deal with the human costs. For example, a recent study of ten different municipal jobs found that in seven out of ten cases of privatization, entry-level wages fell below the poverty line.[85]

Information on what happens to federal employees whose jobs are contracted out is sketchy, but what we know is hardly comforting. According to a 1985 survey, GAO said that of those employees who were involuntarily separated,

"over half were reemployed with the federal government...It is worth noting, however, that although our earlier reports indicated that a significant number of displaced workers found employment in another government job, the current downsizing environment may not provide the same opportunities."[86]

"Over half also said that they had received lower wages, and most reported that contractor benefits were not as good as their government benefits."

Currently federal employees have right of refusal to jobs which have been contracted out under OMB Circular A-76. It is not clear what would happen to this right under the legislation when the Circular is phased out. There is less to this right than meets the eye since the contractor has unfettered discretion to determine that a contracted out federal employee is unqualified. Moreover, the right only applies to jobs created as a result of contracts. Since many contractors already have excess capacity and thus no need for more workers, the right of first refusal sometimes may not be invoked. In addition, despite the layoffs and dislocations that would surely result from enactment of this legislation, no provision is made for buyouts, soft landings, or transition assistance. Perhaps that, too, is beyond the scope of the draft bills, although such provision was made in some previous versions of this legislation.

The Service Contract Act requires that covered federal contract workers be paid "prevailing" wages and benefits. Often, however, despite the modest wages and benefits earned by federal employees, covered federal contract workers can experience sharp drops in their compensation packages. Moreover, a significant group of federal employees are exempt from the law's coverage—and their number is growing. Again, I might suspect that it would be said that addressing those issues is beyond the scope of the legislation. However, when the budget is in surplus, the economy's booming, but income distribution grows worse and worse, how can the federal government justify replacing working and middle class employees with contingent workers who are forced to make do with significantly smaller compensation packages?

Including a successorship provision to ensure that represented federal employees don't lose union representation when their jobs are contracted out also appears to be beyond the scope of this legislation. It would be wrong to assert that AFGE's only interest in the privatization debate is its own bottom line. AFGE has a long-standing policy to follow outsourced work into the private sector once a decision to contract out is made. For example, last year, we signed a contract with a private sector firm, Hughes Aircraft, which would allow AFGE to continue its representation of the employees at the recently converted Naval Air Warfare Center, in Indianapolis, Indiana. Moreover, those contractor employees now enjoy better wages and benefits than they did as federal employees although they are doing the same work in the same productive fashion as before.

Unfortunately, not all contractors are as enlightened as Hughes was in that instance. Newark Air Force Base, in Newark, Ohio, was ordered closed by the 1995 Base Realignment and Closure commission. Instead of consolidating its national security-critical missile guidance workload to other federal facilities, the Administration privatized-in-place the facility, turning it over to a contractor that fiercely and successfully resisted AFGE's organizing effort. Because they lack effective union representation, some were fired without notice, those contracted out federal employees remaining at Newark are earning smaller compensation packages than before, and some of their work has even been exported to Canada.

CONCLUSION

Chairman Brownback, Chairman Horn, I have tried to give the draft bills under consideration today the searching, thoughtful critique they deserve. I realize it is likely that we will disagree on the merits of the legislation, but I hope that our lack of accord will not prevent us from continuing this dialogue. Again, I thank you for this opportunity to speak at today's hearing, and I look forward to answering your questions.

House Rule XI, Clause 2(g)

AFGE has no grants or contracts to declare.

FOOTNOTES

1. The five groups are the Aerospace Industries Association, American Consulting Engineers Council, Electronic Industries Association, Information Technology Association of America, and Professional Services Council.

2. Letter from G. Edward DeSeve, Acting Deputy Director for Management, Office of Management and Budget, to the Honorable John Mica, chairman of the House Civil Service Subcommittee (February 3, 1998).

3. Phone call with OMB (February 4, 1998).

4. Donald F. Kettl, testimony before the Senate Budget Committee (March 7, 1995).

5. Letter from G. Edward DeSeve, Acting Deputy Director for Management, Office of Management and Budget, to the Honorable John Mica, chairman of the House Civil Service Subcommittee (February 3, 1998).

6. For example, Pentagon officials opt out of OMB Circular A-76 by using the looser cost comparison processes allowed by 10 U.S.C. 2462. According to majority staff on the House National Security Readiness Subcommittee, the Pentagon rarely reports to Congress when it contracts out under this authority. And when it does, the cost comparison processes used are often shoddy.

7. P.L. 104-262.

8. InformationWeek, "Outsourcing Backlash" (September 29, 1997).

9. Business Week, "Outsourcing the Outsourcing" (March 10, 1997).

10. Elliot Sclar, The Privatization of Public Service (1997).

11. Charles T. Goodsell, The Case for Bureaucracy: A Public Administration Polemic (1994).

12. The American Prospect, "Can Markets Govern?" (Winter 1994).

13. John Donahue, The Privatization Decision (1989).

14. General Accounting Office, PUBLIC-PRIVATE MIX: Effectiveness and Performance of GSA's In-House and Contracted Services (September 1995).

15. Elliot Sclar, testimony before the Secretary of Labor's Task Force on Excellence in State and Local Government Through Labor-Management Cooperation (May 16, 1995).

16. The authors of two recent articles discussing the special-interest lobbying behind this legislation saw through the contractors' platitudes to public-private competition.

"Approximately 30 business groups want more outside contractors hired to do government work...(T)he U.S. Chamber of Commerce, the National Federation of Independent Business and a host of smaller organizations are unhappy...These groups support legislation that would *block* government from competing with the private sector." National Journal, "Business Wants A Government Job" (May 3, 1997).

"More than 70 trade associations and businesses are forming a coalition to lobby for legislation that they say will *force* federal agencies to turn over more of their work to private industry." The Washington Post, "Special Interests, Lobbying Washington, Wanted: Contracts" (February 26, 1998).

17. Under the Circular's guidelines, managers are entitled to contract out--without first doing cost comparisons--work involving 10 or fewer employees. For work involving 11 or more employees, cost comparisons can be waived for contractors. And the cost comparison process can be "streamlined" for work involving 65 or more employees.

18. After making allowances for drafting errors and misunderstandings, let me list some examples which tend to cast doubt on claims that this legislation is about fair competition.

*With respect to the House draft, it is said that "it is the policy of the United States Government to...rely on the private sector to provide commercial products and services." That, of course, is a change in policy from A-76 which states that private sector reliance occurs when "it is cost-effective to do so." The difference is significant.

*With respect to the House and Senate drafts, contractors who perform work for an agency pursuant to an agreement with another agency, a burgeoning part of federal service contracting, would not be covered by this legislation's source selection process. House and Senate majority staff have offered contradictory explanations for this provision.

*With respect to the House and Senate drafts, work performed by contractors prior to enactment is not subject to this legislation's source selection process. That would be quite a contractor set-aside. Again, House and Senate majority staff have offered contradictory explanations for this provision.

*With respect to the House and Senate drafts, federal bidders would needlessly be judged in part on "technical and

noncost factors" instead of just cost as is the case under A-76. Since the in-house side has already proven its capability to perform, it should continue to be judged exclusively on costs. As a challenger who can only offer the promise of performance, it is appropriate to judge the contractor on non-cost factors to ensure reliability and quality.

19. Both drafts would involve politicians in the process by which work is determined to be inherently governmental or commercial. The drafts require agencies to submit to Congress lists of commercial services. It is perfectly appropriate for lawmakers on the relevant committees to review this information. Indeed, such reviews are a crucial part of their oversight role. But let's consider the context. With respect to this legislation, those lists almost constitute contractors' catalogues and would certainly invite a completely unprecedented and thoroughly unhealthy degree of Congressional micromanagement of contracting out decisions.

In response to lobbying by constituents back home, politicians would be sure to use their influence to have particular services classified according to their preferences, rather than how those services should really be classified. While some politicians may intervene on behalf of federal employees, let's face the facts: contractors have deeper pockets and are thus more capable of getting their way. The result of all this politicization: services which are truly inherently governmental will be put up for bid and perhaps steered towards certain contractors.

20. The Washington Post, "Vote of Support for Employees: Civil Servants Favored Over Politicians, 67 Percent to 16 Percent" (March 10, 1998).

Considering the smear campaign that's been waged against federal employees--from political rhetoric portraying them as an oppressive occupying army to locking them out of their offices and referring to them derisively as "non-essential"--those sky-high ratings for the nation's civil servants are astounding.

21. General Accounting Office, ENERGY MANAGEMENT: Using DoE Employees Can Reduce Costs for Some Support Services (August 1991).

"In fiscal year 1990, DoE obligated $522 million on support service contracts, a 56-percent increase from fiscal year 1986. Support service contracts are appropriate for, among other things, fulfilling specialized needs of a short-term or intermittent nature. However, most of the contracts we reviewed at DoE were not justified on these bases. Instead, most were awarded because DoE lacked sufficient resources to perform the work.

"According to the Office of Management and Budget (OMB), the government's policy is to conduct its operations in a cost-effective manner. Although cost comparisons are an essential control in deciding the most cost-effective way to meet the government's need for services, OMB's guidance on support service contracting does not uniformly require agencies to compare contract and in-house performance costs to determine which is cost-effective. For example, OMB guidance does not call for cost comparisons when contracting for services needed to fulfill new agency requirements or when federal performance is not considered feasible."

A follow-up GAO report showed how difficult it continues to be to bring work back in-house at the agency because of personnel ceilings: "(R)egardless of whether DoE's cost comparisons show that support services can be performed less expensively in-house, personnel ceilings established by OMB for federal agencies limit the number of authorized DoE positions. Therefore, DoE officials believe there is little incentive to perform cost comparisons or, ultimately, to convert contract work to in-house performance, because the work would have to be accommodated within DoE's existing personnel ceiling." General Accounting Office, ENERGY MANAGEMENT: Improving Cost-Effectiveness in DoE's Support Services Will Be Difficult (March 1993).

22. Office of Management and Budget, Summary Report of Agencies' Service Contracting Practices (January 1994).

23. General Accounting Office, GOVERNMENT CONTRACTORS: An Overview of the Federal Contracting-Out Program (March 29, 1995).

24. National Association of Public Administration, Renewing HUD: A Long-Term Agenda for Effective Performance (1994).

25. General Accounting Office, GOVERNMENT CONTRACTORS: An Overview of the Federal Contracting-Out Program (March 29, 1995).

26. General Accounting Office, GOVERNMENT CONTRACTORS: Measuring Costs of Service Contractors Versus Federal Employees (March 1994).

27. The Council of State Governments, Private Practices: A Review of Privatization in State Government (1998).

28. The Council of State Governments, Private Practices: A Review of Privatization in State Government (1998).

29. Charles Goodsell, The Case for Bureaucracy (1994).

30. The American Prospect, "Can Markets Govern?" (Winter 1994).

31. Donald Kettl, testimony before the Senate Budget Committee (March 7, 1995).

32. Two recent newspaper accounts of bid-rigging come to mind.

"Waste Management, Inc., and Browning-Ferris Industries, the two largest solid-waste haulers, agreed yesterday to change their contract practices to settle Justice Department charges that they tried to block smaller trash haulers from entering in four states: Iowa, Tennessee, Georgia, and Louisiana. In two civil lawsuits, the department's antitrust division had charged that Waste Management, which is a unit of WMX Technologies, Inc., and Browning-Ferris used long-term contracts to suppress competition in areas where their subsidiaries control more than 60 percent of the waste-hauling market. The companies agreed to stop using contracts that gave them exclusive rights to waste removal for three years, with automatic three-year renewals." The New York Times, "Waste Haulers Agree To Alter Some Contracts (February 2, 1996).

"Private dredge operators may have conspired to limit competition by rigging bids on contracts with the U.S. Army Corps of Engineers in 1990-94, according to a confidential audit...

"`These contractors appeared to have conspired in an attempt to increase their prices,' said the U.S. Army Audit Agency's report on bid-rigging completed September 12, 1995.

"`They were able to submit potentially collusive bids without detection because the Corps had no formal policies and procedures in place to detect bid-rigging,' the report said. `As a result, dredging contractors may have violated the Sherman Antitrust Act and earned unwarranted profits on the dredging contracts they were awarded.'

"The agency audited more than 1,000 contractor projects valued at $1.7 billion in fiscal years 1990 through 1994. There was no estimate of the potential loss to taxpayers...

"The auditors said they found several `common indicators of collusive bidding," including limited competition, identical line-item bids and some instances in which winning bidders subcontracted the work to losing bidders.

""`When competing contractors prepare bids,' the possibility of having identical prices on any line item is statistically unlikely and could suggest that contractors exchanged information before preparing their bids,' the audit said.

"`About 270 projects worth about $477 million appeared to have complimentary bids,' the audit said. That is when one contractor, based on an agreement with other contractors, submits

a bid that is deliberately high and noncompetitive. The Washington Post, "Audit on Suspected Bid-Rigging May Slow Corps of Engineers Effort to Privatize" (October 13, 1997).

33. The American Prospect, "Can Markets Govern?" (Winter 1994).

34. "(I)t is important to remember that municipal service contractors are also political players. They use every lobbying and campaign-financing ploy that they can to remain in the good graces of state and local decision makers. One of the countless examples of this practice can be easily cited from an incident in Hartford, Conn. By the time Hartford School Board awarded a contract to Education Alternatives Inc. (EAI) in an ill-fated attempt at complete public school privatization, EAI was already an important local political participant. The company had spent two years laying the local political groundwork for its contract through public relations work and community involvement. Once a contract is secured and large sums of money are at risk, contractors will become more embroiled in local politics." Elliot Sclar, The Privatization of Public Service (1997).

35. John Donahue, The Privatization Debate (1989).

36. Stuart Butler, Privatizing Federal Spending: A Strategy to Eliminate the Deficit (1985).

37. "An example of this situation can be found in Scottsdale, Ariz., which has had a private, for-profit fire company since 1948. The same company has always had the work and there is no competitive bidding process. Costs are negotiated each year between the municipality and the fire company. The practice has scarcely spread beyond Scottsdale. Indeed, some locales near Scottsdale, after trying the service, have elected to switch to municipal service in order to save money. Elliot Sclar, The Privatization of Public Service (1997).

38. "New York City's experience with school bus contracting provides a similar example. The city contracts with private companies for school bus service. The critical asset, the fleet of buses, is owned by the companies, not the city. Although the system is supposed to be competitive, that pretense was abandoned long ago. Instead, the contracts are granted on a continuous basis to the same companies for the same service...The city's need for service is so large that every possible competitor already has a piece of the system. The city consequently ends up with little room to maneuver in contract negotiations--the contractors are fully aware that the city has no place else to buy the service. The city can't even change its route structure when it needs to without compensating the contractors for any loss they might incur. In this case, public operation would have been a more desirable managerial strategy." Elliot Sclar, The Privatization of Public Service (1997).

39. Janet Rothenberg Pack, Privatization and Its Alternatives (1991).

40. Study 2
"Two recent studies yield useful insights into the ways in which contracting for social services develops to limit the realization of desired outcomes, including cost reduction and innovation." (One group examined) "purchase of service contracts between the State of Massachusetts and private firms for mental health care," while another group looked "at social service contracts with private nonprofit agencies, also in the State of Massachusetts.

"What has been accomplished? The Department of Mental Health's need for monitoring and oversight, as well as `the legislature's desire to maintain accountability...' have led to a lengthy and complex contract review process which adds to the costs of administration and to the use of line-item budgets, both of which inhibit innovation and flexibility. Wage costs have declined; "employees in contract agencies receive wages 18% below comparably trained employees in the public sector." However, labor turnover has increased, with detrimental consequences for the quality of care. This implies that the initial public sector wage premium may have been efficient. In addition, the labor costs savings are expected to be transitory," because, in part, "unionization of workers is increasing..."

"Still another factor that will affect future costs is the evolution of the system from one explicitly designed to promote competition among private contractors to one that substantially inhibits competition...*(O)nly 20 percent of contracts are competitively bid. In addition, the extent of competition is more limited than anticipated--about 1.7 responses per solicitation.* Several evolutionary factors have limited and will further limit competition. The `goal of maintaining continuity of care,' economies of scale, and the difficulties associated with evaluating providers without a `track record' have led to an increasing concentration of contracts with large organizations."

Study 3
"In 1986, Massachusetts had $600 million of contracts with nonprofit agencies. In the Department of Social Services, 1,700 such contracts constituted 70 percent of the budget. (The author) describes a system in which the government departments became increasingly dependent on private agencies to deliver basic social services.

"The new nonprofit organizations that form the majority of contractors, in contrast with older nonprofits, have no existence apart from government programs. *The government's dependence upon these groups has led, according to (the author), to the propping up of inefficient or mismanaged enterprises in order to maintain continuity and long-term relationships.*

"In addition, given the sensitive nature of the social services--child care, care of the elderly and infirm--and the enormous sums of money being spent, *regulation of the sector has had to expand enormously*. Increased regulation has several important consequences: it encumbers, it reduces flexibility in providing services in innovative ways, and it increases administrative costs. As a result, it inihibits precisely those outcomes that private providers seek. The extensive regulation of the terms and implementation of contracts with private providers of social services identified (by both studies) may be expected to carry over to other types of services..."

"Thus, it appears that *initial savings from private contracting overstate the savings to be realized over the longer period*. In the case of social services, (the two studies) argue persuasively that this is closely linked to the increasingly regulated terms on which the contracts are let and to the related decrease in competition." Janet Rothenberg Pack, Privatization and Its Alternatives (1991).

41. Elliot Sclar, The Privatization of Public Services: Lessons From Case Studies (1997).

42. "The bus privatization effort in Denver followed this trajectory. In 1987 and 1988 when the privatization effort was making its way through the Colorado legislature, privatization advocates claimed that savings on the order of 40% could be expected. In 1995, when the State Auditor reviewed the cost issue, the findings were startling. There was virtually no difference between public and private operating costs. The differences ranged from a high of 4 percent down to a low of seven-tenths of one percent, depending upon route packages. Although these minuscule differences favored the contractors, it is important to note that the Auditor did not account for the fact that under the Denver privatization arrangement the private operators kept the fare revenue. When the revenue loss is added to the operating cost, the Denver privatization is actually losing around $4.25 per revenue hour or almost $1.5 million per year. This is illustrated by the annual financial reports for the system. In each year since 1989, the year that privatization began, the costs of contracted service have risen at a rate approximately double that of the rest of the system." Elliot Sclar, "Paying More, Getting Less: The Denver Experience with Bus Privatization" (February 1997).

43. "Consider Denver once more. There were seven bidders for the first set of contracts. In that competitive environment, Mayflower which won the lion's share of the routes, offered to do the work for around $27 per hour, an amount which RTD's outside evaluators, Peat Marwick, concluded was money losing. By the time of the second contract the only bidders were the three firms

that won in the first round. The only challenge came from the union local representing the public employees. Even though they made the lowest bid, contractor politics being what it is, the process was altered to allow the existing contractors to rebid and match the offer. Since that time Mayflower's low ball initial price has approximately doubled. In the last year, the two largest Denver contractors, Laidlaw and Mayflower have merged, tightening their monopoly position vis-a-vis the RTD. Thus the promise made by the privatization advocates of continual competition has proven to be as hollow as their promise of lower costs." Elliot Sclar, "Paying More, Getting Less: The Denver Experience with Bus Privatization" (February 1997).

44. General Accounting Office, SOCIAL SERVICES PRIVATIZATION: Expansion Poses Challenges in Ensuring Accountability for Program Results (October 1997).

45. The Washington Post, "Energy Department Plans Competition for Big Contracts" (1994).

46. Bureau of National Affairs, Federal Contracts Daily (February 3, 1997).

47. Many observers mistakenly consider depot maintenance to be a public sector stronghold. But much depot maintenance work is contracted out--to the detriment of the taxpayers.

> "(GAO) analyzed 240 active depot maintenance contracts, finding that 182--or 76 percent--were awarded sole-source. Further, about 86 percent of the full and open competitions had 4 or less offers.
>
> (O)ur analysis of a limited number of military systems or components that are dual-sourced--that is, repaired by both a DoD depot and private sector firm--determined that DoD depot prices were lower for 62 percent of the items."

48. The New York Times, "Overhauled Defense Contracts Less Reliant on Pentagon" (February 27, 1998).

49. The Washington Monthly, "The Perils of Privatization" (May 1995).

50. The Nation, "Lockheed Martin's New Empire: Targeting Welfare Dollars," (March 2, 1998).

51. Paul Kettl, testimony before the Senate Budget Committee (March 7, 1995).

52. Moshe Adler, testimony before the California Senate Governmental Organization Committee (April 15, 1997).

53. Elliot Sclar, The Privatization of Public Service (1997).

54. As time goes by, the privatization-related "accomplishments" in Indianapolis, like "privatization-related accomplishments" generally, have proven to be rather ephemeral.

"When (Deputy Mayor Skip) Stitt is asked about where the astronomical savings (from privatization) come from--they represent about half of the city's yearly operating budget of $428 million--he suddenly becomes vague. `Well, a lot of the savings have been estimated over the terms of the contracts. We're really just guessing,' he says. Stitt admits that many of the savings came from eliminating a large layer of middle managers."

(The federal government had an opportunity through the reinvention initiative to reduce superfluous layers of middle management in order to maximize the potential of rank-and-file federal employees who actually deliver services to the American people. As it turned out, after reducing the federal workforce by more than 330,000 employees, middle management emerged almost completely unscathed. Instead, cheaper and more productive rank-and-file federal employees were reduced disproportionately.)

Another Indianapolis area government official says that some savings have been generated by the public-private competitions, "(b)ut she says that extravagant claims made about banking hundreds of millions are dishonest. `Saving more than $200 million through privatization--that is ridiculous, absolutely absurd...But they have been repeated so often people are starting to believe them.'" The Toronto Star, "An Entrepreneurial City, Indianapolis is a laboratory for privatization" (March 10, 1997).

55. Moshe Adler, The New York Times "In City Services, Privatize and Beware" (March 7, 1997).

56. Chairman Horn, as you probably know, Representative Duncan Hunter, your G.O.P. California colleague and chair of the House National Security Procurement Subcommittee, will attempt again later this year, as part of the defense authorization bill, to drastically slash the Department of Defense's acquisition workforce--even though there will likely be dramatic increases in procurement spending over the next several years and the workforce has already been cut by 40% since the end of the Cold War. Should his cuts become law, DoD officials say they will have to contract out their contract administration work.

This recent story is a chilling reminder of the failure of the Administration and the Congress to reform contract

administration--and the consequences for taxpayers and warfighters.

"More news from the home of the $640 toilet seat: The Pentagon's watchdog said that a new purchasing system designed to save money has produced millions of dollars in overpriced spare parts, including a $76 screw and a $714 electrical bell...

"(The Inspector General) cited several examples of overpriced parts: $714 each for 108 electrical bells previously priced at $47; $5.41 for each of 1,844 screw thread inserts, compared with a previous price of 29 cents; $75.60 for each of 187 set screws previously priced at 57 cents."

"`This is deja voodoo pricing by defense contractors,' said Senator Charles Grassley, R-Iowa. Defense purchasing reforms have failed, Grassley said, `because the defense industry is constantly successful in watering down the reforms.'" USA Today, "Audits say Pentagon continues to overpay" (March 19, 1998).

57. Donald Kettl, testimony before the Senate Budget Committee (March 7, 1995).

58. The Washington Monthly, "The Perils of Privatization (May 1995).

59. The Washington Monthly, "The Perils of Privatization" (May 1995).

60. The Washington Monthly, "The Perils of Privatization" (May 1995).

61. The Washington Monthly, "The Perils of Privatization" (May 1995).

62. The Washington Monthly, "The Perils of Privatization" (May 1995).

63. General Accounting Office, FEDERAL CONTRACTING: Cost-Effective Contract Management Requires Sustained Commitment (December 3, 1992).

64. Office of Management and Budget, Summary Report of Agencies' Service Contracting Practices (January 1994).

65. General Accounting Office, High-Risk Series (February 1995).

66. "During one 6-month period in fiscal year 1993, contractors returned to the government $751 million, and in fiscal year 1994, they returned $957 million, most of which appears to have been overpayments detected by the contractors." (Would I be the skunk at the garden party if I were to ask how much went undetected,

accidentally and intentionally, and was not ultimately repaid to the taxpayers?)

GAO also reported that "contractors' systems for charging costs to the government continue to result in contractors' billing for, and Defense paying for, large unallowable amounts. From fiscal years 1991 to 1993, Defense auditors questioned about $3 billion in contractor overhead charges."

67. General Accounting Office, High-Risk Series (February 1997).

68. Bureau of National Affairs, Federal Contracts Daily, "GAO Says Major Waste, Fraud Risks Continue To Plague DoD, Other Agencies" (February 24, 1997)

Just how "out of control" is federal service contracting? We don't even know how many contractor employees are on the government's payroll.

"(O)ver the last fifty years a virtual shadow government of contractors has sucked up taxpayer money and chipped away at the legitimacy of public institutions...Without clear guidelines, good information on what contractors are doing, and the ability to fire them when they screw up, government often ends up spending much more than it would cost to do the work with its own employees." The Washington Monthly, "The Perils of Privatization" (May 1995).

The President and many lawmakers have bragged to their constituents about how drastically they have reduced the size of the federal workforce. But much of the work that used to be performed by federal employees has simply been transferred to the federal government's "shadow workforce" in the private sector. The government's actual workforce is unlikely to have gotten any smaller. It's just that the people who now do the work are no longer on the public payroll--although their salaries are paid for out of the same revenues that pay the salaries of federal employees.

It seems that some politicians want to play a "shell game" on the American people by hiding hundreds of thousands of government employees on contractor payrolls and then claiming to have reduced the size of the government. H.R. 887 would simply require OMB to calculate the size of the government's workforce, but the House Government Reform and Oversight Government Management Subcommittee has failed to act on the legislation.

69. Even the uninformative testimony of the General Accounting Office at the House Committee on Government Reform and Oversight Government Management Subcommittee's September 29, 1997, hearing on H.R. 716 stressed the importance of contract administration.

"Converting government activities to private-sector performance will increase the contractor workload on federal agencies. Conversion to contractor performance requires considerable contract management capability. An agency must have adequate capacity and expertise to successfully carry out the solicitation process and effectively administer, monitor, and audit contracts. In past reports on governmentwide contract management, (GAO) identified major problem areas, such as ineffective contract administration, insufficient oversight of contract auditing, and lack of high-level management attention to and accountability for contract management."

General Accounting Office, PRIVATIZATION AND COMPETITION: Comments on H.R. 716, the Freedom From Government Competition Act (September 29, 1997).

70. General Accounting Office, MANAGING DOE: Government Property Worth Millions of Dollars Is Missing (September 19, 1994).

71. House Report 99-139.

72. General Accounting Office, Overhead Costs: Unallowable and Questionable Costs Charged by Government Contractors (March 3, 1994).

73. The Washington Monthly provides yet another example of just how insidious contractor penetration of the contract administration has become. "Conflict of interest is evident among contractors hired by the Agency for International Development. The agency hired the accounting firm Deloitte & Touche to determine which services Eastern European countries needed--and Deloitte successfully recommended itself to do the work." The Washington Monthly, "The Perils of Privatization" (May 1995).

74. General Accounting Office, FEDERAL CONTRACTING: Cost-Effective Contract Management Requires Sustained Commitment (December 3, 1992).

75. General Accounting Office, OCCUPATIONAL SAFETY AND HEALTH: Violations of Safety and Health Regulations by Federal Contractors (August 1996).

76. General Accounting Office WORKER PROTECTION: Federal Contractors and Violations of Labor Law (October 1995).

77. "Computer Firm Agrees to Pay $400,000 to Settle OFCCP Charges of Pay Equity," BNA Federal Contracts Daily, January 23, 1998.

78. "Provident Bancorp to Pay $887,000 to Resolve Race Discrimination Charges," BNA Federal Contracts Daily, Nov. 19,

1996.

79. "Richmond Distributor to Pay $300,000 to Settle Charges Minorities Were Paid Less," BNA Federal Contracts Daily, June 28, 1996.

80. The Wall Street Journal, "Two-Edged Sword, More Public Workers Lose Well-Paying Jobs As Outsourcing Grows" (October 8, 1996).

81. The Wall Street Journal, "Two-Edged Sword, More Public Workers Lose Well-Paying Jobs As Outsourcing Grows" (October 8, 1996).

82. Bill Eggers, "The Nuts and Bolts: Overcoming the Obstacles to Privatization" (April 1997).

83. The Wall Street Journal, "Two-Edged Sword, More Public Workers Lose Well-Paying Jobs As Outsourcing Grows" (October 8, 1996).

84. The American Prospect, "Can Markets Govern?" (Winter 1994).

85. Does Privatization Pay: A Case Study of Privatization in Chicago, Chicago Institute On Urban Poverty (January 1997).

86. General Accounting Office, GOVERNMENT CONTRACTORS: An Overview of the Federal Contracting-Out Program (March 5, 1995). "For example, the Office of Personnel Management (OPM) operates an interagency placement program to assist separated employees when filling positions through competitive appointments. According to OPM, between the program's inception in December 1993 and September, 16, 1994, from an inventory of 2,018 registrants, agencies made 204 job offers. Among other things, OPM attributes the low number to the fact that agency downsizing has substantially reduced the number of vacancies."

FMA

Federal Managers Association

STATEMENT OF

MICHAEL B. STYLES

NATIONAL PRESIDENT

FEDERAL MANAGERS ASSOCIATION

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES

GOVERNMENT REFORM AND OVERSIGHT

SUBCOMMITTEE ON MANAGEMENT, INFORMATION AND TECHNOLOGY

AND THE

U.S. SENATE

GOVERNMENTAL AFFAIRS

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT,

RESTRUCTURING AND THE DISTRICT OF COLUMBIA

ON FEDERAL CONTRACTING FOR COMMERCIAL SERVICES

MARCH 24, 1998

1641 Prince Street • Alexandria VA 22314-2818 • (703) 683-8700 • FAX (703) 683-8707

INTRODUCTION

Chairman Horn, Chairman Brownback, Ranking Minority Member Kucinich, Ranking Minority Member Lieberman and members of the Subcommittees:

My name is Michael B. Styles and I am the National President of the Federal Managers Association (FMA). On behalf of the 200,000 managers and supervisors in the Federal government whose interests are represented by FMA, I would like to thank you for inviting us to present our views to the House Government Reform and Oversight Subcommittee on Government Management, Information and Technology and the Senate Governmental Affairs Subcommittee on Oversight of Government Management, Restructuring and the District of Columbia on the Competition in Commercial Activities Act and the Fair Competition Act.

I have worked for the Federal Government for 38 years. After leaving the United States Marine Corps, I began my career at the Long Beach Naval Shipyard as an electronics technician and I retired last year after working as a Total Quality Leadership Coordinator for the Marine Corps Communication-Electronics School at the Twenty-nine Palms Marine Corps Air-Ground Combat Center in California. My views on the government's practice of contracting-out for services are based on my first-hand experiences with contractors at Long Beach, my participation in 1988 in the Department of the Navy's Experience with Industry Program and my work at other Federal facilities. My career in Tactical Systems management with the Navy has provided me an opportunity to implement far reaching Total Quality Leadership initiatives positively impacting timely systems acquisition and logistics support that enhanced the overall readiness of the Fleet Marine Force. In addition, my views on contracting-out have been influenced by my experiences over 8 years as President of FMA during numerous visits with managers and supervisors at Federal facilities across government and across America.

FMA is the largest and oldest association of managers and supervisors with members from 25 different departments and agencies. As those who are responsible for the daily management and supervision of government programs and personnel, our members have a broad depth of experience with the government's practice of contracting-out for services.

Mr. Chairman I am glad that you are holding this important hearing today. FMA has just concluded its 60th National Convention and today is our annual Day on the Hill. Approximately 250 managers and supervisors from around the country and across government are meeting with their Members of Congress today to discuss our concerns about fair compensation for Federal workers, cost effective government restructuring and maintaining the core values of the civil service.

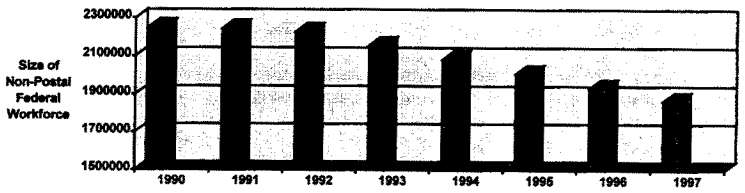
The theme of our convention was "Assessing the Challenges Facing Today's Manager." Contracting-out, particularly within the Department of Defense, is certainly the biggest challenge facing managers today. In the words of OMB Deputy Director G. Edward DeSeve before the House Civil Service Subcommittee on October 1, 1997, the Federal government is "currently engaged in the largest privatization, outsourcing and competition effort ever undertaken."

FMA DISAGREES WITH THE PREMISE OF THE PROPOSED BILLS

In FMA's view, the draft Competition in Commercial Activities Act and the draft Fair Competition Act are "solutions" in search of a "problem." The premise of these proposals appears to be that there are too

many Federal employees and that the current process for contracting-out is not moving enough work to the private sector. This premise is not supported by an examination of the facts.

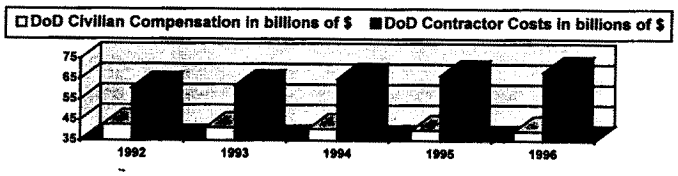
First, the Federal workforce is now the smallest it has been since 1964. In addition, as a percentage of the American workforce, the civil service today is the smallest it has been since 1931. Between 1993 and 1997, the Federal workforce was reduced by 320,500 positions to 1.8 million employees.



Office of Personnel Management, Office of Workforce Information.
SOURCE: SF 113-A Monthly Report of Federal Civilian Employment.
Revised December 2, 1997

Second, while total governmenwide contracting-out for services has remained essentially the same in constant dollars between 1986 ($82.5 billion) and 1996 ($111.7 billion), the Federal workforce has gone through an historic downsizing during this same period. The Government's total payroll cost (including benefits) and the amount spent on contracting-out for services in 1996 were both approximately $112 billion.

The Department of Defense accounts for 62% of Federal contracting dollars and is responsible for 75% of the Federal workforce downsizing. The largest and best documented experience with contracting-out for services indicates a direct correlation between downsizing the Federal workforce while increasing reliance on contractors.



Testimony of Mr. G. Edward DeSeve - Deputy Director for Management OMB
Before the House Government Reform and Oversight Subcommittee on Civil Service - 10/1/97

Workforce downsizing is increasing pressure on DoD managers to contract-out for services even when contractor performance may not be in the best interest of the Government and the taxpayers. In testimony before the House Civil Service Subcommittee in 1995, GAO called personnel ceilings "an

impediment to choosing the option of Federal performance when that is more cost-effective." (GAO/T-GGD-95-131)

DoD's experience clearly rebuts the premise that legislation is needed to increase contracting-out. In a February 3, 1998 response to questions posed by Civil Service Subcommittee Chairman John Mica, OMB indicated that in 1997 DoD conducted 344 cost comparisons covering 25,255 Federal positions. In testimony before the House National Security Committee earlier this month, Deputy Secretary of Defense John J. Hamre discussed DoD's Defense Reform Initiative (DRI) and the Department's plan for competing 150,000 Federal civilian positions over the next five years.

Managers from FMA's Chapter 55 at the Naval Weapons Station at Seal Beach in California are learning first-hand about contracting-out. FMA members from this facility, which won Vice President Gore's Reinventing Government Hammer Award in 1995 and 1996, won the Bronze Eureka Award (California's equivalent of the Malcolm Baldridge Award) in 1995 and the Silver Eureka Award in 1996 and 1997, have learned just recently that the Navy plans to subject their jobs to cost comparisons despite the fact that ordinance receipt, storage, segregation and issue functions have consistently been classified as an inherently governmental function.

PITFALLS AND MYTHS OF PRIVATIZATION

DoD does not need any encouragement to increase contracting-out. It is already ignoring many of the pitfalls and myths of privatization as it rushes to contract-out government functions.

PITFALL - CONTRACTOR STRIKES DISRUPT THEIR OPERATIONS: For Defense civilians, strike is something you do to the enemy not your employer. The same laws that make it illegal for Government workers to strike cannot be applied to the private sector.

In June of 1996, 6,700 workers from the St. Louis headquarters of one of DoD's largest contractors, McDonnell Douglas, went on strike. These workers build the F-15 and the F-18 fighters, the Navy's T-45 training jet, part of the Air Force's C-17 cargo plane and are upgrading the Harrier strike aircraft. The employees were protesting McDonnell Douglas's practice of outsourcing work. (06/05/96, *New York Times*, p. A18)

In negotiating higher wages, the private sector union chief at Sheppard AFB, Texas called the right to strike the union's "ace in the hole." When private sector flight-line maintenance workers for Sheppard's T-37 and T-38 trainer jets went on strike last year they brought the base's training mission to a screeching halt. The strike affected the training of 250 pilots. (08/25/97, *Federal Times*, p. 14)

PITFALL - DoD IS UNABLE TO MONITOR AND CONTROL CONTRACTOR COSTS: Claims of big DoD savings attributed to contracting-out ring hollow in light of the Department's spotty financial accounting systems. In our experience, current methods of cost accounting do not always provide sufficient management controls on contracting-out. "As of May 1996, DoD reported that its problem disbursements totaled about $18 billion. However, our preliminary work on DoD's reporting of problem disbursement data indicates that reported amounts are substantially understated. . . . We found that some contractors had retained overpayments. For example, in one case, a contractor was overpaid $7.5 million due to numerous errors. The overpayment remained outstanding for 8 years. We estimate that

the government lost interest on the overpayment amounting to nearly $5 million." (*GAO/HR-97-4 Defense Contract Management. February 1997.*)

Just last week we learned that the days of the Pentagon purchasing $640 toilet seats are more than just a distant memory. DoD Inspector General Eleanor Hill told the Senate Armed Services Subcommittee on Acquisitions and Technology that Defense Department buyers recently paid $76.50 for each of nearly 2,000 set-screws that usually sell for 57 cents apiece. Part of the problem, according to Hill, was the Pentagon's "extremely disjointed procurement approach." (03/19/98, *Washington Post*, p. A07) DoD's plans to dramatically increase cost comparisons will overtax the Department's financial management resources.

FMA APPRECIATES THE EXEMPTION FOR DEPOTS

The 1998 Department of Defense Authorization, P.L. 105-85, amended 10 U.S.C. 2466 to lower the percentage of $13 billion worth of military upgrade and repair work that must be performed by the public sector from 60% to 50%. This change is expected to result in an additional $1 billion worth of work being transferred to the private sector. The House National Security Committee (HNSC) and the Senate Armed Services Committee (SASC), rejected the Administration's request to eliminate 10 U.S.C. 2466 because after years of study these Committees have come to the conclusion that is vital to our national security to maintain an organic depot maintenance infrastructure. FMA applauds the House and Senate sponsors of the Competition in Commercial Activities Act and the Fair Competition Act for adding an explicit exemption for Chapter 146 of Title 10.

NON-DoD AGENCIES

While non-DoD agencies did not conduct any competitions in 1997, the Federal government spent $43 billion on service contracts for these agencies. FMA would like to know what criteria these agencies are using in making their contracting-out decisions and if Federal employees are being given an opportunity to compete for this work.

CURRENT CONTRACTING-OUT

The exception for public depots highlights the general nature of the proposed legislation as a "cookie-cutter" approach to an issue that should continue to be considered on a case-by-case basis. If Congress is concerned about the fact that non-DoD agencies conducted no A-76 studies in 1997 it could easily inquire into the agencies' decision making processes.

The current method for contracting-out for services is not perfect but it is better than what is being proposed as a replacement. In March of 1996 OMB issued its Revised Supplemental Handbook for OMB Circular No. A-76. FMA agrees with and supports the principles enunciated in the new Supplement:

> *Circular A-76 is not designed to simply contract out. Rather, it is designed to: (1) balance the interests of the parties to a make or buy cost comparison, (2) provide a level playing field between public and private offerors to a competition, and (3) encourage competition and choice in the management and performance of commercial activities. It is designed to empower Federal managers to make sound and justifiable business decisions.*

For the most part, the new Supplement has brought welcome changes. While allowing the Government more flexibility to contract out, the Supplement ensures that employees have more involvement in the competitive process and it also allows work to be contracted-in when it is more cost-effective to do so.

From a line manager's perspective there are four significant differences between the old and new A-76 processes:

1. The average study time has been reduced from 18-60 months to between 12-18 months;
2. "How to" specifications have been replaced with proposals;
3. The emphasis on "low bid" has been changed to "best value"; and,
4. Instead of focusing on individual functions, studies now take a broader systems approach.

FMA'S CONCERNS ABOUT THE DRAFT BILLS

In addition to our general concerns about the draft Competition in Commercial Activities Act and the Fair Competition Act, I would like to highlight some of FMA's concerns about specific aspects of the proposed bills.

CONVERTING CONTRACTED FUNCTIONS TO IN-HOUSE PERFORMANCE SHOULD NOT BE PROHIBITED: FMA is very concerned about the provision in the House and Senate proposed bills that appears to limit the ability of Federal agencies to convert functions previously performed by contractors to in-house performance. This would unduly limit agency flexibility to chose the most appropriate source for the performance of government functions.

An excellent example of our Government rethinking a contracting-out effort is our experience with trying to privatize prisons. At the start of the current Administration, two political promises, one to reduce the size of the Federal bureaucracy and the other to increase the size of the Federal prison system, created a dilemma. The solution, it appeared, would be to privatize some Federal prison operations. Contractor guards wouldn't show up on Federal payrolls and the political leaders could take credit for increasing the number of prison beds. (11/24/95, *New York Times*, p. A1) The Justice Department, however, decided in June of last year to scrap this plan after coming to the conclusion that it could not minimize the impact of contractor strikes and inmate disturbances at contractor run facilities. (06/24/96, *Federal Times*, p. 8)

Another example of rethinking a decision to contract-out a Government function is the INS' recent announcement that it is bringing citizenship testing back in house. The program, which accounted for fifteen percent of the INS' citizenship testing, was subject to fraud, allowing thousands of immigrants to pass the test by paying hundreds of dollars each to private administrators. According to INS Commissioner Doris M. Meissner, the change is intended "to reduce fraud and to improve customer service and efficiency." (03/10/98, *Washington Post*, p. A15)

FMA urges the Subcommittees to clarify this provision and to oppose a trap-door approach to contracting-out that prohibits agencies from rethinking their decisions. Such an approach would only discourage managers from contracting-out when such a choice is appropriate.

SANCTIONS FOR GOVERNMENT FAILURE TO MEET PERFORMANCE REQUIREMENTS APPEAR TO GIVE AGENCIES "TWO-BITES AT THE APPLE" FOR CONVERSION TO CONTRACTOR PERFORMANCE: In addition, FMA is concerned about the sanctions for in-house performers of government functions that fail to meet performance standards set by the agency heads. We are concerned that this provision could be abused by agencies that are determined to contract-out regardless of who wins in a cost comparison.

FMA members at the Air Logistics Center at Warner Robins AFB in Georgia rejoiced last year after winning a head-to-head competition with private sector companies to win a bid for $434 million worth of work over seven years for inspection, repair, overhaul and modification of the C-5 Galaxy transport aircraft. Warner Robins beat out defense giants Boeing and Lockheed Martin. The closest private sector bid was $22 million more than the one turned in by Warner Robins. (09/08/97, *Defense Week*, p. 3) FMA was disappointed to learn that Pentagon officials came to Capitol Hill after the competition and told Members and staff that the private sector should have won. We could envision a situation where an agency sets unreachable performance goals in order to contract-out work that would go to government workers in an open and honest competition. This provision should be dropped unless similar sanctions for private sector performance of government functions are added.

HARSH PENALTY FOR FAILURE TO ISSUE TIMELY DECISION ON CONTRACTOR PROTEST COULD RESULT IN CONTRACTING-OUT OF INHERENTLY GOVERNMENTAL FUNCTIONS: FMA is also concerned that requiring an agency head to put a government activity on a list of commercial activities for competition if he fails to meet the 10 day deadline for responding to a contractor complaint could result in elevating a clerical error to the level of a decision to contract-out an inherently governmental function. This is a clear case of elevating bureaucratic form over substance.

DRAFT LEGISLATION APPEARS TO CREATE POSSIBILITY OF ENDLESS EXPENSIVE LITIGATION AND BURDENSOME CATALOGING REQUIREMENT THAT COULD STIFLE STREAMLINING AND REINVENTION EFFORTS: Finally, FMA is concerned that the proposed legislation could invite endless litigation that could sap precious resources from strapped budgets thereby negatively impacting our ability to accomplish critical agency missions. We are also concerned that the cataloging requirement for government functions would be impossible in today's rapidly changing work environment and could stifle agency streamlining and reinvention efforts.

RECOMMENDATIONS FOR IMPROVING CONTRACTING OUT

FMA supports the following bills introduced by Congresswoman Eleanor Holmes Norton (D-DC) as an excellent starting point for any serious debate on getting a handle on our Nation's shadow-Government of contractors:

- **H.R. 885**, to prevent any executive branch agency from entering into a contract if the services provided under that contract can be performed at a lower cost by employees of the agency.

- **H.R. 886**, to provide full funding for Federal employee pay adjustments through reductions in the $114 billion the Government spends annually to contract for services.

- **H.R. 887**, to require the director of OMB to develop and implement a system for determining and reporting the number of individuals employed by non-Federal government entities providing services under contracts awarded by executive branch agencies.

- **H.R. 888**, to amend current statutory buyout authority to provide that the duties performed by individuals separating from government service as a result of receiving a voluntary separation incentive payment may not be performed by any person under contract with the United States.

BRING COST ACCOUNTABILITY TO GOVERNMENT CONTRACTING-OUT

FMA also recommends Congressional action on H.R. 2712 introduced by Congressman Elijah Cummings. Under current Government contracting rules, when the Government wins a contracting competition we are periodically audited to determine if we remain the most cost-effective providers of service. Ironically, no similar rule is applied to contractors that win competitions. As a result, the biggest criticism of Government contracting is that once the work moves to the private sector there is no way to know if Americans are still getting the best deal for their hard earned tax dollars. H.R. 2712 closes a gaping loop-hole in current contracting rules and keeps the competitive spirit alive by providing a mechanism for automatically reviewing contracts that have exceeded their initial projected costs to determine if the work could be performed more efficiently in-house.

CONCLUSION

A recent "survey, conducted by the Pew Research Center for the People and the Press, found more trust in civil servants than politicians, by 67 percent to 16 percent." (03/10/98, *Washington Post*, p. A15) The American public trusts civil servants to make the right decisions when it comes to contracting-out. FMA hopes Congress will do the same and not replace OMB Circular A-76 with the statutory framework envisioned in the Competition in Commercial Activities Act and the Fair Competition Act.

I want to thank you again for inviting FMA to present our views on contracting-out to the House Government Reform and Oversight Subcommittee on Government Management, Information and Technology and the Senate Governmental Affairs Subcommittee on Oversight of Government Management, Restructuring and the District of Columbia. FMA looks forward to continuing to work with you to improve the ability of Federal managers and supervisors to insure the delivery of high quality goods and services to America. I hope the experiences and suggestions FMA has shared with you will be helpful.

This concludes my prepared remarks. I would be happy to answer any questions you may have.

FEDERAL GRANTS: FMA has not received any Federal grants or contracts within the last two years.

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FEDERAL MANAGERS ASSOCIATION 60TH NATIONAL CONVENTION

Michael B. Styles
FMA National President

A member of the Federal Manager's Association (FMA) Board of Directors since 1986, Mr. Styles has served as its National President since 1990. The foremost management organization within the Federal sector, FMA represents the interests of more than 200,000 managers and supervisors throughout the varied agencies of the Federal government. With membership encompassing senior executive, middle-management, and front-line supervisory positions, FMA plays a vital role in the development and implementation of government-wide policy at all levels of the management spectrum. In his position as president, Mr. Styles works directly with the Executive and Legislative branches on such issues as Downsizing, Privatization, Partnership, Labor Relations, and Federal Personnel, Benefit, Retirement issues.

Mr. Styles sits on the Federal Employee Thrift Advisory Council providing policy-shaping guidance in management and administration of the $25 billion Retirement Investment Fund for Federal employees. Mr. Styles is also a National Board Director for the Federal Employee Education and Assistance Fund which provides scholarships, loans, grants, and emergency assistance to Federal employees and their dependents.

Mr. Style's wide ranging expertise in strategic planning as a consultant, coordinator, and advisor has encompassed both private and public sector projects in finance, education, and defense contractor operations. These include Total Quality Management implementation initiatives at Hughes Aircraft Company, Downey Savings and Loan, and Copper Mountain College. His long career in Tactical Systems management with the Department of the Navy has provided him the opportunity to implement far reaching Total Quality Leadership initiatives positively impacting timely systems acquisition and logistics support thus enhancing the overall readiness of the Fleet Marine Force.

With over thirty years of experience as a lecturer, facilitator, and consultant, Mr. Styles has a comprehensive background in educational theory and practice. An Adjunct professor at the National University School of Management and Technology since 1986, Mr. Styles instructs graduate and undergraduate courses such as: Organizational Behavior; Communications for Managers; Valuing and Managing Cultural Diversity; Behavioral Science; Organizational Effectiveness and Productivity; Managing Human Resources; Psychology for Managers; Information Systems Management; Government, Business, and the Public; Personal and Professional Ethics; Organizational Development; and Ethical Concerns in Business and Management. A Fellow at Syracuse University's Maxwell Center for Advanced Public Management, Mr. Styles has a B.A. and M.A. in Management from the University of Redlands. Mr. Styles is currently the President of the Federal Management Institute.

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March 15, 1998

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Mr. Russell George
Staff Director
Subcommittee on Government
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B373 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. George:

Recently, you received a copy of correspondence from former Congressman Frank Horton, Acting Chairman of the Procurement Round Table (PRT), to Congressman Steve Horn regarding discussion draft legislation titled "Competition in Commercial Activities Act." Congressman Horton asked me to provide more detailed comments on behalf of the PRT, and for this purpose, I am enclosing the PRT's initial assessment of the discussion draft (Enclosure 1). I am also enclosing for your use a copy of the PRT's recent report entitled "Competing Federal Commercial Activities" (Enclosure 2).

Basically stated, we urge that the draft legislation referenced above be refocused—from simply seeking competition for commercial activities performed by government activities, to a stance that fosters an environment of outsourcing, divestiture and privatization. The impact of the draft legislation in its present form is to change existing Federal policy in existence since 1955 that states: "The Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels". In this regard, the proposed policy change is very significant and ignores the question of whether or not the government should be performing the function at all, given the availability of alternative sources in the private sector. Further, the draft legislation appears to encourage other federal activities to bid for what otherwise is classified as a "commercial activity." This appears contradictory to existing public policy.

The draft places responsibility with each agency head to determine if an activity is commercial or inherently governmental without regard to final rules published in the Federal Register on January 26, 1996, implementing Office of Federal Procurement Policy letter 92-1, Inherently Governmental Functions. This, we fear, will lead to a lack of standardization.

While the draft legislation requires that activities identified by agencies as inherently governmental be published and subject to public protest, there are no ground rules or criteria specifying how to judge the protest, nor are there independent activities such as the General Accounting Office or the courts cited wherein the public may appeal an agency's decisions regarding "commerciality." Under the draft legislation, each protest would be heard and disposed of by the same agency head who made the original "commerciality" determination, a process which appears at face value to lack objectivity.

The PRT believes the phase-out of A-76 by March 1999 is good news, but it is unclear what rules and regulations would cover resultant competitions conducted as a result of the proposed legislation other than vague references to "...in accordance with ...procurement laws and the Federal Acquisition Regulation;" (see SEC. 103 (a) (1)) and the references in SEC 104 of the draft). In addition, the Department of Defense has specific rules of competition for such things as depot maintenance. We question where those rules stand under this legislation, and where do competition limits such as the depot 50-50 rule fit in?

More detailed comments on various elements of the draft legislation are included in Enclosure 1. I would like to reiterate Congressman Horton's offer for the PRT to assist you in your efforts aimed at crafting a bill which achieves the objectives of outsourcing and divestiture in both the Department of Defense and civilian agencies.

Sincerely yours,

Robert P. Scott

2 Enclosures as stated

P.S. The PRT requests that, in the event of a hearing on this draft legislation, our position paper (Enclosure 2) be included in the record.

March 15, 1998

INITIAL COMMENTS FOR THE PROCUREMENT ROUND TABLE ON H.R.____, A DISCUSSION DRAFT OF PROPOSED LEGISLATION BY THE GOVERNMENT MANAGEMENT, INFORMATION AND TECHNOLOGY SUBCOMMITTEE OF THE HOUSE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGNT, SHORT TITLE:

"COMPETITION IN COMMERCIAL ACTIVITIES ACT"

Purpose of legislation: "To enhance Government efficiency by requiring the performance of commercial activities of agencies to be subjected to competition, and for other purposes."

Comments:

1. The focus of the draft legislation is on obtaining competition of commercial activities, not on fostering an environment of outsourcing, divestiture and privatization. While competition in and of itself can and does produce cost savings, the larger issue of whether the Federal government should be doing the function at all is not addressed.

2. The distinction in purpose is highlighted by comparing it with the purpose of S. 1724 (104th, 2d Session), as follows: "To require that the Federal Government procure from the private sector the goods and services necessary for the operations and management of certain Government agencies, and for other purposes."

3. The Procurement Round Table February 1998 paper, "Competing Federal Commercial Activities: A Critical Time for Congressional Direction", proposes a legislative solution that combines the two.

Section 101. Statement of Policy.

The draft legislation states policy as: "It is the policy of the Federal Government that the goods and services required by an agency to carry out a commercial activity should be provided by the most competitive source".

Comments:

1. Draft legislation uses the word "should". In any policy statement, this leaves ambiguity.

2. Draft legislation policy statement changes existing Federal policy in existence since 1955 (Bureau of the Budget) which states: "the Federal Government will not start or carry on any commercial activity to provide a service or product for its won use if such product or service can be procured from private enterprise through ordinary business channels". The proposed policy change is significant.

Section 102. Inventory of Agency Activities.

This section allows each agency head to determine if an activity is commercial or inherently governmental, rather than relying on the final rules published in the Federal Register on January 26, 1996, implementing OFPP Policy Letter 92-1, Inherently Governmental Functions. The Section further sets timetables for each agency to publish and transmit their list; allows public protest within 30 days of publication with the requirement that the agency head render a decision within 60 days or publication; sets forth what must be included on the list; and excludes certain activities from being commercial activities.

Comments:

1. The Procurement Round Table recommends that the final rules on "inherently governmental" be used, with all activities not so defined becoming "commercial activities". The draft legislation does not even require agencies to give the rationale for their determinations, only the determinations themselves.

2. The protests allowed have no criteria on which to be judged, would be judged by the same individual who made the original decision, and will become burdensome and delay the process. If protested and the agency head reverses a determination, there is no provision to publish the protest so other parties may comment.

3. The draft legislation automatically excludes some activities from being "commercial", including anything OMB determines is "inherently governmental", interagency contracted functions, any common administrative function where no more than 10 FTE are employed, etc. While current rules on this subject allow OMB to review and modify agency determinations of functions as inherently governmental, these proposed exclusions go far beyond that and far beyond existing rules.

Section 103. Competitions for Performance of Commercial Activities.

This section requires competitions for commercial activities under a set timetable and allows offers from within the agency, from another Federal agency, or from the private sector. This section also phases out A-76 cost comparisons.

Comments:

1. This section says that competitions "may" include evaluations of offers from within the agency, from another agency or from the private sector. Does this mean that agencies cannot preclude public offers for functions they wish to divest or outsource?

2. Where is divestiture covered in the draft legislation?

3. The timetable requires that a competition for the commercial activity be conducted within 2 years of its first being published. For many agencies and for complex functions, this will require a vastly reduced timeframe from what it currently takes for competitions.

4. The intent of the draft legislation appears to be to just compete the activity, rather than to foster outsourcing and divestiture.

5. While the called for phrase out of A-76 by March 1999 is good news, it is unclear what rules and regulations will cover these competitions, other than vague references to "in accordance with ...procurement laws and the Federal Acquisition Regulation (sec. 103(a)(1)) and the references in section 104 (see below). In addition, DoD, for instance, has specific rules of competition for such things as depot maintenance. Where do those rules stand under this legislation and where do competition limits, such as the depot 50-50 rule stand?

Section 104. Regulations.

This section calls for the Director, OMB, to revise the FAR to implement the Act within 6 months of enactment.

Comments:

1. Certain statutes are referenced as being applicable to the competitions called for under the draft legislation. Further analysis is required as to the impact of these references.

2. Reference is also made to using the same source selection procedures under the applicable statutes as used to select private sector sources under the referenced statutes. Needs further analysis.

3. This section further calls for revisions to FAR to obtain comparability between public and private costs using private sector standards and to use the same evaluation factors. The PRT supports this if public-private competitions are allowed.

Section 105. OMB Implementation Responsibilities.

This section calls for the establishment within OMB of a Center for Commercial Activities and Privatization to implement the Act, requires OMB to assist agencies with implementation, calls for periodic OMB review of agency determinations of what are commercial activities, and retains savings for other priority programs for the agency.

Comments:

1. Further thought needs to be given to the establishment of the new Center and what it means in terms of other entities such as OFPP. The merit of establishment of a new bureaucracy is always questionable.

2. It is interesting again that the emphasis in the legislation is on review of agency determinations of what are "commercial activities", rather than current rules which oversee what agencies attempt to declare as "inherently governmental". Is this the intent and signal that the draft legislation wants to send?

3. The PRT heartily endorses the retention of any savings generated by such competitions within the affected agency for other priority programs. However, both OMB and Congress need to ensure this. Such retention is a terrific incentive for the Federal agencies, but to be a realistic incentive, it must show on the bottom line for the agencies.

Section 106. Plans and Report.

This section establishes the requirement for agencies to specifically include implementation plans for complying with this statute in their annual performance plans. Agencies will identify those activities classified as inherently governmental, and also identify commercial activities performed by the agency. This section also requires agencies to provide timetables for conducting competitions related to the identified commercial activities. It requires agencies to report on results of competitions completed over the past five years. Finally, the section establishes the requirement for the Director, Office of Management and Budget, to report annually to Congress on results achieved under this statute.

Comments:

1. We understand and agree with the intent of requiring agencies to include competition of commercial activities in their annual performance plans.

2. Considerable additional data/information is required to be included in the agencies' annual performance plans. As such, the draft legislation goes far beyond the framework and intent of annual performance planning. The annual plan should be just that, with reporting related to five years of competition results best provided in a forum outside the annual plan.

Section 107. Relationship to Other Laws.

This section specifies the relationship of the proposed statute to other statutes.

Section 108. Definitions.

This section defines commonly applied terms used in the draft legislation. Many definitions are taken directly from Appendix 1 of OMB Circular A-76—Revised Supplemental Handbook Performance of Commercial Activities (March 1996) and OFPP Policy Letter 92-1, Inherently Governmental Functions.

Comments.

1. This section attempts to provide key item definitions associated with commercial and inherently governmental activities. We question if this information is intended to supplant final rules published in the Federal register on January 26, 1996, implementing OFPP Policy Letter 92-1. Further clarification is in order.

2. There is considerable information in the interpretations and guidelines included in OFPP Policy Letter 92-1 relating to inherently governmental activities. This guidance is not captured in the draft legislation.. We recommend that final rules published in the Federal Register on January 26, 1996 implementing OFPP Policy Letter 92-1 continue to guide agencies in determining what is, and is not "inherently governmental" activity for purposes of this legislation.

Title II—Miscellaneous Provisions.

These provisions amend the Federal Property and Administrative Services Act—Section 2, and Section 1535 of the Economy Act.

COMPETING FEDERAL COMMERCIAL ACTIVITIES: A CRITICAL TIME FOR CONGRESSIONAL DIRECTION

February 1998

THE PROCUREMENT ROUND TABLE

COMPETING FEDERAL COMMERCIAL ACTIVITIES: A CRITICAL TIME FOR CONGRESSIONAL DIRECTION

EXECUTIVE SUMMARY

The Procurement Round Table (PRT) presents this paper as a part of its continuing series of publications and seminars targeted at prompting discussions and actions that will help improve the Federal acquisition process. In addition to outsourcing and divestiture, the PRT currently is focusing on centralization of DOD's acquisition requirements process, ethics (particularly as related to post government employment), acquisition program stability (through biannual budgeting and multi-year contracting), and readying the Federal acquisition work-force for the 21st century. The PRT is a nonprofit organization chartered in 1984 by former Federal acquisition officials. Its members are private citizens and serve pro bono. The PRT's chairman is Elmer B. Staats, former Comptroller General of the United States with former Congressman Frank Horton serving as acting chairman.

Opening Federal commercial activities to competition has long been an effective method for reducing government costs and improving efficiencies. Despite this fact, decades of divisive debate and numerous barriers have prevented optimizing their use. This PRT paper explores those barriers. It further analyzes several conditions which today provide a unique opportunity for significant breakthrough in the long-standing paralysis that has inhibited effective competition of Federal commercial activities.

To seize this unusual opportunity, legislation is necessary to guide and sustain meaningful action. Absent congressional consensus, Federal agencies have proceeded in a haphazard manner, achieving some notable successes but frequently colliding with Congress and failing to capture the maximum benefits of outsourcing and divestiture actions. This paper outlines a proposed statutory approach to lead outsourcing and divestiture initiatives in both the Department of Defense and civilian agencies. A call for standardized technology and an exploration of some of the myths and realities inhibiting Federal outsourcing and divestiture are detailed in two appendices to the paper. As a first step, competition between public and private activities may be necessary to increase the extent of outsourcing, in the long run the aim should be to confine competition to the private sector only.

If the Federal government is to lead rather than follow opportunities of the 21st century, bold thinking and bold reforms are necessary. Nothing is more critical than applying such boldness to the specific manner in which our government manages its business. The time has come to go beyond noble visions and broad goals and get to the bottom line. The time has come for competition in the business of the Federal government.

COMPETING FEDERAL COMMERCIAL ACTIVITIES: A CRITICAL TIME FOR CONGRESSIONAL DIRECTION

A Position Paper Presented by the Procurement Round Table

February 1998

The Procurement Round Table (PRT) is a non-profit corporation chartered in 1984 by a group of former acquisition officials concerned about the economy, efficiency, and effectiveness of the Federal acquisition process. Its directors are private citizens who are serving pro bono with the objective of advising and assisting the government in making improvements in the process.

INTRODUCTION

"Outsourcing", "privatization", "contracting out", "divestiture" (see Appendix A for PRT definitions) have long been seen as effective methods to achieve several important goals for enhanced government efficiency by:

(1) capitalizing on the competitive market forces of the private sector thereby reducing costs,

(2) increasing productivity, quality and innovation, and

(3) responding to expressed public policy and sentiment for less government intrusion in the business of the nation.

Yet despite these goals and methods being firmly embedded in numerous Federal statutes, regulations and policies (some dating back more than 40 years), operational attainment has proven far more difficult in specific practice.

Since OMB Circular A-76, "Performance of Commercial Activities", was adopted in 1966, Federal agencies have outsourced and divested a limited number of functions. For instance, the Department of Defense completed over 2000 A-76 studies between 1979-1994. But these studies only covered about 90,000 Full Time Equivalents (FTEs). DOD estimates that of the 850,000 FTE positions currently classified as providing commercial services for the military, 640,000 are still held by Federal employees, but admits that the 850,000 figure is under-estimated. Defense Secretary Cohen has directed that DOD review and standardize its classification system by 1999.

After decades of effort, significant success in using outsourcing and divestiture to improve the Federal government and cut costs still remains elusive for two basic reasons:

1. Lack of strategic planning and concerted focus by Federal agencies.

2. Lack of Congressional consensus on an approach that would sustain meaningful Federal action.

Lacking strategic focus and direction, outsourcing and divestiture have proceeded in an ad hoc, haphazard manner, resulting more often than not in a divisive debate over control, trust, money, employment protection, philosophy, and/or agency inaction depending on the specific perspective and function(s) proposed or not proposed to be outsourced or divested. (For further discussion of some basic myths and realities about outsourcing and divestiture, see Appendix B.)

For perhaps the first time in four decades of such debate, however, unique conditions for a resolution are at hand. What remains to be seen is if they will be seized.

THE TIME IS NOW

For 10 years, a similar political paralysis also confronted the complex issue of military base realignments and closures. From 1977 to 1988, despite a bloated base structure, no major military installation was closed. Then in 1990, after a fitful start in 1988, Congress enacted the "Defense Base Closure and Realignment Act (P.L. 101-510). This landmark legislation broke the long-standing base closure logjam in an exercise of superb congressional leadership.

Why and how? Two simple reasons: the conditions were right, and Congress adopted a realistic political approach.

The identical conditions which led to the breakthrough on military infrastructure and the unique process devised by Congress to achieve base closure action also can resolve the paralysis which continues to inhibit outsourcing or divestiture of Federal commercial activities. Conditions for success exist --

Only Congressional consensus and leadership are needed.

THE CONDITIONS FOR SUCCESS

With Defense base realignments and closures (BRAC), critical mass was achieved when three conditions needed for significant breakthrough aligned. Two of these same conditions, NEED and CULTURAL READINESS, exist today with respect to Federal outsourcing and divestiture. The third element, CONGRESSIONAL CONSENSUS, however, is essential for success.

1. NEED EXISTS: With the end of the Cold War and the fall of the Warsaw Pact, U.S. military force structure and budgets changed dramatically. The challenge was not to do less with less but to do more with less. The roles and missions of the military services were expanded, readiness needs became more critical given contingency missions, and training, equipment modernization, and readiness became more challenged. In the last 7 years, the U.S. military has been involved in 25 major operations, as compared with 10 between 1945 and 1989. Yet, from 1985 to 1997, the DOD budget declined nearly 40%, and between 1990 and 1997, DOD spending on procurement declined by 53%. Between 1989 and 1997, the total DOD active, reserve component and civilian workforce was reduced by 1.3 million people, and is scheduled for a further reduction of 315,000 by 2005. Previously excess infrastructure became totally unjustifiable and unsustainable in this environment. The Department of Defense literally begged Congress for relief.

With respect to outsourcing and divestiture, these same conditions of NEED exist today. According to the Vice President's fourth annual National Performance Review Report (issued November 5, 1997), the Federal workforce has declined by 309,000 since 1993, and the budgets for civilian and military agencies continue to decline (with fiscal year 1998 a distinct aberration). Yet, expectations for high level performance have not declined and indeed have increased, and the need for training and technological modernization and innovation (with their concomitant costs) are growing exponentially. In this environment, Federal agencies cannot sustain or justify costly and inefficient in-house performance of functions which can be provided in the private sector. And, as with BRAC, they are asking for Congress for increased latitude to address this dilemma.

2. CULTURAL READINESS EXISTS: Within the DOD workforce, the culture was ready by 1990 to accept significant base closures. Where previously, passive resistance and outright opposition existed, the fall of the Berlin Wall and the precipitous downsizing of personnel and budgets changed the opinion of many within DOD, not to mention the public at large and Members of Congress. Infrastructure overhead became a costly burden that impeded critical modernization and quality of life improvements for those in uniform. BRAC provided the Pentagon with the leadership direction to address this problem.

While the private sector has long advocated contracting out Federal activities that are not inherently governmental, today this same cultural readiness also exists or is beginning to exist within the Federal agencies. Faced with downsized staff and budgets but increased expectations for performance, the Executive Branch , today more than ever before, is ready to embrace a culture of public-private sector competitions, direct outsourcing, and outright divestiture in the quest to stretch budget dollars to meet high priority needs.

Examples of this cultural readiness abound.

a. In 1993, the Administration established the National Performance Review (NPR), with the goal to reinvent and improve the Federal government. While Congress and the Administration may differ on the specific achievements thus far, the focus on measurable results through adopting the best private sector business practices is

having a beneficial effect on bureaucratic culture. Central to the NPR initiative is an assessment of every government program in terms of whether it is critical to the agency's mission. If no, the NPR recommends that it be privatized or terminated. If yes, the NPR calls for an analysis of whether it can be performed as well or better by devolving the activity to state or local governments or by competing its performance with the private sector.

b. Federal agencies, facing significant budget reductions with about $200 billion in procurement dollars at stake, have established their willingness to outsource and divest through recent initiatives such as the May 1995 DOD Commission on Roles and Missions report "Directions for Defense"; the Department of Energy's January 1997 report on "Harnessing the Market: The Opportunities and Challenges of Privatization"; the August 1996 Defense Science Board Task Force Report on "Outsourcing and Privatization" which projects a savings of $7 to 12 billion through outsourcing and divestiture of DOD functions; the independent (but DOD supported) Business Executives for National Security "Tooth-to-Tail Commission"; Defense Secretary Cohen's November 1997 Defense Reform Initiative Report, and numerous civilian agency reviews undertaken as part of the NPR.

c. In addition, Federal agencies have shown increasing creativity and a willingness to innovate through outsourcing. A few such examples include: the National Park Service's 1997 Plan to outsource functions at the Gettysburg National Park and NASA'S major privatization efforts in the Space Program. In the case of NASA, for instance, a private sector joint venture is gradually taking over space shuttle operations under a six year, $7.2 billion contract which is expected to save taxpayers over $400M. This private sector joint venture is proposing to go even further into "Commercialization" whereby shuttle services could be purchased commercially and possibly produce profits for the shuttle program.

d. Many State and local governments are already leading the way, with such initiatives as Indianapolis' public-private bidding success story for city services (25% reduction in the cost of Indianapolis' municipal services and reduction of the city workforce by one-third, for a total city taxpayer savings of $240 million since 1992).

e. The public also has established its interest and intent in not having the government (Federal, state or local) perform those functions that do not have to be performed by that government through public opinion poll and support of outsourcing initiatives.

3. CONGRESSIONAL CONSENSUS ON A PROCESS IS NEEDED: Congress responded to the base closure paralysis with a unique process. Congress had perceived previous base closure recommendations as being based on unsound data and political motivation. Yet, Congressional recognition of the changing military requirements and growing need to respond led to the 1990 BRAC legislation, establishing a process and criteria that Members of Congress could politically

sustain, if not embrace.

The similarly politically and emotionally charged issue of outsourcing or divestiture of Federal commercial activities has yet to be addressed by Congress with the same clear direction and resolve.

Congress has initiated the elements of its intent and leadership through a series of statutes related to Federal acquisition, to include the 1993 Government Performance and Results Act; the Government Management Reform Act of 1994, the Federal Acquisition Streamlining Act (FASA) of 1994; the Federal Acquisition Reform Act (FARA) of 1996 and the Information Technology Management Reform Act (Clinger-Cohen Act); and the 1998 Defense Authorization bill, but none directly providing comprehensive leadership direction on Federal outsourcing and divestiture. Conversely, the landscape of Federal statutes and policies is still littered with inconsistent and conflicting direction with respect to this issue which feeds divisive debate, confusion and frustration.

Congress has the opportunity now to seize on this need and cultural readiness for reform and at long last break through this morass, following the same process they did with base closures.

TWELVE ELEMENTS OF SUCCESS

The "Defense Base Closure and Realignment Act" (BRAC) had a number of unique elements which led to its success. These elements, outlined below, would work equally well as a framework of congressional leadership for outsourcing or divestiture of Federal commercial activities. What made these elements work was the assurance of a process that was fair and open, strategy-driven, analytical, and executable. The 12 elements of BRAC success were:

1. An impartial review Commission established by law with appointment by the President (4 in consultation with Senate and House majority leaders, 2 with the advice of Senate and House minority leaders and 2 independently by the President) and confirmation by the Senate.

2. Specific criteria to guide the process, finalized after public comment, and reviewed by the Commission to support each of the intended actions (for BRAC, DOD established 8 criteria of which 4 received preference).

3. A plan submitted to Congress in advance of the BRAC proposals (in the case of DOD, this was a force-structure plan; for outsourcing/divestiture decisions, this could be a mission-structure plan). The 1993 Government Performance and Results Act requires that Federal agencies establish and submit to Congress strategic plans reflecting their major responsibilities and how they will be attained through long-range goals.

4. A plan for action submitted to the Commission from the Federal agency head based on elements

2 and 3 above with the commitment to initiate action within a set period (2 years for BRAC) and complete it (6 years for BRAC) and a terminus for the entire process (3 rounds of recommendations for BRAC).

5. Review by the General Accounting Office (GAO) of the agency information and data for accuracy.

6. Open public hearings and onsite visits by the Commission for major affected functions.

7. A set time frame for the Commission to finalize its review and make final recommendations to the President (in the case of BRAC, DOD sent the recommendations to the Commission by April 15 with the Commission's final recommendations due to the President by July 1).

8. A statutory test for any Commission modifications to the agency recommendations (in the case of BRAC, this was "substantial deviation" from the agency plan provided -- see 3 above -- and the criteria -- see 2 above).

9. A requirement for Presidential approval or disapproval after a two week review period of the Commission's recommendations. If approved, the report was sent to Congress; if disapproved, the report was sent back to the Commission which then had one month to submit a revised report to the President. The President then had 15 days to approve or disapprove. If no approval was received by September 1, the process ended.)

10. Once (and if) approved by the President, a set period for Congress to approve or disapprove the recommendations with no line item changes allowed.

11. Once approved, facilitated agency implementation through waiver of a number of statutory restraints.

12. Perhaps most important, however, the BRAC legislation for its duration, was the EXCLUSIVE authority for selection and closure or realignment of any military installation, except for specific actions already approved in law. This exclusivity was critical given numerous other statutory restraints on base closures.

NEXT STEPS

The declining Federal budgets and workforce of the 1990s challenge Federal agencies as never before to do business smarter and differently. Where outsourcing and divestiture may at one time have caused fear and loathing in Federal bureaucracies, they are seen today as critical to agency survival. As one DOD leadership report recently stated: "(w)e need to realize that the benefits of competition are not a luxury, but a necessity...."

Congress needs to similarly respond and give focus to this cultural readiness and provide the legislative leadership direction needed to guide its structure and cohesiveness.

The general parameters for such congressional leadership and action are outlined below.

"The Federal Outsourcing and Divestiture Act of 1998"

1. A single BRAC-like statute is needed to guide both civilian and defense agencies for 3 to 4 rounds of outsourcing and divestiture recommendations. No ongoing agency outsourcing or divestiture action should be halted that has been initiated under prior authorities, however, unless the agency determines it preferable to do so. Defining which ongoing actions are to be "grandfathered" potentially will be complex, but is critical to avoid hindering many agency initiatives already underway.

2. Agency plans for each round, which would be published for public comment before they are finalized, should be comprehensive, reflecting the current status of outsourcing/divestiture actions not covered by the Act, the new proposed functions to be outsourced under the Act, and the strategic planning on which the new proposals are based. The plans should also reflect the rationale for any outsourcing and divestiture action for which a public-private competition is not proposed using a business case analysis, and where such competitions are proposed, the plans should reflect the specific set of rules and procedures the agency will use to compare public and private sector bids (e.g., whether A-76 or rules unique to the agency such as DOD has for depot maintenance).

3. It is important that the legislation further revisit and strengthen the Senior Acquisition Executive function, renaming it the Chief Acquisition Officer (CAO), putting that individual on a par with the agencies' CFOs and CIOs, and holding the CAO accountable for implementation of this new Act. Throughout the implementation of BRAC, the Office of the Secretary of Defense maintained close coordination and oversight over the execution of the process by the military services. Such coordination provided for shared insights, innovations and consistency. By making each agency's newly reconstituted CAO responsible, each agency will have a central focal point both for accountability and for sharing of innovations and lessons learned.

4. Federal agencies should be given maximum authority to proceed in the most efficient manner possible with waiver of as many existing statutory constraints as feasible. Congress cannot possibly legislate all of the specific conditions for the functions proposed to be outsourced or divested under this Act as it previously has attempted to do. As with BRAC, the agencies must be allowed to propose the actions and methodologies they believe appropriate. Making the new Act the exclusive authority for the proposals made under its aegis would have the effect of suspending many of the barriers that currently constrain sound business decisions by the agencies, to include the new increase in percentage (50-50) of depot level maintenance and repair that can be contracted for performance by non-government personnel. In addition, specific to divestitures, the Act should permit

noncompetitive procedures when there is only one bidder expressing interest.

5. For DOD, the legislation should further provide for immediate and permanent authority for additional rounds (every two years) of base closings, and to include authority to privatize military base housing. Under current projections (baseline in 1989), by 2003 the defense budget will have declined by 40%, the force structure by 36%, but the domestic base structure by only 21%. Excess infrastructure continues to place an unconscionable drain on declining military resources to the detriment of national security. With two-thirds of military housing already provided by the private sector, there are still today approximately 200,000 DOD owned units that house soldiers in an unacceptable standard. If DOD relied on its own resources to fix these units, soldiers would wait 30 years. If DOD can proceed on a permanent basis with previously authorized privatization initiatives, the Pentagon estimates that all inadequate housing can be eliminated by 2010.

6. As an incentive (a critical component to this legislative initiative), all net cost savings achieved should be retained by the agencies to pay for identified modernization needs in the areas of management improvements, technological upgrades or innovations (to include DOD weapons systems), and acquisition workforce training.

SUMMARY

Outsourcing and divestiture are critical elements in the Federal government's entry to the 21st century. Federal agencies in the new millennium will continue to face dwindling budgets, a declining workforce, and the public's growing expectations and demands for improved service and efficiencies. The private sector is already successfully responding to such changes in an unprecedented decade of mergers, consolidations, reinventions, reengineerings, restructurings, outsourcings, and divestitures. The Federal government requires the same opportunity. The need is there; the cultural readiness for action is there. Congressional consensus and direction are needed to make it happen.

The Procurement Round Table stands ready to assist.

APPENDIX A --DEFINITIONS

In establishing legislation to guide Federal outsourcing and divestiture, Congress needs to standardize clear definitions to ensure that intent is met. The absence of standardized definitions has led to confusion and misuse. The PRT offers the following definitions for consideration. By these definitions, there are only two major ways by which Federally-funded activities can be transferred to the private sector: outsourcing or divestiture. Whether these definitions are accepted or not, the more important issue is to standardize semantics.

Outsourcing - involves transferring (or contracting out) activities that traditionally are being or have been performed in-house at in-house facilities to an outside activity provider; in the case of the Federal government, from federal employees at federal facilities to private contractor employees at federal or private facilities. (1)

Privatization - a subset of outsourcing that applies solely to the public sector and also typically involves transferring the control or ownership of assets (land, facilities, and/or equipment) from the public sector to private entities, or through providing vouchers. A subset of privatization is privatization-in-place (PIP) where an entire workforce, workload, and facility are transferred "as is" to a private sector contractor. Without assessing the workload and capacity before privatizing-in-place, however, costly inefficiencies can be perpetuated. For instance, a May 1997 GAO report estimated that operational costs at two Air Force depots could be $182 million a year more per year than if the workload had been redistributed to other underutilized Air Force depots. (2)

Contracting Out - is essentially used synonymously with "outsourcing". The PRT, however, prefers the term outsourcing since "contracting out" carries a connotation that the function contracted out "belonged" to the Federal government in the first place.

Inherently Governmental Function - "means, as a matter of policy, a function that is so intimately related to the public interest as to mandate performance by Government employees....Governmental functions normally fall into two categories: the act of governing, i.e., the discretionary exercise of Government authority, and monetary transactions and entitlements." This definition is provided in the Final Rule to 48 CFR, Parts 7, 11, and 37, Federal Register, Vol. 61, No. 18, January 26, 1996, pages 2627-2630.

Commercial Activities - defined in this paper as all those governmental functions (activities) not determined to be "inherently governmental" and therefore eligible for outsourcing or divestiture.

Divestiture - involves divesting and no longer funding an activity or function previously performed in-house (can also include land, facilities and equipment). Divestiture entails a decision to get out of the business of performing and funding the divested service or function. Unlike outsourcing or privatization, pure divestitures are based on business analyses of core competencies and not based on A-76 competitions.

These definitions are consistent with a General Accounting Office, Glossary of Terms, July 1997.

APPENDIX B

OUTSOURCING AND DIVESTITURE MYTHS AND REALITIES

To further focus discussion on the issue of outsourcing and divestiture, the Procurement Round Table offers the following points for consideration to counter some of the current misconceptions which impede progress in this matter.

1. Federal Outsourcing and Divestiture Save Money--Reality

The issue of quantifying monetary savings from divestiture or outsourcing is easily challenged through accounting techniques, and opponents of specific outsourcing or divestiture initiatives are often successful in blocking such initiatives on this basis. However, consider the following: .

a. DOD estimates savings of 30-40% through outsourcing support services. Indeed, DOD has estimated that its current cost of performing commercial activities in-house by government employees is about $23-30B annually and believes they can achieve the savings needed for modernization through outsourcing 1/2 to 2/3's of this workload by 2002. (3)

b. Private sector savings from outsourcing in 1996 were estimated at 10-15% (source: Outsourcing Institute).

c. The GAO found that public-private competitions for DOD depot-level maintenance generally resulted in savings. (4)

d. In public-private sector competitions, GAO has stated that government costs are lower (i.e., the government wins the competition) about 40-50% of the time. (5)

e. An OMB study of A-76 competitions from 1981-1988 cited average 20% savings when the Federal government won and 35% savings when the private sector won. (6)

f. DOD reports that of the A-76 studies it undertook between 1979-1996, about half of the competitions were won by the government. (7)

Divestiture similarly produces cost savings. Reductions-in-force, military personnel drawdowns, base closures (which can be considered divestitures if the Federal government has stopped funding and performing a particular function) all have significant upfront costs to recoup, but have all resulted in long-term savings. Federal agencies like the Department of Veterans Affairs and Defense Logistics Agency that have divested themselves of warehousing and distribution functions for a variety of products and relied on private sector systems have all realized significant savings.

2. Outsourcing and Divestiture Cost Savings Can Be Disputed but ...--Reality

Despite such evidence as provided above, arguments still abound to counter savings achieved. For instance, in the case of military depots, the General Accounting Office (GAO) consistently questions excess capacity in the depot system for the function proposed for outsourcing. Indeed, GAO has estimated excess DOD depot capacity at 50% by FY 1999. Critics of specific depot outsourcing, mostly from Congress and/or the affected Federal workforce, state that any savings realized from outsourcing can be offset by not calculating into the cost equation the increased overhead of the underutilized depot capacity remaining. A practical remedy to this is to require excess Federal infrastructure capacity to be addressed as part of the requirements determination.

Another example from the private sector side is that public-private competitions are deemed essentially unfair because comparable cost estimates of direct and indirect costs between the public and private sectors are impossible under current

Federal cost accounting practices. This indeed can be true, but there is nothing that precludes Federal agencies from developing cost accounting practices which resolve this problem. DOD has done just that and reinstituted public-private sector competitions in 1996, after a two year hiatus. Even without "apples to apples" comparisons, however, savings are still being achieved, and private sector firms are still winning the competitions 50-60% of the time. Just to get the issue of outsourcing off dead center, industry is increasingly demonstrating great equanimity when they lose public-private sector competitions. Rather than following the normal protest-as-usual, when the Warner Robins Air Logistics Center recently won a competition over Lockheed Martin and Boeing with a bid 6-7% less than was offered by the private sector, bidders for the $434 million maintenance program for the C-5 actually touted the government's ability to effectively compete.

Statistics, particularly financial statistics, are slippery at best, and all of the above citations can indeed be countered in one fashion or another by one group or another. GAO consistently criticizes Federal agencies for achieving less savings than anticipated through outsourcing. The bottom line, however, is that competition produces savings whether it results in outsourcing, divestiture, or public sector contracting after competition.

3. Public-Private Competitions Are Unfair--Both Myth and Reality

Nothing spurs Federal agency efficiencies like a public-private sector competition, if the public involvement in the competition can be otherwise justified. The reason is simple: competition forces the agency to achieve a "most efficient" organization in order to compete.

Despite the fact that added efficiencies are achieved through public-private sector competitions, a strong case can be made that there should be no public-private sector competitions for commercial activities because of: (i) the lack of current direct and indirect cost comparability, and (ii) more importantly, because the Federal government, by policy, has no business competing in functions that are not "inherently governmental". Federal cost accounting procedures, however, can and need to be changed to reflect private industry practice. While the philosophical issue remains whether the Federal government should be involved at all in commercial activities, a realistic interim solution calls for allowing public-private competitions in outsourcing. Even though competition, whatever its limits, can and does produce cost savings, there will always be concerns about the level playing field. Ultimately, public-private competitions should give way to direct outsourcing or divestiture of commercial activities to the private sector.

4. Outsourcing and Divestiture are Just a Way to Cut Federal Jobs--Myth and Some Reality

During the 1970s and 80s, outsourcing and divestiture in the Federal government were viewed primarily as mechanisms to downsize government. The notion of the Federal government having to be competitive and be better at its "public service" than a private sector entity were somewhat alien thoughts. By policy (published for comment in December 1991 and finalized in March 1996), however, the Federal government is precluded from contracting or divesting "inherently governmental services". With such activities protected, why shouldn't the remaining functions be provided by whomever can provide the taxpayers with the best service for the best price?

The reality is that the issue is not about replacing Federal workers with private sector workers. The issue is about competition, and in such competitions, Federal workers should take distinct pride that they win 40-50% of the time. In those instances where the private sector wins, a 1989 Department of Labor analysis on "The Long-Term Employment Implications of Privatization" found that only 7% of Federal government workers had been laid off due to outsourcing decisions, with more than 58% gaining work with the new private sector company, 24% transferred to other government work, and 7% retiring.

The Congressional Budget Office has estimated that 1.4 million Federal employees are engaged in activities which can be deemed "commercial".

5. Federal Outsourcing/Divestiture are Means to an End--Reality

While it may be philosophically cathartic to recall national concepts of free enterprise, limited Federal powers, and the 200+ year old debates and intentions of our Founding Fathers, outsourcing and divestiture in terms of the Federal government are a practical approach to freeing up needed resources. Philosophical debate has contributed to a hardening of positions on the subject. More to the point, Federal budgets, particularly in the acquisition field, have diminished substantially. In reality,

outsourcing today (and the even bolder initiative of divestiture) represent a unique and substantial potential for obtaining resources needed to meet critical Federal needs.

For instance, budget support for DOD equipment modernization has declined nearly 70% since FY 1985, even with inclusion of the military services' first real net savings from BRAC in 1996. Further force structure reductions pose significant risk, national military readiness is in jeopardy, and further base closures are unlikely in the near future. Where else will the critical resources needed for modernization come? DOD has estimated that aggressive outsourcing could generate savings of up to $7-12 billion annually by FY 2002. Again, GAO, or anyone else, can dispute the projected savings, but whether it is billions or millions, it is "real money" that can be applied to meet critical military modernization needs. Civilian Federal agencies recognize the same potential.

6. Outsourcing and Divestiture are Standard in the Private Sector--Reality

While political angst and incalculable Presidential and Congressional commissions, hearings, conferences, reports and task forces continue to characterize any serious attempts to substantially outsource or divest Federal functions, the private sector has been doing it for decades, has demonstrated that it works, and recognize that outsourcing and divestiture are critical if they are to survive in a rapidly changing world economy and marketplace. Outsourcing and divestiture decision-making, in the private sector, is not rocket science, not a new management mantra, and is not a new fad. Only entrenched federal sector business practices, supported by legislative and regulatory impediments, have made it regrettably seem so in the Federal sector.

7. Outsourcing and Divestiture are Federal Policy--Reality

Federal policy, for over 40 years, has been and remains clear: "the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels" (Bureau of the Budget, 1955). Clarity of policy, however, is rarely sufficient. The old adage: "where there is a will, there's a way" applies more to tough decisions. The Base Closure and Realignment Acts (P.L. 100-526 and P.L. 101-510) that resulted in 4 rounds of base closings after a 10 year hiatus are an excellent example of that adage.

8. Federal Impediments to Outsourcing and Divestiture are Numerous--Reality

Despite stated policy, Federally performed and funded functions are protected like the Queen's crown jewels, both by the Executive and Legislative branches of government. The most onerous of the barriers to overcome include, but are by no means limited to:

a. Time consuming and complicated acquisition regulations and practices, including OMB Circular A-76 (first adopted in 1966). To quote the August 1996 DOD report on "Outsourcing and Privatization", this circular "mandates a cumbersome, time-consuming, and legalistic process that discourages DOD activities from initiating outsourcing actions". The recommendation in this DOD report is to make the "detailed administrative procedures established in A-76...advisory, not mandatory...."

b. OMB scoring rules which require Federal agencies to account for all liabilities in the first year preclude the standard business practice of amortizing these over a period of time.

c. Congressional micro management through such legislative restrictions as the "60-40" rule (10 U.S.C. 2464, wherein not more than 40% of annual depot-level maintenance funding in DOD can be used for private sector performance, recently revised to the 50-50 rule) and numerous other statutory impediments. The issue here is that Congress has mandated a percentage of workload in-house that had nothing to do with capability or reliability or cost effectiveness. Why? Presumably because of constituent jobs but a large percentage of those same constituents can and do still, perform those jobs through privatization. The real question that should be asked is: Is the function being performed in the most efficient and effective fashion, not who is performing it.

d. Executive branch reluctance to fully implement statutory authorities, e.g., the requirement for civilian

agencies to "fence" a budgetary line item for acquisition workforce training. DOD requested a $100M line item in FY 98 for the Defense Acquisition University. The civilian agencies should have budgeted a comparable $20M. They didn't. While this lack of action may not be perceived as having an immediate impact on Federal outsourcing and divestiture, a direct relationship between a well-trained acquisition workforce and its effectiveness in such specialized contracting is documented. In a GAO report, "PRIVATIZATION: Lessons Learned by State and Local Governments" (GAO/GGD-97-48, March 14, 1997), GAO noted that the majority of state and local officials and experts that they surveyed "said that having qualified employees with specific skills related to privatization was important to successfully implementing privatization."

e. Poor government cost accounting capabilities which are more an excuse for nonaction than reform.

f. Cumbersome, confusing and inconsistent rules and procedures that burden and delay outsourcing and divestiture action. It is interesting to note that Operations Desert Shield/Desert Storm were accomplished in far less time than it takes DOD to do a simple A-76 process for "simple, narrow functions requiring only the submission of sealed bids". The United States victory in WWII took not much more time than it normally takes DOD to do a more complex or multiple function A-76 process. As a consideration regarding outsourcing or divestiture, these time frames seem, at the very best, unseemly.

g. Lack of incentive. Beyond the growing internal motivation to increase outsourcing and divestiture to address declining agency budgets, Congress has yet to provide perhaps the most critical incentive: allow the Federal agencies to retain all of the net cost savings from outsourcing and divestiture actions to meet specified, high priority needs which could be annually reported to Congress and evaluated as part of a GAO audit.

FOOTNOTES

(1) Agnes P. Dover, Briefing Papers, Federal Publications, "Outsourcing and Privatization: Recent Developments," March 1997. Also, see Report of the Defense Science Board Task Force, "Outsourcing and Privatization," August 1996
(2) Ibid.
(3) Defense Science Board Task Force, "Outsourcing and Privatization," August 1966
(4) GAO Report, "Defense Depot Maintenance," July 1996 (GAO/NSIAD-96-161)
(5) Ibid.
(6) Ibid.
(7) Defense Reform Initiative Report, November 1997.

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NEWS

For Immediate Release
March 24, 1998

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NTEU President Says Contracting Out No 'Panacea;'
Legislative Proposals Called Unworkable And Unnecessary

Washington, D.C.--In testimony on legislative efforts to sharply increase the contracting out of governmental functions, the leader of the nation's largest independent union of federal employees told Congress that proposed contracting out legislation "would likely lead to higher levels of waste and fraud" in federal contracting as long as the issues of poor management and ineffective oversight remain unaddressed.

National Treasury Employees Union (NTEU) President Robert M. Tobias told a joint Senate-House Subcommittee hearing that this flawed legislation "would allow private contractors unprecedented power to force the federal government to turn over work to the private sector."

He also pointed out that we currently have no idea how many contract workers the federal government employs, or even which agencies they work for.

Tobias called pending contracting legislation "a reckless attempt to accomplish what some in Congress have been unable to do through shutting down the federal government and legislation to eliminate federal departments." The result, he said, would be a private sector that has been "governmentalized, with no oversight and no accountability to Congress or the American people."

Tobias, whose union represents some 150,000 federal employees in 18 agencies and departments, offered testimony before the Senate Subcommittee on Oversight and Government

(MORE)

NTEU on Contracting Out Proposals--Add One

Management and the House Subcommittee on Government Management. He attacked both the proposed Fair Competition Act of 1998 and the Competition in Commercial Activities Act of 1998 as unworkable and unnecessary.

Pointing to the most recently-disclosed Pentagon contracting fiasco, in which the agency was found to have paid $75.60 each for 57-cent screws, Tobias said "you cannot slash the number of purchasing and contract personnel at federal agencies while simultaneously turning the keys over to the private sector." The tax dollars saved by this exercise, he said, "are simply swallowed up by the black hole of private contracting."

Tobias cited General Accounting Office (GAO) and Office of Management and Budget (OMB) studies putting the federal contracting budget at least at $120 billion--and because contract oversight is so poor it could be perhaps twice that much--compared to the government's payroll costs of $108 billion.

He said the bills effectively would eliminate OMB Circular A-76, the directive which bars the contracting out of "inherently governmental functions"--such as the work of the Internal Revenue Service, much of which is specifically cited in A-76--and provides the opportunity for federal employees to compete for work proposed to be contracted out when they can show the work can clearly be accomplished cheaper in-house.

Instead, he said, Congress should use its existing power to require agencies to follow the dictates of Circular A-76 when making a determination to contract out a particular function.

The best course for taxpayers, Tobias said, is to redraft the pending legislation and mandate that agencies follow A-76 when reviewing a function for contracting out, and, even more importantly, reform current contract management and oversight functions first.

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For information and press releases visit the NTEU Home Page
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Statement for the Record

From: The Helicopter Association International
To: The Senate Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia; and
The House Subcommittee on Government Management, Information and Technology

Joint Subcommittee Hearing

Re: Competition in Commercial Activities Act (H.R. 716), the Fair Competition Act (S. 314).

Tuesday, March 24, 1998
Room 342 Dirksen Senate Office Building

This year, the Helicopter Association International (HAI) celebrated its 50th Anniversary as the world's premier industry group representing the civil helicopter industry. While examination of our industry's history reveals that unfair government competition has always been a problem, most industry observers point out that government competition against the commercial providers of helicopter services has grown exponentially worse during the past 15 years. Moreover, most small-businesses persons who operate helicopters for a living identify unfair government competition as the greatest threat to the continued viability of their businesses.

Their concerns stem from the fact that government agencies which operate helicopters enjoy special regulatory exemptions and tax-revenue incomes. Government agencies then use these tax-funded capital assets in the pursuit of commercial activities, thus consuming increasingly larger portions of the commercial marketplace. The following table demonstrates the enormity of the unfair advantages that government helicopter operators deploy against their taxpaying commercial counterparts:

Unfair Advantages Used by Government Agencies Against the Commercial Helicopter Industry		
Item	**Government Agency Helicopter Operators**	**Small Business/Commercial Helicopter Operators**
Taxes	Consumes tax revenues	Generates tax revenues at all levels of government

Unfair Advantages Used by Government Agencies Against the Commercial Helicopter Industry		
Item	**Government Agency Helicopter Operators**	**Small Business/Commercial Helicopter Operators**
Aircraft	1) Utilize tax-purchased helicopters. Often receives "free" helicopters directly from U.S. Military Surplus. 2) Exempt from all Federal Aviation Regulations (FARs) for airworthiness and safety. 3) Not required to comply with manufacturers airworthiness directives.	1) Must purchase from commercial sources; do not qualify for direct acquisition of U.S. Military Surplus aircraft. 2) Must comply with all FARs for airworthiness and safety. 3) Must comply with all manufacturers airworthiness directives.
Aircraft Parts	Exempt from **Federal Aviation Regulations** (FARs) regarding airworthiness standards.	Must use FAA-approved parts, mechanics and procedures.
Materials Sources	Qualifies to purchase from the Government Services Administration (GSA).	Must purchase from commercial sources.
Hangars	Bought by taxpayers	Bought by Small Business Helicopter Operator
Fuel	Bought by taxpayers	Bought by Small Business Helicopter Operator
Insurance	Either: 1) Bought by taxpayers, or 2) Almost always, the agency self-insures, placing taxpayer capital at risk.	Must pay insurance premiums.

Unfair Advantages Used by Government Agencies Against the Commercial Helicopter Industry		
Item	**Government Agency Helicopter Operators**	**Small Business/Commercial Helicopter Operators**
Personnel Training and Certification	Exempt from all Federal Aviation Regulations (FARs) for personnel training. Any training is voluntary and done at taxpayers' expense. Pilots are not even required to be FAA certificated (licensed).	Must comply with and pay for all FAA training requirements for maintenance and crew personnel. All pilots must be FAA certificated (licensed).

It should be noted here that some of the nation's safest and most professional helicopter operators are in the government sector. For the sake of aviation safety and for the safety of the personnel assigned to those government operations, and for the safety of citizens on the ground, HAI supports legislation that would require all nonmilitary aircraft (including government/public aircraft) to be subject to all Federal Aviation Regulations (FARs) and thus be inspected by the FAA. HAI also supports government owning and operating aircraft for inherently governmental functions such as law enforcement.[1] When law enforcement agencies do purchase aircraft, HAI supports them by urging legislatures to purchase the finest, FAA-certificated aircraft and training available that is appropriate to their mission objectives. However, those assets should not be deployed against the taxpayers' livelihood that generated the tax base necessary to fund government operations.

As the above table demonstrates, unfair Government advantages combine to form such a powerful and unfair competitive advantage that it is often impossible for the taxpaying private sector to compete against them. This is why HAI, its Board of Directors, and the hundreds of member organizations that supply civil helicopter services across our nation, commend this Congress for taking action that will, at the very least, place federal agencies onto a more equal playing field with the commercial providers of these services. Representative John J. Duncan, Jr. of Tennessee has introduced H.R. 716, the *Freedom From Government Competition Act of 1997.* Senator Craig Thomas introduced its companion bill, S. 314, in the Senate. Representative Stephen Horn has been working on a House Subcommittee draft known as the *Competition for Commercial Activities Act* on the same subject. Congress must be applauded for conducting hearings on government competition over the past years. Today, however, it is crucial that these joint hearings result in forging a pro-business bill to be sent to the House and Senate for a vote by all its members.

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[1] Many law enforcement agencies choose not to purchase and operate aircraft but to contract out to commercial providers for necessary air support. In these cases, FAA certificated aircraft are always used. This represents a significant safety and tax-dollar value.

Allowing the federal government to act as entrepreneurs in the commercial marketplace represents an enormous compromise with the tenants of our Founding Fathers. None of them envisioned a centralized government that would engage in commerce in direct competition with its citizens, let alone become the largest employer in the nation.

Passage of an equitable bill in the 105th Congress is essential to the civil helicopter industry. Many of our members cannot long endure the unfair, special advantages afforded government agencies. HAI has received numerous requests from its small-business helicopter operators asking their association to help counteract government encroachment into commercial markets. One Sheriff acquired surplus helicopters and began spraying for mosquito abatement; this resulted in the commercial operator losing a 5-year contract. Numerous government agencies across the nation have gone into the aerial firefighting business—traditionally a commercially provided service. These same government helicopters are using their uncertificated aircraft to manage natural resources, to transport government officials, to transport cargo, and to transport photographers and news reporters.

All helicopter services that are provided by government helicopter operations, are available in the commercial sector—the sector that is FAA certificated—the sector that pays taxes. Every time a government helicopter performs commercial services, a small-business helicopter operator loses work, loses revenue, and if the unfair competition persists, will lay off employees and pay much less tax into the treasuries at every level of government. Conversely, every time government helicopters perform commercial work, it uses this work to justify larger budgets, hire more government employees, and consume more tax dollars. As government helicopter operations grow in a finite marketplace, this squeezes out the FAA-approved commercial operator. This causes commercial operators to reduce the scope of their services and operations, and all too frequently, to go out of business. Subsequently, many government competitors claim that some helicopter services are "not commercially available," and use this often unsubstantiated claim to justify more government helicopter encroachment into the marketplace.

Today, Congress has the opportunity to halt this unjustifiable trend. HAI is grateful to Congress for turning its attention to what most civil helicopter operators view as the number-one challenge to their continued viability and very existence. America's civil helicopter industry is unparalleled in the world today. Government competition, especially unfair government competition, threatens this American success story and the thousands of good-paying jobs fostered by the small businesses that provide helicopter services. S. 314 and H.R. 716 portend a strong future for this industry. Accordingly, HAI urges you to support the strongest, probusiness version for which a majority consensus can be achieved.

Thank you for your consideration of these matters which are of such vital interest to America's civil helicopter industry.

HAI is the professional trade association for the civil helicopter industry. Its 1,400-plus member organizations in more than 70 nations safely operate more than 4,000 helicopters approximately two million hours each year. HAI is dedicated to the promotion of the helicopter as a safe, effective method of transportation and to the advancement of the civil helicopter industry.

Helicopter Association International — *Dedicated to the advancement of the civil helicopter industry*

ACSM

American Congress on Surveying and Mapping
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Statement of the American Congress on Surveying and Mapping to the Senate Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, and the Subcommittee on Government Management, Information, and Technology, and on A Free Market Approach to Federal Contracting: the Fair Competition Act of 1998 and the Competition in Commercial Activities Act of 1998

March 24, 1998

The American Congress on Surveying and Mapping (ACSM) is pleased to submit its views on "A Free Market Approach to Federal Contracting: the Fair Competition Act of 1998 and the Competition in Commercial Activities Act of 1998." ACSM is an individual membership society that represents more than 7,500 professionals in the fields of surveying, cartography, geodesy, and geographic information systems technology who work in both the public and private sectors throughout the world. ACSM is made up of four member organizations that serve as special interest groups. ACSM's member organizations are the American Association for Geodetic Surveying, the Cartography and Geographic Information Society, the Geographic and Land Information Society, and the National Society of Professional Surveyors.

In commenting on public policy issues, ACSM seeks to represent the interests of its private- and public-based members, the surveying and mapping profession as a whole, and the nation's long-term interest in ensuring the availability of comprehensive, timely, accurate, and useful geospatial information.

General Comments

ACSM commends Chairman Brownback, Chairman Horn, Representative Duncan, Senator Thomas, and the cosponsors of the Freedom From Government Competition Act, the Fair Competition Act of 1998 and the Competition in Commercial Activities Act of 1998 for developing these proposals. These bills make an important contribution to the ongoing debate over the appropriate roles of government agencies and the private sector in providing needed

services. Whether, and to what degree, services provided by agency staff should be outsourced to private firms is an important part of that debate.

ACSM believes it can look at outsourcing objectively because its membership includes surveying and mapping professionals who work in private firms as well as government agencies. ACSM also can contribute to the debate from its experience over the past three years in generating a nonpartisan analysis of the nation's future geospatial information needs. The study, "Geographic Information for the 21st Century: Building a Strategy for the Nation," was conducted by the National Academy of Public Administration (NAPA) and was released on January 13, 1998. The study includes a discussion of outsourcing that ACSM believes will prove helpful to the subcommittee as it examines the current government competition proposals.

ACSM's Views on the Proposed Freedom From Government Competition Act

ACSM supports having increased opportunities for its private sector members to contract with government agencies to perform surveying and mapping. However, ACSM opposed last year's proposal, the Freedom From Government Competition Act (FFGCA) (S. 314/H.R. 716) because we found it difficult to assess the proposal's real-world impact on scientific fields, such as surveying and mapping. In statements presented to these subcommittees in 1997, ACSM expressed concern that enactment of FFGCA "could disturb the interdependent relationship that exists between government surveying and mapping agencies and private sector professionals, perhaps disrupting the nation's access to timely, accurate geospatial data." ACSM also said that the FFGCA "raises important questions about agencies' roles as providers of base data, ownership of data, maintenance of agencies' core capabilities, and other issues." Finally, ACSM suggested that the FFGCA proposes a broad-based solution to procurement situations that are best addressed on a targeted basis.

Comments on the Current Proposals

ACSM views the current proposals, the Fair Competition Act of 1998 and the Competition in Commercial Activities Act of 1998, as improvements over S. 314 and H.R. 716. In contrast to last year's proposal, the current draft bills do not mandate outsourcing of all agency activities that are not inherently governmental or that should be provided in-house for reasons of national security, best value, or because private sector sources are inadequate to satisfy an agency's requirements. Rather, the current proposals provide a framework for competitions between private sector firms and federal agencies to determine which would provide better value to taxpayers for a given project. The new bills exempt from the competitive process activities that are inherently governmental, activities performed by ten or fewer employees, activities deemed necessary to perform in-house because of national security or a national emergency, activities that private sources are inadequate to meet, activities where an agency

would use a private source pursuant to another agency's contract with that private source; or activities for which an ongoing A-76 cost comparison was already underway or was recently completed.

These are positive changes, but the impact of the revised bills on surveying and mapping, like that of the FFGCA, remains unknown. Because of this uncertainty about the bills' real-world impact, ACSM cannot endorse either the Fair Competition Act of 1998 or the Competition in Commercial Activities Act of 1998. Our specific concerns with the proposals are presented below.

Agencies and Private Surveying and Mapping Firms are Interdependent

Surveying and mapping may differ from other professions that contract with the government in the fact that the relationship between federal surveying and mapping agencies and private practitioners is both interdependent and generally cooperative. ACSM supports having increased opportunities for its private sector members to contract with government agencies to perform surveying and mapping. However, our private sector members are very concerned that any legislation dealing with government competition not disrupt a public-private partnership that is working well to meet the nation's growing need for geospatial information.

Our previous statements presented examples of the many ways in which private surveyors and mappers depend on government agencies for accurate base data that serve as the foundation for geospatial products. Examples included positioning data provided by the National Geodetic Survey and base maps provided by the U.S. Geological Survey (USGS) that are used by land surveyors, geographic information specialists, and private cartographers and academics.

Similarly, agencies increasingly are turning to private firms for a variety of commercial activities, including the production of surveys, maps, and geospatial products. ACSM members at USGS, for example, report that in FY 1998 they will privatize between $70 million and $75 million of the National Mapping Program, which includes $40 million of map and digital data production. Our members at the National Ocean Service (NOS) report that, in line with Congressional guidance, the agency plans to acquire not less than 50 percent of its hydrographic services through private contract or long-term leases by FY 1999. In FY 1998, contracting for hydrographic services will exceed $18 million.

Administrative Process Could Delay Needed Data

ACSM believes that the merits or shortcomings of the current A-76 process versus the competitive procedures presented in the current bills is a matter for discussion between Congress and the administration. However, we note that the proposed system is

administratively complex, potentially costly, and could delay the production of needed geospatial data. Resolution of challenges to agency decisions to leave an activity off the list of items to be competed could further delay the completion of needed projects. We cannot speak for other areas of federal procurement, but we question the need for this complex new process in view of the trend toward increased outsourcing for surveying and mapping reported above.

ISSAs Provide Contracting Opportunities

ACSM is pleased that the sponsors have revised last year's bill to remove the restriction on interservice support agreements (ISSAs) under which agencies obtain goods or services from, or provide goods and services to, other government entities. However, the new House bill would require that for non-inherently governmental activities that appear on an agency's list for Fiscal Years 2001 and 2002, and that are performed under ISSAs, an agency "shall give priority consideration to using the source selection process provided for under this title to select the sources to perform those activities in those years."

ACSM does not object to the House provision per se, but we do not understand why some of the bills' supporters continue to target interagency arrangements that, at least in surveying and mapping, provide effective, cooperative funding mechanisms and often are the most cost effective approach through which agencies can obtain base data and related services that are needed to carry out their missions. For example, development of the GPS Continuously Operating Reference Stations (CORS) network would not have been possible without interagency agreements. Development of CORS involved the cooperation of five federal and seven state and local agencies that pooled their resources and avoided duplication of activities.

Further, rather than taking away work from private firms, ISSAs frequently create opportunities for private firms to contract with agencies for the production of surveys or maps. Examples include the National Aerial Photography Program, Department of the Interior High Priority Program, National Digital Orthophoto Program, National Digital Elevation Program, and the National Land Cover Data Set.

NAPA Study Provides Guidance on Outsourcing

Before moving forward with the current proposals, ACSM suggests that the subcommittees review the discussion of outsourcing in the recent National Academy of Public Administration study mentioned at the beginning of our statement. The study, "Geographic Information for the 21st Century: Building a Strategy for the Nation," arose, in part, from various congressional proposals in 1995 that would have abolished or relocated surveying and mapping agencies and/or required wholesale contracting out of surveying and mapping

services.

The study's sections on balancing public and private sector roles, the public purposes served by geographic information, and outsourcing may be helpful to the committees as they proceed with consideration of the current government competition bills.

Balancing Roles

With respect to balancing public and private roles, NAPA notes that governments inherently have the responsibility to represent the public's interests, not just the interests of particular segments of society, to ensure the general welfare and guard against predatory practices, and to provide economic and societal stability.

Because governments represent the public's common interests, they are best positioned to:

- Ensure sound stewardship of the government's natural and economic resources;
- Take responsibility for archiving the government's information resources;
- Arbitrate legal disputes, including those involving land boundaries;
- Absorb broad liability for public safety;
- Respond to emergencies arising from natural hazards, civil disorder, and military action.

Public Purposes of GI

NAPA identified a number of public purposes that now rely on GI. Some, such as management of public lands and nautical charting, are addressed directly by the federal government. Others, such as transportation, are pursued in partnership with state and local governments through federally aided construction programs and regulatory oversight. Some, such as ecosystem management, may be equally applicable to all levels of government. Still others apply to the private sector, such as agriculture, property rights, and environmental protection.

NAPA's analysis of the public purposes served by GI includes a recommendation for greater use of "multilateral partnering and consortiums" that ACSM believes relates to the topic of ISSAs we discussed earlier. The NAPA report states:

> "GI resource managers should increasingly emphasize multilateral partnerships — interagency, inter-governmental, and with the private sector — to promote a robust

> [National Spatial Data Infrastructure] and as a source of savings. Broad consortiums that involve multiple governmental levels and engage the private sector should be favored, and USGS's unique authority to engage in innovative partnerships should be extended to other agencies."

Rather than being devices that take work away from private firms, ACSM believes that ISSAs are one type of multilevel partnership that can be used to involve federal agencies, other levels of government, and the private sector in cooperative efforts to meet the nation's GI needs.

Outsourcing

Finally, NAPA's report addresses outsourcing. NAPA's discussion recognizes government's ultimate accountability as steward of GI resources, but highlights the importance of government-private sector partnerships by urging that future GI needs be met through greater reliance on the capabilities of a "robust and rapidly advancing private sector."

The study briefly addresses the question of which GI functions should be retained by agencies as "inherently governmental," but concludes, "There is no single right answer to the question of which public purposes should be met in which sector." Outsourcing decisions, NAPA says, should be made carefully, using the following criteria:

- It should be clear what the government is purchasing, how the purchase will be in the public interest, and what the price will be;
- The purchase should be at or below the cost of performing the service in-house;
- Outsourcing should meet quality requirements;
- The government must be able to hold the contractor accountable for performing acceptably.

The last criterion, contract monitoring, is crucial but often is the weakest link in the process. NAPA cites a 1991 General Accounting Office study of outsourcing that concluded that, in some cases, agencies relied on contractors so heavily that the private firms were, in fact, performing inherently governmental functions.

NAPA concludes its discussion of outsourcing with the following recommendations:

- Outsourcing decisions should be made on the basis of the respective roles, responsibilities, and competencies of the governmental and private sectors;

- Cost effectiveness is one of several factors that need to be considered; on the other hand, arbitrary percentage targets for contracting out should be avoided.

In Conclusion

ACSM appreciates this opportunity to present its views on the Fair Competition Act of 1998 and the Competition in Commercial Activities Act of 1998. We view these proposals as improvements over the Freedom From Government Competition Act. We cannot endorse these proposals, however, because their impact on surveying and mapping, like that of the FFGCA, remains unknown.

Our statement outlined several specific concerns with the new proposals. We noted that private surveying and mapping professionals and federal agencies that have geographic information missions enjoy a relationship that is interdependent and generally cooperative. ACSM supports having increased opportunities for its private-base members to contract with government agencies. This is occurring already, however, and we questioned whether a complex, new administrative structure, which could delay completion and dissemination of needed geographic information, is needed in view of the trend toward increased outsourcing of surveying and mapping services. Finally, we suggested that the subcommittees review the NAPA study's findings on balancing public-private sector roles, public purposes, and outsourcing before moving forward with the new government competition proposals.

We will be pleased to provide additional information on any point in our statement. Please contact Joseph Kuchler, ACSM Government Affairs Director, at 301-493-0200, ext. 106.

AMERICAN CONSULTING
ENGINEERS COUNCIL

Date: **March 24, 1998**
For Immediate Release

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Joint Subcommittee Hearings on
The Competition in Commercial Activities Act
and the Fair Competition Acts of 1998

Statement of the American Consulting Engineers Council

The American Consulting Engineers Council (ACEC), a member of the Coalition for Tax Payer Value, joins in supporting the proposed revisions to S 314 and HR 716 embodied in the "Competition in Commercial Activities Act" and the "Fair Competition Act of 1998". The continuing efforts of Senator Craig Thomas and Congressman Jimmy Duncan, and the leadership of Senator Sam Brownback and Congressman Steve Horn, have joined together to craft meaningful legislation that will provide the taxpayers with the best value in government contracting by allowing the private sector to compete for government performed commercial activities.

ACEC is the largest national organization of engineers engaged in the independent practice of consulting engineering. ACEC has more than 5,700 member firms employing nearly 250,000 professional engineers, land surveyors, scientists and technicians who design over $150 billion in construction projects annually. More than 75 percent of these firms are small businesses with fewer than 25 employees each

The Competition in Commercial Activities Act (CCAA, HR 716) and the Fair Competition Act (FCA, S 314) are reasonable and moderate revisions of legislation originally introduced by Senator Thomas (R-WY) and Representative Duncan (R-TN). These revisions would accomplish the following:

- CCAA/FCA reaffirms Federal policy supporting free enterprise in place since the Eisenhower Administration while adhering to the principle of this Administration's National Performance Review that competition will ensure a government that "works better and costs less."

- CCAA/FCA provides a framework for realizing savings in the performance of

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non-inherently governmental activities by authorizing competition between Federal agencies and the private sector. The legislation does not mandate outsourcing or privatization.

- CCAA/FCA seeks to ensure that the government focuses on its core missions and responsibilities while allowing the private sector the opportunity to compete to perform non-inherently governmental, commercial activities.

While many believe that the government should always outsource the performance of non-inherently governmental activities, the legislation attempts to strike a balance between the interests of tax-payers and private sector employees and the interests of public sector employees currently performing non-inherently governmental activities for Federal agencies.

In another area, the CCAA, and to some extent the FCA, creates a bright line in favor of the taxpayer by ensuring that the commercial activities currently and appropriately performed by the private sector will not be acquired for performance by Federal agencies. The CCAA recognizes the danger inherent in permitting tax-payer subsidized Federal agencies to "market" their services to Federal and non-Federal entities in direct competition with the private sector. The FCA could be substantially improved by adopting a comparable provision.

While most of the arguments made against the legislation by representatives of the public sector unions are misdirected, the legislation could be improved by addressing the concerns of public sector employees who may be displaced through competitions. ACEC encourages the sponsors to address these issues and look at examples where the private sector has voluntarily absorbed public employees and maintained their right to collective bargaining.

Reinventing Government scholar David Osborne has identified a number of techniques that State and local governments have employed in "no lay-off policies" in public-private competitions: Training workers for other, mission-focused government jobs; holding vacant government positions open as a "job bank" for those whose activities are outsourced; assisting public managers in taking their organizations private; offering severance packages or early-retirement incentives; and, providing outplacement services. Some of these provisions may be appropriate for this legislation.

By focusing Federal agencies on their primary missions and by using fair competitive processes for outsourcing determinations, enactment of the

CCAA/FCA will ensure that the American taxpayer gets the greatest value for his or her tax dollars.

ACEC believes that the CCAA/FCA reflects a pragmatic and incremental step towards assuring that government contract activities are conducted in the most efficient and dynamic fashion while ensuring that the taxpayer is receiving the best value for their dollar. The legislation is sensitive to the needs of the federal workforce wile striving to introduce the best practices of the private sector. ACEC believes that this legislation will maintain the balance between the public and private sectors. However, in a country built on the entrepreneurial spirit and job creating strength of small business - it is appropriate and efficient that the federal government rely on the private sector to deliver commercial goods and services.

ACEC joins its coalition partners in supporting the concepts embodied in the CCAA/FCA. We ask that the legislation be considered by the full Senate Government Affairs and House Government Reform and Oversight Committee and that the Congress support its enactment into law this year.

STATEMENT OF

SMALL BUSINESS LEGISLATIVE COUNCIL

before the

JOINT HEARING ON

THE FREEDOM FROM COMPETITION ACT OF 1997

MARCH 24, 1998

1156 15th Street, N.W. - Suite 510 Washington, DC 20005 (202) 639-8500 / FAX (202) 296-5333

The Small Business Legislative Council (SBLC) appreciates this opportunity to submit our comments for the hearing record of March 24, 1998 on the Competition in Commercial Activities Act (HR 716) and the Fair Competition Act (S 314).

The SBLC is a permanent, independent coalition of nearly one hundred trade and professional associations that share a common commitment to the future of small business. Our members represent the interests of small businesses in such diverse economic sectors as manufacturing, retailing, distribution, professional and technical services, construction, transportation, and agriculture. Our policies are developed through a consensus among our membership. Individual associations may express their own views.

The SBLC supports Senator Craig Thomas and Representative John Duncan's efforts to stop unfair government competition with the small business sector. Legislation is long overdue. We feel the Competition in Commercial Activities Act (HR 716) and the Fair Competition Act (S 314) are good steps towards reducing unfair government competition with small business and to ensure that the government focuses on its core missions and responsibilites.

Unfair competition may occur when the government conducts activities in-house which could be obtained from the private sector or provides services to the public, which could be provided by the private sector. Over the years these activities have multiplied in number and include such diverse activities as custodial services, nursery farming, and recreational support services. The only federal policy on this subject is an administrative regulation known as OMB Circular A-76. The purpose of the circular is to identify commercial activities that the government does conduct in-house and then to require the agencies to conduct a cost comparison between government performance and business performance.

Unfortunately, A-76 has failed to live up to its charter. Without the force of law behind it, agencies have circumvented the intent of the circular. When the rules of A-76 are applied they are so fraught with loopholes few cost comparisons reflect accurately the efficiency of contracting out activities.

The current bills are the successors to efforts led by Represenatives Bob Smith and Charles Stenholm in the 99th and 100th Congresses, by Senator Warren Rudman in the 98th Congress, and Senator John East and Senator S. I. Hayakawa in the 97th Congress. You can

imagine it has been with some disappointment we view our own failure to ignite congressional interest in this serious problem.

The government's track record in this important area is dismal. As early as 1933 a Special House Committee reported on the growing number of commercial activities being performed by the government. (House Special Committee, Government Competition with Private Enterprise, 72 congress, 1st Session, House Report 235) Even then the list of activities was quite extensive.

During the 1950's, Congress and the Executive Branch undertook the first major effort to grapple with this problem. In 1954, the House Committee on Government Operations issued a report entitled "the Government in Business." The first sentence of that report stands today as topical as the day it was written. The committee stated: "The subject of Government in Business is wide in scope and extremely important in this era of big government debts, heavy taxes, and complex intergovernmental relations." The Report quoted Thomas Jefferson, James Madison, Alexander Hamilton noting that the "Founding fathers did not conceive that the federal government should engage in business in competition with citizens striving for a livelihood."

The committee observed that in 1953 the government operated over 100 business type activities and recommended that the government should stop competing with the private sector. In its conclusion, it made a statement which perhaps best summarizes the concerns of the business community. The committee stated: ***"Genuine efforts should be exerted to encourage rather than discourage industry to handle the government's business. A strange contradiction exists where the government gives lip service to small business and then re-enters into unfair competition with it."*** (emphasis added) In 1954, the House of Representatives passed one of the first bills on this subject, but it failed to pass the Senate.

This attention by Congress did result in executive branch activity. The Bureau of the Budget issued Budget Bulletin 55-4 in January 1955. Business' struggle to get the government to develop a cohesive, realistic management system shifted to the Executive Branch at that point and it is where we have concentrated our efforts for the last 40 years. During this period, we have lived with several versions of the Bureau of Budget's, now the Office of Management and Budget (OMB), attempt to control the growth of government's burgeoning commercial activity.

The most recent version of Circular A-76 is the culmination of this process. The fact that we are no closer to solving this problem over 40 years later is testimony to the fact we need more than an executive policy, we need a clear mandate, which is why we request the support of H.R. 716 and S. 314.

The policy as stated 40 years ago in Budget Bulletin 55-4 was simple and straight forward: ***"It is the general policy of the administration that the federal government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels. Exceptions to this policy shall be made by the head of an agency only where it is clearly demonstrated in each case that it is not in the public interest to procure such product or service form private enterprise."*** We believe this should be the premise of the legislation being discussed today.

Interestingly, the relative costs of government versus private production were introduced in Budget Bulletin 55-4 as a factor only if a product was not available at a reasonable price. "The relative costs of government operation compared to purchase from private sources will be a factor in the determination in those cases where the agency head concludes that the product or service cannot be purchased on a competitive basis and cannot be obtained at reasonable prices form the private industry."

We believe A-76 has failed to produce complete results because it is not perceived as a national priority either within the government or the private sector. A 1997 study by the General Accounting Office came to the same conclusion and recommended, as we do, the establishment of a national policy, endorsed and supported by both the legislative and executive branches. The national policy must be stable, understandable, and provide a balance among many conflicting national issues. (GAO/GGD-97-48, March, 1997)

Over these many years, how many small businesses have failed under the pressure of this unfair competition? How many opportunities have been lost to start a new small business because of this policy? We will probably never know, but we do know what government did over that period of time. It grew and grew and grew some more.

In recent years, there has been considerable documentation of business' ability, particularly small business, to generate new jobs and to fuel the engines of our economy. At the same time we, as a nation, have raised questions about the size and purpose of our government as budget deficits dominate the headlines. Yet, we have failed to enact a policy that will help the job creators; reduce the size of government and the deficit; and, be consistent with the economic philosophy of the founding fathers of this country. It is difficult for the business community to understand the government's inability to develop and implement sound management concepts. We can see no better way to maximize the effective use of our nation's resources than focusing the attention of the government on the act of governance and leaving the job of commercial activity to the private sector. Our founding fathers recognized that business should be left to business. Thomas Jefferson once said, "the true theory of our constitution is surely the wisest and best, that the states are independent as to everything within themselves, and united as to everything respecting foreign nations. ***Let the General Government be reduced to foreign concerns only, and let our affairs be disentangled from those of all other nations, except as to commerce, which the merchants will manage the better, the more they are left free to manage for themselves, and our General Government may be reduced to a very simple organization, and a very inexpensive one; a few plain duties to be performed by a few servants.***" (emphasis added)

Thank you for the opportunity to discuss unfair competition by the government.

NATIONAL FEDERATION OF FEDERAL EMPLOYEES

POSITION OF THE
NATIONAL FEDERATION OF FEDERAL EMPLOYEES

BEFORE
THE UNITED STATES HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON MANAGEMENT,
INFORMATION AND TECHNOLOGY
AND
THE UNITED STATES SENATE
SUBCOMMITTEE ON OVERSIGHT OF
GOVERNMENT MANAGEMENT, RESTRUCTURING,
AND THE DISTRICT OF COLUMBIA

ON H.R. 716: REQUIRING FEDERAL AGENCIES
TO OBTAIN ALL GOODS AND SERVICES NECESSARY FOR
OR BENEFICIAL TO THE ACCOMPLISHMENT
OF THEIR AUTHORIZED FUNCTIONS
BY PROCUREMENT FROM PRIVATE SOURCES

HEARING DATE: MARCH 24, 1998

POSITION STATEMENT

National Federation of Federal Employees
1016 16th Street, NW, Washington, DC 20036 (202) 862-4400

INTRODUCTION

The National Federation of Federal Employees (NFFE) appreciates the opportunity to present our views on H.R. 716, the Freedom From Government Competition Act. NFFE represents approximately 150,000 Federal workers in 52 agencies across the country and is the oldest independent Federal employee union.

NFFE's position on H.R. 716 is this: Contracting out does not produce a more efficient and cost-effective government. In fact, contracting out does the exact opposite: it fosters inefficiency and pushes costs through the proverbial roof. Contracting out also threatens national security. For these reasons, NFFE strongly urges this Subcommittee to eliminate contracting out altogether. For purposes of this piece of legislation, however, structured and limited government competition with the private sector is a more efficient and cost-effective alternative to awarding all contracts to the private sector. The examples discussed below illustrate this point.

DISCUSSION

Contracting Out Poses a Threat to National Security

Maintaining a strong Federal workforce is vital to maintaining a strong national defense. Mixing contractors in with Federal employees weakens that bond and means that important government information lacks safeguards.

Contractors within the U.S. Army Medical Research Facility in Maryland perform background investigations for security clearances. They decide who to trust with access to sensitive information such as chemical defense strategy.

Another questionable practice within that facility is to allow contractors to work alongside Federal employees doing chemical research. Contractors have taken government research results and patented them. The government covered the overhead and research and development at taxpayer expense.

No check whatsoever exists on these contractors. To balance contractor power, one would demand a concurrent investment in the integrity of the Federal government. These contractors, however, have no investment in the integrity of the Federal government. They do not depend upon the government for job retention or promotions. A contractor may lose a particular contract. Individual contract employees may leave their jobs at any time.

Federal employees, on the other hand, have a personal stake in their work. They work for the Federal government because they believe that serving the public is a patriotic and noble duty. These employees are dedicated and committed to the ideal that the government exists to serve its citizens. Federal employees strive each day to ensure that the American public receives the services it needs and expects. Even more, Federal employees depend on the Federal government for job security. They make an effort to hire someone they can trust with sensitive documents and chemical compounds, for example. They are trustworthy themselves.

Federal employees are also subject to ethics laws. Even if that personal stake were not enough, the law gives Federal employees an added incentive to be trustworthy. Private contractors are not subject to the same ethics laws that protect the public from corrupt practices and conflicts of interest. For example, U.S. General Survey (USGS) employees are prohibited from holding stock in mining, oil and gas, and energy companies. A contractor, on the other hand, can own such stock, and therefore can work to benefit the particular company rather than the American public.

For these reasons, H.R. 716 threatens national security and should not be enacted.

Government Contracts Are Too Costly

Contracting produces costly, extraneous expenses the Federal government could avoid simply by keeping work in-house.

"Unanticipated" Expenses that a Reasonable Contractor Would Anticipate Arise During the Course of the Contract. To obtain a government contract, a contractor must submit a bid for work at less than what one would consider even reasonable and customary. To keep that estimate low, however, a contractor often leaves out expenses that inevitably arise during the course of the contract. The contractors hold up work and request additional funds for these additional, "unanticipated" expenses, often at a very high cost to the government.

For example, a U.S. Army Technical Escort Unit contractor began work on land adjacent to private property. The private property owner asked if the contractor was insured. The contractor said "no," it had failed to budget for insurance. Any reasonable contractor would have had insurance in place before beginning work. In this case, however, the contractor had to stop work to purchase $200,000 worth of insurance, which it promptly billed to the government.

Contractors often are not prepared to do the job, and the government pays to train them. Another costly and extraneous expense to contracting out is in training contract employees. Many times, contractual staff are not properly trained to walk in and perform according to the contract. Instead, they go to government-sponsored training to learn to do their jobs, making the government pay for their training as well as for the work itself.

Another training problem is that space in each class is limited and filled on a first-come first-serve basis. Many Federal employees are turned away from these sessions because contractors predominate. While the government pays to train contractors, it fails to train

its own employees to serve the public better. As a result, the government keeps itself caught in a vicious cycle.

In a similar vicious cycle, Federal employees are called upon more and more to oversee contractual staff rather than do the work they were hired to do. This trend affects mostly the professional community, who must stay current with new procedures and discoveries and complete a significant amount of bench work. Without that up-to-the-minute information, Federal employees cannot serve the public the best way possible.

Federal employees must redo incompetent contractor work. The contractor who did not anticipate insurance submitted a report to a government contract officer that did not meet statement of work requirements. Federal employees had to rewrite that report entirely. As a result, the government paid twice for the same work.

In another incompetent-contractor situation, the U.S. Army Medical Research Facility hired two contract personnel to train specific behaviors in research animals prior to the start of a study. The contract officer assigned to oversee these personnel did not have access to their work area. When the contract was paid and the researcher was prepared to conduct his study, he found the animals were untrained. Once again, Federal employees came to the rescue and efficiently trained the animals within a short period of time. The contractor was paid for work not completed and American taxpayers paid twice.

In yet another example, the same facility entered into a contract for provide histological support. When the work was complete and given to the agency, the agency deemed it unacceptable and required a Federal employee to repeat the original task from start to finish. The project was delayed and, again, taxpayers paid twice.

Contractors fail to provide items necessary to fulfill their contractual obligations. A contractor should pay for items necessary to fulfill a contract. For example, a contractor doing chemical research should supply technical and safety equipment, health

monitoring, lab and office supplies, and lab space. Instead, the Army Medical Research Facility supplied those items to one of its contractors. As a result, the facility absorbed the contractor's overhead costs, and the contractor received a double benefit.

For these reasons, contracting out is more expensive than doing work in-house and H.R. 716 should not be enacted.

H.R. 716 Would Not Help Small Businesses

Finally, contracting out more government functions would not help small businesses. Based on economies of scale, large businesses who can afford to keep their overhead down will be able to submit the cheapest bids. As such, small businesses would not compete with the Federal government; rather, they would compete with large businesses. That struggle is one that contracting out will not help.

For this reason, H.R. 716 should not be enacted.

CONCLUSION

These examples illustrate the fact that competitive private sector enterprises are not the most productive, efficient, and effective sources of goods and services. Competitive private sector enterprises are inefficient and expensive. A better use of the government's resources would be to put the money used to contract out back into agencies to cultivate an even better educated, trained, experienced, and productive workforce.

Thank you for the opportunity to present this position paper.

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