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THEN AND NOW: AN UPDATE ON THE BUSH ADMINISTRATION'S COMPETITIVE SOURCING INITIATIVE

HEARING

BEFORE THE

OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

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THEN AND NOW: AN UPDATE ON THE BUSH ADMINISTRATION'S COMPETITIVE SOURCING INITIATIVE

THURSDAY, JULY 24, 2003

U.S. SENATE,
OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA SUBCOMMITTEE,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:43 a.m., in room SD–342, Dirksen Senate Office Building, Senator George V. Voinovich (Chairman of the Subcommittee) presiding.

Present: Senators Voinovich, Akaka, Durbin, Carper, and Lautenberg.

Senator VOINOVICH. I would like to welcome everyone here to the Subcommittee on the Oversight of Government Management, the Federal Workforce, and the District of Columbia's hearing to discuss the past, present and future of the Bush Administration's competitive sourcing agenda.

Senator Durbin has indicated to me that he is in the midst of a markup in the Judiciary Committee, and I would like to accommodate him and give him an opportunity to make his opening statement before I make my statement as Chairman of the Subcommittee.

Any objection to that Senator Lautenberg?

Senator LAUTENBERG. Not really. [Laughter.]

Senator VOINOVICH. Senator Durbin.

OPENING STATEMENT OF SENATOR DURBIN

Senator DURBIN. Thanks for the vote of confidence, Mr. Chairman, and my colleague, Senator Lautenberg.

Thank you all for joining us today, and thanks for convening this morning's hearing to examine the complex and controversial topic of competitive sourcing initiative being advanced by the administration.

I want to thank the Chairman for his willingness to hold this first Senate hearing on this topic since the publication of the rewritten OMB Circular A–76 in May. I have heard from a lot of my constituents who are proud Federal public servants, dedicated to their chosen professions, who expressed their growing apprehension about what the administration's plans might do to their jobs.

Federal employees are concerned that agencies are conducting competitions simply to meet quotas, not because there are valid

reasons to believe the private sector could do the work more efficiently.

Federal employees are concerned under the rewritten rules the definition of what is inherently governmental has evolved into a stringent test that is specified under Federal law by adding inappropriate modifiers or conditions, and they are concerned as well that even when A–76 competitions are adequately performed, careful analysis cannot establish that decisions have been beneficial and cost-effective. They are concerned that outsourcing decisions will not be based on merit or cost savings, but on OMB mandates, and because of the unprecedented magnitude of OMB's quotas, the variability of the agency's to fulfill their missions will be put at risk.

Numerous questions need to be asked and answered. Do the agencies have the resources to carry out fair and equitable competition? Have Federal agencies lost the capability to effectively perform their missions due to over outsourcing? How will current competitive sourcing quotas affect capabilities, and how are we going to monitor this to make sure that the private sector is doing the job and doing it well?

Mr. Chairman, I note you have raised the issue of human capital implications. If there is one issue that has been the hallmark of your Senate career, it is your dedication to professionalism and improving the Federal workforce. It strikes me that it will be just about as formidable as the perils of Sisyphus to make any headway in tackling the human capital challenge by trying to recruit and retain the best and brightest Federal workforce, when in the same breath, these Federal workers are being told, "Oh, by the way, over the next few years, one out of four jobs could disappear into the private sector. How are you going to maintain morale and interest in aspiring to Federal service with that hanging over the Federal workforce."

It is no wonder there is real concern about morale among the Federal workforce. How can we possibly expect peak performance when those we entrust with meeting missions on the front line are consumed with concerns about whether their career is at stake on any given day because of an OMB order.

This is a real Catch-22. In an effort to meet these quotas, Federal agencies may not have the personnel in place to even handle the competitions.

I would like to make the rest of this statement part of the record, Mr. Chairman, and thank you of raising this issue.

[The prepared statement of Senator Durbin follows:]

PREPARED OPENING STATEMENT OF SENATOR DURBIN

Thank you, Mr. Chairman, for convening this morning's hearing to examine the complex and controversial topic of the Competitive Sourcing Initiative being advanced by the Administration.

I applaud your willingness to hold this first Senate hearing on this subject since the publication of the rewritten OMB Circular A–76 in May. I also appreciated your interest and participation in a similar hearing I chaired in March 2002 on the issue of "Who's Doing Work for the Government?: Monitoring, Accountability and Competition in the Federal and Service Contract Workforce."

I have heard from many of my constituents who are proud Frderal public servants dedicated to their chosen professions but who express their growing apprehension

about what this Administration's plans for competing jobs may do to their livelihoods.

Federal employees are concerned that agencies are conducting competitions simply to meet quotas, not because these are valid reasons to believe that the private sector could do the work more effectively.

Federal employees are concerned that under the rewritten rules, the definition of what is an "inherently governmental" function has been morphed with a more stringent test than specified under Federal law by adding inappropriate modifiers or conditions.

Federal employees are concerned that even when A–76 competitions are adequately performed, careful analysis cannot establish that decisions have been beneficial and cost-effective.

Federal employees are concerned that outsourcing "decisions" will not be made based on merit or cost savings, but on OMB's mandates and the lack of agency familiarity with the A–76 process.

And because of the unprecedented magnitude of OMB's quotas, the very ability of agencies to fulfill their missions will be put at risk and tens to hundreds of thousands of civil servants will be displaced.

Numerous questions need to be asked and answered. Are OMB's quotas justified by considered research and sound analysis, and are they consistent with the mission of the agencies? Are internal agency quotas so jusitified?

Do the agencies have the resources to carry out fair and equitable competitions? Have Federal agencies lost the capability to effectively perform their missions due to over-outsourcing? How will current competitive sourcing quotas affect their capabilities?

How are we monitoring and evaluating the costs and the quality of services being performed in the private sector under contract with the Federal Government? Do the current rules and practices ensure that in-house talent gets a fair opportunity to compete for their jobs?

Mr. Chairman, I note that you have raised the issue of human capital implications of this effort. It strikes me that it will be just about as formidable as the perils of Sisyphus to make any headway in tackling the "human capital" challenge by trying to recruit and retain the best and brightest to the Federal workforce when in the very next breath they're being told that, "oh, by the way, over the next few years one out of every four jobs could potentially disappear into the private sector."

It's no wonder there's angst and anguish capturing headlines like this one from June 10th's edition of *The Washington Post:* "Cuts Sap Morale of Parks Employees" with the subhead of "Many Fear Losing Jobs to Outsourcing."

How can we possibly expect peak performance when those whom we entrust with meeting agency missions on the front line are consumed with concerns about the continuation of their careers? At what point do efforts to study whether to privatize become counterproductive and disruptive to government operations?

It also strikes me that we have a Catch-22. In an effort to meet these quotas, Federal agencies may not have the personnel in place to even handle the competitions. As they bump up against what are now even tighter deadlines, they may end up just directly concerting the work to the private sector or using streamlined processes that may not provide essential protections.

We really don't have a trove of solid, agency-by-agency information about the costs and performance of work that is being performed for the government under contract. I have long been interested in whether we have a good system (or any system at all) to measure and account for these costs, determine if there are savings, and oversee the work that is being done with Federal funds.

It's been my impression that some of my colleagues have been just hidebound to outsource, without regard to either the price tag or the performance. Their motivation is to reduce the size of the Federal workforce—at any cost.

When I have suggested amendments—arguing that we had to save money, they rejected them. They told me that's not the point—we have to turn some lights out in some Federal buildings. I'd like to know whether that's still driving the outsourcing fervor.

During the last Congress, joined by over two dozen colleagues, I introduced legislation to try to get a better handle on this situation. I am putting the finishing touches on similar legislation to be introduced shortly. Mr. Chairman, I'd like to share a draft with you with the hope that you could join me in making this a bipartisan effort.

The TRAC Act would require Federal agencies to track the costs and savings from contracting out. It also calls for a comparative study of wages and benefits, conducted by the Office of Personnel Management and the Department of Labor to get better information. GAO has indicated that since contractors have no oblication to

furnish the necessary data, it is difficult to assess this. The bill provides a reasonable opportunity for Federal agencies to make substantial progress in carrying out the tracking requirements before enforcement remedies like suspension of further outsourcing would be invoked.

I am concerned that decisions to shift work to the private sector be made fairly, not arbitrarily; that public-private competition is fostered; and that we have a reliable system in place to track costs and performance of work being performed with Federal funds by the private sector under these contracts. In sessence, real accountability and true transparency.

I also hope that we can get an answer to another important question about whether OMB is paying any attention to a Congressional directive prohibiting the use of arbitrary numerical quotas in its push to privatize work performed by Federal employees. I'm referring to Section 647 of Division J of the FY03 Omnibus Appropriations (P.L. 108–7) signed into law on February 20 of this year. Specifically, bill language stated that

> "[N]one of the funds made available in this Act may be used by an agency of the executive branch to establish, apply, or enforce any numerical goal, target, or quota for subjecting the employees of the executive agency to public-private competitions or for concerting such employees or the work performed by such employees to private contractor performance under the Office of Management and Budget Circular A–76 or any other administrative regulation, directive, or policy *unless the goal, target, or quota is based on considered research and sound analysis of past activities and is consistent with the stated mission of the executive agency.*" (emphasis added)

and conference report language provided that:

> "If any goals, targets, or quotas are established following 'considered research and sound analysis' under the terms of this provision, the conferees direct the Office of Management and Budget to provide a report to the Committees on Appropriations no later than 30 days following the announcement of those goals, targets, or quotas, specifically detailing the research and sound analysis that was used in reaching the decision."

I would like to note for the record that this morning, our full Committee's Ranking Member, Senator Joe Lieberman, is sending a letter to OMB Director Joshua Bolten seeking answers to vital questions about the Administration's compliance with this particular provision and the reporting responsibilities. I ask unanimous consent that a copy of Senator Lieberman's letter be made a part of the record of this proceeding, and that the record be left open to permit inclusion of the Administration's response.

Mr. Chairman, I think today's hearing will be an opportunity to probe these and other issues. I thank you again for scheduling it and welcome our distinguished witnesses.

Senator DURBIN. I believe that we need to get to the bottom of this. If the goal here is to outsource, to save the taxpayers money, and to provide better services, then this conversation is an important one.

If the goal is simply the elimination of the Federal workforce and reduction of that workforce, then, frankly, I think it is wrong-headed. It is going to destroy the morale of many of those who were involved in the workforce today.

I would like to note for the record this morning our full Committee Ranking Member, Senator Lieberman, is sending a letter to OMB Director Josh Bolten seeking answers to vital questions about the administration's compliance with the appropriation provision and reporting responsibilities, and I ask unanimous consent that a copy of Senator Lieberman's letter be made part of the record, and the record be left open for an inclusion of the administration's response.

Senator VOINOVICH. Without objection.

[The letter of Senator Lieberman follows:]

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United States Senate
COMMITTEE ON
GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510–6250

July 24, 2003

The Honorable Joshua Bolten
Director
The Office of Management and Budget
Executive Office Building
Washington, DC 20503

Dear Mr. Bolten:

I am very concerned that the Administration appears to have disregarded a clear directive from Congress, prohibiting the use of arbitrary numerical quotas in its push to privatize work performed by federal employees. When you recently appeared before the Senate Governmental Affairs Committee for confirmation to the position of Director of Office of Management and Budget (OMB), you agreed that OMB had failed to provide Congress with a report, required by law, on the Administration's use of numerical quotas. You declined to answer other questions, and as a result it is impossible to determine the extent of the Administration's non-compliance with the law. I regard this as a very serious matter, and now that you have been confirmed as OMB Director, I ask that you provide complete answers to the Governmental Affairs Committee, as you had promised you would during your confirmation proceedings.

As you are aware, in February of this year Congress precluded the Administration from using appropriated funds to implement the arbitrary numerical quotas that the White House had set for outsourcing federal government jobs. Section 647 of the FY'03 Omnibus Appropriations Bill (P.L. 108-7), which was enacted on February 20, 2003, provides, in part:

> [N]one of the funds made available in this Act may be used by an agency of the executive branch to establish, apply, or enforce any numerical goal, target, or quota for subjecting the employees of the executive agency to public-private competitions or for converting such employees or the work performed by such employees to private contractor performance under the Office of Management and Budget Circular A-76 or any other administrative regulation, directive, or policy unless the goal, target, or quota is based on considered research and sound analysis of past activities and is consistent with the stated mission of the executive agency.

The conferees included report language clarifying both chambers' "strong opposition" to the use of arbitrary quotas:

> The conferees agree to a Senate provision prohibiting the use of funds to establish, apply, or enforce any numerical goal, target, or quota for contracting out unless the goal, target, or quota is based on considered research and sound analysis of past

> activities and is consistent with the stated mission of the executive agency. Although the Senate provision was somewhat different than the provision adopted by the House, the conferees want to emphasize the strong opposition in both chambers to the establishment of arbitrary goals, targets, and quotas. If any goals, targets, or quotas are established following "considered research and sound analysis" under the terms of this provision, the conferees direct the Office of Management and Budget to provide a report to the Committees on Appropriations no later than 30 days following the announcement of those goals, targets, or quotas, specifically detailing the research and sound analysis that was used in reaching the decision.

Like many in Congress, I strongly oppose the imposition of any numerical quotas on federal agencies in furtherance of the Administration's outsourcing agenda. When managed properly, equitable competition for new and existing federal government work is one of several tools that can help agencies reduce costs and become more responsive to customers and taxpayers. The Administration's arbitrary quantitative targets, however, chill other more creative means of achieving costs savings, overtax agencies already struggling to monitor work performed by contractors, and undermine the civil service through procedures biased against federal employees.

In the Senate, I supported a provision, identical to one that had passed the House, that would have prohibited outright the use of numerical quotas. The language quoted above was the result of a Republican amendment watering down the prohibition, which narrowly passed on a party-line vote. Nevertheless, even this watered-down language requires the Administration to base its quotas on considered research and sound analysis of each agency's past activities, and to ensure that the quotas are consistent with the stated mission of each executive agency. In short, each agency may only be subject to a quota that is appropriately tailored to its circumstances and derived using a sound methodology.

The Administration's outsourcing policies have never been based on considered research and sound analysis, and they have never been based on the circumstances of individual agencies. Rather, they have been driven by an untested ideological assumption that contractors should be doing much more of the work that is currently performed by federal employees. At the beginning of his Administration, the President set a goal of competing or converting 50% of the 850,000 jobs listed on agencies' FAIR Act inventories. In furtherance of that arbitrary numerical goal, the Administration established another arbitrary numerical quota of competing or converting 15% of the listed federal jobs. OMB made clear that all agencies had to meet this 15% goal by September 30, 2003, and that non-compliance would be noted. For example, the Administration's budget for FY'04, released in February of 2003, automatically gave agencies "red" scores on its management scorecard if they had "[c]ompleted public-private or direct conversion competition on less than 15 percent of the full-time equivalent employees listed on the approved FAIR Act inventories."

In your answers to written questions posed during the Committee's confirmation process, you made a few unsubstantiated assertions regarding OMB's compliance with the law, but declined to provide substantive answers to most of the questions on this topic. For example, you confirmed that

the OMB has not provided Congress with the report required by law, but declined to explain why a report has not been submitted. You claimed that since the enactment of the FY '03 Omnibus Appropriations bill, "agencies are no longer required to meet a government-wide competitive sourcing quota." You suggested that individual agency competitive sourcing plans were already in effect, and "are based on considered research and sound analysis," but you disclaimed any knowledge of "the specific research and analysis used to establish these plans." You also acknowledged that the 15% goal formulated "early in the Administration" was developed "as a good faith estimate of the amount of activity that would help generate an infrastructure for public-private competition." In other words, far from responding to the needs of individual agencies, the goal was developed to expedite the Administration's overall outsourcing policies.

Now that you are Director of OMB, I am writing to seek complete answers from you regarding the status of the OMB's and agencies' compliance with Section 647 of the FY'03 Omnibus Appropriations Bill. Your promises that the law, for the most part, was being respected do not reassure me in the absence of supporting evidence (evidence that should have been provided in the Congressionally mandated report). Considering that any actions taken to implement the 15% goal would be a clear violation of the law, I would have expected OMB to take quick and unequivocal action to inform agencies that they were not expected to meet the goal, and to disavow the rigid approach mandated as recently as February in the FY '04 budget. I have not seen evidence of this. Some statements by OMB and agency officials convey the clear impression that agencies are still expected to meet the government-wide 15% numerical goal. In other cases, government officials have alluded vaguely to "negotiated" or "tailored" goals, but that leads to another question: if new goals have been developed for all agencies, where is the agency-specific research and analysis that the law requires? Congress has not seen it, and I question whether it has been done.

For example, Angela Styles, Administrator of the Office of Procurement Policy at OMB, has continued to refer publicly to the 15% goal being imposed on agencies, long after having claimed that tailored plans were in effect. As early as March 19, in testimony before the Senate Armed Services Committee, Ms. Styles stated that "[w]e have worked so hard to make sure that the plans are appropriate for the mission of each agency, that are carefully considered, that are based on sound analysis and research, that we have that available for almost every department and agency." Ms. Styles gave this assurance to Congress that the OMB was following the law, and that it had developed agency-specific goals, three months ago. Yet there has been no report to Congress, as required by law, describing the new numerical goals OMB supposedly developed, nor is it clear that agency officials themselves were aware of new, tailored goals.

Other statements by Ms. Styles suggests that agencies were still being judged by their ability to meet the 15% quota. On May 29 and May 30, both *The Washington Post* and *Government Executive* quoted Styles declaring that only a few agencies would meet OMB's September 30 deadline for finishing competitions on 15% of their commercial jobs. On June 11, *Federal Human Resources Week* reported that Ms. Styles had recently decided to give agencies several more months to meet their 2003 target of competing 15% of their commercial jobs. On June 26, in testimony before the House Government Reform Committee, Ms. Styles testified that OMB had "asked the agencies to generally presume that 15 percent was going to be appropriate for them," that it had "developed tailored,

individual plans for each department and agency," and that no more than four or five agencies would "actually compete 15% of their commercial activities before the end of this fiscal year."

Ongoing OMB management initiatives also appear to have violated Section 647 of the FY'03 Omnibus Appropriations Bill. In an April 17 memorandum, Clay Johnson, then the nominee for OMB Deputy Director for Management, distributed to agencies exhortations to reach pre-determined mileposts towards fully implementing the President's Management Agenda. An attached "assessment" from Angela Styles indicates that, by July of 2004, "[c]ompetitions for 15% of government's commercial activities will have been initiated or completed." Even more arbitrarily, the Styles assessment included a "stretch goal": "If DoD commits to subject an additional 130,000 positions to competition, the civilian agencies will subject additional positions to competition." Imposing a higher quota on civilian agencies, should the Department of Defense meet an arbitrary number, could not possibly qualify as a goal based on considered research and sound analysis of each agency's past activities. Making clear that numerical quotas were still in effect, Robert Shea, Counselor to the Deputy Director for Management, wrote to *Government Executive,* in response to an article reporting on the Johnson memo, to assure the magazine that the deadline for competing 15% of listed federal jobs had not been extended: "Despite the contention of your May 21 article, July 2004 is not a deadline for anything. We haven't moved the date by which agencies are expected to complete 15 percent of their commercial activities, as the article states."

In a new management scorecard released by OMB on July 14, all but three agencies received "red" scores for the third quarter of FY '03 for their outsourcing initiatives. The OMB's compilation of the scores did not list any new numerical goals based on each agency's past practices and missions, but the evaluation did note that the Department of Justice had "[I]nitiated competitions covering 15 percent of its commercial positions." Although the OMB web-site contains links to budget documents and management scorecards reflecting that agencies automatically received "red" scores for failing to meet the 15% competitive sourcing goal, no update on the site indicates that the automatic imposition of the 15% goal has been invalidated by Congress.

Given these statements from the OMB officials responsible for directing agencies' procurement activities, it is hardly surprising that agency officials would continue to believe the 15% goals were in effect, long after Congress had prohibited the use of that arbitrarily derived quota. For example, at a May 1 hearing before the Senate Appropriations Committee, NASA Administrator Sean O'Keefe testified the agency had "achieved the government-wide, 15 percent competitive sourcing goal." At a May 6 hearing before the House Government Reform Committee, Kay Coles James, Director of the Office of Personnel Management, referred to the 15% competitive sourcing mandate applicable to her agency.

In a May 28 internal memorandum, the General Counsel of the Department of Veterans Affairs determined that "[b]ecause the OMB directives cited in paragraph 2 [referring to the 15% competitive sourcing goal for FY '03] mandate that studies be undertaken for all activities, VA is required to carry out these mandates using other funding sources, and employees paid from these sources, if legally available." In other words, not only did the VA believe that the OMB was still requiring it to meet the

15% quota, agency personnel felt they had no choice but to divert funds appropriated for other purposes so that it could conduct the required competitions.

Similarly, in a June 9 memo to regional administrators, the Forest Service proposed submitting to competition thousands of jobs in order to meet annual numerical targets, including the Administration's 15% target for FY'03. The proposal even envisioned the possibility of contracting out firefighting jobs. The Senate Appropriations Committee recently noted in a committee report, ". . .significant sums are being expended in violation of the Committee's reprogramming guidelines and at the expense of critical on-the-ground work such as maintenance of Federal facilities. The Forest Service alone plans to spend $10,000,000 on competitive sourcing in fiscal year 2003, including $8,000,000 to establish a competitive sourcing office." (Senate Rpt. 108-89, P. 8) Not only is Forest Service money being misspent on enforcing competitive sourcing quotas in violation of the law, the money is being misspent for that purpose when the agency is stretched thin battling fires in the West.

Collectively, this adds up to clear evidence that the OMB and federal agencies have been violating the law in pursuit of the Administration's pre-established numerical quotas for outsourcing. It seems inconceivable to me that officials at each of these agencies understood they were only to apply numerical quotas "based on considered research and sound analysis" of the agency's activities. It is less likely still that any meaningful research and analysis on individual agencies' circumstances would have led to the same result: the Administration's pre-existing goal of 15%.

Accordingly, I ask you address the following questions regarding the Administration's compliance with Section 647 of the FY '03 Omnibus Appropriations bill.

1. Since the enactment of the FY'03 Omnibus Appropriations bill on February 20, 2003, have the OMB or any agencies established, applied, or enforced any numerical goal, target or quota for subjecting federal employees to public-private competitions or for converting work performed by federal employees to private contractor performance?

2. Please list and describe each numerical goal, target, or quota established, applied, or enforced by OMB or agencies since February 20, 2003. For each one, describe:

    a) the agency or agencies affected by the numerical goal;
    b) the nature of the numerical goal;
    c) the date or time period in which the numerical goal was established, applied, or enforced, as well as the date the goal was first developed;
    d) the methodology with which the goal was developed, including, where applicable, the research and analysis used, and factors taken into account, in developing the goal and reaching the decision to use it;
    e) the manner in which the numerical goal was communicated to personnel at the relevant agency; and
    f) all instances in which federal employees were subjected to public-private competitions or direct conversions based on the numerical goal, including the number of employees affected and the results of the activity.

3. During any time period between February 20, 2003, and the present, have any agencies established, applied, or enforced numerical goals, targets, or quotas that were not based on considered research and sound analysis of the agency's past activities, or were not consistent with the agency's stated mission? For each such instance, describe:

   a) the agency or agencies using the numerical goal;
   b) the nature of the numerical goal;
   c) the date or time period in which the numerical goal was established, applied, or enforced;
   d) the methodology with which the goal was developed;
   e) all instances in which federal employees were subjected to public-private competitions or direct conversions based on the numerical goal, including the number of employees affected and the results of the activity; and
   f) the funds expended on establishing, applying, or enforcing the numerical goal.

4. Have agencies been informed that they are no longer expected to comply with the 15% goal described in the Administration's FY '04 budget, and that their failure to reach that goal will not lead to a "red" score or other administrative action? If so, when and how were they so informed?

5. The conference report to the FY '03 Omnibus Appropriations bill provided that "[i]f any goals, targets, or quotas are established following 'considered research and sound analysis' under the terms of this provision, the conferees direct the Office of Management and Budget to provide a report to the Committees on Appropriations no later than 30 days following the announcement of those goals, targets, or quotas, specifically detailing the research and sound analysis that was used in reaching the decision." Why hasn't a report been submitted under this provision? When will a report be submitted?

6. How much money has been spent by the federal government since February 20, 2003, to establish, apply or enforce numerical goals, targets, or quotas for subjecting federal employees to public-private competitions, or for converting the work performed by federal employees to private contractor performance? For each agency that has expended funds, list and describe:

   a) the amounts expended by the agency;
   b) how the funds were spent;
   c) how much of the funds were spent for activities that were not based on considered research and sound analysis of the agency's past activities or were not consistent with agency's mission.

7. If you determine that funds have been spent in violation of Section 647 of P.L. 108-7, how would you respond?

8. What will be done to reverse job competitions illegally based on arbitrary numerical quotas?

I look forward to your prompt response to the above questions. Please contact Kevin Landy of my staff at (202) 224-2627 if you have any questions.

Sincerely,

Joseph I. Lieberman
Ranking Member

cc: Senator Susan Collins

Senator DURBIN. Thank you very much, Mr. Chairman.

OPENING STATEMENT OF CHAIRMAN VOINOVICH

Senator VOINOVICH. Thank you.

I think everyone realizes that in August 2001, President Bush introduced his management agenda, with the goal of creating a citizen-centered, results-oriented and market-based Federal Government.

The five governmentwide initiatives of the President's management agenda are (1) strategic management of human capital, (2) competitive sourcing, (3) improved financial performance, (4) expanded electronic government, and (5) budget and management performance integration. The administration also created an Executive Branch management scorecard to weave a results-based management approach into the fabric of Federal programs.

As a former chief executive of the City of Cleveland, and the State of Ohio, I applaud President Bush for having the foresight to design a strategic, comprehensive and integrated plan to reform Federal Government operations. It was long overdue.

The administration did not simply issue a press release describing high-minded management goals. Rather, they have sought to implement the management agenda vigorously, and it is having a positive effect. For example, the Economic Development Agency of the Department of Commerce requested a $15-million increase over the President's FY 2003 request. OMB recognized EDA as an "effective" agency, focused on results in internal management improvement, therefore increased its budget.

This type of analysis should be undertaken for every agency. It shows somebody is paying attention to whether we are getting something done.

Despite significant turnover in the senior ranks, OMB has been able to maintain its focus on improving management. I recently met with Clay Johnson, the new Deputy Director for Management of OMB. I was impressed by his vision and encouraged by his stated willingness to partner with Federal employee groups, and that he has been meeting on a regular basis with them, which is important to the success of any program in this area.

One of the five pillars of the President's management agenda, competitive sourcing, has come under a hail of criticism from Federal employees, their unions, and Members of Congress of both parties. As far as I know, it is the only element of the Management Agenda to generate such opposition. Resistance is based, in part, on the administration's goal of competing with the private sector the activities of almost one-quarter of the Federal Government's nonpostal civilian workforce.

To many, these goals seem arbitrary and lack a firm analytical basis. The potential job loss feared as a result of this initiative is doubtless another major cause for concern, particularly among our unions.

On March 6, 2002, I participated in a Governmental Affairs Committee hearing, chaired by Senator Durbin, that examined competitive sourcing. During that hearing, I voiced my concerns with several aspects of the initiative, many of which I still have.

My chief concern is that the administration's original, across-the-board goals failed to take into account the unique mission and circumstances at each agency. In other words, competitive sourcing goals were not being driven by an agency's strategic human capital plan.

Without proper strategic planning, competitive sourcing could be as damaging to the Federal workforce as the Clinton Administration's indiscriminate downsizing initiative. OMB is now working to establish competitive sourcing goals on an agency-by-agency basis. This is a great improvement, and I would like to hear more about this shift today.

Second, I am concerned that senior managers may decline to make the necessary investment in their Federal employees, and indeed decide to conduct a competition with the private sector. OMB must make sure that even when Federal activities are being competed, Federal employees are given the professional development and empowerment to do the best job they possibly can. In other words, we must do everything we can to make sure our Federal workforce is competitive; evaluate our agencies and recognize here are some wonderful people. With upgrading their skills, they can get the job done.

Third, I am concerned that competitive sourcing may dissuade good people from seeking Federal employment. I have devoted much time and energy to improving the Federal service and have worked with leading public policy experts to examine how we can do a better job of attracting new talent to government.

Competitive sourcing could be at variance with this goal. Although roughly 75 percent of the Federal workforce would not be subject to competition, the knowledge that many Federal jobs could shift to the private sector might stifle recruiting efforts at a time when the Federal Government needs the right people to address our many significant challenges and replace the large number of baby boomers who are going to retire this decade.

A student at Harvard's Kennedy School of Government, when I was there, mentioned this exact concern, and I am interested to learn if OMB has thought of a way to address this possible unintended consequence. We do not want young people thinking about a career in government and then seeing everything compete. They will ask why should I go there and instead consider employment and go someplace else.

Fourth, I am worried about the ability of each Federal agency to conduct public-private competitions and the resources associated with these efforts. I think Senator Durbin referenced that. Until this initiative began, most agencies had little experience conducting public-private competitions. Additionally, it is my impression that many acquisition offices are overworked and understaffed.

Holding agencies accountable to competition goals before they have the capacity to conduct such competition is unfair. The government needs a robust acquisition workforce now more than ever. Without strong contract oversight, the government will be hard-pressed to realize the savings generated by competition and ensure that contractors are meeting their goals.

In addition, the need to conduct competitions must not cause unplanned cutbacks in other areas of agencies' operations. It was re-

ported recently in the *Washington Post* that the National Park Service postponed maintenance in order to pay for an 18-month privatization study by consultants. This type of trade-off is unacceptable. OMB must provide adequate resources for agencies to conduct competitions without putting their operations or service at risk.

Fifth, I have a specific concern regarding the recently revised A–76 guidelines. While I support the effort to streamline and improve the public-private competition process, I am troubled by the requirement that the government's most efficient organization is subjected to a recompetition every 5 years. This may have yet another unintended consequence: Federal employees may believe that there is always another job competition just around the corner, which could weaken morale. I ask OMB to reconsider this provision.

Finally, the tremendous anxiety this initiative has caused Federal employees lies partly, I believe, in the failure of OMB to fully explain the purpose of competitive sourcing.

I take Ms. Styles at her word, that the initiative is not part of an ideological crusade against Federal employees. If I believed it was, I would be completely opposed to it. Rather, the purpose is to increase the efficiency of certain Federal operations through competition.

This idea has merit. But the management shortcomings I have noted must be addressed, and the reasons and implementation for this initiative must be communicated more effectively to Federal employees, their unions, and Members of Congress. All of this could be done without an act of Congress.

To the administration's credit, they have made improvements to the competitive sourcing initiative since the hearing in March 2001. We appreciate the fact that someone was listening.

I am encouraged that OMB is now working with agencies on a case-by-case basis to make sure that the infrastructure to properly conduct public-private competitions. It is my understanding that Ms. Styles is going to announce additional modifications to the initiative today, which I will let her describe. These additional changes could go a long way towards reassuring skeptics that this initiative is being carried out in a careful, methodical manner and not with an arbitrary, one-size-fits-all approach.

Federal employees deserve to know the administration's plan for competitive sourcing. I intend to ensure that this initiative is soundly managed, and I will continue to conduct oversight towards that end.

I would now like to yield to the Senator from New Jersey for his remarks, and thank you for being here this morning, Frank.

OPENING STATEMENT OF SENATOR LAUTENBERG

Senator LAUTENBERG. Thanks very much, Mr. Chairman. I think my absence of a couple years sabbatical I took may make people forget who I was and the fact that I am the junior member of the Committee puts me in a position that I do not really like. I had the fear that somehow or another I was going to be outsourced, that I was at the tail end of the senior list. [Laughter.]

But, Mr. Chairman, you know we have a relationship that is treasured, I think, by both of us, respect, because I know how sin-

cere you are about your responsibilities to your job and know that you, in your former career, exhibited the same kind of concerns for people. While you ran things with as tight a hand as you could do it, the taxpayers were treated fairly as well.

I thank you for holding this hearing. The administration's desire to privatize these vast swathes of the Federal workforce is fraught with controversy and needs a great deal of scrutiny by Congress.

Now, I would like to say at the outset that I think there are jobs that could well be done outside of the government workforce, but I would tell you, having had 30 years in the corporate world, having built a company that I and two others started with nothing and now employs 40,000 people in an outsourcing business, and now having been in government 19 years—18½, who is counting—and the fact is that I am able, I think, to make comparisons between the folks who are working for government and those who work in the private sector.

I will take a minute more on my own background because it sets the condition for me to examine these things.

(A) the company was not a unionized company. We were very careful about how we treated our employees. Everybody was made a partner through the stock options or stock purchase plans, and they worked hard, enormous hours, and rarely could a holiday be taken by all of the employees because our work had to be turned out on a daily cycle.

Then, I come to government, and I see the same kind of loyalty, same kind of energy, but not the same kind of paychecks and not the same opportunity for advancement that I saw with people in the corporate world.

(B) is that when our greatest growth took place, it took place when there was relatively full employment, and people were hard to find, and we siphoned off a part of the office operation and did it for our clients—over 400,000 of them. The company is a great American story about three poor boys who started the company, today, 45,000 employees. When the president of the company—and forgive this immodesty—when the president of the company talks to the employees, it is immediately translated into 10 languages. So the breadth is there, and it was all done with an understanding that the most important ingredient we had were not the programs, not the name, because the name itself did not carry it, but it was the output.

And I see in my office, and I know I speak for lots of other people here, the kind of staffing, the kind of dedication, the kind of zeal for the job that you just do not see in the private sector, and I do not know where we are going with this.

So, ultimately, when I look at this and think about today's hearing, about people, individuals, who work for our government and who pay their taxes. Civil servants are the backbone of our government, and we have to remember that the skills, the talent, and the professionalism of the men and women in the Federal workplace are the best in the world.

If there are malingerers, there are malingerers in every part of the economic world, and I saw it in my own company, and I have seen it here, but that is human nature. It does not mean that people who work for government are people who are trying to escape

responsibilities. It means that they are—most of them, 98 percent, perhaps—are hardworking, committed people, and they are here in the morning, and they are here at night.

The overwhelming majority of our civil servants are truly dedicated to their jobs, and many of them could make more money in the private sector, and I do not want my staff to hear this, but they work in government because they see public service as a higher calling, and the ability to make more money outside was just a passing thing.

It is crucial that we all hold civil servants accountable for the jobs they do. There are jobs and activities that should be moved from the public sector to the private sector. As a former businessman, I salute that review. But I must say that I am concerned about the administration's announced intention to compete 127,500 Federal jobs within the next year. I am particularly concerned about setting an arbitrary quota and impossible deadline for privatization, and then deliberately withholding from agencies the financial resources they need to conduct the public/private competitions.

I get the impression that the administration has determined in advance the way these competitions always should go, and that is to the private sector. And we heard Grover Nordquist, who is a senior adviser to the administration, paid or otherwise, I am not sure, but the fact is that he does render advice that government should be squeezed down, and we should try to eliminate 850,000 jobs.

And with all due respect, many of us here in the Congress disagree when we look at how stretched we are militarily right now, wish we had more people, asking the people who are serving to go way beyond the call of duty, those who are reservists to be called on maybe for a weekend every other week and for a couple of weeks of summertime, away from home a year-plus, away from family, away from jobs. We ask so much, and the military, in my view, compares very favorably, let us say, to the FAA, which I see as a fifth branch of the military.

And with all due respect, many of us here see anomalies. For instance, it struck me as ludicrous that we would federalize baggage screening at airports, then turn air traffic control over to the lowest bidder. Talk about security on the cheap, that is really backwards. So I offered an amendment to the FAA reauthorization bill to prevent that. Eleven Republicans voted with me—and that is not an easy job for a Republican, George. Eleven Republicans voted with me on an amendment which the Senate adopted 56 to 41 to keep FAA in the Federal employment structure.

Last week, the *Washington Post* ran an article about the administration's attempt to privatize the job of the archaeologists who protected cultural heritage contained, found in our national parks. John Ehrenhard, director of the Southeast Archeological Center, put it this way: "We do what is in the best interests of the public, which is not always in the best interests of some developer. It may not make the most sense economically, but we are the government, and we can't be bought."

And I think those are wise words, and we should contract out where it makes sense, but not because there is an ideology that

says they would like to cripple the government. Many people correctly point out that taxpayers are owners of the Federal Government and deserve the most effective and efficient government possible.

And I agree, but I would also point out that Federal employees do pay taxes also. They have invested even more than their taxes. They have invested their working lives. They deserve to be treated fairly and with respect, and doing so will maximize all taxpayer values.

And I find it such a challenge, when I look at a report that is GovernmentExec.com, issued on July 11. The writer writes, "Nearly a million and a half in performance bonuses went to political appointees in 2002, according to the Office of Personnel Management, and one House Democratic leader is raising a question about the Bush Administration's use of bonuses at a time when the administration is seeking to hold down pay raises for rank-and-file Federal employees. The cash awards were sent to 470 political appointees."

There is something that just does not ring true here. We have got over 6 percent of our people unemployed, we lost nearly 2.5 million jobs in the last couple of years, and now we want to farm out these people who have been good, loyal people, to say there is going to be competition for your job, and you may be put out of work. And we will have someone performing services, and what do we do if there is a strike, a labor difficulty with a company out there that is providing some of the replacements?

I think there are serious questions and, Mr. Chairman, I thank you for the opportunity to make the statement, and I look forward to hearing from our witnesses.

Senator VOINOVICH. Thank you, Senator Lautenberg. Senator Akaka.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Thank you very much, Mr. Chairman.

Good morning to you and good morning to our panel. I want to thank you, Chairman Voinovich, for having this hearing today. It is certainly a step in the direction of dealing with some of the issues that will be facing us quickly concerning our workforce and for continuing the Committee's interests in issues affecting the Federal workforce and the management of agencies.

Ms. Styles, I want you to know that I really appreciate your time and your effort you have spent on these issues over the past several years, and I would also like to thank Mr. Walker for his tremendous dedication, and I say that because I have been working with him, also, and I want to thank our witnesses for your testimony this morning.

Mr. Chairman, no one disputes the importance of a government that is both cost-effective and accountable. Agencies require the appropriate tools and skilled personnel to meet their missions. It is in that light that we should examine what work is best performed by government employees and which could be performed by the private sector. And when I say that, I want to, again, think about what Senator Lautenberg mentioned, as a person who has been on both sides, and deeply on both sides, and can certainly share his experiences.

As agencies make their contracting decisions, we should ask what impact outsourcing will have on the Federal workforce. With a number of the current Federal workforce eligible for retirement, we should take steps now to fill the void that they will leave, and that is something that we need to work on immediately and take care of. We cannot expect our young people to work for the government if they believe their work will be subject to outsourcing, nor should we accept policies that will instill fear and distrust among current employees.

While the contracting debate is not new, the administration's contracting and other management proposals have attracted congressional attention. There is growing bipartisan concern that too much government work has been contracted out already.

We should encourage, and I want to stress that, we should encourage, not discourage, employment with the Federal Government. We should tear down barriers that stand in the way of promoting the Federal Government as an employer of choice. We should ensure that Federal managers, employees, their unions and associations, Congress, Office of Personnel Management, and Office of Management and Budget work together to determine what is inherently governmental.

Contracting policies should be fair to Federal workers, should be transparent, and in the best interests of the public. We have a strong and effective Federal workforce and should put to rest, once and for all, the faults, stereotype of the inefficient government bureaucrat.

Let me touch, briefly, on the newly revised A–76 process for public-private competitions. Mr. Walker and Ms. Styles are familiar with my concerns over what I see as a lack of fairness and transparency in the revised rules for A–76 competitions. Under the revised A–76 process, government work could be contracted out, even if the work could be performed more efficiently by Federal employees.

Moreover, the revision sets unrealistic deadlines for conducting public-private competitions that could push government work out the door to the private sector as fast as possible and may not give Federal workers a fair chance to compete. Unlike the private sector, Federal workers are required to compete for their jobs every 5 years and are prevented from competing for contracted-out work.

True competition should be cost-effective and must promote trust. Federal workers should be provided with sufficient funds and personnel to compete. Revising the government's contracting process without improving contract management will likely result in hollow victories.

Mr. Chairman, I thank you again for holding today's hearing. I thank our witnesses again for their time today, and I look forward to their thoughts and suggestions on the new A–76 process and other contracting issues.

Mr. Chairman, I would ask that a copy of my full statement be included in the record.

Senator VOINOVICH. Without objection. Thank you, Senator Akaka.

[The prepared opening statement of Senator Akaka follows:]

PREPARED OPENING STATEMENT OF SENATOR AKAKA

Good morning. I want to thank Chairman Voinovich for holding today's hearing which continues this Subcommittee's interest in issues affecting the Federal workforce and the management of agencies. Ms. Styles, I sincerely appreciate the time and effort you have spent on these issues over the past several years. I would also like to thank Mr. Walker for his tremendous dedication, and I thank our witnesses for their testimony this morning.

No one disputes the importance of a government that is both cost-effective and accountable. Agencies require the appropriate tools and skilled personnel to meet their missions. It is in that light that we should examine what work is best performed by government employees and which could be performed by the private sector.

As agencies make their contacting decisions, we should ask what impact outsourcing will have on the Federal workforce. With a large number of the current Federal workforce eligible for retirement, we should take steps now to fill the void that they will leave.

We cannot expect young people to work for the government if they believe their work will be subject to outsourcing. Nor should we accept policies that will instill fear and distrust in current employees.

While the contracting debate is not new, the administration's contracting and other management proposals have attracted congressional attention. There is growing bipartisan concern that too much government work has been contracted out already. For example:

- The Fiscal Year 2003 Omnibus appropriations bill prohibits the use of funds to impose outsourcing goals, targets, or quotas at Federal agencies without thorough analysis.
- The Senate-passed Department of Defense Appropriations bill includes a bipartisan amendment requiring the Department to achieve a 10 percent cost savings before work is contracted out.
- The House—by a vote of 362 to 57—passed legislation to restrict contracting out in the National Parks Service.

We should *encourage*—not discourage—employment with the Federal Government.

We should tear down barriers that stand in the way of promoting the Federal Government as an employer of choice.

We should ensure that Federal managers, employees, their unions and associations, Congress, the Office of Personnel Management, and the Office of Management and Budget work together to determine what is inherently governmental. By involving all parties within the Federal Government we are better able to forge contracting policies that are fair to Federal workers, transparent, and in the best interest of the public.

We can do all of this and still ensure efficient and cost effective government contracting. We already have a strong and effective Federal workforce. We ought to put to rest, once and for all, the false stereotype of the inefficient government bureaucrat.

As the Comptroller General has said repeatedly, poor contract management costs the government billions of dollars. These deficiencies can be improved by ensuring that the government has the employees, skills, and technologies to determine costs for both government and contracted out activities over the long-term.

Let me touch briefly on the newly revised A–76 process for public-private competitions. Mr. Walker and Ms. Styles are familiar with my concerns over what I see as a lack of fairness and transparency in the revised rules for A–76 competitions.

Under the revised A–76 process, government work could be contracted out even if the work could be performed more efficiently by Federal employees. Moreover, the revision sets unrealistic deadlines for conducting public-private competitions that could push government work out the door to the private sector as fast as possible and may not give Federal workers a fair chance to compete. Unlike the private sector, Federal workers are required to compete for their jobs every 5 years and are prevented from competing for contracted out work.

True competition should be cost-effective and promote trust. Federal workers should be provided with sufficient funds and personnel to compete. Revising the government's contracting process without improving contract management will likely result in hollow victories.

Mr. Chairman, thank you again for holding today's hearing. I thank our witnesses for their time today, and I look forward to hearing their thoughts and suggestions on the new A–76 process and other contracting issues.

Senator VOINOVICH. I would like to introduce the witnesses testifying today. Sitting on the first panel is the Hon. Angela Styles, the Administrator of the Office of Federal Procurement Policy of the Office of Management and Budget, and the Hon. David Walker, Comptroller General of the United States and head of the General Accounting Office.

Our second panel consists of Dr. Jacques Gansler, a former Under Secretary of Defense during the Clinton Administration, now with the School of Public Policy at the University of Maryland; Dr. Paul Light is a senior fellow at The Brookings Institute and has testified before my Subcommittee many times before; Charles Tiefer, a professor of law at the University of Baltimore; and Dr. Frank Camm, a senior analyst at RAND.

If you will, I would like all of the witnesses to stand and be sworn in.

[Witnesses sworn en masse.]

Senator VOINOVICH. Let the record show that the answers are an affirmative of at least four of our witnesses.

I would like to note that many other groups, including the American Federation of Government Employees, the Professional Services Council, and the Federally Employed Women requested the opportunity to testify before the Subcommittee today. Although the Subcommittee could not accommodate everyone's request, we feel that this hearing will produce a balance and substantive discussion.

And without objection, I will leave the hearing record open for 1 week to allow any, and all, interested groups to submit their views for the official hearing record. Without objection, that will be the case.

We are very fortunate to have Ms. Styles here, and I second Senator Akaka's compliment of the time and effort that you have put into this effort.

Comptroller General Walker, I want to say thank you for everything that you have done for this Committee and this Subcommittee. Without your input over the last couple of years, the significant changes that we made in the Federal workforce would not have occurred, and so I welcome both of you here today, and I appreciate your patience.

Ms. Styles, you have heard some comments from us today, and I am anxious to hear your testimony.

TESTIMONY OF ANGELA STYLES,[1] ADMINISTRATOR, OFFICE OF FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET

Ms. STYLES. Thank you very much.

I appreciate the opportunity to be here today to update you on the administration's competitive sourcing initiative. We are making significant progress towards public-private competition——

[1] The prepared statement of Ms. Styles with an attachment appears in the Appendix on page 57.

This initiative asks people to make very hard management choices, choices that affect real jobs that are held by dedicated and loyal career civil servants. But the fact that public-private competition and our initiative require hard choices and a lot of hard work, makes it one that can, and is, affecting fundamental real and lasting changes to the way we manage the Federal Government.

The clincher here for us is the taxpayer. Competitive sourcing strives to focus the Federal Government on its mission, delivering high-quality services to our citizens at the lowest possible cost.

I would like to spend a few minutes addressing four issues that I know are of particular concern to you: The use of numerical targets, communication with employees and the unions, the recompetition requirements of the new circular, and the effect of competitive sourcing on our ability to recruit Federal employees.

First, the use of numerical targets. Attached to my testimony, you will find a report released by OMB today that contains an extensive discussion about the history of competitive sourcing and the use of numerical targets. Most significantly, you will note that we have changed our management scorecard to eliminate the use of governmentwide numerical targets for the measurement of success.

Second, you have expressed concerns about communications with the employees and employee unions. I can tell you that the most challenging part of my job is effective communication. I spend the vast majority of my day, explaining to people that competitive sourcing is about a commitment to management excellence. It is a commitment to ensuring that our citizens are receiving the highest-quality service from their government, without regard to whether that job is being done by dedicated Federal employees or the private sector.

In spite of our extensive efforts, there is a tremendous amount of disinformation and confusion. Two examples have been mentioned here this morning:

One, is maintenance at the Park Service. There were several press reports out dealing with Mount Rainier in Washington State and maintenance of the Park Service and funds being taken away from maintenance activities to actually run competitions at Mount Rainier. There are no public-private competitions planned in the near future, there are no public-private competitions planned at the current time at Mount Rainier, so those reports were erroneous.

There was also a recent press report dealing with archaeologists. I have spent a lot of time researching the archaeologists that were mentioned in the *Washington Post* last week. The more research I have done, the more I have found out that these are not actually just archaeologists.

These are technicians, these are people running computer databases. They are actually based in a Federal building in downtown Lincoln, Nebraska. They are not actually in a national park. They are not actually out in the field doing archeological work. They are running computer databases. They are publishing and writing newsletters. So I think it is a little bit different than has been articulated.

We are constantly, as you look at those examples, fighting a flurry of erroneous propaganda about competitive sourcing. Unlike our

past reforms that are focused on outsourcing, unlike other past reforms that have focused on outsourcing, privatization or downsizing through arbitrary FTE cuts, competitive sourcing is a review process that asks two very important questions: Should we reorganize for greater efficiency, and might a different provider, a local government, a nonprofit organization that employs disabled members of our society or a private business be better able to provide this service at a lower cost?

Third, you have expressed concerns about the recompetition procedures in the circular. Specifically, our new circular does not assume that one competition or review of a function will ensure that the function is efficiently organized for the next 50 years. The concept here is that relevant procurement statutes and regulations require the private sector to recompete for government work every 3 to 5 years. Competition and recompetition reduces costs and ensures that we are receiving the maximum benefit of private sector innovation.

The policy in the circular applies this concept to commercial work performed by government employees, with a significantly less-stringent time frame: Every 5 to 8 years. There are also clear procedures for requesting a deviation from this generous time frame, and I can tell you that we will grant any deviation that is requested and supported.

The practical reality of the situation, from my perspective, is there has not been one, not a single recompetition of a government function employed by Federal employees in the 55-year history of this circular. The reality is that we have well over 400,000 commercial positions, positions that the agencies have designated as open to competition, but have never been tested, reviewed or even competed one time.

For a Federal employee that fears recompetition of a function that they have recently won and competed for, I think they are fearing a very distant and tenuous possibility. As a matter of practical reality, it will be quite a while before we even start thinking about recompeting functions won by government employees in the first round of competition.

Finally, you have expressed concerns about the effect of competitive sourcing on our ability to recruit Federal employees. Clearly, competitive sourcing poses challenges for government personnel who perform commercial activities. These providers must critically examine their current processes and figure out how they can improve the delivery of services. Answers may not come easily, but they are ones which our taxpayers are owed and ones which efficient private-sector service providers ask themselves routinely.

Despite the difficulty of this task, we have every reason to believe our workforce is up to the challenge. Historically, the government wins over 50 percent of these public-private competitions. The high success rate should give employees confidence that they can, and do, compete effectively in head-to-head competition with the private sector.

The revised circular recognizes the talents of the Federal workforce, the conditions under which the workforce operates, and the importance of providing the workforce with adequate training and

technical support during the competition process to ensure that they can effectively compete.

In particular, the revised circular seeks to ensure that the agency provider has the resources available to develop a competitive agency offer.

As an example—and this is one of my best recent examples—the Department of Energy competed the graphics function at their headquarters. Before the competition, this was a 13-person operation for graphics at DOE headquarters. Through the competitive process, the incumbent government provider, and the in-house organization, determined they could do the same job with six people. By sharpening their pencils and reorganizing the function, the Federal employees won against the private sector. Importantly, through managed attrition, there were no involuntary separations.

Though small in number, this competition exemplifies the benefits of competitive sourcing. From this very small competition, DOE was estimating $635,000 in annual savings. The employees won, but through competition, we were able to save $635,000 a year for a 13-person operation.

Even when the commercial sector is chosen to perform the activity, there are usually a very small number of involuntary separations—8 percent, according to one study that is listed in the report that I have attached to my prepared statement today, and 3.4 percent, according to another report. The percentage, I believe, should remain very small.

In conclusion, while there is a certain comfort level in maintaining the status quo, our taxpayers cannot afford, nor should they be asked, to support a system that operates at an unnecessarily high cost because many of our commercial activities are performed by agencies without the benefit of competition.

For this reason, the administration has called upon the agencies to transform their business practices, and we have provided the tools for them to meet this objective in a responsible, fair and reasoned manner.

This concludes my statement.

Senator VOINOVICH. Thank you very much. Comptroller General Walker.

TESTIMONY OF HON. DAVID WALKER,[1] COMPTROLLER GENERAL, U.S. ACCOUNTING OFFICE

Mr. WALKER. Thank you, Mr. Chairman, Senator Akaka, Senator Lautenberg, and other Members of the Subcommittee. It is a pleasure to be back before you, this time on the important issue of competitive sourcing.

If I might, Mr. Chairman, I assume my entire statement will be included for the record.

Senator VOINOVICH. Without objection.

Mr. WALKER. Thank you, and therefore I will summarize some highlights.

Let me say at the outset, that this is a highly complex and controversial topic. It has been for years, and it is likely to remain so for a number of years. But let me also say that I have had the

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

pleasure to work with Angela Styles on this complex and controversial topic over the last couple of years, and that in my mind there is no question that she is a dedicated, capable and caring public servant trying to balance the various issues here. She is only one member of the administration, and obviously there are not necessarily always uniform views, but I wanted to say that as part of the record.

I think the critical points are as follows:

First, our Nation faces a number of major trends and challenges that have no boundaries. Second, our Nation faces large and growing budget deficits and fiscal imbalances for a variety of reasons. Tough choices will be required in defining what the government's proper role is in the 21st Century, how the government should do business in the 21st Century and, in some cases, who should do the government's business in the 21st Century.

Competitive sourcing is a tool. It is a means to an end. It is not an end in and of itself. It is not a panacea. It is something that clearly has implications from the standpoint of cost and quality. It also is important, not just what you do, but how you do it and when you do it, in order to address the very human elements and the issues that all of you Senators have talked about—the interaction between our desire to maximize economy, efficiency and effectiveness, at the same point in time being able to attract and retain a high-quality and high-performing workforce.

I think we need to keep in mind that sourcing has to be a strategic decision. It could be outsourcing, it could be in-sourcing or, in many cases, it could be co-sourcing which, quite frankly, is frequently the case: Furthermore, even if the decision is to outsource, it is critically important that the government have enough qualified and capable public servants to manage cost, quality and performance of those activities that have been contracted out, and if we do not, everybody is going to be in trouble.

And, in fact, we have several agencies—NASA, DOE, DOD, just to name three—that are on our high-risk list because of failure to do just that.

As you know, the Congress has been concerned with this issue for a number of years, and therefore asked me to chair a Commercial Activities Panel, comprised of top-level individuals with a variety of perspectives. The Panel met for over a year, conducted a number of hearings, both in Washington and outside of Washington, came up with a report where there was unanimous agreement on 10 sourcing principles, and there was a supermajority agreement on a variety of other recommendations.

Based upon the review of my staff and myself, it appears as if the revised Circular is generally consistent with the 10 principles that were unanimously agreed to by the Commercial Activities Panel. However, there are certain areas of concern, and there are certain omissions, some of which go beyond the principles, to the other recommendations that a supermajority of the Panel recommended.

Those concerns are noted in my statement. I will mention a few at this time:

The new Circular provides for expedited time frames for conducting these competitions. In order for that to occur, Federal em-

ployees are going to have to have financial and technical assistance to be able to compete effectively and for the system to be fair, not only in reality, but in perception.

There are also several concerns with regard to the streamlined competitions which, as you know, are for under 65 full-time equivalents, or FTEs.

First, there is not an express provision to deal with potential unbundling by agencies of functions, activities or operations to get under the 65 number, and therefore be able to circumvent some of the other requirements; second, there is no 10-percent cost differential; third, there is no internal or external appeal right, which could leave an accountability gap. And depending upon how much activity ends up occurring under 65, it could end up being a matter of concern.

And last, but certainly not least, is the Panel's recommendation on high-performing organizations, one key element that a supermajority of the Panel recommended and, that members of organized labor supported, even though we voted on the supplemental recommendations as a package. Technically they did not vote for it because they did not vote in favor of the supplemental recommendations but they expressed support for this element. It was based on the idea that we need to recognize, and as I think Ms. Styles' statement notes, and the report that she issues today notes, a vast majority of government will never be subject to competitive sourcing. Therefore it is incumbent upon all of us to figure out not only how can we make sure that these MEOs, most efficient organizations, can compete fairly and effectively, but also what can we do to try to make sure that for the vast majority of government that will never be subject to competitive sourcing, that we can improve its economy, efficiency, effectiveness, and responsiveness. And it is in that regard that a supermajority of the Panel recommended taking steps to create high-performing organizations throughout government.

There is also interest in government in moving more towards pay-for-performance. However, the Federal Government, at the present point in time, and a vast majority of Executive Branch agencies, do not have modern, effective, credible and validated performance appraisal and management systems in order to make intelligent decisions on how to implement a pay-for-performance system.

Therefore, Mr. Chairman, and Members of the Subcommittee, as noted at the end of my statement, OMB has recently recommended creation of a governmentwide fund for purposes of pay for performance. I would respectfully suggest we are not ready yet to implement such a governmentwide fund, and that while it is highly desirable that we end up moving forward towards pay for performance on a broader basis, we need to have the infrastructure in place in order to do it effectively and fairly and in a nondiscriminatory manner.

Therefore, I would respectfully suggest that the Congress consider taking this governmentwide fund concept and making those funds available for several things:

One, to provide financial and technical assistance such that most efficient organizations can compete effectively and fairly within

these expedited time frames; two, that we can end up promoting high-performing organizations throughout the rest of government that will never be subject to competitive sourcing; and, three, as a subelement of both, that we provide support on a business case-basis for all of these, to be able to help agencies develop the type of systems and infrastructure that has to be in place in order to move towards more pay-for-performance-oriented structures. I think there would be many, many winners by taking that type of approach, and I think the time has come that we need to seriously consider doing that.

Thank you, Mr. Chairman. I would be more than happy to answer any questions that you or the other Subcommittee Members may have.

Senator VOINOVICH. Thank you, Mr. Walker.

We are going to have 5 minutes of questioning by each of the Senators. I will try to stick to that and ask my colleagues to do the same. We will have a few rounds of questions.

Ms. Styles, I am pleased to hear that the administration has decided to drop the government goals related to competitive sourcing. It is a significant change, and I commend you for going forward with it. How did you come to this decision?

Ms. STYLES. I think it has come over a long period of time over the past 2½ years, with experience that we have had with public-private competition, with input from the Hill.

We do not want a number to be distracting from what we are really trying to do, which is provide a better service for the taxpayer at a lower cost. I think we want people to realize that we are listening to their concerns, and if the arbitrary numbers are making this controversial, then we don't want a number to make this controversial.

We want this initiative to work, and I think we are willing to recognize people's concerns, to work with them to make this initiative work and to be effective. We really are committed to making this an accepted management practice at the departments and agencies. And if numbers and goals that are governmentwide are distracting us from that, then we will move away from those, and that is what we did today.

Senator VOINOVICH. So agencies are not going to be graded on their scorecards, in terms of percentages, then?

Ms. STYLES. Absolutely not. There will be individual plans for each department and agency that is appropriate for that department and agency. I think a lot of those have already been negotiated and are in place. For a long time, we have had departments and agencies that are moving to yellow, well below a 15-percent number, and I think we finally decided that we had so many exceptions to that rule that it made sense to get rid of the numbers.

Senator VOINOVICH. Thank you. From my experience, when given the opportunity in competition, I have been amazed at what the internal group can do. I have seen that over the years.

I will never forget, when I was mayor of the City of Cleveland, that we considered outsourcing the garbage collection. There was a lot of "feather bedding," and I will never forget, after a long negotiation, the head of the union said to me, "Why didn't somebody suggest that we do this a long time ago?" We eliminated one indi-

vidual from the collection and reduced 50 percent the people that were working at the transfer stations. We saved a lot of money. I also had these experiences when I was governor of Ohio.

So going forward with this does have some real ways of providing efficiencies to organizations.

Mr. Walker, you observed the changes OMB has made, in the A–76 circular. Do you want to comment on them?

Mr. WALKER. Yes. They have made a number of changes in response to comments by us and others, and I think they have generally been responsive. I will say that I think it is totally appropriate that the administration has eliminated the 50-percent and the 15-percent across-the-board numbers. The Panel noted that there should not be any quotas of any type; and there should not be arbitrary goals.

At the same point in time, I think that what the administration is now trying to move to, as I understand it, is considered goals, which are based upon individual facts and circumstances which can potentially end up resulting in a quantifiable target on an agency-by-agency basis in order to hold management accountable for results.

So I think quotas are bad, arbitrary goals are bad, but considered goals, if they are established the right way, can be necessary and, in fact, appropriate.

Ms. STYLES. We provided several examples of the specific agency plans for competition to move from red to yellow on our management scorecard. It is in the report that is attached. So people can get a very good idea of the numbers we are talking about, as well as the types of functions that agencies have decided to compete, the types of functions that they decided are not appropriate for competition right now.

So we are trying to give people examples of how this is working with the departments and agencies. We will have a report out by the end of September that goes through this for every department and agency and is very forthcoming in what our plans are and where we intend to go with this.

Senator VOINOVICH. I think, as you move along, it would be beneficial to share that with this Committee.

Ms. STYLES. We absolutely will.

Senator VOINOVICH. One of the things that was brought up in Comptroller General Walker's testimony is the issue of improving and giving Federal employees the tools that they need and the empowerment to do better work. I would be interested in some written information about what it is that the administration is going to be doing in order to make that happen, I am particularly interested in the area of training, and upgrading the skills of individuals. I think that in too many agencies, that does not occur, and as a result of that, they cannot take on new challenges. Unfortunately the belief is training money is available, which hurts us in terms of our recruitment.

So I would like to know what you are doing to try and help the current workforce, to empower them and give them the tools and the training they need to grow in the jobs that they have.

Ms. STYLES. Absolutely.

Senator VOINOVICH. We are going to use the early bird rule, for asking questions. Senator Lautenberg, I will call on you first.

Senator LAUTENBERG. Thank you, Mr. Chairman.

I want to say at the outset that I listened to each of you and am impressed with the way you have handled your respective assignments, the positions you hold regularly, but even as you make the case here. So this is not intended to be questions about you, but questions so much more about the policy that got us where we are.

Because as I look at what is intended here, I get the feeling—and I know both of you have excellent professional backgrounds—I get the feeling that this is much more political than it is an exercise in efficiency. And I say that because, Ms. Styles, the fact that you say there are no arbitrary targets and so forth, but what is magic about the 65 number that can be handled at the local level, department level, up to 65 employees can have their jobs eliminated, turning toward commercialization, and why is 65 the magic number?

Ms. STYLES. They actually can't have their jobs eliminated. We eliminated the use of direct conversions altogether. One of the problems I saw is the old circular had a process that if it was a function of less than 10, you could directly convert that work to the private sector without determining whether it made sense or the in-house organization could perform it. And I saw agencies doing it all of the time, without a significant justification. Even if it is a small function, I just don't think that is appropriate.

What we did was we took a process that has been in place for at least 6 years, that was created by the previous administration for a function that is less than 65 Federal employees. We added to that I think a lot of transparency. It is called a streamlined competition process. It is not as extensive as our full-blown competition.

Senator LAUTENBERG. No, but it does say that, in the streamlined process, the Federal agency head can outsource Federal work for a function of 65 FTEs, and private or private bids are not necessary because the streamlined process does not require truly competitive cost comparisons; is that not correct?

Ms. STYLES. I do not believe that is correct. It is a competition process. There is transparency. The agency has to put a public notice out before they do it, and when they finish, and they also have to supply you, and me, and everybody else with a form that says what the private sector cost was, what the public sector cost was and explain to all of us why they made the decision. So I wanted some transparency and accountability in this.

Senator LAUTENBERG. Well, what we will do, since we disagree here, is we will discuss this, Mr. Chairman, further, and we will have a sit-down, and we will go through that.

Ms. STYLES. I am very happy to supply any information you want on this process.

Senator LAUTENBERG. Yes, I am sure.

And the question about how we got here reminds me of a little song that says, "Where did all of the money go?" I know it is a substitute for words, but the melody is there. "Where did all of the money go?"

The fact is that we are not struggling alone here because there is not or there has not been sufficient funds to carry out the programs as we would like to, as we would like to be more intensive training. We certainly ought to be looking at the implementation of more efficiencies, the technology applications, wherever they can be, and as far as I am concerned, though we cannot discuss this at length here, I think the money went for other purposes. And when we look at the deficit, the money is not created, the deficit is not created by the explosion of costs internally, not at all. There have not been wholesale raises, there has not been anything that says suddenly it is going to cost more to operate.

It is because people like me are getting tax breaks that we do not need, and frankly I would rather have plowed back into our society to build a stronger, more harmonious society than give people who have been successful more than they already have, and they have earned it under the system.

So I look at this as a political exercise, denominated by the statement that I read earlier, and that is the mission is to get rid of 850,000 employees, and let us do that. And that is as arbitrary as it gets to be. I do not understand why we do not look at what we have got, where we are going, and how we finance internal operations.

And I can tell you this, that if we were to advertise for employees on the basis that they would find in the commercial world, I do not think that you would get anybody to work here. I think the fact that we have seniority systems that provide for longevity, and, yes, there are blips along the way, but the fact is that we do lots of things right.

We have lots of policies that are excellent in terms of our research and things of that nature that carry on, beyond the military, beyond the law enforcement, and the money has gone into other places, Mr. Chairman. That is what I see as the biggest difficulty that precipitates this kind of thinking.

Senator VOINOVICH. Thank you, Senator. Senator Akaka.

Senator AKAKA. Thank you very much, Mr. Chairman.

Ms. Styles, you mentioned the rumors within the Park Service in your testimony. As the ranking member of the Senate Park Subcommittee, I am curious as to how you communicated with NPS employees to counteract these rumors.

Ms. STYLES. There actually is a hearing this afternoon dealing with the Park Service, where Fran Mainella, the head of the National Park Service, is testifying.

We do generally leave it to the agencies. We try to provide them as much information as we can, the resources to communicate with their people, and I know that the Secretary of Interior has sent out all employee E-mails trying to explain this initiative, and I know that Fran Mainella has worked hard to fight against this initiative. But we fight against information that may be inaccurate and not correct all the time, and I think we put—I don't think we have put in enough effort, I think we put in a lot of effort, but I don't think we could ever put in enough efforts to make sure that we are communicating appropriately on this, but we do keep trying.

Senator AKAKA. Is OMB questioning agency decisions not to include a function on its FAIR Act inventory and under what circumstances would you do so?

Ms. STYLES. We are actually required by statute to review those functions and make sure that they are consistent within agencies and among agencies. So, yes, we do review, as we are required to, and I think we fulfill that role as we go through each year with the FAIR Act inventory process.

Senator AKAKA. Mr. Walker, you have reported, and OMB has acknowledged, severe limitations in the financial management systems throughout the Federal Government. How do these problems affect an agency's ability to determine the cost of the President's competitive sourcing initiative?

Mr. WALKER. They have a very real effect. And let me say that, while I know that Bobby Harnage is not going to be physically present today, he has a statement for the record, and he has a comment there that I would like to address, in response to your question.

The Federal Government's financial management systems are not what they need to be. We have made a lot of progress, but we still have major challenges, especially in the Department of Defense. A vast majority of the historical A–76 competitive sourcing competition activity has been within the Department of Defense. The fact of the matter is that DOD and OMB estimate that historical savings, from A–76 competitions have ranged from 20 to 30 percent no matter who wins.

Those are unaudited numbers. They are OMB and DOD's numbers. GAO has done work in this area, and we do believe that there are real cost savings. However we can't express an opinion as to whether or not that 20- to 30-percent range is reasonable because the cost accounting systems are just not of a state that we can form an opinion on it.

Senator AKAKA. Ms. Styles, I was pleased to receive OMB's competitive sourcing report last night and hear your testimony this morning which focused on the steps OMB is taking to institutionalize the administration's contracting out policies.

The report appropriately acknowledged that now two agencies are alike. This is an important recognition, especially, as Mr. Walker notes, Federal agencies are faced with the dual challenges of implementing the revised A–76 provisions and the competitive sourcing portion of the President's management agenda.

He points to the Department of Defense, as he did, which despite being the government's largest procurer of outside goods and services, has long occupied a place on GAO's high-risk list because of contract management problems.

Considering that most agencies lack the knowledge base, personnel and funding to carry out outsourcing competitions, what guidance will OMB offer to the new competitive sourcing officials to ensure that an agency's competitive sourcing activities integrate with their human capital and funding needs?

Ms. STYLES. We actually wrote the new circular with that specific thought in mind. When we looked at competitions in the Department of Defense, I can tell you what bothered me the most was the Department of Defense will go out, they make an announcement,

without a whole lot of thought about it, that we are going to compete 1,000 people at this base, and then 4 years later they decided, after they did a little work and a little planning, we are really only going to compete 100 people here. And for 4 years, there were 900 people that were very concerned about this, and there were expectations raised in the private sector about what this competition was going to look like.

We want agencies to do a great deal of preliminary planning. You will see 2 pages, in a 23-page circular, that talk about preliminary planning, that before you make any public announcement of what you are doing, reengineer, understand what you do, understand the workload, understand how the private sector does this, understand what your human capital requirements are, and then make an announcement of what you are going to source.

The best example I have is the Department of Education. They did it this way. They spent 2 years reengineering and planning before they made any announcements of what they were going to source, and it has worked very well.

Senator AKAKA. Thank you, Mr. Chairman.

Mr. WALKER. Mr. Chairman, can I come back on that?

Senator VOINOVICH. Yes. Go ahead.

Mr. WALKER. I think the process is very important, but I think this also reinforces a point that I made before. It takes time, it takes financial and technical assistance in order to be able to make this work, and what are we going to do for the 75 percent of government that is not subject to competitive sourcing? They need to look at their people, process, technology, and environmental situations, and we need to figure out ways that we can provide them with financial and technical assistance to get that done.

Senator VOINOVICH. Ms. Styles, I share Senator Akaka's concerns about having the people get the job done. And as you know, the acquisition workforce is facing a serious human capital challenges. It has been underscored by GAO, for instance. Twenty-two percent of the acquisition workforce is eligible to retire between now and 2005, and after 2005, 69 percent of the workforce will be eligible to retire.

What strategies will OMB employ to ensure that those Federal employees responsible for conducting public-private competitions and contract management receive the tools, training, and the resources they need to do their job efficiently?

In other words, one of the things that Senator Akaka and I did last year when we amended the Homeland Security Act was upgrade human capital awareness by creating chief human capital officers in each of the departments.

What are you going to be doing to make sure that those human capital officers have the people to do the work within their agencies?

I think the point was that you have expedited in less than 12 months that you are going to move forward with it. Well, you know, and I know, there is no way you can do that unless you have the people on board to get the job done. So I would be interested in learing more about that.

The other thing is that we have not had any oversight hearings, and I am going to talk to Senator Collins about it, and particularly

in the area that Dave Walker has referenced, in terms of these acquisition workforce, particularly in the Department of Defense.

And I really think this is something that somebody is going to hone in on, and I would like to know what are you doing currently to respond to that.

Ms. STYLES. Sure. I think it is a very serious and a valid concern. Our acquisition workforce took severe cuts over the past 10 years. They have been asked to do much more with much less. I will comment, though, on the 12-month time frame, that clock doesn't start ticking until the agency decides they want it to. They do all of their preliminary planning, and once they get through preliminary planning, they decide when they want that clock to start ticking.

In the human capital arena, as it relates to competitive sourcing, we recently established, with the help of the Council for Excellence in Government, a new council, a Federal Acquisition Council, and we met with groups of people from the agencies, specific people that are designated to this council. Much like the new Human Capital Officers Council, the CFO Council, CIO Council, we have one for acquisition, and we recreated it with the help of the Council for Excellence in Government. And one of our main focuses is human capital and competitive sourcing and how those two relate together.

What we have asked is for the leads from the agencies—one is Scott Cameron from Interior on competitive sourcing, the other one is a career person from NASA, Tom Ludke—to get together and help us form a small group of Federal employees that will go to each agency and assess at that agency what their infrastructure is in place for competitive sourcing.

I know one contact at the agency, but I do not now exactly what their infrastructure is, and who is doing this, and who is actually leading the charge below the head person. So we can take the best practices. We can understand where there are deficiencies. We can compare and share among the different departments and agencies.

So we are trying to be very proactive in assessing what is working and what is not and where we have problems and what strains competitive sourcing is putting on our acquisition workforce or sometimes this isn't always in the acquisition shop, which is an interesting dynamic at the agencies. Sometimes it is within the CFO shop or a different location, and we are trying to better understand the agencies that are successful and are not, how they are working and what infrastructure is best here.

Senator VOINOVICH. Well, one of the concerns I have is that we speak about doing some of these things, but now that agencies are starting to think about workforce in reshaping they realize they do not have the people they need. I am hopeful that when an agency comes back to OMB and says, we do not have the folks to get the job done, that it is reflected in preparing their budget requests.

Because part of the problem that we have had here is that, in the last dozen or so years, we just downsized and did not replace the people who were needed. Some agencies had the wrong people. We did not have the opportunity for early separation or for early retirement. I need some reassurance to know that you are just not going through the process, and then we just do not have the people there to get the job done.

I know one of the things I was impressed with in my experience on the Foreign Relations Committee, was hearing Secretary Powell talk about adding about 300 people—and I know people do not want to hear about adding people—but the State Department was riddled, and they needed people. They are moving forward. He was very excited that a lot of people are interested in going to work for the State Department.

I think too often the human capital aspect of one's budget does not get the kind of attention that it ought to be getting.

Ms. STYLES. We will——

Senator VOINOVICH. In the last budget, for example, did you entertain any requests for people?

Ms. STYLES. Absolutely. We sit down with the agencies on a quarterly basis, and it is the relationship on competitive sourcing and the resources that are needed is maintained on a day-to-day basis, but we have designated quarterly meetings with the agencies to discuss where they are in the initiative and what their needs are.

In our recent A–11 guidance to the agencies on preparing their 2005 budget, we have a very specific item called out for them to designate what their needs are in terms of resources for competitive sourcing, so we can be very clear about the costs and what the agencies' needs are in these areas.

Senator VOINOVICH. Ms. Styles, the Commercial Activities Panel recommended limited changes to the A–76 and develop instead a FAR-type process for public-private competition. Could you describe how OMB came to the decision to incorporate those recommendations into the complete rewrite of Circular A–76?

Ms. STYLES. Certainly. I was a participant on the Commercial Activities Panel, and one thing that I saw, and I think everybody on the panel saw, was that we had two different types of people. We had people who understood public-private competition and people who understood private-private competition. We had rules for private-private competition that worked very well together, and we really fundamentally needed to integrate those rules together.

We took the recommendations of the panel very seriously, as we did our rewrite. We went out with a Notice for Public Comment. We received 700 comments on our draft, and we took all of those very seriously. We met and had discussions with GAO, the unions, the private sector and people that were involved before we actually came out—and the agencies, too. I sat down with every single agency for a 4-hour period, before that circular went out, to make sure I understood what the effect of these new provisions would be on their particular agency.

So we spent a lot of time I think integrating the panel recommendations into our circular and working with people to make sure we understood the effects.

Senator VOINOVICH. Mr. Walker, would you enunciate any further recommendations? We have the revised circular, and do you think there is anything that needs to be added or deleted?

Mr. WALKER. Well, I mentioned in my oral remarks, as well as more detailed in my written testimony, some areas that I think bear looking at.

I do also have a concern, which I don't believe is in my testimony, about this recompetition 5 to 8 years down the road. My personal view is that it kind of relates to the high-performing organization issue that I talked about before. We need to have fair and effective competitions with regard to MEOs. A decision gets made.

We then have to recognize that is not forever, but we ought to be incorporating the concepts of these high-performing organizations there, and only if there is a significant change in the circumstances, should we think about recompeting. I don't think it should be something that is automatic. I think it should be something that is based on facts and circumstances, but we need to have mechanisms to provide reasonable assurance that there is continuous——

Senator VOINOVICH. In other words, eliminate the requirement that every 5 years, if you have decided they are doing the job, then it ought to be? The real issue should be not a 5-year deadline, but whether or not they are performing. It could be in 3 years that the decision is made that they are not performing, but if somebody is getting the job done, they ought not to be forced, at the end of 5 years, Ms. Styles, to recompete. I do not think that is good public policy.

Mr. WALKER. It should be facts and circumstances, and I think that is what Ms. Styles said, to a certain extent——

Ms. STYLES. Right.

Mr. WALKER. At the same point in time, I think we also have to recognize: Perceptions matter. Even though there may be a small percentage that ultimately might be recompeted, if the perception is that the rule is that you are going to be recompeted after 5 to 8 years, then perceptions matter, and that can have adverse behavioral effects, and I think we just need to be sensitive to that.

Ms. STYLES. I have to say, in writing that provision, it was a very difficult one to write because the private sector feels that they have to recompete every 3 to 5 years, and I thought 5 years was too short a period of time for an organization that was doing a good job, and performing well, and was a group of Federal employees.

I also understood the reality of the situation, that we can write a policy that says every 5 years, but I don't think that we are really going to be able to enforce that. But that is the reason that we wrote one that essentially said, if you are a high-performing organization, you can have an extension of a period of time. I think it is a good question whether that is a long enough period of time, what other mechanism.

There is a mechanism in place that even after 2 years, if you are the government organization and a private sector not performing, that you can terminate the contract. So it is not just you get it for 5 years and that is it. But as a matter of practical reality, if you get it for 5 years, generally, you continue to perform for 5 years, and people try to help you perform better if things aren't working out, whether you are a private contractor or a Federal employee.

Senator VOINOVICH. I have just about run out of my time. Senator Lautenberg.

Senator LAUTENBERG. Thanks, Mr. Chairman, and I will try to be short here.

Ms. Styles, in looking at your statement, I am reminded that you made a specific comment, "The revised circular eliminates direct conversions and instead provides a versatile streamlined competition process for agencies to efficiently capture the benefits of public-private competition for activities performed by 65 or fewer full-time equivalent employees."

So that 65 is a target. I mean, why did you not say 75? Why did you not say 95? I am just curious.

Ms. STYLES. I think that is a fair question because it is a question of why is 65 an appropriate number for a less-extensive competition process than would be used for over 65.

Senator LAUTENBERG. Yes.

Ms. STYLES. I will be honest with you. The reason we chose it is because it was the standard that had been chosen before. It was the standard that was in the old circular that had been amended in 1996 and was used. From my perspective, it was less controversial to stick with an established standard.

Senator LAUTENBERG. Fair enough. Now, those people who are in that group, do they lose some of the benefits they might lose, in terms of a retirement program as a consequence of the streamlining?

Ms. STYLES. No, if they are involuntarily, I don't believe they do.

Senator LAUTENBERG. Well, right now, if we want to terminate somebody under the Federal system, assuming that there is, first, you justify the cause, but are there not benefits that are carried out or available to someone who is leaving the service?

Ms. STYLES. Yes.

Senator LAUTENBERG. The same would apply to these if they are one of the——

Ms. STYLES. Absolutely, all of the procedures that are in place would be the same for both mechanisms.

Senator LAUTENBERG. Ms. Styles, you know that my amendment to the FAA reauthorization bill, and I mentioned this earlier, passed the Senate by a vote of 56–41 on June 12. My amendment would prevent the administration from trying to outsource or privatize air traffic control people using the A–76 process.

And I think we saw quite a demonstration of skill, loyalty, and determination on September 11 when the air traffic control system jumped into place to bring roughly 10,000 flights to the ground safely, to clear the skies. There was a moment of great tension and fear, and I said earlier that I regard that as kind of the fifth branch of the military because of the emergency nature of their functioning.

Why is the administration so focused on privatizing the air traffic control system?

Ms. STYLES. We have no intention of privatizing the air traffic control system.

Senator LAUTENBERG. But we have taken off a significant portion of them and taken them away from the inherently government protection that otherwise would be there.

Ms. STYLES. There are a whole cadre of people that are commercial that are exempt from competition. There are three categories of people at the FAA, generally speaking, that your amendment affects. There are the large air traffic control towers and air traffic

controllers. There are the small towers, over 100 of which are run right now by the private sector with a better safety record than Federal towers at a lower cost.

Senator LAUTENBERG. Right.

Ms. STYLES. There are also flight service stations as well. My understanding of your amendment is that we would not be able to look at any of these functions for public-private competition.

Senator LAUTENBERG. Right. But it does grandfather the small airports and the services that go there. They are commercially handled now, and we are not thinking of doing anything differently. A lot of them are in remote places where it is hard to move people.

Ms. STYLES. We have been very clear. There are two points here. We have been very clear that all we are doing here is being what we believe is honest in our articulation of air traffic controllers as being a commercial function because some of our towers are actually in the private sector. Other countries have privatized their entire air traffic control function.

Senator LAUTENBERG. Have you examined the consequences of that privatization in the U.K. and Canada, for instance, where the number of near misses in the air have increased——

Ms. STYLES. I have not, personally, but I believe other people have.

Senator LAUTENBERG. I am sure you have not, and I am not being critical of you, but I think any evaluation like that has to look at what happened in Canada and in the U.K., where expenses soared, where services were substantially reduced, where bailouts had to come in by those governments to further lend financial credibility.

Ms. STYLES. Well, we have no intention of—all we wanted to say is that it is considered commercial in other places. We consider it commercial, but we are not going to compete it.

The other part is we have flight service stations. These are people that check the weather for private pilots. There are 2,700 of them across the country.

Senator LAUTENBERG. Ask Senator Stevens how he feels about the weather forecasters up in Alaska, and you will get a pretty interesting response.

What I say to you, we have passed this through the Senate. Do you know whether the administration is going to help see that this gets through the conference and leaves it to reflect the will of the Senate when, again 11 Democrats joined me and others to say that this should not be done at this point?

Ms. STYLES. I think we have been very clear that the President's senior advisers would recommend a veto if there is not a sunset provision for the larger towers. And if we are constrained in our ability to look at the smaller towers or the flight service stations.

Senator LAUTENBERG. So, in effect, it says, no matter what you folks in the Senate feel, that we are going to veto the will of the Senate and abandon the check and balance that is purportedly existent between the Legislative and the Executive Branch.

Thanks very much, Mr. Chairman.

Senator VOINOVICH. Senator Lautenberg, I wish to correct a statement. You said there were 11 Democrats that joined you, but there were 11 Republicans.

Senator LAUTENBERG. That was a terrible oversight. [Laughter.]

I guess that was, you know, sometimes dreams come out—you are right—dreams come out, and you say things you do not really mean, but you would like to see happen.

Senator VOINOVICH. Senator Akaka.

Senator AKAKA. Ms. Styles, your testimony states that competitive sourcing is a major component of the administration's vision of a market-based government, and therefore I would like to ask whether you would please provide us with a governmentwide estimate for the cost, an estimate of the cost of implementing the competitive sourcing component of the President's management agenda, if you will.

Ms. STYLES. We are certainly working—that is part of the reason we amended our guidance for the fiscal year 2005 budget is because we do not have a clear number to give you. I can give you estimates of how much it cost per person, although I have to tell you it is a double-edged sword. On one hand, you asked us to help the employees be able to compete, and on the other hand, people want us to keep the cost per position being competed low.

So it is very conflicting goals here, in terms of making sure we have the resources available for our people to compete and keeping the cost of these competitions low because we get criticized on both sides of this.

Senator AKAKA. Talking about kinds of costs, why is there no minimum cost savings for streamlined competitions?

Ms. STYLES. When I took this circular to the Director at the time, when we were going through this, I had examples of competitions, and there would be one where the government offer was $3.4 million and the private sector offer was $3 million, and the government won. And I had a very hard time explaining why that was. We decided for a streamlined process to remove that cost differential in order to give agencies the flexibility that they were asking us for in doing these competitions.

Senator AKAKA. Mr. Walker, I liked your comment about outsourcing as being a tool and its effectiveness would depend on how and when you do it to maximize the effects. I think that will ring throughout these discussions as we go along and prove you to be right.

As you know, Mr. Walker, the Commercial Activities Panel, which you chaired, recommended that Federal employees be allowed to appeal A–76 and its decisions, just as contractors may do now.

I understand that GAO is considering options for addressing this so-called inequity. What is the progress of GAO's review of bid protests, and when do you expect the review to be completed?

Mr. WALKER. Well, first, let me note that, as I have mentioned in my testimony, that for the streamlined competitions of under 65 FTE there is not an internal appeal process or an external appeal process which I believe creates an accountability gap, which is a matter of concern.

With regard to your question, Senator, we sent out a public notice seeking comments, and have received 50 comments back, some favoring us being able to consider appeals, some opposing it for various reasons. This is a high priority for us. We have a target

of Labor Day. We would like to be able to come out with something the week of Labor Day, as to what our decision will be, and I hope that we can meet that time frame.

Senator AKAKA. Ms. Styles, as you know, bipartisan legislation has been introduced in the House to identify contractors with histories of misconduct and bar them from receiving government contracts. What disbarment programs are now in effect?

Ms. STYLES. We have what I believe is a rather rigorous process at the agencies for looking at the present responsibility of a contractor, whether they are financially capable, whether they are a good corporate citizen, whether they can perform, and this process is one that was established by statute and implemented by regulations, and it is pretty rigorous at most of our departments and agencies.

It affords due process for the contractors to be able to make their case if there is an issue or a problem or a proposed debarment or suspension, and I think it generally works well.

Senator AKAKA. Mr. Walker—for my final question, Mr. Chairman—the Defense Department procures more government contracts than any other Federal agency. It is responsible for $90 billion in service contracts alone. DOD has been identified on GAO's high-risk list for contract management since 1992.

At the same time, DOD's Inspector General has released a report that DOD may have paid more than $4 billion for services without first determining that the work was needed. In fact, the report found that DOD failed to enforce contract terms and made payments without determining that contract terms were met.

My question is how will OMB's revisions to A–76 impact contract management challenges at DOD?

Mr. WALKER. Well, directly, I don't believe that they do because we are really talking about two areas that are on our high-risk list: First, current concerns with regard to inadequate procedures and practices to oversee contract management; and, second, also the acquisitions process, especially in conjunction with major weapons systems. Unless there is some intent to be able to do further outsourcing in this particular area with regard to the individuals who are performing this oversight that obviously would be a problem. We are not doing enough, if you will.

As I said to you, when we contract out, we need to have an adequate number of skilled individuals to manage cost, quality, and performance of the contractors. I question whether or not we have that at DOD right now.

DOD is an "A" on effectiveness. We are No. 1 in the world in fighting and winning armed conflicts.

DOD is a "D" on economy, efficiency, transparency, and accountability. The general culture is get the money, spend the money; get the money, spend the money. There are not adequate checks and balances to protect the taxpayers' interests in the military industrial complex, and we have a number of recommendations that we have had for a period of time in this area. Some have been adopted and others remain to be adopted.

Senator AKAKA. Thank you very much, Mr. Chairman.

Senator VOINOVICH. Thank you, Senator Akaka.

We have many other questions, but in fairness to the next panel, I think that we will conclude.

There are still some questions, Ms. Styles, that I would like to have answered, and I thank you for being here. You have had an opportunity to hear some of our concerns, and I would be interested in, after your hearing these concerns, if there is going to be any response to any of them that we have raised today in terms of where you are going.

Senator LAUTENBERG. Mr. Chairman, just one comment, and I do not want to interrupt the flow, so, please, as far as I am concerned, feel free to get up. But I would say but there is another policy that could be spend the money, then get the money, and you can borrow it from places around town.

Senator VOINOVICH. Thank you very much.

Our next panel will come forward, and I think that all of you have been sworn in but for Dr. Light, if I am not mistaken. Is that right?

Mr. LIGHT. I was not sworn in with the other witnesses.

[Witness sworn.]

Senator VOINOVICH. Thank you. Let the record show—Mr. Tiefer, did you get sworn in too?

Mr. TIEFER. I am sworn.

Senator VOINOVICH. We thank you for your patience. In order for us to get some questions answered, I would like you, if possible, to see if you can share with us, within 5 minutes, your testimony, understanding that the rest of your testimony will be made a part of the record this morning.

We really appreciate your being here today. It is an intellectual group of people who are going to be looking at this. Frankly, we did not bring the unions in, or the contractors and so forth because so often it turns into a very contentious debate, and hopefully we are going to get a more objective view from the four of you, in terms of what you think about the competitive sourcing initiative.

So, Dr. Gansler, we will start with you.

TESTIMONY OF JACQUES GANSLER, Ph.D.,[1] SCHOOL OF PUBLIC AFFAIRS, UNIVERSITY OF MARYLAND

Mr. GANSLER. Thank you, Mr. Chairman. Thank you very much for inviting me here today to discuss competitive sourcing.

Let me start off, though, Mr. Chairman, by complimenting you and the rest of the Subcommittee for focusing on this really critical issue of the government workforce. It is important, complex, and I must say obviously a somewhat controversial aspect of this competitive sourcing debate.

I believe everybody here can agree that the government needs a high-performance, high-quality workforce for the 21st Century. The question is will competitive sourcing help or hurt in that objective? It is my personal belief that it will help, significantly.

Unfortunately, today, many Federal employees view competitive sourcing as a personal assault, an accusation that they are incompetent, lazy and only interested in secure, life-long employment. In

[1] The prepared statement of Mr. Gansler with an attachment appears in the Appendix on page 93.

fact, competitive sourcing is not an attack on Federal employees; it is an attack on a system that encourages government organizations to maintain a monopoly over a service sector. And whenever a monopoly exists in the public or the private sector, innovation, improvements and cost reductions are discouraged. The missing ingredient is competition.

Yet, while the evidence overwhelmingly demonstrates that competitive sourcing really works, we continue to hear the statements that, for example, "there is no data that show any benefits from competitive sourcing." But there actually has been an abundance of data generated; it just hasn't been made widely available.

Recently, I issued a report on this existing data; I put copies of it over on the table (and it is referenced in my prepared remarks). What I found was that there was much confusion, including even on definitions, and I even heard some of them today. For example, competitive sourcing is not outsourcing, nor is competitive sourcing privatization, though it is often referred to in that way. In fact, the public sector has won, depending upon what statistics you use, 40 to 60 percent of these competitions, and the public sector has won 98 percent of the streamlined competitions.

To summarize the overall results actually found, based on over 2,000 cases in the Department of Defense alone, plus hundreds of other cases at the Federal, State and local levels, when competitive sourcing is done right—and that is important, and I will come back to that—the performance improves significantly, performance improves significantly while costs go down by an average of over 30 percent. And, this result is true whether the winner is the government or the private sector.

It is really important to understand that even when the award stays within the government, the performance improves significantly and the costs go down significantly. This is due simply to the shift from a monopoly environment to a competitive one.

The incentives created by competition are what make the difference. Let me provide a few specifics that address what I think are the six most common misperceptions about the actual results achieved.

First, performance does improve. The data at Federal, State and local levels overwhelmingly demonstrate that the performance improves dramatically, whether it is measured as customer satisfaction, system reliability, on-time delivery or whatever. These are measured results, comparing performance before and performance after the competition is introduced.

Second, the savings are real. Again, the verified, comparative costs actually show an average saving of over 30 percent. And, this has been shown not to be due to low individual hourly rates, but due to productivity gains from process changes, as driven by the competitive forces, using obviously significantly fewer people, but often at higher individual hourly rates.

Third, contractor costs do not increase after the award. Independent studies have found that, when best practices have been utilized, when a private-sector firm won the competition, the savings that were promised were actually realized at the end of the contract period. However, when a government organization wins the competition, there have been problems.

Specifically, as was noted a few minutes ago, it has often been difficult to identify overall government costs, especially overhead costs, either before award or after performance achievement. However, you can use head count before and after as a way of making a comparison in the government, and they generally do match the reduced numbers in the government bids. Clearly, future government-cost visibility would be highly desirable.

Fourth, small businesses actually benefit. Again, when best practices are utilized, the data show that small businesses do extremely well. For example, between 1995 and 2001, the Department of Defense conducted 784 public-private competitions and 79 percent of all of those awarded as contracts went to small businesses.

Additionally, small business requirements for subcontracts and large awards can be even more significant to the small businesses. For example, the outsourcing of the Navy and Marine Corps Intranet, as well as the National Security Agency information technology infrastructure—these are both multi-billion-dollar awards—each had a 35-percent small business requirement.

Fifth, there is a minimum impact on government employees. As I noted, even when the government wins, the data show a 20- to 40-percent reduction in the government staff. However, the independent studies of this show actual involuntary separation was only in single digits, ranging from one study that found about 8 percent to another that found around 3 percent and some that found 0 percent.

This low rate of involuntary separation is due to a combination of transfers to other government positions, retirements, and voluntary separations, often to the jobs created with the winning contractor. Clearly, this issue of the workforce is an important area, and it should be a major consideration, in both the requests-for-proposal and the ensuing competition. In my report, I cover some ways in which that can be done specifically.

And, finally, sixth, and of greatest importance, I would argue, is the government actually has greater control if you use competitive sourcing. In a competitive environment, the government managers have been found to have far greater control no matter who wins.

If the government wins, it is now required to keep performance and cost metrics, along with the potential for competition—and I emphasize potential for competition—in 3 to 5 years in order to keep the pressure on the government workforce for continuous productivity gains. And I should emphasize that that is very similar to the normal competitive pressures that one in industry sees all of the time. So people going to work for the government or going to work for industry have the same competitive pressures at all times.

While, if the contractor wins, the government manager has full of control and visibility into the performance and cost and can terminate the contract if they are dissatisfied, something the government manager cannot do with a civil service workforce.

Senator VOINOVICH. Dr. Gansler, could you wrap up your testimony?

Mr. GANSLER. Sure. In fact, I just wanted to summarize the five points that I think make the difference in terms of whether or not you do it right, and I think this is critically important.

The most important key to success is shifting from a monopoly to a competitive environment.

Second, the competition must be for best value, not simply for cheapest.

Third, even when the government contracts out the work to be performed, it does not give up any of its management responsibilities.

Fourth, critical performance and cost metrics must be mutually agreed to at the beginning and monitored and reported throughout the program, and they have to be output oriented, results oriented.

And, last, the government must aggressively provide the training, that you emphasized as being so necessary, to reshape and sustain the workforce and to help overcome the natural resistance to the changes that competitive sourcing brings.

If one does these "best practices," it is very clear that the government will gain, and the employees will be fulfilled employees working up to their full potential.

Thank you very much, Mr. Chairman.

Senator VOINOVICH. Thank you, Dr. Gansler. Dr. Light.

TESTIMONY OF PAUL C. LIGHT, Ph.D.,[1] SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. LIGHT. It is a pleasure to be here.

Senator VOINOVICH. I am glad to welcome you back, Paul. You have been a frequent visitor over the years, and we thank you publicly for all of the help that you have given us.

Mr. LIGHT. Thank you. It is a pleasure to be before you and on this panel. Jack and Frank I have known off and on for a long time, and we will have to get to know each other.

I am going to leave it to Frank to talk about the quality of the data that underpin these estimates. The best research has been done by RAND, and I have a lot of confidence in their analysis of how much money gets saved and how durable the savings are, but I think the RAND analysts would say that it is a limited study, but an important contribution to the debate. Some of the data that float around here is just not very good, and that is an issue that you all may want to take on.

I am going to be very brief here. I want to make one or two comments about the testimony this morning by OFPP Director Styles. I think what you are seeing here is, from a skeptic's point of view, a little bit of a sleight of hand. It is true that we are going to get rid of the arbitrary targets, and I think that is a wonderful and important step forward, but I think what you are hearing and what you see in the OMB document is that the debate is going to move upstream. The debate is going to be about what the term "inherently governmental" means and what the reason codes justify by way of exemptions.

The appointment of a chief or a competitive sourcing officer in every department is an important step forward here, but I think the debate is now going to shift to a place where we are not going to be able to view it very closely.

[1] The prepared statement of Mr. Light appears in the Appendix on page 159.

Instead of 25 percent of Federal jobs being eligible for competitive sourcing, I would estimate—or I can't estimate—I would argue that the goal will be to increase that number steadily by questioning the reason codes that are currently used to exempt commercially available activities from competition and by changing the definition of inherently governmental.

Indeed, in the revised A–76 circular, there is an important change to the definition of what is, in fact, inherently governmental from activities which involve the discretion, the exercise of discretion of government authorities to the definition of activities that involve the "substantial" exercise of discretion.

Now, substantiality is very much in the eye of the beholder, and I think what you are going to see here, as an important issue for oversight, is to maintain a steady focus on where the key decisions are made about eligibility.

So, with all due respect to the Chairman, I do not believe that we are talking about a relatively small number of jobs in the long haul.

With all due respect to my colleague and friend from GAO, who rightly argues that we need to bring these competitive pressures to bear throughout the government, if we are getting these kinds of savings, through competitive sourcing, why aren't we getting them elsewhere?

I will argue that within several years, we are going to see a very large proportion of jobs that will be defined as eligible for competitive sourcing, and that is an important area for debate. Now, this Committee, this Congress may decide that it would be best to codify the definitions of inherently governmental and commercially available, rather than leaving that to the Office of Management and Budget for regulatory rulemaking.

In fact, you may wish to take a look at the OFPP policy letter, which defines these terms, which I would argue to you is an utter mess, in terms of actually interpreting what these terms means. What is inherently governmental? What is commercially available? Where do you use the reason codes?

And if ever there was an area where the U.S. Congress could do the Executive Branch a favor, it would be in codifying the definitions of what these terms mean, so that as we move ahead with competitive sourcing, everybody is reading from the same script, in terms of what is what.

I noted with some interest and support that OMB has decided that no two agencies are created alike. Arguably, on the air traffic sourcing issue, the United Kingdom, Canada, and the United States are, in fact, enough alike to make the decision that we can make some of our air traffic control commercially available.

My summary, my statement goes into the good and the bad reasons for outsourcing. I accept and embrace the notion that competitive competition can, and does have, a salutary effect on performance. I think we need to learn how to do it so that it affects all Federal agencies. I believe the way to go is possibly through pay for performance of the kind that this Subcommittee has been struggling with.

I also note with some concern the use of price as a surrogate measure of things we value. Price is not a good measure of motiva-

tion. Price is not a good measure of fairness and commitment to the public service. So as we proceed with competitive sourcing by putting the emphasis on price, we need to understand not just what price measures, but what it ignores.

I submit my statement for the record, and I am delighted to answer any questions that you might have.

Thank you for having me.

Senator VOINOVICH. Thank you very much. Mr. Tiefer.

TESTIMONY OF CHARLES TIEFER,[1] PROFESSOR OF LAW, UNIVERSITY OF BALTIMORE

Mr. TIEFER. Thank you, Mr. Chairman. I am a professor of law at the University of Baltimore and the author of "Government Contract Law."

Mr. Chairman, you, yourself, have appropriately focused your own legislative efforts, in general, and this Subcommittee's work on workforce issues. And like other people, like your colleagues and other witnesses, I salute you for those efforts.

Today, you began the hearing by expressing a half a dozen concerns about the new A–76, which I can only say were extremely well taken, well articulated, and I share them more intensely I think even than you.

Your first concern was the issue of across-the-board goals. Although we are trying to think positively of the steps we have heard today from OMB, I have studied the report and the testimony that they filed, and I am unable to find the tremendous departure from across-the-board goals that they seem to be contending they have made.

When I look at Page 5 of their competitive sourcing report, "Under the scorecard approach, numerical mandates were converted to incentives," not eliminated, converted. "An agency would move from a red score to a yellow score if it completed competitions for 15 percent of the total commercial positions," and it will move from yellow to green when it completes 50 percent of the total commercial positions.

Now, earlier this year, OMB had a 15-percent near-term and 50-percent eventual target, and as of today, OMB still has a 15-percent near-term and 50-percent eventual target. It does not have an announced percentage target that varies from agency to agency; it may have fixed governmentwide percentage targets. So that concern has not been eliminated.

Another concern that the Chairman appropriately expressed was that as a result of this heavy emphasis on outsourcing, managers will not be investing enough in alternatives in ways of making their existing workforce do the job better, and I combine this with concerns that several members of this panel have expressed about the A–76 innovation of this radically exalted, "streamlined" procedure. The streamlined procedure is a way for a manager who is trying to meet these percentage targets not to invest in his workforce, but instead just to outsource.

And in particular, the streamlined procedure does away with the requirement of a most efficient organization, an in-house bid that

[1] The prepared statement of Mr. Tiefer appears in the Appendix on page 175.

tries to maximize the in-house resources. Instead, it is practically a direct conversion. A manager who goes by a streamlined competition not only does not have to work on producing a most efficient organization, but as Senator Akaka emphasized, it eliminates, when you do a streamlined competition, the 10-percent minimum cost differential.

And there was a very interesting exchange in which Ms. Styles was asked, "Where did that come from? Why did you get rid of the 10 percent?"

And she basically said, "I had a conversation with my Director, and my Director insisted on it."

Now, that is a translation. Ms. Styles is a government contracting professional. She yielded to the political directive, come up with a tool to outsource rapidly.

Finally, the Chairman expressed his concern that their acquisition officers in the government are understaffed and overworked, and therefore unable to conduct full-scale, meaningful competitions, public and private. I share that. I cited the statistics. I am familiar with it from general government contract law, that the radical truncation, the cutting in half of the DOD acquisition force has produced problems in government contracting across the board, greatly decreased competition, greatly increased sole sourcing, and we are about to see what it is going to produce in the outsourcing area.

It is going to produce a reliance upon streamlined, meaning nonreal competition or, if there is a full-scale competition because you are dealing with some large facility, over 65 people, that cannot even be split and broken down, which is an available tactic to avoid the 65 level.

What we are about to see is that this underworked acquisition force will simply throw up its hands and say, "Give the jobs out."

Thank you, Mr. Chairman.

Senator VOINOVICH. Thank you. Mr. Camm.

TESTIMONY OF FRANK CAMM, Ph.D.,[1] SENIOR ANALYST, RAND

Mr. CAMM. Thank you, Mr. Chairman, for your invitation to testify here today. I will be testifying on the basis of work that I did on the Commercial Activities Panel, as well as policy analysis that we have conducted at RAND, but let me be clear that I am testifying as an individual not representing views from the RAND Corporation.

I share your belief, Mr. Chairman, that we should treat the government's career employees with respect and appreciation. Competition affects every person's sense of self-respect throughout our society. Some Federal employees fear competition because they are convinced that they and their colleagues cannot or will not be allowed to compete successfully against an alternative commercial source. That cannot be good for morale, whether competition occurs or not.

But on the other hand, thousands of other Federal employees have affirmed their self-respect by helping their Federal colleagues win public-private competitions. To me, the two critical challenges we should be thinking about here, for competitive sourcing policy,

[1] The prepared statement of Mr. Camm appears in the Appendix on page 190.

are to ensure that we properly empower our Federal employees, as has been repeated here today, and to create as level a playing field as possible for them to compete on and to prove themselves.

Let me offer the following observations from the work that we have done at RAND and, to some extent, on the panel as well.

Competitive sourcing is one of the best tools we have available to improve the cost effectiveness of Federal agencies. In its efforts to improve productivity since 1996, for example, the Department of Defense has consistently preferred this as the option with the best documented history of improvement.

RAND analysis on the best commercial sourcing practices indicates the following conditions improved the morale of the workforce in a company when it is considering whether or not to outsource an activity.

The sourcing decision process should be fair, objective and transparent enough for employees to understand the final decision.

Second, the decision process should proceed rapidly. Employee morale suffers most when awaiting a decision and suffers more the longer the process takes.

Third, displaced employees should be assured employment elsewhere in the firm.

And, fourth, displaced employees should receive a soft landing if they leave the firm. This can occur in one of two ways. First, it can occur through formal severance or outplacement agreements with the firm if it outsources their positions. Alternatively, it can occur through criteria that are used to choose an external source that reward that source for having generous compensation benefit and training plans, as well as good opportunities for advancement.

When we look in the commercial sector, well-managed outsourcing programs displace workers who often find themselves to be better off after being outsourced. Their new employers, who specialize more than their original employers did, are often more willing to invest in their skills and more likely to give them opportunities to grow.

That said, we have to recognize that individuals who have self-selected into government jobs may simply not like jobs in the private sector, even if those opportunities are better for them in the private sector.

OMB's goal in the past of competing 50 percent of the positions in the commercial activities of the Federal Government has clearly raised concerns, and you all have expressed those clearly here today. Our analysis at RAND has long supported the strong empirical findings at the Center for Naval Analysis that the OMB Circular A–76 has achieved savings through competition and not through outsourcing. This simply confirms what Dr. Gansler talked about a moment ago, and we are talking about the same sources of information here.

OMB's recent changes in Circular A–76 emphasized that it is a competitive sourcing program. It is not an outsourcing program. Again, I emphasize the difference that Dr. Gansler drew between these two because it is important to see it. That said, is the 50-percent goal the right goal? I think everyone here today has agreed that it is not. The fact is that there is no one right percentage that can be applied to every agency. More broadly, a reliable method

does not yet exist to determine exactly where competitive sourcing is cost effective in any agency, even DOD, the agency with the most experience in the Federal Government.

I would prefer an OMB policy that motivated competitive sourcing with targets that had more operational or strategic significance to Federal managers, like specific targets for cost reductions or for performance improvements. Such a policy would make it easier for people to understand that competitive sourcing is, in fact, a tool, not an end in itself.

OMB has done a remarkably good job of implementing the key elements of the Commercial Activity Panel's recommendations that it can control. I generally agree with General Walker's careful delineation of differences between the panel's recommendations and OMB's new version of A–76, and I will not try to list those differences here. Rather, I would direct your attention to the extent to which the new version of A–76 captures the central elements of the panel's strong consensus on principles.

Taken together as a coherent whole, these principles call for major changes in competitive sourcing policy, and OMB's recent revision of A–76 captures many of those changes in an effectively integrated manner. The changes that Ms. Styles told us about today make it even more closely matched to the panel's findings.

Thank you, again, for the opportunity to testify. I look forward to answering your questions.

Senator VOINOVICH. Thank you.

There is one thing that I want to correct for the record. Mr. Tiefer, you said that reading a summary on page 5 of OMB's new report on the new definition of what is required, in terms of getting yellow and green on the scorecard is not written in percentages. In other words, this document, the Competitive Sourcing, July 2003, lays out the new scorecard criteria. "OMB has modified the scorecard criteria. These refinements have been informed by discussions with," and so on, "ensure an agency's commitment to competitive sourcing is measured against targets that reasonably reflect its unique mission and circumstances, not arbitrary or official goals."

I just want to clear that up, and it is interesting that Dr. Light, you make the point that your concern is in the definition—this definition could open up a lot more functions because of the definition, and so we are going to look into that suggestion that you have made.

Dr. Gansler, I am interested in your comment that competition is what provides the improvement in performance. If 75 percent of the workforce is not subject to competition, God help us if the only way you can improve performance is by turning to competition. I want to say that I got involved in this whole area in the beginning because I wanted to change the culture of the Federal workforce and try to build on what I did when I was in Cleveland, and when I was governor, where we aggressively pursued quality management and trained some 58,000 people in quality management.

I and the union leaders had a 3-day retreat. At the end of my term we had 17 percent less employees in the State of Ohio. We did not just hack them out of there, but we did it through tools such as attrition, and we had a much better workforce because we empowered them, we gave them the tools, we increased dramati-

cally the amount of money that we provided to train them so they could upgrade their skills. I think that the next issue after this year is over that I am going to start going back to that and identifying agencies that have quality management.

Mr. GANSLER. I couldn't agree with you more, Senator.

Senator VOINOVICH. I would like to give you each an opportunity to comment on the testimony of someone else at the table. I am sure there may be some questions, there may be some differences. I would give you this chance to do that.

Mr. GANSLER. In the same order, I guess.

The one obvious point that I would like to make about Mr. Tiefer's comments, where he said that streamlining is the same as direct conversion, the empirical data are exactly the opposite. Ninety-eight percent of the time when streamlining is used the government wins. So, if you are worried about the government trying to break up the size of competitions so that they can use streamlining, the government is likely to win more of them than, on average, what it has in the past—40 to 60 percent—under full A–76 competitions.

I think that streamlining, in fact, has favored the government rather dramatically, in terms of its win ratio. Having said that, I still think the important point here is not the fact that you get a cost reduction. The really important point is that you get performance improvement at lower cost, and that is what I think the government needs. That is your high-performance workforce, and that is what we need to strive for in the 75 percent not affected by competitive sourcing, as well as in the 25 percent that are.

Mr. LIGHT. My general reaction is that I think Jack has taught me a great deal in his paper, and others have taught me a great deal about the value of competition. I think that we have got a serious problem in government playing off or pivoting off Frank Camm's comments about allowing Federal employees or giving Federal employees the tools to compete and also creating a culture in which competition is not necessarily the only tool that you have available as a manager.

One of the issues surrounding this is the presence of relatively low-powered incentives in government, and I think that is where DOD started out this spring, in terms of its arguments on behalf of personnel reform; the notion being that give us some tools that we can use on a day-to-day basis to promote higher performance.

I guess my general reaction is this is a tool that needs to be very carefully used because of its repercussions throughout government on government morale, and its kind of reinforcing effects on whether or not or doubts among Federal employees that they do, in fact, have the tools with which to compete.

I think there are an awful lot of Federal employees out there who are saying give us the training, give us the staffing, give us the resources so that we can do the jobs that we came here to do. In that regard, you bring competition in on a unit, you have to, at some level, deal with that general sense that there are not enough resources out there.

Senator VOINOVICH. Mr. Tiefer, would you like to comment?

Mr. TIEFER. Thank you, Mr. Chairman.

Dr. Gansler has noticed that I am concerned about the streamlining process and that I have a question about the government breaking units so they get them under the 65 level and other shifts in it. I can't claim originality on these. I read the GAO report that was provided today, and I listened to Comptroller General Walker's testimony. And as he said in his section entitled, "Potential Issues with Streamlined Cost Comparison Process," there used to be—well, he says:

"First, the prior version of the circular contained an express prohibition on dividing functions so as to come under the 65 FTE limit for using a streamlined process. The revised circular contains no such prohibition. We are concerned that in the absence of an express prohibition, agencies could arbitrarily split activities, entities or functions to circumvent the 65 FTE ceiling applicable to the streamlined process," and then goes on to comment about the elimination of the 10-percent conversion differential.

There is a reason why a procurement professional, such as the Comptroller General or myself, is worried about this. Splitting things in order to come under the limit is tactic, No. 1 for speeding things through the procurement process. The Comptroller General has seen this everywhere else in procurement, as have I. That is the problem.

Senator VOINOVICH. Dr. Camm.

Mr. CAMM. Let me just comment on a couple of things that Dr. Light said. I agree with him that, as we get into this, the debate is going to move towards the question of how to define the inventory, and I actually welcome that. Because I think if we can get agreement on an improved competition process through A–76, then we can move on to what is a much more difficult question. And that is which activities really do belong within the government and which should be taken care of by an outside provider.

I have been privileged to be present at many of the discussions inside different agencies about how that decision is made, and I look forward to improvements in the process that is used, because the processes I have observed in a number of different settings are not reassuring.

I think there is a lot of misunderstanding about what core competency means, there is a lot of misunderstanding about what inherently governmental means, there is a lot of misunderstanding about what the risks are that are present when you are using an internal, as opposed to an external source. We need a lot of learning on the part of our government decisionmakers about this, because this is a strategic decision that has to be made, and I think Dr. Light is right. I think the focus will be moving in that direction. We need to be prepared to keep an eye on that.

I also agree, and I guess it has been said several times, but let me emphasize that the secret to the success of this whole program is going to lie in its implementation. I have spent a lot of time in several parts of DOD helping people go through these competitions, and so I have a special appreciation for the challenge that they face.

You are asking people who have full-time jobs to take on an additional job they have never had before—and in all likelihood, one they won't have again in the foreseeable future—a very difficult

thing. They are going to be doing things that their commercial counterparts do every day for a living, and so they are very good at it. These people are frightened, and they need help.

I think that there are lots of things that could be recommended to empower these people. I think we can put together what in the Air Force was called a central tiger team that could go from one location to the next. Experts can come in and provide a very clear way of executing an A–76 study from the government point of view.

We can provide just-in-time training. There is a nice program in place which has been recommended at the Defense Acquisition University, that could apply throughout the government. There is nothing special about Defense. Just before one of these studies, the program trains the people who are going to be involved in exactly how the study runs. It is a simple thing to do, and I think it will be quite effective to try.

And I think Federal employees can benefit from analytic support from third parties. Unless we spend the money to do that, we are going to be in big trouble. I appreciate Ms. Styles' comments that, on the one hand, we want to get the cost of these competitions down, but on the other hand, if we want them to run right. As Dr. Gansler has suggested, if you want to do this right, it is not going to be cheap, and we shouldn't do it on the cheap.

Senator VOINOVICH. Thank you very much. Senator Lautenberg.

Senator LAUTENBERG. Thanks very much, Mr. Chairman, and thank all of you for your interesting testimony. I am not going to try to create condition, but I can tell you that several hours in the room would probably be a good way to get to understand what it is precisely that we are talking about here because there is no magic that says competition—I think you, Mr. Chairman, said something about it—being the driver always for the best result.

Look at the management of some of our great companies that used to exist, I might add, about how they competed for capital dollars, how they competed for wealth and how they competed for position and the kind of chicanery that crept in there to try and make it look like it was straight old competition. Well, it was not.

And I come from the management school, and I really do buy into the training of the people that we have, insisting that there be some criteria for performance given to them and discussed with them.

We found in my first 18 years here, when I was very involved in the superfund, the development of this program, the management of these huge projects, is that too often the management really did not get to the people who had to do the job and let them understand what was required of them, and we tend to permit those things to slip by in government because of the magnitude of the job, the growth of the responsibility, the growth of our country, the demographic growth. I mean, look at what has happened. We put on maybe 100 million people in the last 25 or 30 years, and there are a lot of services required. So it is complicated.

And I do not say you have to keep everybody on the Federal payroll that you started with, but Professor Gansler, I am curious about one thing, do you support tenure as a mark of appropriateness on the college campus?

Mr. GANSLER. I have to tell you, Senator, I, for most of my life, was either in industry, mostly in industry, and served two terms in the government, and during that period I chaired an advisory board at the University of Virginia and another one at the University of Maryland, and frankly I was against tenure. Now, I have it. [Laughter.]

There are some advantages, but clearly I think, in the long run, it is not a good idea. Personally, I don't think it is a good idea.

Senator LAUTENBERG. Therefore, then, if one takes a sabbatical, do not come back or something like that?

Mr. GANSLER. No, I think you should measure an individual on their performance, and if they do a good job, they should keep their jobs. I believe the same thing should be true for the government workforce, as well as for the private sector. The difference is, in the private sector, I had more flexibility than I did in the government when I had government workers working for me.

Senator LAUTENBERG. Yes. How do the others of you feel about tenure on the campus? I am just curious. Dr. Camm, do you——

Mr. CAMM. Well, I don't have tenure. My company doesn't believe in it, and I think it——

Senator LAUTENBERG. They believe in it, but they just do not enforce it.

Mr. CAMM. Well, we don't have tenure, and I think we are better for it. I think it makes it a more interesting place to work.

Senator LAUTENBERG. Yes. My company did not have any tenure either, and we got up to 45,000 employees and started with zero, and capital, just good will handed down by our parents, and that was it. We had no—the company is called ADP, Automatic Data Processing, and in business now, 50 years, and I am one of the three founders, and the other two guys are in better shape than I am. So that tells you something about what hard work does.

But the fact of the matter is, if there is an incentive, and I do not quite know how we do it in government. You cannot just do it with plaques, and little hors d'oeuvres and a glass of Diet Coke. That is not quite enough. But I will tell you, and I am a firm supporter of the workforce generally in the government, and I see that when they are asked to do things, when there is leadership, they perform as no other workforce that I have seen. And, again, we had a very successful one, and I know lots of people in the private world. And I am considered a Hall of Famer in information processing. I had to do that to match Bill Bradley's Hall of Fame and reputation in similar things—— [Laughter.]

But the fact of the matter is that I was a pioneer in outsourcing. That is what that began, and I really believe in it, but what do you outsource? You do not outsource jobs, you outsource assignments, and here we start talking about it as outsourcing jobs. I would prefer another look at things.

So, when I look at what has happened—and this is what worries me—I have a particular focus on the FAA and where it belongs. Again, I think it is like the fifth branch of the military, and I cannot believe, and I am sorry that Ms. Styles is not here, that the President would veto a bill that takes care of essential air service, advances the technology and FAA, etc., because we passed, with

the help of 11 Republicans, a bill to restrict FAA to inherently government because I have looked at other situations.

In Great Britain, since privatization, near misses or other problems have increased by 50 percent. That is near misses in the area. Delays caused by air traffic control have increased by 20 percent, and the story goes on. Debt service has increased by 80 percent. Canada's privatized system has run up a $145-million deficit just in the past year, and I worry about what happens when you buy security on the cheap, and that is what you have got when you are up there, and there is a labor dispute. I mean, we can talk about strike prohibitions here, but when you turn it out to an employer, you cannot say, and, remember, they are not allowed to strike. It is impossible.

So the review is an excellent one, and I thank each one of you for your contribution, especially my good friend, the Chairman here, who has an earnest view of the responsibility to employees, but also responsibility to the constituents in the government, and I salute that.

I thank you very much.

Senator CARPER. Is there going to be a second round of questions? Do you have some questions?

Senator VOINOVICH. No, I think we will conclude with yours.

Senator CARPER. All right.

Senator VOINOVICH. Because we are past the 12 o'clock hour.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. I apologize for not being here earlier to hear your testimony. Others of my colleagues and I are working with things on the floor, and we have constituents that are in and trying to meet with us, and so I apologize for having missed your testimony.

OPENING PREPARED STATEMENT OF SENATOR CARPER

Thank you, Mr. Chairman. I think we would all agree that the goal of any effort to encourage public-private competitions for Federal work should be to ensure that the people best able to do the work win the competition, regardless of whether they are Federal employees or from the private sector. I am concerned, however, that the administration's competitive sourcing initiative, at the very least, sends the message that most work is better handled by the private sector.

As a former governor who has some experience managing a public workforce, I can appreciate the President's desire to fix the competitive sourcing process. The old process took too long and probably prevented qualified contractors who could have saved the Federal Government money from competing for work. That said, the new process laid out in revised OMB Circular A–76 probably makes it more likely that private sector bidders will be awarded Federal contracts, even if that is not in our best interests. While I am concerned that some of the new time limits for public-private competitions laid out in the revised rules may not give Federal employees enough time to put forward their best bid, I am most concerned with aspects of the rules that could unfairly tilt the process in the private sector's favor.

First, requiring agencies to decide a competition based on "best value" instead of cost could be positive if it allows agencies to contract out in situations in which the private bidder is more expensive initially but could save them money in the long run. However, I think it should be made clear that cost should be the main item agencies look at when deciding who wins a competition.

Also, while I would generally look on increased competition as a good thing, I do not think it is a good idea to dramatically expand the number of Federal jobs eligible for competition. There are certain jobs, such as air traffic control and food inspection, that I think should not be competed under any set of rules. I am concerned

that the revised rules could classify too many sensitive jobs as "commercial" in nature and led to irresponsible outsourcing decisions.

Finally, while they have been moderated somewhat in recent months, I would argue that the administration's competitive sourcing goals are arbitrary and will force agency managers to compete jobs even when they might not think doing so is the best thing to do.

In closing, I will point out that, if we are going to increase public-private competition, we must also increase the resources made available for contracting management and oversight. Federal employees forced to bid for their jobs under tight timelines need to get enough resources to be able to make their best offer. Perhaps more importantly, agencies must also be capable of monitoring contractors to ensure that they are providing taxpayers good service.

Thank you, Mr. Chairman, for holding this important hearing and thank you Administrator Styles and Comptroller General Walker for your work on this issue.

Senator CARPER. I have a summary of what you have said, but I probably will not have a chance to read your testimony. Let me just ask each of you, when I walk out of here, I do not know if I will ever see you fellows, again, but I want to thank you for having come today and shared your thoughts with us.

Just take a minute, what would you like for me to take out of this hearing that you think will be most valuable to us as we go through our deliberations?

Mr. CAMM. What I would suggest is that A–76 should be considered as an integral part of the strategic management of the Federal workforce and that Federal workers must recognize that they are part of a broader economy where competition drives the way the workforce works.

When we use the word "human capital," and we use it repeatedly without thinking about what it means, it means you carry a basket of skills with you wherever you go. We need to make sure that the workers in the Federal workforce have the basket of skills they need, whether they stay in the Federal workforce or go someplace else.

A–76 is an integral part of that because it trains them in what competition is, and it makes them skilled and useful if they decide to go somewhere else. So I would hope that you would remember A–76 as being an integral part of that strategic human capital planning process.

Senator CARPER. Thanks. Mr. Tiefer.

Mr. TIEFER. What I think we have seen today is, let us put it this way, already this year the issue of outsourcing has been handled a number of times by appropriation riders because last year that is how it was handled, by an anti-quota provision that became Section 647 on the omnibus appropriation because there is a great deal of support in Congress for not having numerical targets for outsourcing, and although there was some modification today, Ms. Styles implicitly adheres to a 15-percent near-term and 50-percent long-term target, the same targets we have been seeing previously this year for what should be put through the competition process, and it is a streamlined process.

And so the up-shot is you are going to be seeing plenty more of those appropriation rider votes the rest of the year because we are still stuck with numerical targets.

Senator CARPER. Thank you. Dr. Light.

Mr. LIGHT. I would say that the thing that I would emphasize is that we have a workforce that does the job for the Federal Gov-

ernment that is much larger than just civil servants. If you add up the contractors, and the grantees, the military personnel and Federal civil servants, we have a workforce in the Federal Government of about 12.5 million employees.

What we ought to be thinking about is how to make sure they are all performing well, how to make sure they all have the tools to succeed, and how to get on with this very difficult issue of how you sort who does the job. We are dealing with terms here, commercially available, and inherently governmental, that were first applied in the 1950's, and I think we are well beyond the sort of environment in which we invented this system that we use now for sorting jobs. It is just not up to snuff, I would argue, for managing the kind of workforce we have and managing the kinds of functions that we perform.

Senator CARPER. Thanks, Dr. Light. Dr. Gansler.

Mr. GANSLER. I would first of all point out, that there have been lots and lots of examples, thousands of examples of competitive sourcing. And what they show is when it is done right, that the benefits of, first, improved performance, and then lower cost, are really very important and worth it for the government, for the appropriate portions of the government, that are doing work that is not inherently governmental.

On the other hand, I think it is equally important to recognize that we have a really great workforce, the people are very dedicated. It is not the people that we are trying to attack here. It is the system that basically has a monopoly environment and that no matter who wins the competition—the government or the private sector—there is a significant improvement in performance and a significant reduction in cost.

And so we need to move in that direction, as the Chairman said, for 100 percent of the workforce, and this means a high-quality, performance-oriented, excellent workforce. That is the direction that we really need to move in across the board. Competition is one way to do that in those sectors where we have non-inherently governmental work.

Senator CARPER. Could I have one more minute?

Senator VOINOVICH. Sure.

Senator CARPER. Governor Voinovich and I were governors once in an earlier life, and I recall debates in the way we awarded construction contracts. We used to award them on lowest bid, and if the——

I like to run. I go back and forth to Delaware every day, and I am a runner. And sometimes when I run, I run by a high school that is not too far from our house. And the school, I see them replacing the windows of the school, and I am reminded of the contract that was let in one of our schools where they were rehabbing an older school, and they let the contract out to the lowest bidder for replacing the windows. It turned out the company did not know what they were doing, did a lousy job, a couple of years later had to replace the windows, but we awarded the bid on the lowest possible cost, not best value.

I remember the governor's house down in Dover. It is an old house, in fact, over 200 years old. It is the oldest governor's mansion in America. And I remember we had to replace the patio

around the house, George, and the folks that came in to do the masonry work won it on the lowest bid, the lowest cost, but as it turns out the work that they did had to be basically ripped up and replaced within a year—not best value.

Somewhere inherent in this debate is the question of awarding bids who work on the lowest cost versus best value—my last question is to ask you your thoughts on either approach.

Mr. CAMM. The government wants to move towards the use of performance-based contracting. This is standard policy in the Department of Defense. It is spreading to the rest of the government as well. They have learned this from the commercial sector.

In the commercial sector, you cannot do performance-based contracting successfully unless you are also doing best-value competition. The reason for that is that you don't want to rely in a performance-based contract on the minimum cost offeror. And so I would say that, because we have this policy of pursuing performance-based contracts, we have to recognize that it has to be matched to a sourcing policy based on best value. That is true for private-private competitions; it is true for public-private competitions.

I am very concerned that right now Congress does not allow the Department of Defense to use best-value in public-private competitions. I think we are going to run into trouble down the road, because the Department of Defense is pursuing these performance-based arrangements. DoD is going to get poor providers, and they are not going to work. So I am quite concerned about it.

Senator CARPER. Thank you. Mr. Tiefer.

Mr. TIEFER. Senator Carper, the new A–76 makes a change I think in the wrong direction in the area that you are talking about—I discuss it on Page 13 of my written testimony—in that you now can have a competition, a public-private competition of a certain kind, a specialized kind, in which, a trade-off kind it is called, in which they not only have gone away from lowest cost, but there is not even a requirement, there was in the draft, and it was taken out in the final, there is not even a requirement of a "quantifiable" basis for choosing the private contractor.

Now, the history that you described is your classic correct executive perspective, which is the movement, the evolution from pure cost comparisons to best value, and it is a classic correct analysis, but at least there should be a quantifiable basis, and that, for the choice, and now that has been taken out even of the final.

Senator CARPER. Thank you.

Dr. Light and Dr. Gansler, we have about 6 minutes to go in a vote that is underway, so I will just ask you to use about a minute apiece, if you would.

Mr. LIGHT. Yes, I agree with Frank Camm on this issue. The problem is that we have an environment that is so distrustful right now between the people making the decisions about outsourcing or competitive sourcing and the people who are involved in actually the target or the emphasis of this that I don't see how we can create a political environment in which we could allow for a best-value competition.

I don't see why, I mean, on the surface, you would like to get away from price as the consideration here because it is entirely

conceivable that a private contractor could do a job better at a higher price or that a Federal unit could do the job better at a higher price. You get better value, but the politics of this are just so extreme right now, and the anxiety in the workforce so extreme that I just don't see how we get there.

Maybe if we do this work on defining terms more carefully so that we could bring a quantitative position to bear on it, perhaps.

Senator CARPER. Thank you.

Mr. GANSLER. I think we must use best value. It is clearly the objective here has to be to improve performance at lower cost. It is the improved service that is really the objective, and if you don't use best value, what you get is cheap service, and that is not acceptable service, as far as I am concerned.

The answer has to be to move towards best value. It will be more difficult because it becomes more subjective in some ways, but even the performance is measurable in most cases, and you should be able to use that the same way you and I do when we go out shopping in the stores. We don't buy the cheapest, we buy something that is the best value.

Senator CARPER [presiding]. My wife says I buy the cheapest. [Laughter.]

I tell her I am looking for the best value. That is what we ought to be looking for, I think, for our taxpayers.

But you are good to come here and share your time and your thoughts with all of us.

Senator Voinovich has gone to vote, and I probably ought to go join him or I am going to miss this opportunity.

Thank you very much, and the Committee stands adjourned.

[Whereupon, at 12:20 p.m., the Subcommittee was adjourned.]

APPENDIX

STATEMENT OF ANGELA B. STYLES

ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT,

THE FEDERAL WORKFORCE AND THE DISTRICT OF COLUMBIA

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

JULY 24, 2003

Chairman Voinovich, Senator Durbin, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the Administration's competitive sourcing initiative. Two years ago, the Administration unveiled the President's Management Agenda (PMA), a bold strategy for improving the management and performance of the federal government. Opening commercial activities performed by the government to the dynamics of competition -- i.e., competitive sourcing -- is a major component of the PMA and the Administration's vision for a market-based government.

A number of Administrations have encouraged the use of competitive sourcing -- through memoranda, a Circular, a government-wide handbook, and even an Executive Order. Like us, past Administrations recognized that public-private competition improves service delivery and decreases costs to taxpayers, irrespective of which sector wins the competition. Various studies have found savings of anywhere from 10-40%, on

average, regardless of the sector that wins the competition. In fact, savings can be even higher. For example:

- Federal employees won a public-private competition in 1994 to perform base operations support at Goodfellow Air Force Base. The competition has resulted in an effective savings of 46%.

- Private sector performance of aircraft maintenance at McChord Air Force Base, work previously performed by the government, has resulted in an effective savings of 66% following a public-private competition in the early 1990s.

Despite these positive results, use of public-private competition has not taken hold outside of the Department of Defense. Our competitive sourcing initiative seeks to institutionalize public-private competition by providing an infrastructure and management blueprint for its considered application.

Today, the Office of Management and Budget (OMB) is providing a report to Congress describing the steps we have been and are taking to implement competitive sourcing. A copy of the report is attached to this statement. I would like to summarize that report for you this morning. I think you will find that the report provides important insight regarding our reasoned and responsible approach for ensuring the fair and effective application of this important management tool. I would also like to address the specific concern you raised in your letter of invitation regarding the potential impact of competitive sourcing on the federal workforce.

The strategy for implementing competitive sourcing

The Administration's strategy for institutionalizing public-private competition has three features:

1. Agency-specific competition plans that are customized, based on considered research and sound analysis, to address the agency's mission and workforce mix;

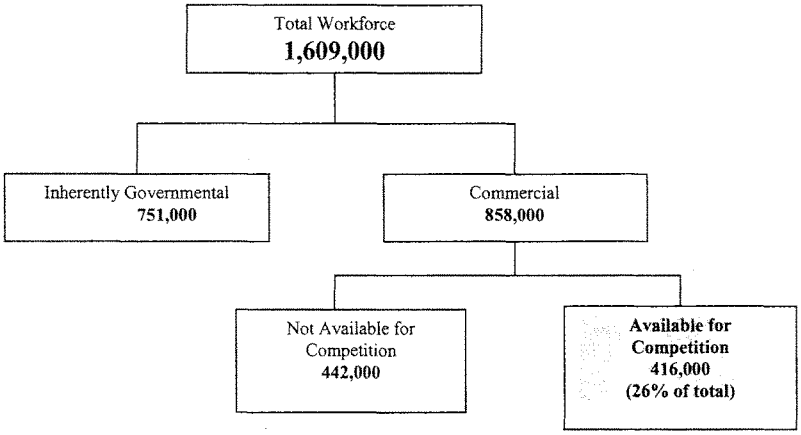
2. A dedicated infrastructure within each agency to promote sound and accountable decision making; and

3. Improved processes for the fair and efficient conduct of public-private competition.

Let me briefly describe how each of these features reinforces careful planning and well informed decision making.

Customized competition plans. The preparation of competition plans begins with the development of workforce inventories, as required by OMB guidance and the Federal Activities Inventory Reform (FAIR) Act. Agencies first differentiate inherently governmental activities from commercial activities. Inherently governmental activities are excluded immediately from performance by the private sector. Agencies then separate commercial activities that are available for competition from those that are not. In deciding whether a commercial activity is inappropriate for potential performance by the private sector, agencies take various factors into consideration, such as the unavailability of private sector expertise, preservation of core competencies, or the need for confidentiality in support of senior level decision making. As noted in the diagram below, OMB estimates that approximately 26% of the workforce from agencies being tracked under the PMA are engaged in commercial activities that should be available for competition. Individual agency determinations, however, vary from under 20 percent to over 60 percent: no two agencies are alike.

OMB Estimated Aggregate Workforce Profile of Agencies Being Tracked under the PMA



Once an agency has identified commercial activities available for competition, they consider, in a disciplined way, which of these might benefit most from comparison with the private sector. Agencies are generally focusing use of public-private competition on commonly available routine commercial services where there are likely to be numerous capable and highly competitive private sector contractors worthy of comparison to agency providers. They also consider factors such as workforce mix, attrition rates, capacity to conduct reviews, the percentage of service contracts, and the strength of the agency's contract management capabilities. For our part, OMB has created scorecards to measure agency progress in implementing competition plans. We have also committed to meeting with agencies on a quarterly basis to provide assistance in the use of competitive sourcing as a management tool.

OMB has moved away from mandated numerical goals and uniform baselines that were introduced at the beginning of the initiative to ensure a level of commitment that would institutionalize use of the tool within each agency. Instead, we have negotiated tailored baselines based on mission needs and conditions unique to the agency. As an additional step to reinforce our customized approach to competitive sourcing, OMB has revised the criteria that will be used to grade agency progress. The revised criteria, which are set forth in section III of our report, contain no government-wide numerical goals that would require an agency to compete a portion of the commercial activities performed by the government. However, the scorecard still includes the types of incentives that should facilitate the application of competitive sourcing in a sound manner.

Agency management infrastructure. OMB requires that agencies designate a Competitive Sourcing Official (CSO) to be accountable for competitive sourcing actions in the agency. The organizational placement of the CSO is left to each individual agency. OMB further requires that agencies centralize oversight responsibility to help facilitate a wide range of activities, including:

- the development of inventories of commercial and inherently governmental activities;
- the determination of whether commercial activities are suitable for competition;
- the scheduling and preliminary planning of competitions, including the coordination of resources to support the agency provider;
- the tracking of results; and
- information sharing within the agency so past experiences can inform future actions.

Improved processes for conducting public-private competitions. For a long time, the acquisition community has argued that the benefit derived from public-private competitions could be much greater if processes for conducting competitions were improved. Towards this end, OMB has revised Circular A-76, the document that sets forth the guidelines for conducting public-private competitions. In developing the

revisions, we carefully considered the guiding principles of the Commercial Activities Panel. We believe the Circular is generally consistent with the Panel's principles and recommendations. The General Accounting Office has indicated that it shares this belief.

Of particular importance, the revised processes concentrate on results -- not the sector that provides the service -- so that agencies and the taxpayer may reap the full benefit of competition. The processes are intended to ensure a level playing field for public and private sector sources with incentives to devise the most effective means to provide needed services. Here are a few of the new features of A-76.

- Focus on selecting the best available source. Because OMB seeks to emphasize selection of the best service provider, as determined through competition, the revised Circular deletes a long-standing statement that the government should not compete with its citizens. Deletion of the "reliance" statement is not intended to denigrate the critical contribution the private sector plays in facilitating the effective operation of government. The deletion is simply meant to avoid a presumption that the government should not compete for work to meet its own needs. Current government incumbents should have the opportunity to demonstrate their ability to provide better value to the taxpayer.
- Better planning. The revised Circular emphasizes the importance of preliminary planning as a prerequisite for sound sourcing decisions. Before announcing the commencement of a competition, agencies must complete a series of actions including:
  - determining the scope of activities and positions to be competed;
  - conducting preliminary research to determine the appropriate grouping of activities as business units; and

- determining the baseline cost of the activity as performed by the incumbent service provider.

- Elimination of "direct conversions." During the development of Circular revisions, some public commenters complained that the traditional authority to convert functions with 10 or fewer positions directly to private sector performance was encouraging agencies to ignore consideration of the agency provider, even where a more efficient, cost-effective government organization could offer the better alternative. The revised Circular eliminates direct conversions and instead provides a versatile streamlined competition process for agencies to efficiently capture the benefits of public-private competition for activities performed by 65 or fewer full-time-equivalent employees.

While providing added flexibility, the Circular also incorporates mechanisms to ensure that agencies act as responsible stewards. For example, agencies must publicly announce both the start of a streamlined competition and the performance decision made by the agency. The notice announcing the initiation of a competition must include, among other things, the activity being competed, incumbent service providers, number of government personnel performing the activity, names of certain competition officials, and the projected end date of the competition. In addition, agencies must document cost calculations and comparisons on a standardized streamlined competition form. The official who documents the cost estimate for agency performance must be different from the one who documents the cost estimates for performance by either the private sector or a public reimbursable source. Finally, the agency must certify that the performance decision is cost-effective.

- Establishment of firewalls. The revised Circular seeks to improve public trust in sourcing decisions by reinforcing mechanisms of transparency, fairness, and integrity. Among other things, the revised Circular establishes new rules to avoid the appearance of a conflict of interest. The revised Circular separates the team formed to write the performance work statement from the team formed to develop the most efficient organization (MEO) -- i.e., the staffing plan that will form the foundation of the agency's tender. In addition, the MEO team, directly affected personnel and their representatives, and any individual with knowledge of the MEO or agency cost estimate in the agency tender will not be permitted to be advisors to, or members of, the source selection evaluation board.
- Post-competition accountability. During the revision process, we heard numerous complaints regarding weaknesses in post-competition oversight. Among other things, the old Circular required post-competition reviews only for 20 percent of the functions performed by the government following a cost comparison. As a result, even where competition has been used to transform a public provider into a high-value service provider, insufficient steps have been taken to ensure this potential translates into positive results.

  Under the revised Circular, agencies will be expected to implement a quality assurance surveillance plan and track execution of competitions in a government management information system. Irrespective of whether the service provider is from the public or private sector, agencies will be expected to record the actual cost of performance and collect performance information that may be considered in future competitions.

OMB intends to work with the agencies to review costs and results achieved. This information will be used to evaluate the effectiveness of competitive sourcing at each agency and devise additional strategies to address agency-unique implementation issues. We will also work with the agencies to ensure they provide the Congress with the information Congress needs to ensure sufficient oversight of these activities and their associated costs.

Finally, with the assistance of the Federal Acquisition Council, agencies will share lessons learned and best practices for addressing common issues. Using past experiences to inform future decision making will further ensure that competitive sourcing is a fair and effective tool for improving the delivery of services to our citizens.

Competitive sourcing and the federal workforce

Mr. Chairman, in your letter of invitation, you raise concerns regarding the potential impact of competitive sourcing on the federal workforce. You fear that the initiative may have an adverse impact on federal employee morale, recruiting efforts, and possibly its effectiveness.

Clearly, competitive sourcing poses a challenge for government personnel who perform commercial activities that are available for competition. These providers must critically examine their current processes and determine how they can improve the delivery of services. Answers may not come easily, but they are ones which our taxpayers are owed.

Historically, the government wins over 50% of public-private competitions. This high success rate should give employees confidence that they can and do compete effectively head-to-head with the private sector. As I described a moment ago, the revised Circular has a number of specific features to ensure that competition is applied in an even-handed manner. Equally important, the revised Circular recognizes the talents of the federal workforce, the conditions under which the workforce operates, and the importance of providing the workforce with adequate training and technical support during the competition process to ensure they are able to compete effectively. In particular, the revised Circular seeks to ensure that the agency provider has the available resources (e.g., skilled manpower, funding) necessary to develop a competitive agency tender.

As an example, the Department of Energy (DOE) recently competed the graphics function at DOE headquarters. Before the competition, this was a 13-person operation at DOE. Through the competitive process, the incumbent government provider determined that it could do the same job with 6 people. In other words, the same graphics service could be delivered by half the number of people. By sharpening their pencils, benchmarking the private sector, and reorganizing the function, the federal employees won the graphics function competition against the private sector. Importantly, however, through managed attrition, no involuntary separations are anticipated. Though small in number, this competition exemplifies the benefits of the competitive sourcing initiative. As a result of the competitive process, this organization determined how to become more efficient. The competition at DOE is a significant win for the taxpayer.

Even when the commercial sector is chosen to perform the activity, there generally are only a small number of involuntary separations of federal employees -- 8% according to one study; 3.4% according to another. The percentage of involuntary separations should remain small. Nearly 40% of all federal workers will be eligible to retire by 2005, creating many new job opportunities across government. The Administration's human capital initiative is already helping agencies better train and retain a capable workforce.

Conclusion

The Administration is committed to creating a market-based government that embraces the benefits generated by competition, innovation, and choice. We are equally committed to ensuring that this endeavor is pursued in a reasoned and responsible manner.

Competitive sourcing is not about arbitrary numbers. This initiative is about reasoned plans, accountable infrastructures, and balanced processes that facilitate the application of public-private competition where it benefits mission objectives and the needs of our citizens. We appreciate the Subcommittee's interest in our competitive sourcing initiative. We look forward to working with you and the other members of Congress as we strive to bring lasting improvements to the performance of government through the sensible application of competition.

This concludes my prepared statement. I would be pleased to answer any questions you may have.

COMPETITIVE SOURCING

Conducting Public-Private Competition in a Reasoned and Responsible Manner

JULY 2003

Competitive Sourcing: Conducting Public-Private Competition in a Reasoned and Responsible Manner

In the spring of 2001, the Administration announced its intention to open the commercial activities performed by the government to the dynamics of competition between the public and private sectors. Soon thereafter, the President's Management Agenda (PMA) designated this effort, known as competitive sourcing, as a major initiative. This designation reflected the Administration's commitment to market-based government, where competition drives improved performance and efficiency of federal programs.

Promoting use of public-private competition is not a new idea. Many administrations have encouraged agencies to consider whether commercial activities performed by the government could be provided by the private sector in a more cost-effective manner.[1] This Administration's efforts build on those of the past by using a tailored approach to ensure competition is applied in a reasoned and responsible manner by each agency.

This report describes the Administration's three-pronged strategy for institutionalizing public-private competition as an effective and prudent management tool. This strategy features:

1. Agency-specific competition plans that --
   - are *customized,* based on considered research and sound analysis, to address the agency's mission and workforce mix; and
   - will be *continually refined* to reflect changed circumstances, improved insight into agency programs, and experiences with conducting competitions;
2. A dedicated infrastructure within each agency to promote sound and accountable decision making; and
3. Improved processes for the fair and efficient conduct of public-private competition.

I. The arguments for and against competitive sourcing

Critics of public-private competition argue that the benefits of competitive sourcing may be insufficient for agencies to pursue on a broad scale. Others, who fear that government providers cannot sustain the pressures of competition, assert that competitive sourcing will ultimately dismantle the workforce. The facts tell a much different story.

Public-private competition improves service delivery and decreases costs to taxpayers.

Both the public and private sectors have conducted independent studies to document the effects of public-private competition. Each has reached the same conclusion: subjecting in-house operations to competition consistently generates cost savings -- anywhere from 10-40 percent on average, regardless of whether the competition is won by a private contractor or the government.[2] The Department of Defense (DoD) alone projects savings of more than $6 billion from A-76 competitions completed from 2000 through 2003 involving approximately 73,000 positions. Studies also have cited improvements in service delivery.[3]

Savings of this magnitude make a compelling case for ensuring that resources are available for covering competitive sourcing activities. Historically, savings have far outweighed costs associated with competition. Costs are roughly estimated to be anywhere from $2,000 - $5,000 per position studied, but can be lower, and may, in some cases, be higher. Arguably, savings could increase as agencies gain experience and become more efficient in conducting public-private competition. DoD estimates long term savings of around $85,000 per position over 5 years.

Competitive sourcing is neither dismantling the workforce at large nor limiting future opportunities for federal service.

On average, the government wins just over 50% of public-private competitions. The government should continue to enjoy this level of success with the elimination of direct conversions and other procedural changes made to ensure more even-handed consideration of both sectors' capabilities (see section II.c., below).

Even when the commercial sector is chosen to perform the activity, there generally are only a small number of involuntary separations of federal employees -- 8% according to one study; 3.4% according to another.[4] The Department of the Interior (DOI), which has studied a significant number of commercial activities since the start of the Administration's competitive sourcing initiative, has experienced no involuntary employee separations. The percentage of involuntary separations should remain small. Nearly 40% of all federal workers will be eligible to retire by 2005, creating many new job opportunities across government. The Administration's human capital initiative is already helping agencies better train and retain a capable workforce.

II. Implementation of the competitive sourcing initiative

Past efforts to promote competitive sourcing have not brought about sustained use of public-private competition outside of DoD.[5] As a result, taxpayers have had to pay more for many commercial services they receive from the government. To institutionalize competitive sourcing, the Office of Management and Budget (OMB) has: (a) worked with each member agency of the President's Management Council and other

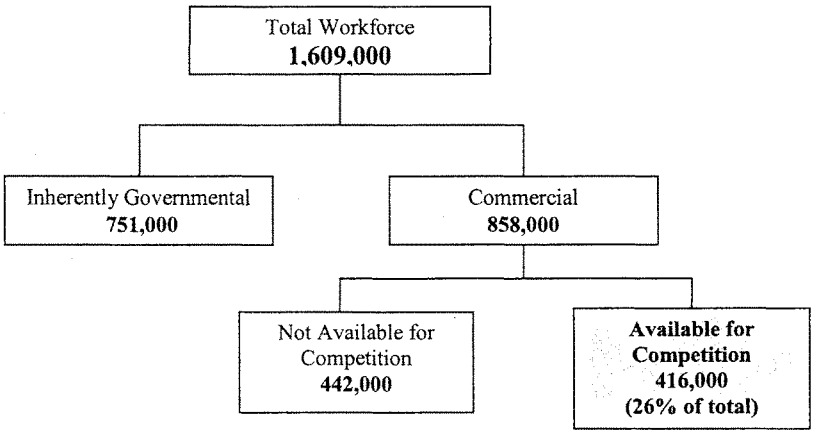
selected agencies to develop tailored plans for the application of competition to commercial activities performed by the government,[6] (b) required all agencies to designate a competitive sourcing official (CSO) and centralize oversight for public-private competition, and (c) improved processes for the conduct of public-private competitions.

a. *Customized competition plans.* Competition plans serve as a focal point for coordinated and considered preparations for public-private competitions. Agencies have built competition plans around: (i) a reasoned classification of their workforce, (ii) careful consideration of where competitive sourcing can best help their mission and workforce, and (iii) collaborative reviews with OMB.

i. Workforce inventories. Agencies are required to prepare annual inventories that categorize all activities performed by their government personnel as either commercial or inherently governmental. For commercial activities, agencies are further required to differentiate those available for competition from those that are not available for comparison with the private sector.[7]

In total, OMB estimates that approximately 26% of the workforce from agencies being tracked under the PMA are engaged in commercial activities that should be available for competition.

Figure 1. OMB Estimated Aggregate Workforce Profile of Agencies Being Tracked under the PMA



However, no two agencies are alike. In preparing inventories, agencies have been given considerable latitude to determine if a commercial activity is inappropriate for public-private competition. Agencies may take various factors into consideration to inform these determinations, such as the unavailability of private sector expertise,

preservation of core competencies, or need for confidentiality in support of senior level decision making. Through this process, agencies have reached very different conclusions regarding the extent to which their commercial activities should be made available for competition.[8]

Table 1. OMB Estimates of Commercial Activities at Select Agencies*

Agency	Total Workforce	Total # of Commercial Activities	Total # of Commercial Activities Available for Competition**	% of Total Workforce Available for Competition
USDA	98,500	46,500	35,600	36
ED	4,700	3,100	2,900	62
DOE	15,100	7,800	4,700	31
HHS	64,900	31,400	11,200	17
DOI	70,200	33,900	23,000	33

*The sample figures in this table represent a rough OMB estimate based on initial 2002 inventory submissions to OMB. OMB will provide information on all agencies being tracked in the PMA by 9/26/03.
**OMB anticipates that information from the agencies' 2003 inventories will allow for a more accurate assessment of commercial activities as a result of refinements made to the reason codes used for identifying whether an activity is available for competition.

ii. Agency analysis. Agencies have developed competition plans using their commercial inventories as a baseline. Specifically, agencies have considered, in a disciplined way, which of the commercial activities available for competition might benefit most from comparison with the private sector. Agency decisions have been informed by a wide variety of factors, including, but not limited to: workforce mix, attrition rates, capacity to conduct reviews, the percentage of service contracts, and the strength of the agency's contract management capabilities.

A comparison of sample customized plans, as set forth in Table 2., indicates that agencies are generally focusing use of public-private competition on commonly available routine commercial services where there are likely to be numerous capable and highly competitive private sector contractors worthy of comparison to agency providers. Equally important, Table 2. reveals that competition is being applied to different types of activities and in differing degrees. These disparities are neither surprising nor troubling, since they reflect each agency's best business judgment regarding how public-private competitions can enhance their mission's performance.

iii. OMB guidance and collaboration. To begin the process of opening commercial activities identified on workforce inventories to competition, OMB instructed agencies to complete competitions on 5 percent of these activities by the end of fiscal year 2001 and an additional 10 percent by the end of fiscal year 2003.[9] These figures were intended to ensure a level of commitment that would help institutionalize use of the tool within each agency. Agencies were given broad discretion to determine the types of commercial activities to be competed.

With experience, OMB recognized that its initial numerically-based directions were inadequate. The guidance provided no management incentives or disincentives, no process for evaluating progress, and no mechanism for interacting with the agencies to reinforce strengths and correct weaknesses. To address these concerns, OMB created scorecards to measure progress using a traffic-light (i.e., "red-yellow-green") grading system. OMB also committed to quarterly meetings with the agencies to discuss progress and provide assistance in the use of competitive sourcing as a management tool.

Under the scorecard approach, numerical mandates were converted to incentives: an agency would move from a "red" score to a "yellow" score if it completed competitions for 15% of the total commercial positions listed on their inventories. An agency would move from "yellow" to "green" status when it completed competition for 50% of the total commercial positions listed on their inventories.[10] The 50% figure was meant to ensure that the dynamics of competition would be brought to bear on a significant portion of commercial activities over time. Equally important, this figure also recognized that some commercial activities may not be suitable for competition, even in the long term. The management scorecard criteria set no time frame for reaching either the 15% or 50% goal.

Through individual interactions with the agencies to evaluate progress, OMB learned that baselines would need to vary based on mission needs and conditions unique to the agency. OMB reviewed all agency baselines and negotiated new baselines with a number of agencies. These negotiations, in combination with the continued broad discretion afforded to agencies to identify appropriate commercial activities, have allowed agencies to create customized plans for the successful application of public-private competition.

b. *Competitive Sourcing Official (CSO) and centralized oversight.* OMB requires agencies to designate a CSO to be responsible and accountable for competitive sourcing activities in the agency.[11] The organizational placement of the CSO is left to each individual agency.

OMB further requires agencies to centralize oversight responsibility.[12] Centralizing oversight responsibility will help to facilitate a wide range of activities, including:

- the development of inventories of commercial and inherently governmental activities;
- the determination of whether commercial activities are suitable for competition;
- the scheduling and preliminary planning of competitions, including the coordination of resources to support the agency provider;[13]
- the tracking of results; and
- information sharing within the agency so past experiences can inform future actions.[14]

Table 2. Sample Profiles of Agency Competition Plans*

Agency	# of Positions in Competition Plan**	Examples of Commercial Activities in Competition Plan***	Examples of Commercial Activities EXCLUDED from Competition Plan****
USDA	5,822	• data center activities • loan operations • administrative support • equipment operators • road maintenance • maintenance, repair, & minor construction of real property • fleet management services & motor vehicle maintenance	• data collection & analysis for regulatory and program management • program planning & support for regulatory and program management • systems design, support, & computer programming services • compliance operations for regulatory and program management • insurance analysis for regulatory and program management • food and drug testing and inspection services
ED	220	• human resources services • payment processing	• management evaluations/audits for investigations • performance audits for investigations • public affairs/relations
DOE	1,180	• information technology services • logistics • financial management • graphics • human resources / training	• maintenance, repair, & minor construction of real property • safety (environment) • engineering & technical services
HHS	2,510	• library services • building maintenance • grants administration support functions • graphic design	• medical & dental equipment repair and maintenance • biomedical research • management & support to research and development (R&D) • basic R&D • applied research
DOI	3,041	• maintenance, repair, & minor construction of real property • engineering & technical services • administrative support services • custodial services • natural resource services • motor vehicle operations • water data collection/analysis • automatic data processing systems design, development & programming services	• maintenance, repair, & minor construction of real property • general administrative support services • natural resource services • motor vehicle operations • voucher examination • historical or heraldry services

* OMB will provide information on all agencies being tracked in the PMA by 9/26/03.
**These figures reflect the number of positions that OMB and the agencies have agreed will be sufficient to justify a move to a "yellow" status on the management scorecard.
*** The listing of an activity in this column does not mean all agency positions dedicated to this activity are included in an agency's competition plan. An agency may opt to exclude some positions of an activity from its competition plan while including other positions performing the same activity in the plan based on the agency's consideration of the suitability of public-private competition.
*** *This list includes activities the agency has determined are commercial but not appropriate for private sector performance. It does not include commercial activities for which private sector performance is statutorily prohibited. (Nor does it include inherently governmental functions.)

c. *Improved processes for conducting public-private competitions.* OMB recently issued significant revisions to OMB Circular A-76, the guidelines agencies must use when conducting public-private competition. The revisions should ensure that public-private competition is used *strictly* as a tool to select the best available source, irrespective of the sector. The processes concentrate on results -- not the sector that provides the service -- so that agencies and the taxpayer may reap the full benefit of competition. The guidelines are intended to ensure a level playing field for public and private sector sources with incentives to devise the most effective means to provide needed services. Of particular note, the revised Circular:

- eliminates a long-standing policy that discouraged the government from competing with the private sector, even though the government might be able to provide better value to the taxpayer;
- ends the practice of converting work directly to private sector performance without considering agency capabilities (so-called "direct conversions");
- creates versatile streamlined competition processes to help agencies efficiently consider the capabilities of both sectors;
- imposes firewalls between certain participants to avoid the appearance of a conflict of interest and build public confidence in the process; and
- requires agencies to track results, including the actual cost of performance.[15]

At a recent Congressional hearing, the General Accounting Office stated that the revised Circular should result in better transparency, increased savings, improved performance, and greater accountability.[16]

III. <u>Next steps</u>

Effective implementation of the competitive sourcing initiative requires that both OMB and the agencies be prepared to continually refine plans, management structures, and strategies to reflect changed circumstances, improved insight into agency programs, and experiences with conducting competitions. To achieve long-term success, OMB is taking the following steps:

a. *New scorecard criteria.* OMB has modified the scorecard criteria. These refinements have been informed by discussions with and recommendations from the Congress. These new criteria should ensure that an agency's commitment to competitive sourcing is measured against targets that reasonably reflect its unique mission and circumstances, not arbitrary or artificial goals.

Under the new criteria agencies will receive a "yellow" status if they have:

- an OMB approved "yellow" competition plan to compete commercial activities available for competition;
- completed one standard competition or publicly announced standard competitions that exceed the number of positions identified for competition in the agency's "yellow" competition plan;

- in the past two quarters, completed 75% of streamlined competitions in a 90-day timeframe; and
- in the past two quarters, canceled less than 20% of publicly announced standard and streamlined competitions.

Agencies will receive a "green" status if they have:

- an OMB approved "green" competition plan to compete commercial activities available for competition;
- publicly announced standard competitions in accordance with the schedule outlined in the agency "green" competition plan;
- since January 2001, completed at least 10 competitions (no minimum number of positions required per competition);
- in the past year, completed 90% of all standard competitions in a 12-month time frame;
- in the past year, completed 95% of all streamlined competitions in a 90-day timeframe;
- in the past year, canceled fewer than 10% of publicly announced standard and streamlined competitions; and
- OMB-approved justifications for all categories of commercial activities exempt from competition.

b. *Additional interactions*. OMB and the agencies will monitor costs and results achieved. This information will be used to evaluate the effectiveness of competitive sourcing at each agency and devise additional strategies to address agency-unique implementation issues. With the assistance of the Federal Acquisition Council,[17] agencies will share lessons learned and best practices for addressing common issues. Using past experiences to inform future decision making will further ensure competitive sourcing is a fair and effective tool for improving the delivery of services to our citizens.

Notes

[1] The executive branch first addressed the performance of commercial activities by government agencies in 1955. See Bureau of the Budget Bulletin 55-4, Commercial-industrial activities of the Government providing products or services for governmental use (January 15, 1955). Policies addressing the performance of commercial activities are currently set forth in OMB Circular A-76. Since its original issuance in 1966, the Circular has been revised four times -- in 1967, 1979, 1983 and, just recently, in May 2003. In 1979, OMB issued a supplemental handbook to accompany the Circular, and subsequently revised it three times. In May, the handbook was rescinded and its contents were revised and incorporated in attachments to the Circular as part of OMB's efforts to streamline guidance on public-private competitions.

[2] DoD, which has, by far, the most extensive program for public-private competition, estimates savings of 33% on the roughly 3000 competitions it has conducted since 1979. Numerous sources outside the executive branch also have confirmed the benefits of public-private competition. See, e.g., *Long-Run Costs and Performance Effects of Competitive Sourcing*, Center for Naval Analysis, CRM D0002765.A2 (February 2001) (16 competitions yielded estimated effective savings of 34 percent through the life of the contracts); *Personnel Savings in Competitive Sourced Activities: Are They Real? Will They Last?*, National Defense Research Institute, RAND (2002) (expected savings for contractor wins ranged from 41-59 percent and for the government employees from 34-59 percent); *Moving Toward Market-Based Government: The Changing Role of Government as the Provider*, IBM Endowment for The Business of Government (June 2003) (the presence of competition creates the previously missing incentive for government providers to significantly improve processes that lower costs and increase performance); *COMPETITIVE SOURCING: Implementation Will Be Key to Success of New Circular A-76*, GAO-03-943T (June 26, 2003) (the new Circular should result in increased savings, improved performance, and greater accountability).

[3] See, e.g., *Moving Toward Market-Based Government: The Changing Role of Government as the Provider*, note 2 at 49-50.

[4] See, e.g., *DOD COMPETITIVE SOURCING: Effects of A-76 Studies on Federal Employees' Employment, Pay, and Benefits Vary*, GAO-01-388 (March 2001); *Case Studies in DoD Outsourcing*, Center for Naval Analysis Report, CAB96-62 (January 1997).

[5] In 1998, the GAO reported that Circular A-76 was seldom used in civilian agencies. See, *OMB CIRCULAR A-76: Oversight and Implementation Issues*, GAO/T-GGD-98-146 (June 4, 1998).

[6] Departments and agencies that are being evaluated under the competitive sourcing initiative include: (1) the Department of Agriculture (USDA), (2) the Department of Commerce, (3) DoD, (4) the Department of Education (ED), (5) the Department of Energy (DOE), (6) the Environmental Protection Agency, (7) the Department of Health and Human Services (HHS), (8) the Department of Homeland Security, (9) the Department of Housing and Urban Development, (10) DOI, (11) the Department of Justice, (12) the Department or Labor, (13) the Department of State, (14) the Department of Transportation, (15) the Department of the Treasury, (16) the Department of Veterans Affairs, (17) the Agency for International Development, (18) the Corps of Engineers, (19) the General Services Administration, (20) the National Aeronautics and Space Administration, (21) the National Science Foundation, (22) OMB, (23) the Office of Personnel Management, (24) the Small Business Administration, (25) the Smithsonian, and (26) the Social Security Administration.

[7] Requirements for preparing inventories are set forth in Attachment A of Circular A-76, as revised in May 2003, and include the requirements of the Federal Activities Inventory Reform Act of 1998, 31 U.S.C. § 501 note. The Circular provides "reason codes" for agencies to indicate the rationale for government performance of a commercial activity. For example, a statute may preclude performance by the private sector or the agency may have determined that performance by the private sector is inappropriate.

[8] Under Circular A-76, as revised, the agency must justify determinations that commercial activities are not appropriate for competition.

[9] See OMB Memorandum M-01-15, Performance Goals and Management Initiatives for the FY 2002 Budget (March 9, 2001). A copy is provided as Attachment A.

[10] A copy of the scorecard criteria defining red, yellow, and green status is provided as Attachment B.

[11] See paragraph 4.f. of OMB Circular A-76, as revised.

[12] See paragraph 4.h. of OMB Circular A-76, as revised.

[13] At the Internal Revenue Service (IRS), for instance, the CSO works extensively with the IRS business units in selecting candidate commercial activities to undergo a business case analysis to support a go/no-go decision on conducting a public-private competition. Pre-decisional documents are vetted with the business units prior to formal discussion with the IRS Executive Steering Committee, led by the IRS Commissioner. Decisions to proceed with public-private competitions are quickly shared in writing and verbally with the president of the employees union. The union is also briefed on the final business case. The CSO holds monthly competitive sourcing coordination group meetings to discuss progress for each competition. Participants include: project team leaders and representatives from human resources, communications and liaison, general legal services, and the employees union. This cross-functional representation helps to facilitate effective communication and a broad-based understanding of IRS' competitive sourcing activities.

[14] Sharing experiences should be especially helpful to government providers, who have the capability to be highly competitive but often lack the private sector's insight and experience in competing for work.

[15] For additional discussion about the revised Circular, see 64 FR 32134 (May 29, 2003).

[16] *COMPETITIVE SOURCING: Implementation Will Be Key to Success of New Circular A-76*, *supra* note 2.

[17] The Federal Acquisition Council provides a senior level forum for a diverse group of executive branch acquisition officials to monitor and improve the federal acquisition system through efforts that are aligned with the PMA. The Council promotes effective business practices to ensure the timely delivery of best value products and services to the agencies, achieve public policy objectives, and further integrity, fairness, competition, and openness in the federal acquisition system.

Attachment A

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DEPUTY DIRECTOR

March 9, 2001

M-01-15

MEMORANDUM FOR HEADS AND ACTING HEADS OF DEPARTMENTS AND AGENCIES

FROM: Sean O'Keefe
Deputy Director

SUBJECT: Performance Goals and Management Initiatives for the FY 2002 Budget

In accordance with the Director's memorandum, subject above, dated February 14, 2001, the Office of Management and Budget is providing additional guidance on the development of performance plans regarding the following reform initiatives:

1. Making greater use of performance-based contracts: For FY 2002, the Performance-Based Contracting (PBSC) goal is to award contracts over $25,000 using PBSC techniques for not less than 20 percent of the total eligible service contracting dollars. This goal is based on the goals established under the Government-Wide Acquisition Performance Measurement Program established by the Procurement Executives Council.

2. Expanding the application of on-line procurement: For FY 2002, agencies will post (a) all synopses for acquisitions valued at over $25,000 for which widespread notice is required and (b) all associated solicitations unless covered by an exemption in the Federal Acquisition Regulation on the government-wide point-of-entry website (www.FedBizOpps.gov). The President's commitment is to shift procurement to the Internet at the same rate as the private sector and to increase competition and accessibility.

3. Expanding A-76 competitions and more accurate FAIR Act inventories: For FY 2002, agencies will complete public-private or direct conversion competitions on not less than 5 percent of the FTEs listed on their Federal Activities Inventory Reform Act inventories. Agency plans will include the number of FTEs by function and location being competed, training requirements and planned contract support. The President's commitment is to open at least one-half of the Federal positions listed on the FAIR Act inventory of commercial functions to competition with the private sector.

Agency plans should outline how the agency intends to meet these goals. If the agency does not believe that it will achieve these goals within the FY 2002 Budget time-frame, the agency should describe the actions they intend to take in order to mitigate this problem. Agencies should provide a time-line showing when it expects to achieve this FY 2002 Budget goal.

The Office of Federal Procurement Policy staff is ready to work with you as you prepare these plans and coordinate your budget impacts, if any, with your budget examiners.

Attachment B

Competitive Sourcing
Original Scorecard Criteria

GREEN	YELLOW	RED
Must Meet All Core Criteria: Completed public-private or direct conversion competition on not less than 50 percent of the full-time equivalent employees listed on the approved FAIR Act inventories. Competitions and direct conversions conducted pursuant to approved competition plan. Commercial reimbursable support service arrangements between agencies are competed with the private sector on a recurring basis.	Achievement of Some but not All Core Criteria; No Red Conditions.	Has Any One of the Following Conditions: Completed public-private or direct conversion competition on less than 15 percent of the full-time equivalent employees listed on the approved FAIR Act inventories. Competitions and direct conversions are not conducted in accordance with approved competition plan. No commercial reimbursable support service arrangements between agencies are competed with the private sector.

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, Committee on Governmental Affairs, U.S. Senate

For Release on Delivery
Expected at 9:30 a.m. EDT
July 24, 2003

COMPETITIVE SOURCING

Implementation Will Be Challenging for Federal Agencies

Statement of David M. Walker
Comptroller General of the United States

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Highlights

Highlights of GAO-03-1022T, a testimony before the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia, Committee on Governmental Affairs, U.S. Senate

Why GAO Did This Study

In May 2003, the Office of Management and Budget (OMB) released a revised Circular A-76, which represents a comprehensive set of changes to the rules governing competitive sourcing—one of five governmentwide items in the President's Management Agenda. Determining whether to obtain services in-house or through commercial contracts is an important economic and strategic decision for agencies, and the use of Circular A-76 is expected to grow throughout the federal government.

In the past, however, the A-76 process has been difficult to implement, and the impact on the morale of the federal workforce has been profound. Concerns in the public and private sectors were also raised about the timeliness and fairness of the process for public-private competitions.

It was against this backdrop that the Congress enacted legislation mandating a study of the A-76 process, which was carried out by the Commercial Activities Panel, chaired by the Comptroller General of the United States.

This testimony focuses on how the new Circular addresses the Panel's recommendations reported in April 2002, the challenges agencies may face in implementing the new Circular A-76, and the need for effective workforce practices to help ensure the successful implementation of competitive sourcing in the federal government.

www.gao.gov/cgi-bin/getrpt?GAO-03-1022T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William T. Woods at (202) 512-8214 or woodsw@gao.gov.

COMPETITIVE SOURCING

Implementation Will Be Challenging for Federal Agencies

What GAO Found

The revised Circular A-76 is generally consistent with the Commercial Activities Panel's principles and recommendations, and should provide an improved foundation for competitive sourcing decisions in the federal government. In particular, the new Circular permits greater reliance on procedures in the Federal Acquisition Regulation—which should result in a more transparent and consistently applied competitive process—as well as source selection decisions based on trade-offs between technical factors and cost. The new Circular also suggests the potential use of alternatives to the competitive sourcing process, such as public-private and public-public partnerships.

However, implementing the new Circular will likely be challenging for many agencies. Foremost among the challenges that agencies face is setting and meeting appropriate goals integrated with other priorities, as opposed to arbitrary quotas. Additionally, there are potential issues with the streamlined cost comparison process and protest rights. The revised streamlined process lacks a number of key features designed to ensure that agency sourcing decisions are sound, including the absence of an appeal process. Finally, the right of in-house competitors to file a bid protest at GAO challenging the sourcing decisions in favor of the private sector remains an open question.

For many agencies, effective implementation will depend on their ability to understand that their workforce is their most important organizational asset. Agencies will need to aid their workforce in transitioning to a competitive sourcing environment. For example, agencies will need a skilled workforce and adequate infrastructure and funding to manage competitions; to prepare the in-house offer; and to oversee the cost, quality, and performance of whichever service provider is selected.

Guiding Principles for Sourcing Policy

Federal sourcing policies should:

1. Support agency missions, goals, and objectives.
2. Be consistent with human capital practices designed to attract, motivate, retain, and reward a high-performing federal workforce.
3. Recognize that inherently governmental and certain other functions should be performed by federal workers.
4. Create incentives and processes to foster high performing, efficient, and effective organizations throughout the federal government.
5. Be based on a clear, transparent, and consistently applied process.
6. Avoid arbitrary full-time equivalent or other arbitrary numerical goals.
7. Establish a process that, for activities that may be performed by either the public or the private sector, would permit public and private sources to participate in competitions for work currently performed in-house, work currently contracted to the private sector, and new work, consistent with these guiding principles.
8. Ensure that, when competitions are held, they are conducted as fairly, effectively, and efficiently as possible.
9. Ensure that competitions involve a process that considers both quality and cost factors.
10. Provide for accountability in connection with all sourcing decisions.

Chairman Voinovich, Ranking Member Durbin, and Members of the Subcommittee:

I am pleased to be here today to participate in the subcommittee's hearing on competitive sourcing, one of five governmentwide initiatives in the President's Management Agenda. The Office of Management and Budget (OMB) recently released a new Circular A-76, which represents the most comprehensive set of changes to the rules governing competitive sourcing since the initial Circular A-76 was issued in 1966. As agencies implement the revised Circular and the initiative outlined in the President's Management Agenda, they will need to develop strategies to address the challenges they inevitably will face in implementing this significant change in their operations.

Today's hearing occurs at a critical and challenging time for federal agencies. They operate in an environment in which new security threats, demographic changes, rapidly evolving technologies, increased pressure for demonstrable results, and serious and growing fiscal imbalances demand that the federal government engage in a fundamental review, reassessment, and reprioritization of its missions and operations. Federal agencies are increasingly relying on enhanced technology and a range of technical and support services to accomplish their missions. Consequently, it is important for agencies to consider how best to acquire and deliver such capabilities—including, in some cases, who the service provider should be.

Determining whether to obtain services in-house, through contracts with the private sector, or through a combination of the two—in other words, through insourcing, outsourcing, or, in some cases, cosourcing—is an important economic and strategic decision for agency managers. In the past, however, the government's competitive sourcing process—set forth in OMB Circular A-76—has been difficult to implement. The impact of the A-76 process on the morale of the federal workforce has been profound, and there have been concerns in both the public and private sectors about the timeliness and fairness of the process and the extent to which there is a "level playing field" for conducting public-private competitions. While Circular A-76 competitions historically have represented only a small portion of the government's service contracting dollars, competitive sourcing is expected to grow throughout the federal government.

It was against this backdrop that the Congress enacted legislation mandating a study of the government's competitive sourcing process.[1] This study was carried out by the Commercial Activities Panel, which I chaired. My comments today will focus on how the new Circular addresses the Panel's recommendations with regard to providing a better foundation for competitive sourcing decisions and the challenges that agencies may face in implementing the new Circular A-76. I will also highlight the need for effective workforce practices to help ensure successful implementation of competitive sourcing.

New Circular Provides an Improved Foundation for Competitive Sourcing Decisions

In April 2002, following a yearlong study, the Commercial Activities Panel reported its findings on competitive sourcing in the federal government. The report lays out 10 sourcing principles and several recommendations, which provide a road map for improving sourcing decisions across the federal government. Overall, the new Circular is generally consistent with these principles and recommendations.

The Commercial Activities Panel held 11 meetings, including three public hearings in Washington, D.C.; Indianapolis, Indiana; and San Antonio, Texas. At these hearings, the Panel heard repeatedly about the importance of competition and its central role in fostering economy, efficiency, and continuous performance improvement. Panel members heard first-hand about the current process—primarily the cost comparison process conducted under OMB Circular A-76—as well as alternatives to that process. Panel staff conducted extensive additional research, review, and analysis to supplement and evaluate the public comments. Recognizing that its mission was complex and controversial, the Panel agreed that a supermajority of two-thirds of the Panel members would have to vote for any finding or recommendation in order for it to be adopted. Importantly, the Panel unanimously agreed upon a set of 10 principles it believed should guide all administrative and legislative actions in competitive sourcing. The Panel itself used these principles to assess the government's existing sourcing system and to develop additional recommendations.

[1] Section 832, Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, P.L.106-398 (Oct. 30, 2000).

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9. Ensure that competitions involve a process that considers both quality and cost factors.
10. Provide for accountability in connection with all sourcing decisions.

A supermajority of the Panel agreed on a package of additional recommendations. Chief among these was a recommendation that public-private competitions be conducted using the framework of the Federal Acquisition Regulation (FAR). Although a minority of the Panel did not support the package of additional recommendations, some of these Panel members indicated that they supported one or more elements of the package, such as the recommendation to encourage high-performing organizations (HPO) throughout the government. Importantly, there was a good faith effort to maximize agreement and minimize differences between Panel members. In fact, changes were made to the Panel's report and recommendations even when it was clear that some Panel members seeking changes were highly unlikely to vote for the supplemental package of recommendations. As a result, on the basis of Panel meetings and my personal discussions with Panel members at the end of our deliberative process, I believe the major differences between Panel members were few in number and philosophical in nature. Specifically, disagreement centered primarily on (1) the recommendation related to the role of cost in the new FAR-type process and (2) the number of times the Congress should be required to act on the new FAR-type process, including whether the Congress should authorize a pilot program to test that process for a specific time period.

As I noted previously, the new Circular A-76 is generally consistent with the Commercial Activities Panel's sourcing principles and recommendations and, as such, provides an improved foundation for competitive sourcing decisions in the federal government. In particular, the new Circular permits:

- greater reliance on procedures contained in the FAR, which should result in a more transparent, simpler, and consistently applied competitive process, and
- source selection decisions based on trade-offs between technical factors and cost.

The new Circular also suggests the potential use of alternatives to the competitive sourcing process, such as public-private and public-public partnerships and high-performing organizations. It does not, however, specifically address how and when these alternatives might be used.

If effectively implemented, the new Circular should result in increased savings, improved performance, and greater accountability, regardless of the service provider selected. However, this competitive sourcing initiative is a major change in the way government agencies operate, and successful implementation of the Circular's provisions will require that adequate support be made available to federal agencies and employees, especially if the time frames called for in the new Circular are to be achieved.

Challenges in Implementing Competitive Sourcing

Implementing the new Circular A-76 will likely be challenging for many agencies. Our prior work on acquisition, human capital, and information technology management—in particular, our work on the Department of Defense's (DOD) efforts to implement competitive sourcing[2]—provides a strong knowledge base from which to anticipate challenges as agencies implement this initiative.

[2] U.S. General Accounting Office, *Best Practices: Taking a Strategic Approach Could Improve DOD's Acquisition of Services*, GAO-02-230 (Washington, D.C.: Jan. 18, 2002); U.S. General Accounting Office, *Information Technology: DOD Needs to Leverage Lessons Learned from Its Outsourcing Projects*, GAO-03-37 (Washington, D.C.: Apr. 25, 2003); U.S. General Accounting Office, *A Model of Strategic Human Capital Management*, GAO-02-373SP (Washington, D.C.: Mar. 15, 2002); and U.S. General Accounting Office, *Acquisition Workforce: Status of Agency Efforts to Address Future Needs*, GAO-03-55 (Washington, D.C.: Dec. 18, 2002).

Foremost among the challenges that agencies face is setting and meeting appropriate goals that are integrated with other priorities. Quotas and arbitrary goals are inappropriate. Sourcing goals and targets should contribute to mission requirements and improved performance and be based on considered research and sound analysis of past activities. Agencies will need to consider how competitive sourcing relates to the strategic management of human capital, improved financial performance, expanded reliance on electronic government, and budget and performance integration, consistent with the President's Management Agenda. At the request of Senator Byrd and this subcommittee, we recently initiated work to look at how agencies are implementing their competitive sourcing programs. Our work is focused on goal setting and implementation strategies at several large agencies.

DOD has been at the forefront of federal agencies in using the A-76 process and, since the mid-to-late 1990s, we have tracked DOD's progress in implementing its A-76 program. The challenges we have identified hold important lessons that civilian agencies should consider as they implement their own competitive sourcing initiatives.[3] Notably:

- competitions took longer than initially projected,
- costs and resources required for the competitions were underestimated,
- selecting and grouping functions to compete were problematic, and
- determining and maintaining reliable estimates of savings were difficult.

DOD's experience also indicates that agencies will have difficulties in meeting the time frames set out in the new Circular for completing the standard competition process. Those time frames are intended to respond to complaints from all sides about the length of time taken to conduct A-76 cost comparisons—complaints that the Panel repeatedly heard in the course of its review. The new Circular states that standard competitions shall not exceed 12 months from public announcement (start date) to performance decision (end date), with certain preliminary planning steps to be completed before a public announcement. Under certain conditions, there may be extensions of no more than 6 months. We welcome efforts to reduce the time required to complete these studies. Even so, our studies of DOD's competitive sourcing have found that competitions can take much longer than the time frames outlined in the

[3] U.S. General Accounting Office, *Competitive Sourcing: Challenges in Expanding A-76 Governmentwide*, GAO-02-498T (Washington, D.C.: Mar. 6, 2002).

new Circular. Specifically, DOD's most recent data indicate that competitions have taken, on average, 25 months. It is not clear, however, how much of this time was needed for any planning that may now be outside the revised Circular's time frame. In commenting on OMB's November 2002 draft proposal, we recommended that the time frame be extended to perhaps 15 to 18 months overall, and that OMB ensure that agencies provide sufficient resources to comply with Circular A-76. In any case, we believe that additional financial and technical support and incentives will be needed for agencies as they attempt to meet these ambitious time frames.

Finally, federal agencies and OMB will be challenged to effectively share lessons learned and establish sufficient guidance to implement certain A-76 requirements. For example, calculating savings that accrue from A-76 competitions, as required by the new Circular, will be difficult or may be done inconsistently across agencies without additional guidance, which will contribute to uncertainties over savings.

Potential Issues with Streamlined Cost Comparison Process

The prior version of Circular A-76 provided for a streamlined cost comparison process for activities with 65 or fewer full-time equivalent (FTE) employees. Although the revised Circular also provides for a streamlined process at comparable FTE levels, the revised streamlined process lacks a number of key features designed to ensure that agencies' sourcing decisions are sound.

First, the prior version of the Circular contained an express prohibition on dividing functions so as to come under the 65-FTE limit for using a streamlined process. The revised Circular contains no such prohibition. We are concerned that in the absence of an express prohibition, agencies could arbitrarily split activities, entities, or functions to circumvent the 65-FTE ceiling applicable to the streamlined process. Second, the 10 percent conversion differential[4] under the prior Circular has been removed for streamlined cost comparisons. The Panel viewed this differential as a reasonable way to account for the disruption and risk entailed in converting between the public and private sectors. Third, the streamlined process requires an agency to certify that its performance

[4] The conversion differential is the lesser of 10 percent of the most efficient organization's personnel-related costs or $10 million over all the performance periods stated in the solicitation. The conversion differential is added to the cost of performance by a nonincumbent source.

decision is cost-effective. It is not clear from the revised Circular, however, whether the term "cost-effective" means the low-cost provider or whether other factors may be taken into account (such as the disruption and risk factors previously accounted for through the 10 percent conversion differential).

Finally, the revised Circular has created an accountability gap by prohibiting all challenges to streamlined cost comparisons. Under the prior Circular, both the public and the private sectors had the right to file appeals to ad hoc agency appeal boards. That right extended to all cost comparisons, no matter how small or large (and to decisions to waive the A-76 cost comparison process). The new Circular abolishes the ad hoc appeal board process and instead relies on the FAR-based agency-level protest process for challenges to standard competitions, which are conducted under a FAR-based process. While we recognize that streamlined cost comparisons are intended to be inexpensive, expeditious processes for relatively small functions, we are nonetheless concerned that the absence of an appeal process may result in less transparency and accountability.

Protest Rights

Another accountability issue relates to the right of in-house competitors to challenge sourcing decisions in favor of the private sector—an issue that the Commercial Activities Panel addressed in its report. While both the public and the private sectors could file appeals to the ad hoc agency appeal boards under the prior Circular, only the private sector had the right, if dissatisfied with the ruling of the agency appeal board, to file a bid protest at GAO or in court. Under the previous version of the Circular, both GAO and the Court of Appeals for the Federal Circuit held that federal employees and their unions were not "interested parties" with the standing to challenge the results of A-76 cost comparisons. The Panel heard many complaints from federal employees and their representatives about this inequality in protest rights. The Panel recommended that, in the context of improving the federal government's process for making sourcing decisions, a way be found to level the playing field by allowing in-house entities to file a protest at GAO, as private-sector competitors have been allowed to do. The Panel noted, though, that if a decision were made to permit the public-sector competitor to protest A–76 procurements, the question of who would have representational capacity to file such a protest would need to be carefully considered.

An important legal question is whether the shift from the cost comparisons under the prior Circular to the FAR-like standard competitions under the

new one means that the in-house most-efficient organization (MEO) should now be found eligible to file a bid protest at GAO. If the MEO is allowed to protest, there is a second question: Who will speak for the MEO and protest in its name? To ensure that our legal analysis of these questions benefits from input from everyone with a stake in this important area, GAO posted a notice in the *Federal Register* on June 13, 2003, seeking public comment on these and several related questions. Responses were due July 16, and we are currently reviewing the more than 50 responses that we received from private individuals, Members of Congress, federal agencies, unions, and other organizations. We intend to reach a conclusion on these important legal questions in the coming weeks.

Effective Human Capital Practices Will Be Key to Successful Implementation of Competitive Sourcing

For many agencies, effective implementation of the new Circular will depend on their ability to understand that their workforce is their most important organizational asset. Recognizing this, the Panel adopted a principle stipulating that sourcing and related policies be consistent with human capital practices that are designed to attract, motivate, retain, and reward a high-performing workforce. Conducting competitions as fairly, effectively, and efficiently as possible requires sufficient agency capacity—that is, a skilled workforce and adequate infrastructure and funding.

Agencies will need to build and maintain capacity to manage competitions, to prepare the in-house MEO, and to oversee the work—regardless of whether the private sector or MEO is selected. Building this capacity is important, particularly for agencies that have not been heavily invested in competitive sourcing previously. Agencies must manage this effort while addressing high-risk areas, such as human capital and contract management. In this regard, GAO has listed contract management at DOD, the National Aeronautics and Space Administration, the Department of Housing and Urban Development, and the Department of Energy as an area of high risk. With a likely increase in the number of public-private competitions and the requirement to hold accountable whichever sector wins, agencies will need to ensure that they have an acquisition workforce sufficient in numbers and abilities to manage the cost, quality, and performance of the service provider.

In our prior work—notably in studying the lessons that state and local governments learned in conducting competitions and in private-sector outsourcing of information technology services—we found that certain strategies and practices can help ensure the success of workforce

transitions when deciding who should provide the services they perform.[5] In general, these strategies recognized that the workforce defines an organization's character, affects its capacity to perform, and represents its knowledge base. When an agency's leadership is committed to effective human capital management, they view people as assets whose value can be enhanced through investments.

Agencies can aid their workforce in transitioning to a competitive sourcing environment if they:

- ensure employee involvement in the transition process; for example, by clearly communicating to employees what is going to happen and when it is going to happen;
- provide skills training for either competing against the private sector or monitoring contractor performance;
- create a safety net for displaced employees to bolster their support for the changes as well as to aid in the transition to a competitive environment, such as offering workers early retirement, severance pay, or a buyout;
- facilitate the transition of staff to the private sector or reimbursable provider when that is their choice and assist employees who do not want to transfer to find other federal jobs; and
- develop employee retention programs and offer bonuses to keep people where appropriate.

Recognizing the workforce as an asset also requires agency officials to view competitive sourcing—whether it results in outsourcing, insourcing, or cosourcing—as a tool to help ensure we have the right people providing services in an effective and efficient manner. The Panel recommended that employees should receive technical and financial assistance, as appropriate, to structure the MEO, to conduct cost comparisons, and to create HPOs. However, it is unclear whether agencies will have adequate financial and technical resources to implement effective competitive sourcing programs or make needed improvements.

The administration has proposed the creation of a governmentwide fund for performance-based compensation. However, most federal agencies lack modern, effective, credible, and validated performance management systems to effectively implement performance-based compensation

[5] U.S. General Accounting Office, *Privatization: Lessons Learned by State and Local Governments*, GAO/GGD-97-48 (Washington, D.C. Mar. 14, 1997); GAO-02-230; and GAO-03-37.

approaches. Importantly, a clear need exists to provide assistance both to government employees to create MEOs that can compete effectively and to agencies to promote HPOs throughout the federal government, especially in connection with functions, activities, and entities that will never be subject to competitive sourcing. Assistance is also needed in helping to create the systems and structures needed to support the effective and equitable implementation of more performance-based compensation approaches. As a result, we believe consideration should be given to establishing a governmentwide fund that would be available to agencies, on the basis of a business case, to provide technical and financial assistance to federal employees to develop MEOs and for creating HPOs, including the creation of modern, effective, and credible performance management systems.

Conclusion

While the new Circular provides an improved foundation for competitive sourcing decisions, implementing this initiative will undoubtedly be a significant challenge for many federal agencies. The success of the competitive sourcing program will ultimately be measured by the results achieved in terms of providing value to the taxpayer, not the size of the in-house or contractor workforce or the number of positions competed to meet arbitrary quotas. Successful implementation will require adequate technical and financial resources, as well as sustained commitment by senior leadership to establish fact-based goals, make effective decisions, achieve continuous improvement based on lessons learned, and provide ongoing communication to ensure that federal workers know and believe that they will be viewed and treated as valuable assets.

Mr. Chairman, this concludes my statement. I will be happy to answer any questions you or other Members of the subcommittee may have.

Competitive Sourcing: What the Data Actually Show

Testimony for the Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia

July 24, 2003

By: The Honorable Jacques S. Gansler[1]
Professor and Roger C. Lipitz Chair
Center for Public Policy and Private Enterprise
School of Public Affairs
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Thank you for inviting me here today to talk with you about "competitive sourcing." I would like to begin by complementing Senator Voinovich and the rest of the Subcommittee for focusing on the critical issue of the government workforce; an important, complex, and somewhat controversial aspect of the competitive sourcing debate.

I believe everyone here can agree that the government needs a high-performance, high-quality workforce for the 21st century. The question is, will competitive sourcing help or hurt that objective? It is my personal belief that it will help. In fact, as I will point out (based on the evidence to date) competitive sourcing will greatly assist in improving the performance of the government workforce and get it on a path to becoming "world-class." And, as we improve the efficiency and effectiveness of the government, we will also create a challenging environment that attracts and retains employees that take pride in knowing they are the best, and who strive to provide outstanding, and continuously improving, service.

Unfortunately, today many federal employees view "competitive sourcing" as a personal assault—an accusation that they are incompetent, lazy, and only interested in secure, life-long employment. Anyone who has spent any time as a manager in the federal bureaucracy knows that nothing is further from the truth. I have spent most of my adult life either working with government civilians, as a defense contractor, or supervising them, as a senior Department of Defense official. Although the pool of employees is large and their performance spectrum broad, most federal employees are well-educated, dedicated, hardworking, and very loyal. "Competitive sourcing" is not an attack on federal employees; it is an attack on a system that encourages government organizations to maintain a monopoly over a service sector. And, whenever a monopoly

[1] Dr. Gansler was Undersecretary of Defense (Acquisition, Technology, & Logistics) from 1997 to 2001.

exists, innovation and improvement are discouraged, and perverse incentives are often created—such as, managers not being rewarded for performing tasks better, and with less people or with smaller budgets. In fact, the traditional bureaucracy actually encourages growth in organizations and budgets. The missing ingredient is competition!

The objective of "competitive sourcing" is not to punish employees or enrich contractors. The objective is to introduce competition into government service and incentivize government mangers and organizations to become more effective and efficient. The ultimate goal is to make government as effective and efficient as possible. I believe we can do that, and do it in such a way as to keep the adverse impacts to the employees at a minimum.

In the private sector—where continuous competition is the norm—top-performing employees strive to be hired by, and be retained by, the top performing companies. The objective in the public sector must be to attract and retain such people by making the government a "high performance" organization.

Yet, while the evidence overwhelmingly demonstrates—from literally thousands of examples—that (when properly done) "competitive sourcing" really works (to get higher performance at lower costs; regardless of whether the winner of the competition is the public sector or the private sector); we still continue to hear that "it is an attack on loyal, hardworking civil servants." And, we continue to hear (from those opposed to competitive sourcing) that "there is nothing to show that it can be done better or cheaper through competitive sourcing," or that "there is no data that show any benefits from competitive sourcing." But there actually has been an abundance of data generated; it just hasn't been made widely available.

Recently, I issued a report on this existing data.[2] What I found first, was that there is much confusion between competitive sourcing, outsourcing, privatization, public-private partnerships and government inter-service support agreements (franchising). For example, competitive sourcing is not outsourcing or privatization (as it is frequently misrepresented in the press and by those who oppose it). In fact the public sector has won 40 to 60 percent of the full competitions (depending on which data are selected)—and approximately 98 percent of the "streamlined" ones.

To summarize the overall results actually found, based on over 2,000 cases in the Department of Defense alone, plus hundreds of others at federal, state, and local level—when competitive sourcing is done right (and I'll explain that in a few minutes)—the performance improves significantly and costs go down by an average of over 30 percent. And, this result is true whether the winner is the government or the private sector! This is important to understand—even when the award stays within the government the performance improves and the costs go down. This is due to the shift from a monopoly

[2] *Moving Toward Market Based Government: The Changing role of Government as the Provider*, published by The IBM Endowment for the Business of Government, Washington, D.C., June 2003, available at http://www.businessofgovernment.org/publications.

environment to a competitive one. The incentives created by competition are what make the difference.

There are basically 6 arguments given against this shift in how the government provides services, i.e. a shift from a monopoly supplier to a competitive environment of some form (whether it be public/private competition, competitive outsourcing, competitive privatization, or competitive public/private partnerships)—and, the empirical data clearly refute all 6 of these traditional arguments!

Argument 1: *Performance will deteriorate; since industry will focus on profits not public needs;* or, *since the government is more experienced at these jobs, they are already being done as well as possible.*

But the data—at federal, state, and local levels—as verified by the GAO, think tanks, academics, and the government itself, overwhelmingly say the performance improves dramatically—whether it is measured as "customer satisfaction," system reliability, on-time delivery, or whatever. These are measured results (comparing before and after performances).

Argument 2: *Costs will be higher since government employees are paid less than industry, and the government doesn't have to add a fee.*

Again, the verified comparative costs actually show an average savings of over 30%. And, this has been shown not to be due to low individual hourly rates, but due to productivity gains from process changes (as driven by competitive forces)—using significantly fewer people, but often at higher individual hourly rates.

Argument 3: *Sure, they [contractors]will promise cost savings; but, after award, the costs will rise and the promised savings will not be realized.*

By contrast, independent studies (by the GAO, The Center for Naval Analysis, RAND, and others) have all found that (again, when the competition is done properly) when a private sector firm won the competition, the savings promised were actually realized at the end of the contract period. However, when a government organization wins the competition there have been problems. Specifically, it has often been difficult to identify overall government costs (especially overhead)—either before award or after performance achievement. However, head counts (before and after) can be compared, and they generally do match the reduced numbers in the bids. Future government cost visibility, however, would obviously be highly desirable.

Argument 4: *Small businesses will be negatively impacted, since the jobs will be "bundled" to make a larger award.*

In fact, the data show that small businesses do extremely well. For example: between 1995 and 2001, DoD conducted 784 public/private competitions—and 79 percent of all those awarded as contracts went to small businesses. Additionally, with regard to "bundling," since the data clearly show that combining a significant number of tasks into one larger one allows more re-engineering of the processes, which results in

greater performance improvements at much lower costs—so it should be done. But, small business requirements for subcontracts in these large awards can be made even more significant to the small businesses. For example, the outsourcing of the Navy/Marine Corps Intranet and the National Security Agency Information Technology Infrastructure—both multi-billion dollar awards—each had a 35 percent small business requirement.

Argument 5: *A large number of government workers will be involuntarily separated— no matter who wins the award.*

This area was one of the surprises that came from looking at the actual results. As I noted, even when the government wins, the data show a 20 to 40 percent reduction in staff. However, the independent studies of this show actual involuntary separation only in single digits— ranging from one study that found 8 percent; to another that found 3 percent; and even some at 0 percent. This low rate of involuntary separation is due to a combination of transfers to other government positions, retirements, and voluntary separations—often to the jobs created with the winning company. Clearly, this issue of the workforce is an important area, and it should be a major consideration in both the request-for-proposal and the ensuing competition.

Thoughtful planning can result in a true win-win situation for both the employees and the government—even if the previously-government work is contracted out. For example, the Army had historically maintained a group of 400 workers to support an antiquated (Cobol-based) legacy logistics information system at computer software centers in St. Louis, MO, and Chambersburg, PA. When the Army made the decision to upgrade to a commercial-off-the-shelf software package it only made sense to outsource the support. One condition the Army set was that the winning contractor would have to hire 100 percent of the displaced employees for at least one year, as well as agree to train these workers in a modern software language (e.g., C++). These employees would be used to maintain the legacy system during the transition, and then, with their up-to-date training, they would be more valuable to the contractor, (or to any other contractor). Thus, a win-win situation was created; the Army upgraded its logistics capability and the employees subsequently testified that they were also extremely pleased with the outcome. Using these kinds of creative solutions can minimize the negative impacts on the civilian workforce.

Argument 6: *Surveys show that the number one fear of the government managers is that there will be a significant loss of control as a result of contracting out some of their work.*

Although perhaps not intuitive, in a competitive environment the government managers actually have far greater control—again, no matter who wins! If the government wins, it is now required to keep performance and cost metrics; along with the potential for competition in 3 to 5 years—in order to keep pressure on the government workforce for continuous productivity gains. And, if the contractor wins, the government manager has full control and visibility into performance and cost, and can terminate the contract if dissatisfied (something the manager can't do with the civil-service workforce).

Steven Goldsmith, when he was Mayor of Indianapolis, stated he had far greater control as a result of introducing competitive sourcing then he ever had before (with government monopolies).

In summary, the actual data refute all of the traditional arguments against competitive sourcing. However, based on the many examples in my report, there are five key principles that must be followed for success.

1. The most important key to success is shifting from a monopoly to a competitive environment. It is not a question of public workers or private sector workers! It is the incentives introduced to either workforce by competition (a private monopoly is equally poor at innovation and cost reduction as a public sector monopoly). And, competition need not be automatic. If the winner of the prior competition continues to improve performance and lower costs—then don't re-compete. But the potential for competition must always be present!

2. The competition must be for "Best Value," not simply low cost. The objective must be increasing performance at lower and lower cost—the combination is critical. Otherwise, you just get "cheap" labor and minimal (at best) performance. In my opinion, "minimally acceptable services are not acceptable." And, we must use "performance-based, service contracts"—something the government is increasingly learning to do.

3. Even when the government contracts out the work to be performed it does not give up any of its management responsibilities. This has been a recurring problem in government service contracts. The government must monitor contractor performance and costs—this is its oversight function. If there are problems, it is just as much the government manager's responsibility as the contractor's.

4. Critical performance and cost metrics must be mutually agreed to at the beginning, and monitored and reported throughout the program—and they must be output oriented/ results oriented (not input oriented). These metrics should be compared to both historic performance and cost data, as well as to "best practices" (benchmarks) in order to show continuously improving trends. For the government (when they win) this may require introducing some form of both output measures and activities-based costing—but that's desirable anyway!

5. Government must aggressively provide the training necessary to reshape and sustain its workforce, and to help overcome their natural resistance to the changes that competitive sourcing brings. Increasing the visibility of the results achieved and the best practices for achieving them would help gain wider acceptance and understanding of the benefits that come from a shift away from monopoly government operations for all of those functions that are not "inherently governmental." Additionally, government managers and senior leaders need education and training to expand their management skills to prepare them for their new roles in a more market-based government.

Let me end with an example of successful competitive sourcing—one in which the government workforce was the winner. It was for a large A-76 competition at Offutt Air Force Base, Nebraska, covering 1,459 jobs (including aircraft maintenance, hazardous waste management, cargo transportation, real estate management, and base communications). A group of in-house employees came up with a workforce restructuring plan that would cut 58 percent in annual manpower costs alone—a savings of nearly $46 million annually. The contractor's bid came in with a savings of 42 percent, so the work remained in the government. Since most of the original jobs were being performed by military personnel, they either retired or were reassigned. No civilians lost their jobs. Also, since this award was made in March of last year, preliminary performance results are starting to come in. In one area, jet engine repairs (which is the biggest impact on Air Force readiness and highest cost area in the DoD), had previously been staffed with 10 workers and had a 68 day turnaround for jet engine overhaul. The government workforce in this unit is now down to 5, and the repair turnaround time has been cut to 28 days. In this case, competition resulted in very significant performance improvement (over 50 percent) at half the costs![3]

In conclusion, the President has made "competitive sourcing" one of his top five management initiatives; and OMB has taken steps to improve the process (with the new release of A-76)—now we must apply "best practices" to doing it. If we do, we should get significantly improved performances at greatly reduced costs; as well as fulfilled employees working up to their full potential! That's a goal, I believe we can all support.

[3] Cahlink, G., "Defense has much at stake in job competition push," Government *Executive*, Daily Brief, July 11, 2003, viewed at http://www.govexec.com/dailyfed/0703/071103nj1.htm.

NEW WAYS TO MANAGE SERIES

Moving Toward Market-Based Government: The Changing Role of Government as the Provider

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FOREWORD

June 2003

On behalf of the IBM Endowment for The Business of Government, we are pleased to present this report by Jacques S. Gansler, "Moving Toward Market-Based Government: The Changing Role of Government as the Provider."

In this important report, Professor Gansler attempts to clarify the somewhat muddled debate currently under way across the nation about the various ways in which government can undertake a specific activity: outsourcing, competitive sourcing, privatization, public-private partnerships, or government entrepreneurship. This debate represents a significant evolution in the changing role of government. Professor Gansler argues that government is now undergoing a major shift away from providing services itself to becoming a "manager of the providers."

But this new role as "manager of the providers" is fraught with complexity. As Professor Gansler describes in the report, government now has to make a decision as to which of the following mechanisms can best accomplish the given program objective: competitive sourcing, privatization, or creation of a public-private partnership or a government franchise.

A major contribution of this report is that Professor Gansler directly addresses the six concerns most frequently raised about the shift from "government as the doer" to "government as the manager of the doers." Based on his analysis presented in this report, Professor Gansler finds that empirical data refute all six of the common concerns. He found that market-based government actually improved government performance, decreased costs, realized savings over time, benefited small businesses, separated few government employees, and gave government even greater control than it has today over government activities.

We trust that this report will assist government executives in clarifying the current debate about how government can effectively move from "doer" to "manager of doers."

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Overview

One of the major changes taking place today in government management (federal, state, and local) is the shift *from* the government as the historic "provider" of public services *to* the government as the "manager of the providers" of services to the public. The basic rationale for this change is that—when properly implemented—it results in significant benefits, in terms of improved performance *and* lower costs, to both the government and to the public being served. Essentially, it is a shift from a monopoly supplier (the historic government "provider") to a competitive environment. These benefits are realized regardless of whether the winner of the competition is the public or private sector supplier.

While the empirical data (as presented in this report) demonstrate the benefits of this shift, it is still not widely understood or accepted. Part of the resistance is the natural fear of change, especially if jobs are at stake. Another part of the resistance is due to understandable confusion over the details. The wide variety of approaches (public-private competitions, outsourcing, privatization, public-private partnerships, government entrepreneurships, etc.) adds to this confusion. Moreover, there has been little effort made at defining terms, collecting data and lessons learned, documenting best practices and case studies, and developing educational programs in this area. It is the purpose of this report to help in this regard.

The report is divided into sections. The first section, "Understanding the Issue," provides the background and the highlights of the various sourcing options. Each of the second through sixth sections examines one approach and, for each approach, provides a clear definition; summaries of example case studies (e.g., for competitive sourcing, for privatization, etc.); a discussion of strengths and weaknesses; lessons learned/best practices; actual performance and cost results achieved; and other relevant considerations—such as personnel impacts, small business considerations, and government management-control perceptions. And, in each area, detailed references are provided for the reader who wants to pursue further the specifics of the implementation for a particular issue.

The seventh section of the report, "Contractors in Security Operations: A Special Case," examines an area that, although not a unique sourcing option, has become a high-interest item for the Department of Defense and numerous other agencies—namely, using contractors in security operations (including combat)—and describes the special considerations for this area along with some example cases.

Finally, "Findings and Conclusions" discusses the six common arguments against changing the role of government, summarizes the actual results achieved for each of these areas, and presents specific recommendations for moving forward.

It is hoped that the material in this report will help in providing a better understanding of this important—and, the author believes, essential—shift in the way government will provide its public services in the 21st century.

Acknowledgments

The author is indebted to Pelin Turunc and Erin Johansson, who, while graduate students at the University of Maryland, performed much of the basic research for this report. Additionally, I want to thank my coworkers Kim Ross (the executive director of the Center for Public Policy and Private Enterprise at the School of Public Affairs at the University of Maryland) and William Lucyshyn (a research scholar at the Center for Public Policy and Private Enterprise) for their assistance with the research and for their review of the manuscript.

The author would like to acknowledge the outstanding work of E. S. Savas, whose three books on this report's topic from 1980–1999, along with his personal work in New York, helped to establish a good deal of the theoretical and empirical work in this field—particularly at the state and local levels.

Finally, the author deeply appreciates the support of Mark Abramson and the IBM Endowment for The Business of Government in supporting not only this work, but also a number of other essential activities in this and related areas devoted to improving the way in which government can provide better and more cost-effective services to the public.

Understanding the Issue

Background

It has always been the stated U.S. federal economic policy that the government will not produce products or provide services that are available in the private sector.[1] Free enterprise and capitalism are the basic models of the American system. However, over the nation's history the American public has asked government at all levels to provide more and more services, to the point where today federal, state, and local government expenditures make up one-third of the gross domestic product of the nation (with a growing shift from federal to state and local). And, as government expenditures grew, so did the number of government employees. In many cases it was assumed that these governmental functions should be performed by government employees, resulting in the build-up of large government bureaucracies.

In recent years the assumption that government services must be carried out by government workers has been questioned. This began first at the state and local level, where people asked, "Why is garbage collection or bus transportation an inherently governmental job? Wouldn't it be better to let the private sector perform such functions under a competitively awarded government contract?" In an effort to meet tight budgets, city council members and local mayors thus attempted to implement—in a variety of forms—competitions for this work.[2] In some cases, the approach was to allow private sector competition for the work among firms that specialized in that business. In other cases, the work was competed between the current government employees and the private sector; while in still other cases, the work was simply privatized by letting private companies bid for the government capital equipment and employees.[3]

There was, of course, resistance to these trends from government workers, their unions, and their political representatives. Nonetheless, the results of these steps were positive. As the advocates had claimed (and as the large amount of data in this report will demonstrate), performance improved and costs were reduced. While this concept was catching on widely at the state and local levels in the 1980s and early 1990s, it was not until the mid-1990s—led by the Department of Defense—that there was widespread consideration of this approach taking hold at the federal level.[4]

With the election of President George W. Bush, it became official policy for the executive branch. In his President's Management Agenda (released in August 2001), the President stated, "Government should be market-based—we should not be afraid of competition, innovation, and choice. Our government must be open to the discipline of competition." To implement this policy, the Office of Management and Budget (OMB) explicitly set targets and dates. In response to a congressional mandate (in 1998, through the Federal Acquisition Inventory Reform Act [FAIR])[5] that all federal agencies must identify those positions that were "not inherently governmental," agencies identified 849,389 positions in February 2001. OMB declared that by 2005, at least half of these positions should be up for competition in one form or another. This would affect approximately 50 percent

of the 1.7 million federal positions considered "eligible" for competition (military personnel, for example, were excluded). Clearly, when fully implemented, this could potentially have a dramatic impact on the way the government provides its services. It is the intent of this report to explicitly address the following questions: *How* could this be done? *Why* is it desirable? *What* results are likely to be achieved?

Selecting the Business Model

Before agencies examine detailed sourcing options they should first examine their missions and identify the services they are truly required to provide in order to perform those missions most effectively. This effort must consider the fact that governments have many tools they can use to provide a required service indirectly. These include grants, loans/guarantees, the tax code, insurance, and regulation, as well as several different sourcing options that can be used to transfer the responsibility to another organization or level of government. This review can result in changes to the form of services and how they are provided.

The U.S. Postal Service (USPS), for example, was being overwhelmed by bulk mailings. One distinct option was to buy more sorting equipment, hire more employees, and handle the increase in volume. They came up with a different approach, and instead offered their customers a discount if they pre-sorted their mail prior to pickup by the postal service. This shifted a portion of the USPS workload to the private sector by simply changing the way they conducted business.

Another example is the Veterans Health Administration (VHA). The VHA had failed to keep up with the trend in the health care industry. It was using the same model of delivering health care developed in the1950s—in-patient care in large hospitals—centrally controlled from Washington. In the mid-1990s the system was reengineered, creating 22 regional networks that integrated the hospitals with nursing homes and emphasized home health care and outpatient options. The decentralization and shift in emphasis allowed regions to significantly improve the care provided to veterans without increasing their budgets.[5]

Once an agency decides on a business and governance model of how to provide its services, it can begin to examine sourcing options for its core missions.

Four Principles of Program Delivery

Based on the large number of cases that have now been completed at the local, state, and federal levels, four key principles of the market-based approach for shifting from a monopoly to a competition-based environment stand out in the implementation area.

1. **The key to success is shifting from a monopoly to a competitive environment.** Simply shifting from a government workforce to a private sector one while still in a monopoly environment does not create the incentives required to achieve the potential performance gains and cost reductions that a competitive environment offers. Similarly, after an initial competitive award is made—either to the public sector workers or to the private sector—it is essential that the potential for future competition (in a few years) still be maintained.

   This potential need not be exercised if the winning performer not only realizes its claimed performance improvements and cost reductions, but also continues to demonstrate enhanced performance at lower costs. But the potential for competition must be maintained. Unfortunately, it has been found in a number of cases—particularly when the government workforce won the initial competition—that this potential disappeared and the performance and costs reverted back to monopoly conditions. *It is the presence of competition (or even the clear potential for it) that forces the performer to innovate for higher performance at lower cost.*

   In the absence of such competition you must deal with a monopolist; and monopolies, as is well documented, tend to become inefficient, ineffective, and unresponsive. Nonetheless, people somehow believe that because the monopoly is a public one (i.e., being run by government employees), it therefore will (somehow) operate totally in the public interest—and be efficient, effective, and responsive. As all of the data in this report indicate, that has not been the case. Shifting to a competitive

environment results in an improvement in efficiency, effectiveness, and responsiveness.

2. **The competition must be run for "best value" rather than simply for "low cost."** The idea, which comes out of looking at the lessons learned from prior efforts, is not simply to get cheaper services; rather, it is to get better services at lower costs. This is a dramatically different approach than simply going to the "low bidder" who promises to meet "minimal acceptable performance."

   This is admittedly a more difficult action for the buying organization of the government, because it requires a serious value judgment in comparing potential performance and costs for each of the bidders (public or private). *It also means that the contract itself must be a "performance-based contract,"* i.e., one that specifies what the buyer broadly is striving to achieve, but doesn't tell the supplier how to do it. This type of contract is also more difficult to write—especially when buying services rather than products—but it is absolutely essential in order to get the best overall value from the performer. This procurement area is one that will require considerable workforce education and training in order to skillfully perform best-value awards on performance-based service contracts.

3. **Even when the government contracts out work to be performed, it does not give up any of its control or management responsibilities.** In the case of service contracts, for example, a recurring problem is the government's failure to maintain responsibility for assuring that the contracted-out function is performed effectively and efficiently. This means that the government still has a strong oversight function: to manage the contract and to monitor its performance and cost. If the work is not done properly, the responsibility still rests with the government.

   Clearly, the government can terminate the contractor as an ultimate control mechanism. Prior to that action, however, the government should be continuously monitoring the contractor's performance and cost to ensure the required function is being properly performed. This point cannot be overemphasized; and yet, as noted, it has been a major problem in a number of prior efforts (i.e., the government did not properly oversee the supplier—public or private—once the award was made).

4. **There is a critical need for detailed metrics.** The government manager and the performer (public or private) must agree at the beginning of the contract on the key measurements of performance and cost that will be continuously monitored and reported. Obviously, these must relate to the performance and cost measures associated with the government function being achieved; and while many of these functions

Table 1: Sourcing Options

Sourcing Approach	Definition
Outsourcing	Organizational activities are contracted out to vendors or suppliers who specialize in these activities (usually in a competitive fashion).
Competitive Sourcing	Current public providers and private providers compete.
Privatization	Current government capital equipment, facilities, and workers are moved into the private sector—either competitively or on a sole-source basis.
Public-Private Partnerships	Attempts are made to combine the best of both the public and private sectors—either in a competitive or sole-source environment. One type of public-private partnership is *private financing*: In private financing, instead of having the government provide the resources for public functions, this work is actually financed by the private sector in a variety of approaches.
Government Entrepreneurship ("Franchising")	One government agency specializes in a given function and provides it to other government agencies or even to the private sector—again, either competitively or on a sole-source basis.

may be long term, shorter-term measurements must be implemented to determine progress.

Additionally, these metrics should be compared with historical data and "best practice" benchmarks to show improving trends in both performance and cost. In prior efforts, particularly when the government workforce prevailed in the competition, good visibility into these metrics was not maintained. This has proven to be a particularly difficult thing for the government providers when they are not clear about their total-cost basis in the first place, as they do not have any initial benchmarks to utilize.

To achieve such metrics for the government workforce will often mean a transition to some form of activities-based costing, so that one can determine the actual government total cost associated with the function being performed. (This would include all government "indirect" costs that support the particular function being performed, and costs which are not currently identified to that function—such as finance, legal, personnel, etc.)

Understanding Sourcing Options

As can be seen in Table 1, these choices cover a wide spectrum—from more work being done internally, to more work being shared, to full external services (but still under government management). Further, there are appropriate times and places for each of these techniques as well as best practices that should be applied (practices based on lessons learned from previous attempts at either the state, local, or federal levels). There are pros and cons for each approach, and the following sections discuss—with examples—appropriate applications for each as well as the likely results (again, based upon the results of prior demonstrations in each category).

Needless to say, there are no hard and fast rules that can be applied in this area; which technique is used and what results are actually achieved will vary considerably from case to case depending on the unique circumstances in each. Nonetheless, when properly implemented, the overall results are consistent—both qualitatively and quantitatively. The key, of course, is how to do them "right."

One of the things that scares people away from this area is the sheer number of different ways in which to approach the shift from the government as the "provider" to the government as the "manager of the providers." The reality is that there is no right answer to this dilemma other than the following points highlighted earlier in The Four Principles of Program Delivery: create the right incentives via *competition;* utilize *best-value* rather than low cost in the competitions; *continue to manage* the provider (public or private) after the award; and utilize performance-based and cost-based *metrics* that are monitored throughout the contract. Beyond these basic guidelines, each case can be treated as an individual event, and the government managers need to make their own assessment as to which of the various forms discussed herein would best fit the situation. In fact, it may well be that a number of the forms fit the situation, and that it becomes a question of "management judgment" as to which would be appropriate for that individual case. The important thing to realize is that if the basic principles—particularly that of competition—are utilized, there should be significant performance improvements and cost reductions from any of the various forms to be considered.

Nonetheless, it is appropriate to define the six approaches, to provide a few examples of each along with comments on observed "best practices," and to review the actual results of these efforts. With these data, a government manager should be in a good position to both argue the case for the change and anticipate what are likely to be the benefits. With this in mind, the following sections address the five categories introduced in Table 1, presenting the most common ones first, then moving to those less frequently used.

Outsourcing

Definition

Outsourcing is a management strategy that contracts out organizational activities to vendors or suppliers who specialize in these activities in order to perform them more efficiently and effectively. Outsourcing is defined as the practice of turning over entire business functions to an outside vendor that ostensibly can perform the specialized tasks in question better and less expensively than the organization choosing to outsource.[7] Outsourcing differs from privatization in that in outsourcing, the workload is shifted from in-house government providers to the private sector, but no transfer or sale of assets has occurred. Outsourcing or "contracting out" still requires the government to remain fully responsible for the provision of all services and management decisions. Other common outsourcing transactions include "direct vendor delivery," hiring of long-term trained (but private) staff, and vouchers.

Outsourcing can be done either sole-source or through competitive bidding. However, one of the major advantages of outsourcing is the potential for introducing competition among firms and to encourage innovation for performance improvements and productivity gains, so competitive bidding should be used whenever possible. And, to gain the benefits of greater performance at lower costs, the competitions should be based on the "best value" combination of performance and cost (rather than simply "low bid" to a minimum performance requirement). Also, so that the government does not get stuck with a monopoly supplier who subsequently reduces performance and/or raises prices, the government should assume that it maintains the option of subsequent competition (but only needs to exercise this option if performance or costs do not meet expectations).

Cost savings are generally considered to increase as the complexity of the outsourced application increases.[8] According to one report, companies that outsource to a web hosting company can save up to 40 percent in costs, while increasing the quality of their infrastructure.[9] Outsource vendors provide superior performance at lower cost because the function they provide is their core function, they have good specialists, and they invest in improving their techniques and technology to stay competitive in their market. Outsourcing allows firms to concentrate on their core functions and grow their business while the government benefits from the higher performance at lower costs, and the ability to use employees only when they are needed (rather than having permanent employees).

The reason outsourcing sometimes fails is that outsourcing candidates were not examined carefully before making the selection decision. To prevent these failures, management should examine qualifications of potential outsourcing candidates and should choose the one that best fits with the firm's strategic goals. Issues such as prior experience, culture clash, training needs, metrics and control, and the level of relationship between the parties must be carefully considered. Organizations should build relationship management capabilities to develop trust between themselves and the outsourced firm.

Although outsourcing involves signing a contract, there are important differences between the terms "outsourcing" and "contracting" as they are used.

Firms use contractors when they need specialized staff services for relatively shorter periods of time. In addition, contractor personnel are usually integrated into an organization's normal operations. In contrast, outsourcing agreements are usually long term, with an average of seven to 10 years. However, the government needs to frequently monitor contractor performance and cost—and maintain the option of termination or competition at any time—if results are undesirable. Finally, the outsourcing firm is generally off-site, and performance measurement of the outsource firm is not through assessment of individual tasks, but through compliance with some type of service level agreement.

Case Studies

1. National Mail Order Pharmacy Program of the Defense Supply Center Philadelphia (DSCP)[10]

In the early 1990s, DSCP competitively bought the services of a private contractor, Merck-Medco Managed Care, to buy and distribute prescriptions to the Department of Defense's (DoD) 7.2 million eligible active-duty service members, retirees, and dependents. This outsourcing contract resulted in significant quality and customer service improvements, as well as reductions in the costs of medicine to the military customers by 30 to 70 percent—prices lower than those paid by regional hospitals. The savings to the government is at least 40 percent.

Two three-state regional pilots were conducted in 1993, and the program expanded to over a dozen states in 1995. The national contract was signed in 1997. Responsibilities of the DSCP contractor include receiving prescriptions, certifying beneficiaries' eligibility, making sure that participants are taking the right drugs in the right amounts, monitoring drug interactions, verifying prescriptions, and dispensing and mailing the drugs. The firm also runs a customer service center. DSCP developed an automated system to monitor contractor compliance with all contract requirements, but is not otherwise involved in drug delivery.

Savings and service improvements: The National Mail Order Pharmacy saves money and time for military service members and their dependents, and frees up DoD funds to improve other health programs. The program gives DSCP an opportunity to serve a whole new class of customers while reducing beneficiaries' co-payments—$23 million on 1.3 million prescriptions in FY 1999, while saving DoD an estimated $55 million. DSCP monitors drug prices continuously and sends Merck-Medco an automated pricing file each month to ensure that DoD is getting the best possible prices. DSCP sold more than $4.8 billion in supplies worldwide in 1999, while reducing the inventory it held by 19 percent over 1998. The center's staff has also been reduced from 7,000 in 1993 to 2,900 in 2000.

The service received by the military personnel and their dependents has also improved a great deal. Before the mail order program, those eligible for DoD drug benefits had to drive great distances to military pharmacies or retail drug stores, where they paid co-payments of 15 percent to 25 percent of the commercial cost of pharmaceuticals. However, under the mail order pharmacy, active-duty members pay no co-payments and their dependents pay a fixed charge of $4, while retirees and their dependents pay a fixed charge of $8 per prescription. Further, beneficiaries can get up to a 90-day supply of drugs (as opposed to a 30-day limit imposed by retail pharmacies), and the drugs are mailed to their homes, making it easier for many personnel.

Conclusions: As a result of implementing this new service, inventories were reduced by 19 percent and staffing was reduced by 58 percent. Apart from the savings and service improvements the program provided, it has demonstrated innovative contracting and transitioned DCSP into a supply chain and relationships manager—rather than buyer and distributor.

2. Air Force's Hunley Park Military Family Housing Renovation[11]

When the Air Force inherited Charleston Naval Base from the Navy in 1996, it also received the responsibility of the Hunley Park military family housing renovation project. The houses required extensive renovation, including asbestos remediation and underground utility work. Congress allocated $7.4 million to help begin the renovation in November 1997, and wanted the money spent by March 1, 1998. Many of the previous Air Force housing projects resulted in cost overruns. Additionally, the contracts usually involved schedule slips. These issues forced the Air Force to develop a new contracting strategy to avoid the problems

and complete the project within the mandated time schedule. The Air Force's normal approach, which typically required 180 days just to develop a design, would not work. Instead, they formed an integrated project team to manage the contracting and other aspects of the project concurrently, rather than having the various phases laid out end to end over the period of a year. The design phase, with the help of this innovative approach, took only two months instead of the normal six months, reducing the completion time by 66 percent.

The acquisition team required all the bidders to provide evidence of past performance in whole-house renovation and underground utility upgrades. The "best value" approach was used, trading off price with past performance. This resulted in the lowest bidder being eliminated because of a limited experience base. The contract was eventually awarded to H&N Constructors, a small firm in Louisville, Kentucky.

One of the common problems in the past was costly renovation contract modifications caused by unforeseen problems encountered during construction. Instead of trying to define the scope of the project without knowing all of the potential problems that can cause modification, the team decided that the contract should require the contractor to experiment with just a few homes first. The prototyping revealed the actual condition of the houses and how much material and equipment would be required to finish the project. After the prototyping, the team let the future occupants tour the houses and make suggestions. This acquisition innovation (i.e., user reviews of prototype) added up to a total cost increase of just $35,000 or 0.06 percent, a mere fraction of a typical renovation project overrun. According to interviews with current occupants, they are truly satisfied with the renovated houses.

Conclusions: This project shows how performance-based service contracting can save significant amounts of time and money, even when the winner of the contract isn't the lowest-price bidder. They used performance-based contracting and prototyping and took user feedback, all of which proved to be useful strategies for the outsourcing project. The decrease from cost overruns alone saved at least 5 percent.

3. The Navy's Sailor Assisted Move (SAM) Program[72]

Traditionally, the Military Traffic Management Command awarded contracts to the lowest bidder without performance considerations. Additionally, they would divide up service members' moving business evenly among all the qualified carriers. DoD surveys indicated that more than 75 percent of the personnel moving were unhappy with the existing system. Additionally, 25 percent experienced property loss or damage during the moves, more than twice the rate outside the military. Moving is big business in the military—military services pay commercial carriers more than $1.2 billion annually to move 650,000 military personnel. DoD is the single largest customer in the property shipment industry, accounting for more than 15 percent of the industry's business.

In contrast to the traditional approach, the SAM program allows sailors to choose their own moving companies based on their own or others' experience with the firms. During the move, sailors can check on the status and location of their household goods and alter delivery plans as needed. In addition, for the first time service members receive full-value protection against property loss and damage. Additionally, they can be reimbursed by directly negotiating with the carrier in just two weeks—compared to depreciated reimbursement of damage after several months, when military legal officials filed claims for damage under the old system. Letting sailors choose firms based on their track records adds a vital performance piece to the deal. The carriers are also happier with the system that rewards high performance and eliminates paperwork and bureaucracy.

In customer surveys, 95 percent of SAM customers reported satisfaction with their moves, compared to 23 percent under the traditional moving program. In 1999, during the second year of the program, SAM attracted about 25 percent of the sailors eligible to participate, a 1,500 percent increase over participation in 1998. In addition to improved customer satisfaction, damage claims under SAM dropped from one in every four moves to one in 12; and, according to the Navy, the dollar value of an average claim has dropped 50 percent, from $550 to $224. The potential savings are huge. In

1996 alone, service members filed more than $100 million in damage claims under DoD's traditional moving program, about 10 percent of program costs.

Conclusions: Letting the sailors choose contractors based on performance records and shifting to a competitive best-value (vs. "lowest bidder") approach improved performance and decreased costs significantly. Savings from damage costs alone are 87 percent. There was a 300 percent customer satisfaction improvement, and a 66 percent reduction in the number of damage claims.

4. The Navy Marine Corps Intranet (NMCI)[13]
The NMCI is a comprehensive, enterprise-wide contracting-out initiative that will make the full range of network-based information services available to sailors and Marines for day-to-day activities and in war. When the actual costs figures are used, from the initial rollout of NMCI seats (desktop computer workstations) at seven sites, the average cost per seat before NMCI was about $3,545 per year, and the cost of an average NMCI seat is $4,179. Although the NMCI cost is 18 percent higher, the price of an NMCI seat includes capabilities that were not available in the pre-NMCI environment, such as compliance with DoD mandates, records management, public key infrastructure, and information security upgrades. If the pre-NMCI estimates are adjusted to reflect these added capabilities, the original seat cost would increase to at least $4,286—more than 2 percent higher than the NMCI seat cost. The decision to undertake the NMCI initiative was not based solely on cost; rather, it focused on performance improvements (including security) that the Navy would not be able to provide through the traditional information technology approach. In addition, the Navy and Marine Corps are obtaining all the benefits of a state-of-the-art, fully integrated information system.

Conclusions: Cost-benefit analysis is a necessary tool and a significant part of agency decisions. The contracting in this case resulted in capability and performance improvements too costly or not possible for the Navy to achieve itself—and the competitive outsourcing controlled the costs.

Strengths of Outsourcing:

- Outsourcing is more efficient (and reduces costs significantly) because:
  - It harnesses competition and brings the pressure of the marketplace to bear on the inefficient producers.
  - It permits better management control by freeing government managers of most of the distracting influences of overtly political organizations and civil service constraints.
  - Managers can see more directly the costs and benefits of their decisions.
- Outsourcing enables the government to take advantage of specialized skills, new technology, and innovation that are lacking in its own organization.
- Outsourcing can reduce dependence on a single supplier (i.e., the government), and the potential for future competition provides a continuing incentive for higher performance at lower cost.

Weaknesses of Outsourcing:

- Outsourcing can limit the flexibility of government in responding to emergencies if not provided for in advance, via the contract.
- Contracting processes can be complex, time-consuming, and costly if proper management and a standardized process are not provided.
- Outsourcing can cause personnel disruptions and transition problems if not planned well.

Lessons Learned and Recommendations

1. **Use performance-based contracting** instead of contracts based on fixed costs. Performance-based contracts do not list tasks but state the results sought or problems to be solved. This takes the performance risk off the government and shifts it to the contractor, and decreases the likelihood of cost overruns. Contracts prepared this way contain performance measures agreed upon by both parties.
2. **Choose contractors according to "best value"** by trading off performance and price instead of simply awarding to the lowest bidder. Issues

such as past performance, culture clash, training needs, metrics and control, and the level of relationship between the parties must be carefully considered. The organization should build relationship management capabilities to develop trust between themselves and the outsourced firm.

3. **Use prototyping and pilot implementations** for outsourcing projects to make an estimation of total costs, scope of the project, necessary supplies and equipment, and to foresee problems that are likely to be faced during the implementation. Obtain user feedback along the way and incorporate lessons learned into the implementation. (Whenever possible, use competitive prototypes.)

4. **Apply integrated (with "bundled" functions) outsourcing.** Outsourcing should be done in an integrated (multifunction) way for improvements in efficiency and performance. Make the outsourcing decisions by contracting similar functions (or functions that can be done by the same contractor) to the same contractor instead of to a number of them. An effective and closely integrated management of services is essential to applying these principles. In addition to savings from economies of scale and from integrating the tasks of different functions, having larger bids also attracts a larger number of and more qualified contractors, decreasing the resulting bid. It also allows the winner to re-engineer the multiple functions for far better performance and significant additional cost savings. In addition, it should be noted that bundling need not reduce the amount of small business contracts, and would even improve it, if it is made a subcontracting requirement of the winning bidder. The key in making bundling decisions is to look at similar samples in the industry.

5. **The larger the award, the greater the savings.** The quantitative benefits of larger-sized awards for outsourcing would be very similar to those shown in Table 5 (namely, larger percent savings with larger size awards, and far fewer awards with very little savings).

6. **Success requires strong managerial support, skill, and knowledge.**[14] In a study on information technology (IT) outsourcing, it was found that management played a key role in the success of the contracts. Overall, the benefits of IT outsourcing are many: cost savings, greater access and flexibility in using appropriate technology, and utilization of skilled IT personnel. But in order to obtain these benefits, management at the top needs to be supportive and involved in the process; managers must allocate the necessary amount of time and resources at all stages of the process; managers need strong, continually updated procurement skills and knowledge; and frequent communication must occur within the partnership of agencies and their service providers.

Competitive Sourcing

Definition

"Competitive sourcing" assumes a competition for work between the government and the private sector, and can result in activities being performed either by government (in-house) or by contract personnel depending upon who wins the competition. Competitive sourcing differs from outsourcing in that outsourcing assumes that the in-house (i.e., within government) workload will be contracted out to the private sector. It also differs from privatization, in which the government transfers the ownership of its equipment and facilities involved in performing the function to the private sector.

Privatization and contracting out policies are subject to the theoretical assumption, *a priori,* that private sector service delivery is always less costly and is always of an equal or better quality than public sector service delivery. Public-private competition ("competitive sourcing") makes no such ideological value judgment, but rather treats the question as an empirical one subject to testing. Public-private competition is predicated on the notion that it is not the ownership of the service delivery (public or private) that leads to improved service quality and lower service costs, but rather the presence and degree of competition.[15]

Various Forms

The type of public-private competition that covers most federal government work is governed by OMB Circular A-76. Depot competitions are excluded from A-76, but generally follow a similar process (see Case 5 below regarding a maintenance depot public-private competition). Other approaches are possible, such as using the normal Federal Acquisition Regulations for competition (i.e., "FAR-Based"), and there are many state and local approaches. These latter forms of public-private competition are often ad hoc approaches (public sector service delivery is simply compared to private sector delivery), or utilize informal bidding (public sector submits informal bids). An example of a local and state approach with a less formal bidding process is the competitive sourcing of the road and repair work in Indianapolis (explained in Case 1).

A-76 Process

In 1966, OMB issued Circular A-76: Performance of Commercial Activities, which established the policy for acquiring commercial activities. In 1979, OMB issued procedures for A-76 cost comparison studies to determine whether commercial activities should be performed by government, by another federal agency, or by the private sector.[16] The objective of A-76 is to provide a "fair" public-private competitive sourcing process, seeking to determine the most cost-effective method of obtaining services that are available from the commercial market. Because the A-76 process is very complicated and presents a considerable administrative burden, many circulars have been issued since 1966 that simplify the cost comparison procedures, provide options for "reinventing government" operations, and identify potential positions to be "studied" (the term-of-art used to describe the public-private competition process). OMB is currently revising the circular in an effort to streamline the process and make it more equitable. Their goal is to have the new circular approved and released in the second quarter of 2003.

At present, an A-76 study requires an agency to develop a performance work statement (PWS) to identify the work to be done; to prepare a government in-house cost estimate based upon a Most Efficient Organization (MEO) that can accomplish the work; to solicit bids to perform this work from the private sector; and to compare this estimate with the lowest or best-value offer from the private sector. The government converts to performance by the private sector if the offer is lower than the in-house estimate either by 10 percent of direct personnel costs or by $10 million over the length of the specified performance period. The time period established for cost comparisons is 24 months for a single function and 48 months for multifunction competitions.

It is important to note that the government's bid of the MEO is almost always significantly less than its current (monopoly-based) costs. The presence of competition creates the previously missing incentive to significantly improve processes to lower costs while increasing performance.

Agencies are supposed to submit a list of non-inherently governmental activities (commercial activities inventories) that are being performed by government employees. Such activities are suitable for competitive sourcing or outsourcing. Inherently governmental functions cannot be competed and must be performed by the government.

There are also functions that are not inherently governmental, but may (under special conditions) be considered as such because of the way in which the contractor performs the contract or the manner in which the government administers contractor performance. Examples include services that involve feasibility, efficiency, and cost analysis; services that involve reorganization, regulations, and planning; contractors providing technical evaluation of contract proposals or providing assistance in development of statements of work; and contractors providing inspection services.

Under the Clinton administration, OMB estimated savings of roughly $9.2 billion in DoD operating costs between 1997 and 2005 and $2.8 billion in annual recurring savings after 2005 that resulted from A-76 studies.[17] The Bush administration is taking steps to achieve even larger savings and management reforms. They have proposed that (for the overall federal government) over 400,000 positions (i.e., 50 percent of all non-inherently governmental positions identified) should be competitively sourced by 2005, and agencies are reviewing positions to determine their exact number.

Case Studies

1. Road Repair Work in Indianapolis[18]

In 1992, Mayor Stephen Goldsmith, a believer in free markets, decided to privatize some of the public operations in the city of Indianapolis. To avoid the expected reaction of the employee unions to possible layoffs, Goldsmith decided to organize a public-private competition instead of firing the employees precipitously. One issue raised with the public-private competition was whether such a competition would be fair. A second issue was the difficulty in determining the full costs of current public operations. In addition to finding solutions to these problems, the mayor's office had to decide which of the operations (among trash pickup, wastewater treatment, and street repairs) to initially compete and how to organize the competition.

Among several options, filling potholes was chosen for public-private competition because of its high public visibility. First, cooperation with the union and employees was obtained. To provide fair bidding, private sector consultants were brought in to help public employees prepare bids. Cost determination was one of the most difficult steps during the bid preparation. To ensure the highest level of accuracy, activity-based costing (ABC) was used to determine cost figures. Employee timesheets, interviews to determine the time required for each task, and market price for the materials were used. Historical averages were used to estimate the quantity (number of potholes to be filled) in order to determine total costs. Senior management cost was not considered, as top management would remain public to monitor performance. Public employees prepared a bid of $301 per ton of asphalt put down after performing detailed studies to decrease the labor and equipment cost (i.e., to get the MEO). They cut costs from $407 to $301, a 25 percent cost reduction.

Only the threat of competition removed some of the slack that existed as part of the costs of the job.

Middle managers who were not essential and held positions used solely for political patronage were laid off to reduce the cost of management. An independent committee was established to evaluate the bids. However, there was an unexpected problem in the bidding process: The work to be done was not adequately described—it was not clear whether the job was simply to fill in the potholes or repair the whole road. As a result, there was a vast difference between the public bids and the lowest private bid. The work was awarded to the public workers; and subsequent competitions focused on much clearer performance specifications.

Conclusions: The threat of competition cut costs by 25 percent in this case. Among the initial challenges were a lack of government cost data and difficulty in determining the job-based cost. Resistance was dealt with by cooperating with the union and by ensuring a level playing field. One of the problems during competition was a poorly prepared performance work statement.

2. The Navy's Public-Private Competition[19]

After the election of Ronald Reagan in 1980, strengthening national defense and increasing government's reliance on private goods and services were two of the government's top priorities. By 1984, the Navy introduced several elements of a Navy Industrial Improvement Program; the most important was a program authorized by Congress in 1984 to test public-private competition for the Navy's multibillion-dollar overhaul and repair work.

The Navy's shipbuilding contractors had cost problems on new ship constructions because of the high inflation rates in the 1970s. This was compounded by unrealistic schedules and planning mistakes, which resulted in an inability to cover costs. These factors seriously crippled the United States shipbuilding industry at the end of the 1970s. The Navy's trend was toward using private sector capacity more widely; however, the projects given to the private sector did not have motivating contracts for the contractors. Also, there was dissatisfaction among private shipbuilding employees because of their lower salaries and benefits compared to those of public employees. Project orders specified the work to be performed, the anticipated cost, and schedule of performance; but unlike normal commercial contracts, these cost-based, percent-of-cost fee contracts did not specify any incentives or penalties to motivate adherence to these terms.

Consequently, in the 1980s, senior Navy leadership started to discuss taking advantage of the excess capacity of the private sector compared to the full loading of public shipyards. The eight public shipyards, five of which were built in the 1800s, were devoted exclusively to the overhaul and repair of naval vessels. In 1982, the Undersecretary of the Department of the Navy commissioned an in-depth study by a team of two management consulting firms on how to improve the naval shipyards' performance and costs. By 1984, most of the team's 130 recommendations were approved, one of which was to test the recommendation that the naval shipyards be required to compete with the private sector for scheduled overhaul and repair work.

The test programs started in 1985. The competition program not only included overhauls and repairs, but also ship alterations and the Naval Sea Systems Command's Nuclear Propulsion Directorate. In the test competitions, the contract would not be awarded simply to the lowest bidder; instead, performance would also be carefully assessed and both sectors would be required to submit fixed-price incentive-fee bids, with a target price and a ceiling price above which the shipyard would absorb all the costs. The competition process involved a lot of learning, especially for the public employees (who obtained private consultant help in preparing bids), and for the Navy management (regarding how to ensure a fair comparison). There were complaints and investigation requests after the first contracts, on which the General Accounting Office (GAO) prepared reports and basically upheld the Navy's decisions to award one overhaul to a private yard and one (at a significantly higher cost) to the public yard. The Navy then ran a competition for another ship; a public yard (Charleston) won with a bid of $112 million (14 percent less than its previous, similar overhaul cost of $130 million).

Conclusions: The Navy solved most of its problems with the naval shipyards and maintenance in the early 1980s using competitive sourcing based on best value. The incentives created by the competitive environment allowed them to achieve both greater control and significant cost reductions, without sacrificing performance.

3. Services at Fort Rucker Aviation Training Base

Fort Rucker, the Army's main aviation training base, has been using competitive sourcing for its pilot training and aircraft maintenance services since the 1980s. Three examples of the public-private competitions (described below) brought between 20 and 40 percent savings, with equal or higher performance.

- In 1991, the Army competed some of the services at its Fort Rucker base using the A-76 process. A large training services unit (providing audiovisual support to trainers) was contracted out. Savings from the original baseline were about 40 percent. The in-house bid would have produced a savings of 17 percent, although that was not enough to retain the work. All 72 government employees were retained in place, though some were downgraded.[20]
- Another public-private competition at Fort Rucker was for the director of logistics (for base support functions that employed about 400 people). It was competed in 1991, about seven years after the announcement date. The work remained in-house, and there was a 20 percent savings from the original baseline cost.[21]
- A more recent competition[22] (in 2001) at Fort Rucker resulted in contracting out despite some strong objections. The savings realized were 30 percent. The Army awarded the company a $44.6 million contract to perform services at Fort Rucker, which would eliminate 338 federal civilian jobs at the base. The employees at the base urged the Army not to proceed with the contract award on the grounds that the contractor's bid was based on outdated cost estimates and contractor labor costs. The contractor's bid relied on data from 1997, when the base first started studying whether contractors could perform the job at a lower cost. The contractor bid did not take into account additional services and new buildings built since then. However, the contract was awarded, and revisions to cost calculations made. The private bid came in $10 million under that of the federal workers and, even after the revisions, the contract was awarded and the appeal rejected.

Conclusions: In the recent competitions at Fort Rucker, the competitions still took two to four years, and some of the earlier ones took even longer—primarily to overcome Army, union, and congressional opposition. Clearly, this time period needs to be shortened. Nonetheless, the competitions resulted in significant savings in spite of the process problems.

4. Six DoD Cases Examined by RAND[23]

RAND examined six competitive sourcing competitions (one for the Army, one for the Navy, and four for the Air Force) to determine their expected savings, whether the savings were real and enduring, and how they were achieved. The expected personnel cost savings were found to range from 34 percent to 59 percent of the baseline personnel costs. The savings were found to be real and enduring for the three contractor awards. They could not be fully verified for the three in-house awards (due to the lack of cost visibility on government full costs). The cases covered base operating support (2), missile maintenance (1), aircraft maintenance (2), and telecommunication maintenance and operations (1).

RAND concluded that the labor savings came from three major factors:

- Using fewer workers—contributing factors included civilianization, multiskilling (cross-training, combining job series), organizational restructuring, reduced work scope, and labor availability/increased work intensity
- Downgrading positions and paying lower wages for lower-skilled jobs
- Capital-labor substitution

These savings were found to be real and enduring. For the private contractors, the difference between the contractor bid and the actual contract payment is a good indicator of whether the savings were realized as expected. This difference was at most a 2.5 percent increase in the payment (and was actually a decrease of 13 percent in one case). For the public sector the difference between personnel slots in the MEO bid and current staffing is an indication of whether savings endure over time. The differences are small, indicating that savings endured. To get an actual cost comparison, the government would need to move to a method (such as activity-based costing) that would provide full-cost visibility.

5. Organizational and Intermediate Maintenance of Navy Aircraft[24]

The Navy competitively sourced its personnel and equipment for the organizational (O) and intermediate (I) level maintenance of the TA-4J aircraft. The award was made to the private sector. The analyses of performance and cost data show a 33 percent reduction in costs at the same level of performance.

The analysis of cost was done by comparing direct maintenance man-hours per flight hour (DMMH), which shows the amount of resources used to complete the task. The performance analysis compared full mission capable rate (FMC)—the percentage of time the aircraft is ready—mission capable rate (MC)—the percentage of time the aircraft can fly and complete the mission—and not-mission-capable rate (NMC)—the percentage of time the aircraft cannot perform the mission. All three of these performance measures remained essentially the same.

Thus, there is a significant difference between DMMH (costs) in favor of the contractor, while differences between MC, FMC, and NMC rates (performance measures) are not significant when the in-house and contractor performance are compared. However, on this program the transition from in-house to contractor was not well planned and it took about two years for the contractor to reach the previous performance of the in-house workforce. Yet, when the contractor subsequently turned over the task to another contractor, there was no such drop in performance as the personnel stayed the same and only the management changed in this case—clearly, the initial transition was not well handled by the Navy.

Finally, since the contractor provided an equivalent flight hour with a 34 percent reduction in direct maintenance man-hours (an obvious resource and cost savings), some of these savings could instead be used to improve performance even further. Competition leads to a gain in efficiency. How this gain is divided between performance gains and cost reductions depends on how the contract is written. One other conclusion from this case is that if the transition period is not smooth, both performance and savings can suffer.

6. Defense Finance and Accounting Service (DFAS) Studies

During the period 1995–2001, DFAS ran nine competitive sourcings for a variety of finance and accounting functions.[25] They varied in size from 84 man years to 650 man years—for a baseline total of 2,929 man years. The vast majority of these competitions were won by the in-house MEO. The savings ranged from 20 percent to 69 percent, with an average of 32 percent, with seven of the nine falling in the range of 25 percent to 39 percent.

What is particularly important about these studies is the fact that when competition is introduced, even when the award goes to the in-house organization, there is likely to be a savings in the range of 30 percent.

Aggregated Results of DoD Competitive Sourcing

Table 2 summarizes the average expected savings from DoD competitive sourcing studies completed (i.e., the comparison between the prior in-house costs and the winning bid).

Realized savings: There are two studies that examine the actual (realized) savings from the DoD competitive sourcings after the work has been completed: one from the Center for Naval Analysis (CNA) and one from RAND.

The CNA study[26] on actual realized savings and their comparison with expected savings is illustrated in Table 3.

"Effective costs" exclude cost changes that would have occurred whether or not the function was competed (such as one-time cost increases caused by an increase in workload). Thus, comparison of costs before the competition and the effective costs after the competition gives a good measure of the results of competition. Effective costs are 98 percent of expected costs, which shows that expected costs are generally a good estimation of later realized costs. The "observed" costs include the effects of added workloads and scope. It is observed that even with this added work, there was still a 24 percent savings relative to the in-house baseline without the added work.

Table 2: Average Expected Savings from DoD Competitive Sourcing Studies

Time period	Agency	Number of Competitions	Average Percent Savings	Source
1995–1998	DoD total	53	42%	GAO report Jan. 1999
1994–1998	Air Force	44	42%	CNA report Nov. 1998
1994–1998	Navy	3	37%	CNA report Nov. 1998
1995–2000	DFAS	9 (2,929 FTEs)	32%	DFAS report 2000
1975–2001	DoD total	2,287 (98,348 FTEs)	33%	CNA report 2001
1997–2001	Army	105 (10,791 FTEs)	39%	Department of Army report 2001
1998	DoD	5 (1,840 FTEs)	47%	RAND report 2000

Table 3: Actual Realized Savings from CNA study

			Savings		
Time period	Agency	Number of Competitions	Expected	Effective	Observed
1988–1996	DoD	16	35%	34%	24%

Analysis of Case Results

For the competitive sourcing initiatives described above, the average savings of the cases is 33 percent—and the savings are expected to be between 25 percent and 43 percent, 95 percent of the time. Also, for those limited cases where performance improvements were quantified, the performance improvement averaged 109 percent.

To achieve an optimum implementation strategy, it is important to define the Performance Work Statement, or PWS, clearly and completely. A successful example is the application in DFAS: introducing a two-team and three-stage methodology to PWS and MEO development, establishing a new process to enhance and potentially speed up competition, instituting an executive steering group to provide oversight, and involving all DFAS business partners in the process. The strategies were seen to be effective in making the process less complicated and effective.[27]

Effects of Competitive Sourcing on the Workforce

One of the greatest concerns about competitive sourcing is that no matter who wins—the public or private sector—there will be a significant number of public employees forced out of work. In contrast, actual results show that the number of civil employees laid off is in the single-digit percentages, even when the private sector wins. A GAO study[28] examining the effects of competitive sourcing initiatives on the workforce for three large competitive sourcing cases (with one in-house win and two contractor wins) found that very few of the employees were involuntarily separated (only 8 percent), while the actual government workforce reduction was quite significant (1,079 military were reassigned, and 348 civilian positions remained from the original 1,111 civilian positions). The remaining civilians were either transferred (27 percent) or voluntarily retired or separated (65 percent). The study also found that 26 percent of those who voluntarily separated or retired took jobs with the contractor.

Strengths and Weaknesses of Competitive Sourcing

Strengths

- Competitive sourcing introduces competition (vs. prior monopoly), which promises to raise performance and significantly lower costs.
- Competitive sourcing allows historic government workforce an opportunity to bid to retain the work (vs. outsourcing or privatization).

Weaknesses

- The current process (A-76) is both time-consuming and expensive—as well as very complex (and not based on "best value").
- Competitive sourcing will have an impact on government workforce (both in morale and in limited involuntary separations).

An earlier CNA study found that DoD personnel programs were very effective in minimizing involuntary job loss. Even though 40 percent of the employees at depot facilities were targeted for Reduction in Force (RIF)—involuntary separation—many found other jobs through DoD job placement services, some voluntarily retired, and others voluntarily separated to take jobs with the winning contractor. As a result, only 3.4 percent were actually RIFed.[29]

Findings from Competitive Sourcing Initiatives

1. **Trend of savings:** When the historical trends of overall DoD-expected savings from competitive sourcing between 1975 and 2001 are examined, it is evident that savings are increasing with the improvement in implementation;[30] specifically, average savings before 1994 are around 31 percent, while average savings from competitions since then are around 42 percent. Similarly, a Department of the Army (DA) independent study found that, for these same time periods, savings improved significantly—from 28 percent to 39 percent.
2. **Performance improvements:** Performance is found to improve, or at least stay the same, after the competitions (as long as this is a consideration in the process). Note that in some cases implementation during the transition period is somewhat problematic because of lack of training and support. This results in performance being lower during the first year compared to subsequent years.
3. **Average time to complete studies (competitions) decreased over time:** Average time to complete competitions declined from 51 months before 1994 to 18 months for single functions, and 30 months for multiple functions.[31] The decline in completion time contributed to implementation effectiveness and the increasing trend in percent savings. However, it is still far too long.
4. **Percent contractor wins increased over time:** Between 1978 and 1994, roughly half of competitions were won by private sector contractors, while for competitions held after 1995, about 60 percent were won by contractors.[32]
5. **Winners:** Savings from contracting decisions (i.e., private sector awards) are generally higher than in-house decisions, as seen in Table 4. However, savings from both public and private sector wins are significant, and getting larger with learning.
6. **Savings/size relationship:** As shown in Table 5, average savings are significantly larger for bigger competitions; yet they are still important even for small ones. The percent savings and savings per personnel billet increase noticeably as the size of the function increases.[33]

   Although average percent savings are smaller for the very small competitions, and regulations don't obligate competition (especially for 1–10 billets), 82 percent of studies completed had less than 45 billets, and 73 percent had less than 25 billets.[34] In DoD between 1978 and 1994, half the competitions were for 14 or fewer positions.[35] Notice also (from Table 5) that while average savings are still significant, small competitions are more likely to produce no savings than are large competitions; and the larger ones (over 250 people) will always have savings.

   Finally, although A-76 processes are not normally required for functions with 10 or fewer

Table 4: Savings from Contracting Decisions

Time Period	Agency	Number of Competitions	Contracting Decision	Percent Savings	Source
1978–1994	DoD	2,131 (82,000 FTEs)	Contractor In-house	40% 20%	CNA report
1997–2001	DA	105 (10,291 FTEs)	Contractor In-house	51% 22%	DA report 2001

Table 5: Saving vs. Size of Competed Effort

Size (number of personnel)	Total Studies	Average Percent Savings[39]	Percent with 0 Savings[40]
1 to 10	796	22%	37%
11 to 30	633	29%	14%
31 to 45	142	32%	9%
46 to 75	94	30%	
76 to 100	42	34%	3%
101 to 150	36	42%	4%
151 to 200			9%
201 to 250	31	41%	5%
>251			0%
Total	**1774**	**34%**	

personnel, one study[36] found that 858 functions (around 40 percent of all the competitions in that database) with 1–10 personnel were competed using the full A-76 process. Clearly, this was both expensive and time consuming, but may have been the only way (politically) to get it done.

7. **Savings/number of bidders relationship:** This is an area of some controversy, since one RAND study[37] found that competition effectiveness was greatest when there were a few very qualified bidders (e.g., 3–6), and it fell off as the numbers became very large. Another study[38] (by CNA) found that savings continue to increase with the number of bidders, and as the number of bidders gets larger (after around 17 bidders), the increase slows down. However, in the CNA study the median number of bidders was four, so the data may not be too inconsistent (although this is an area requiring further research). Clearly there have been many examples of fierce competition when there were only two bidders for a significant contract (for example, for the DoD purchase of jet engines).[41]

8. **Sustaining savings:** Multiple studies found that savings from A-76 competitions were sustained over time. Nine of the 14 competitions analyzed by CNA (where data existed) showed no significant increase in realized ("effective") costs over the first solicitation period bids.[42] Similarly, a RAND study[43] found that savings are endured over time. (Evidence of sustained savings was more apparent for the cases where the private sector won because the costs were measurable; but the head counts for the public sector ended close to the MEO's bid, so it is believed that the costs were sustained).

9. **A credible threat of competition can result in significant (about 20–25 percent) savings:** One example is competition of road repair work in Indianapolis. In-house cost was decreased easily by 25 percent while preparing the bid. Also, according to bidding behavior simulation,[44] 22 percent savings are expected if no contractor bidding is actually performed, but only if the in-house team is facing the threat of competition. This indicates the effect of maintaining a credible potential for competition on savings, as well as the existence of slack (easily removable extra costs) as big as 22 percent (on average) for the non-competed, in-house functions.

10. **Savings by function:** When savings by function group are analyzed,[45] savings are found to be significantly higher for research, development, test, and evaluation (RDT&E) support functions

(69 percent), followed by real property maintenance, installation services, and intermediate maintenance. Essentially, the more a process can be "reengineered" for productivity gains, the greater the savings potential from competition. But even simple functions show gains as a result of the competitive pressure.

11. **Effect on Government Workforce:** A number of studies have shown that the effect of competitive sourcing on the government workforce is considerably less than has been expected. In fact, even when the winner of the competition is the private sector (replacing the prior government performers), the involuntary separations are in single-digit percentages. The vast majority of the government workers have either found other government work or gone to work for the contractor.

Recommendations

1. **Establish an effective training system to:**

- Inform government managers that increased efficiency does not mean decreased effectiveness, and that the target of the reforms is to improve both effectiveness and efficiency.
- Inform managers in developing Performance Work Statements and Most Efficient Organizations.
- Inform managers to make better cost estimations, and assessments of actual costs and savings.

2. **Establish a system to facilitate tracking cost and performance.** Cost information should be presented using an appropriate (and consistent) activity-based accounting method that considers all relevant costs. Government management should be able to isolate a particular unit or activity within government and identify all reasonable costs associated with that activity. This is important for establishing a level playing field for industry and government competition comparisons—as well as for post-award tracking.

3. **Build an independent research unit.** There is an urgent need to collect data and analyze realized savings as well as other effects of competitions. This data and analysis, which is critical for making effective strategic decisions, is largely missing today.

4. **Create incentives and alignment of goals with mission.** As for every organizational reform, leadership and support from all levels of management are critical for a successful competitive sourcing effort. To ensure support, management should align goals of the program with the organization's mission.

5. **Subject in-house wins to recompetition every five years if performance or cost standards are not met (as is done with private sector wins).** The option of competition should always be kept open.

6. **Make comparisons, but trade off performance against cost.** Choose the party offering "best value" instead of merely choosing the lowest bidder.

7. **Shift to a Federal Acquisition Regulation-based approach,** which will be fairer than the current A-76 process as all parties will compete under the same set of well-known rules. According to GAO observations, most of the appeals after the competitive bidding process are related to compliance with A-76 regulations.[46]

8. **Shorten the competition time.** The requirement should be to complete the process in less than 12 months—outsourcing the award if it takes longer. To achieve this shortened cycle will undoubtedly require process simplification (an obviously desirable feature, in any case).

9. **Limit the process to functions that have more than 10 billets.** Competing larger projects/jobs brings more savings than competing smaller ones for which the long and costly competitive sourcing process may not be worth the results.

10. **Require senior leadership approval to cancel competitions.** Cancellations deteriorate savings a great deal and discourage future bidders. (Note that when a competition is cancelled, there is no requirement for the in-house organization to implement the MEO.)

11. **Bundle similar and small functions in one competition.** Bundling similar functions increases the size of the competition (and thus increases savings) and attracts more qualified and a larger number of bidders. More importantly, bundling similar functions creates synergy from reengineering, and increases

efficiency and effectiveness by enabling better utilization of workforce, cross training, and multitasking. Additionally, to address the issue of small business involvement, contractors competing should be obligated to have a certain percentage (around 20 percent) of their subcontracts as small businesses.

Privatization

Definition

Privatization is the process of transferring an existing public entity or enterprise to private ownership. It can be done with or without competition. It differs from "outsourcing" in that the management and the workforce—and often the equipment and facilities—remain the same as before, except that they are now private employees (and private equipment and facilities); it differs from "competitive sourcing" in that there is no option of the work staying in the government.

Various Forms

- *Full privatization:* A government agency is sold completely, including all the capital assets as well as the transfer of the workforce. The property, employees, and management are all private.
- *Partial privatization:* The equipment and facility remain government-owned but the workforce is privatized (i.e., government-owned and contractor-operated). This can also be considered a form of public-private partnership.
- *"Privatization-in-place":* The work remains at the prior facility, and can be both "full" privatization (i.e., labor and equipment), or "partial" privatization (i.e., labor only). This arrangement preserves jobs and may guarantee workload, although civil servants transition to contract labor. Kelly Air Force Base and McClellan Air Force Base are two examples of privatization-in-place, and are explained in Case 4 below.
- *Employee Stock Ownership Plan (ESOP):*[47] This is a form of full privatization. In these initiatives, the operation is transferred to a private firm owned by the former government employees. The employees essentially transform governmental services into a profit-making ESOP company (among other forms, ESOPs can also be nonprofit, or linked in partnerships with a private firm). These ESOPs provide former government workers with the opportunities that a new business can offer, and enable a smooth transition from government employment. But while an ESOP may develop worker support for privatization, it is not a preferred model of privatization in that unless the former government service is in real demand in the open market, the model lacks the element of competition. The privatization of the Office of Personnel Management's Background Investigation Unit is an example of an ESOP, which is explained in Case 1 below.
- *Transitional Benefit Corporation Model (TBC)*[48]*:* The TBC model transfers underutilized government assets to the private sector, allowing for more efficient use of real estate, equipment, and even intellectual property. The TBC model occurs under the legal and business framework of a nonprofit umbrella structure, which oversees the gradual transfer of government employees and property to the private sector. The TBC model is beneficial in that it allows government employees to retain their public benefits, while improving costs and efficiency through the maximum utilization of workload and assets. However, like the ESOP, the TBC does not have the benefit of competition during the transfer process; therefore, incentives to

improve costs and performance are present only when the TBC competes for additional work in the outside marketplace.

Case Studies

1. Office of Personnel Management's Background Investigation Unit ESOP[49]

Federal agencies rely on the Office of Personnel Management (OPM) to conduct background investigations and training. In response to a decision to close its Background Investigation Unit, OPM proposed to privatize that operation through an employee stock ownership program, or ESOP. Since there is also a strong commercial market in this business, the ESOP had to become competitive. This effort has saved OPM over $75 million during its first five years.[50] In addition, the employees have received bonuses and stock options. The transition was transparent to the using agencies.

OPM used a sole-source, three-year contract (with two options years) initially to help ensure that the U.S. Investigations Services, Inc. (USIS) got off to a good start. USIS was awarded the contract again in 1998, and also entered into a contract with DoD for $200 million. By bringing in commercial business, USIS has continued to grow, with over 1,000 employees in 2000. The ESOP shares were recently bought by an investment firm for $545 million, which will be distributed among the 3,600 current employees, 1,400 former employees, and other shareholders.

Conclusion: The investigation unit of OPM was a good candidate for an ESOP-type privatization as the services it provides are in demand outside of government. The potential of the privatized organization to be a strong commercial enterprise in the competitive market is one of the criteria for deciding which federal organizations are good candidates for an ESOP.

2. Indianapolis International Airport[51]

As a result of falling revenues and increased expenses, the Airport Authority Board looked for better ways to manage the Indianapolis airport system. They resolved that through privatization they could cut operating costs, improve customer service, attract added revenue to the airports, and make the airport more competitive with lower per-passenger costs. In 1995, the Airport Authority chose a private contractor after receiving several proposals. The contractor hired the full airport staff and estimated that the costs of operating the airport would fall by 25 percent (without any performance reduction). The agreement made Indianapolis International Airport one of the largest privately managed airports in the United States.

Conclusion: During the first year of operations, the contractor was able to decrease the per-passenger cost from an average of $6.70 to $3.87. This savings, along with a 50 percent increase in per-passenger concessions and parking revenue, led the airport to reduce landing fees by 70 percent. A reduction in landing fees will benefit the city by potentially attracting more business to the airport, meeting their goal of making the airport more competitive in the region. After seven years of managing the airport, the contractor generated $34 million in non-airline revenue. Rather than charging the airlines more for the use of the airport, the contractor generated money for the airport through increased food, retail, and cargo sales.[52]

3. British Telecom: An International Privatization Case[53]

Great Britain's efforts to privatize British Telecom (BT) in the 1980s involved a publicity campaign to counter public and employee opposition. This campaign promoted the purchase of shares in the denationalized company by small investors and BT employees.[54] In 1984, BT was publicly sold—nearly 2 million people attempted to purchase shares—with 90 percent of their employees purchasing shares.

This privatization resulted in significant performance improvements. Long waiting lists for phone installation were eliminated, the number of public phones increased by 83 percent after 15 years,[55] and the call-failure rate of 1 in 25 was improved to 1 in 200 (an 800 percent improvement). In addition to these improvements in customer service, privatization still allowed BT to fulfill the requirement of maintaining costly emergency phone needs and public phones in rural communities. The government allowed BT to introduce pricing that was based on the competitive market, with adjustments for maintenance costs and reasonable profit.

One of the reasons for the success of the BT privatization was the element of competition introduced by government regulation, as well as license requirements for increased performance. Once privatization was realized, with the significant number of citizen and employee stockholders, reversing the process was not politically feasible. This successful case of privatization in Britain provided the necessary incentive for the rest of Europe to follow suit. The results of privatization in 1998 were noticeable; in Western Europe, countries with competitive telecommunications have local business rates that are 27 percent lower than in monopoly countries; calls to the United States from Western Europe average 22 percent lower with international competition allowed; and Internet costs are 34 percent lower in countries with competition.[56] Thus, even with criticisms of competition being slow to start (BT did not compete in an open market until seven years after competing in a duopoly), the benefits of competition are measurable for consumers.

4. Kelly and McClellan Air Force Bases[57]

Privatization-in-place was employed by the Air Force as a remedy for excess labor and facilities at Air Logistics Centers attempting to avoid job losses while increasing efficiency. Previously, Air Logistics Centers were operating at less than 50 percent capacity. As a result, the Base Realignment and Closure Commission (BRAC) recommended closure of these facilities. Instead, President Clinton decided to privatize these centers at the Kelly and McClellan Air Force Bases, allowing the more than 25,000 civilian employees to stay on as private employees. This decision to use privatization-in-place served to avoid politically sensitive layoffs while still maintaining surge capacity for emergency situations (as long as the excess capacity is funded, or if the privatized facility is able to bring in other work).

A GAO study[58] estimated that the potential savings from the logistics center closures could be as high as $206 million, well above the savings of $70 million estimated by the BRAC. The GAO study based that estimate on the assumption that the closing depots' work would be transferred to the three remaining Air Force depots, since the privatization-in-place plan does not solve the excess capacity problem at the other depots. The GAO estimated that the greater savings resulting from the transfer of work will occur when the remaining depots reduce excess capacity from 46 percent to 8 percent, economies of scale and other efficiencies are employed, and the hourly rates of those at the receiving locations are lowered by an average of $6. But even given these GAO figures, privatization-in-place was considered a more attractive option than the full transfer of work to another facility, considering the political ramifications of the latter. Also, even if the work had been transferred, it would still be performed without any competition (i.e., on a monopoly basis by the government). However, with the privatization approach, if the contractor performed poorly or costs rose, the government could then run a competition for its work, allowing other private or government sources to bid.

Recent contracts indicate that in these two cases the privatization-in-place plans were successful Two contracts, worth a combined $11.8 billion, were competitively won for work performed out of Kelly by private companies working in partnerships with the Tinker and Hill Air Force Bases.[59] The Air Force expects that overall savings from the consolidation of depot work will be worth $2.6 billion over the course of roughly 15 years.[60] However, because of the success of the privatized depots, concerns remain about the "50-50" law imposed by Congress to ensure that only 50 percent of depot work is contracted out, as it hinders the Air Force from operating with efficiency and flexibility.

5. Naval Air Warfare Center Takeover by the City of Indianapolis[61]

In the mid-1990s, a series of base closures nationwide galvanized Indianapolis officials to work to save the 2,800 jobs at the Indianapolis Naval Air Warfare Center (NAWC), a large contributor to the local economy. In a solution that benefited the city, the workers, and the Navy, city officials decided to competitively contract with a private firm to operate the center, bringing in outside work in addition to performing the services needed by the Navy. The deal allowed the jobs to remain in the city, but technically skilled workers would be private rather than government employees. This is an example of partial privatization, where the civilian workforce becomes a private workforce under the new contractor, but remains in the government-owned facility; and the contractor is free to add new capital equipment (over which it will retain ownership).

Results: Because 98 percent of the original NAWC employees chose to work for the new contractor, there was a smooth transition in providing the services that the Navy required. In addition, the cost savings planned will greatly benefit the Navy; the contractor has committed to reducing the rates it charges the Navy by 15 percent over the next five years. After that time, the company will have to compete with other firms for Navy contracts to ensure that costs remain low.

As for the city of Indianapolis, the privatization move allowed it to keep the jobs important for the local economy, and the contractor planned to increase employment at the site to 3,000 by 2002. The city also receives more than $3 million annually in taxes on property that was previously tax-exempt. Thus the plan at NAWC enabled a skilled workforce to keep their jobs, performing additional work in the private sector while providing the public sector with lower cost services.

6. United States Enrichment Corporation (USEC)

In the 1940s, the United States government created the United States Enrichment Program (in the public sector) for the provision of enriched uranium for nuclear weapons. In 1996, Congress passed the USEC Privatization Act, which required that the United States Enrichment Corporation would be sold either to a third party or as a public offering. The act established four criteria necessary for the sale: the United States Treasury would receive the net present value of USEC; USEC would be protected against foreign ownership; protections would be in place for public health, security, and the environment; and domestic utility industry demands would be reasonably met. To satisfy these criteria and to ensure that the privatization process was accomplished in the best public interest, the Treasury coordinated the input from government agencies, outside financial advisors, bidders, unions, and other affected parties. After the consultation process, the Treasury decided on the public offering, which was expected to result in fewer layoffs, less initial debt, and higher proceeds.[62]

Results: The public offering of USEC resulted in a net revenue for the government of $1.38 billion, with 100 million shares offered at a price of $14.25 per share.[63] The Treasury continued to monitor the company through a "post-closing" agreement, which limited layoffs, plant closings, and executive compensation for the two years following the sale. The government also remained involved with the company after the sale through the investment of research and development (R&D) funds to aid in research to lower production costs, ensuring that the company would be better able to compete with foreign companies.[64] By 2000, the Treasury testified before Congress that it was satisfied with the sale and the status of USEC and had decided to remove its extensive oversight and allow the company to function as a fully private entity.

Strengths and Weaknesses of Privatization

Strengths

- If competition is introduced, customers receive better prices and higher performance for private services formerly provided by government monopolies.
- Government assets can be converted into revenue through sales to private firms.
- Excess capacity of government facilities can be addressed through privatization-in-place, maintaining jobs and, if competition is introduced, using facilities more effectively.

Weaknesses

- Where there were once public monopolies, privatization may produce private monopolies, not competition.
- Governments can maintain control over newly privatized firms, preventing open market competition.

Lessons Learned and Recommendations

1. **Privatization introduces savings and quality improvements** (as long as competition is maintained). Expected savings from the cases ranged from 15 to 25 percent and, for the limited cases that have been analyzed, the savings were, in fact, realized.

2. **Competition is key.** Expected savings from sole-source privatization are lower than savings from privatization with competition for the award. Privatization with subsequent competition is expected to yield significantly more savings and performance improvements.

3. **Privatize services in demand.** Agencies that provide services that are in demand in both the public and private sectors, such as the investigative services of OPM, are good candidates for privatization (and for building ESOPs). The newly private entity should be self-sustaining, and should not need the government to subsidize it in order to stay afloat.[65]

4. **Consider change management issues.** It is important in cases where the government's existing workforce is retained under new (private sector) management (such as ESOPs or privatization-in-place) to give special consideration to change management and competitive incentives, as culture clash is likely. Private consultants can be used in implementing and establishing change.

5. **Government should strictly maintain open market competition and fair prices after privatization occurs.** The British Telecom privatization was a big success, with the help of supportive regulations; other European governments that failed to maintain a truly competitive market after privatizing services were less successful. One of the government's principal roles in the implementation of privatization is to make and enforce the rules and regulations that keep the market open and competitive.

6. **Government needs to monitor (but not control) newly privatized entities to ensure full public benefit.** The Treasury practiced continuous oversight of the United States Enrichment Corporation for the two years following the sale to ensure that it remained a benefit to the public. The government invested R&D funds to help the company in the competitive enrichment market. However, after two years, the Treasury reached the decision to allow the company to act fully private, in contrast to some of the European models in which the government remained intertwined with the private company.

7. **Privatization-in-place allows addition of private work to lower costs of public work.** The privatization of the Indianapolis Naval Air Warfare Center demonstrated how a contractor could utilize skilled former Navy employees for private enterprise, which enabled the firm to commit to charging lower rates to the Navy.

8. **Privatization of assets and operations that are not inherently governmental can result in large revenues for the public.** Private firms worldwide are able to enrich uranium and make a profit. With no justifiable reason for the United States government to perform such work, the Treasury was able to bring in $1.38 billion in revenue from the sale of USEC. Other government assets (like helium) offer similar possibilities for privatization revenue.

Public-Private Partnerships

Definition

Public-private partnerships (PPP), also referred to as public-private ventures, allow the public and private sectors to share the costs, risks, benefits, and profits. Public-private partnerships take many forms, between the range of fully public and fully private operations.[66] In PPP initiatives, production work, facilities management, and the investment of capital are functions that can be shared between public and private entities to obtain efficiency and cost savings. One of the key elements of a PPP is the allocation of risks between the public and private sectors. When using other strategies, the government assumes only recipient risks; in PPPs, it has to assume both recipient and sourcing risks. When used appropriately, PPPs can enable the government to take advantage of privately owned infrastructure, technology, financing, or capabilities. To be truly effective, a PPP must operate in a competitive environment; otherwise the incentives for high performance at low cost will be missing.

Private Financing

Private financing is the use of private funds (rather than public funds) to provide a public good. Private financing, as a form of public-private partnership, is utilized by government entities to enlist the investment of private firms in order to afford to finance a project. The firm benefits from the partnership with revenue from the project, and the government benefits in various ways: sharing the revenue, decreasing its costs, and having the facility or service offered by the private firm available. The VA Medical Center took advantage of private financing to construct a needed energy facility (Case 3), as did the state of Virginia in authorizing the construction of a private toll road to ease traffic congestion (Case 4).

Case Studies

1. Army Partnerships: Three Cases

In 2002, the Army considered a more effective use of its valuable property through public-private partnerships. Army repair depots were operating at 77 percent capacity, and the Army had to increase its budget for the depots by 34 percent from FY 2002 to FY 2003.[67] The Army planned to focus its personnel only on tasks essential to war-fighting, and to privatize those functions that are non-essential to the mission or that detract from the mission, such as property maintenance. The Army estimated that it could save over $600 million a year by moving many of the approximately 11,000 civilian and military depot personnel into private jobs, and from the for-profit use of the excess capacity of their facilities.[68] Partnerships with private firms already existed at the Red River, Tobyhanna, and Anniston Army Depots.

The results of a RAND study[69] in 2002 found that the Army could improve its "readiness posture" by removing the distraction of maintenance from its war focus. Additionally, facilities would be better prepared in the case of emergency, because the Army could not afford the upgrade money, and private investment in the maintenance of these facilities could improve them. The study recommended that the Army use its property to save costs and

attract revenue by converting its five repair depots into entities called Federal Government Corporations (FGCs). These FGCs would operate with the flexibility of a private company regarding their finances, personnel, and other operations; however, they would need to balance that flexibility with congressional oversight in order to be effective and to address inevitable political concerns.[70]

Aberdeen Test Center

The Army plans to open Aberdeen Test Center (ATC) in Maryland to outside academic and private entities for research use, and estimates savings of $1 million to $3 million per year in revenues.[71] The partnership, referred to as the National Testing, Training and Technology Company (NT³C), will be set up by 2004 if the Army and Congress complete authorizing legislation. NT³C will be a "limited liability company" with private and academic partners, enabling the partners to share liability through the pooling of their capital and expertise.[72] The potential partners the ATC is pursuing are those interested in testing vehicle and communication products.

Currently, the ATC operates with 25 percent of its funding from the Army and 75 percent from test customers. By forming this new company, the ATC hopes to continue to obtain private funding needed to maintain a state-of-the-art test facility for optimum military tests. The private uses of the facility will also help to lower overhead costs and offer the highly skilled workforce more frequent testing experience. Of course, it will have to offer competitive prices and performance to attract private activities.

Sharing Production at Anniston and Letterkenny Depots[73]

In 1997, the Anniston Depot partnered with a private firm to upgrade 62 Fox reconnaissance vehicles.[74] The company used the depot for production, and then paid the depot for tasks such as welding, grinding, cleaning, and painting. As of 1998, the depot had received $1 million for work done on the first eight vehicles. According to depot personnel, the partnership has also resulted in lower total costs for the combined work while the core depot capabilities remained intact; and the contractor invested $450,000 in facility upgrades.

In 1993, a work-sharing partnership was also developed at Letterkenny Army Depot to efficiently construct the Paladin, a self-propelled Howitzer. By using government facilities and contractor components, $15 million in savings resulted, as well as $3.4 million in contractor investments to renovate the facilities.

Armament Retooling and Manufacturing Support (ARMS) Act[75]

In 1992, the Armament Retooling and Manufacturing Support (ARMS) Act authorized the Army to invest funds in its ammunitions plants in order to attract private tenants. The ARMS Act predicted that by repairing, refurbishing, and upgrading ammunitions plants, the Army would be able to reduce maintenance costs, create jobs, and encourage private use of the facilities while retaining core manufacturing capabilities.

Results: Between 1993 and 1999, the government saved $103 million and 5,133 jobs were created as a result of the ARMS program. The number of tenant employees, 90 percent of whom are commercial, grew by 30 percent from 1994 to1999. There are still concerns about the program regarding the unclear roles and responsibilities between the public and private partners in the management of the Army ammunition plants. Additionally, some of the facilities discontinued the ARMS program before the benefits could be realized. Overall, though, it is clear that the program has succeeded in lowering facility costs, encouraging more private tenants, creating jobs, and bringing in revenue to cover the costs of facility improvements.

2. Indianapolis Wastewater Treatment (White River Environmental Partnership)[76]

In the early 1990s, the city of Indianapolis had to deal with tremendous deficits and impending infrastructure improvement costs for its water system. To handle these issues, city officials decided to develop a public-private partnership; a private organization would manage the two publicly owned Advanced Wastewater Treatment (AWT) facilities that served the city. In 1993, the city signed a contract with the White River Environmental Partnership (WREP), a consortium of three companies, one of which was the parent company to the Indianapolis Water Company. Knowing that it was the first major city

to contract wastewater facilities, the city used independent consultants to carefully plan and conduct the competitive bidding process before the WREP was chosen.

Results: By 1999, the WREP partnership had generated over $72 million in savings for the city. WREP reduced staff levels from 328 in 1993 to 157 in 1998. In anticipation of layoffs, the city transferred 67 of the staff to other city jobs, 43 found jobs through an outplacement system funded by the WREP, 10 found jobs on their own, and five retired (there is no information on the remaining 46 employees laid off). The union admits that the environment for members at the AWT facilities has improved; wages and benefits are 9 to 28 percent higher than for other city employees, accidents are down 84 percent, and grievances are fewer. Performance has also improved as water quality violations have fallen 86 percent; thus, the WREP exceeded city performance measurements. Due to the success of this partnership, the city granted the WREP a 10-year extension to the contract in 1997, projecting future savings of $189 million as a result of the move away from city management.

3. VA Medical Center, Mountain Home, Tennessee[77]

In an effort to take advantage of its property holdings to attract revenue, the Department of Veterans Affairs (VA) developed an enhanced-use leasing arrangement whereby private firms could finance, develop, manage, and profit from VA property. This arrangement was authorized in 1991 and, since then, has enabled the VA to enter into PPPs involving diverse projects, including office buildings, senior residential facilities, homeless shelters, and health care support facilities. This lease allows for private investment and use of VA properties in return for various benefits such as a share of revenue, services, and facility use. All proceeds related to the lease, after costs are reimbursed, go straight into medical care appropriations; this creates incentives for managers to make the most productive use of property in order to improve the core functions of the agency.

In 2001, the VA opened the Mountain Home Energy Center, a facility financed, developed, and operated by a private contractor to provide energy for the James H. Quillen VA Medical Center and for non-VA customers. The facility was designed not only to meet the regular energy needs of the VA, but also to meet 100 percent of its emergency power needs, an improvement over its previous capabilities. The lease requires fixed terms for the VA to purchase energy for 35 years; yet there was built-in flexibility allowing the VA to adjust for future needs. Overall, the partnership resulted in savings for the VA of $35 million, with $11.5 million in discounted recurring costs and $17.5 million in life-cycle costs. The private lessee was to profit by selling excess energy to non-VA customers, and the VA would receive a percentage of that revenue, estimated at $5 million.

4. Dulles Greenway

The concept of a privately financed toll road developed in response to increasing strain on current highways and a lack of state resources to improve them. The states authorized the creation of these roads by transferring control over the property and rights of the private entity to collect tolls, generally for a temporary period of time. This transaction balances risk between public and private entities.[78] In the late 1980s, the state of Virginia faced a $7 billion deficit for transportation needs, yet it needed to build a highway to give residents of Loudoun County access to expanding employment opportunities located in northern Virginia and Washington, D.C. To solve this problem, the state authorized the development of private toll roads in 1988, and by 1990, granted the partnership Trip II the authority to build the Dulles Greenway, a completely private venture that would be returned to public ownership in 2036.

The Dulles Greenway is a 14.1-mile extension to the state-owned Dulles Toll Road. It opened in 1995 as the first private toll road to be built in the state since 1816, and one of the first national roads to be financed, built, and operated with private money since the 19th century. When the road opened September 1995, ridership was a disappointment; only about 10,500 vehicles per day used the extension after the first six months.[79] The project originally estimated ridership based on the economic growth of the late 1980s, and did not include the proper level of risk when developing its financing plan, thus causing serious financial problems with much lower than expected revenue.[80] As

Strengths and Weaknesses of Public-Private Partnerships

Strengths

- PPPs allow the government to finance facilities or services needed, but which it could not afford to publicly fund.
- PPPs make the most productive use of valuable government assets by bringing in revenue, reducing overhead costs, and providing investments for facilities; and can be used to address excess capacity.

Weaknesses

- Authority can be blurred and roles made unclear between public and private partners.
- The government assumes a greater portion of risk compared to other forms of privatization.

a result, the project barely met operating costs, and by 1996, Greenway owners began to default on their loans and were on the verge of bankruptcy. Rather than acting as a partner to support this project, the state expanded a free road competing for ridership, and state officials were said to be ambivalent about the private project.[81]

In 1999, the project received a private refinancing package of $360 million in insured bonds, and was able to repay its initial creditors and expand the road. Ridership then quadrupled from 10,500 weekday commuters in 1995 to nearly 44,000 by 1999.[82] With this increase in ridership along with an increase in toll charges (except for passengers using the electronic system), the project was able to afford expansion. Without needing state money to finance the project, the Greenway was able—with private financing—to complete the first five miles of a six-lane widening project in 2001.[83]

Lessons Learned and Recommendations

1. **Competition is critical.** Once again, incentives are required to create the motivation for a PPP to achieve lower costs and higher performance (otherwise, it is simply a public-private monopoly).
2. **Significant savings and increased revenues result.** Examples demonstrate the savings to public services, lower-cost facility maintenance, and decreased excess capacity, as well as revenues resulting from PPPs.
3. **Performance improvements can result.** The WREP partnership in Indianapolis improved water standards, by multiple measures, over the previous city management. The Mountain Home Energy Center provided the VA Medical Center with 100 percent of its emergency energy needs.
4. **Underutilized, costly-to-maintain facilities are potentially valuable assets for PPP initiatives.** The Army now recognizes that its depots and ammunitions plants, which are both valuable and underutilized, can operate at lower costs and greater capacity with the influx of private tenants and production. The VA developed enhanced-use leases to make more productive use of its property assets and to raise funds for its core functions.
5. **Balance is needed between government oversight and flexible, local control over initiatives.** Partnerships can blur the lines of authority between public and private entities. The RAND recommendations for the ARMS program and the results of the VA Medical Center partnership illustrate the need for a balance between flexibility in operations and government oversight and accountability.
6. **Efficiency can result from the sharing of production.** The Army's Aberdeen Test Center, Letterkenny Depot, and Anniston Depot utilize facilities to share the production of goods with private partners, resulting in lower overhead costs, investments in facilities, and more efficient use of its workforce.
7. **Understanding market demand for new product/service is vital.** Though the Dulles Greenway eventually recovered financially and has increased ridership, it nearly went bankrupt in failing to adequately predict the number of riders, the marketing needed, the toll that customers were willing to pay, and subsequent revenue that would result.
8. **Private financing can be utilized to fund projects the government cannot afford.** Virginia

authorized the private Dulles Greenway to pay for needed infrastructure that the state could not afford with its huge deficits. The VA Medical Center used private financing to build an energy facility to improve capabilities. Projects providing public services with private financing, building, and operations are widely being used, enabling infrastructure to be improved without raising taxes or draining scare government resources.[84]

Government Entrepreneurship ("Franchising")

Definition

Government entrepreneurship is the development of separate fee-for-service entities operating within a governmental agency. These entities compete to sell services to other government agencies and often contract with the private sector to provide the services offered, while a core staff of government employees retains managerial control over the operation.

The term "franchising" is often used in place of "entrepreneurship." In this context it does not refer to the traditional franchise arrangement wherein a private business is given a license to operate a service on government land (e.g., a gas station or a fast food outlet) or to provide a service government traditionally provided.

Various Forms

Within the federal government, entrepreneurship has taken several forms. Under the 1994 Government Management and Reform Act (GMRA), franchises were allowed to form in order to eliminate the monopoly of administrative services offered to the government. These "enterprises" or "franchises" were expected to operate within a competitive environment and offer better services for lower costs. Previously, cross-servicing agreements enabled agencies to charge fees to other agencies for services provided, but the 1994 law allowed the formation of separate franchise funds to operate with more financial freedom and act more like private businesses. Government agencies now have the ability to choose among the service providers or retain an in-house arrangement in order to obtain the best services based on quality, cost, and other factors.

In addition to franchises, entrepreneurship in government can take the form of long-term Government-Wide Acquisitions Contracts (GWACs) for IT products, where the sponsoring enterprise assembles an acquisition contract that other agencies can use for a fee. The Clinger-Cohen Act of 1996 allowed for the formation of these IT GWACs.

Case Studies

1. Franchise Fund Pilot Program

Six franchise funds were established as a pilot program through the 1994 GMRA. These funded pilot programs act as internal entrepreneurs and are authorized to provide their customers—other government agencies—with administrative support services. The goal of this program was to lower the unit cost of administrative services by introducing competition and economies of scale, and eliminating duplicated services. The pilot program also established several operating criteria, including competition, transparent pricing, full cost recovery, surge capacity, performance measurements, and benchmarks against competitors.

In 2002, John Callahan reported on the achievement of the GMRA experiment.[85] He assessed the overall program to be a success; however, this conclusion is reached by measuring only the limited available data that compares the first two full years of operation: FY 1997 and FY 1998. In these two years, the funds generated $600 million in rev-

enues. For the funds with available data, the growth in revenues averaged 128 percent, with a low of 1 percent to a high of 468 percent. The vast majority of this business (from 50 percent to 95 percent) was handled by private contractors, yet the services were managed and monitored by the government employees who have the organizational knowledge to meet the needs of their customers. In addition to financial strength, the funds demonstrated their ability to compete—four franchises competed for a total of 60 bids and won 43 to 100 percent of the competitions. Finally, savings were achieved for customers of four funds. The results are given in Table 6 below for five franchises; two of them are described in more detail below.

Federal Occupational Health

The Federal Occupational Health (FOH) fund was created in the Department of Health and Human Services (HHS) to provide basic occupational health services to locations across the country, ranging from physical and mental health care to workplace safety training and hazard protection. The agency manages the subcontracting service providers—84 "core" government employees oversee the tasks of over 1,600 contracted employees. These core employees, similar to those in other funds, have developed essential managerial and marketing skills to provide high-quality, customer-focused services, often custom-tailored to fit the customers' needs. This attention to the customer has paid off—the FOH received 88 to 92 percent "excellent" or "good" responses on five measures of customer satisfaction. However, some fund managers were concerned that with these marketable customer skills, their core staff would move to private industry for better pay.

As a measure of the fund's overall success, the FOH managed to achieve a 10 percent growth in revenue from FY 1996 to FY 2001 (from $84.9 million to $93.6 million). In addition to creating revenue growth, the FOH worked with HHS to intelligently manage risk. One of the potential disadvantages of the franchise structure is that, similar to PPP initiatives, the government assumes a higher level of risk. While the FOH aggressively sought new customers, offering such quick services as the anthrax inoculation needed by the U.S. Army, the franchise was careful not to take on risks that could have been too great. HHS turned down a proposal by the FOH to manage environmental cleanup of a contaminated U.S. Navy site, citing the potential for FOH to incur costly legal liability for the site. The FOH has also considered its strengths in competing for services, moving more toward reasonably priced, quality services and away from lower-quality and lower-priced services.

Table 6: Characteristics of Franchise Funds, FY 1997–FY 1998[86]

Franchise Fund	Year Started	Service Efficiency	Revenue Growth	Full-Time Employees	Percent Business Private Contractor	Competitive Bidding
Department of the Treasury	1996	7–27% support cost reductions	$37–$80 million	84 (120 FTEs)	84%	10 bids, 50% won
Department of Health and Human Services	1997	Reduced clinical training costs	$81–$82 million (by FY01, $93.5 M)	103 (90 FTEs)	87%	21 bids, 43% won
Department of Veterans Affairs	1996	83% unit rates decreased	$59.2–$88 million	433 (546 FTEs)	50%	25 bids, 100% won
Department of the Interior	1996	n/a	$3.4–$19.3 million	12 (58 FTEs)	85%	4 bids, 50% won
Environmental Protection Agency	1996	9.6–20% cost savings in business units	$104–$111 million	65 (59 FTEs)	95%	None

Treasury Franchise Fund

The Treasury Franchise Fund (TFF) was designated as a way for the Treasury Department to provide a wide range of administrative services, from accounting and auditor training to mail and messenger services. The TFF has a core staff of 490 employees, with subcontractors performing the majority of the services (and receiving 83 percent of the revenue). The TFF was designed with strict rules:

- Operating costs cannot be subsidized.
- Quarterly statements must be issued.
- Annual audits must be conducted.
- Benchmarks are used to measure service performance.

But given this strict financial and performance scrutiny, the business units within the TFF act as fairly self-sustaining units, as separate private entities would.

By FY 2000, the TFF had met all of its benchmarks of performance, including measures of customer service, financial self-sufficiency, and competitiveness. Compared to the FOH, the TFF has achieved an even greater growth in revenue, from $38 million in FY 1997 to $165 million in FY 2000 (an increase of 334 percent). Additionally, the TFF exceeded its customer service approval rating of 80 percent in both 1999 and 2000. High customer approval may in part be attributed to the fact that customers of TFF have reduced administrative costs from 7.3 percent of the budget to 5.5 percent. But, given these successes, the TFF has concerns that its temporary pilot status, as well as impending retirements of its core staff, will impede its future success.

With this initial success, the Treasury decided in 2000 to launch a new advertising brand called FedSource, with the three franchises under TFF combining to market their services. They currently maintain a website advertising their services, which is indistinguishable from that of a private company. Other enterprises have followed this marketing strategy; in 2002, GovWorks was created as a trademarked brand for an enterprise operating within the Department of the Interior.

2. Government-Wide Information Technology Acquisition Contracts[87]

In 1996, Congress passed the Clinger-Cohen Act, which replaced the 1965 Brooks Act and enabled agencies to assemble long-term, government-wide acquisition contracts, or GWACs, for IT products and to charge fees for their use. The goal of this enterprise was to offer agencies a faster, cheaper alternative to competing sources and writing their own contracts, thereby saving those administrative costs.

The National Institutes of Health's Information Technology Acquisition and Assessment Center (NITAAC) stepped up to the challenge and awarded Indefinite-Delivery, Indefinite-Quantity (IDIQ) contracts. These contracts enable companies to constantly bid for every order through a faster purchasing cycle, rather than opening a lengthy competition process for each order. NITAAC's IDIQ initiative successfully attracted the business previously lost within its own department.

In 1996, the Department of Transportation formed a franchise called the Transportation Administrative Services Center (TASC) to handle administrative services for a fee. With a focus on providing good service to customers at a fair price, TASC offered a GWAC called Information Technology Omnibus Procurement (ITOP), which by 1999 was used by more than four agencies to make 250 orders worth $851 million. The process benefited the agencies involved by saving them time; the normal contracting process took approximately one year, while with ITOP it took a mere six to eight weeks. By charging fees of 1 percent to 2.75 percent, ITOP generated income of roughly $20 million from the orders. To attract more customers, fees are set in a range based on the amount of work the customer is willing to perform. The success of the first ITOP allowed for an ITOP II, a $10 billion multi-agency pact awarded in 1999.

Thus government entrepreneurs took advantage of the loosening of government restrictions on the procurement process by creating contracts for agencies to share—saving both time and money. Once again, entrepreneurs succeeded by seizing an opportunity and focusing on customer service demands.

3. The Forest Service[88]

After staff and budget cuts in the 1990s left the Forest Service short on skilled staff, the agency experimented with a plan to create competitive, self-supporting enterprises within the agency. Unlike other government businesses that are hesitant to provide services core to their missions, the Forest Service enterprises utilize the expertise of its staff to provide trail services and tree assessments for timber yields, along with more administrative services like workers' compensation claims. In the first year, workers' compensation services resolved eight cases that saved the Forest Service $244,000 (as much as $4 million over the course of the employees' lives). One employee was able to save his job by capitalizing on his skills as a tree measurer and sell his services as an entrepreneur.

In order to give these enterprises the freedom to take risks and act independently, the Forest Service had them report to a separate department called the "reinvention laboratory," established with the mission of fostering innovation. Because these enterprises must cover all overhead costs, along with salaries and benefits, the laboratory provides them with advisory financial services. With this help, the enterprises are able to keep close watch over their finances, calculating their true costs and knowing where they can cut costs (e.g., several offices moved to lower-cost rental space). In addition to financial help, the laboratories have supported employees through the difficult transition from bureaucrat to entrepreneur, and have enlisted the support of local managers as well as the union located in the forest area served by the enterprises (called Region 5).

After four years, Region 5 fostered the growth of 18 enterprises. Through the financial and managerial support of the laboratory, most of the enterprises were able to cover their costs within the first year. Additionally, employees gained valuable marketing, accounting, and innovative skills through the experience.

4. e-Payroll for the Federal Government

In 2002, the Office of Personnel Management (OPM) started a program called the e-Payroll initiative, which consolidates the entire federal payroll operations into the hands of four agencies, including two franchises: the Department of Agriculture's National Finance Center and the Interior Department's National Business Center. Government agencies must decide which of the four agencies they will pay to operate their payroll systems. The idea behind the initiative is that by taking advantage of economies of scale, agencies will be able to lower their current costs of cutting checks (costs which average between $32 to $663 per payee, annually).

A 2001 analysis for OMB[89] reported that the e-Payroll initiative could greatly reduce costs and avoid expensive system improvements with the consolidation of the payroll system. The problems they identified with the current system included a lack of standardized payroll processes; software systems 13 to 35 years old supporting 80 percent of payroll transactions; and potential systems infrastructure improvements that could cost up to $200 million per system. To remedy these problems, the report recommended the following:

- Designate OPM to manage payroll policy and operations, allowing for a centralized analysis of processes and better decision-making capabilities.
- Standardize federal payroll policies and processes. This would create cost savings through easier consolidation, and provide more timely and improved financial information for managers to use.
- Consolidate systems, allowing for a choice among two to three providers. This would reduce costs through economies of scale, and avoid large-scale system improvement costs associated with having 14 providers. Consolidation also reduces the number of government employees devoted to non-core missions.
- Integrate human resources and payroll processes, reducing redundancies and lowering overhead.

OPM has adopted many of these suggestions, including the consolidation of providers down to four agencies. It estimates that costs of migration of payroll systems to the four providers will be $40 million this fiscal year and $50 million next fiscal year.[90] Technology replacements for the four systems will occur in 2005. While this plan will likely result in savings from consolidation and cost avoidance, it lacks a key element: competition. Since

Strengths and Weaknesses of Government Entrepreneurship

Strengths

- Franchising provides administrative services to government agencies in a competitive environment, thus improving performance and lowering costs
- Franchising enables government agencies to acknowledge the true costs of their services, and subsequently adjust to save costs

Weaknesses

- Funds are relatively independent from political oversight and accountability to Congress.
- There is a potential for the agency to lose sight of its core functions.
- There is a tendency not to use competition, and thus lose the incentive for higher performance at lower costs.

agencies are assigned to a service provider, there is no strong incentive for costs to remain low, and the initial savings realized may not last.

Lessons Learned and Recommendations

1. **Government "customers" save money and receive quality services.** Much of the cost savings is due to the ability of franchises to aggregate the service needs of smaller agencies and then use economies of scale to charge lower prices for them.[91]
2. **Fees paid to enterprises can provide full cost coverage.** With financial help from the reinvention laboratory, Forest Service franchises charged fees that reflected true hourly rates of their staff, and most were able to cover costs within a year. Within one year of the formation of the six government franchises, three had plans in place for full cost recovery.
3. **Employees develop strong managerial and customer-service skills.** By having to compete with other enterprises, employees must maintain a strong focus on customer service and meeting demand, and have the skills to market the services and the financial know-how to cover the costs of operations. While these highly qualified employees contribute to the success of the enterprises, managers worry that these skilled individuals will be lost to higher paying jobs in the private sector.
4. **"Franchise funds" maintain the role of government as "manager" while allowing private contractors to be the "provider."** Close to 80 percent of federal "franchise" revenues go competitively to private firms,[92] while government workers with organizational knowledge are able to maintain control over the operations and meet the needs of customers. The fact that the majority of funds go into private companies counters the criticism by private contractors that government businesses unfairly favor the government.
5. **An event or opportunity is often necessary to enact change.** The Forest Service used impending staff and budget cuts to gain support for enterprises as a "do or die" solution. NITAAC and TASC took advantage of the Clinger-Cohen Act to develop the successful shared-IT acquisition contracts.
6. **Strong leadership and support at the top is necessary for success.** A business unit within the Treasury Franchise Fund was forced to shut down after failing to cover costs in 2000 and 2001. The unit succeeded in 1998 and 1999, but after a leadership change in the Treasury Department led to a lack of support and a more micromanaging style overseeing the unit, the unit had a high turnover of staff and failed to perform.[93] On the other hand, the leadership and support given by the reinvention laboratory was crucial for the success of the Forest Service enterprises, having offered financial advice and obtained the support of the regional managers and union.[94]
7. **Services in demand need to be identified.** The Forest Service staff decided to offer workers' compensation services when they saw claims falling through the cracks. The IT GWACs were a response to the lengthy procurement process that agencies were willing to pay fees to circumvent.

8. **The focus must be on the primary mission and political accountability of the agency.** Enterprises need to be monitored to ensure that the core mission of the agency is not compromised. As Congress loses budgetary control with the increase of franchises, there is concern about the level of political accountability that remains. Some of these concerns will be addressed, as OMB now requires agencies to report the number of employees funded by fee-for-service agreements, and is moving to make the interagency contracts open to competition more frequently.[95]

9. **Maintaining competition among franchises will be key to long-term efficiency**. While the OPM e-Payroll initiative will likely result in savings in the near future, because agencies are assigned to one of the four franchise providers, the project will not have the future benefit of competition.

Contractors in Security Operations: A Special Case

Although not a distinctive sourcing strategy, the use of contractors in security operations (including on or near the battlefield) poses some unique issues that are addressed here.

Definition

Using contractors in security operations has developed as a method to achieve more cost effectiveness in the military, to compensate for military personnel cuts, to utilize the technological expertise of contractors, and to allow for flexibility from congressional troop limits. Contractors on the battlefield are not considered combatants, but rather civilians accompanying the force. Contractors provide the military with a wide variety of services, ranging from logistics support (i.e., maintenance, housing, food, and basic health care), recruitment and training, the development and operation of new technology, security services for State Department personnel, and even military operations.[96]

These contracts are basically a form of contracting-out for services (as described in the introduction in "Understanding Sourcing Options"). However, because of the risks involved to individuals and corporations performing the services, they have many unique requirements. Nonetheless, the overriding consideration is that they, like other contracting-out activities, receive their maximum benefits—in performance improvements and cost reductions—through the presence of competition; and they can be acquired and terminated as the services are needed (rather than hired as permanent government employees—military or civilian).

Overall, an estimated 1,000 U.S. companies now provide support of all sorts for the armed services.[97] It is clearly a growing trend. In the 1991 Persian Gulf war there were 10,800 contractor employees (making up 2 percent of those deployed), while in the mobilization in preparation for the 2003 Persian Gulf conflict there were 25,000 contractor employees (making up 11 percent of the deployment).[98] The positions are frequently filled and directed by former military officers and enlisted personnel. Nonetheless, it is a requirement that contractors send employees who will be stationed for 30 days or more near the front lines to Fort Benning, Georgia, for training and equipment (including seminars on the region they are going to, and all required documentation and equipment).[99]

Various Forms[100]

Theater support contractors provide services to deployed forces that meet the immediate needs of the operational commander, conducted under the authority of the theater principal authority responsible for contracting (PARC). Examples of services provided include construction, port operations, transportation, and security.

External support contractors provide support to deployed forces that augment the shortage of military capabilities through contracts that are administered by organizations other than the PARC. Many external contractors work within a pre-arranged umbrella contract called the Logistics Civil Augmentation Program (LOGCAP), in addition to the Air Force Contract Augmentation Program (AFCAP). Much of this base operating support is provided to peacekeeping deployments.

Systems contractors provide support to material systems by enhancing their readiness, and by offering mission-enhancing and mission-essential maintenance and operation services. Many of these contractors contribute sophisticated technical expertise to operate some of the equipment used by the military.

Case Studies

1. Logistics Civil Augmentation Program (LOGCAP): Two Cases

Since 1992, the Army has used LOGCAP to hire contractors to provide logistics and engineering support to contingency operations. The U.S. Army Materiel Command centrally manages and administers the contract, which involves worldwide and regional planning before the contractors begin. The Army's principle is to use the LOGCAP contract as a last resort measure, such as lack of host nation support, and to allow military units to fulfill their primary obligations (without exceeding troop ceilings).[101] From 1992 to 1995, LOGCAP provided logistics support in the form of construction, food supply, maintenance, and transport services for seven major operations in Somalia, Rwanda, Haiti, Saudi Arabia/Kuwait, Italy, and Bosnia.

Brown & Root in Bosnia

In 1992, the Army contracted with Brown & Root Services (BRS)—after a competition with three other companies—to provide logistics services at military bases and camps in Bosnia. The logistics services provided included basic life support, engineering, and maintenance work for Operation Joint Endeavor.[102] Both the Army and BRS claim that by not having the military perform the support services, the contract saved the government 30 percent in costs.[103] BRS hired about 6,700 workers, and paid them at lower local wages to perform the tasks that would have normally required 8,500 troops (a personnel reduction of 21 percent).[104] Freed from much of the logistics activity, the units then had more troops available for combat and humanitarian operations.

In spite of these very significant benefits, in reviewing the operations of BRS in the Balkans, a GAO study[105] concluded that the Army needed to provide more continuous oversight of the contractor to ensure that costs were controlled. Between 1995 and 2000, private contractors received 10 percent of the $13.8 billion spent on operations in the Balkans. Yet by 2000, the Army was only beginning to attempt to keep contractor costs down, and was exercising minimal control over the costs of recurring services. Employees were found to be frequently idle, as BRS had hired too many local employees. Part of this lack of control is attributed to the nature of the Balkans Support Contract. Because the contract is a cost reimbursement, performance-based contract, the government gives the contractors a fair amount of freedom to perform the generalized tasks required. In addition, the government civilians in charge of administering the contract rotated every six months, preventing them from developing an expertise on the contract and from building relationships with the contractors to ensure efficient operations. Finally, the study found that the government and contract personnel were never clear on how much authority the government had over the contracts, nor were they properly trained to implement such a contract.

DynCorp in East Timor[106]

In 1999, the Army called on LOGCAP to provide heavy helicopter lift support in East Timor, where a U.S. force was deployed. The former province of Indonesia had mountainous terrain and poor infrastructure that required the contracting of the helicopter service for the transport of refugees and humanitarian supplies. The Army paid DynCorp $10 million for the contract in order to free up what would have been a large U.S. military presence on the island for an indefinite period of time. The soldiers used for supervision were deployed from an Army Reserve unit, a unit under the operational control of the Army Materiel Command (AMC), the LOGCAP manager. DynCorp had to quickly complete a market survey in order for LOGCAP to estimate the costs and to ensure that the contract would be feasible. Once the contract was authorized, DynCorp and its subcontractors prepared for the helicopter mission and ground support required to replace the Navy and Marine Corps forces. After several days, a base camp was constructed to receive the helicopters and for DynCorp staff. The helicopters were able to complete more than 39 flying hours, transporting 434 passengers and over 28,000 pounds of cargo in just nine days.[107] Thus

the contractor was able to quickly respond and meet the entire needs of the Army in East Timor while allowing the U.S. military to perform important functions elsewhere.

2. Logistics Support for Weapons Systems: Two Cases

Because of the high skill required to maintain many of today's modern weapon systems, contractors have been increasingly involved—first, in the United States and, in growing numbers since Vietnam, on or near the front lines.

In 2002 the GAO examined a large number of contractor-supported weapon systems used by the Army and Navy.[108] The average projected cost savings were 20 percent, and significant performance benefits were also projected. The Army and Navy broadly measured the performance of the contractors between 1998 and 2001. The contractors for the Army performed "satisfactory" or above in 98 percent of 100 cases, and 93.4 percent of contractors were "satisfactory" or above for 802 cases in the Navy. However, the GAO found that costs were not adequately monitored—either before or after the contractor involvement—so demonstration of the savings was difficult.

Additionally, the study pointed out a number of areas to focus on in such contract work in the future:

- The use of contractors in support of weapons systems reduces the minimum amount of technical skills for military personnel that are required for war-fighting capability. (So care should be paid to training in this area.)
- There are concerns with contractors on the battlefield regarding their willingness to stay on or near the battlefield during hostilities, which could weaken wartime missions. (Although current experience—due to their military backgrounds—has not found this to be the case.)
- Protection of the contractors requires diverted personnel and resources. (So thorough planning is required for deploying, protecting, and managing contractors, and verifying compliance.)
- Because contracts are treated as relatively fixed obligations, there is limited flexibility with funding. This limits the transfer of funds to respond to changing needs and requirements of weapons systems. (So contractors should provide adequate flexibility.)
- DoD must assure that contractor maintenance costs for their original equipment is reasonably priced.

Air Force F-117 Aircraft Support[109]

In 1998, the Air Force entered into a contract with Lockheed Martin to provide the systems support for the operation of the F-117 fleet. The contract, called Total System Performance Responsibility (TSPR), had built-in performance measures and projections of cost savings, in addition to profit incentives for improvements in the reliability of the fleet.[110] The contract also required the company to respond to maintenance requests within 24 hours.

Within two years, savings of $30 million were achieved,[111] the majority of which derived from the reduction in personnel from 242 to 55 in the government's F-117 System Program Office. Personnel reductions were estimated to save $90 million over the life of the contract, and with other efficiencies incorporated, total savings are estimated at $170 million. In addition to cost effectiveness, the contract provided performance improvements to the fleet. All of the TSPR performance measures were exceeded. The Air Force sets a goal of keeping the number of non-mission-capable aircraft down to 7 percent of the fleet; the rate for the F-117 was 5 percent the first year, decreasing to less than 3 percent by 2001, significantly less than many (most) Air Force systems.

Deployment Through Private Transportation

The crucial mission of transferring deployed troops is increasingly performed by the private sector. During the Persian Gulf War, 85 percent of troops and cargo were transported by commercial aircraft and ships. Since then, the military has sought to reduce deployment time with upgrades; however, the military is facing shortfalls and is turning to commercial aircraft and shipping to meet transport needs.[112] The Air Force is planning to purchase, or lease, commercial jetliners from Boeing (for transportation as well as for refueling), while the Military Sealift Command charters foreign vessels

Strengths and Weaknesses of Contractors in Security Operations

Strengths

- The use of contractors allows military personnel to focus on core missions and stay within troop ceilings.
- Cost savings are achieved through flexibility offered to the military in hiring contractors to provide a service when required.
- The military can take advantage of sophisticated technology offered through the private sector.
- The military can use commercial transport capabilities to meet surge requirements.

Weaknesses

- The potential unwillingness of contractors to work during periods of hostility can hinder the war-fighting capabilities of the deployed troops.
- The need for commanders to offer contractors protection can detract from mission.
- The vague legal status of contractors can cause difficulties.
- Commercial transport may lack the security that military transport provides for troops and cargo.

from allies. Even though the private sector is able to fulfill this important role and assist the military in meeting surge requirements, there are still concerns regarding security. A 2002 GAO study[113] found that there are serious risks posed to commercial ships and commercial seaports being used for troop deployment, as the DoD is limited in its ability to provide adequate security at various stages in transit. With an increase in reliance on commercial craft for deployment, there is greater potential for harm as these craft enter regions in close proximity to the battlefield. Therefore, the DoD needs to assess these new security risks and take appropriate measures to address them.

Lessons Learned and Recommendations

1. **Use of contractors allows military to circumvent troop ceilings.** When Congress placed a limit of 20,000 troops to be stationed in Bosnia, the executive branch circumvented that restriction by providing another 2,000 contractors.[114] This allowed the Army to move support functions to contractors so the remaining troops could focus on peace operations. Contractors are also able to hire local citizens in a station where there are caps on the number of military and civilian personnel. This practice does raise issues as to the level of authority the executive branch assumes when working around congressional troop limits.
2. **More continuous oversight of the contractor is required to ensure that costs are controlled.** As the GAO study on contractors supporting weapons systems demonstrated, the DoD often does not maintain adequate information on the costs and performance exhibited over the course of the contract, and how it compares to initial expectations.
3. **Deployment of temporary workers is cost-effective.** Since the Gulf War, overall military forces have fallen by 500,000, but the number of regional operations has increased. To compensate for the loss of military personnel, the DoD and State Department have been using temporary, private contractors to save money and fill in workers for short-term use, allowing remaining troops to focus on fighting.
4. **Commercial transportation can compensate for low capacity in the military.** The use of private ships, aircraft, railroads, and trucking can fulfill the growing demands of the military to meet capacity requirements.
5. **More permanent government contract administrators/managers should be hired to better oversee commercial contracts.** The Brown & Root case demonstrates how a lack of consistent personnel to administer contracts lessened government control, and resultant cost effectiveness, of the contract.[115]
6. **Proximity to the battlefield can endanger contractors, even with legal protections in status.** The Geneva Convention recognizes the status of contractors as "Civilians Accompanying the Force" (CAF), yet this status is irrelevant if the enemy does not recognize it. Additionally, contractors who support weapon systems in a

hostile environment are evolving away from a purely civilian role. This highlights the need for further examination of the CAF requirements as the line between combatant and contractor blurs.[136]

7. **A high degree of planning is necessary for contractors on the battlefield to deploy and operate without detracting from combat effectiveness.** Because the commander is responsible for the contractors' safety, it is important that detailed plans are made in advance to cover the contractors' arrival, numbers, positioning on the battlefield, protection, and emergency life support needs.[137]

8. **Improved security measures are needed for future private transportation.** As the GAO study demonstrated, the DoD is lacking in adequate research, planning, and protection for the security needs of commercial ships, seaports, railroads, and port workers involved in transporting military cargo and personnel.

9. **Contractors do not have to follow military codes of conduct.** Private contractors are obligated to take orders only from their employer (the firm hired by the DoD), and are not subject to military discipline. In a case where DynCorp employees were found to be operating a sex ring for underaged women in Bosnia, employees involved were merely fired, and were not subject to any form of military (or local) discipline.[138] In addition to discipline issues, because contractors are not required to take military orders, they pose a threat to themselves and raise questions as to the level of responsibility that military personnel have over their safety.

Findings and Conclusions

From the cases examined, one can reach two overriding conclusions:

- Competition, when properly emphasizing both performance and cost (i.e., best value), can have significant benefits—specifically, in achieving better results at lower costs, regardless of whether the winner is the public or the private sector.
- However, this is not automatically achieved. It requires the government to properly manage the winner (again, either public or private sector) and to have a credible option of reintroducing competition should performance fall off or costs rise.

It is also clear from the examples studied that there is a wide variety of forms that the shift from the "government as the doer" to the "government as the manager of the doers" can take; and that in many circumstances, there really is no single "right answer." It is simply a management judgment. However, almost any choice can have very significant benefits if properly implemented. Thus, there is a very real need for the government to educate and train acquisition personnel in this increasingly important field so that they will have the management skills and the experience to achieve the best possible results at the lowest possible costs.

Concerns about the Changing Role of Government

As would be expected, there has been resistance to the implementation of this whole shift in the role of the government from the "provider" to the "manager of the providers." Specifically, six concerns have been raised whenever the issue comes up.

1. Performance will deteriorate (since industry will focus on profits and not public needs; and since the government is more experienced at these jobs, they will do it better).
2. Costs will be higher (since government employees are paid less than in industry and the government doesn't have to add on a "fee").
3. The promised savings (from the competitions) will not be realized over time.
4. Small businesses will be negatively impacted (since the small contracts will now be part of a much larger overall competition for the full function).
5. A large number of government employees will be involuntarily separated (as a result of their either losing the competition to the private sector or as a result of their having to become much more efficient in order to win the competition).
6. There will be a significant loss of control by government management (as a result of contracting out much of the work).

It might be noted that these six points are not listed here in priority order (in fact, the fifth and sixth items are the ones of greatest concern to the employees and to the government, respectively); but they are usually not explicitly raised—except by the politicians. Rather, when trying to argue against any form of shift of government functions,

Table 7: Clarifying the Debate about Market-based Government

Common Concerns	Study Findings
Performance will deteriorate.	Performance improves significantly.
Costs will be higher.	Costs decrease significantly.
Promised savings will not be realized over time.	Promised savings are realized over time.
Small businesses will be negatively impacted.	Small businesses have actually benefited.
A large number of government employees will be separated.	Involuntary separations of government employees are few.
Government management has a significant loss of control.	Government actually has greater control.

they will raise the first four points. But the last two are implicit—and the biggest barriers.

Importantly, each of these six points has a valid basis for concern, and needs to be explicitly addressed in any government decision making as it shifts work to a competitive environment. However, the reality is that when each of them is directly addressed—and in most programs, they have been—*the results indicate that these "concerns" are not based on realized results, and that the empirical data refute all six of them.* The next section will provide the findings based on the case study results.

Findings

1. Performance Improves Significantly

As noted above, many of the earlier efforts at shifting the role of government were done at the local (city) level. In 1995, a survey of 100 of the largest cities in the United States was conducted with regard to their efforts at "privatization."[19] (This term is often used—although improperly—as a collective term for the various forms of shifting work from a government monopoly to a competitive environment.) Of the 66 responding cities, 82 percent reported that they were satisfied or very satisfied with privatization, and the remaining 18 percent were neutral. None said they were dissatisfied. In explaining their reasons for having decided to privatize, 54 percent replied that they had done it to reduce costs, while 30 percent did it to improve service. However, in after-the-fact reports they found an average improvement in service delivery of about 25 percent for each of the four major service areas: public works/transportation, public safety, human services, and parks and recreation.

Typical results achieved in various studies of city transportation systems give a feeling for the gains. For example, one study of Los Angeles public transportation from 1980 to 1996 showed service reliability increases of 300 percent and complaints reduced by 75 percent. Similar results in Denver, San Diego, Indianapolis, and Las Vegas showed service-level increases from 26 percent to 243 percent. It must be emphasized that for these five examples of public transportation, shifts from a public monopoly to a competitive environment not only improved performance dramatically, but also achieved savings that ranged from 20 percent to 60 percent, compared to the costs of the non-competitive services of the past. Another example is that of Indianapolis' wastewater treatment where, in the competitive environment, the city partnered with a private water supply utility. In this case, employee accidents fell by 70 percent and effluent violations fell 86 percent—and costs of the operation's partnership fell by 40 percent.

Similar results have been achieved at the federal level. For example, when the U.S. Navy changed from having all its moving being centrally controlled and allocated by the military traffic management command (in a non-competitive fashion) to allowing sailors to choose their own moving companies from the private sector (in a competitive fashion),

the customer satisfaction increased from 23 percent to 95 percent and the damage claims dropped from 1 in 4 to 1 in 12 moves. As another example, when the British privatized their telecommunications service in 1994, the call failures dropped from 1 in 25 to 1 in 200, and the number of public pay phones increased by 83 percent.

Finally, there have been many examples in the Department of Defense in recent years where they have shifted from having government workers perform equipment maintenance (known as "organic maintenance") to having the work competitively sourced in one form or another. In each case, there was a significant improvement in the availability and reliability of the systems, while at the same time there was a significant reduction in cost. As an example, when the Navy went (in competition) to a public-private partnership for the maintenance and logistics support (spare parts, etc.) of an auxiliary power unit (APU) for its carrier-based aircraft (from a prior government monopoly of this work), they found that the reliability of the APUs increased by more than a factor of 10. In addition, the mean flight hours between unscheduled removals for the P-3 aircraft improved 300 percent, for the F/A-18 aircraft by 45 percent, and for the S-3 and C-2 aircraft by 15 to 25 percent. Further, when the Navy went to war in Afghanistan, the public-private partnership was able to "surge" by 50 percent to fill all of the emergency demands. As another example, when the Navy competitively outsourced its jet trainer maintenance, its "fully mission capable rate" increased by 13 percent while the direct man-hours required for maintenance decreased by 33 percent, thus showing that the increased reliability was not achieved by increased costs, but from increased efficiency in the process.

The fact that the performance increased while costs went down in these and the other cases described in "Understanding Sourcing Options" indicates that if the contracts are focused on this combination of increased performance and lower costs, innovation within the companies will be required to improve both efficiency and effectiveness. Additionally, the examples show that companies can still make a profit while the total cost to the government goes down significantly, allowing the government to both save money and receive better services.

2. Costs Decrease Significantly

Many analyses of this shift from the government as the "doer" to the "manager of the doers" compare the costs as bid from the competitive environment with those which were the best estimates of the government's actual costs prior to the competition. As the performance data above indicate, even though performance improvements were sometimes the objective of the competitions, there was still a significant focus on cost reduction; and, in fact, the cost reductions were achieved. However, in most cases the government's purpose in pursuing the competition was primarily that of cost reduction. For example, in the Department of Defense there were 2,138 competitions run from 1978 to 1994 (usually between private bidders and the current government workforce—where the latter could bid their "most efficient organization," and to win, the private sector had to be 10 percent less than that). *The average cost savings projected as a result of these competitions was 31 percent* (specifically, for the Army, 27 percent; the Air Force, 36 percent; the Marine Corps, 34 percent; the Navy, 30 percent; and the Defense agencies, 28 percent.)[120]

Subsequently, the General Accounting Office performed a competitive sourcing analysis of the more recent time period from FY 1995 to FY 1999.[121] They looked at 286 "studies" (the term-of-art for these competitions) by the Department of Defense. For these, the DoD actually competed 138 between the public and private sectors, of which 40 percent were won by the private sector and 60 percent by the public sector. They also had 148 "direct conversions," of which 134 were moved from the public to the private sector (and then competed there), and the other 14 were actually conversions from the private sector back to the public sector. From these 286 efforts, the Department of Defense reported cost savings of 39 percent. The GAO concluded that they could not precisely verify the savings (partly because of the difficulty of determining the actual government baseline cost prior to the competition), but they did state that "the savings from the studies between public and private sector competitions are substantial and sustained over time."

Finally, in another analysis, based on DoD CAMIS[122] data of public/private competitions by the Department of Defense from FY 1997 through FY 2001, where there were 314 comparisons made,

the number of people required to do the work was (on average) reduced by 35 percent; yet only 40 percent of these competitions were won by the private sector. The conclusion one might reach is that when the public sector is forced to compete, they are able to do the same work just as well, or better, than before the competitions, but with significantly fewer people—in fact, frequently with 20 to 40 percent fewer people.

Interestingly, similar results in terms of the savings realized have been found at the state and even local levels, as well as on international comparisons (as seen earlier in "Understanding Sourcing Options"). For example, two studies were conducted by the auditor/controller of Los Angeles County for the 1980s time period that showed savings of 32 percent and 28 percent.[123]

Importantly, the productivity gains through this competitive process resulted, in general, from more work performed per employee per unit time, not from lower wages. A study by the National Commission for Employment Policy found no significant pattern of lower wages paid by private contractors.[124] In fact, a detailed survey of municipal privatization in Illinois found that 78 percent reported that wages were the same (40 percent) or greater (38 percent) than municipal wages paid for that same work.[125] One early study attempting to analyze this phenomenon concluded that there is no statistically significant difference between municipal and contract work with respect to salaries or the costs of fringe benefits. The study found that the observed cost difference is accounted for by productivity factors (including using lower-skilled workers for appropriate work, holding managers more responsible for the work of their employees, giving first-line supervisors more hire and fire flexibility, using incentive systems, making the work less labor intensive through capital equipment investments, and having a higher ratio of workers to supervisors).[126] In fact, in many cases the private sector will use higher-paid workers because of their greater experience, innovation, or skills. Thus, if one higher-paid worker can do the work of three lower-paid workers, the costs are still significantly less. (Unfortunately, too often the government uses individual workers' hourly pay as the measure of total cost, which is clearly not an appropriate way to measure overall productivity.)

3. Promised Savings Are Realized Over Time

The conclusion that promised savings are realized over time is conditioned by the potential for future competition to be maintained after the initial award. In fact, at least two studies have gone back and shown that when the public sector has won the initial competitions, there has been no effort made to reintroduce the potential for competition and, therefore, in many of those cases, the promised savings have not been realized.[127] However, when the potential for reintroducing competition was present—in order to create the necessary incentives for either the public or private sector to not only realize their promised savings but to continue to introduce productivity innovations for improved performance at a lower cost—then the promised savings have been realized (as found by not only the GAO but also a number of independent studies).

For example, the Center for Naval Analysis reviewed 16 specific competitions and found that the average expected savings (as bid by the winner, whether it be government or private) was 35 percent.[128] The actual savings (as measured after the fact) on those 16 programs was 24 percent, but that included increased scope and quantity increases to the contracts. When those changes mandated by the government were removed, then the realized savings for the same scope and quantity as had been originally contracted was 34 percent. In effect, not only did the government fully realize the savings that had been projected, but it also gained significant increases in scope and quantity for less money than had been expended originally for significantly less work.

Similarly, a RAND Corporation study of six contracts in which the expected savings for contractor wins ranged from 41 percent to 59 percent, and for the government employees' wins from 34 percent to 59 percent, found that the contractors' savings were sustained over time—but no total data was kept for the in-house wins, so direct comparisons could not be made. However, by comparing the government head counts before the competition with those promised by the government bidders (their "Most Efficient Organization" bid) and observing that the resultant head count was close to the MEO, there was some confidence that the promised reductions were realized.[129]

One area that the Department of Defense has recently been moving into is that of having contractors replace military personnel and/or civilian government workers in areas outside of the continental United States—including on the "battlefield" (see "Contractors in Security Operations: A Special Case"). For example, the firm of Brown and Root was hired to provide logistics services at a military base in Bosnia. This had a number of significant advantages. First, and most obvious, the contractor was able to do the work with 21 percent fewer laborers. Second, the contractor was able to hire workers at local salary levels (which were significantly less). Third, the contractor could hire workers as needed and could terminate them when they were no longer required. Finally, it freed up soldiers to perform war-fighting functions. Thus, the savings to the Army were quite significant—without any reduction (and in fact with some significant improvement) in reported performance.[130]

Similar realized results have been achieved at the state and local levels. For example, the Public Service Electric and Gas Company in New Jersey contracted its recycling responsibilities to another firm. The private recycling company operates as a "material recovery facility" and is allowed to charge lower fees than landfills. With mechanized recycling and the sale of processed materials, the company can offer lower rates for disposal. Overall, the realized savings are approximately 42 percent.[131] As a final example, in Chicago the job of towing scrap vehicles (formerly a government responsibility) was given to a private-sector contractor. The private-sector company actually pays the city $25 per vehicle and then sells the vehicles as scrap, providing Chicago with revenues of $1.2 million when it was previously losing money.[132]

4. Small Businesses Have Actually Benefited

Government at all levels, and especially the federal government, uses contracting not only to procure goods and services, but also to achieve social objectives. There are laws and regulations that provide preferences to small businesses, women- and minority-owned businesses, nonprofit corporations, and firms that hire disadvantaged individuals; restrictions to buy only American-made products; preferences to hire veterans; and many others. These can have an impact on reducing competition unless these considerations are addressed directly.

Since many innovations and positive competitive pressures often come directly from small businesses, this report focuses on them. The conclusion that one can come to is that, contrary to the perceptions, small businesses have actually benefited.

Again, the finding that small businesses have actually benefited is conditional upon the fact that when the competitions are being conducted there is an explicit consideration of the potential small business impacts. Various techniques can be used to address this issue, from making the competitions specific small business set-asides, to allowing extra credit to small businesses on their bids, to requiring a significant percentage of the work to be done by small businesses through the larger prime contractor. Utilizing these and other techniques, the actual results have been quite encouraging for small businesses. When this fact is combined with the reality that advertising competitions on the Internet has significantly increased small businesses' participation (because they now have as much insight into the programs as do large companies with big marketing organizations, and because the small firms now have high visibility to the customer through their responses on the web), results for small business have been extremely positive. For example, between 1995 and 2001, the Department of Defense conducted 784 public-private competitions; 79 percent of all the contracts were awarded to small businesses.[133]

Additionally, many of the large outsourcing contracts had requirements for a significant share to go to small businesses as subcontracts. In fact, two of the largest awards of outsourcing by the Department of Defense—the Navy Marine Corps Intranet and the National Security Agency Intranet (both multi-billion dollar contracts)—each had a mandate of a 35 percent small business subcontract set-aside that the winner had to guarantee; and at least 10 percent of that subcontract effort had to be in direct-labor costs. This 35 percent requirement (of a multi-billion dollar contract) is obviously a much larger one than is typical for a government agency in direct contracting with small business, and is a large benefit to small contractors.

It must be emphasized that numerous studies show that a contracted-out activity can be made much more efficient through reengineering of a significant number of multiple functions than if each of

the small functions was separately contracted out (see Table 5, showing savings vs. size of the competitive effort.) Nonetheless, the government has traditionally found it much easier (for both internal and external political reasons) to separately contract for small awards. (Over 80 percent of the public-private competitions by the Department of Defense have been for fewer than 45 people each.) This makes no sense from either an efficiency or an effectiveness perspective. Yet it is greatly encouraged by the small-business people. The answer, from the perspective of both government and the small businesses, is to go to larger contracts but to require significant small business set-asides within them. In this way, one could satisfy the small business benefits as well as the efficiency and effectiveness associated with the potential for multi-functioned integration and economies of scale. This can be a "win-win" situation, but it does require the small business interests to recognize the value of the subcontracts, not just direct prime contracts from the government. (Legislation against "bundling" of small competitions into larger, multi-function competitions would be counterproductive to the government's interest.)

5. Involuntary Separations of Government Employees Are Few

The finding that only a small number of government employees will be involuntarily separated has come as somewhat of a surprise, since the above-noted figures indicate that there are labor savings of 20 to 40 percent (compared to the original government workforce), even when the government wins. However, all of the independent studies show that the vast majority of impacted employees can be well taken care of through a variety of actions. Again, this assumes consideration of this issue in the planning process associated with the competition.

In today's environment, when a military person is replaced by a contractor, that military person moves into a combat position. On the other hand, civilian employees of the government have numerous other options. In one study the GAO examined three DoD competitions[134] and found that of over 1,000 civilian positions that had to be reduced as a result of the savings on these three competitions (one in-house win and two contractor wins), 27 percent were transferred, 65 percent voluntarily retired or separated (17 percent of those who voluntarily separated or retired took jobs with the contractor) and only 8 percent were involuntarily separated. Another study led by the Center for Navy Analysis[135] found that the DoD has been very effective in minimizing involuntary job losses. They looked at competitions in large depot maintenance facilities where the promised reductions would amount to 40 percent of the employees scheduled to go. They determined that these employees either found other DoD or federal jobs, that many were hired by the winning contractor, and that others chose to retire; only 3.4 percent were actually involuntarily separated.

One specific case worth noting was an Army competition to replace an in-house group of 400 workers who were maintaining an old logistics information system written in the COBOL computer language. The Army decided to competitively outsource this work to any contractor who had an off-the-shelf commercial software package to do this work. However, they specified as a condition of the outsourcing that the winning contractor would have to hire 100 percent of the workers for at least one year, and that they would have to agree to train these workers in a modern computer language (e.g., C++). The workers would initially be utilized to maintain the old system during the transition and would, with additional training, be of much greater value to the contractor (or to any other contractor) than they would have been with their previous skills. The Army, of course, gained a much more efficient and effective logistics information system in the process. Subsequent testimony by the employees who had been hired by the winning contractor found that they were extremely pleased with the outcome of this effort. What this demonstrates is that manpower considerations can be made a major part of the competition itself, thus minimizing the negative personnel impacts.

Similar results (i.e., very few involuntary separations even though large personnel cutbacks result from the competitive sourcing process) are found in studies of competitions at the state and local levels. For example, a study of the privatization efforts in Los Angeles County[136] found that the elimination of 4,700 positions was accomplished with "only a handful of layoffs." Given the difficulty of getting rid of poor-performing government workers (at the

local, state, or federal levels), one perspective on these single-digit impacts is that the employees not shifted to other jobs or picked up by the winning contractors are most likely those at the bottom of the performance or skill rungs. Perhaps these losses are not that significant to the performance of the government functions.

Any time individuals (even a small number) must be involuntarily separated, there is a potential for personal hardships. This represents a social problem that clearly must be directly addressed; the government, however, cannot be viewed as a guarantor of permanent employment (regardless of performance) and still be expected to be efficient and effective.

6. Government Actually Has Greater Control

As noted above, it is essential that when the government makes an award to a performer (either public or private), it carefully monitors that performance using agreed-to metrics on both performance and cost. Government "control" after the competitive award is of such concern because many government managers feel that when they have the employees directly reporting to them, they somehow think they have more control than if they have to exercise control through a contractor. In reality, the government has very little ability to hire or fire civil service workers compared to the ability they have with contractors. In fact, the data show that there is very little cost visibility into the total cost of government work since most government organizations do not perform activities-based costing and therefore lack visibility of the indirect costs associated with their work. Additionally, changing processes within the government is extremely difficult, and innovation (as with most monopolies) tends to be stifled. Therefore, true control over change is minimized in such an environment.

Mayor Steven Goldsmith of Indianapolis asserted that he has "far more control over contractors than he ever had over his own in-house workforce; he can fire a contractor for poor performance but cannot do much with or to a malfunctioning city department."[137] He believed that this increased control was gained because governments will have to write a detailed performance specification for the contract (which they rarely do when the work is routinely done in-house), as well as because of the legendary rigidity of the civil service system (which is reinforced by union contracts, and which limits an official's managerial authority). In essence, the government managers can now utilize the competitive market to reward or replace, based on the measured performance and costs, under the contract. And with the threat of potential future competition, if the results are not the desirable ones, there is, in fact, greater control—in contrast with the government manager's lack of visibility or control in the presence of a government monopoly.

However, this obviously assumes that when the government awards a contract, it does not turn its back and walk away. Rather, the government must assume full managerial responsibility whether the work is done in-house or by a contractor.

Recommendations on Overcoming Barriers and Moving Ahead

The empirical data are very clear in refuting the six concerns (or perceptions) with regard to the changing role of the government from "provider" to "manager of the provider." While there have been significant increases in the number of positions being shifted, and while President Bush has made clear the privatization goals of his administration, there is still significant resistance to making these changes. This resistance begins with government workers' fears about losing their jobs and with government managers' concerns about loss of control. These then are reflected by local politicians and, in turn, at the federal level in Congress, where efforts have increasingly been made to legislate against such changes. Further, such changes are strongly resisted by the federal government workers' union.[138] Since the empirical evidence is so convincing with regard to improved performance and reduced costs as a result of the presence of competitive market courses (although concerns regarding lower performance and higher costs are still raised), it is clear that more explicit attention needs to be given to the political and personal concerns of the workers and managers—along with education on what the actual results are likely to be and how they can best be achieved.

This educational process needs to be extended not just to the federal level but down to the state and local levels. A 1989 survey of city officials in cities

with populations of more than 5,000 and county officials in counties with populations greater than 25,000 found that the greatest impediment to privatization by contracting is the fear of loss of control (which was named by 51 percent of the responding officials) and that employee (and union) resistance was second (identified by 47 percent of the respondents), while "politics" was third (as named by 42 percent).[139] A similar survey of U.S. state governments in 1992 identified loss of control and labor problems as the principal impediments to contracting for services.[140] These are concerns that must be explicitly addressed from perspectives of unions, government workers, and government managers. Undoubtedly the best way to address them is with empirical data and case studies that address the key concerns (some of which are described earlier in "Understanding Sourcing Options").

Nonetheless, there are also very real procedural barriers to be overcome. The most obvious of these is the procedure for competing the public against the private sectors at the federal level. This procedure, which is contained in OMB Circular A-76, was negotiated 36 years ago between the government unions and the executive branch, and has been in existence ever since. It has a number of major shortcomings, which were highlighted in a 2001–2002 congressionally mandated Commercial Activities Panel study (headed by the GAO).[141]

- In the first place, the current process uses "low cost" as the source selection criterion, and thus eliminates the possibility of making selections on the basis of "best value," i.e., balancing performance and cost.
- Second, the comparative "studies" (competitions) take far too long (an average of 25 months from start date until tentative decision date for the DoD studies from FY 1997 to FY 2001), and they cost far too much (one 2001 estimate ranged from $1,300 to $3,700 for each position competed).
- Finally, the current process provides no guidelines for selecting and grouping functions, which is highly desirable since the more functions that can be put together (to allow reengineering of the process), the greater the potential benefits in efficiency and effectiveness.

In addition to the problems with the A-76 process, there is the critical fact that the government has very little visibility for its own initial, full-cost baseline. So there is, in effect, a "Catch-22 " built into the process. For instance, the government wants a "business case" analysis performed in order to justify the likely benefits of the competition, but since no credible baseline is available, it is impossible to generate a valid business case that would justify running the competition despite the likelihood of significant performance improvements and cost savings if the competition and management oversight subsequent to the competition are conducted properly.

What needs to be done to allow, and encourage, more of a shift in the direction of improved efficiency and effectiveness through the use of competitive market forces? First, and most obvious, is the *need for the government to develop a new competitive process that is faster, less expensive, and based upon "best value" competitions.* A November 14, 2002, draft revision of A-76 by the Office of Management and Budget[142] makes these recommendations, and goes further to recommend that each agency be forced to define those functions that are "inherently governmental"—under the assumption that all others should be subject to competition within the next five years. It also requires that *full metrics should be kept on performance and cost, regardless of whether the competitions are won by the public or private sector.* Implementation of recommendations such as these is critical. Obviously, there will be significant resistance; but if the government is to move in the direction of increased efficiency and effectiveness—in a period of declining budgets (particularly at the state and local levels, but also at the federal level)—then this resistance must be overcome.

One way to overcome resistance to this change is to increase education and training in this area. Increasing the visibility of the results achieved and the best practices for achieving them would likely garner wider acceptance and understanding of the benefits (higher performance and lower costs) realized from a shift from monopoly government performance of essential functions to government management of competitively awarded performers (either public or private). This is too important a result not to take full advantage of it.

Endnotes

1. The Eisenhower Administration Budget Bulletin 55-4, January 1955 stated: "It is the general policy of the Federal Government that it will not start or carry on any commercial activity to provide a product or service for its own use if such a product or service can be procured from private enterprise through ordinary business channels."

2. Mayor Steven Goldsmith of Indianapolis was one of the early innovators in this area (see Husock, Howard, "Organizing Competition in Indianapolis: Mayor Stephen Goldsmith and the Quest for Lower Costs (A) (B)," Kennedy School of Government Case Program, February 1995. See also Barry Rubin and Richard Rubin, "Labor-Management Partnerships: A New Approach to Collaborative Management," IBM Endowment for The Business of Government, July 2001.

3. This trend in state and local government shifts to competitive sourcing of government functions is extremely well described in the book by E. S. Savas, *Privatization and Public–Private Partnerships*. Chatham House Publishers, 2000.

4. The trend has not been limited to the United States. The United Kingdom's Ministry of Defence has made significant strides in using the private sector in various ways to provide services. However, as RAND noted, "Because of a lack of published data or follow-up studies it is difficult to assess how these initiatives have affected the cost and performance of specific MOD services." These initiatives have helped to meet their annual 3-4 percent efficiency savings targets. See Pint, Ellen M., et al., "Public-Private Partnerships," Arroyo Center, RAND, 2001.

5. Refer to the Federal Acquisition Inventory Reform (FAIR) Act of 1998.

6. Weinstock, Matthew, "Path to recovery," *Government Executive*, September 1, 2001, viewed at http://www.govexec.com/features/0901/0901s7.htm. See also Marilyn A. DeLuca, "Trans-Atlantic Experiences in Health Reform: The United Kingdom's National Health Service and the United States Veterans Health Administration," IBM Endowment for The Business of Government, May 2000; and Gary J. Young, "Transforming Government: The Revitalization of the Veterans Health Administration," IBM Endowment for The Business of Government, June 2000.

7. Lahneman, William J., "Restructuring the U.S. Intelligence Community for A Changing Threat Environment: Outsourcing Stovepipes?" 43rd Annual ISA Convention, New Orleans, La., March 25, 2002.

8. Rouse, Bob, "Outsourcing for Better Results," *Latin Finance* 131 (October 2001 supp. Technological Edge): 18-19. See also Yu-Che Chen and James L. Perry, "IT Outsourcing: A Primer for Public Managers," IBM Endowment for The Business of Government, February 2003.

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12. Ibid.

13. Dorobek, Christopher, "Study: NMCI Worth the Cost," *Federal Computer Week*, July 15, 2002.

14. Chen, Yu-Che, and James L. Perry, "IT Outsourcing: A Primer for Public Managers," IBM Endowment for the Business of Government, February 2003.

15. Martin, Lawrence L., "Determining a Level Playing Field for Public-Private Competition," IBM Endowment for The Business of Government, November 1999.

16. Allen, Charles D., "A-76 Implementation and Implications for the US Army," Strategy Research Project, U.S. Army War College, 13 Mar 2001, Carlisle Barracks, Pa.

17. Clark, Frances, et al., "Long-Run Costs and Performance Effects of Competitive Sourcing," Center for Naval Analysis, February 2001.

18. Husock, Howard, "Organizing Competition in Indianapolis: Mayor Stephen Goldsmith and the Quest for Lower Costs (A) (B)," Kennedy School of Government Case Program, February 1995. See also Barry Rubin and Richard Rubin, "Labor-Management Partnerships: A New Approach to Collaborative Management," IBM Endowment for The Business of Government, July 2001.

19. Kennedy School of Government Case Program, "The Navy's Public-Private Competition: (A) Challenge to Improve Shipyard Performance and (B) A New Ballgame for Charleston Naval Shipyard," 1989.

20. Tighe, Carla E. et al., "Case Studies in DoD Outsourcing," Center for Naval Analysis, January 1997.

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25. Defense Finance and Accounting Service Presentation, "Year 2000: Approach to Competitive Sourcing: Implementing the A-76 Program."

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AN UPDATE ON THE BUSH ADMINISTRATION'S COMPETITIVE SOURCING INITIATIVE

TESTIMONY BEFORE THE U.S. SENATE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE AND THE DISTRICT OF COLUMBIA

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JULY 24, 2003

Thank you for inviting me to testify today regarding the Bush Administration's competitive sourcing initiative, which promises to subject at least 50 percent of the Federal Activities Inventory Reform Act (FAIR Act) not-inherently governmental jobs to competition by some as-yet-to-be-determined date. As you know, the Office of Management and Budget has given some ground on the competition quotas—the 50 percent goal is still a bit fuzzy, but is embedded in the criteria governing the red-to-green ratings in the president's management agenda.

As I have argued before, the competitive sourcing initiative is part of a long-standing effort to keep the total headcount of government as low as possible, whether through hiring freezes, personnel ceilings, or outsourcing initiatives. This is certainly the history of the FAIR Act, which is driving the current sourcing initiative.

Congress and the president have long understood that the federal government could not fulfill its mission without outside help. From the very beginning of the space and nuclear programs, for example, government has relied on contractors and consultants to conduct the essential research *and* manage the programs.

Where Does Government End?

To this day, no one has made a more determined effort at establishing a bright line between public and private than David Bell, the Kennedy Administration's first Budget Director. Acting at the president's request, Bell led a senior task force composed of NASA Administrator James Webb, White House Science Adviser Jerome Weisner, Defense Secretary Robert McNamara, and the chairmen of the Atomic Energy Commission, the Civil Service Commission, and the National Science Foundation. The Bell report began with a sweeping assessment of what it called government's "increasing reliance" on private contractors to do the research and development work of government.

Those contractors were hardly selfless giants, the report argued. Rather, they had come to depend for their existence and growth "not on the open competitive market of traditional economic theory, but on sales only to the United States Government. And, moreover, companies in these industries have the strongest incentives to seek contracts for research and development work, which will give them both the know-how and the preferred position to seek later follow-on production contracts." Because the profit incentive would lead contractors to expand their markets even to the detriment of agency capacity, the Bell Task Force set two criteria for casting the choice to contract out: (1) Getting the job done effectively and efficiently, with due regard to the long-term strength of the Nation's scientific and technical resources, and (2) Avoiding assignments of work, which would create inherent conflicts of interest.

The Bell Task Force argued that it is "axiomatic that policy decisions respecting the Government's research and development programs—decisions concerning the types of work to be undertaken, by whom, and at what cost—must be made by full-time Government officials

clearly responsible to the President and to the Congress. There are primary functions of management which cannot be transferred to any contractor if we are to have proper accountability for the performance of public functions and for the use of public funds."

The task force clearly understood that the distinction was easier stated than applied, however. To maintain in-house control, government would need enough technical capacity in-house to know when and if contractors were doing the job. It would also need to be "particularly sensitive to the cumulative effects of contracting out Government work. A series of actions to contract out important activities, each wholly justified when considered on its own merits, may when taken together, begin to erode the Government's ability to manage its research and development programs." In short, government could push so much of its work down and out that it would eventually atrophy as a source of control. NASA needs to know how to build satellites, not just acquire them; EPA needs to know how to build waste water treatment plants, not just grant them; the Department of Energy needs to know how to run a nuclear reactor, not just oversee a contractor that knows.

The task force clearly believed that there were times when contracting out was perfectly appropriate and times when it weakened the government's core capacity to perform its mission. Although the Bell Task Force expressed support for both goals, it reserved its strongest concern for protecting government from the private sector, not vice versa. As the final report warned, "the Government's ability to perform essential management functions has diminished because of an increasing dependence on contractors to determine policies of a technical nature and to exercise the type of management functions which Government itself should perform," that a new generation of nonprofit contractors "are intruding on traditional functions performed by competitive industry," that "universities are undertaking research and development programs of a nature and size which may interfere with their traditional educational functions," and that government itself was "relying so heavily on contractors to perform research and development work as simply a device for circumventing civil service rules and regulations."

Most important, the task force warned that the growing contract workforce was eroding the distinction between public and private. Its warning is well worth reading in its whole: "A number of profound questions affecting the structure of our society are raised by our inability to apply the classical distinctions between what is public and what is private. For example, should a corporation created to provide services to Government and receiving 100 percent of its financial support from Government be considered a 'public' or a 'private' agency? In what sense is a business corporation doing nearly 100 percent of its business with the Government engaged in 'free enterprise?'

Paying attention to such issues would require a far broader instrument than Budget Circular A-76, of course. But the point is well taken: competitive sourcing should ask not just how to protect the private sector from government, but how to protect civil society from the private sector. According to my estimates, roughly 40 percent of all U.S. households contain at least one wage-earner who works for the federal, state, or local government, or for a contractor or grantee.

Defining Terms

The Bell Task Force clearly struggled to find useful applications of what have become two of the most confusing phrases in government: "commercial activities" and "inherently governmental functions." On the surface, each term makes sense. It is in the application that confusion appears to reign.

Commercial Activities

Start with commercial activities, arguably the simpler of the two terms at issue. The Office of Management and Budget's Circular No. A-76, which governs commercial activities, could not provide a clearer definition: "A commercial activity is the process resulting in a product of service that is or could be obtained from a private sector source." It is a definition that has remained similar to the one used in 1955 when the Eisenhower Administration prohibited federal departments and agencies from starting or carrying on "any commercial activity to provide a service or product for its own use if such a product or service can be procured from private enterprise through ordinary business channels."

Almost three decades later, the Reagan Administration restated the principle in a 1983 revision: "In the process of governing, the Government should not compete with its citizens. The competitive enterprise system, characterized by individual freedom and initiative, is the primary source of national economic strength. In recognition of this principle, it has been and continues to be the general policy of the government to rely on commercial sources to supply the products and services the Government needs." Thirteen years later still, the Clinton Administration restated the principle once again, releasing an A-76 *Revised Supplemental Handbook* with a rather different rationale:

> Americans want to "get their money's worth" and want a Government that is more businesslike and better managed....Circular A-76 is not designed to simply contract out. Rather, it is designed to: (1) balance the interests of the parties to make or buy cost comparison, (2) provide a level playing field between public and private competitors, 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."

In contrast to the Eisenhower and Reagan Administrations, the Clinton Administration viewed the A-76 process less as a device for protecting the private sector from government and much more as a tool for stimulating greater efficiency inside government.

Even if the overall purpose of the cost comparisons between government and private delivery was clear, the actual process for testing the respective strength of the two sectors is both cumbersome and confusing. The federal government is allowed to engage in commercial activities for an assortment of reasons, some that are objective—including national defense or intelligence security, patient care, temporary emergencies, and functions for which there is no commercial source available or involving 10 or fewer employees—and some that are entirely

subjective, including the need to maintain core capability, engage in research and development, or meet or exceed a recognized industry performance or cost standard.

There are two broad exemptions from the A-76 requirements. The first involves inherently governmental activities, which are exempt from A-76 entirely. The second involves a lower government cost, which can only be proven through a three-step cost comparison study: (1) development of a work statement for a specific commercial activity, (2) completion of a management study of the organization, staffing, and operation of what would be the government's most efficient organization (MEO) for producing the good or service, and (3) a request for bids from private sources to assess the relative cost of private sector versus MEO delivery. A private source can only win the competition with a bid that is at least 10 percent lower than the MEO price. Even if government wins the competition by meeting or beating the private bid, however, it must still build the MEO, meaning that taxpayers should benefit regardless of the outcome.

Taxpayers cannot benefit, of course, unless the A-76 studies occur. Whether because departments and agencies are somehow convinced that they have become MEOs through a decade of downsizing, or because they either do not have the staff resources to conduct the studies or believe everything they do is inherently governmental, the number of A-76 studies has declined dramatically since the mid-1980s. According to the General Accounting Office, there were exactly zero non-Defense positions studied in 1997, and at least three departments, Education, Housing and Urban Development, and Justice, had not studied a single position since 1988.

There are two patterns worth noting here. First, administrations vary significantly in their general commitment to A-76. The federal government studied an average of over 16,000 positions a year under Reagan (1983-1988), 5,200 per year under Bush (1989-1992), and 7,000 under Clinton (1993-1997). Second, the Department of Defense is by far the most experienced at competition—remove Defense from the A-76 totals, and activity tumbles from 4,100 non-Defense positions a year under Reagan to less than 1,500 under Bush, and exactly 84 under Clinton.

In this regard, it is useful to note that even experts such as DoD can make big mistakes, as witnessed in the recent Defense Finance and Accounting Service competition involving 650 jobs in Cleveland and Denver. Anyone can fall into this trap, of course, but this one shows the potential weaknesses as the Bush Administration puts greater pressure on agencies that have not done A-76 competitions in years, even decades.

The point here is not to endorse greater A-76 activity. To the contrary, it is to suggest the limited utility of using A-76 as the primary sorting device for managing federal headcount. Even with the fullest presidential commitment possible in the mid-1980s, A-76 covered barely two percent of the full-time permanent civil service. The definition of commercial activity may be clear in the abstract, but the utility of the term as a method for shifting jobs from government to the shadow and back is limited at best. Without assaying the value of A-76 as a disciplining tool,

it seems reasonable to argue that it can never be more than a minor lever in allocating headcount constraints more systematically.

Inherently Governmental Functions

As noted above, departments and agencies can exempt themselves from A-76 by declaring a given commercial activity an inherently governmental function. Like commercial activities, the term seems easy to define. According to the Office of Federal Procurement Policy (OFPP), which was created in 1974 to strengthen federal oversight of an increasingly complicated procurement system, the term encompasses "a function that is so intimately related to the public interest as to mandate performance by Government employees." That includes activities that "require either the exercise of discretion" or "the casting of value judgments in casting decisions for the Government."

Defined formally in 1992, an inherently governmental function is nothing less than the faithful execution of the laws, which OFPP defines as any action to: "(a) bind the United States to take or not take some action by contract, policy, regulation, authorization, order, or otherwise; (b) determine, protect, and advance its economic, political, territorial, property, or other interests by military or diplomatic action, civil or criminal judicial proceedings, contract management, or otherwise; (c) significantly affect the life, liberty, or property of private persons; (d) commission, appoint, direct, or control offices of employees of the United States; or (e) exert ultimate control over the acquisition, use, or disposition of the property, real or personal, tangible or intangible, of the United States, including the collection, control, or disbursement of appropriated and other Federal funds."

Much as one can admire OFPP's effort to define a bright line, its policy letter mixed in just enough exemption to leave the reader wondering whether such a bright line could ever exist. "While inherently governmental functions necessarily involve the exercise of substantial discretion," OFPP stated on page three of its letter, "not every exercise of discretion is evidence that such a function is involved. Rather, the use of discretion must have the effect of committing the Federal Government to a course of action when two or more alternative courses of action exist."

"Determining whether a function is an inherently governmental function often is difficult and depends upon an analysis of the factors of the case," OFPP continued on page 4. "Such analysis involves consideration of a number of actors, and the presence or absence of any one is not in itself determinative of the issue. Nor will the same emphasis necessarily be placed on any factor at different times, due to the changing nature of the Government's requirements." As if to acknowledge its own difficulties finding the bright line, OFPP added two appendices giving examples of activities likely to be declared inherently or not inherently governmental functions.

There are two problems with the list. First, as noted above, the policy letter was heavily caveated with "could be" and "might be" legalese. Try as it might to define terms and set boundaries, OFPP left plenty of room for reinterpretation, not the least of which was its statement that "This policy letter is not intended to provide a constitutional or statutory

interpretation of any kind, and should not be construed, to create any right or benefit, substantive or procedural, enforceable at law by a party against the United States, its agencies, its officers, or any person." As such, the letter could not be used to create a basis on which to challenge an agency action. Notwithstanding the value of such boilerplate, agencies could rightly conclude that practically anything goes.

Second, the policy letter left the final interpretation to agencies alone. Although OFPP did reserve the right to review a particular decision, agencies had to follow their own interpretation. If the Department of Energy decided that having contractors write congressional testimony for the secretary was not an inherently governmental function, which it did in the early 1990s, so be it. "The extent of reliance on service contractors is not by itself a cause of concern," the OFPP letter writers argued. "Agencies must, however, have a sufficient number of trained and experienced staff to manage Government programs properly. The greater the degree of reliance on contractors the greater the need for oversight by agencies. What number of Government officials is needed to oversee a particular contract is a management decision to be made after analysis of a number of factors."

The Definitional Intersection

Despite the relative difficulties in defining commercial activities and inherently governmental functions separately, the two terms interact to form separate zones for pure privatization, contracts, grants, and mandates, and full government involvement. Presumably, government should never privatize a non-commercial activity that is an inherently governmental function, and should never retain a commercial activity that is not an inherently governmental function. It is not enough to examine the two terms separately. One must ask whether an activity is commercial and inherently governmental simultaneously.

The definitional tangle comes from the fact that the answer is rarely definitive. Doing laundry for the Navy can be a purely commercial activity in home ports such as Norfolk, Virginia, but can be an inherently governmental function in the Persian Gulf. Testing ordinance equipment can be a commercial activity in testing ammunition for an M-16 rifle, but an inherently governmental function when calibrating a laser for a missile defense system. Building a communications satellite or rocket motor can be an entirely commercial activity unless building that satellite or rocket motor is top secret or essential to government's ability to oversee contracts for the commercial activity.

Where one sets the boundaries for each zone depends on more than just context, however. It also involves politics. Witness the decision to allow government agencies to bid against private firms to perform commercial activities for other government agencies. The Reagan Administration almost certainly would not have allowed the Agriculture Department's National Information Technology Center in Kansas City to best IBM and Computer Sciences Corporation in a competition to build a $250 million Federal Aviation Administration data center, as was done in 1997. Nor would it have allowed the Treasury Department to create a Center for Applied Financial Management that would compete with private firms in providing $11 million in administrative support to other government agencies in 1997, or the Interior Department's

Administrative Support Center in Denver to win a contract from the Social Security Administration to provide payroll services in 1998. Not only did the Clinton Administration allow all three departments to bid and win, it openly encouraged government to take on the private sector through the creation of "franchise funds" that allow departments and agencies to carry over earnings from year to year. Congress approved a five-year experiment with the franchise funds as part of the Government Performance and Results Act of 1993.

A Brief History of FAIR

Passage of the Federal Activities Inventory Reform Act (FAIR) in 1998 provided a tool for measuring at least one dimension of the federal workforce—that is, the degree to which it engages in inherently governmental activities. The final bill was a fair distance from the original proposal, which was titled "The Freedom from Government Competition Act." That bill, which was authored by Senator Craig Thomas (R-WY), began with a sweeping indictment of the traditional sorting process: (1) "government competition with the private sector of the economy is at an unacceptably high level, both in scope and in dollar volume" and (2) "current laws and policies have failed to address adequately the problem of government competition."

In its initial form, the act would have prohibited agencies from beginning or carrying out "any activity to provide any products or services that can be provided by the private sector," or from obtaining any goods or services from any other governmental entity, meaning the franchise funds described above. It also would have created an Office of Management and Budget (OMB) entity called the Center for Commercial Activities to promote maximum conversion of government activities to private sector sources.

Facing intense opposition, sponsors eventually accepted the much more modest proposal embedded in FAIR. Under the final proposal, which basically codified the A-76 process, federal departments and agencies are required to identify and publish comprehensive lists of all activities deemed not inherently governmental. Once published, every activity on the list is theoretically subject to competition at the department or agency head's discretion. Despite its earlier criticism of the A-76 sorting process, the Freedom from Government Competition Act accepted the Office of Federal Procurement Policy's definition of inherently governmental functions word for word as a complete exemption from conversion, as did FAIR as a complete protection against listing.

What distinguished FAIR from A-76 was the annual listing requirement and an entirely new appeal process. Under the act, an interested party can challenge the omission of an activity from the list within 30 days of its publication, to which the agency must respond within 28 days, to which the interested party may appeal within ten days, to which the agency must respond a final time within ten days. However, just because an activity reaches the list of not inherently government functions does not mean it will never be subject to competition. Again, it is up to the agency head to decide what stays or goes. Because there is no judicial review under the act, all agency decisions are final. (At least one earlier version of FAIR had provided for judicial review by the United States Court of Federal Claims to render judgment on omissions from the inventories.)

Obviously, supporters of the bill envisioned a much larger zone for private delivery of public services. Noting that the bill was supported by the Clinton Administration and over 1,000 organizations, John Duncan, Jr., (R-TN), heralded FAIR as a way to get federal agencies "out of private industry and stick to performing those functions that only government can do well. At the same time it will allow our great private enterprise system to do those things it does best, providing commercial goods and services in a competitive environment." Pete Sessions (R-TX) put it more succinctly by cribbing from the original version of A-76: "The government should not be in the business of competition with private business."

Interestingly, as Stephen Horn (R-CA) noted in chairing subcommittee hearings on FAIR, the debate was "eerily familiar" to the controversy surrounding passage of H.R. 9835 in 1954. That bill, which passed the House only to die in the end-of-session rush in the Senate, provoked intense opposition, too, raising the ire of a junior member named Thomas P. O'Neill, Jr., who pleaded on behalf of a Navy rope plant in Massachusetts. "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."

Why Outsource?

Given the definitional discretion embedded in the current sorting systems, it should come as no surprise that some contracting is for the right reasons and other contracting is driven by less-noble instincts. A department that wishes to insulate a particular activity from A-76 can do so, if not with complete impunity, at least with significant delaying power; an agency that wishes to push an inherently governmental function out to a contractor can also do so, arguably with even greater impunity.

But whether the decision is to protect or push, headcount constraints assure that the decisions have unintended consequences both within each department or agency and across the rest of government. The decision to protect a unit in Commerce may force contracting out at HUD, the decision to mandate out in Health and Human Services may create capacity for civil service expansion in Justice. Even if OMB never puts the decisions together in any kind of systematic analysis, headcount constraints eventually reshape government. Whether the result is a sculpting or demolition, depends largely on whether the shadows of government are used to hide weakness or build strength.

Poor Excuses

There are clearly times when contracting out is used not as a source of strength, but as a way to get a job done in the face of apparent incompetence. Although this contracting out may make perfect sense in the short-run, it eventually weakens government by excusing systemic problems or outright negligence.

1. Evading Headcounts.

The first excuse for contracting out is to evade headcount pressures. Given a choice between inflicting pain and contracting out, the federal government will almost always contract out.

This is not to suggest that government backfills downsized positions through some deliberate process. Bluntly put, most departments and agencies do not have the workforce planning systems to engage in such deliberate shell games. Although downsized employees occasionally do return to their agencies as contract workers, as National Institutes of Health radiologists did in the late 1980s, most agencies simply cannot play such games. To do so would mean linking an agency's human resource office, which is responsible for downsizing, with its acquisition office, which is responsible for contracting. The two barely talk to each other, let alone acknowledge the potential benefits of working together. The fact is that the federal government simply does not have a workforce planning system to shift jobs deliberately.

2. Evading Bureaucracy.

Departments and agencies also use contracts, grants, and mandates to evade the antiquated administrative systems that plague the federal government, a case that was effectively articulated by the first of Vice President Al Gore's reinventing reports.

Vice President Gore was hardly the first to make the case against over-control, however. Program managers have felt besieged by internal red tape for decades. The National Academy of Public Administration (NAPA) weighed in with its own call for reinventing government a full decade before Gore put pen to paper: "What is bitterly ironic is the fact that Federal managers, both political and career, typically regard themselves as captives of a series of cumbersome internal management 'systems' which they do not control." Describing the systems as "so rigid, stultifying, and burdened with red tape" that they undermine government's capacity to serve the public on "a responsive and low-cost basis," NAPA offered an all-too-familiar complaint:

> "Many of the restraints and regulatory requirements which now make it so difficult for Federal managers to function have their origin in commendable efforts to prevent or control waste, abuse of authority, or corruption....Unfortunately, the cumulative impact of an ever increasing number of procedures, findings, appeals, and notifications is to jeopardize the effective execution of [government]. Moreover, regulatory requirements, once adopted, tend to be retained long after they have ceased to make any constructive contribution to program management." To reinforce its point, NAPA put a drawing of Gulliver bound by the Lilliputians on the cover.

What neither NAPA nor Gore ever wrote about is the role of such constraints in driving managers to create shadows. Much as federal managers might complain publicly about the contracting out of high impact jobs, many attest privately that they have greater control over the

work done as a result. There is no need to go through endless appeals to fire poorly performing employees nor any need to wait to add new staff.

Over time, the convenience of contracting can lead even the most dutiful federal manager to take the easy route. The federal manager can pay prevailing wages for high demand positions, while giving their contract employees the breathing room to do their jobs unencumbered by pesky overseers and what they see as needless paperwork. Herbert Hoover promised a government that works better and costs less in 1949, as did Johnson, Nixon, Carter (a government as good as the people, too), Reagan, and Clinton/Gore. Although the Gore effort appears to have penetrated more deeply than its predecessors, shadow casting may be the only way to make the numbers add up to performance.

3. Evading Poor Performance.

Contracts, grants, and mandates can also be used to hide poor performance within government's own workforce. When departments and agencies want the job done right, they sometimes look outside.

There are two ways to prevent what might be called "defensive" outsourcing. The first is to provide the pay and training to make the government workforce evenly effective. The second way is to hold government accountable for results, not compliance. Unfortunately, even the effort to shift accountability from rules to results can involve a plethora of rules.

4. Evading Blame.

Outsourcing clearly weakens government when it is used to avoid blame. There are times, although rare, when having a contractor in charge of a dangerous or risky program is the most comfortable position for government politically. In 1985, for example, just a year or so before the Shuttle Challenger tragedy, NASA asked NAPA to examine the feasibility of privatizing the entire program. From a perfectly appropriate perspective, the privatization study was merely good business planning. NASA was clearly concerned about the long-term burdens of running what it hoped would soon become a relatively routine cargo program. From a much more troublesome perspective, senior NASA officials also expressed worries about the potential for another "204 incident," a term used to identify the fire that took the lives of three Apollo astronauts in 1967. Privatizing the shuttle would give the agency some protection in the event of another catastrophe by shifting blame to the contractor.

The Challenger investigation obviously proved otherwise. Although the contractor, Morton Thiokol, was harshly criticized for suppressing internal objections to the launch of Flight 51-L, NASA's decision casting process was clearly identified as the contributing cause of the accident. NASA's middle-level contract managers not only knew that the O-rings used to seal the solid rocket motor joints would be compromised at low temperatures, they made no effort to relay the intensely-felt Thiokol worries upward on the night before launch. To the contrary, NASA contractor managers clearly pressured Thiokol to reverse what had been its original recommendation not to launch until temperatures went up. "My God, Thiokol," one NASA

manager asked, "when do you want me to launch, next April?" It was as if, one Thiokol engineer later testified, the contractor had to prove beyond a shadow of a doubt that it was unsafe to fly instead of proving just the opposite.

As the presidential commission appointed to investigate the accident concluded, "The decision to launch the Challenger was flawed. Those who made that decision were unaware of the recent history of problems concerning the O-rings and the joints and were unaware of the initial written recommendation of the contractor advising against the launch at temperatures below 53 degrees Fahrenheit and the continuing opposition of the engineers at Thiokol after the management reversed its position....If the decisionmakers had known all of the facts, it is highly unlikely that they would have decided to launch 51-L on January 28, 1968."

5. Meeting Quotas.

I can think of few more destructive reasons for outsourcing than meeting arbitrary quotas of one kind or another. Such quotas send the signal that outsourcing is nothing more than a "body count" exercise, in which agencies are encouraged to push as much out the door as possible with little or no planning. Without top-to-bottom review, the outsourcing merely replaces one set of bureaucracy with another, and disconnects the workforce planning process embedded in the Government Performance and Results Act with a manic contest to see which jobs can be moved out the fastest. The result can only be a perpetuation of middle- and top-heavy government—if only because it is the middle and top of government that makes the decisions on meeting the quotas.

Good Reasons

If there is one word to separate the outsourcing that hides weakness from outsourcing that builds strength, it is "deliberative." Outsourcing that builds strength involves hard choices about where government begins and ends, who should do what work, and how to deliver the goods in time. "It's time to lower the level of rhetoric of outsourcing and contracting out," former OFPP administrator Steven Kelman remarked in 1998 as Congress began debating a stack of bills requiring agencies to hold public/private competitions for any activities not deemed inherently governmental functions. "It's not a question of big government/small government, nor is it a question of do you or don't you like the federal workforce. It is a good management principle to stick to your core competency."

1. Acquiring Skills.

This is arguably the best reason for outsourcing. Simply stated, the federal government must be able to acquire skills that it cannot develop or maintain on its own civil service workforce. Having chosen to run the nation's nuclear weapons plants with contractors, for example, the Department of Energy never developed an internal capacity to clean up nuclear waste. Thus, when it came time to start closing the facilities at Savannah River, Fernald, or Rocky Flats, the department had little choice but to acquire clean-up specialists from the private sector.

The question is why outsourcing under such circumstances is any more acceptable than using a contract to evade pay limits on positions already within the civil service. The answer lies in the inability to build the internal capacity at a reasonable cost. If the federal government is not paying enough to recruit the auditors, computer programmers, and program analysts to deliver public goods effectively, Congress and the president should raise the rates or create a special pay system such as the one used by the Federal Reserve Board. But if it has never had the capacity to begin with or allowed the capacity to slowly leak away through headcounts, the federal government may eventually have no choice but to use a shadow workforce to get the job done. Thus, does the inappropriate use of contracts to evade pay ceilings eventually force the appropriate use of contracts to buy back the institutional memory (if it ever existed) from the private firms that now own it.

In a similar vein, the federal government has reasonable cause to use contracts to address crises such as the Y2K computer glitch, particularly when the need is clearly limited to the crisis. As noted earlier, it makes no sense to rebuild the federal government's COBOL competencies for a one-time event. Such one-time events hardly need be restricted to a year or two. At NASA in the 1960s, for example, the Apollo program created a surge in contractor involvement that peaked five years into the program, falling back as the program reached its goal in 1969.

2. Acquiring Flexibility.

Outsourcing also allows agencies to acquire needed flexibility to manage uneven work flows. NASA remains the premier example. Its workforce, both civil service and contract-created, was designed to rise and fall with mission demands from the very beginning. Although there were clearly places where the Whitten Amendment forced the agency to contract out activities that it would have preferred to create and maintain in-house, NASA's success depended on acquiring expertise already available on the outside. The surge-tank model also happened to fit NASA's political circumstances.

Despite President Kennedy's embrace, it is not clear that NASA's mission was broad enough to assure public support for a massive new bureaucracy. Even with its limited civil service workforce, NASA faced more than its share of controversy as America launched a war on poverty in the midst of a war in Vietnam. As the pressures to do more with less increased as both wars heated up, NASA pushed more and more of its work into the shadow, prompting calls for a rebalancing of in-house and out-of-house capacity. Nevertheless, as NASA historian Arnold Levine writes, "The case for service contracts rested on one powerful argument that was never adequately refuted: An agency with such urgent and unique assignments could have done the job with its in-house staff alone....Faced with ambiguous guidelines, NASA officials believed that resorting to the private sector was inevitable and that the question of whether a task was covered in-house or by contract was less important than the knowledge that the capability would be there when needed."

More recently, many federal agencies have been using contracts and temporary appointments to create what some have called a blended workforce composed of permanent civil servants, more or less permanent contractor employees, and outside consultants and easily

severable part-timers and temporaries, all theoretically working side-by-side toward the public good. The only difference is that the permanent employees will stay at the end of the surge, while the temporaries will go. At the Department of Energy, for example, temporaries are carrying an enormous burden in the clean-up of aging nuclear weapons plants.

Although blending most certainly reflects headcount pressure, making a virtue out of stark reality, it also addresses the difficulties the federal government faces in recruiting young Americans to public service. The old notion of spending a lifetime in the civil service is just that, old. Young Americans expect to change jobs much more frequently than their parents and are much more reluctant to make work the centerpiece of their lives.

3. Acquiring Savings.

The final reason for outsourcing, or at least competing, federal jobs is to save money. Let me start by noting that there is absolutely nothing wrong with saving money on tasks that are not inherently governmental, the problem again being how to define the term with enough precision. Democrats and Republicans have long agreed that government should never pay more than it has to in purchasing any good or service. It should be a "smart buyer" at all times, demanding the highest value for the money.

They have also long agreed that government should protect the private sector whenever possible. As noted above, the challenge is not to issue bright lines such as A-76, but to make them meaningful to the sorting of responsibilities. Although Democrats and Republicans alike believe in the efficiency-producing effects of competition, the question is how best to protect the private and public sectors from each other. Much as the Reagan Administration pushed government to conduct A-76 cost comparisons, even to the point of issuing a 1987 executive order requiring individual agencies to review at least 3 percent of all agency jobs annually until all commercial activities had been exposed, there is little evidence that the effort produced more than frustration.

There is at least some reason to believe that competition has a salutary impact on the price of goods and services. According to RAND, a Santa Monica-based think tank, Defense Department job-outsourcing competitions have saved from 30 to 60 percent regardless of whether government or the private sector wins. The source of the savings is almost always a net reduction in the number of people needed to do the job. The study shows that neither government nor private firms enjoy a particular advantage in reducing personnel costs—they both do it the same way, by using fewer people and pushing resources downward. The question, of course, is whether A-76 or competitive sourcing is the most efficient way to get these results. Why not ask agencies to reduce personnel costs through a more deliberate method?

The Problem of Price

As this discussion suggests, there are many more reasons for in-sourcing or outsourcing than just the price of a good or service. However, the current criteria for making the outsourcing decision is price. There is little room for considering other issues.

The problem is that price is a poor measure of other factors the government might value. Price reveals little about potential performance, for example. Although there is limited evidence that competition may produce greater customer satisfaction, the data on objective performance is poor at best. Morton Thiokol won the space shuttle solid-rocket contract based on price, for example, but the price was based on a design that put the burden on two thin O-rings to protect shuttle astronauts from harm. Mellon Bank won an Internal Revenue Service tax-return processing contract also based on price, but the price was based on employee piece-rates that fell to shreds when rush-hour hit.

Price also reveals little about public trust, innovation, helpfulness, or fairness. At least according to national surveys by the Center for Public Service, which I direct, the nonprofit sector has an edge over the federal government and private firms on virtually every measure of a healthy workplace imaginable. Nonprofit employees are more likely than federal or private employees to see their co-workers as helpful, committed, and open to new ideas, and more likely to describe their organizations and sector as the best place to go for innovation. Asked which sector is the best for helping people, even federal and private employees agree: It is the nonprofit sector. As for spending money wisely, even private employees split their votes almost evenly between the private sector and nonprofits.

Finally, price also reveals little about employee motivation. Asked why they come to work in the morning, almost half of the private employees interviewed in 2001 said they show up for the compensation, compared to less than a third of federal employees and less than a fifth of their nonprofit peers. According to advanced statistical analysis, private employees are motivated more by the compensation than either federal government or nonprofit employees. Satisfaction with salary is the number one predictor of job satisfaction among private employees, followed by pride in the organization and the sense that the work they do is interesting. In contrast, the opportunity to accomplish something worthwhile is the number one predictor of job satisfaction for federal employees, followed by the sense that they are given a chance to do the things they do best, and a belief that the work they do is interesting. Salary makes no difference in predicting job satisfaction among federal employees.

To the extent the federal government wants employees to put salary at the top of their list of concerns, going private makes greater sense. Moreover, as noted above, there are areas where salaries are so much higher in the private sector that the federal government cannot get the talent in-house. However, to the extent that the federal government wants a different set of motivations in play, it might consider nonprofits or federal employees.

The point here, of course, is where one gets labor depends in part on what one wants the labor to produce. If competition is the key to all of this, we all ought to figure out a way to put

greater competitive pressure on employees—for example, through pay for performance that really works. In this regard, passage of the Senate's version of the Defense Department personnel reforms might be a far better way to assure more cost-effective production inside government than further investments in A-76 competition. One could easily argue, for example, that the money spent on A-76 would be better spent on a bonus pool that truly rewards high performance.

One could also argue that the money should be allocated to alternative methods that would allow government units to compete against each for business. Why not let Denver and Cleveland compete against each other for the DFAS business, for example? No one has ever argued that competition between federal units and private firms is the key to cost savings. Rather, it is competition alone that provides the salutary effect. The competition can involve federal agencies competing against each other, or, in the recent case of the Transportation Security Administration's human resource contracting, it could be private firms competing against quasi-government firms. (The winner of the $554 million TSA new contract for recruiting and hiring passenger and baggage screeners was won by CPS Human Resource Services, a partnership between the California State Personnel Board and several local governments in and outside California.)

The ultimate challenge, therefore, is to move away from blunt instruments such as A-76, and the temptation to set targets, and toward performance-sensitive systems that allow federal agencies to achieve the effects of competition more naturally. If competition is, in fact, a good thing for government employees, and I believe that it is, the question is how to make it felt throughout government at a relatively low cost.

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TESTIMONY BEFORE THE
SENATE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, RESTRUCTURING AND THE DISTRICT OF COLUMBIA OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS

by Professor Charles Tiefer

THE DOWNSIDE OF THE COMPETITIVE SOURCING INITIATIVE?

NUMERICAL OUTSOURCING TARGETS UNDER THE TILTED NEW A-76

Thank you for the opportunity to testify on the subject of the Administration's outsourcing effort. I am Professor of Government Contracts at the University of Baltimore Law School and the author of GOVERNMENT CONTRACT LAW: CASES AND MATERIALS (Carolina Academic Press 2d edition forthcoming 2004)(co-authored with William A. Shook) and several law review and bar journal articles on A-76.

OUTLINE OF TESTIMONY

Overall

Topics

- Workforce Issues and the Administration's Overdependence Upon Outsourcing
- Examples and Problems With Outsourcing at Specific Agencies
- New A-76's Tilt Toward Outsourcing
- Inadequately Clear Rights to Protest Outsourcing Awards

OVERALL

In the past year, the Administration's competitive sourcing initiative has taken a turn for the worse with overdependence on outsourcing based on two main parts. First, the Office of Management and Budget (OMB) has high numerical targets (50% of all pertinent government jobs, or 850,000, put through the outsourcing process ultimately; 15% of all such jobs to go through by the end of this FY). And, the office of Federal Procurement Policy (OFPP) has promulgated its new revisions of the public/private competition process, in revised Circular A-76.

This overdependence upon outsourcing is disruptive in the short term, and impedes other ways to address workforce issues in the long term.

Important examples from specific agencies include Defense Finance and Accounting Service (DFAS)-Cleveland; Veterans Administration (VA); Forest Service.

New A-76 tilts heavily toward outsourcing. Its procedures include defaults and streamlining that lead to outsourcing without an adequate showing of merit for it.

These problems make it particularly important that legal mistakes in outsourcing be reviewed and corrected, by federal employee unions having the clear legal protest rights enjoyed by contractors.

WORKFORCE ISSUES AND ADMINISTRATION OVERDEPENDENCE UPON OUTSOURCING

Chairman Voinovich, you have appropriately focused your own legislative effort in general, and this Subcommittee's attention in particular, on the issues facing the federal workforce ahead. The public has benefited from your bringing your experience at several executive levels, particularly Governor, to these issues before Congress.

We all have a sense of the general challenges facing the federal workforce. Taking the department with the largest number of employees, the Department of Defense, as an example, a recent GAO report laid out those challenges. Actions Needed to Strengthen Civilian Human Capital Strategic Planning, GAO-03-475 (March 2003). First, the civilian workforce has been downsizing, and is now susceptible to retirements, in a rapid and potentially threatening way. From 1989 to 2002, DOD's civilian workforce shrank from 1.07 million to .67 million – about a 38 percent reduction. Of today's workforce, 58 percent will be eligible for early or regular retirement in the next three years. Second, these drops threaten shortfalls of critical skills and lack of orderly transfer of DOD's institutional knowledge. Hence, GAO designated strategic human capital as a high-risk area.

What about the developments of the past year? In brief, my own view is that for both the short-term and long-term problems of the federal workforce, the Administration's initiative goes in the opposite direction from what is needed. The Administration is pursuing its "15/50" concept – 15% of all jobs put through the process this FY, 50% ultimately. Critics called this a "quota," OMB called it a "goal." For convenience, here it will be called a "target."

In the short term, the outsourcing process itself will increase burdens, impair effectiveness, and occur in a manner that impedes the diverse ways to prepare for the long-term workforce issues. To explain why a set of fixed numerical targets, as OMB has attempted to lay down, is bad policy, there is no improving upon the excellent analyses a year ago both by

Chairman Voinovich, and by then subcommittee, and current full committee chair of the House Committee on Government Reform and Oversight, Rep. Tom Davis.

At a full Committee hearing on March 6, 2002, Senator Voinovich said:

> I agree with your Committee and feel that arbitrary goals for public/private competitions simply do not make sense. Logic tells me that this policy does not equate given the fact that the Federal Government may lose up to 70 percent of the Senior Executive Service by 2005, through retirement or early retirement, and about 55 percent of the Federal workforce by 2004.
>
> Arbitrary contracting goals send the wrong message to our Federal workforce . . . .
>
> * * *
>
> Furthermore, I am concerned about the negative effect that outsourcing may have on prospective government employees . . . .
>
> * * *
>
> . . . . We have seen an influx of contractors in the Federal workforce. Anecdotal evidence suggests we have not witnessed a significant improvement in Federal agencies' management of service contracts.

Similarly, Chairman Davis made this critical address on the House floor in support of the bipartisan anti- outsourcing "quota" appropriation limitation that, as adapted to prohibit "arbitrary" quotas, later became law. He said, at 148 Cong. Rec. 5325 (July 24, 2002):

> Mr. TOM DAVIS of Virginia. Mr. Chairman, I rise to speak in favor of the amendment. The question has always been do we take a matter in-house or outsource it. . . . .
>
> Now, the previous administration had numerous initiatives whereby they would eliminate Federal jobs, and **they defined their success by how few Federal employees they had. This was a mistake**. What we should have been asking was how much money do we save the American taxpayer, **not** how many employees we have, **how much we are outsourcing** and the like.
>
> In some cases the jobs eliminated did not save anything because these jobs were off-budget. They were fee paid for, and they were not costing the taxpayers or the general fund a nickel. In some cases **we found out we eliminated Federal jobs, but it ended up costing us more money by going outside. But it was driven by quotas, it was driven by numbers, and I submit that is the wrong approach**; and that is the problem with the current legislation, which is why I support the Moran amendment because the current legislation looks at arbitrary percentages and says when it comes to outsourcing and competing things in-house, we are going to look at certain percentages in certain agencies, and we are going to define it by this rather than where do we think we can get the best value for the American taxpayer, not how much money will it save.
>
> **There is precious little evidence that the elimination of Federal employees by itself saved money during the previous administration.** In some cases, as I noted before, these were fee-based employees, and whatever happened was not going to cost the taxpayers or fee payers a penny, but it was arbitrary.
>
> Competitive sourcing is a good thing; **but arbitrary quotas, numerical targets, are a**

bad thing. I would say to this body that the Moran amendment eliminates the arbitrary numbers. This will still allow discretion within Federal agencies to go and compete things. We should encourage them to do that where it makes sense and where we can bring savings to the American taxpayers.

Our goal should not be to preserve jobs at the Federal level, **nor should it be to get a certain percentage to get outsourced.** Our number one priority that should drive procurement policy, how do we get the best value to the American taxpayer, this amendment furthers that goal. That is why I urge my colleagues to support it.

Congress ultimately enacted a prohibition against arbitrary numerical quotas. Section 647 of the Consolidated Appropriations Resolution, 2003, Pub. L. No. 108-7, to be codified at 5 U.S.C. 8335). The conference report went further, directing OMB to provide a report, which it has apparently not yet provided, and which would have materially assisted this hearing. The Conference Report directive is as follows (in H.R. Conf. Rep. 108-10 (Feb. 13, 2003), 2003 WL 394983 (Leg.Hist.), in the discussion for the Treasury-Postal segment of the bill, corresponding to section 647):

CONTRACTING OUT QUOTAS

The conferees agree to a Senate provision prohibiting the use of funds to establish, apply, or enforce any numerical goal, target, or quota for contracting out unless the goal, target, or quota is based on considered research and sound analysis of past activities and is consistent with the stated mission of the executive agency. Although the Senate provision was somewhat different than the provision adopted by the House, the conferees want to emphasize the **strong opposition in both chambers** to the establishment of arbitrary goals, targets, and quotas. If any goals, targets, or quotas are established following "considered research and sound analysis" under the terms of this provision, **the conferees direct the Office of Management and Budget to provide a report to the Committees on Appropriations no later than 30 days following the announcement of those goals, targets, or quotas, specifically detailing the research and sound analysis that was used in reaching the decision.**

It is a special occasion when the Conference Committee on the omnibus appropriation, which is as close to the highest-level invocation by Congress of its power of the purse as one finds, directs OMB, in this way, to provide such a report "specifically detailing the research and sound analysis that was used in reaching the decision." If OMB had provided the specified report, the witnesses at today's hearing would have been able to analyze it. GAO, the academic witnesses, and the committee staff would all have studied it. A sound discussion of workforce issues would have ensued, with legitimate oversight of OMB's decision to proceed with its high numerical targets despite "strong opposition in both chambers" to arbitrary targets.

The absence of this report is doubly important because of the major questions, discussed below, about what OMB has done in promulgating the new A-76. For example, suppose OMB cannot really produce persuasive "research and sound analysis" for across-the-board numerical targets. Then, it would become more important than ever, that the process for competing

particular contracting-out decisions provides a valid basis for making each such decision. Yet, as discussed below, in many ways, new A-76 goes in the opposite direction, allowing and perhaps even forcing a contracting-out decision without such a valid basis.

Why, in the short term, does a drive toward outsourcing, posed in terms of high numerical targets, increase agency burdens? Because federal managers – both contracting personnel and mission managers - must preoccupy themselves with the outsourcing rather than their mission-supporting responsibilities. As a government contracting professor, I pay particular attention to how, in the 1990s, agencies downsized their acquisition workforce, a trend which may, unfortunately, continue. The DOD IG testified in 2001 that DOD has "reduced its acquisition workforce from 460,516 people in September 1991 to 235,560 in September 1999, a reduction of 50 percent. Further cuts are likely . . . ." And, the GAO has estimated that 27 percent of agencies current contracting officers will be eligible to retire though the year 2005. This downsizing of the acquisition workforce has been extensively critiqued for its part in diminishing of formal competition and increases in sole-source awards, and the reduced oversight of contractors. See Project on Government Oversight, *Pick Pocketing the Taxpayer: The Insidious Effects of Acquisition Reform* (2002); and, Professor Steven L. Schooner, *Fear of Oversight: The Fundamental Failure of Businesslike Government*, 50 Am. U. L. Rev. 627 (2001).

Contracting personnel now can barely cope with their regular workload, a problem that would increase greatly with an outsourcing initiative. The complexity of changing from in-house effort to outsourcing will further heavily burden already-strained acquisition personnel. The outsourcing being contemplated does not consist primarily of just ordering more tasks under existing indefinite quantity (IDIQ) contracts, or even awarding new contracts for supplies or services which have previously been acquired. Rather, new outsourcing means that the acquisition personnel must draft new requests for proposals, often for services not previously outsourced. Prior to this must come a planning process; subsequent to this must come whatever competition process is followed, including the evaluating of outside and in-house proposals; after that must come the process of overseeing awarded outsourced contracts (and, for that matter, overseeing in-sourced offers). Each part of this combination of planning, competition, evaluation, and contract oversight places heavy burdens, especially on the experienced acquisition personnel in most demand and present in diminishing numbers.

Moreover, scarce budget resources must also get devoted to the outsourcing process. These resources come from already-strained pools. And, one thing outsourcing efforts drain, is the alternative efforts at human capital strategic planning. As one goes through Actions Needed to Strengthen Civilian Human Capital Strategic Planning, GAO-03-475 (March 2003), one is struck by how many such actions have been foregone, and will be foregone, due to the diversion of scarce resources to the outsourcing. Within DOD, only the Air Force and the Defense Contract Management Agency (DCMA) - not the Army, the Marine Corps, and DoD (department-level) – have even developed information about their future workforce needs.

In other words, the Army can easily find itself – as it faces expanded missions, such as in Iraq – critically short of skilled personnel, without even a plan about what to do. Why is that? Because the Army has been preoccupied, in terms of its planning resources in this context, with its "Third Wave," the highly controversial plan to cut more than 214,000 Army jobs. See House Members Denounce Army Outsourcing Plan, Federal Human Resources Week, Jan. 13, 2003.

After the short term disruption just described from the shortage of acquisition personnel

and the preoccupation of managers with outsourcing, there is, of course, the effect on the morale and efficiency of mission personnel. To quote from the Report of the National Commission on the Public Service, Urgent Business for America (Jan. 2003)(the "Volcker Commission Report"), at 31: "we are also concerned that when competitive sourcing is perceived as unfair or for the purpose of reducing the government workforce, it breeds mistrust and undermines employee morale."

Let us turn to describing the long term effect of an approach to workforce issues that is too dependent upon outsourcing. There are many different strategies for addressing workforce issues: relying so much upon outsourcing precludes proper weight for the others. For one, developing creative new in-house approaches often deals best with workforce issues. For example, the Department of Veterans Affairs developed creative new pharmacy arrangements that handle enormous quantities of prescription-ordering, agency-wide, with great efficiency. The same reasons increased productivity can occur in the private sector – such as improved use of information technology – can occur with new in-house federal government approaches of that creative kind

Yet, dependence upon outsourcing stifles such creative new in-house approaches in the long term. The managerial attention and resources needed to develop them, get diverted to outsourcing. And, the pressure from above to outsource, deters managers from developing such in-house approaches. Putting the line personnel in fear of the disruption of outsourcing, or the actual process of considering or conducting outsourcing, impairs their motivation to work with such new approaches. The entire agency has its hands full handling outsourcing itself – such as handling disrupted operations, arranging the shift of work, and training contractor personnel – so that the additional effort of creating new approaches in the other areas which are not (yet) being outsourced becomes that much less feasible for the overtaxed agency. And, the difficulty of the federal government recruiting the new skilled personnel – like those with IT skills – due to its highly-publicized outsourcing, precludes launching such new approaches.

For another, outsourcing itself often replaces existing operations in a way that disperses the personnel and precludes further or later use of that existing structure and set of experienced personnel. So, the value that the outsourcing would have for new work, it lacks when it subtracts from the valuable existing in-house operations. Later it is too late to salvage what has been lost.

Also, outsourcing compounds the exposure of at-risk agencies. The GAO has pointed out that agencies with an existing high level of outsourcing, such as NASA, already go on its list of high-risk agencies. Existing capability is inadequate to supervise the already-high level of contracting-out; it will be even less able to cope with a heightened level of contracting-out. Further outsourcing just compounds this problem.

EXAMPLES AND PROBLEMS AT SPECIFIC AGENCIES

I am unimpressed that overall discussion about competitive sourcing, and specifically about outsourcing, can capture the diversity of federal agencies and their missions, particularly their service missions. This requires discussing examples and problems at specific agencies, in order to capture the magnitude of the concerns.

Arbitrary numerical targets, and a tilted A-76, are top-down approaches that follow a too-

rigid ideology without sensitivity to a particular agency's mission.(Fn 1) Moreover, in terms of Congressional action, the response to numerical targets for outsourcing and to new A-76 appears likely to be, at least in part, agency-by-agency appropriation limitation provisions concerning outsourcing at specific agencies. Considering that this has already become the focus, general discussion must yield in part to the specific.

Defense Finance and Accounting Service - Cleveland

A particularly illuminating example of the problems of outsourcing has come to light by way of an inquiry by the Inspector General of the Department of Defense, Joseph E. Schmitz, as to work hitherto performed in Cleveland, Ohio. A public/private competition had been held for the Defense Finance and Accounting Service, as to its Military Retired and Annuitant Pay Functions. The work got outsourced, pursuant to A-76, to Affiliated Computer Service (ACS) by a contract with a potential 10 year value of $346 million. After award, when it was too late, the IG discovered a huge error that had inflated the in-house cost estimate by $31.8 million, producing an erroneous outsourcing award when the work should have been kept in-house. What particularly stung, was that the audit component of the IG's own office had acted as the independent review officer (IRO) of the competition, and so, should have detected, but had not detected, the huge error.

I gave some personal study to this particular example myself several months ago, and became familiar with how it combines relatively common features of outsourcing with the disastrous error that was made. First of all, it has a geographic aspect likely to recur. ACS is a Dallas-headquartered firm that planned to move the jobs around from one location to another, including moving some of the jobs from Cleveland to Kentucky. This is fairly familiar. Hitherto, many sensible considerations tended to stabilize the geographic distribution of the federal service workforce and its work. Notice that the Senate and House Appropriation Committees devote an entire, important Subcommittee to Military Construction, and you have a vivid reflection of how important – and, hitherto, relatively stable – the siting of federal facilities and the location of their workforce has been.

Once an agency, sometimes in consultation with Congress, authorized and funded a federal facility at a particular location to perform work, that work and that workforce tended for

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1 For example, it is all very well to note that private companies accomplish, by private contracting, the "protective function" for their facilities and personnel, and then to size up the number of federal employees performing protective functions who might potentially be replaced by outsourcing. But, does that capture what the reaction would be, if someone proposed replacing the President's Secret Service detail with contractor personnel? Does it take into account the reasons, after September 11, the public insisted on federal screeners in the new TSA, not private companies like Argenbright? Different missions cannot be reduced to uniform functions found in the private sector and calculable by one-dimensional numerical data. Debt collection by agencies for, say, student loans, cannot be equated to IRS collection activity. Federal prisons cannot be equated to local jails. And, health care for veterans cannot be equated to Medicaid. The public desires, and deserves, that federal missions of such kinds be performed by a highly motivated federal civil service – not a contracted-out minimum wage, high-turnover workforce.

efficiency reasons to stay there, all other things being equal. At least, there had to be some showing of a reason, before undertaking the disruption and expense of moving the work around. Since experienced personnel may not follow the work when it moves, even if offered a chance – for example, they may not want to uproot their families and move – moving the work often means sacrificing the use of experienced federal personnel. Through outsourcing and A-76, however – especially through new A-76 – there is now a procedure, favored by OMB and agency higher-ups eager to meet outsourcing targets, for undertaking precisely that disruption and expense of moving the work.

Not coincidentally, the work may well follow a particular migratory pattern. It is not surprising that ACS, a firm headquartered in Dallas, having work performed in the state of Kentucky, would tend to be a winner, and Cleveland would be a relative loser. Once work is put into "play" geographically, so to speak, it does not move around randomly. Even at best, it moves toward the lower-wage regions of the country. (It is important to remember that there are so many loopholes in the Service Contracting Act, that it does not effectively preclude contracting out to result in lowest-wage work.) At worst, the contracted-out work moves toward where newly-interested contractors take an interest in developing sufficient political influence to make federal policy go in their preferred direction.

Also, the particular DFAS problem reflects how new A-76 will make matters worse, especially unless protest rights are now established. The huge error in computing the cost estimate for the in-house bid went unnoticed by the IRO even though, in that instance, that review function was being performed by the relatively experienced and qualified DOD IG's office.(Fn 2) Currently, some experienced personnel may work on designing and costing the in-house bid – the Most Efficient Organization, or MEO - and errors may get caught by an independent review officer, even if they did not in the DFAS instance. Under new A-76, one-sided rules against conflicts of interest will keep most experienced personnel from work on the MEO, and the phase of independent review has been cut out. The quality of MEO design and costing will suffer, and with it, the employees' fair chance to keep the work.

And, new A-76 continues to have, as its Achilles' heel, that the contractors talk a great game about savings without diminished services, but in reality, they lose experienced personnel, and they do not have the idealistic motivation of the federal civil service. ACS has been fined nearly $500,000 for not meeting performance standards. Concretely, that means military widows not being able to get answers to their questions about complex but important pension formulae, or even having their checks sent to the wrong banks. As a former DFAS employee who went to work for ACS but quit after two months told the Cleveland Plain Dealer: "They were trying to do it with fewer people to save money." Sabrina Eaton, Firm That Replaced Cleveland Workers Fined, Cleveland Plain Dealer, July 19, 2003.

VA Services

Traditionally, the Department of Veterans Affairs (VA) had a statutory safeguard against

2 That is entirely possible because many aspects of public/private competitions are atypical in general procurement, and may trip up even experienced acquisition personnel. Among the atypical aspects are, for example, the special aspects of cost estimation involving the costs of conversion of facilities from public to private, the costs of supervising a newly awarded outsourced contract, the computations for overhead as to in-house bids, the comparison between public and private descriptions of how work will be performed, and so on.

privatization. 38 U.S.C. sec. 8110(a)(5). Now, however, the Administration is pressing to fund VA privatization studies. The Veterans Health Administration (VHA) represents a major quarry for the outsourcing hunt. Currently, the VHA has more than 206,000 employees, with over 50,000 considered candidates for privatization. So, since OMB wants to meet high government-wide numerical targets for outsourcing, the VA offers a tempting opportunity. And, new A-76 offers an easy way to take that opportunity. The VA's single largest function consists of its hospital system, something outsourcing enthusiasts would want to view as particularly commercial.

Yet, outsourcing at the VA has its own special downsides. The VA's budget has not risen at the rate either of general medical costs or the dramatically increasing population of veterans needing care. The report of the President's Task Force to Improve Health Care Delivery for our Nation's Veterans (May 28, 2003), urged measures from better DoD-VA collaboration to full funding of VA's obligations. Conspicuously absent was any proposal to outsource the running of the VA health care system. (There was a proposal that when the existing VA facilities cannot meet the demand for services, opportunities should occur for VA patients to receive those services outside of VA facilities, but that is very different from outsourcing the existing work in the existing VA facilities.) Quite the opposite, the Administration proposes to spend $50 million on VA competition studies – funds that could instead be used for veteran's health care itself.

To take another specific point which Congress would note in studying the VA example, currently, 52% of all VA blue collar workers in food service, housekeeping, and grounds maintenance are veterans. (These are particularly targeted for privatization, although many white collar jobs, from nurses to radiologists, are also targeted.) Asked about whether outsourcing would mean fewer jobs for veterans, contractor organizations mumble about possible clauses in subcontracts. As a government contracts professor, to me that sounds like rank double-talk. The short answer is apparently that VA outsourcing will be a backdoor way to repeal partially the veterans employment preference – something which, if attempted on the floor of Congress, would surely fail. Critics could consider it hypocritical for an Administration which purports not just in general to administer effectively, but in particular to be more pro-veteran than its predecessor, to engage in such a backdoor repeal of the veteran's preference. Throwing blue-collar veterans out of work – when they are performing VA work without criticism - at a time of high unemployment, hardly seems pro-veteran.

Forest Service

At the beginning of July 2003, it came out that the Forest Service is initiating studies for contracting out its entire law enforcement, budgetary and human resources staff. It is also doing so for significant portions of its environmental, fire control and timber sale workforce. The proposals mean outsourcing more than a quarter of the Forest Service's 34,700 jobs by the end of FY 2005. The more than $10 million for planning and studies this year would come out of the budgets of these areas. Moreover, thousands of Forest Service managers and workers have been drawn away from their regular duties, like forest firefighting planning and efforts, to work on outsourcing. See Christopher Lee, Forest Service Works to Meet Bush Policy on Outsourcing, Washington Post, July 1, 2003 at A11.

This has been sufficiently controversial that the recently House-passed version of the Interior Appropriation Bill carries a broad ban on outsourcing studies, and the Senate version

may have a similar provision. The issue has aroused the environmental community, which sees a danger that the responsibility for protecting the nation's forests will get turned over by this process to the very firms being criticized for over-exploiting the forests. For example, the timber sale workforce is at the center of a highly intense policy controversy over whether expanded timber sales represent an anti-forest fire measure, as the Administration maintains, or will lead to clearcutting in old growth areas, the most lucrative activity for contractors. Turning the timber sale activity itself over to private contractors seems a formula for imposing an environment-threatening agenda on the national forests.

Quite concretely, the Forest Service matter illustrates the themes discussed throughout this testimony. Outsourcing is only one approach to workforce issues, yet this Administration overdepends upon it, implementing it in a heavy-handed way, by agency-wide numerical targets. The impact upon the Forest Service, as upon the IRS and the VA, shows no sensitivity to agencies that have done traditional governmental work, treating them as no different than private sector firms without the same longstanding idealistic missions, specialized functions, and public interest responsibilities. In the near term, the proposals for the Forest Service, like those for other agencies, produce disruption, plummeting morale, and fear in the community most concerned about the agency's mission.

Even the cost and effort of outsourcing draws heavily on agency resources. There is a subtle message in the fact that the Forest Service would spend $10 million on such studies. I believe that when the Administrator of OFPP was asked what would drive an agency to meet its targets, her answer was to innocently suggest that nothing drove them – that no one does anything to an agency to make it meet its OMB-set outsourcing targets. However, the drive to meet outsourcing targets does not come from just some merely cheerleading federal official with a nice symbolic title but no particular authority. It comes from OMB. OMB has its hands on the money. *See generally* Charles Tiefer, *Controlling Federal Agencies by Claims on Their Appropriations? The Takings Bill and the Power of the Purse*, 13 Yale J. on Reg. 501, 519-24 (1996)(describing OMB's authority). So OMB has the power, which no one else does, to make an agency like the Forest Service take $10 million its employees would much rather devote to its environmental mission, and spend that instead on outsourcing studies. And, in the long term, a range of major deleterious effects, such as, for the Forest Service, delivering its environmental mission into the hands of profit-oriented firms that may well be perceived publicly as anti-environmental, will ensue.

NEW A-76'S TILT TOWARD OUTSOURCING

I recently published an article in a federal bar newsletter critiquing the new A-76 – which was the first (and may still be the only) academic analysis of the new circular. Charles Tiefer, OMB's New A-76: Tilting the Contracting-out Process, Federal Bar Association Government Contracts Section Newsletter, Spring 2003, at 6. New A-76's tilting comes under several separate headings.

Defining What Is "Governmental".

First, new A-76 radically expands the effective definition of what is to get contracted-out. Congress itself previously drew the lines about what is "inherently governmental" in the Federal Activities Inventory Reform (FAIR) Act, with its annual inventory of federal services to list which ones could have public-private competitions. While the FAIR Act, written by Congress in 1998, only drove contracting-out a limited distance in recent years, many features in the new A-

76 are ready to push the process much further. New A-76 arranges to inventory all inherently governmental activities, with a novel suggestion that all activities performed by the federal government shall now be deemed commercial, unless justified in writing as inherently governmental.(Fn 3)

The directive newly redefines as commercial even governmental activities that involve an exercise of federal discretionary authority affecting individual liberty, so long as higher agency officials set procedures enabling what is called regular oversight.(Fn 4) OFPP has tried to argue that it has just recycled a definition in use in a 1992 policy letter. However, the 1992 policy letter predated the FAIR Act by six years, and was not part of an action mechanism. It did not drive the annual creation of inventories used to get agencies to meet numerical targets for outsourcing. For purposes of action, Congress took a more cautious approach in the FAIR Act. OFPP has overthrown that cautious approach.

These changes in the annual inventory process intimate what agencies might do to meet OMB contracting-out quotas. They might declare that their agents exercising discretion over the most sensitive matters - say, choices among which of the powerful IRS collection techniques ought to apply to particular taxpayers, or choices among which levels of isolation punishment ought to apply to particular federal prisoners(Fn 5) - might now, under agency oversight procedures, be privatized as commercial. The rule of federal law is becoming rule by contractors. The American Federation of Government Employees, and the National Treasury Employees Union, have filed lawsuits challenging new A-76, including the new expanded definition of what can be contracted-out. I urge Congress not to abdicate its oversight role.(Fn 6)

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3 The Draft A-76 (Nov. 14, 2002) expressly stated the presumption as that agencies shall "Presume all activities are commercial in nature unless an activity is justified as inherently governmental." (Page 1, point 4.1.; see also App. A-1.) The Final A-76 (May 29, 2003), requires that "The CSO shall justify, in writing, any designation of government personnel performing inherently governmental activities." Activities not so justified, and hence, not inherently governmental, must be commercial.

4 Section B.1.a.3, at page A-2, lets something be considered an inherently governmental activity if it involves "Significantly affecting the life, liberty, or property of private persons." By the canon of *expression unius*, if something affects individual liberty but not "significantly" affects it, then it is commercial rather than inherently governmental. For example, even if the Administration would concede that IRS collections activity can affect the liberty and property of taxpayers, presumably its position may be that such activity does not "significantly" affect liberty and property.

5 The policies about not deeming commercial those government activities that significantly and directly affect life and liberty, "do not prohibit contracting for . . . the operation of prison or detention facilities." Att. A, App. A-3, point B.1.c.4.

6 The Executive Branch will set up several doctrines in the way of a fair judicial ruling against it. It can urge that the issue, in whole or in part, is not yet "ripe" until federal employees suffer the actual hardship of RIFs. It will argue that its interpretation of the relevant legal principles, right or wrong, ought to receive various kinds of "deference." Congress has no reason to heed these kind of excuses for avoiding scrutiny of the A-76 changes. And, Congress can consider policy arguments on all sides. For example, a study by a former IRS commissioner concluded that a dollar invested in additional IRS in-house personnel would return $31 in additional collections, while, at a 25 percent commission, contractors will return only $3 for every dollar spent – putting aside all the other issues about contracting IRS collections out. Albert B. Crenshaw, Tax-Collection Proposal Draws Criticism on Hill; Private Firms would Pursue Debtors, Wash. Post, May 14, 2003, at E2. Congress can consider such policy studies, of course, while the Justice Department will likely urge the courts not to. So, Congressional attention and oversight on this issue are necessary and proper.

Outsourcing "Wins" By Default or By Skewed Calculations

New A-76 says that a standard competition must occur on a timetable forcing decision within a set period, and it is not easy to waive the deadline. A-76, point D.1 If agency managers, even just from the uncertainties of designing an MEO for types of services never before competed this way, submit a materially deficient tender, the public service proposal might not be considered - and the private contractor, regardless of relative lack of merit, wins by default.(Fn 7) The extraordinary concept is that service by public employees must cease if the process of deciding about this runs into problems, whatever the reason.

Also, new A-76 puts great emphasis upon something newly injected with significance, the "streamlined competition" for outsourcing that OFPP will now use to handles activities involving 65 or fewer FTEs. This eliminates so much of the process that it is in some ways more like a direct conversion than a genuine competition, but, hitherto, direct conversions were only for activities involving 10 or fewer FTEs. For example, OFPP has told agencies they need not even bother to develop an MEO for the public offer in a streamlined competition, but rather, "An agency may base the agency cost estimate on the incumbent activity." Att. B., point C.1.a.(Fn 8) This is an extraordinary truncation of the process, considering that in past A-76 competitions, the in-house MEO won sixty percent of the time. Now, in other words, even if agency employees could win the competition and do better and cheaper work than the private contractors if given half a chance by proposing how to improve their operation, the agency, to save time, can skip giving them that opportunity and just zoom ahead by a "streamlined" route to outsourcing.

OFPP has tried to contend that the new aspects of revised A-76 were at least vetted by the Commercial Activities Panel (CAP). Not even the thinnest claim of prior vetting can be made for what new A-76 does with this "streamlined" procedure for relatively substantial operations (65 FTEs). This was not only not proposed or considered by the CAP, it was not even in the original late 2002 proposal for new A-76 that received public comment. It sprang forth, without opportunity for formal public discussion or explanation, in the May 2003 final version. OMB has given no reason to doubt that it developed this powerful "streamlined" procedure to implement the Administration's element of hard-line enthusiasm for outsourcing that lies behind the high numerical goals.

Unfortunately, there is every reason to expect that OMB will treat the "streamlined" process as a way to outsource without putting in the resources in planning, attention, and consideration, to fairly weigh public vs. private alternatives. This is particularly likely when an agency considers itself under heavy pressure from OMB or higher-ups to meet arbitrary targets. It is significant that the "streamlined" process can even use multiple-award contracts for the private offer, so that an agency can, in effect, push through outsourcing on an automatic, cookie-cutter basis, outsourcing one in-house operation after another without even a minimal new or tailored effort or expense by the private contractors to beat, in competition, a specific MEO in the

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7 "If the CSO determines that the ATO cannot correct the material deficiency with a reasonable commitment of additional resources, the CSO may advise the SSA to exclude the agency tender form the standard competition . . . . and the SSA shall make the performance decision . . . ." Att. B, point C.5.c.(3).

8 To hammer the point home, Att. B, point A.5.b.(2), says to look for a threshold determination at the "agency tender (for a standard competition)" but at "the agency cost estimate (for a streamlined competition)." In other words, there may well not be any agency tender in a streamlined competition – just an agency cost estimate derived from the current agency activity (not an MEO).

specific existing in-house operation. This metes out the economic equivalent of capital punishment to federal employees without even adapting the indictment or evidence to the specific facts.

The most dicey part of the new directive consists of letting go of what hitherto gave the public-private competition a semblance of objectivity - the standard of making public and private offerors compete as to the lowest calculated cost to the taxpayer. Inherently, calculations of the lowest cost, albeit manipulable to make private providers look better than they actually prove, put some kind of limits on outsized profits blatantly built into private proposals. Congress has particularly wanted the Defense Department only to contract out upon a persuasive demonstration it saves the taxpayer money. *See* 10 U.S.C sec. 2462; 10 U.S.C. sec. 129a. Without adhering to that, there is too large a danger of contractor giveaways to meet numerical outsourcing quotas. See Charles Tiefer, Giving Away the Store: How Much More Can the New Administration Surrender to Contractors?, Legal Times, March 5, 2001, at 36 ("the policy case for enfeebling the competitive procedures of A-76 is weak").

Yet, new A-76 includes the option of the private provider winning without competing on cost. It explicitly allows standard competitions to come to a performance decision other than on low cost. The private contractor merely needs to make a proposal that the agency decides has some obscure or irrelevant kind of technical superiority, providing in new A-76's terms, a rationale for the decision to award other than the low-cost provider. An agency can, with ease, skew a set of arbitrarily-picked non-cost technical factors to assure meeting its contracting-out quota. It can exclude factors the public appreciates in civil servants - experienced service, public spirit, incorruptibility, respectable levels of women or minority employment. And, it can overvalue technical factors found predominantly in the private offers - say, frilly features of the latest information technology that contractors can buy but that OMB would not let public employees have. See Charles Tiefer & William A. Shook, Government Contract Law 108-121 (1999 ed.)(agency discretion on evaluation factors).

Indeed, the final version of A-76 made it even easier to outsource than that. The draft version had required a "quantifiable rationale" for not taking a lower-cost in-house offer. But, the final version dropped the requirement that the rationale be "quantifiable." It is no wonder that critics of new A-76 warn that it will provide a field day for purely subjective decisions to outsource: now the rationale can even be non-quantifiable. In other words, the in-house offer can not only be lowest-cost, it can even be numerically superior by every quantifiable measure – and an agency under the gun to meet its numerical target can still go ahead with outsourcing.

A subtle point in new A-76 consists of what might be called the contractor "write your own dream ticket" provision. The technical term is the "phased evaluation" process. Att. B, point D.5.b.(2), at B-13. If a contractor does not like the agency's statement of the work to be done, the contractor can submit its own alternative. For example, suppose the current worksite is Cleveland – or Chicago – and the agency's statement of work requires continuing to do the work on site there. But, a would-be contractor may be in Dallas. The contractor can submit the alternative of moving the work to Dallas, which, presumably, would give it an incredible advantage over the in-house bid.

It need hardly be said, that any would-be contractor's lawyer given this opportunity, could easily figure out a way to stack such an alternative to give his contractor-client a tremendous advantage in the ensuing competition. This procedure is a godsend for the contractor who could

not otherwise win a public-private competition, or at any rate could not do so without less profit than he wishes. Even GAO, which tried its very hardest to keep mute about the problems in new A-76, found this part "burdensome in implementation" and one which "may affect the timeliness of the process." (GAO Testimony before the House Comm. on Government Reform, June 26, 2003, GAO-03-943T.) Translation: GAO cannot avoid mentioning that this stacked pro-contractor process by which the contractor gets to say what work the government should pay for, has the potential to drag on indefinitely, impose large burdens, and make a mockery of the competition.

INADEQUATELY CLEAR RIGHTS TO PROTEST OUTSOURCING AWARDS

Considering the heightened risks under the new A-76 of the tilt toward outsourcing, it matters more than ever what rights exist to protest an improper contract award. An important legal issue has long concerned the denial of rights either to someone articulating the government's in-house position or the employees and their unions, to protest improper awards. This is a subject I addressed in some detail in a law review article published not long ago. Charles Tiefer & Jennifer Ferragut, Letting Federal Unions Protest Improper Contracting-Out, 10 Cornell Journal of Law & Public Policy 581 (2001). As I discussed at length, the barriers to employee union protests in this context are the hoary leftovers of long-obsolete circumstances. The better decisions (or dissenting opinions) in support of union protests make a persuasive case, and show that the supposed barriers or problems are just not serious. *See National Air Traffic Controllers Association v. Pena,* 78 F.3d 585, 1996 WL 102421 (6th Cir. 1996); *Diebold v. United States* , 947 F.2d 787 (6th Cir. 1991); *National Federation of Federal Employees v. Cheney* , 883 F.2d 1038, 1054(D.C. Cir. 1989) (Mikva, C.J., dissenting); *International Assn. of Firefighters, Local 5-0100 v. United States Department of the Navy*, 536 F. Supp. 1254 (D.R.I. 1982).

Of course, this issue has received special consideration due to recent developments: new A-76 itself calls the Agency Tender Official or ATO, in devising, defending, and filing internal appeals for the MEO, a directly interested party, and takes other formal steps to put the MEO on a formal basis. In light of new A-76, the GAO has published an invitation to comment on whether to allow standing for a public-side protest right. There is a substantial chance the GAO will allow the ATO, one way or another, to pursue protests to obtain independent judgments of legal flaws in public-private competitions. After all, new A-76 makes the MEO, far more than ever, an entity with distinct formal rights and interests, bound by a stiff contractual instrument (a letter of obligation), subject to termination for default, and lasting just for a specific term.

Contractor associations will urge that no such protest rights should be extended even to the ATO, let alone to employees and their unions. And, presumably, they will urge a hands-off stance by Congress. However, I would suggest a number of reasons, in this new situation, for Congress to study and to encourage the recognition both of full ATO protest rights – the easy step – and the more worthwhile, but more strongly contractor-resisted, step of recognition of rights to protest contracting-out by employees and their unions.(Fn 9)

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9 Part of what holds back GAO and the Court of Federal Claims consists of formal or precedential considerations that cannot be argued the same way to Congress. Both GAO and the Court of Federal Claims have past precedents against union standing to protest. It will be argued to them by contractors that these are *stare decisis*

Contractors will argue to these other forums that any protest rights for the ATO – the agency official who formulates the MEO – is more than sufficient, and, hence, that no recognition at all should be given to employees and their unions. Although I have hoped, and continue to hope, that this argument will not overly sway these other forums, Congress in particular is immune to some of the subtext underlying this argument. Contractors like to argue that there is no symmetry between them and unions: that contractors must have the right to protest flawed agency decisions about contracting-out, while unions should not have such a right. Congress, in particular, can recognize contractor arguments for such asymmetry as self-serving: that it is utterly unfair and illogical that the only errors in the outsourcing process that get corrected should be the ones contractors want to see getting corrected, not the rest. The protest forums would become like one-way pro-contractor auditors, who could only take notice of situations where the public should pay the contractors more, but who are forbidden to take notice of those in which the public should pay the contractor less. Both basic fairness, and the public interest, call for legally mistaken awards of contracts in the outsourcing process to be at least as subject to protest as decisions the other way.

And, rights for ATOs to protest, although better than nothing, also fall short of the more worthwhile situation from recognizing rights in employees and their unions. ATOs are, after all, agency officials. They know the desire of OMB and their superiors for outsourcing, and even if this does not totally sap their willingness to propose in-house alternatives, it may somewhat put a ceiling on how far they will fight in calling attention to the errors committed in the error-prone A-76 process in rejecting those alternatives. ATOs may not have as much independence of outlook, experience with the downsides of outsourcing throughout the government, and vigor of presentation, as the employees and their unions.

This is particularly necessary in light of what the new A-76 does. For, by its new provisions such as denying consideration of in-house alternatives deemed materially deficient on technical factors, it creates new ways a contractor could receive a legally unmerited award in effect by default. More than ever, employees and their unions must have a forum to go to, when they lose an A-76 competition, not on the merits, but by these forms of default.

And, if ATOs receive the right to protest, there may be new ways for employees and their unions to participate, which GAO and the courts will adequately consider only if encouraged by Congress. In outsourcing cases, the GAO and the courts should be encouraged, with ATOs now playing a role as a protester, to readily grant unions that apply for it, intervenor status.(10)

I thank the Subcommittee for the opportunity to testify.

– settled precedents not to be overruled – because in some respects the precedents are interpretations of the Competition in Contracting Act, or other statutes, and these forums will be told not to change previous statutory interpretations. Although new A-76 makes changes in the public-private competition process, so that the *stare decisis* argument is largely without merit in this situation, still, it is an argument which contractors can use to distract these other forums in a way that would be completely ineffective in Congress.

10 This is another way to make up for the fact that agencies or ATOs may not have as much independence of outlook, experience with the downsides of outsourcing throughout the government, and vigor of presentation, as the employees and their unions. (For example, during protests of awards during all-private competitions, the petitioner is the rejected contractor and the respondent is the agency, but the contractor receiving the award often participates as an intervenor. It is similarly common in general labor relations cases (e.g., appeals from NLRB decisions on unfair labor practices in organizing), when a corporation appeals and the agency is the respondent, for the union to become an intervenor.)

T E S T I M O N Y

RAND

Competitive Sourcing and the Morale of Federal Employees

Frank Camm

RAND Senior Economist

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Before the Committee on Governmental Affairs Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia

United States Senate

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Statement of Frank Camm[1]
RAND Senior Economist

Mr. Chairman and members of the Subcommittee, thank you for the invitation to testify before you today. It is a particular privilege to testify before Senator Pryor today. I served with your father on the congressionally mandated Commercial Activities Panel (CAP) last year and learned a great deal from him. My testimony today draws on that work[2] and, more generally, on policy analysis I have done at RAND.[3] In today's testimony, however, I speak as an individual.

I share your belief, Mr. Chairman, that we should treat the government's career employees with respect and appreciation. Competition affects every person's sense of self-respect throughout our society. Some federal employees fear competition, because they are convinced that they and their colleagues cannot—or will not be allowed to—compete successfully against an alternative commercial source. That cannot be good for morale, whether competition occurs or not. Can such organizations hope to recruit the kind of employees we need in the federal workforce? Thousands of other federal employees have affirmed their self-respect by helping their federal colleagues win public-private competitions. To me, two critical challenges for competitive sourcing policy itself are to (1) ensure that we properly empower federal employees to compete and (2) create as level a playing field as possible for them to compete on and prove themselves.[4]

Let me offer the following observations:

1. Competitive sourcing is one of the best tools we have available to improve the cost-effectiveness of federal agencies. In its efforts to improve productivity since 1996, for example, the Department of Defense has consistently preferred this as the option with the best-documented history of improvement.[5]

2. RAND analysis on the best <u>commercial</u> sourcing practices indicates that the following conditions improve the morale of the workforce in a company deciding whether or not to outsource an activity.[6] Empirical information on commercial practice collected by the Commercial Activities Panel is consistent with these findings:

- The sourcing decision process is fair, objective, and transparent enough for employees to understand the final decision. The decision that such a process yields is more likely to enhance the long-term health of the company involved and so the long-term growth opportunities for employees who remain.[7]
- The decision process proceeds rapidly. Employee morale suffers most while awaiting a decision and suffers more, the longer the process takes.[8]
- Key employees are protected and encouraged to remain with a variety of incentives. This is obviously most important to the morale of the key personnel, but it also helps others who depend on their skills for their own job security.[9]
- Displaced employees are assured employment elsewhere in a firm. Employment elsewhere may require relocation or a lower job classification and commitments to retrain, but the option of remaining in the firm can limit the loss that an employee expects.[10]
- Displaced employees receive a soft landing if they leave a firm. This can occur through (1) formal severance or outplacement agreements with the firm if it outsources their positions, or (2) criteria used to choose an external source that reward a provider with generous compensation, benefit, and training programs and good opportunities for advancement.[11] A soft landing affects the morale of both the employees displaced and the employees who remain and watch these employees be displaced.

3. In well-managed outsourcing programs in the commercial sector, displaced workers often find themselves better off. Their new employers, who specialize more in their skills than their original employers did, are often more willing to invest in them and more likely to offer them growth opportunities.[12] That said, we must recognize that individuals who self-select into government jobs may simply not like jobs in the private sector, even if they offer better opportunities than the government did.

4. OMB's goal of competing 50 percent of positions in commercial activities in the federal government has clearly raised concerns among many in the federal workforce. Even though OMB has repeatedly clarified that it does not view this policy as an outsourcing program, employees afraid of outsourcing could easily misinterpret the policy's intent. RAND's analysis has long supported the strong empirical findings by the Center for Naval Analyses (CNA) that OMB Circular A-76 achieved savings through competition, not outsourcing.[13] OMB's recent changes in Circ. A-76 emphasize that it is a competitive sourcing policy, not an outsourcing

policy.[14] OMB's policy echoes that of the Department of Defense (DoD) in the 1990s, which emphasized competitive sourcing, because it had the best track record for improving government cost-effectiveness.[15]

Is 50 percent the right goal? It cannot be the right goal for every agency. A reliable method does not yet exist to determine exactly where competitive sourcing is cost-effective in any agency, even in DoD, the agency with the most experience in the federal government.[16] I would prefer an OMB policy that motivated competitive sourcing with targets that had more operational or strategic significance to federal managers, like specific targets for cost reductions or performance improvements.[17] For me, OMB's 50 percent goal is what the Commercial Activities Panel rejected as an "arbitrary numerical goal." I know that OMB disagrees.

5. That said, I think OMB has done a remarkably good job of implementing key elements of the Commercial Activity Panel's recommendations that it can control. I generally agree with Comptroller General David Walker's careful delineation of differences between the Panel's recommendations and OMB's new version of Circ. A-76.[18] I will not even attempt to list them here. Rather, I would direct your attention to the extent to which the new version of Circ. A-76 captures the central elements of the Panel's strong consensus on principles.[19] Taken together as a coherent whole, these principles call for major changes in competitive sourcing policy. OMB's recent revision of Circ. A-76 captures many of these changes in an effectively integrated manner.

6. From the perspective of employee morale, I think the following issues merit your further attention as OMB implements its new version of competitive sourcing:

- Are federal agencies actually giving their employees the support they need--in training, analytic support, and slack time--to participate effectively in public-private competitions? If they are not, the competitions cannot be fair and could well yield outcomes that do not serve taxpayers well either. OMB's decision not to program for the costs of competitions in its FY04 budget submission raises some concern. But I would be much more concerned if agencies were not devoting appropriate resources to these competitions.[20] The sooner agencies make appropriate investments to initiate well organized competitive sourcing under OMB's revised Circular A-76, the better.

- More broadly, are federal agencies investing in their internal processes to make them as cost-effective as possible? A central goal of extensive competitive sourcing is to induce such improvement across the board. To take full advantage of the power of public-private competitions, federal agencies will ultimately have to consider the past performance of federal activities as a selection criterion in these competitions.[21] Unless federal employees believe that their managers are investing in their capabilities in good faith, they will resist evaluation of their past performance or consider it an unfair criterion.
- Does the government "offeror" have an effective way to protest elements of competitive sourcing or final decisions as effectively as external offerors can? What is the best way to level the playing field in this portion of the competitive sourcing process? Giving public unions standing will not level the playing field unless private unions also get standing, which makes little sense to me. But until this matter is resolved, government employees can legitimately argue that they are not being treated fairly.
- Broadly applied competitive sourcing will displace large numbers of federal workers from the federal workforce—far more than it has in the past. That is an inevitable outcome of any effective effort to improve the productivity of the federal government. I favor more flexible Office of Personnel Management policies to provide a soft landing for these employees, particularly when a decision to outsource degrades their pension benefits.[22]

Thank you again for the opportunity to testify here today. I would be happy to answer any questions.

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[1] I thank Michele Anandappa, Frank A. Camm, Ray Conley, Susan Gates, Henry Leonard, Nancy Moore, Wendy Moltrup, and Shirley Ruhe for helping me prepare this testimony. The opinions and conclusions expressed here are mine alone and should not be interpreted as representing those of RAND or of any of the sponsors of RAND's research.

[2] See Commercial Activities Panel, 2002.

[3] Much of this work is summarized in Camm, 2002; and Johnson *et al.*, 2003, pp. 211-246. The work provides the basic policy context for Anderson, 1999.

[4] The very view of employees as "human capital" implicitly envisions individuals with skills that they can carry with them from one employer to the next. Increasingly, the notion of "job

security" in the private sector emphasizes an employee's ability to acquire useful skills and apply them wherever relevant opportunities are available, not lifetime employment in one company. Exposing federal employees to competition and investing in them to help them compete successfully can be viewed as an integral part of a broader human capital policy designed to help prepare federal employees for successful life in today's economy.

[5] In 1996, the Office of the Secretary of Defense gave each of the armed services goals for improvement. The Quadrennial Defense Review (QDR) of 1997 documents the strategies they chose to meet these goals. Attracted by the carefully documented history of DoD's experience with competitive sourcing, all of the services placed heavy reliance on competitive sourcing relative to any other option. They have since shifted their emphasis to include other ways to improve performance but, among these, only competitive sourcing has a well-documented history of success in the federal government. See Cohen, 1997.

[6] "Best commercial sourcing practices" are the practices that (1) private firms use to choose and manage sources and (2) their peers consider to be "best in class." Commercial firms use a "make-or-buy" process to decide what to outsource. The process differs substantially from firm to firm. We have never observed a process in the commercial sector as formal and transparent as that defined by the Office of Management and Budget's (OMB) Circular A-76. Commercial firms usually use a process closer to an administrative benefit-cost analysis than to a formal source selection. Among the most transparent commercial processes are those in which companies work with their employees' unions to ensure fair and objective decisions. Most firms examined in RAND analysis consider employee morale a key factor in make-or-buy decisions and attempt to design make-or-buy decisions that sustain employee morale relevant to business success.

[7] In the commercial firms that RAND examined, employees increasingly appreciate that their future opportunities in the firm depend on its business success and that success depends on cost-effective sourcing decisions. They clearly understand that sourcing decisions must reflect the firm's strategic goals. These firms can plausibly argue that, when internal process improvements improve their competitiveness in the market place, the improvements open the opportunity for corporate expansion and increased employment. A fair, objective, transparent make-or-buy decision process helps verify that any decision in fact reflects the firm's broader interest and is not motivated by the personal interests on a specific manager, a vindictive view

of specific workers, or some other illegitimate motive. The survival of government agencies does not depend cost-effective make-or-buy decisions, and a federal agency can rarely increase demand for its employees' work by improving their productivity. A fair, objective, transparent make-or-buy decision process protects government employees more against the inappropriately political decisions of a government manager than against the effects of bad business decisions on the success of their employer.

[8] In the past, many defended the lengthy A-76 process as a buffer that gave employees time to come to terms with change. Commercial firms have generally found that their employees like neither change nor uncertainty. But if change must come, doing it quickly can resolve uncertainty so that employees can get on with their lives. Morale suffers during a commercial make-or-buy decision process and can fall so low that workers leave, effectively leaving the firm without a viable option of keeping work in-house. The costs of low morale can be so high that some firms are willing to sacrifice reliability in their estimates of the costs and benefits of in-house and contract options to avoid transition costs.

[9] The best employees—the employees with the best external opportunities—often leave a commercial firm as soon as a make-or-buy decision process starts. Commercial firms can sign agreements with key personnel to retain them through a sourcing decision and beyond if necessary. The retention of key personnel keeps skills in-house that are relevant to the decision process itself and to continuing in-house execution if the firm decides against outsourcing. Retention of key personnel can also stabilize the work force as a whole during a sourcing decision, moderating the negative effects of employee morale on business performance. Watching respected peers leave easily leads remaining workers to believe outsourcing is more likely.

[10] Most of the government employees displaced by early outsourcing in DoD through A-76 could move elsewhere in DoD if they chose to. "Bumping" and other government personnel management techniques allowed them to retain their pay and benefit levels for a period of time that could potentially allow them to gain new skills. "Bumping," of course, allows an employee displaced by an A-76 study to displace another, less senior employee elsewhere in the government, spreading the negative effects of the initial study on government employee morale. For more information, see Robbert et al., 1997; Gates and Robbert, 2000.

[11] "Best in class" commercial firms use a broader range of tools than those available to the federal government, suggesting that greater flexibility could help the government create a better safety net for displaced employees. Federal law currently requires that federal contractors pay at least the prevailing wage rates for specific skills and regions. (See, for example, provisions of the Service Contract Act [especially § 351, "Required Contract Provisions; Minimum Wages"] and the Davis-Bacon Act.) This provides some protection for displaced workers. In principle, the Federal Acquisition Regulation allows government agencies to consider more aggressive protection of displaced workers in the source selection criteria for competitions. By requiring that DoD use only minimum-cost public-private competitions, current congressional legislation prevents DoD from pursuing such protection. See 10 USCS § 2462, "Contracting for Certain Supplies and Services Required When Cost Is Lower." Added July 19, 1988, P.L. 100-370, § 2(a)(1), 102 Stat. 851.

[12] Many firms also outsource to place their employees on a lower wage scale. This generally occurs in companies whose core competencies rely on highly skilled and well-paid employees, but who also require input from lower-skilled employees. These firms find it easier to outsource than to institute separate pay scales for high- and low-skill workers. The federal government could in principle pursue a similar policy, but nothing in policy or law requires it to. Low-skilled federal workers face such a risk only if the federal government chooses such an approach. Whether or not to pursue such an approach to competitive sourcing must be an integral part of the government strategy of sourcing.

[13] See, for example, Marcus, 1993; Tighe *et al.*, 1996a; Tighe *et al.*, 1996b.

[14] For example, Angela Styles, director of the Office of Federal Procurement Policy, has repeatedly explained that direct conversions were not compatible with a policy focused on competitive sourcing and so would no longer be allowed in cases under OMB's control following the most recent revision of Circ. A-76. See, for example, Peckenpaugh, 2003.

[15] DoD called its initial efforts, during the mid-1990s, to renew its use of Circular A-76 "outsourcing." As the principals involved came to understand how Circular A-76 actually worked, they quickly renamed these efforts "competitive sourcing" and pursued an approach that was neutral about whether a task remained in-house or not.

[16] The government currently uses comparatively primitive methods to distinguish positions that should be competitively sourced from those that should not. The methods differ across agencies. They are likely to overstate the opportunities suitable for competitive sourcing in some areas and understate them in others. Until the government uses better methods to implement the Federal Activities Inventory Reform (FAIR) Act inventory, it will be hard to interpret what percentage goals set for individual agencies even mean. Best commercial practice offers valuable lessons on how to improve these methods. The most obvious is to rely on the users of any activity inside an agency to determine whether it should be competitively sourced, not managers or workers within the activity itself.

[17] Best commercial practice attempts to link key decisions to high-level strategic goals, like performance and total ownership cost. Firms that use this approach motivate their executives responsible for sourcing decisions with metrics that reflect these high-level goals. We have not encountered a metric like "percentage of positions studied" in the commercial firms we have examined. For more information, see Baldwin et al., 2000; Kaplan and Norton, 1996; Moore et al., 2002.

[18] See, for example, Walker, 2003a; Walker, 2003b. I agree whole-heartedly that the key to the success of OMB's changes in Circular A-76 lies in their effective implementation. I am less concerned than Mr. Walker about OMB's aggressive goals to shorten the decision cycle for A-76 studies. Major changes in past practice will have to occur to make OMB's goals feasible, but I believe the goals are worth striving for. DoD's competitive sourcing office believes that processes can change to achieve these goals. As noted above, shorter cycle times should reduce the negative effects of competition on employee morale.

[19] The media have tended to overlook or underplay the fact that all Panel members supported the ten principles stated in the Commercial Activities Panel's final report (Commercial Activity Panel, 2002, pp. 33-36).

[20] Best commercial sourcing practice formally recognizes the resources required to support change and justifies them, in corporate resource allocation processes, with reference to how these resources will affect a firm's high-level performance and cost goals. A fairly transparent ability to justify investments in change is one key advantage of using high-level strategic metrics

to drive make-or-buy decisions rather than metrics like OMB's percentage of commercial positions reviewed.

[21] Competition can more easily improve performance when it is flexible enough to capture the buyer's priorities and reflect them in the decision of which source matches them most completely. A "past performance" criterion uses a source's performance on similar work in the past to measure how well it will perform a workload being competed. Past performance is heavily used in commercial competitions that will result in performance-based contracts. Performance-based contracting is the preferred approach to buying services in DoD today. The Federal Acquisition Regulation easily accommodates the use of past performance as a source selection criterion in private-private competitions. Current congressional legislation prohibits DoD from using best-value criteria, including past performance, in any public-private competition (10 USCS § 2462). This denies the use of an essential tool in public-private DoD competitions that Congress has allowed in private-private competitions for decades.

[22] Loss of pensions will become a smaller issue each year as the federal employees with Civil Service Retirement System (CSRS) pension plans phase out of the federal work force and remaining employees use the Federal Employees Retirement System (FERS). But loss of pensions remains an important issue today. One way to deal with this problem (and others), which the DoD Business Initiatives Council (BIC) has explored, is the use of a Transitional Benefit Corporation. For details, see Sorett, 2001.

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WRITTEN TESTIMONY OF THE

FEDERALLY EMPLOYED WOMEN (FEW)

SENATE GOVERNMENTAL AFFAIRS SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA

OVERSIGHT HEARING ON "Now and Then: An Update on the Bush Administration's Competitive Sourcing Initiative"

July 24, 2003

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FEW is a private, non-profit organization founded in 1968 after Executive Order 11375 – that added sex discrimination to the list of prohibited discrimination in the federal government – was issued. FEW has grown into an international organization serving the one million federally employed women (both civilian and military). FEW is the only organization dedicated solely to eliminating sex discrimination in the federal workplace.

INTRODUCTION

FEW very much appreciates the opportunity to submit this written testimony on competitive sourcing of federal government jobs. On behalf of the one million women employed in the federal government and military, we thank Chairman Voinovich, Ranking Member Durbin and the other Senators serving on this Subcommittee for conducting this important hearing. Because outsourcing tends to adversely impact women and minorities in the government, we believe our views and concerns should be heard during this debate.

FEW is a private, non-profit organization founded in 1968 after Executive Order 11375 – that added sex discrimination to the other forms of discrimination prohibited in the federal government – was issued. The early organizers of FEW realized that the government could dismantle the Federal Women's Program (FWP) that was established after E.O. 11375 was issued within most Federal agencies. They wanted to ensure that there would always be an organization dedicated to promoting equality for women and addressing concerns of women in the Federal workforce.

As a private organization, FEW works as a constructive pressure group to improve the status of women employed by the Federal government. This includes contact with Congress to encourage progressive legislation. FEW national officers also meet with agency officials at all levels to demonstrate support of the FWP, encourage officials to support the program and to obtain insight on the effectiveness of the FWP at agency and local levels. FEW has been called on in past years to testify before Congress on sexual discrimination and sexual harassment cases.

For 35 years, Federally Employed Women has been working to end sexual discrimination and enhance opportunities for the advancement of women in government. Every day, nationwide, FEW members work together to bring about

an awareness of the issues facing women throughout the federal government and achieve positive reforms and equality for women in the federal workplace.

In addition, FEW members support all efforts within the government to improve operations and efficiencies in the federal workforce.

OUR VIEWS

Since FEW members are inherently interested in ensuring that the federal government operates in an effective and efficient manner, we agree that some federal jobs and responsibilities are better done by the private sector. However, we ask that the following guidelines be followed when making these decisions:

1. Outsourcing of federal jobs should not always be the first option considered by management.
2. Outsourcing should only be considered when the job function is readily available in the private sector to the affected federal employee.
3. These jobs should not be inherently governmental in nature.
4. Most importantly, that it can be proven that outsourcing is the most efficient and effective way to perform the job function.

We firmly deny the charge that the use of outsourcing is without a doubt the best way to improve government operations. This is not true for the following reasons:

1. Federal jobs ensure against undue political influence.
2. Relying more and more on the private sector to perform government jobs will further escalate the decreased interest of new employees to join the federal workforce and will certainly negatively impact recruitment efforts.
3. There will be more of an emphasis on "profit" rather than serving the public good.

WHEN OUTSOURCING DOES OCCUR

Because it is inevitable that some outsourcing will occur in the federal government, and as mentioned above, when outsourcing represents the best solution, we would like to offer this Subcommittee our suggestions on how to best help these displaced workers get back into the workforce.

First and foremost, we assert that the Congress has a very important role in monitoring outsourcing initiatives to ensure that there is no disparate impact on women and minorities. The federal government is closely monitored for its diversity in hiring practices, as well as its Equal Opportunity laws, and we applaud these efforts. The same needs to be required from our contractors. We must not create a situation where women and minorities, who are many times serving in those occupations that have been targeted for privatization and are lower in seniority ranks, are put at a serious disadvantage in the workforce with unequal levels of job security.

We would ask that Congress enact some type of law or regulatory language that requires contractors to maintain diversity and fairness in their hiring practices, and that affected employees have priority rights of placement in positions that are outsourced. Sample language could include the following:

> ***Outsourcing initiatives should address the impact on the federal workforce and should be implemented in a manner consistent with EEO laws. Companies bidding on outsourcing RFQs should include in their proposals to the government plans to ensure that workforce hiring, training, and promotion opportunities are implemented in a manner consistent with EEO laws, will encourage workforce diversity, and provide affected employees with priority rights of placement.***

Finally, we ask that government agencies be monitored by Congress on the impacts of outsourcing on women and minorities within their own agencies and within the companies to whom outsourcing functions have been bestowed, including areas of pay equity, promotion opportunities, and training.

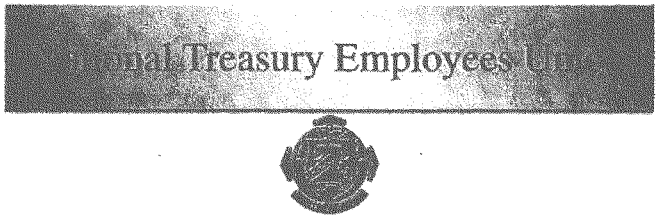
THE DISPLACED FEDERAL WORKERS

FEW is also asking that Congress work with the federal agencies to ensure that displaced federal workers receive protections that help them find employment within the government or in jobs within the private sector. Among the support mechanisms are:

- Job retraining
- Priority placement
- Early retirement
- Employment counseling
- Outplacement assistance
- Extended insurance benefits
- Supplemental wage or relocation allowances

While we acknowledge that some of these options are already available to displaced federal workers, we are asking that these employees receive maximum support, and that mechanisms be put in place to guarantee these benefits will remain in place.

Again, we very much appreciate the Subcommittee's work on the competitive sourcing issue and the opportunity to submit this written testimony. We look forward to working with the Subcommittee members on developing a fair sourcing system that maintains the high levels of diversity and equal opportunities that the federal government has strived so hard to achieve.



Testimony
Of
Colleen M. Kelley
National President
National Treasury Employees Union

"NTEU Views on the Administration's Privatization Initiatives"

July 24, 2003

Subcommittee on Oversight of Government Management,
the Federal Workforce, and the District of Columbia
Committee on Governmental Affairs
342 Dirksen Senate Office Building

Chairman Voinovich, Ranking Member Durbin, and other distinguished Members of this committee, my name is Colleen Kelley and I am the National President of the National Treasury Employees Union (NTEU). I was one of the twelve members of the Commercial Activities Panel (CAP). NTEU represents 150, 000 federal employees in 29 federal agencies and departments. I appreciate you giving me the opportunity to submit testimony on behalf of frontline federal employees on the Office of Management and Budget (OMB) rewrite of the A-76 outsourcing rules, and how the new A-76 will affect the Administration's privatization initiatives.

Let me be very clear: NTEU strongly opposes OMB's quota-driven campaign to privatize more than 850,000 federal employee jobs. OMB's rewrite of A-76 gives agencies even greater flexibility to turn the work of the federal government over to private contractors. I caution committee members not to be misled by OMB rhetoric that this new A-76 Circular will improve the use of public-private competitions. Instead, the new A-76 Circular is designed to give OMB one more tool to contract out as many federal employee jobs as quickly as possible. While the old A-76 Circular was not perfect, the revisions are unfair to federal employees, and will result in contractor services at higher costs and lower value to the taxpayers.

Opening Up Inherently Governmental Jobs to Contractors

Under the A-76 revisions, more federal jobs will be put up for grabs to the private sector, since OMB's sweeping changes expand the number of federal employee jobs eligible for privatization. Recently, NTEU filed a lawsuit in federal court alleging that OMB's revisions to A-76 are illegal. NTEU believes that OMB has illegally trumped Congress on the sensitive issue of determining whether a function is "so intimately related to the public interest as to require performance by federal government employees." In the lawsuit, we point out that the A-76 revisions require federal agencies to apply a substantially narrower definition of inherently governmental functions than is now contained in federal law. Under the Federal Activities Inventory Reform (FAIR) Act of 1998, activities that are inherently governmental may only be performed by federal employees, while those activities designated as "commercial" may be contracted to the private sector.

The FAIR Act requires the exercise of "discretion" for a function to be deemed inherently governmental. The revised Circular A-76, on the other hand, rules out as inherently governmental all functions that do not require the exercise of "substantial" discretion – a significant difference in language.

Moreover, functions involving the collection, control or disbursement of federal funds, which have been deemed inherently governmental under the FAIR Act and well before the FAIR Act, may obtain that designation under the new circular <u>only</u> if they include the authority "to establish policies and procedures."

These sweeping changes would have a substantial adverse impact on large numbers of federal employees, including thousands of NTEU-represented employees who are engaged in the collection, control or disbursement of appropriated or other federal funds, even though they may not be responsible for "establishing policies or procedures." For example, as a result of OMB's

unilateral expansion of the definition of "commercial in nature," we have already heard from the IRS that their FAIR Act inventory of federal jobs eligible for privatization will nearly double next year.

In conjunction with narrowing the inherently governmental definition, OMB also has restricted the rights of unions and other interested parties to challenge improper agency designations of functions as "commercial." The circular replaces the FAIR Act's broad right to pursue such "challenges" with a one-shot opportunity to file a challenge only if and when an agency changes the function's classification. This, too, runs afoul of the FAIR Act.

Ensuring that inherently governmental functions are performed by federal employees only is firmly rooted in sound government policies, such as ensuring that confidential taxpayer information is safeguarded and that the government maintains needed expertise at all times. I urge this subcommittee to seek to uphold the long held definition of inherently governmental.

NTEU has several other concerns with the A-76 revisions. In response to OMB's initial proposed revisions to Circular A-76, NTEU submitted detailed comments describing how the new provisions were unfair to federal employees and would deprive taxpayers of the benefits of true public-private competition. Unfortunately, the final version of the Circular remains heavily slanted in favor of private contractors over federal employees, and will deprive taxpayers of the benefits of fair competition.

Lack of Accountability from Contractors

The revisions to A-76 will move even more federal jobs to the private sector, yet the revisions would not make one single meaningful change to improve oversight of contractors and better track their performance. Oversight is particularly important now, as the Administration requires that more and more government functions be opened to contractors. The revised Circular continues to fail in effectively holding contractors accountable for their costs and performance. The Circular endorses the status quo of asking agencies to monitor the work of contractors, without having given these agencies any additional resources to better track their work.

The revised Circular requires agencies to redouble their time and resources to produce inventories of the size and makeup of the entire federal workforce, including those performing both commercial and inherently governmental functions, yet it fails to require agencies to implement systems to track whether current contracting efforts are in the best interests of the taxpayers. The new A-76 continues to disregard the need for agencies to determine how much the contractors' work costs the taxpayers, how the actual costs of the contract compare to what the contractors originally promised, whether the contractors are delivering the services they promised to deliver within the timeframes they promised, and whether the services are being delivered at an acceptable level of quality. When a contractor is not living up to its end of the deal, the government must have the realistic capability to bring the work back in-house. The government owes this accountability to the taxpayers who fund it. Agencies and the taxpayers did not know this information before the revised A-76 was released, and they would still be in the dark now.

Once a contractor gets a contract, that work is out the door and rarely--if ever--scrutinized again. For example, Mellon Bank, a contractor hired by the IRS as part of its "lockbox program," lost, shredded, or removed 70,000 taxpayer checks worth $1.2 billion in revenues for the U.S. Treasury. In January of this year, GAO issued a report (GAO-03-299) criticizing the inadequate oversight of Mellon Bank. Among other things, GAO found that:

(1) "Oversight of lockbox banks was not fully effective for fiscal year 2002 to ensure that taxpayer data and receipts were adequately safeguarded and properly processed. The weaknesses in oversight resulted largely from key oversight functions not being performed" (p.3)

(2) "Tax receipts and data were unnecessarily exposed to an increased risk of theft." (p. 21)

(3) Contract "employees were given access to taxpayer data and receipts before bank management received results of their FBI fingerprint checks." (p.29)

Another example of poor agency management of contractors came to light recently when a contractor hired by the IRS and other federal agencies to provide bomb detection dogs and services to patrol the perimeters at several federal facilities, including the IRS Service Center in Fresno, was convicted after he lied about the qualifications of his dogs, then faked the dogs' certifications to keep his business with these federal agencies. Fortunately, the government was able to catch this contractor, but unfortunately it was well after the contractor already had put at risk the security of thousands of federal employees.

The new A-76 fails to make any genuine improvements in contractor oversight to prevent contracting frauds like the Mellon Bank and security dog cases from happening again. I wish I could say with a straight face that lessons have been learned from contracting debacles of the past and OMB has applied these lessons to the new A-76. Unfortunately, I cannot. The new A-76 is business as usual when it comes to lack of accountability from contractors. Taxpayers and federal employees deserve, at a minimum, the same level of transparency and accountability from contractors as there is of the federal workforce.

Privatization Without Competition

While I was very concerned that a number of the issues NTEU raised were not addressed in the revised A-76 Circular, I was pleased that the new Circular supposedly eliminates the use of direct conversions, a flawed privatization process in which federal employees are not given an opportunity to compete in defense of their jobs. The revised Circular mandates that even those direct conversions that were underway under the old Circular, but not publicly announced before May 29, 2003, had to be converted to streamlined or standard competitions within 30 days.

However, within days of the release of the revised Circular, we started hearing complaints about the new direct conversion rules from agencies that were performing such conversions prior to May 29 under the old Circular. And now, it is unclear what action, if any, OMB will take with agencies that are either bypassing the new rules altogether or seeking waivers to continue with direct conversions. Like so much in the A-76 Circular, OMB has

managed to create numerous loopholes to ensure that more government jobs are moved to the private sector as quickly as possible and with as little competition as possible.

Another loophole for agencies to circumvent OMB's stated goals for competition is the so-called "streamlined competition" process. Streamlined studies are nothing more than sugar-coated direct conversions, in which federal jobs are transferred to contractors without first giving federal employees an opportunity to put forward a competitive proposal. Much like the direct conversion provisions in the old A-76, the new streamlined rules emphasize speed in privatizing federal jobs at the expense of quality and costs.

Agencies can use the streamlined process if a government function involves fewer than 65 federal employees. Because of the rigid timeframe of 90 days in which agencies must complete the streamlined study, agencies have absolutely no incentive to reorganize their own employees in a way that will deliver higher quality services to the taxpayers at a lower cost. The shortened process will make it harder, if not impossible, for an in-house proposal to maximize new efficiencies and innovations, thereby creating a strong bias in favor of the outside contractor. This streamlined proposal runs counter to the recommendation of the Commercial Activities Panel to encourage the establishment of high-performing organizations and continuous improvements throughout the federal government.

Furthermore, under a streamlined study, no longer are contractors required to come in at the lowest cost with their bids in order to win the competition: contracts can now be awarded to contractors if their bids are "cost effective," a much weaker selection criteria to meet. And whereas in the past, the costs incurred by the taxpayers as a result of converting federal work to contractors were factored into the private sector bids, these costs are no longer included under a streamlined study. Finally, what limited rights employees have to challenge faulty award decisions under standard A-76 competitions have been completely eliminated under the streamlined process.

Privatization of Tax Collection Activities

It is no coincidence that at the same time OMB was revising A-76 and enforcing its privatization quotas, the IRS was developing a proposal with private debt collectors to privatize tax collection functions. This is even further evidence of the Administration's aggressive push to privatize government activities with or without competition and whether or not they are inherently governmental.

Tax collection has always been off limits to private contractors, since it has historically been deemed an inherently governmental function. Even under the new A-76's watered down definition of inherently governmental, the Administration acknowledges that tax collection is inherently governmental, and would require legislation before it could be privatized. But the fact that the Administration is even seeking legislative authority to outsource tax collection proves that if for some reason A-76 does not allow an agency to privatize a certain function, this Administration will find a way to privatize it.

Under this latest scheme, the IRS is proposing to pay private collection agencies on a commission basis to collect tax debt. The IRS wants to privatize these activities without first conducting a public-private competition to determine what is best for the taxpayers.

The IRS tax collection privatization proposal will cost the taxpayers $3.25 billion, more than ten times as much as it would cost the IRS to use its own employees. In a report submitted to the IRS Oversight Board last September, titled "Assessment of the IRS and the Tax System," former Commissioner Charles Rossotti made clear that with more resources to increase IRS staffing, the IRS will be able to close the compliance gap. The report found that if Congress were to appropriate an additional $296 million to hire more IRS compliance employees to focus on Field and Phone Accounts Receivable, the IRS could collect an additional $9.47 billion in known tax debts per year. This would be a $31 return for every dollar spent. Compare that to the contractor 25% commission scheme in which the contractors will be paid $3.25 billion to collect $13 billion: a three dollar return for every dollar spent. According to the Joint Committee on Taxation, the Administration's tax collection privatization proposal would bring in less than $1 billion over ten years at a cost of over $200 million. The IRS could bring in that amount in one year with just over $30 million in additional in-house enforcement resources.

The proposal to privatize tax collection is opposed by the Citizens for Tax Justice, the Consumer Federation of America, the Consumers Union, the National Consumer Law Center, and the National Consumers League. And concerns about the IRS's ability to manage debt collection contractors and adequately protect the rights and privacy of the American taxpayers have been raised by the General Accounting Office, the Treasury Inspector General for Tax Administration, the National Taxpayer Advocate, the Tax Executives Institute, the National Association of Enrolled Agents, and the Tax Section of the American Bar Association.

Two pilot projects were authorized by Congress to test private collection of tax debt for 1996 and 1997. The 1996 pilot was so unsuccessful that the 1997 project was cancelled. Contractors violated the Fair Debt Collection Practices Act (FDCPA) and did not protect the security of sensitive taxpayer information and the IRS officials charged with oversight of the contracts were ill-informed of the law and lax in their duties, failing to cancel the contracts of those in violation even though they had the authority to do so.

In addition to using prohibited collection techniques and not safeguarding confidential taxpayer information, the contractors did not bring in anywhere near the dollars they projected, millions of dollars were spent by the IRS to train the contractors, and millions were not collected by IRS employees because they were training the contractors instead of doing their jobs. (See GAO/GGD-97-129R and IRS Private Debt Collection Pilot Project, Final Report, Oct. 1997)

So while the subcommittee is debating the nuances of OMB's troubling revisions to the A-76 Circular, in practice, agencies are seeking to privatize thousands of federal employee jobs without using A-76. Billions of taxpayer dollars are flying out of the Treasury coffers to pay private contractors to perform government functions that were never – and if OMB has its way, will never be – first subjected to public-private competition. Based on what NTEU sees happening at federal agencies, it is obvious that OMB's real motive behind the A-76 revisions is

to move more federal jobs to the private sector, regardless of cost, quality, and reliability of services.

Congress should require OMB to go back to the drawing board and develop an A-76 process that requires public-private competition before any government work is privatized, instead of one that allows agencies to pick and choose when they want to use a competitive process.

A Process That Costs the Taxpayers

After seeing all of the loopholes in A-76 to privatize federal jobs without competition, it is hard to believe that the A-76 process is actually supposed to be about competition. But even if agencies actually do conduct a standard A-76 public-private competition, OMB's changes tilt the playing field heavily in favor of contractors. First of all, agencies are required to complete standard A-76 competitions within twelve months, even though the most efficiently run A-76 studies have routinely taken 18 months or more to complete. And while OMB has gone to great pains to include every potential cost of federal employee performance of the work, the new A-76 arbitrarily excludes from the private sector bid legitimate costs of doing business with non-governmental entities. As an example of a windfall to the contractors in the costing process, the cost that must be incurred for a performance bond, if required by the solicitation, would be excluded from the contractor's price when compared against the agency bid. This is an actual cost of doing business with contractors that would not be incurred if federal employees performed the service: yet once again the contractors enjoy the benefit of having this cost excluded.

A Costly Alternative

NTEU is also concerned that the new A-76 Circular encourages agencies to move away from cost-based competitions to more subjective analyses that will lead to more outsourcing at higher costs to the taxpayers. The revised Circular now allows agencies to use the so-called "Tradeoff Source Selection Process" for selecting a winner in a competition between federal employees and contractors. This proposal is harmful not just to federal workers, but to American taxpayers who will wind up paying more than is necessary to get the job done and who will have less accountability as to how their tax dollars are spent.

The revisions to the Circular would, for the first time, allow contracting officers to use subjective determinations in public-private competitions. This would allow contracting officers to award contracts to a bidder that comes in with a more expensive bid than other bidders, but promises to perform work not requested by the agency. Introducing this tradeoff concept into public-private competitions would make fair comparisons between bids even more difficult, as it undermines the agency's ability to conduct an "apples-to-apples" comparison, an important aspect of any procurement decision.

OMB claims that the tradeoff process would be implemented on a limited basis only. However, the revised Circular gives agencies wide latitude to use this process. If the Administration is adamant about using this risky process, then it should first limit its application, so that we can find out whether or not it works for the taxpayers. Not until this process has been

tested and proven effective should the study be approved for government-wide use by the agencies.

I welcomed the Administration's effort to revise the OMB Circular A-76 as an excellent opportunity to improve the delivery of services to the taxpayers through fair competition on a truly level playing field for those competing. To my dismay, the new A-76 does nothing to advance the principles of increasing taxpayer value and leveling the playing field. Not only would federal employees suffer as a result of the revisions, but the taxpayers would as well. I therefore urge this subcommittee to work to block the implementation of the revised A-76 until the countless problems I mentioned are resolved.

Thank you for giving me the opportunity to submit testimony today.

STATEMENT BY

BOBBY L. HARNAGE, SR.
NATIONAL PRESIDENT
AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, AFL-CIO

BEFORE

THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS,
SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT

REGARDING

THE BUSH ADMINISTRATION'S WHOLESALE PRIVATIZATION AGENDA

JULY 24, 2003

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I. INTRODUCTION

My name is Bobby L. Harnage, Sr., and I am the National President of the American Federation of Government Employees. Given that federal employees have more at stake than any other group in the debate over the costs and consequences of the Bush Administration's wholesale privatization agenda, it is profoundly unfortunate that union representatives of federal employees were not invited to testify in person this morning.

I want to take this opportunity to thank several Ohio lawmakers for the tremendous service they have done to taxpayers, warfighters, and federal employees by fighting to bring back in-house work that has been wrongly privatized because of a systematic flaw in OMB Circular A-76, one which was actually exacerbated by the recent rewrite. Representative Dennis Kucinich and a bipartisan band of other Ohio Representatives deserve our profound thanks for their efforts.

By now, everybody knows the case of the botched public-private competition at the Defense Finance and Accounting Service's (DFAS) facility in Cleveland. As the Inspector General determined after a lengthy investigation, federal employees who performed military retired and annuitant pay functions were wrongly privatized, because $31.8 million was wrongly added to the in-house bid. DFAS has refused to bring the work back in-house where it could be performed by reliable and experienced federal employees.

Despite spurious claims of superior contractor performance from defensive DFAS officials, it was reported last Saturday in the *The Cleveland Plain Dealer* that the contractor "that took over more than 500 federal jobs in Cleveland last year has been fined nearly $500,000 for not meeting performance standards...DFAS (auditors) have repeatedly fined Dallas-based Affiliated Computer Services, known as ACS, for failing to quickly answer phone calls from military retirees whose benefit payments ACS handles and for failing to meet targets for promptly opening new retiree cases and making changes to existing accounts."

AFGE appreciates the leadership Representative Kucinich has shown, as well as his loyalty to hundreds of hard-working Ohio citizens whose jobs were stolen because of the Bush Administration's wholesale privatization effort. The Cleveland DFAS case is an indictment of so many problems and inequities in the privatization process: bad contract administration, pro-contractor conflicts of interest, lack of legal standing for federal employees, and a refusal to contract in (even when a contractor is demonstrably less efficient and less competent), to name just a few. We will continue to work with Representatives Kucinich, Steven LaTourette, Stephanie Tubbs Jones, Sherrod Brown, and Marcy Kaptur to right this terrible wrong and bring that work back in-house where it belongs.

Had AFGE been invited to testify in person, we would have attempted to clear up the four most significant areas of confusion at an earlier hearing on the same topic before the House Government Reform Committee.

1. At the House hearing, the General Accounting Office's (GAO) written testimony acknowledged, as it traditionally has, that "determining and maintaining reliable estimates of savings was difficult." However, in oral remarks, it was said that "Historically the savings have been in the 20 to 30 percent range with regard to historical competitions no matter who wins the competition." That is, of course, the unverified and self-justifying savings estimates provided by contractors and their cheerleaders in the Bush Administration. GAO staff have twice instructed us that the agency has not changed its historical position. Given that the misstatement at the House hearing has been passed on by partisans in the privatization debate ranging from Grover Norquist to Craig Thomas, I hope this unfortunate matter can be quickly resolved.

2. The witness from GAO did acknowledge that the streamlined competition process—which, if it is used as planned in lieu of direct conversions, will likely be the preferred process in well over one-half of all public-private competitions (based on the Department of Defense's (DoD) historical use of OMB Circular A-76)—is at variance with the Commercial Activities Panel's (CAP) recommendation. It is also at variance with the CAP's recommendation to ensure federal employees have opportunities to submit their best bids through Most Efficient Organization (MEO) plans. As the CAP wrote in its report: "Positive Elements of Circular A-76: Despite the widespread criticism that the Panel heard about the conduct of cost comparisons under Circular A-76, there are certain areas in which the A-76 process fares reasonably well in terms of the Panel's principles. The Panel concluded that these elements need to be carefully considered and, where appropriate, retained in any changes to the commercial activity sourcing process. The A-76 process encourages federal activities to develop 'most efficient organizations' designed to achieve efficiencies and promote higher level of performance."

3. It was said by the GAO witness and the witness from the Office of Management and Budget (OMB) that the Bush Administration no longer subjected agencies to numerical privatization quotas. However, that is not correct.

   OMB has failed to perform any of the research and analysis required by the FY2003 Omnibus Appropriations Bill for the establishment, application, or enforcement of any numerical privatization targets, goals, or quotas, or supply a report to the Congress with the justification for its wholesale privatization policy. Consequently, any numerical quotas, whether government-wide or agency-specific, are in fact illegal.

Moreover, as the FY2004 budget and the "Proud to Be!" goals demonstrate, OMB is still imposing—and has never retracted—government-wide privatization quotas. In *Performance and Management Assessments*, an agency can get a green light only if it has "complete public-private or direct conversion competition (sic) on not less than 50 percent of the full-time equivalent employees..." An agency receives a red light if it has not subjected 15 percent of its commercial workforce to privatization reviews. Throughout the assessments of individual agencies, agencies are alternately scorned or cheered for fulfilling the 15 percent privatization quota, and scored accordingly.

The more recent "Proud to Be! Goals reemphasize the 15 percent quota. While the overall 50 percent quota includes some boilerplate ("appropriate percentage determined for each agency individually"), no such rhetoric accompanies the reestablishment of the 15 percent quota. Moreover, the "Proud to Be!" Goals include the most blatant privatization quota yet: "If DoD commits to subject an additional 130,000 positions to competition, the civilian agencies will subject additional positions to competition."

AFGE is also in possession of internal documents from various agencies which show that the privatization quota is as alive and well as the OMB's quota report is unwritten and unsubmitted.

4. Whether the new OMB Circular A-76 is actually "generally consistent" with the CAP's recommendations is, obviously a matter of opinion.

   a. As noted earlier, more than one-half of all competitions under the new OMB Circular A-76 will not allow federal employees to submit their best bids or require contractors to at least promise appreciable savings before taking work from federal employees—completely contrary to the CAP's recommendation.

   b. The new A-76 mentions worthwhile alternatives to privatization in little more than a sentence—completely contrary to the CAP's recommendation to genuinely invest in federal employees with high-performing organizations.

   c. The new A-76 holds federal employees absolutely accountable for failure—but not contractors—completely contrary to the CAP's recommendation that both contractors and federal employees should be treated equitably.

   d. The new A-76 requires federal employees to always compete to acquire and retain work—but not contractors—completely contrary to the CAP's

recommendation that both contractors and federal employees should be treated equitably.

e. The new A-76 can be used, as it is indeed being used right now, to prevent federal employees from competing for new work or contractor work—completely contrary to the CAP's principle that such work should be open to public-private competition.

f. The new A-76 can be used, as it is indeed being used right now, to implement a privatization quota, contrary to a CAP principle and the law.

g. Contrary to the CAP principle to respect the integrity of inherently governmental work, the new A-76 actually narrows the definition of inherently governmental and fails to track contractor work so that inherently governmental work that is currently outsourced can be brought back in-house.

h. The new A-76 utterly fails to address the CAP principle to "be consistent with human capital practices designed to attract, motivate, retain, and reward a high performing federal workforce."

i. The new A-76 addresses only one conflict of interest, one which might have conceivably benefited federal employees, but leaves in place the myriad others that keep the pro-contractor conflicts of interests raging and the infamous revolving door spinning.

j. Contractors, and only contractors, have appellate rights, contrary to the CAP's principle that both parties should have "legal standing to challenge the way a competition has been conducted at all appropriate forums..."

But I'll run out of letters in the alphabet. As I said, the consistency of the new A-76 with the CAP report is a matter of opinion. However, if it is consistent with the new A-76, then that speaks volumes about the merits and fairness of the CAP report.

SUMMARY OF AFGE'S CONCERNS WITH THE NEW OMB CIRCULAR A-76

1. It would retain direct conversions, albeit shifting authority to the Office of Management Budget, and aggressively emphasize a second-rate competition process that makes the Most Efficient Organization optional as well as impractical and eliminates a requirement that contractors at least promise appreciable savings before work is contracted out.

2. It would, if a recent Department of Defense Inspector General's report is to be believed, significantly overcharge federal employee bids for overhead; in fact, it would double-charge federal employee bids for some indirect personnel costs, while not charging contractors once for indirect labor costs incurred by agencies through contract administration.

3. It would do nothing to prevent contracting out from being done to undercut workers on their pay and benefits and continue turning back the clock on diversity in the federal workforce.

4. It would introduce a controversial and subjective "best value" process that is as unnecessary as it is vulnerable to anti-federal employee bias.

5. It would impose absolute competition requirements on federal employees for acquiring and retaining existing work—but not contractors.

6. It would hold federal employees absolutely accountable for failure through recompetition—but not contractors.

7. Contractors—but not federal employees and their union representatives—would have standing before the General Accounting Office and Court of Federal Claims.

8. It would further narrow the definition of "inherently governmental."

9. It would, with the privatization quotas, emphasize privatization at the expense of all other methods to improve efficiency.

10. It would not ensure that federal employees could finally compete for new work and contractor work.

11. It would not require anything significantly new with respect to tracking the cost and quality of work performed by contractors.

12. It would, with the House defense authorization bill, hold federal employees, in almost all cases, to five-year contracts—but not contractors—and allow contractors—but not federal employees—to win contracts on the basis of how much time they spent, instead of what they actually accomplished.

Before proceeding any further, it is important that the revisions to the circular be reviewed in the context of OMB's privatization / "Proud to Be!" quotas, which charge all agencies with reviewing for privatization at least 50% of all activities performed by federal employees that are categorized as "commercial" as well as the Federal Acquisition Regulation (FAR), which has been severely criticized for failing to ensure that contractors actually compete against one another to acquire and retain their contracts.

Contractors have openly predicted that OMB's rewrite of the circular would allow them to win more competitions against federal employees than ever before. In fact, a contractor analyst who spoke at a Contract Services Association of America event last year declared that the new A-76 could allow contractors to win 90% of public-private competitions. Contractors have every reason to be pleased with the results of OMB's A-76 rewrite.

I appreciate the time that Office of Federal Procurement Policy Administrator (OFPP) Angela Styles spent discussing with AFGE the changes she was making to A-76. She has proven to be more accessible and competent than all of her predecessors in the previous Administration, combined. However, access is not the same as influence; and, ultimately, the new A-76 must be judged on whether it holds contractors accountable to the taxpayers and is fair to federal employees. And the new A-76 fails, utterly and absolutely, on both counts.

II. AFGE'S CONCERNS WITH THE NEW OMB CIRCULAR A-76

Here is a summary of AFGE's most significant concerns with the new OMB Circular A-76.

1. The new A-76 would emphasize a second-rate competition process, which was rejected even by the CAP's pro-contractor majority. Using a "streamlined" competition process, agencies would be encouraged to perform quick-and-dirty competitions in as few as 90 days. The use of the most efficient organization process (the in-house bid) would be purely optional, and the minimum cost differential would be eliminated, in defiance of the CAP's recommendation, for which both OMB and the contractors voted.

2. Despite concerns raised by the Department of Defense Inspector General (D-2003-056), the rewrite leaves in place the controversial 12% overhead rate imposed against all-in-house bids. According to the Inspector General, the 12% overhead rate is "unsupportable...a major cost issue that can affect numerous competitive sourcing decisions...Unless...a supportable rate (is developed) or an alternative method to calculate a fair and reasonable rate, the results of future competition will be questionable." Moreover, the new A-76 would wrongly inflate the costs of in-house bids by subtly charging federal employees twice for indirect labor costs. At the same time, contractors are

not charged to the actual extent of indirect agency labor costs associated with contract administration.

3. The new A-76 will continue to encourage work to be contracted out in order to provide those who perform the federal government's work with inferior pay and benefits. Moreover, according to the Departments of Transportation and Veterans Affairs, as well as the National Park Service, OMB's privatization agenda is destructive of the diversity of the federal workforce and has a disproportionate impact on women and minorities.

4. The new A-76, through the introduction of a subjective and unprecedented "best value" process, will allow contractors to win awards even when they submit more expensive and less responsive bids than federal employees.

5. The new A-76 imposes absolute competition requirements on federal employees for acquiring new work and retaining existing work—but not contractors.

6. The new A-76 holds federal employees absolutely accountable for failure, but not contractors.

7. Under the new A-76, federal employees would have standing only for purposes of an internal agency appellate process—but not for the GAO or the Court of Federal Claims, like contractors. Federal employees would lose their ability to contest any decision involving the "streamlined" competition process, while contractors would continue to be able to protest those same decisions to the GAO and the Court of Federal Claims.

8. Under the new A-76, it would be even easier to privatize work now categorized as inherently governmental.

9. Under the new A-76 and the OMB quotas / "Proud to Be!" goals, privatization would be used to the exclusion of all methods of improving operations (i.e., strategic sourcing).

10. Under the new A-76 and the OMB privatization quotas / "Proud to Be!" goals, federal employees are scheduled to compete for only a tiny handful of contractor jobs. In fact, in OMB's "Proud to Be!" scheme to implement the President's Management Agenda, goals are established for conducting arbitrary numbers of competitions in arbitrary periods of time. However, no goals are imposed for specifically ensuring that federal employees are finally allowed to compete for new work and contractor work.

11. Despite the Administration's contention that the OMB privatization quotas and the A-76 rewrite are all about saving money for taxpayers, tracking the costs of work given to contractors is accorded the usual short shrift. In fact, in

OMB's "Proud to Be!" scheme to implement the President's Management Agenda, goals are established for conducting arbitrary numbers of competitions in arbitrary periods of time. However, no goals are imposed for the establishment of reliable and comprehensive systems for ensuring taxpayer dollars entrusted to contractors are well spent. The emphasis is on turning the work over to contractors, not in making sure the work is done right. More significantly, agencies receive no additional resources to better administer contracts at the same time OMB is imposing the onerous privatization quotas.

12. An already unfair competition process threatens to be made even more inequitable by provisions in the House defense authorization bill (H.R. 1588). Section 1431 would allow agencies to repeatedly roll over contracts, thus allowing contractors to avoid recompetitions. At the same time the A-76 rewrite would force federal employees to be recompeted at least once every eight years, and almost always every five years. Section 1442 would allow contractors to be given time and materials contracts and labor-hour contracts, which pay contractors on the basis of their time, rather than their achievements. On the other hand, federal employees, under the new A-76, would be held to strict, results-based performance agreements.

Here is a detailed discussion of each of those twelve concerns:

1. EMPHASIS ON A SECOND-RATE COMPETITION PROCESS, WHICH WOULD BE REJECTED EVEN BY THE COMMERCIAL ACTIVITIES PANEL'S PRO-CONTRACTOR MAJORITY

In March 19 testimony before the Senate Armed Services Subcommittee on Readiness and Management Support, Ms. Styles acknowledged that "Our concern certainly has been, over the last two years, that agencies have made decisions to directly convert that may not be in the best interest of the taxpayer. We do not want that to continue." Of course, it is precisely because of the OMB privatization quotas, which explicitly encourage direct conversions, that the direct conversion authority has been abused.

Contrary to OMB's protestations, direct conversions, giving work performed by federal employees to contractors, are still a part of OMB Circular A-76. The difference is that authority has shifted from the agencies to OMB. As a contractor lobbyist told *Federal Computer Week*, on June 13, "OMB does have the authority to say yes, you can do it (undertake a direct conversion)," he said. "That used to be at the discretion of the agency. Now, it's at the discretion of OMB."

And despite the circular's insistence that "agencies shall convert...direct conversions to streamlined or standard competitions under this revised circular," OMB officials are encouraging agencies to petition OMB for authority to give

work performed by federal employees to contractors without any public-private competition. As was reported in GovExec.com on June 2, 2003, "(Office of Federal Procurement Policy Administrator Angela) Styles emphasized that agencies should contact OMB if they are having trouble...and said that exceptions to the conversion requirement are possible. The Defense Department has about 30 direct conversions that were nearing completion, and that could be affected by OMB's rule change, according to Joe Sikes, director of Defense's office of competitive sourcing and privatization. Sikes will soon meet with competitive sourcing officials from the military services to discuss how to handle these direct conversions, he said. `If there are some that are too close [to completion] we might call [OMB] and try to work out some kind of accommodation,' he said."

Moreover, mechanisms to give work performed by federal employees to contractors outside of OMB Circular A-76, including the infamous Native American direct conversion process, have not gone away. In fact, the Senate Defense Appropriations Bill includes new language that would require that any federal employee jobs given to contractors through this process count towards any privatization quotas.

Publicly, however, OMB officials are emphasizing the use of "streamlined" competitions in lieu of direct conversions. "Streamlined" public-private competitions under the revised circular are very different from traditional public-private competitions. Any activity involving 65 or fewer employees could be subjected to a "streamlined" process, which would last no longer than 90 days, except in extraordinary circumstances, when they could last no longer than 135 days.

The use of "streamlined" competitions in place of direct conversions was pioneered last year by the Department of Interior (DoI). Significantly, DoI developed a "streamlined" competition process to avoid having to directly convert functions involving ten or fewer employees. According to a DoI official, in a GovExec.com posting on April 8, 2002, "The methodologies typically available in OMB Circular A-76—full studies, streamlined studies, or direct conversions without further consideration—don't appear to meet our culture and our commitment to our employees very well. So part of our intent here is to provide our managers with a tool *they can use to consider the 10-or-less situation without making that pre-emptive decision to contract.*" (Emphasis added)

OMB, however, would take that limited streamlined approach for avoiding de minimis direct conversions and encourage it to be used in lieu of real competitions for any function involving 65 or fewer employees.

There are two extremely important differences between a "streamlined" competition and a standard competition under the revised circular:

a. The Most Efficient Organization (MEO) would be optional for the "streamlined" competition, per page B-4. The MEO is the in-house bid; it is a way for managers and employees to improve upon the status quo by changing how they deliver a service, instead of being stuck with the current arrangement. If we are really interested in using public-private competition to make federal agencies more efficient, as opposed to just enriching contractors, then it is imperative that we let in-house workforces submit their most competitive bids.

   Even the pro-contractor CAP insisted, on page 50, in its recommendation, which was approved by contractors and Bush Administration officials, that any replacement to the current competition process include "the right of employees to base their proposal on a more (sic) efficient organization, rather than the status quo." There was no exception to this right for functions involving 65 or fewer employees.

   Moreover, even if an in-house workforce is allowed to form an MEO as part of a "streamlined" competition, OMB officials acknowledged that it is all but impossible to pull off in as few as 90 days, and certainly not in a manner that would give federal employees fair chances to compete in defense of their jobs.

b. There would be no minimum cost differential, which requires the challenger, whether in-house or contractor, to be 10% or $10 million more efficient than the incumbent, whether in-house or contractor. Because there is a cost associated with conducting a competition, as much as $8,000 per employee reviewed, according to the March issue of *Government Executive*, and in transitioning the work, it has always been required that there be appreciable savings before moving work back and forth between the federal sector and the contractor sector.

   Again, even the pro-contractor Commercial Activities Panel (CAP) insisted in its recommendation, on page 50, which was approved by contractors and Bush Administration officials, including Ms. Styles, that any replacement to the current competition process include "the A-76 conversion differential factor (10 percent of in-house personnel costs or $10 million, whichever is less) (which) would apply to whichever sector is currently performing the work..." Again, there was no exception to this requirement for functions involving 65 or fewer employees.

The old circular, on page 31 of the Revised Supplemental handbook, contains a very rarely used "streamlined" cost comparison process for functions involving activities with 65 or fewer employees. Its relative unimportance in the old circular is shown by its location in the handbook: at the very end, right before the Appendix. DoD reported to the CAP that, between FY1997 and FY2001, it used the streamlined process on 1/37 of all the civilian and military positions reviewed

under OMB Circular A-76. In contrast, the "streamlined" competition process is discussed in the revised circular before the traditional competition process, which makes sense because it is clear that agencies will be expected to use it much more frequently, particularly in the absence of agency authority for direct conversions.

Even so, there are several important ways in which the revised circular changes the "streamlined" process for the worse:

a. The "streamlined" process in the old circular included a minimum cost differential, on page 31. As discussed above, the revised circular does away with the minimum cost differential for "streamlined" competitions, in defiance of the CAP's pro-contractor recommendation.

b. The "streamlined" process in the old circular, on page 31, prohibits "any commercial activity involving 66 or more employees (from being) modified, reorganized, divided or in any way changed for the purpose of circumventing" the requirement to conduct real public-private competitions for activities of that size. Such a prohibition is strangely absent from the new A-76.

c. The "streamlined" process in the old circular could only be used on certain simple activities (e.g., custodial, grounds, guard, refuse, pest control, and warehousing services) that are commonly competed, competed largely on the basis of labor and material costs, and which don't require significant purchases of capital assets. Use of the old "streamlined" process was limited because it was so quick-and-dirty. In contrast, the revised circular's "streamlined" competition process can be used on any activity, no matter how complicated.

d. The "streamlined" process in the old circular, on page 31, requires the contracting officer to "develop a range of contract cost estimates, based upon not less than four comparable service contracts." In contrast, the revised circular would allow a contracting officer, on page B-4, to determine an estimated contract price merely by using "documented market research" (which includes, declared Ms. Styles, at a recent event at the Heritage Foundation, calling a contractor for a quote). This loosey-goosey "market research" is particularly prone to abuse when the minimum cost differential is dropped.

e. The "streamlined" process in the old circular need not be finished in time to meet an arbitrary deadline, unlike the "streamlined" process included in the revised circular. Please note that DoD reported to the CAP that the typical streamlined cost comparison process took "20 months regardless of size." OMB would point out that the "streamlined" process in the revised circular would allow an agency to switch to a traditional

competition if a "streamlined" competition is not completed by the arbitrary deadline. However, because of the mad rush inspired by the OMB privatization quotas, agencies have little incentive to avoid conducting quick-and-dirty competitions. The emphasis in agencies is on meeting the onerous OMB privatization quotas, not using a thoughtful and careful approach that yields the best deal for taxpayers and customers.

f. The internal appellate process, the only one available to federal employees, cannot be used, per page B-20, to challenge any decision made by management pursuant to the "streamlined" competition process. While also unable to contest a "streamlined" competition process, a contractor could still protest a "streamlined" competition process to GAO and the Court of Federal Claims.

2. CIVILIAN EMPLOYEES ARE SIGNIFICANTLY DISADVANTAGED BY HOW COSTS ARE CALCULATED

The new A-76 would continue to impose, on page C-20, a 12% overhead cost factor on all in-house bids, which is said to "include costs that are not 100 percent attributable to the activity being competed but are generally associated with the recurring management or support of the activity."

The Inspector General determined in the report D-2003-056 that not a single cent of the $33.7 million of the 12% overhead cost factor charged against an in-house bid for military retired and annuitant pay functions in a DFAS public-private competition was legitimate because those overhead costs would not change, whether the activity was performed by civilian employees or a contractor. The Inspector General recommended that DoD devise a more accurate overhead cost factor or develop alternative methodologies to allow overhead to be calculated on a case-by-case basis.

DoD officials were "non-responsive" to these recommendations, according to the Inspector General. There is nothing unique about the DFAS activity that was being reviewed with respect to its scope or nature. Consequently, the current circular may include a systematic inequity against in-house bids that artificially inflates overhead costs, thus giving contractors an unfair advantage.

But it gets worse. The November draft added a second charge for indirect labor, although such costs are already included in the 12% overhead cost factor. As the Department of Energy pointed out, "(T)his requirement would appear to require double counting of costs that should largely be captured in the 12% Overhead Factor applied to the Government's in-house bid." OMB took out the "Indirect Labor" section in the new A-76. However, OMB kept the redundant indirect labor charge by combining the "Direct Labor" and "Indirect Labor" sections into a "Labor Costs" section, on page C-7, which includes "indirect labor" related to "supervision and management" of the MEO.

At the same time, the revised circular would not charge contractors for their own overhead of agency indirect labor costs. Costs associated with contract administration are charged against contractors' bids, on page C-22—but not the indirect labor costs associated with contract administration, e.g., managers and supervisors above the first line of supervision in the organization responsible for ultimately overseeing the contract administrators, human resources personnel who hire the contract administrators, the comptroller who tracks the costs of the contract administrators, the general counsel who represents the legal interests of the contract administrators, etc.

3. PERPETUATES THE HUMAN TOLL FROM CONTRACTING OUT

The new A-76 continues to encourage contractors to undercut agencies on pay and benefits in order to generate savings from privatization that come at the expense of those who perform the federal government's work. That contractors provide inferior pay and benefits, particularly for lower-level work, has been conclusively established by the Economic Policy Institute (THE FORGOTTEN WORKFORCE: More Than One in 10 Federal Contract Workers Earn Less Than a Living Wage, 2000).

OMB should have striven to exclude pay and benefits from the cost comparison process, so that competitions can focus on staffing levels and methods of delivering services, and thus avoid giving contractors incentives to undercut the pay and benefits of those who perform the federal government's work.

Agency managers anguish openly about the impact of OMB's privatization effort on women and minorities in the federal workforce. DVA managers have publicly expressed concern about the impact of the OMB privatization quotas on the hard-won diversity of the agency's workforce. DVA, in its A-76 comments, reports that "(A)ny significant effort to outsource jobs will have huge diversity implications." Moreover, the Department of Transportation, in its comments on OMB's A-76 rewrite, reported the disproportionate impact of the privatization quotas' direct conversions on women and minorities. A consultant who has run federal public-private competitions for more than 20 years told *Government Executive* that, "(I)n looking at the affected workforce, it is disproportionately minority and female." In April, the Director of the National Park Service wrote to her superior that the impact of the OMB privatization quotas on diversity "concern(ed)" her.

4. ENCOURAGES THE USE OF A SUBJECTIVE AND EXPENSIVE "BEST VALUE" PUBLIC-PRIVATE COMPETITION PROCESS THAT IS AS UNNECESSARY AND UNPRECEDENTED AS IT IS VULNERABLE TO ABUSE

A-76 used to be an ultimately cost-based process. In the end, A-76 competitions were won on the basis of the lower cost to the taxpayers. Does that mean the old process didn't take into account issues of quality so that agencies secured the "best value?" No. Under the old A-76, agencies were free to specify the quality of services they wanted in the solicitations. After determining that an offeror could provide the service in question at the necessary level of quality, the competition proceeded on the basis of cost: which offeror could provide what the agency needed at the lower cost to taxpayers.

Contractors are unable to win as often as they'd like with public-private competitions that are ultimately cost-based. So they insisted that OMB switch to a subjective process called "best value" that would allow them to submit bids that are less responsive to the terms of the solicitation and more expensive than bids submitted by federal employees—and still win. In fact, "best value" is nothing more than a subtle industrial policy whereby the Bush Administration provides a particularly demanding business constituency, contractors generally but information technology contractors in particular, with subsidies that could never be justified through a fair, objective, and ultimately cost-based process.

Boosters of "best value," whether in the Congress, in the GAO, in the Administration, or in the contractor community, despite their immense combined propaganda resources, have consistently been unable to show how an ultimately cost-based competition process prevents agencies from making needed improvements in the quality of services. Insisting that "innovative" contractors are afraid to participate in an ultimately cost-based process is not a substitute for rational argument.

The revised circular, on page B-14, would encourage agencies to use a "best value" process for the first time ever in public-private competitions. OMB pressed the Congress this year to allow "best value" competitions to be used in DoD. However, the House Armed Services Committee said "No!" and the Senate Armed Services Committee would allow only a limited, four-year pilot project for information technology services. Why did "best value" receive such a cool reception from defense authorizers, both Republicans and Democrats, in both chambers?

a. "Best value" takes longer than competitions that are ultimately cost-based, according to the results of "best value" competitions between contractors.

b. "Best value" costs taxpayers more than if the same work had been competed under an ultimately cost-based process, according to the results of "best value" competitions between contractors.

c. "Best value" is not necessary because the current process already allows contracting officers to explicitly take into account quality.

d. "Best value" allows contracting officers an extraordinary amount of discretion. Contractors note that "best value" has been used in competitions between contractors. However, its use has been controversial and extensively litigated because some contractors think "best value" is being used to favor their competitors. While it is difficult to systematically discriminate against one group of contractors in favor of another group of contractors, "best value" could be used systematically to discriminate against federal employees in favor of contractors, especially when wielded by an openly pro-contractor Administration that is rushing to review for privatization at least 425,000 federal employee jobs.

e. The "best value" process in the A-76 rewrite has few checks to prevent the process from being used to discriminate. Federal employees would not have the same legal standing as contractors to ensure that their concerns can be reviewed by the courts or GAO. Even if they did, most decisions, however subjective, cannot be appealed.

Unfortunately, non-DoD agencies don't benefit from the same safeguard that protects DoD. To her credit, Administrator Styles has attempted to make the irredeemably arbitrary "best value" process somewhat less arbitrary. GAO, perhaps the biggest booster of "best value," criticized OMB in its comments on the November draft for not fulfilling GAO's expectations for a new "best value" process, but never found the time to ask Ms. Styles to make the process less arbitrary.

While some additional guidance that was included by Ms. Styles in the new circular to make "best value" less arbitrary is clear and forthright (e.g., "All evaluation factors shall be clearly identified in the solicitation." and "For tradeoff source selection, the solicitation shall identify the specific weight given the evaluation factors and sub-factors, including cost or price."), other additional guidance is loose and unenforceable (e.g., "To the extent practicable, evaluation factors shall be limited to commonly used factors..." and "The quality of competition will be enhanced by using, to the extent practicable, evaluation factors and subfactors susceptible to objective measurement and evaluation.") To the extent there is no express requirement, an agency's policies and judgments are generally not subject to protest procedures. Moreover, even if we had standing, which we don't, most of these decisions are beyond judicial review. GAO, for example, requires credible evidence of bias and that the bias translated into action that unfairly affected the protester's competitive position. Ultimately, there is no protection against bias against federal employees, deliberate or accidental, because it is usually impossible to meet the burden or proof.

It is outrageous that the "best value" process can be used any time an agency notifies OMB of its intention. The Congress is right to limit the use of "best value" to no more than a pilot project for DoD. Non-DoD agencies, particularly the taxpayers who support them and the customers who depend upon them, deserve

no less protection from this unnecessary, unprecedented, and dangerous process. Contractors often assert that a "best value" public-private competition process should not be viewed as novel because "best value" is used regularly in private-private competitions. However, given the efforts made by Ms. Styles to render the A-76 "best value" process less arbitrary as well as the absence of standing for federal sector offerors, there is no precedent for this new "best value" process, making it incumbent upon the Congress to restrict its use to a pilot project for all agencies.

5. ABSOLUTE COMPETITION REQUIREMENTS FOR FEDERAL EMPLOYEES FOR NEW WORK AND RENEWALS OF EXISTING WORK, BUT NOT FOR CONTRACTORS

The revised circular, on page 2, would require federal employees to compete in order to acquire new work or retain existing work: "Before government personnel may perform a new requirement, an expansion to an existing commercial activity, or an activity performed by the private sector, a streamlined or standard competition shall be used to determine whether government personnel should perform the commercial activity." However, contractors would not be held to those requirements. "A streamlined or standard competition is not required for private sector performance of a new requirement, private sector performance of a segregable expansion to an existing commercial activity performed by government personnel, or continued private sector performance of a commercial activity."

Instead, contractors would be held to the FAR. The FAR, however, as it is written and as it is applied, would not hold contractors to the same requirements as those imposed on federal employees.

That contracting officers use loopholes in the FAR to avoid subjecting contractors to competition is an established fact. According to the DoD Inspector General (D-2000-100), in the last comprehensive survey, "(I)nadequate competition occurred for 63 of the 105 contract actions (reviewed)...The abuse of the FAR requirement to give contractors a fair opportunity to be considered was worse than (had been reported previously)."

Judge Stephen M. Daniels, Chairman of the General Services Board of Contract Appeals, has declared that, "Although some parts of the (1984 Competition in Contracting Act) remain on the statute books, the guts have been ripped out of it. Openness, fairness, economy, and accountability have been replaced as guiding principles by speed and ease of contracting. Where the interests of the taxpayers were once supreme, now the convenience of agency program managers is most important. Full and open competition has become a slogan, not a standard; agencies have to implement it only `in a manner that is consistent with the need to efficiently fulfill the Government's requirements.' It is now much easier to acquire goods and services without competition.

Ms. Styles herself has said that "Since the beginning of the (acquisition) reform movement, over a decade ago, I have not seen a serious examination of the effects of reform on competition, fairness, integrity, or transparency. As a result, I think we are seeing some serious competitive problems surface with the proliferation of government-wide contracting vehicles and service contracting."

6. COMPLETE ACCOUNTABILITY WHEN CIVILIAN EMPLOYEES FAIL, BUT NOT FOR CONTRACTORS

When civilian employees fail to perform, the new A-76 requires, on page B-20, that their work be recompeted. "Upon terminating an MEO letter of obligation, an agency shall change the inventory coding to reflect that the activity is no longer performed by an MEO and shall perform either a streamlined or standard competition." The fate of a defaulting contractor, one to whom a notice of termination has been issued, consistent with FAR Part 49, is not stated. However, FAR 49.402-4 (Procedure in lieu of termination for default) allows the contractor to continue performance under a revised delivery schedule or by means of a subcontract or other business arrangements. Moreover, the defaulting contractor can also litigate before the GAO and the Court of Federal Claims, another option not available to federal employees.

7. ONLY CONTRACTORS WOULD HAVE FULL LEGAL STANDING

Contractors—but not civilian employees directly affected by privatization or their union representatives—can participate in all appellate processes, including the GAO and the Court of Federal Claims. Directly affected civilian employees would be able to participate only in a purely internal appellate process, which rarely produces rulings in favor of protesters. And, per page B-20, federal employees wouldn't even have access to the internal appellate process for all streamlined competitions: "No party may contest any aspect of a streamlined competition."

While federal service contracting is riddled with inequities against its dedicated in-house workforce, it boggles the mind that federal employees and their union representatives are unable to hold agency officials responsible for their decisions in the same fashion as contractors. Asserting that our interests can be represented by a management official, particularly in the virulently anti-federal employee Bush Administration, is preposterous. Perhaps the legal interests of contractors should be represented by the Project on Government Oversight?

8. MAKE IT EVEN EASIER TO PRIVATIZE WORK CURRENTLY CATEGORIZED AS INHERENTLY GOVERNMENTAL

The revised circular, on page A-2, would include an implicit bias against the categorization of a function as inherently governmental. The new A-76 would require an agency to justify that a particular function was inherently

governmental, although no such requirement is imposed if an agency were to designate a function as commercial.

The new A-76 would also change the threshold set in statute for categorizing a function as inherently governmental by changing the definition established in law. Per the Federal Activities Inventory Reform Act (P.L. 105-270), "The term ("inherently governmental") includes activities that require either the exercise of discretion in applying Federal Government authority..." On page A-2, OMB has taken that definition and inserted the word "substantial" before the word "discretion" in order to weaken the definition of "inherently governmental."

The new A-76, on page A-4, would also allow contractors to challenge for the first time agencies' determinations of functions that are commercial but are too important or sensitive to be turned over to contractors (Reason Code A).

The weakening of the distinction between inherently governmental and commercial is particularly disturbing when it is recalled that, for example, DoD officials have expressed fear that inherently governmental work has already been privatized. "(A) reassessment (of our manpower structure) may very well show we have already contracted out capabilities to the private sector, that are essential to our mission..." wrote E.C. "Pete" Aldridge, undersecretary of Defense for Acquisition, Technology and Logistics, in a letter to OMB on December 26, 2002. Significantly, OMB has failed to require that agencies develop inventories of work performed by contractors in order to identify inherently governmental work that has been wrongly given to contractors because of the Administration's wholesale privatization effort.

9. EMPHASIZE PRIVATIZATION ONLY

In concert with the privatization quotas, the revised circular would continue to emphasize privatization reviews to the exclusion of all other methods for improving operations, often grouped under the rubric "strategic sourcing," including reorganizations, consolidations, business process reengineering, and labor-management partnerships. Considering that privatization reviews can cost as much as $8,000 per employee, according to the March issue of *Government Executive*, managers should be able to use those other methods as well.

In the new A-76, it is written, on page 2, "Agencies are encouraged to use a deviation procedure to explore innovative alternatives to standard or streamlined competitions, including public-private partnerships, and high performing organizations." However, those options are not discussed in any detail or encouraged in any meaningful way, even though the CAP's pro-contractor majority explicitly endorsed the implementation of high-performing organizations. Moreover, Administrator Styles, who is responsible both for revising A-76 as well as imposing the privatization quotas, has said that agencies would receive <u>no</u> credit for any of those efforts towards the privatization quotas. "None of that

("various alternatives to competitive sourcing, such as strategic sourcing") is going to go towards our goals," Ms. Styles told *Federal Times* on March 17.

10. DOD EMPLOYEES WOULD NOT ACTUALLY BE GUARANTEED OPPORTUNITIES TO FINALLY COMPETE FOR NEW WORK AND WORK PERFORMED BY CONTRACTORS

The revised circular rhetorically supports the notion that civilian employees should be allowed to compete for new work and contractor work. In fact, Ms. Styles told the Senate Armed Services Subcommittee on Readiness and Management Support earlier this year that "I have made changes to eliminate all barriers to bringing work back in-house, to holding a competition for bringing work back in-house."

Nevertheless, OMB's approach towards public-private competition is still almost entirely one-sided. In OMB's "Proud to Be!" goals for the implementation of the President's Management Agenda, goals are established for conducting arbitrary numbers of competitions in arbitrary periods of time. However, no goals are imposed for specifically ensuring that federal employees are finally allowed to compete for new work and contractor work, despite the fact that, according to OMB, contractors acquire and retain almost all of their work without ever having to compete against federal employees. Moreover, according to studies by GAO and the DoD Inspector General, contractors frequently don't even have to compete against one another.

Only a single agency, the Department of Housing and Urban Development (HUD), is reviewing work performed by contractors for possible insourcing: "There are some things that (HUD managers) are going to look at in terms of bringing it back in-house," Ms. Styles told *Government Executive* in March. That HUD is such an isolated example is hardly surprising, given the Administration's bias towards contractors. DoD officials, for example, have made it clear that no competitions for new work or contractor work would ever be conducted because the civilian workforce would not be allowed to grow. In fact, Ray Dubois, the Deputy Defense Undersecretary, in an article in the March 4, 2002, edition of *Federal Times*, said that "When public employees retire, they're (going to be) replaced with private sector employees..."

11. CONTINUING TO GIVE SHORT-SHRIFT TO TRACKING THE COST AND QUALITY OF WORK PERFORMED BY CONTRACTORS

Despite the Administration's contention that the OMB privatization quotas and the A-76 rewrite are all about saving money for taxpayers, tracking the costs of work given to contractors is given the usual short shrift. In fact, on page B-19, it turns out that it's business as usual. Contracting officers are required to implement a "quality assurance surveillance plan" as well as "maintain the currency of the

contract file" and "report performance information, consistent with the Federal Acquisition Regulation," which they are required to do already.

Moreover, in OMB's "Proud to Be!" scheme to implement the President's Management Agenda, goals are established for conducting arbitrary numbers of competitions in arbitrary periods of time. However, no goals are imposed for the establishment of reliable and comprehensive systems for ensuring taxpayer dollars entrusted to contractors are well spent. The emphasis is on turning the work over to contractors, not in making sure the work is done right. More significantly, agencies receive no additional resources to better administer contracts at the same time OMB is imposing its onerous privatization quotas.

Allowing the executive branch to establish its own underfunded and underresourced process for tracking the cost and quality of work performed by contractors has repeatedly failed. The Department of Defense uses the Commercial Activities Management Information System (CAMIS) to track the cost of performance of commercial activities. CAMIS is nothing new; and its execution has been consistently found wanting.

According to GAO-01-20, "As early as 1990, (GAO) stated that CAMIS contained inaccurate and incomplete data. In a 1996 report, the Center for Naval Analyses also found that the data in CAMIS were incomplete and inconsistent among the services and recommended that the data collection process be more tightly controlled so that data would be consistently recorded. As recently as August 2000, we continued to find that CAMIS did not always record information on completed competitions or reported incomplete or incorrect information. The exclusion of 53 studies because of incomplete data illustrates this point. While DOD officials initiated steps this year to improve the accuracy and completeness of data included in CAMIS...(t)o what extent that may have resolved shortcomings associated with CAMIS data is uncertain."

12. HOUSE PROVISIONS BEING CONSIDERED IN DEFENSE AUTHORIZATION CONFERENCE COULD MAKE NEW A-76 EVEN MORE UNFAIR FOR FEDERAL EMPLOYEES BY ALLOWING CONTRACTORS

    a. TO ACQUIRE CONTRACTS-FOR-LIFE, WHILE FEDERAL EMPLOYEES WILL BE HELD TO STRICT TERM LIMITS, AND

    b. TO WIN CONTRACTS ON THE BASIS OF THE TIME THEY USED, WHILE FEDERAL EMPLOYEES WOULD COMPETE ON THE BASIS OF WHAT THEY ACTUALLY DID

Section 1431 of the House defense authorization bill would allow contracting officers to repeatedly invoke options to extend contracts beyond their original duration. Indeed, the provision includes no numerical limitations on the number

of options or the duration of those options ("extend the contract by one or more periods...").

Supporters will no doubt point to this language in the provision: "...and shall only be exercised in accordance with applicable provisions of law or regulation that set forth restrictions on the duration of the contract containing the option..." However, there is no strict five-year limitation in the FAR for the duration of contracts. In fact, FAR 17.204 leaves agencies with extraordinary loopholes to extend contracts well past five years: "*Unless otherwise approved in accordance with agency procedures*, the total of the basic and option periods shall not exceed 5 years in the case of services...*These limitations do not apply to information technology contracts.*" And, of course, a five-year limitation on duration is not the same as a five-year recompetition requirement.

In contrast, winning MEO's will usually be forced to recompete every five years. On page B-9, the competitive sourcing official "shall obtain prior written approval from OMB to use performance periods that exceed five years (excluding the phase-in period)." On page B-19, the winning MEO's must undergo a recompetition "before the end of the last performance period unless the Competitive Sourcing Official," identified as "an assistant secretary or equivalent official with responsibility for implementing this circular," (without delegation) "extend(s) the performance period for a high performing organization, and, on those occasions, for no more than three years."

However, "(f)or private sector performance decisions (on page B-20), the contracting officer shall comply with the FAR for follow-on competition." The historic use of loopholes within the FAR to avoid requiring contractors to undergo recompetition is extensively documented.

Section 1431, by allowing contracts to be extended without limitation, consistent with the provision of law or regulation, would allow contractors to avoid being subject to competition, while winning MEO's will, under the new A-76, be forced to recompete every five years, and no later than eight years.

Interestingly, Ms. Styles defended Section 1431, which has been accurately referred to by procurement experts and some Members of Congress as the "contractor-for-life" provision, by asserting at a House Government Reform Committee hearing earlier this year that she believed it "codifies existing flexibilities." Whether Section 1431 changes the law or reaffirms existing practice, it is wrong to hold federal employees to much more limited performance periods than contractors.

Section 1442 of the House defense authorization bill would encourage the use of time and materials as well as labor-hour contracts. These controversial contracting vehicles, which are similar to cost-reimbursement contracts in that they put the risk entirely on agencies, allow contractors to charge taxpayers for

their time, i.e., how long contractors work, rather than their results, i.e., what contractors actually accomplish.

In contrast, MEO's are performance-based and thus unable to submit bids that are open-ended on results. Repeatedly, OMB officials have insisted that one of the most significant changes to be wrought by the new A-76 is the increased accountability of the winning MEO's. In other words, at the same time federal employees would be held strictly accountable for their results under the new A-76, contractors would increasingly be held accountable only for their time.

III. THE EXTENT TO WHICH THE PRINCIPLES ENDORSED BY THE CAP ARE REFLECTED IN THE NEW OMB CIRCULAR A-76

Again, it would be foolhardy to limit the discussion to the mechanics of the new circular. How the new circular will be used to achieve the privatization quotas is as important as how the new circular works. Consequently, it is necessary to consider both the new OMB Circular A-76 and the old OMB privatization quotas in tandem.

1. Support agency missions, goals, and objectives.

The circular was revised in order to expedite the privatization quotas. In tandem, the new circular and the old quotas subordinate "agency missions, goals, and objectives" to OMB's political objective of stroking an important constituency of the Bush Administration. In OMB's view, agencies exist not to provide services, but to privatize services, jobs, and the public interest. Agencies don't decide how much they should privatize—OMB does. Agencies don't decide which services are inherently governmental—OMB does. Agencies' front-line managers don't decide which services are privatized and how that happens—agencies' privatization czars, a.k.a., the Competitive Sourcing Officials do.

Even the nuts and bolts of the rewritten circular demonstrate how privatization is relentlessly pursued at the expense of agencies' missions. If an agency doesn't receive any worthwhile contractor offers, then the agency should invite contractors to rewrite the solicitation. If an agency's contract administration apparatus is already stretched to the breaking point, too bad; many more competitions must be undertaken, and they've got to be run faster than ever before.

2. Be consistent with human capital practices designed to attract, motivate, retain, and reward a high-performing federal workforce.

The commentary to this principle insists that agencies should consider the impact of outsourcing on recruitment and retention and that the federal workforce should be treated as "valuable assets." Can anyone, no matter how pro-privatization, seriously contend that the privatization quotas and the rewritten circular show

any evidence whatsoever that the experienced and reliable women and men who make up the civil service are even remotely regarded as "valuable assets?"

It is surely self-evident that enlightened human capital practices are fundamentally in conflict with the widespread practice encouraged by A-76 and the privatization quotas of privatizing work performed by federal employees in order to lower wages, reduce benefits, and avoid unions.

It must be noted that the rewritten circular actually exacerbates the perverse incentive to privatize work in order to reduce the pay and benefits of those who perform work for the federal government by imposing redundant and irrelevant overhead personnel costs on in-house proposals.

3. *Recognize that inherently governmental and certain other functions should be performed by federal workers.*

The rewritten circular actually narrows the definition of "inherently governmental" so as to force agencies to contract out work that has always been considered too important or too sensitive to entrust to contractors; and behind-the-scenes, OMB is pressuring agencies to list jobs as commercial that agencies actually consider "inherently governmental." Moreover, the failure to establish a contractor inventory means that agencies will be unable to systematically determine just how much inherently governmental work has already been privatized.

In the panel's commentary for this principle, it was said that "(c)ertain other capabilities...or other competencies such as those directly linked to national security, also must be retained in-house to help ensure effective mission execution." Although far too narrowly stated, this is an excellent point. That is, commercial functions can be contracted out to such an excessive extent that it undermines the government's ability to perform its work. However, if agencies aren't systematically tracking contractors' work, how do they know when too much commercial work has been contracted out?

4. *Create incentives and processes to foster high-performing, efficient and effective organizations throughout the federal government.*

As noted earlier, the rewritten circular and the privatization quotas emphasize privatization to the exclusion of all other methods for improving the delivery of services, including, "public-private partnerships and enhanced worker-management cooperation," which were mentioned in the text to this principle. Moreover, High Performing Organizations, a pet project of the CAP Chairman, which would function both as an alternative and a complement to public-private competition, are very conspicuous by their near invisibility in the new circular, notwithstanding that all Administration panelists, including the OMB representative, voted in favor of their establishment.

5. Be based on a clear, transparent, and consistently applied process.

Can a circular that can't bring itself to unambiguously condemn the use of subjective evaluation factors be considered "clear, transparent, and consistently applied?"

Can a process that allows a contractor to win when the in-house proposal is less expensive and more responsive be considered "clear, transparent, and consistently applied?"

Can a process that allows a contracting officer to give special credit to a contractor for a feature not included in the solicitation but not then give federal employees an opportunity to reformulate their proposal to include that new feature be considered "clear, transparent, and consistently applied?"

Can a process that charges in-house proposals twice for indirect labor costs—and contractors not even once—be considered "consistently applied?"

Can a process that requires federal employees to compete in order to acquire and retain work—but not contractors—be considered "consistently applied?"

Can a process, which when combined with the OMB privatization quotas, require that hundreds of thousands of federal employee jobs—but just a tiny handful of contractor jobs—undergo competitions be considered "consistently applied?"

6. Avoid arbitrary full-time equivalent or other arbitrary numerical goals.

The rewritten circular and the OMB privatization quotas are based on two numerical goals, one number that is either 50 or higher and another number that is extremely close to 0. Agencies are required to review for privatization at least 50% of their in-house commercial workforces. Agencies are required to allow federal employees to compete for 0% of new work. And agencies are required to review for insourcing slightly more than 0% of contractor jobs.

7. Establish a process that, for activities that may be performed by either the public or the private sector, would permit public and private sources to participate in competitions for work currently performed in-house, work currently contracted to the private sector, and new work, consistent with these guiding principles.

As noted before, the rewritten circular must be placed in its political context, specifically the OMB privatization quotas. Although Administrator Styles claims to have removed all obstacles that were in the old circular to federal employees competing for new work and contractor work, the quotas work in one-sided fashion. Clearly, opportunities for federal employees to compete for new work and contractor work exist only on paper.

Ms. Styles and her contractor allies are wont to say that contractors are already subject to competition. However, federal government work currently performed by contractors was acquired almost exclusively without any public-private competition; and that work, according to GAO and the DoD Inspector General, was all-too-frequently acquired without any private-private competition. And, of course, there is even less reason to prevent federal employees from competing for new work since it has, by necessity, never been subject to any competition. Given how proud Ms. Styles and her contractor allies are of the new circular's expedited competition process, lawmakers opposed to the TRAC Act and TRAC-like amendments can never again fall back on arguments about the process being too bureaucratic and too cumbersome to allow for subjecting contractors to public-private competitions for new work and the work they are currently performing.

8. *Ensure that when competitions are held, they are conducted as fairly, effectively, and efficiently as possible.*

The CAP principles were sometimes repetitive, so I must refer readers to my discussion of the other principles, for the most part.

As discussed above, the "streamlined" process, which is so strongly emphasized in the new circular, is contrary to the CAP report, both in regard to this principle and the recommendation, with respect to its deletion of the minimum cost differential, its failure to make mandatory the Most Efficient Organization process, and its inclusion of a wholly arbitrary 90-day deadline.

Moreover, in the minds of those who wrote the new circular, the only conflicts of interest worth addressing are those that might conceivably benefit federal employees in the privatization process; the longstanding conflicts of interest which demonstrably benefit contractors will be permitted to continue to undermine the integrity of the privatization process.

The privatization process is rife with conflicts of interest that benefit contractors. FAR Subpart 9.5 purports to minimize contractor conflicts of interest. However, it is largely full of empty exhortations. Conflicts of interest arise when contractors recommend or otherwise advise buying agencies to make additional purchases from the contractors with whom the recommending contractors have business interests. While the FAR tries to address blatant conflicts (e.g., contractors recommending themselves for jobs), the nature of modern day government contracting is replete with contractor "partnerships," "strategic relationships," and other arrangements in which various contractors agree to help one another out—usually through various subcontracting relationships. The rewrite of the circular raises the very real prospect that contractors will be increasingly responsible for evaluating the work of other contractors—contractors with whom they have business interests at many levels. The inevitable conflicts of interest and the

resulting corruption have the potential to make recent accounting and auditing scandals pale in comparison.

9. *Ensure that competitions involve a process that considers both quality and cost factors.*

The CAP's pro-taxpayer minority, noting the inability of the panel's pro-contractor majority to show why a "best value" process was needed, saw this principle as a recitation of the obvious, understanding that any ultimately cost-based process allows for quality to be explicitly taken into account so that agencies can have the best of both worlds: the services they need, but at the lowest possible prices.

However, even assuming for the sake of argument that the principle endorses "best value," it can be said that the OMB rewrite includes a "best value" process that increases the role of politics, bias, and corruption in the selection process and undermines taxpayer interests by encouraging agencies to buy what they want, rather than what they need.

10. Provide for accountability in connection with all sourcing decisions.

Work performed by federal employees is meticulously monitored through the FAIR Act, the budget process, and the appropriations process. On the other hand, agencies don't even know what work contractors are doing—let alone how well they are performing. Is that accountable? Other than to insist that contracting officers do what they are already required to do to monitor contractor performance, the new A-76 does next to nothing to establish reliable and comprehensive systems to track the cost and quality of work performed by contractors.

Rank-and-file federal employees and their unions have no meaningful appellate rights. In fact, we even lose our ability to contest decisions made pursuant to the aggressively-emphasized "streamlined" competitions. Meanwhile, contractors can appeal decisions to the GAO and the Court of Federal Claims. Is that accountable?

Because of the intrinsic subjectivity of the "best value" process, most agency decisions are beyond any judicial review, even if rank-and-file federal employees and their unions possessed standing. How accountable is that?

When an MEO falls into default, the work is recompeted. However, when a contractor defaults, it could be business as usual. How accountable is that?

Under existing law and regulation, federal employees—but not contractors—should continue to be subject to a myriad of requirements and obligations. As the independent scholar Dan Guttman has written, federal employees, but not contractors, are subject to a variety of rules "that address conflict of interest (e.g.,

18 U.S.C. 208), assure that government activities are (with limits) `open' to the public (e.g., Freedom of Information Act), limit the pay for official service, and limit the participation of officials in political activities." Despite the Bush Administration's extraordinary effort to massively increase the number of politically well-connected contractors on the federal payroll and so completely blur the appropriate and vital distinction between public and private, OMB will make no effort to ensure that contractors are as accountable to the American people as federal employees already are. How accountable is that?

STATEMENT BY
WILLIAM DOUGAN
PRESIDENT, FOREST SERVICE COUNCIL
NATIONAL FEDERATION OF FEDERAL EMPLOYEES
INTERNATIONAL ASSN OF MACHINISTS & AEROSPACE WORKERS
AFL-CIO

BEFORE THE

SUBCOMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT, THE FEDERAL WORKFORCE, AND THE DISTRICT OF COLUMBIA

UNITED STATES SENATE

CONCERNING

NOW AND THEN: AN UPDATE ON THE BUSH ADMINISTRATION'S COMPETITIVE SOURCING INITIATIVE

Introduction

On behalf of the Forest Service Council, which represents approximately 20,000 dedicated public servants committed to the professional and ethical management of the 192-million-acre National Forest System, I thank the Subcommittee for the opportunity to present our observations pertaining to the effects of the competitive sourcing initiative on the Forest Service. I hope this assessment of the specific case of the Forest Service's implementation of the initiative will be useful to the Subcommittee in its consideration of the effects of the competitive sourcing initiative across other government agencies.

The Forest Service Council wholeheartedly supports this initiative's stated goal of increasing the efficiency and effectiveness of public institutions. The goal is not at issue here; the question is whether or not the initiative is achieving that goal. There are concerns about the costs of implementation of the competitive sourcing initiative in the Forest Service. In addition, there are profound concerns about the effectiveness of the A-76 tool in reducing the costs of performing specific work activities and, more seriously, about the potential of the process to erode the capability of the agency to perform critical mission work.

While there are many aspects of the competitive sourcing initiative that demand examination, today the Forest Service Council will limit its written testimony to the following:

1. An examination of the way the mission of the Forest Service drives the way it conducts its business, and the changes to this way of doing business that A-76 rules require,

2. An examination of potential outcomes and consequences of the Forest Service's competitive sourcing activities,
3. An analysis of flaws in the implementation of the competitive sourcing initiative by the Forest Service and by the Office of Management and Budget,
4. An analysis of the extent to which A-76 procedures and the competitive sourcing initiative bring competitive forces to bear on agencies to effect positive change, and
5. A discussion related to the engagement of Congress to effect positive change in the Office of Management and Budget's flawed implementation of *The President's Management Agenda.*

The Organization of the Forest Service

The Forest Service is the lead Federal agency in land and resource management, responsible for managing the 192-million-acre National Forest System. To meet these responsibilities, the agency employs on average about 25 full-time employees, and perhaps 100 seasonal workers, in each of several hundred Ranger Districts located all across the country. Thus, the broad geographic scope of the Forest Service's responsibilities has driven its organizational structure. Agency personnel are sparsely deployed to provide the necessary coverage.

Because of the small size of the Ranger Districts, and the variety of tasks that are required, Forest Service employees are called upon to perform a variety of duties. For example, one Forest Service employee staffs the District's front desk and performs public affairs work, but is also a certified archeological surveyor and assists in archeological inventory work, and is also trained and certified to work on the fire line in the event of wildfire. As a consequence of its use of multi-skill employees to fulfill multiple roles, the agency provides full-time employment in these rural areas. The local economies of many rural communities depend upon this way of doing business.

One of the most critical functions of the Forest Service is fire protection. Not only are National Forest lands threatened when a wildfire occurs, but local communities and rural dwellings in the rural/urban interface are also often at risk. The geographically disperse structure of the Forest Service is highly advantageous for the rapid and effective response to wildfires. Many Forest Service employees who "normally" perform other work, such as maintenance or forestry work, are highly skilled firefighters as well, and provide the front-line expertise of the agency's fire militia. Because of the geographic dispersion of Forest Service Ranger Districts, these employees can be deployed quickly during the early stages of a fire when control is critical.

As a result of its expertise in responding to fire emergencies, the Forest Service has taken on significant Homeland Security responsibilities as well. To manage resources rapidly and effectively in responding to wildfires, the Forest Service has become the expert federal agency in utilizing a very sophisticated Incident Command System. The Incident Command System is based on a military model. Incident Command System personnel

perform the command, operations, planning, logistics, and finance/administration management activities required for a coordinated response to any emergency incident.

Forest Service Incident Command System teams can be mobilized and fully operational within two to four hours. Whether the nation is responding to a natural disaster or to a terrorist attack, it is the Forest Service's responsibility to get there first, set up camp, and get things running. In many cases, command is subsequently transferred to FEMA or to the military; however, this may be a week or more after the initial response. Clearly, the hours and days following a natural disaster such as a hurricane are crucial. America depends on the Forest Service to provide this coverage. Over 90% of the country's Incident Command System initial response capability resides in the Forest Service.

For example, Forest Service Incident Command System teams coordinated the search and recovery mission after the space shuttle Columbia tragedy, and the Department of Agriculture's response to an outbreak of Newcastle's Disease in southern Californian poultry. After 9/11, three Forest Service Incident Command System teams played critical roles in our nation's response at the World Trade Center and Pentagon attack sites.

The A-76 Process

There is no denying that competition in the free market drives down costs. The competitive sourcing initiative, however, is somewhat misnamed in that it does not represent such a free-market competition. Rather, it represents the use by government agencies of a bureaucratic analysis to attempt to completely describe some work, to develop a new government organization to perform the work, to calculate the cost of performing the work, to determine the relative technical merits of ways of performing the work, and finally, to determine if a private firm will be awarded a contract for work currently performed by the government workforce. This is a different matter altogether than the competition between Dick's Auto Body and Dan's Garage in the free market.

The procedures listed above are codified in the Office of Management and Budget's A-76 circular. The A-76 circular is the only tool the Forest Service may use to comply with the competitive sourcing initiative. When used properly, the A-76 competition process results in an impartial cost comparison to determine whether government work will be contracted out or performed in house. If A-76 calculations predict that outsourcing would be expected to generate savings, the agency is bound by this finding to outsource the work.

The Forest Service is currently conducting A-76 studies on over 3,700 positions involving various maintenance activities, information technology activities, and all work functions at the agency's Civilian Conservation Centers. Agency plans are to continue with A-76 studies at a similar pace over the next several years. Thus, the question of the correctness of the Office of Management and Budget's "one size fits all" premise regarding the A-76 process is a crucial one for the very survival of the agency as a viable institution with the ability to carry out its mission.

Does One Size Fit All?

The A-76 process was developed for large, centralized facilities (*e.g.* military installations) whose organization is driven by work function. It is designed for cost comparisons involving simple, well-defined work for which a complete, quantitative description of the work can be made in the form of a Performance Work Statement. This is a reasonable task when employees are assigned to single work functions and the work can be readily quantified. For example, there are numerous consultants currently pocketing substantial sums of taxpayer's money to describe to Federal personnel how to develop a Performance Work Statement for cutting the grass, or for preparing food. Unfortunately, the vast majority of the 850,000 Federal employees eligible for competitive sourcing study perform work that is substantially more complex and varied than that.

Completely describing and quantifying complex and varied work is a daunting task, and any work that is left out of the Performance Work Statement biases the A-76 result toward outsourcing. In a variety of situations (complex work, multi-function employees, small offices), there are very serious challenges in conducting A-76 studies, as well as making subsequent staffing decisions.

As described above, the geographic-driven organization of the Forest Service has led to the staffing of small offices with multi-functional employees, precisely the sort of situation that is problematic for the A-76 process. To quote an April, 2003 Forest Service Congressional Briefing Paper, "Current A-76 methodology does not easily allow for the recognition of large-scale collateral duties... The Forest Service is seeking solutions and requesting assistance from the Office of Management and Budget..." This collateral duty problem has not been solved; however, the agency continues to move forward with A-76 studies in spite of this fact. In so doing, the Forest Service did not consider the consequences discussed below:

Effects of the Initiative on Emergency Response to Fire and Other Incidents. Incident Command System teams are staffed on a collateral duty basis with Forest Service employees from a variety of program areas. Team members perform other work until they are mobilized in response to an emergency, thereby maximizing both the efficient use of personnel and effectiveness in responding to wildfire and other critical incidents. In addition to Incident Command System command staffing, the agency may also call up thousands of employees with specialized training, skills, and experience to man the front fire lines. Again, this work is on a collateral basis for the employees involved.

Most of the Forest Service studies are being performed under Streamlined or Express A-76 rules. Under these rules, the Forest Service may not "compete" such an organization, which has been optimized to meet agency requirements by decades of experience, but rather must "bundle" its work functions to match service packages

that are available in the private sector. In other words, because no contractor currently provides both maintenance and fire suppression, the Forest Service is forced by A-76 rules to consider these activities separately. Currently, the "other work" (*e.g.* maintenance work) performed by many Incident Command System team members and fire militia personnel is under A-76 study. A-76 requires that this situation be handled as follows: if an employee spends half of his/her time on fire suppression and half on maintenance work, then half of the position is included in the maintenance A-76 study. If the agency employs 2,000 such multi-functional employees, then 1,000 positions must be included in the maintenance A-76 study.

Clearly, by dissecting out individual work activities, A-76 fails to consider the efficiencies associated with the Forest Service's collateral approach. More significantly, the Forest Service has not adequately determined how it will handle the potential outcome of such studies. Forest Service "guidance" to the field units conducting these studies states, "*Fire collateral duties should be excluded from all Streamlined and Express studies. If a study concludes that a function should be performed externally and management believes that fire support is a collateral expectation of this organization, management has the option to directly convert the fire responsibility and add it to the Request for Proposal.*" Thus, if A-76 calculations require that the above hypothetical 1,000 maintenance positions be outsourced, the Forest Service runs the risk of having all 2,000 employees outsourced.

Cost and Returns. Because of the geographic dispersion of the agency, the costs of implementing the competitive sourcing initiative in the Forest Service have been enormous. The Forest Service estimate of $10 million includes the cost of activities at the national level, but the agency has pushed the bulk of the work onto its field units. In the field, the diversion of resources to support the initiative is huge. Although the agency has not tracked these costs, and so a genuine accounting will never be done, it is likely that the true cost is closer to $100 million than $10 million.

Recall that many Forest Service employees perform multiple roles, or collateral duties, and that the A-76 process is not designed for this situation. To comply with the initiative, the Forest Service is considering work that a given employee may perform only 5% of the time. In one research facility, for example, machinists and electronics technicians perform research support work, and most building maintenance work is already contracted out. However, these personnel also occasionally take care of certain maintenance work on a collateral basis. Although these maintenance activities involve only 5-20% of their time, this 5-20% is being studied, and A-76 may require that it be contracted out. If this occurs, these personnel will still be required for research support, but the Forest Service will have to pay contractors to perform the minor and/or emergency repairs that they previously handled on a collateral basis. If the "in-house organization" retains the work, A-76 imposes a substantial paperwork burden to document that actual ongoing costs are in line with the A-76 estimated costs. Either outcome will have a negative

cost effect. Because small facilities and substantial use of collateral duties is the norm for the Forest Service, such outcomes will be common.

Economic Effects on Rural Communities. Because of the Forest Service's use of multi-skill employees to perform multiple duties, Forest Service employees are able to meet diverse work requirements in isolated areas and at the same time be full-time, productive citizens in these areas. The economies of many rural communities depend on Forest Service employees. Forest Service employees participate in and support a wide variety of community programs and services. Local school districts receive a monetary allocation for each child of a federal employee in their district. But the A-76 process is based strictly on work functions. Under this model, help may be shipped into the area on a task-by-task basis. Because as much as half of the work on many National Forests is already contracted, we know what the effect will be. In general, contractors bring their own people in from out of the area. One contract workforce may stay 3 months for a soils inventory project; a second may stay for a year or two for a watershed restoration project. But they don't come to stay, and they don't make the same kind of community contributions as do the permanent Forest Service employees. If these Forest Service employees are forced to leave these rural communities because their jobs are contracted out, the economic effects in places like Trinity County, CA and Beaverhead County, MT will be devastating.

Human Capital Effects

Regarding the Forest Service's criteria for land management decisions, the first Chief of the Forest Service, Gifford Pinchot, stated, "*all the land is to be devoted to its most productive use for the permanent good of the whole people, and not for the temporary benefit of individuals or companies... Where conflicting interests must be reconciled the question will always be decided from the standpoint of the greatest good of the greatest number in the long run.*" This remains the agency's goal today. Quantitatively capturing this type of work in a Performance Work Statement is clearly a much more daunting, if not impossible, task than would be the case for cutting the grass. And yet, personnel intimately involved in such decisions are currently eligible for outsourcing under the Forest Service's implementation of the competitive sourcing initiative.

The Forest Service uses decentralized authority to provide the flexibility needed to meet the particular needs of different localities. Because of the unique requirements of the diverse lands managed by the Forest Service, the District Ranger is empowered to make many important decisions. He/she depends on professional longevity and experience in a given geographic area in making these decisions. The criticality of the human capital involved in such work is captured very well in this analysis by a forester in the field: *"For example, well-intentioned foresters during the early part of the 20th century applied the clear-cut method to Douglas-fir and to high elevation Englemann spruce stands in many areas. While the clear-cut regeneration system is compatible with the more mesic West Coast Douglas-fir and spruce (areas where many of the early foresters*

July 31, 2003

Honorable George Voinovich
Chairman
Subcommittee on Oversight of Government Management,
Federal Workforce, and District of Columbia
United States Senate
Washington, DC 20510

Dear Chairman Voinovich:

On July 26, your Subcommittee held an important hearing on the Bush Administration's competitive sourcing initiative. As you and your committee explore the critical issues associated with government human capital challenges and opportunities and, in particular, their relationship to the administration's competitive sourcing initiatives, I appreciate your invitation to offer the perspectives of the Professional Services Council. PSC is the principal national trade association of the government technology and professional services industry and has great interest in the issues you and the subcommittee are currently deliberating. In addition to these comments, we would welcome any further opportunities to discuss these and related issues with you and your staff.

I was pleased to serve as a member of the congressionally established 2002 Commercial Activities Panel (CAP). The unanimous recommendations in the CAP's final report, taken in their totality, offers an appropriate and balanced framework for government sourcing policy. The CAP unanimously adopted ten overarching principles to govern federal sourcing policy. Among those principles were recommendations that the process includes the consideration of both cost and non-cost (quality) factors; that all parties, public and private, be subject to the same responsibilities and afforded the same rights; and that sourcing itself be viewed as a strategic, not an arbitrary, process.

Key among the strategic considerations, of course, is that of human capital. There are many ways in which competitive sourcing and human capital are connected. For example:

- **The relationship between competitive sourcing and the government's ability to recruit and retain a highly skilled workforce**

This issue has appropriately been assigned a high priority, which is especially important given the enormous federal retirement wave that is inevitable over the next several years.

There is little doubt that the government today is not competing well for many critical workforce skills. By and large, the private sector continues to win that competition. Yet in the private sector, job stability and security is non-existent, competition is a way of life, and change is constant. Clearly, those factors are of less significance in a potential employee's job criteria than some believe. Moreover, most private sector human resource professionals agree that the best

and most highly skilled workers are those who, among other things, are most adaptable to a continually changing environment, competition, and challenge. For potential new hires, the most important attributes of a job opportunity include professional and personal development, an employer's system of reward and incentives, and the quality of the work environment.

Many surveys, including those conducted by Paul Light of the Brookings Institution, clearly demonstrate that the government generally is not an employer of choice, and those very attributes are continuously cited as the government's greatest weaknesses. These findings are mirrored by surveys of current government employees as well, large majorities of whom express frustrations about the government's overly bureaucratic human resources processes and the lack of a real incentive and reward system.

These issues are not solely applicable to the government's professional/white collar employees. As several major private sector labor unions have publicly stated, one of the hallmarks of private sector collective bargaining agreements is the training and development programs that are offered to their workforces. Such programs are almost non-existent in the government. Hence, unions including the Laborers' International Union, the International Union of Operating Engineers, and the International Federation of Professional and Technical Engineers have consistently opposed restrictions on government competitive sourcing and outsourcing. Among their concerns is that their employees would be denied such important development opportunities if the work they are performing were brought back "in-house."

While job security and stability is always an issue, the evidence strongly suggests that it is not as central to the government's human resource challenges as some might believe. Thus, your leadership on issues associated with civil service reform, particularly as it relates to those factors that most directly drive successful recruitment and retention, is of immeasurable importance.

- **The relationship between competitive sourcing and strategic human capital planning**

The first and foremost of the CAP's unanimously recommended principles is that sourcing policy be a strategic exercise and not one governed by arbitrary quotas or goals, or equally arbitrary limitations. While much of the discussion surrounding this principle has centered on the administration's competitive sourcing goals, there is much more to it. Indeed, in making decisions whether a function can or should be performed by either the public or private sector, agency management must take into account the human resource realities it faces. As such, in cases where the government is simply not competing well for the "best in class" in important skill areas, a competitive-outsourcing network is clearly in the best interests of the government. In fact, this is one of the most critical of all strategic considerations that must be factored into an agency's sourcing decisions.

In making such sourcing determinations, an agency's analyses of answers to two questions are essential.

- Does the agency have in place a workforce that has the requisite skills to perform the function at an optimal level? Indeed, if an agency has or will have a real struggle attracting and retaining the highly skilled workforce needed, and the work must continue to be done, why not outsource the work?

- Realistically, does the agency have the resources to fully support and develop a workforce in this functional area? One reason many companies have moved increasingly to outsourcing is their recognition that, with resources always limited, they can only provide adequate support and development for their employees performing the company's core competencies. If they retain too much work in-house, the available resources for professional development must be spread across a larger number of people, thus diluting their ability to focus on those functions that must be performed in house. The same is true for the government.

It is precisely because of the importance of these matters that external mandates to always conduct public/private competitions, or to place arbitrary restrictions on outsourcing, are a disservice to the agencies and the taxpayer. Moreover, while the Commercial Activities Panel did endorse an approach in which public/private competitions would be the norm for assessing work currently being performed by government employees, the CAP also stated clearly that the mere fact that either sector could perform the work should not mandate that such competitions always be conducted, and that the determination as to when such competitions should be conducted should be "consistent with these principles."

- **The relationship between outsourcing and overall compensation and benefits for affected federal workers**

This issue has been studied numerous times, including by the General Accounting Office, and each objective study has reached the same conclusion: there is no evidence that, overall, outsourcing results in significant job loss, reduced pay or benefits. Federal employee unions base their campaign for higher federal wages and benefits on the "pay gap" between the public and private sectors; they also claim that private contractors pay significantly less than the government pays. However, considering the fact that the private contractor community is competing for the same skills as their non-government contractor competitors, such arguments are unsupportable. At the lower end of the wage scale, where the greater concern might exist, workers are protected by the Service Contract Act, which is specifically designed to ensure that wage grade employees—the most vulnerable of all workers—are paid a fair wage and given fair benefits. Those wages and benefits are based on the government's assessment for a given job in a given region.

The very existence of public/private competitions can and does significantly limit the opportunities available to affected federal employees. As demonstrated by the National Security Agency's "Groundbreaker" procurement, the Army's "Wholesale Logistics Modernization Initiative" and elsewhere, when a public/private competition is NOT conducted, and the employee's interests and benefits are made a significant source selection factor, federal employees can be substantially advantaged through outsourcing. Such benefits cannot occur, of course, when the workforce is one of the competitors.

Unfortunately, because their "addressable market" is determined solely by the number of federal employees, the federal employee unions are adamant in their refusal to both acknowledge this fact and to allow such alternatives to be pursued. While their "market" concern is understandable, it is simply not a sound basis on which to make national policy; occasionally, it even places the union's best interests in direct conflict with their membership's best interests.

- **The relationship between outsourcing and government employee levels over the last decade**

Looking across the government, it is clear that there is little relationship between full time equivalent federal employee levels and outsourcing activities.

According to the Federal Procurement Data System, from 1991 and 2001, service contracting across the civilian agencies grew by some 33% (an average growth of just over 3% per year). However, according to the Congressional Budget Office, over that same decade civilian employment levels in the civilian agencies fell by a total of less than 3%. At the Department of Defense, the converse was true. During the period 1991 to 2001, service contracting grew by only 14%, while civilian employment levels dropped by over 35%, most of which was due to general DoD downsizing and several rounds of base closures. Despite the constant rhetoric to the contrary, on a macro level, the government has not been undergoing a massive civilian downsizing in favor of contracting to the private sector. While there may be discrete components of the government where this has happened, the data clearly shows that it is not the norm.

To further assist the Subcommittee in understanding the details of the revised OMB A-76 process and its affect on the workforce, attached is a point paper that dispels some of the myths included in AFGE's testimony submitted for the record on July 24, 2003.

Mr. Chairman, the relationship between human capital and competitive sourcing is very important. As the committee continues its deliberations on these issues, we will look forward to further opportunities to work with you and your staff on appropriate policy measures that will serve the interests of the government and the taxpayer. In the meantime, if you have any questions, the members of the Professional Services Council, and I, are available at your convenience.

Thank you for your time and consideration of our views.

Sincerely,

Stan Soloway
President

Cc: Honorable Richard Durbin
Ranking Member

PERPETUATING THE MYTHS:
AFGE AND OMB's REVISIONS TO OMB CIRCULAR A-76

In recent congressional testimony, the American Federation of Government Employees (AFGE) listed a litany of complaints and concerns regarding the Administration's May 29, 2003 revisions to Circular A-76 governing the policies and processes that guide public-private competitions.

While the Circular still needs additional work to become the optimally effective management tool that it can be, AFGE's complaints with the revisions are both inconsistent with the concept of fair competition and with the ten overarching principles governing public/private competition that were unanimously adopted by the 2002 Commercial Activities Panel, chaired by the Comptroller General and on which the President of AFGE was a member. Those principles focus on a sourcing policy that is based on an agency's mission and strategic needs and conducting source selections through a process that provides both equal rights and equal responsibilities for all bidders.

Ironically, despite the union's role on the CAP and support for those principles, many of AFGE's complaints about the new circular go in the opposite direction. Below are some examples of AFGE's concerns, as articulated in their recent testimony,[1] followed by the real facts surrounding the issues raised.

I. **Myth:**
The Streamlined Process involves a "second rate" competition process, fosters more direct conversions (the shifting of work from the government to private contractors without the incumbent government workforce participating in the competition), and obviates any requirement that the contractor demonstrate "appreciable" savings.

Fact:
The new Streamlined Process does not promote direct conversions. Rather, it requires each agency to conduct a substantive analysis of alternatives—which can include a full up competition—to determine whether retaining the work in-house or outsourcing it makes the most sense. Since the process is limited to activities with 65 full-time equivalent's (FTE's) or less, such analysis is more than adequate to make sound business decisions for the government, provided that the analysis is serious, transparent and well documented. Indeed, the accountability of the Streamlined Process is where our collective concerns should be focused.

[1] Before Senate SubCommittee on Oversight of Government Management, Federal Workforce, and District of Columbia July 24, 2003.

Moreover, when an agency determines under the Streamlined Process that work should be outsourced, a "direct conversion" does not equate to a sole-source award. Other than in limited, statutorily driven cases, all work that is outsourced is subjected to robust competition. While the Streamlined Process contains no arbitrary minimal savings requirements, it is ludicrous to suggest that an agency, particularly in the current resource constrained environment, could afford to even consider outsourcing a function unless doing so resulted in savings at either the functional and/or organizational level, or both.

In addition to the issue of transparency and accountability, the other critical issue with the Streamlined Process is really one of competition. Over the last several years, more than 90% of all "streamlined competitions" conducted under the old A-76 process were retained in-house and almost always without any significant competition. For those who believe competition is the most effective means of driving higher efficiency and performance, that is the issue of greatest concern.

II. Myth:
The revisions considerably overcharge federal employee bids for overhead.

Fact:
The Circular requires that the government use a fixed twelve percent for overhead costs for government bids because the government financial systems are incapable of calculating precise overhead figures such as those required of contractors. Concerned about the intentional underestimating of overhead by government MEOs, in 1996 OMB established the fixed rate for overhead (according to DoD, the average overhead factor previously bid by MEOs had been in the 1.5% to 2.5% range). The 12% figure is based on various government assessments of what the actual overhead for government activities should be (based on the unique government definition of overhead).

The unions and the DoD Inspector General are technically correct that the 12% overhead factor is not supportable by absolute data. But this is a function of gaps in the government's financial and management systems, not a failure of the Circular. It is neither capricious nor unfair. Indeed, if anything the rate significantly underestimates overhead. Actual rates are preferred and government bidders should be required to develop actual rates as soon as possible.

III. Myth:
Contracting out "undercuts" federal employee pay and benefits.

Fact:
As the General Accounting Office has reported, there is no evidence that contracting out regularly leads to reduced pay and benefits for federal employees. For wage grade positions, contractors are required to pay no less than the wages and benefits set by the U.S. Department of Labor, based

on the prevailing wage rate for the work covered. Moreover, even as the government employee unions decry the poor pay and conditions offered in the private sector, they are conducting a parallel campaign for higher federal wages, citing a "pay gap" between the public and private sectors for comparable work. There is plenty of evidence to support the "pay-gap" contention. However, they cannot be right on both points.

IV. Myth:
The revisions to A-76 "introduce a controversial and subjective" best value process that is "unnecessary."

Fact:
Over the last decade, Congress and two successive Administrations have worked together to improve federal procurement processes. One of the key improvements has been the advent of "best value" contracting, which recognizes that cost, while always important, is not the only factor to be considered in procurement, particularly when the requirements involve a meaningful degree of technology or complexity. Past performance, technical skills, technology infusion, innovation, management, and more are all factors that virtually everyone agrees ought to be included in the agency's evaluation of bids submitted. Best value is where cost and quality meet. It is neither controversial nor subjective. With the sole exception of A-76 competitions, virtually all federal procurements have long had the authority to use such strategies.

It is fallacious to suggest that best value is either overly subjective or biased against any one bidder, public or private. While best value is designed to enable the matching of source selection criteria to a given procurement, it contains numerous protections against capriciousness or abuse. It is the common procurement language of government acquisition and reflects the common means by which most institutions and individuals make acquisition decisions. Best value is the common sense approach to federal procurement.

V. Myth:
The revisions impose competition requirements on federal employees but not on contractors.

Fact:
By law and by regulation, the vast bulk of all government service contracts must be re-competed every few years. The A-76 revisions thus do not need to address this issue as it relates to contractors. Indeed, the revisions begin to require that government activities that are commercial in nature be subjected to some of the same competitive pressures contractors face everyday. That is good for the agency and good for the taxpayer.

VI. Myth:
The revisions hold federal employees "absolutely accountable" for failure, but not contractors.

Fact:
All contractors are bound by contracts—binding, legal agreements. Government activities that win A-76 competitions under the revised Circular will now be required to enter into a Letter of Obligation, the closest process to a "contract" by and between elements of the government. How could this be unfair to the government entity? Moreover, by law, the Letter of Obligation cannot be truly "binding" and there is no way for the government to NOT pay its employees if they fail to perform, even though contractor payments can be and often are withheld if the contractor does not perform. The need to focus in this area is supported by studies from the Center for Naval Analyses and various GAO reports, that make clear that the government has far more insight into and information about expenditures on individual contracts than it does on expenditures of organic activities.

VII. Myth:
The protest and appeal process is unfair because contractors, but not federal employees or their unions, would have standing to protest source selection decisions before the General Accounting Office and Court of Federal Claims.

Fact:
It is true that contractors have standing to protest source selection decisions before the GAO and the Courts. It is also true that federal employees and their unions do not have such standing. However, contractor employees and their unions do not have such standing either.

By law, standing to challenge an agency action at GAO or in court is only available to the entity that has the financial and legal responsibility for the bid and for performance. Thus, private sector employees and their unions, while clearly "affected parties" in a source selection decision, do not have standing to challenge an adverse action because they do not meet the statutory test. The same applies to the government.

Under the revised A-76, it is possible that the government's Agency Tender Official (the official responsible for tendering the government's bid and signing the government's Letter of Obligation in the event the government team wins the competition) will be granted standing to protest before GAO. However, it is inconceivable that such standing would be granted to federal employees and/or their unions for the reasons stated above. To do otherwise would be to directly violate the spirit and letter of numerous federal laws and longstanding legal precedent in federal management, procurement, and labor statutes. It would, for the first time, give federal employees a right of individual action never before granted and raises significant constitutional

questions revolving around the government's (or it's employees') ability to "sue" itself over a management decision.

VIII. Myth:
The revisions further narrow the definition of "inherently governmental."

Fact:
The definition of inherently governmental (functions that cannot be outsourced because their nature is such that they must be performed by government employees) is not significantly different from the 1992 policy letter issued by OMB defining inherently governmental functions. Moreover, the new Circular removes the 55 year old policy statement that states the government's intention to rely on the private sector for the provision of goods and services.

IX. Myth:
The revisions require nothing new in the way of tracing the cost and quality of work performed by contractors.

Fact:
The revised Circular places on all parties, public and private, the same responsibilities for meeting the terms and performance requirements of their contract/letter of obligation. Nonetheless, while contractors are legally bound to execute the contracts they sign, and under which they simply do not get paid for a failure to perform, government entities will be under no similar requirement.

X. Myth:
The revisions hold federal employees, but not contractors, to five year contracts and allow contractors to win contracts on "the basis of how much time they spent instead of what they actually accomplished."

Fact:
Contractors, like federal entities that win competitions, will be required to adhere to the terms of their performance agreements. Indeed, one critical goal of the A-76 revisions is to ensure accountability of performance whether it is by federal employees or contractors. While the typical Letter of Obligation with a winning government entity will be five years, much as is the norm with contractors, government employees will also have the ability for non-competitive extensions based on exceptional performance, such as is now possible in only rare instances for government contractors.

XI. Myth:

Under the new A-76, and the OMB "quotas/'Proud to Be" goals, privatization would be used to the exclusion of all methods of improving operations (i.e., strategic sourcing).

Fact:

This statement ignores two critical facts: first, the administration's competitive sourcing "quotas" no longer exist and were never "privatization" quotas. The "goals" were for competition and were, and remain, completely agnostic relative to who wins the competition. Competition is the goal because competition is widely agreed to be the most effective means of driving higher performance and higher efficiency. In light of the recent study in which 90% of government managers acknowledged that their agencies were not yet delivering top quality service to their customers, it is government's responsibility to utilize the best possible tools to improve service and enhance efficiencies.

Second, strategic sourcing, while a popular concept, has unfortunately proven to be a tool for avoiding competition and retaining the status quo. The most aggressive practitioner of strategic sourcing to date has been the U.S. Navy, which has done more than twice as much "strategic sourcing" as it has competitive sourcing. The results, according to the Navy itself, are that strategic sourcing initiatives are averaging only about 14% percent savings, while the Navy's competitive sourcing initiatives (based on the procedures of the previous Circular) are averaging three times as much (43%). This is just one more example of the effectiveness and importance of competition. While competition is the norm among private government contractors, it remains all too rare for commercial functions performed by the government.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

THE PRESIDENT'S MANAGEMENT AGENDA

FISCAL YEAR 2002

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President's Message

I am pleased to send to the Congress a bold strategy for improving the management and performance of the federal government. Government likes to begin things—to declare grand new programs and causes. But good beginnings are not the measure of success. What matters in the end is completion. Performance. Results. Not just making promises, but making good on promises. In my Administration, that will be the standard from the farthest regional office of government to the highest office in the land.

This Report focuses on fourteen areas of improvement where we can begin to deliver on our promises. The recommendations we have targeted address the most apparent deficiencies where the opportunity to improve performance is the greatest. These solutions are practical measures, well within our reach to implement.

These proposals will often require the cooperation of Congress. Congress' agenda is a crowded one, and there is an understandable temptation to ignore management reforms in favor of new policies and programs. However, what matters most is performance and results. In the long term, there are few items more urgent than ensuring that the federal government is well run and results-oriented.

This Administration is dedicated to ensuring that the resources entrusted to the federal government are well managed and wisely used. We owe that to the American people.

GEORGE W. BUSH

Improving Government Performance

> *"Government likes to begin things—to declare grand new programs and causes and national objectives. But good beginnings are not the measure of success. What matters in the end is completion. Performance. Results. Not just making promises, but making good on promises. In my Administration, that will be the standard from the farthest regional office of government to the highest office of the land."*
>
> Governor George W. Bush

To reform government, we must rethink government.

The need for reform is urgent. The General Accounting Office (GAO) "high-risk" list identifies areas throughout the federal government that are most vulnerable to fraud, waste, and abuse. Ten years ago, the GAO found eight such areas. Today it lists 22. Perhaps as significant, government programs too often deliver inadequate service at excessive cost.

New programs are frequently created with little review or assessment of the already-existing programs to address the same perceived problem. Over time, numerous programs with overlapping missions and competing agendas grow up alongside one another—wasting money and baffling citizens.

> *"Congress and the new administration face an array of challenges and opportunities to enhance performance and assure the accountability of the federal government. Increased globalization, rapid technological advances, shifting demographics, changing security threats, and various quality of life considerations are prompting fundamental changes in the environment in which the government operates. We should seize the opportunity to address today's challenges while preparing for tomorrow."*
>
> Comptroller General David M. Walker

Though reform is badly needed, the obstacles are daunting—as previous generations of would be reformers have repeatedly discovered. The work of reform is continually overwhelmed by the constant multiplication of hopeful new government programs, each of whose authors is certain that this particular idea will avoid the managerial problems to which all previous government programs have succumbed. Congress, the Executive Branch, and the media have all shown far greater interest in the launch of new initiatives than in following up to see if anything useful ever occurred.

So while the government needs to reform its operations—how it goes about its business and how it treats the people it serves, it also needs to rethink its purpose—how it defines what business is and what services it should provide.

The President's vision for government reform is guided by three principles. Government should be:

— Citizen-centered, not bureaucracy-centered;

— Results-oriented;

— Market-based, actively promoting rather than stifling innovation through competition.

The President has called for a government that is active but limited, that focuses on priorities and does them well. That same spirit should be brought to the work of reform. Rather than pursue an array of management initiatives, we have elected to identify the government's most glaring problems—and solve them. The President's Management Agenda is a starting point for management reform.

- The Agenda contains five government-wide and nine agency-specific goals to improve federal management and deliver results that matter to the American people.
- It reflects the Administration's commitment to achieve immediate, concrete, and measurable results in the near term.
- It focuses on remedies to problems generally agreed to be serious, and commits to implement them fully.
- The goals in this Agenda are being undertaken *in advance of*, not *instead of* other needed management improvements.
- Additional goals will be undertaken, as tangible improvements are made in this initial set of initiatives.

A COHERENT AND COORDINATED PLAN

The five government-wide goals are mutually reinforcing. For example,

- Workforce planning and restructuring undertaken as part of *Strategic Management of Human Capital* will be defined in terms of each agency's mission, goals, and objectives—a key element of *Budget and Performance Integration*.
- Agency restructuring is expected to incorporate organizational and staffing changes resulting from *Competitive Sourcing and Expanded E-government*.
- Likewise, efforts toward *Budget and Performance Integration* will reflect improved program performance and savings achieved from *Competitive Sourcing* and will benefit from financial and cost accounting and information systems which are part of efforts in *Improved Financial Management*.

IMPLEMENTING THE PLAN

The President has not only set an initial agenda, but is already implementing this plan.

- In July, the President directed Cabinet Secretaries and agency heads to designate a "chief operating officer" to have responsibility for day-to-day operations of departments and agencies.
- At the same time, the President re-established the President's Management Council (PMC) consisting of the chief operating officers. The PMC provides an integrating mechanism for policy implementation within agencies and across government. Importantly, the PMC is a way for the departments and agencies to support the President's government-wide priorities and to build a community of management leadership that learns, solves problems, and innovates together.

> Typically the department's No. 2 official, its "chief operating officer," has agency-wide authority and reports directly to the agency head. This assignment places "management" with Presidential appointed officials, primarily at the deputy secretary level, where policy and management meet.

- First results have already been achieved in several reform categories. See *Competitive Sourcing, Privatization of Military Housing,* and *Elimination of Fraud and Error in Student Aid Programs and Deficiencies in Financial Management* for examples.

FREEDOM TO MANAGE

Federal managers are greatly limited in how they can use available financial and human resources to manage programs; they lack much of the discretion given to their private sector counterparts to do what it takes to get the job done. Red tape still hinders the efficient operation of government organizations; excessive control and approval mechanisms afflict bureaucratic processes. Micro-management from various sources—Congressional, departmental, and bureau—imposes unnecessary operational rigidity.

The Administration will sponsor a three-part Freedom to Manage initiative to clear statutory impediments to efficient management:

- *Statutory cleanup.* As part of the 2003 budget process, OMB has asked departments and agencies to identify statutory impediments to good management. Agencies are reviewing government-wide statutory provisions which, if repealed, would remove barriers to efficient management.
- *Fast-track authority.* We will propose legislation to establish a procedure under which heads of departments and agencies could identify structural barriers imposed by law, and Congress would quickly and decisively consider and act to remove those obstacles.

- *Managerial flexibility and authority.* OMB will package affirmative legislation comprising proposals to free managers in areas such as personnel, budgeting, and property disposal.

> - For years NASA was expressly prohibited by statute from relocating aircraft based east of the Mississippi River to the Dryden Flight Research Center in California for the purpose of the consolidation of such aircraft.
> - The 2001 Defense Appropriations Act requires the U.S. military installations in Kaiserslauten, Germany to use U.S. coal as their energy source for heat. The same provision allows U.S. bases at Landstuhl and Ramstein to acquire their heat energy from any source, but they must consider U.S. coal as an energy source in making their selection. The provision restricts use of the most economical energy source and imposes higher costs on the Defense Department as a result.
> - The Department of Agriculture is prohibited by statute from closing or relocating a state Rural Development Office.

As the barriers to more efficient management are removed, we will expect higher performance. With Freedom to Manage will come clear expectations of improved performance and accountability.

A SHARED RESPONSIBILITY

All too often Congress is a part of the government's managerial problems. Many members find it more rewarding to announce a new program rather than to fix (or terminate) an existing one that is failing. The Congressional practice of "earmarking" special projects in appropriations bills has exploded—growing more than six-fold in the last four years. Excessive earmarks lead to wasteful spending and hogtie executive decision-making, making it more difficult for agencies to fund higher priorities and accomplish larger goals as needed funds are diverted.

The President has made solving these problems a top priority. Congress can help in a number of important ways, among them:

- actively supporting government management reforms;
- using its oversight powers to insist that agencies fix their problems;
- providing the investments and the tools necessary;
- helping agencies remove barriers to change; and
- not placing limitations on reform efforts.

THE EXPECTED LONG-TERM RESULTS

The impetus for government reform comes, in part, as a reaction to chronic poor performance and continuing disclosure of intolerable waste. Agencies will take a disciplined and focused approach to address these long-standing and substantial challenges and begin the steps necessary to become high performing organizations in which:

- hierarchical, "command and control" bureaucracies will become flatter and more responsive;
- emphasis on process will be replaced by a focus on results;
- organizations burdened with overlapping functions, inefficiencies, and turf battles will function more harmoniously; and
- agencies will strengthen and make the most of the knowledge, skills, and abilities of their people; in order to meet the needs and expectations of their ultimate clients—the American people.

A MANAGEABLE GOVERNMENT

The most difficult, but most important, job of a good leader is to ask tough questions about the institution: Is this program needed? Is it a wise use of the organization's finite resources? Could those resources be used better elsewhere? These are questions that the structure and incentives of government do not encourage. We need to:

- *Shift the burden of proof.* Today, those who propose to shift priorities or adjust funding levels are expected to demonstrate that a program or activity should be changed. It is time, instead, that program proponents bear the burden of proof to demonstrate that the programs they advocate actually accomplish their goals, and do so better than alternative ways of spending the same money.
- *Focus on the "base" not the "increment."* Policy and budget debates focus on the marginal increase (or cut) in a program—failing to look at whether the program as a whole (the base) is working or achieving anything worthwhile. We need to reverse the presumption that this year's funding level is the starting point for considering next year's funding level.
- *Focus on results.* A mere desire to address a problem is not a sufficient justification for spending the public's money. Performance-based budgeting would mean that money would be allocated not just on the basis of perceived needs, but also on the basis of what is actually being accomplished.
- *Impose consequences.* Underperforming agencies are sometimes given incentives to improve, but rarely face consequences for persistent failure. This all-carrot-no-stick approach is unlikely to elicit improvement from troubled organizations. Instead, we should identify mismanaged, wasteful or duplicative government programs, with an eye to cutting their funding, redesigning them, or eliminating them altogether.

- *Demand evidence.* Many agencies and programs lack rigorous data or evaluations to show that they work. Such evidence should be a prerequisite to continued funding.

Over the past three decades, reform initiatives have come and gone. Some genuine improvements have been made. But the record on the whole has been a disappointing one. That must change—and this report is a primer on how that change can be achieved.

2. Competitive Sourcing

> *"Government should be market-based—we should not be afraid of competition, innovation, and choice. I will open government to the discipline of competition."*
>
> Governor George W. Bush

THE PROBLEM

- Nearly half of all federal employees perform tasks that are readily available in the commercial marketplace—tasks like data collection, administrative support, and payroll services. Historically, the government has realized cost savings in a range of 20 to 50 percent when federal and private sector service providers compete to perform these functions. Unfortunately, competition between public and private sources remains an unfulfilled management promise. By rarely subjecting commercial tasks performed by the government to competition, agencies have insulated themselves from the pressures that produce quality service at reasonable cost.
- Because agencies do not maintain adequate records on work performed in-house, they have often taken three to four years to define the jobs being considered for competition.
- To compare the cost of in-house performance to private sector performance, detailed estimates of the full cost of government performance to the taxpayer have to be calculated. The development of these estimates has devolved into a contentious and rigid exercise in precision.

THE INITIATIVES

To achieve efficient and effective competition between public and private sources, the Administration has committed itself to simplifying and improving the procedures for evaluating public and private sources, to better publicizing the activities subject to competition, and to ensuring senior level agency attention to the promotion of competition.

- In accordance with the Federal Activities Inventory Reform (FAIR) Act, agencies are assessing the susceptibility to competition of the activities their workforces are performing. After review by OMB, the agencies will provide their inventories to Congress and make them available to the public. Interested parties may challenge the omission or inclusion of any particular activity.

- Agencies are developing specific performance plans to meet the 2002 goal of completing public-private or direct conversion competition on not less than five percent of the full-time equivalent employees listed on the FAIR Act inventories. The performance target will increase by 10 percent in 2003.
- The Administration will adopt procedures to improve and expand competition. As a first step, OMB has proposed that reimbursable (fee-for-service) work involving performance by a federal agency be recompeted every three to five years, similar to standard contract review, renewal, or solicitation procedures.
- The Administration will seek to implement findings of the Commercial Activities Panel, a commission created by Congress to examine the policies and procedures governing public-private competition.
- Finally, the Administration is pursuing administrative and legislative actions to incorporate the full costs of agency work into the daily budget and acquisition process. This will eliminate the complex, after-the-fact calculation of public-sector costs.

THE EXPECTED RESULTS

Increased competition consistently generates significant savings and noticeable performance improvements.

- Recent competitions under OMB Circular A–76[1] have resulted in savings of more than 20 percent for work that stays in-house and more than 30 percent for work outsourced to the private sector.
- From 1995 through 2000, the Department of Defense completed over 550 A-76 initiatives, which resulted in an average 34 percent reduction in cost. DoD expects to achieve $11.7 billion in savings as a result of A-76 competition between 1997 and 2005.
- Numerous studies conducted by the GAO, the Center for Naval Analyses, and others confirm the magnitude of these savings.
- Competition promotes innovation, efficiency, and greater effectiveness. For many activities, citizens do not care whether the private or public sector provides the service or administers the program. The process of competition provides an imperative for the public sector to focus on continuous improvement and removing roadblocks to greater efficiency.
- By focusing on desired results and outcomes, the objective becomes identifying the most efficient means to accomplish the task.

[1] Public-private competition is governed by OMB Circular A–76. The Circular establishes federal policy for determining whether commercial activities should be provided through contract with commercial sources, use of in-house government personnel, or through interservice support agreements with other federal agencies.

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Daily Briefing

May 21, 2003

Clay Johnson's "Where We'd Be Proud To Be" Memo

MEMORANDUM TO THE PRESIDENT'S MANAGEMENT COUNCIL

Through: Mark Everson
From: Clay Johnson III
Subject: Where We'd Be Proud To Be

As I have discussed with you individually and at the last PMC meeting, our progress on the President's Management Agenda (PMA) has reached the point where it is appropriate to think about where we'd be proud to be a year or so from now, after three full years of implementing the PMA.

To begin this effort, the owners of the five government-wide initiatives have each assessed where he/she would be "proud to be" on July 1, 2004. The attached assessment includes:

- the percentage of agencies the Initiative Owner would be proud to say have achieved green and yellow status for the initiative by July 1, 2004;
- a succinct description of the ultimate goals for the key components of the initiative, and the percentage of agencies the Initiative Owner would be proud to say have accomplished those goals by July 1, 2004;
- stretch goals for each of the initiatives, i.e., what would be possible if certain uncertainties were accomplished, like new legislation or additional funding;
- key milestones, i.e., what the initiative owner will do to advance each of the components of the initiative to help the agencies get to green; and
- a more specific description of what is necessary to achieve green and yellow status for each of the initiatives.

This information responds to your requests for greater clarity of targets and a more precise definition of yellow status, in particular. This document also provides current thinking on each of the initiatives given all that has been accomplished to date. In the competitive sourcing area, for instance, many agencies have established the infrastructure necessary to implement competitions which, together with the pending revised A-76 circular, will poise us for real advances in this area. Similarly, we now have experience using the Program Assessment Rating Tool (PART) and have a fuller understanding of its usefulness. In response to your requests at the PMC retreat, we have clarified the role of the PART in the budget and performance

integration initiative. Initiative owners have also indicated what they will do to help you get to green.

I now want to ask each agency to indicate where they would be proud to be on July 1, 2004 with regard to each initiative and each component of each initiative. Each agency should also indicate the key milestones they intend to hit to get there. A format that parallels the initiative owners' "proud to be" document is provided for your use. Please complete and return your agency's "proud to be" document by Friday, May 9, 2003.

To answer some obvious questions about this exercise:

- We are attempting only to make the goals clearer, but not easier or harder to achieve
- We do not expect agencies that have already worked with their OMB RMOs to map out their deliverables for the next year or so to change their thinking about what is possible for them to achieve. Those agreements should drive what agency targets and milestones are; however, the plans may need to be extended to reach July 1, 2004
- We want to help the agencies who are now thinking out a quarter at a time, to determine where they hope the sum of their quarterly milestone achievements will take them
- Listed agency milestones should not be as detailed as the milestones negotiated with the OMB RMOs each quarter, nor should their inclusion here replace the quarterly negotiations/adjustments.
- OMB and OPM staff are available to help the agencies understand the exercise, project what they might be able to achieve in this time period, and figure out how to get to where they aspire to be by July 1, 2004.

Separately, we will meet with some of you to go through a similar exercise for the program specific initiatives, such as the Faith-Based and Community Initiative, and the items on GAO's high risk list.

Please call me, Robert Shea, or Diana Espinosa if you have questions about this exercise.

Attachments

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	Current Status					Progress in Implementation				
	Human Capital	Comp. Sourcing	Financial Mgmt.	E-Gov	Budget/ Perf.	Human Capital	Comp. Sourcing	Financial Mgmt.	E-Gov	Budget/ Perf.
AGRICULTURE	●	●	●	○	●	●	○	●	●	●
COMMERCE	○	●	●	○	○	●	○	●	○	●
DEFENSE	○	○↑	●	●	○	●	○	●	●	●
EDUCATION	○	○↑	●	○	●	●	●	●	●	●
ENERGY	○	●	○	○	●	●	●	●	●	●
EPA	●	●	●↑	○	○	○	●	●	○	●
HHS	●	●	●	●	●	●	●	●	●	●
HOMELAND	●	●	●	●	●	○	●	●	●	●
HUD	●	●	●	●	●	●	○	●	●	●
INTERIOR	●	●	●	●	●	●	●	○	●	○
JUSTICE	●	●	●	●	●	●	●	●	●	●
LABOR	○	●	○	○	○	●	○	●	●	●
STATE	○↑	●	●	●	●	●	○	●	●	●
DOT	○↑	●	●	●	○	●	●	●	●	●
TREASURY	●	●	●	●	●	●	●	○	●	○
VA	●	●	●	○	○	●	●	●	●	●
AID	●	●	●	●	●	○	○	●	●	●
CORPS of ENGINEERS	○↑	●	●	●	●	●	●	○	●	○
GSA	●	●	○	●	●	●	○	●	●	○
NASA	○	●	●	●	○	●	●	●	●	●
NSF	●	●	●	●	●	●	●	●	●	○
OMB	●	●	●	●	●	●	○	○	●	●
OPM	○	○↑	○	○	●	●	●	●	●	●
SBA	○↑	●	●	○	○	●	●	●	○	○
SMITHSONIAN	●	●	●	○	●	●	●	○	○	○
SSA	○	●	●↑	○	○	●	●	●	●	●

Standards for Success - Competitive Sourcing

Must Meet All Core Criteria: • Completed public-private or direct conversion competition on not less than 50 percent of the full-time equivalent employees listed on the approved FAIR Act inventories. • Competitions and direct conversions conducted pursuant to approved competition plan. • Commercial reimbursable support service arrangements between agencies are competed with the private sector on a recurring basis.	Achievement of Some but not All Core Criteria; No Red Conditions.	Has Any One of the Following Conditions: • Completed public-private or direct conversion competition on less than 15 percent of the full-time equivalent employees listed on the approved FAIR Act inventories. • Competitions and direct conversions are not conducted in accordance with approved competition plan. • No commercial reimbursable support service arrangements between agencies are competed with the private sector.

Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

October 3, 2003

The Honorable George V. Voinovich
Chairman
The Honorable Richard J. Durbin
Ranking Member
Subcommittee on Oversight of Government Management,
the Federal Workforce, and the District of Columbia
Committee on Governmental Affairs
United States Senate

Subject: Questions for Competitive Sourcing Hearing Record

It was a pleasure to appear before the subcommittee on July 24, 2003, to discuss various competitive sourcing issues, including the recent revisions made by the Office of Management and Budget (OMB) to its Circular A-76. This letter responds to your request for my views on the following questions for the record:

Q. The revised OMB Circular A-76 makes "best value" instead of "lowest cost" the factor that agencies must use in determining who will win a public-private competition. Some have alleged that this change is simply an effort to ensure that more private contractors win competitions. How do you see agencies benefiting from the change? How much of a factor do you see cost playing in determining which bidder is offering an agency the "best value?"

For many years, federal agencies conducting negotiated procurements under the Federal Acquisition Regulation (FAR) routinely have traded off cost and non-cost factors in making contract award decisions. The tradeoff process is often called "best value." Among the most common non-cost factors, all of which are required to be identified in the solicitation, are the contractor's technical approach, past performance, and management plan. Tradeoffs reflect a widespread practice used by other governments (state, local, and foreign) as well as by the private sector.

The tradeoff process moves the federal government past the "low bid" mentality of the past, with increasing consideration of factors such as quality and past performance. It entrusts federal employees acting as source selection officials with the authority to use their judgment in selecting among proposals offered. While concern sometimes has been expressed that the tradeoff process allows source selection officials very broad discretion, that discretion has boundaries. An award decision must comply with pre-established evaluation criteria, and is subject to challenge if it appears it did not. In this regard, GAO considers bid protests

challenging the way tradeoffs are conducted, and sustains protests where the process was unfair, unreasonable, or inconsistent with the terms of a solicitation.

The previous version of OMB Circular A-76 allowed the use of a "best value" tradeoff selection process among private-sector proposals. The process created in the March 1996 revisions to the Circular A-76 Supplemental Handbook endeavored to capture the benefits of the tradeoff process, while maintaining the perceived objectivity of a cost-only selection.

Under the new Circular A-76 issued in May, federal agencies will be able to use tradeoffs only under certain conditions. Under the terms of the new Circular, a tradeoff source selection is allowed in a standard competition for (a) information technology activities, (b) commercial activities performed by a private sector source, (c) new requirements, or (d) certain expansions of current work. An agency also may use a tradeoff source selection process for a specific standard competition if, prior to the public announcement of the competition, the agency's Competitive Sourcing Official approves use of the process in writing and notifies OMB.

The extent to which cost in tradeoff decisions will be a significant factor under the new Circular is unknown. But while the role of cost is important it must be balanced with the government's ability to obtain the technical capability and quality it needs to meet mission requirements. As I testified before the Subcommittee, although cost is important, it is not everything.

Q. Part of the administration's goal in revising A-76 was to increase the amount of work submitted to public-private competition. If that happens, are agencies capable of effectively managing competitions and overseeing contracts? If not, what level of resources will we need to dedicate to bolstering agency contracting offices? Should that effort have come before we revised A-76?

Agencies will face significant challenges in managing their competitive sourcing programs, and will be doing so while addressing high-risk areas, such as human capital and contract management. In this regard, GAO has listed contract management at the National Aeronautics and Space Administration and the Departments of Housing and Urban Development, Defense and Energy as high-risk areas. With a likely increase in the number of public-private competitions and the requirement to hold accountable whichever sector wins, agencies will need to ensure that they have an acquisition workforce sufficient in numbers and abilities to administer and oversee these arrangements effectively.

Conducting fair, effective and efficient competitions requires sufficient agency capacity—that is, a skilled workforce and adequate infrastructure and funding. Agencies will need to build and maintain capacity to manage competitions, to prepare the in-house most effective organization (MEO), and to oversee the work—regardless of whether the private sector or the MEO is selected. While the level of resources needed will vary among the agencies, building and maintaining this capacity will likely be a challenge for many agencies, particularly those that have not been heavily invested in competitive sourcing previously. As I mentioned during the hearing,

establishing a government-wide fund at OMB that agencies could access based on a sound business case would help to assure that the new process is both efficient and fair.

Q. The administration has said in the past that the 12-month time limit placed on competitions in the revised OMB Circular A-76 should be sufficient if agencies plan properly before the competition begins. However, most competitions conducted under the old rules took much longer than 12 months, often twice as long. Do you think the time limits are appropriate? In your estimation, how much of the time taken to conduct competitions in the past was used to do things that you believe could be handled before the competition begins?

A major challenge agencies will face will be meeting the 12-month limit for completing the standard competition process in the new Circular. This provision is intended to respond to complaints from all sides about the length of time historically taken to conduct A-76 cost comparisons—complaints that the Commercial Activities Panel repeatedly heard in the course of its review. OMB's new Circular states that standard competitions shall not exceed 12 months from the public announcement (start date) to performance decision (end date). Under certain conditions, there may be extensions of no more than 6 months. The new Circular also states that agencies shall complete certain preliminary planning steps before a pubic announcement. These steps are:

(1) Determining the activities and full time equivalent (FTE) positions to be competed.
(2) Conducting preliminary research to determine the appropriate grouping of activities as business units to be consistent with market and industry structures.
(3) Assessing the availability of workload data and data collection systems.
(4) Determining the activity baseline costs as performed by the incumbent.
(5) Determining whether a streamlined or standard competition will be used.
(6) Developing preliminary competition and completion schedules.
(7) Determining the roles, responsibilities, and availability of participants in the process.
(8) Appointing competition officials (agency tender official, contracting officer, performance work statement team leader, human resource advisor and source selection authority).
(9) Informing any incumbent service providers of the date of the public announcement.

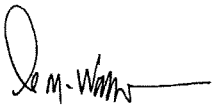
We welcome efforts to reduce the time required to complete these studies. Even so, our studies of competitive sourcing at the Department of Defense (DOD) have found that competitions can take much longer than the time frames outlined in the new Circular. Specifically, recent DOD data indicate that competitions take on average 25 months. It is not clear how much of this time was needed for any planning activities that may now be done outside the revised Circular's 12-month time frame. It appears, however, that a significant amount of the process—developing the performance work statement, preparing the agency tender offer and most efficient organization, and

conducting the source selection process—still needs to be done within the 12-month time limit.

In commenting on OMB's November 2002 draft proposal, we recommended that the time frame be extended to perhaps 15 to 18 months overall, and that OMB ensure that agencies provide sufficient resources to comply with the Circular. As such, we believe that additional financial and technical support and incentives will be needed for agencies as they attempt to meet the ambitious 12-month time frame. In this regard, we believe that implementation of the government-wide fund approach noted in my response to the prior question would help to assure that the needed resources are available.

I look forward to working with you on these and other issues in the future. If you have any further questions or would like to discuss any of the issues in more detail, please call me at (202) 512-5500; or Bill Woods, Director, Acquisition and Sourcing Management at (202) 512-8214.

Sincerely yours,



David M. Walker
Comptroller General
of the United States

(120285)

Senator Tom Carper
Oversight of Government Management Subcommittee
Governmental Affairs Committee
Questions for Administrator Styles

1. The revised OMB Circular A-76 makes "best value" instead of "lowest cost" the factor that agencies must use in determining who will win a public-private competition. Some have alleged that this change is simply an effort to ensure that more private contractors win competitions. How do you see agencies benefiting from the change? How much of a factor do you see cost playing in determining which bidder is offering an agency the "best value?"

   Response: While cost will be the predominant factor in many competitive sourcing decisions, OMB believes that agencies also need the ability to consider quality so that they can make strategic decisions for the agency. This same conclusion was reached by the public and private sector representatives of the Commercial Activities Panel, convened by the GAO to study competitive sourcing. For this reason, the revised Circular offers procedures that give agencies leeway to consider non-cost factors. One procedure allows agencies to trade off cost and quality considerations. At the same time, the Circular continues to recognize that cost plays an important role. With respect to tradeoffs, for example, cost or price generally must be at least equal to all other evaluation factors.

   We do not have reason to believe that use of best value, as described above, should result in increased outsourcing. To the contrary, the Circular has been designed to create a level playing field that focuses on results, not the sector that performs the work, so taxpayers may reap maximum benefit from competition. To ensure federal employees are able to effectively compete, for instance, the Circular expressly requires agencies to provide their in-house sources with access to available resources necessary to develop competitive agency tenders.

2. I am certain that part of the administration's goal in revising OMB Circular A-76 was to increase the amount of work submitted to public-private competition. If so, how does the administration plan to ensure that agencies have enough resources to manage competitions and oversee contracts?

   Response: We view competitive sourcing as one tool of many for improving the cost-effectiveness and quality of agency operations. As such, we expect agencies to cover the costs associated with competitive sourcing from the same funds that the agency would use to pursue any other management initiative to improve mission efficiency and effectiveness. Because competitive sourcing has a history of generating cost savings -- anywhere from 10 to 40 percent -- irrespective of which sector wins the competition, there is a compelling case for agencies to make sure resources are available

for this initiative. OMB will continue to work with agencies to develop a consistent method of tracking and reporting competitive sourcing costs and other data elements Congress and our citizens need to ensure public resources are being spent wisely.

3. The administration has said in the past that the 12-month time limit you place on competitions in the revised OMB Circular A-76 should be sufficient if agencies plan properly before the competition begins. However, most competitions conducted under the old rules took much longer than 12 months, often twice as long. In determining what an appropriate time limit should be, were you able to learn how much of the time taken to conduct competitions in the past was used to do things that you believe should best be handled before the competition begins?

   Response: In developing the Circular's coverage on time limits, OMB worked closely with officials from the Department of Defense, which has had the greatest experience with public-private competitions. OMB appreciates that proper planning is key to a successful competition, which is why the Circular emphasizes preliminary planning and imposes no time limit on preparations for competition.

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