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CUTTING THE DEFICIT AND IMPROVING SERVICES BY CONTRACTING OUT

INTRODUCTION

Contracting out government services to the private sector offers the new Congress the winning opportunity to make substantial cuts in federal spending—as much as \$9 billion per year—without reducing essential constituent services.¹ Indeed, if properly implemented, an aggressive program of contracting out at the federal level could even lead to improved service at significant budgetary savings, reproducing improvements routinely achieved by states and municipalities.

Contracting out is the process in which government hires, by way of competitive bids, qualified private businesses to perform essential services on its behalf. Typically, governments have used contracting out to provide routine support services such as data processing, trash pickup, landscaping, building maintenance, motor pools, printing, and library management. However, there is no reason why more sophisticated and complex services could not be contracted out. For example, the Defense Department has demonstrated that contractors can perform successfully in a number of sensitive and sophisticated areas vital to national defense. Recently a number of communities have contracted out functions once deemed uniquely governmental, such as prisons (73 sites in sixteen states) and the management of both individual schools (Baltimore, Maryland) and an entire school system (Hartford, Connecticut), with excellent results. With many recently elected mayors and governors committed to aggressive privatization and contracting out strategies in an effort to offer the best service at lowest cost, it is likely that this trend toward the privatization of more sophisticated functions will continue.

1 “Essential” is emphasized here with the understanding that any “unessential” services ought to be terminated.

Typically, the main reasons for contracting out include:

- ① **Substantial budgetary savings over what it costs government workers to perform the same service,**
- ② **The availability of specialized skills not typically found in a government workforce,**
- ③ **Concentration of the government's workforce on those responsibilities that are uniquely government's, and**
- ④ **The introduction of market competition into the provision of government services.**

Unlike private business, which must compete with many competitors on a day-to-day basis and therefore must offer consistently good services at low prices, the federal workforce operates as a protected monopoly in most of its activities. Efforts to interject competitive practices into the system have met with considerable resistance from the federal workforce, including both workers and managers, who believe that contracting out threatens their job security and compensation, despite studies which show that no more than 5 percent of the affected workers are at risk of losing their jobs. In response to these concerns, Congress frequently has introduced legislation that directly or indirectly prohibits agencies and departments from contracting out some specific function or bureau, be it the work of three individuals at an isolated government weather station or two thousand clerical workers at a major claims processing facility.

As a consequence of this resistance and subsequent congressional prohibitions, contracting out at the federal level has merely scratched the surface of potential opportunity. As much as \$9 billion could be saved each year if the process were applied in a comprehensive and systematic fashion to the basically commercial functions now performed by federal workers.

To realize these potential savings, Congress and the White House must cooperate in establishing well-defined management procedures and clear objectives to guide the federal establishment to a level of competitive contracting substantially higher than anything yet attempted. Key elements of such a plan would include elimination of needless prohibitions, timely completion of comprehensive inventories of federal agencies' commercial positions and functions, and well-defined goals for subjecting these positions to the competitive review process.

THE BIPARTISAN SUPPORT ON CONTRACTING

Contracting out became formal federal policy in 1955, when the Eisenhower Administration issued Bureau of the Budget Bulletin 55-4, affirming that the "Federal government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels." Used sporadically in the decades thereafter, it was not until 1987, when the Reagan Administration issued Executive Order 12615 and established the Privatization Office in the Office of Management and Budget (OMB), that contracting out became a required feature of government departments and agencies—albeit only briefly. In 1989, 20,000 federal positions—an annual record—were subject to the formal

competitive review process under the A-76 program, named after the OMB Circular guiding the process of competitive contracting.

Although the Reagan Administration's privatization effort was allowed to lapse during the Bush Administration, in 1993 Vice President Albert Gore gave the competitive process a strong endorsement in the report of his National Performance Review:

Every federal agency needs support services—accounting, property management, payroll processing, legal advice, and so on. Currently, most managers have little choice about where to get them; they must use what's available in-house. But no manager should be confined to an agency monopoly. Nor should agencies provide services in-house unless the services can compete with those of other agencies and private companies.²

In the same chapter, the Vice President specifically urged competitive contracting (or private/public partnerships) for many responsibilities and programs of the Government Printing Office, Department of Housing and Urban Development, General Services Administration, and National Oceanic and Atmospheric Administration; for non-core functions of the Department of Defense; and for the Labor Department's Job Corps Civilian Conservation Centers.

THE POTENTIAL SAVINGS

With the bipartisan support it lacked in the past, and with congressional and executive branch agreement on its importance, the federal government could achieve the level of savings routinely obtained by other levels of government. Thus, a very specific and comprehensive program of contracting out should be a major component of this year's budget resolution and the accompanying appropriation bills.

Although honored more in the breach than in practice, the limited number of contracting out initiatives actually taken already have led to substantial savings as thousands of federal jobs and services have been transferred to more efficient private-sector providers. Based upon experience to date, contracting out saves money regardless of whether the private sector or government wins the contract—the threat to contract out alone can spur improvements in efficiency. Since 1981, approximately 112,000 full-time equivalent (FTE) employees, mostly in Defense, have been subject to the A-76 competitive review process, yielding cumulative savings of \$7 billion and current annual savings of about \$1 billion.

Notwithstanding the government's long and successful experience with contracting out, however, and despite the existence of numerous executive orders and bulletins advocating its use, numerous reviews and analysis by OMB indicate that as many as a million of the three million civilian federal workers still are performing commercial types of duties and should be subject to the A-76 review process.

² Vice President Al Gore, *Creating a Government That Works Better & Costs Less: Report of the National Performance Review*, U.S. Government Printing Office, September 7, 1993, p. 57.

Governed by procedures detailed in OMB Circular A-76, "Performance of Commercial Activities," federal contracting out essentially is a process in which the cost of activities performed by the existing federal workforce is compared with that proposed by qualified private-sector bidders. In all cases, the federal workforce is given an opportunity to restructure its operations and submit its own competitive bid. Moreover, it is given a 10 percent cost advantage and thus can lose only if the private bidder offers more than a 10 percent savings over the federal bid.

Still, despite this built-in federal advantage, in recent years private contractors have been winning about 50 percent of the bids (compared with about 70 percent in the 1980s). Savings have averaged between 20 percent and 30 percent compared with previous costs. Moreover, when government workers win and retain the service, generally it is by achieving an average savings of between 15 percent to 20 percent compared with their previous cost of providing the service. Expressed another way, competitive review saves, on average, \$9,000 per year for each government employment position reviewed. With annual estimated savings of \$9,000 per FTE formally reviewed by the A-76 process, potential budgetary savings of up to \$9 billion per year could be attained if the program were fully used.

Fear of Job Loss. Although demonstrably successful, the contracting out program has diminished in scope since the peak reached in 1988-1989. One reason for the limited application of contracting to government programs has been the fear that it will lead to massive layoffs of government workers. Not surprisingly, the chief opponents are government employee unions and government managers, who fear losing their jobs, and the elected officials who represent them. But studies of actual contracting experience indicate that only 5 percent of affected federal workers lost their jobs. The remaining 95 percent found jobs elsewhere in government, joined the private contractor, or retired.³

TARGETS OF OPPORTUNITY

As noted above, as many as one million federal positions may be amenable to commercialization and contracting out. The most recent edition of OMB's Circular A-76 provides a comprehensive list of positions and functions that should be reviewed and subject to competitive bidding. These include automated data processing, data transcription, training, food service, facilities/grounds/utilities maintenance, mail processing, architecture and civil engineering, library management, laundry and dry cleaning, warehouse and stock handling, accounts management, and loan processing.⁴

3 National Commission on Employment Policy, *Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers*, May 1988, p. 17.

4 See for example, U.S. General Accounting Office, "Public Private Mix: Extent of Contracting Out for Real Property Management Services in GSA," GAO/GGD-94-126BR, May 1994, for a discussion of the savings achieved in the contracting out of certain building management functions.

In addition to these opportunities, however, other areas of potentially considerable savings exist throughout the government. Among them:

EXAMPLE #1: Maintenance and management of government motor pools and transportation services. According to the most recent GAO report on the subject, the federal motor vehicle fleet (passenger vehicles and light trucks) totaled 375,381 vehicles as of July 1992 and entailed an annual expenditure of approximately \$1 billion for acquisition, operations, maintenance, and disposal.⁵ Greater use of private livery services and contractor management and maintenance of motor fleets could lead to considerable savings, perhaps as high as \$200 million to \$300 million per annum, if past patterns hold.

Similarly, federal agencies operate a vast fleet of aircraft, estimated at 1,250 planes and helicopters, dedicated to non-military purposes, including between 200 to 300 craft used for passenger travel. Performing essentially the same service as corporate jets, much of this fleet could be sold if government officials were required to utilize regularly scheduled airlines, private air-forwarding companies, and contractors providing aviation services for more specialized needs. These civilian aircraft have been a persistent source of misuse and waste, as indicated by recent media revelations concerning high White House officials and their golf game, as well as Air Force Generals and their pet cats. The latter incident, involving a flight from Italy to the United States, cost the taxpayer \$120,000 but was said by Pentagon officials to have broken no laws.⁶

EXAMPLE #2: Veterans Administration hospitals. Over the past several decades, many municipal and non-profit hospitals have achieved substantial savings—and improvements in quality—by contracting with private hospital management companies.

Despite their reputation for poor service, however, the staff and management of Veterans Administration hospitals have been protected from competition by a variety of federal laws and regulations. Until recently, for example, legislation established an employment floor of 157,000 for total VA personnel, so using outside management personnel would have forced the VA to add rather than reduce hospital staff. Other laws explicitly prohibit the contracting out of activities of the Department of Medicine and Surgery. And while the government workforce is given a 10 percent cost preference in all other federal contracting, in VA that preference was 15 percent, and the private bidder was required to add the government's review costs to his own when submitting the bid, until 1994 when Congress, recognizing the excessive costs these restrictions imposed on veterans' programs, agreed to place these restrictions in abeyance for five years. This should be made permanent.

EXAMPLE #3: The National Park Service. Large savings in the running of national parks can be effected by contracting out many routine services now performed by costly uniformed personnel. Uniformed Park Service employees provide janitorial,

5 U.S. General Accounting Office, "Federal Motor Vehicles: Private and State Practices Can Improve Fleet Management," GAO/GGD-95-18, December 1994.

6 Dana Priest, "Non-Defense Projects Targeted; Pentagon Supports Some, Not All Against GOP Attack," *The Washington Post*, February 10, 1995, p. A1.

trash-collection, ticket-taking, maintenance, grounds-keeping, security, and other basic, semi-skilled services routinely contracted out by other organizations, including most other government agencies.

The problem is existing congressional prohibitions on contracting out Park Service tasks. These prohibitions should be removed, and the Park Service should be required to take private bids for all routine service positions within the next twelve months. The money saved by contracting out basic services could be reinvested in national parks and historic structures which now suffer from neglect and deferred maintenance.

EXAMPLE #4: Mapmaking. Thirty-nine federal departments, agencies, and bureaus, including the U.S. Geological Survey, National Oceanic and Atmospheric Administration, Army Corps of Engineers, Defense Mapping Agency, and National Mapping Division of the Department of Interior, employ 7,000 workers and spend approximately \$1 billion in surveying and mapmaking. Mapmaking is a service that is readily available from private industry at competitive costs. All government mapmaking activities should be opened to bids from private-sector suppliers.

HOW TO REVIVE THE CONTRACTING PROGRAM

Past experience in the United States and abroad demonstrates that successful contracting out requires strong leadership and a commitment from both the Congress and the executive branch. Without such a commitment, and without rewards and penalties for success or failure, government departments and agencies will be disinclined to implement a program that creates uncertainty among existing workers merely to save money for taxpayers and improve efficiency. The lack of this commitment in recent years helps explain why as many as half of the executive branch departments have never conducted an A-76 review of any facet of their operations.

To obtain the efficiency savings potentially available from this form of privatization, a revived contracting out program must include the following elements:

ELEMENT #1: Appoint a "Privatization Czar."

The position of Associate Director for Privatization should be re-established within OMB, and each government agency, in cooperation with Congress and OMB, should be required to designate a privatization official to identify those offices and divisions that are performing commercial-like functions and that portion of its workforce (expressed as full time equivalents, or FTEs) that may be performing services available from the private sector.

ELEMENT #2: Identify areas for contracting out.

Congress and OMB, in cooperation with the General Accounting Office (GAO) and Congressional Budget Office (CBO), should review and approve the list or make recommendations for its improvement. H.R. 28, introduced by Representative John J. Duncan, Jr. (R-TN), would require OMB to create such a list.

ELEMENT #3: Contract out where appropriate.

Once the list is approved, each department and agency should be required to subject to competitive review, under the process laid out in OMB Circular A-76 or through a similar procedure, between five and ten percent of all positions (FTE), offices, and divisions included in the list. Ten percent would mean as many as 100,000 positions per year, compared to the past peak of about 20,000 reviews in the last year of the Reagan Administration, and (based upon past experience) annual savings of \$9 billion. In the event the review indicated potential savings in excess of ten percent over current costs, the agency should be required to contract out those areas to qualified private contractors. Offices and divisions winning the competitions would remain within government—typically in a more efficient and less costly form. Offices, divisions, and FTE positions that failed the competition would be replaced by the winning private contractor.

ELEMENT #4: Monitor progress.

Departmental and agency progress—or the lack of it—toward the goals set by the White House should be subject to periodic review by OMB and Congress.

ELEMENT #5: Create stronger incentives for privatization.

In dealing with large bureaucracies, even the best-laid reform plans are doomed to failure unless they are accompanied by meaningful incentives for performance and penalties for non-performance. There are several ways in which agencies could be spurred to conduct formal competitive reviews and contract out appropriate functions. Among them:

- ✓ **Congress simply could assume the savings in advance in an agency's budget allocation.** For example, if A-76 competitive reviews typically save \$9,000 per FTE reviewed, and if a specific agency is assigned to review 3,000 FTEs in the coming year, an expected savings of \$27 million would be taken in advance from the next year's budget.
- ✓ **Anticipating that contractors would win half the competitions and that federal workforce victories in the other half would lead to efficiencies and FTE savings,** Congress could reduce the number of FTEs the agency is permitted during that year. Agencies then would have a powerful incentive to adopt contracting to maintain services with fewer resources.
- ✓ **Using a carrot rather than a stick,** the agencies could be permitted to keep any savings achieved over and above the level required (\$27 million in the above example) by Congress.

ELEMENT #6: Remove obstacles to privatization.

While many government departments have successfully resisted competitive review through bureaucratic maneuvering, progress also has been stymied by congressional prohibitions and obstacles. A top priority for this Congress should be to repeal all legislative obstacles that needlessly inhibit or prohibit contracting out and other forms of privatization. The appendix provides a detailed list of some of the prohibitions Congress has enacted in the past. The following are typical:

- ✓ **Outright prohibitions** on contracting of specific functions.
- ✓ **Denial of funds** for purposes of contracting—in some cases, bans on even studying the potential savings from privatization.
- ✓ **Removal of contracting authority** from certain government officials.
- ✓ **Minimum staffing requirements.** Once applied to such agencies as the Farmers Home Administration, Agriculture Stabilization and Conservation Service, Railroad Retirement Board, Federal Aviation Administration, and the Veterans Administration, among others, these employment floors were perhaps the most pernicious of all obstacles because they also discouraged internal management improvements and the introduction of labor savings techniques and equipment. Most of these minimum requirements have been removed in recent years, and Congress should resist constituent pressure to establish new ones.
- ✓ **The Service Contract Act.** This statute has forced prospective private contractors to inflate their proposed wage costs artificially when competing for government contracts, thereby rendering them less competitive with government workers already in place, whose wages may be less than the so-called prevailing wages imposed on contractors by the Act. In cases where union wages may be less than government wages, the Labor Department often rules that higher government wages are the “prevailing wages.” Thus, even when the contractor wins the bid and performs the service for less than the government charged itself, the final costs may be higher than necessary because of the inflationary provisions of the Service Contract Act.

The Service Contract Act also artificially inflates contracting out costs even when there is no competing federal workforce. For example, when the Environmental Protection Agency hires a private contractor to clean up a hazardous waste site under the Superfund program, wages must conform to those designated under the Act—even if qualified workers are available for less. Congress should follow the 1983 recommendation of its own GAO and repeal the Service Contract Act.⁷ H.R. 246, introduced by Representative Harris Fawell (R-IL), would repeal this Act.

- ✓ **The Davis-Bacon Act.** This statute places the same “prevailing wage” requirement on contractors bidding for construction projects. It has had the same effect on these private contractors as the Service Contract Act. Davis-Bacon will be a serious obstacle to obtaining the full benefits of infrastructure privatization unless repealed.⁸ S. 141, introduced by Senator Nancy Landon Kassebaum (R-KS), and H.R. 500, introduced by Representative Cass Ballenger (R-NC) would repeal the Davis-Bacon Act.
- ✓ **Section 13(c) of the 1964 Urban Mass Transit Act.** Counterproductive federal regulations greatly limit the extent to which regional and metropolitan mass transit authorities can reduce costs and improve service through contracting. Section 13(c)

⁷ U.S. General Accounting Office, “The Congress Should Consider Repeal of the Service Contract Act,” GAO/HRD-83-4, January 31, 1983.

⁸ U.S. General Accounting Office, “The Davis-Bacon Act Should Be Repealed,” HRD-79-18, April 27, 1979.

requires that transit authorities receiving federal grants hold special negotiations with transit unions. Moreover, transit workers must receive six years severance pay in the event their job is lost because of contracting. This obviously introduces a severe disincentive against any local contracting and is estimated to cost transit authorities \$2 billion to \$3 billion per year in foregone savings. This Congress should repeal this section of the Act in order to free local transit agencies from onerous federal regulations.⁹

CONCLUSION

Although contracting out commercial-type government services to the private sector has been formal federal policy since 1955, its application to eligible programs and opportunities has barely scratched the surface. Serious obstacles erected by Congress, often combined with executive branch indifference, have kept the program on the back burner for much of the last forty years. Nonetheless, enough federal departments and agencies, as well as state and local governments, have applied the program to establish an impressive record of cost savings and service improvements.

Unlike the past, when the program's application was limited by a generally hostile Congress confronting an often unenthusiastic President, both branches of government today have endorsed the contracting out approach. What is needed now is an aggressive and comprehensive program as part of this year's budget and appropriations process.

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⁹ Wendell Cox and Jean Love, "Reclaiming Transit for the Riders and Taxpayers," in Edward L. Hudgins and Ronald D. Utt, eds. *How Privatization Can Solve America's Infrastructure Crisis* (Washington, D.C.: The Heritage Foundation, 1992).

¹⁰ During the Reagan Administration, Dr. Utt was Associate Director for Privatization at the Office of Management and Budget. That position was abolished during the Bush Administration and has not been revived under the Clinton Administration.

HOW CONGRESS HAS BLOCKED PRIVATIZATION

AGRICULTURE

- ✘ Minimum employment levels exist at the Farmers Home Administration, Agricultural Stabilization and Conservation Service, and the Soil Conservation Service.
- ✘ The Farmers Home Administration is prohibited from contracting with private debt collection firms to collect delinquent payments.
- ✘ Agriculture is precluded from selling loans made by the Agricultural Credit Insurance Fund.

COMMERCE

- ✘ NOAA is prohibited from commercializing meteorological satellites.
- ✘ NOAA is required to use appropriated funds for certain projects.
- ✘ The Department of Commerce is prohibited from selling its economic development loans.
- ✘ The National Technical Information Service is prohibited from contracting out services.

DEFENSE

- ✘ Minimum civilian employment levels exist at Army depots.
- ✘ The Department of Defense is prohibited from contracting out security and firefighting services.
- ✘ The Crane Army Ammunition Activity and McAlester Army Ammunition Plants are prohibited from contracting out services.
- ✘ The Department of Defense is prohibited from contracting out core logistics maintenance functions.
- ✘ The Philadelphia Defense Personnel Support Center is prohibited from contracting out services.
- ✘ The Department of Defense is prohibited from contracting out any activity performed by 10 or more civilian employees.
- ✘ The Department of Defense is prohibited from contracting out logistics activities to non-governmental personnel.
- ✘ The Department of Defense is prohibited from contracting out entire medical facilities.

- ✘ Officers at Fort Benjamin Harrison, Indiana are prohibited from A-76 procedures.¹¹
- ✘ A-76 implementation is impeded by complicated requirements for notice and reporting.
- ✘ The Army Corps of Engineers is prohibited from contracting out reservoirs in Mississippi.
- ✘ The Army Corps of Engineers is prohibited from contracting out the operations and maintenance of hydroelectric power facilities.
- ✘ Only installation commanders have the authority to decide which commercial activities will be subject to A-76 review (Nichols amendment).

ENERGY

- ✘ The Department of Energy is prohibited from studying alternative pricing structures.
- ✘ The Department of Energy is prohibited from studying the sale of the Power Marketing Administrations, except Alaska.
- ✘ The Department of Energy is prohibited from using appropriations for the privatization of the Naval Petroleum Reserves.
- ✘ The Department of Energy is prohibited from studying or proposing the privatization of the uranium enrichment programs.

GENERAL SERVICES ADMINISTRATION

- ✘ GSA is prohibited from contracting out certain intra-agency service positions.

HEALTH AND HUMAN SERVICES

- ✘ The FDA is prohibited from adopting user fees.
- ✘ The Social Security Administration is prohibited from contracting outside the United States for printing services.

HOUSING AND URBAN DEVELOPMENT

- ✘ HUD is prevented from selling section 202 loans.
- ✘ Minimum employment levels exist within the Public and Indian Housing Program.
- ✘ HUD is prohibited from selling section 312 direct loans.

11 A-76 is the title of the OMB circular that outlines and regulates the process and procedures for federal contracting out of competition.

INTERIOR

- ✘ The National Park Service, Fish and Wildlife Service and Bureau of Land Management are prohibited from contracting out any services.

JUSTICE

- ✘ The Department of Justice is prohibited from contracting out any functions involving law enforcement, litigation or the administration of justice.
- ✘ The Department of Justice is prohibited from the sale of loans or guarantees held by the Federal Financial Bank.

LABOR

- ✘ The Job Corps is forbidden to contract out any Civilian Conservation Center.

TRANSPORTATION

- ✘ The FAA is prohibited from contracting out maintenance for national airways system facilities.
- ✘ The Coast Guard must delay the A-76 process for congressional review.
- ✘ Minimum employment levels exist within the FAA for air traffic controllers.
- ✘ The Department of Transportation is prohibited from funding changes in the current federal status of the Transportation Systems Center or the Turner-Fairbank Highway Research Center.

TREASURY

- ✘ Minimum employment levels exist at the Customs Service despite the fact that automation has reduced the need for large staffing levels.

VETERANS AFFAIRS

- ✘ Minimum employment levels exist within the VA medical care staff.
- ✘ The Department of Medicine and Surgery is prohibited from contracting out certain activities.

RAILROAD RETIREMENT BOARD

- ✘ Minimum employment levels exist within the Railroad Unemployment Insurance Trust Fund.

SMALL BUSINESS ADMINISTRATION

- ✘ The SBA is prohibited from selling loans held or guaranteed by SBA and held by FFB.