

The Thomas A. Roe Institute for Economic Policy Studies

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# PRIVATIZE THE GENERAL SERVICES ADMINISTRATION THROUGH AN EMPLOYEE BUYOUT

## INTRODUCTION

**H**olding a legal monopoly on basic support services to government offices and office workers, the 18,500-employee General Services Administration (GSA) operates on a budget of \$200 million but controls between \$45 billion and \$50 billion in government purchases and leases of buildings, building services, office supplies, telecommunications, and computer equipment. Thus, the real savings to the taxpayer from any reforms of GSA come not so much from reductions in GSA's operating budget as from potentially substantial reductions in construction costs, lower building rents, less costly maintenance, and lower prices for supplies and equipment.

Although GSA has been the object of reform efforts for some fifteen years, the savings achieved have been minor compared with the excess costs the agency's monopoly has imposed on government agencies and taxpayers. Initially targeted for a strong dose of competition by Vice President Al Gore's National Performance Review,<sup>1</sup> the GSA has sidestepped White House efforts to reform it by promising to reform itself—while still operating as the federal government's chief custodian, leasing agent, and purveyor of supplies.

As part of its supposed reform program, the GSA has "reengineered" many of its departments, giving them such private-sector-sounding names as Commercial Brokerage, Fee Developer, and Portfolio Management. While GSA's managers may have fooled the White House and the media,<sup>2</sup> the congressional budget committees should not allow

<sup>1</sup> *Creating a Government That Works Better and Costs Less: The General Services Administration*, Accompanying Report of the National Performance Review, Vice President Al Gore, Washington, D.C., September 1993.

themselves to be taken in so easily. Instead, Congress should:

- ✓ **Move forward** with the Vice President's original plans to end GSA's supply monopoly and require it to compete with private sector suppliers.
- ✓ **Break up** GSA into separate enterprises along its major functional lines.
- ✓ **Privatize** each of these successor entities with substantial ownership participation by current GSA employees.

Exposing GSA to competitive market pressures and allowing agencies to seek the best price for needed services will mean lower overhead costs for the \$45 billion to \$50 billion of federal services that GSA influences or provides. Efficiencies of just 10 percent would lead to annual budgetary savings of \$4.5 billion to \$5 billion. Efficiencies of 25 percent, the average rate of improvement when the federal government contracts out to the competitive private sector, could mean annual budgetary savings between \$11.25 billion and \$12.5 billion.

The NPR's recommendations are a good starting point, but they beg the question of why the federal government should be in the business of cleaning buildings, selling paper clips, operating e-mail systems, or providing other routine support services. These functions are not uniquely governmental, are not strategic to the nation's well-being, and are commonly available from a competitive private sector at lower costs. In addition, they keep GSA from doing well those things a federal agency should do, such as providing for the security of government property and staff. In 1988 Congress passed a law that called for hiring 1,000 uniformed federal officers for duty at government buildings around the country, but GSA has been able to hire and retain no more than about 400 at a time. GSA reportedly blames lack of funding, high turnover, and subsequent decisions to downsize the agency for its failure to meet this goal.<sup>3</sup> Yet at the same time, President Clinton's 1996 budget reveals, GSA somehow was able to propose (in competition with the private sector) 28 new construction projects, operate "reinvention laboratories" in Philadelphia and Denver, and offer a new "Help Desk" for government e-mail users.

## THE ROLE OF GSA

Under current law and practice, most civilian government agencies must use the GSA for basic building and office services on a fee basis. If a government agency needs new office space, the GSA will arrange for its construction and acquisition or will lease it from private sector owners, in turn re-leasing the space to the agency. Once the space is occupied, the GSA will arrange for maintenance, cleaning, repair, heating and cooling, and other service, either through its own staff or through qualified private contractors. To fund this operation, government agencies pay rent to the GSA out of funds appropriated to them by Congress. At present, the GSA manages and oversees 268 million square feet of space in approximately 8,000 buildings; about half of this space is leased from other owners.<sup>4</sup>

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2 Stephen Barr, "Agency Prepared to Chip in With \$24 Billion in Savings," *The Washington Post*, January 12, 1995, p. A25.

3 Stephen Barr, "Safety Concerns Are Heightened in the Wake of Bombing," *The Washington Post*, April 27, 1995, p. A9.

With government-owned buildings, the rent payment (after deducting operating expenses) goes into GSA's Federal Buildings Fund, where it may be used to repay debt owed to the Treasury from past construction borrowings or to fund new construction and/or substantial renovation. The Clinton Administration has requested funds for 28 new construction projects proposed in GSA's FY 1996 budget,<sup>5</sup> which conflicts directly with the NPR's September 1993 recommendation that the agency temporarily suspend all acquisition of net new office space and courthouses.<sup>6</sup>

Where the GSA leases a building from the private sector for government use (for example, the headquarters of the Department of Transportation and the Department of Housing and Urban Development), it then re-leases the building to the agency that will occupy it, at rent that covers the payment to the building's owner and GSA's costs.

The GSA also provides telephone service by way of master contracts with private sector providers, office supplies through its General Supply Fund, and computer equipment and information processing services through its Information Technology Service. Each agency's transportation needs are met through the GSA Interagency Fleet Management System.

The principle behind GSA's creation in 1949 was that a centralized buying facility could save money through specialization and economies of scale in buying or leasing in bulk. Instead of duplicative departments in each agency all trying to do the same thing, trained GSA specialists would do it for them at the lowest possible price. In practice, however, any cost advantages from the government's vast buying power are more than offset by the bureaucratic inefficiencies and rigidities that beset any government monopoly that attempts to do what often is done better and cheaper by leaner and more flexible profit-making private companies. Federal agencies end up paying more for goods and services than if they had purchased them directly from private suppliers.

## INEFFICIENCIES AND HIGH COSTS

Placing GSA's vast bureaucracy between government agencies and private sector suppliers is a costly burden to the taxpayer. As the NPR concluded, the GSA "suffers from fundamental flaws in its operation, from the contradictory nature of its tasks, to the monopoly it enjoys over services provided to federal agencies."<sup>7</sup> Many of these flaws and excessive costs have been documented in General Accounting Office (GAO) reports published over the past several years at the request of Congress.

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4 U.S. General Accounting Office, "Real Property Management: Reforms in Four Countries," GAO/GGD-94-166, September 1994, p. 2.

5 Appendix, Budget of The United States Government, Fiscal Year 1996, p. 885.

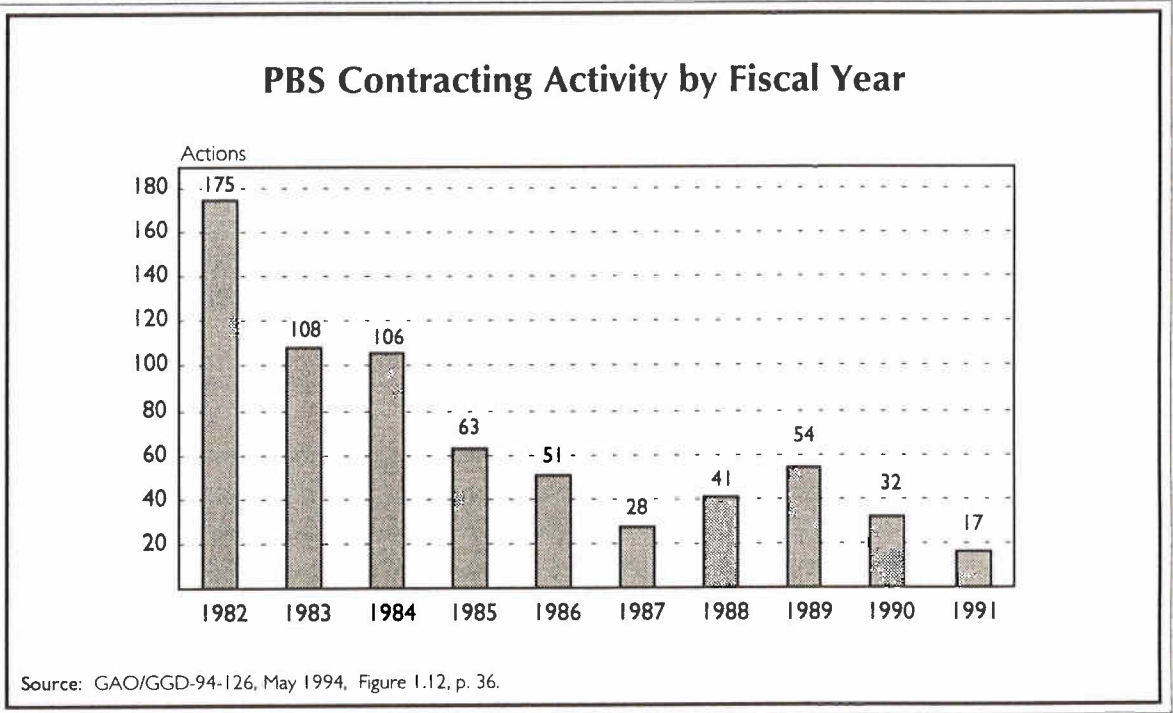
6 *Creating a Government that Works Better and Costs Less: The General Services Administration*, p. 12. See also "Oversight Subcommittee Hearing to Examine Waste in Federal Property Management," News from Senator Bill Cohen of Maine, July 26, 1993.

7 *Creating a Government That Works Better and Costs Less: The General Services Administration*, p. 5.



**High Service Costs.** The level of savings to be achieved if government agencies relied on the private sector is indicated by GSA's experience in contracting out some of its own activities to private companies in the last decade, as it reduced its workforce from 37,000 in 1980 to 19,500 in 1994 and a projected 16,900 by the end of 1995. According to the GAO,<sup>8</sup> between 1982 and 1992 the GSA reviewed 731 commercial activities in its Public Building Service for contracting out under OMB's Circular A-76 procedures.<sup>9</sup> Of these, 73 percent were contracted out to the private sector, 24 percent were retained in-house, and three were closed down.

For those services contracted out, the savings were substantial. On average, low contractor bids were 39 percent less than the government's own cost. For custodial services, the low contractors' bid was 50 percent less than the government's cost estimate. Unfortunately, most of this cost comparison and contracting activity occurred before 1985; largely as a result of leadership changes, GSA's review and contracting program is operating now at just a fraction of the pace seen during the first half of that decade. The table below summarizes GSA Public Building Services (PBS) contracting actions during the past decade with actions defined both as functions formally reviewed for contracting and as functions contracted directly without formal review.



**Construction Cost Overruns.** The GAO also has found numerous long-standing inefficiencies and management problems in GSA's building construction program. These problems continue despite repeated GAO reports and recommendations. For example:

- 8 U.S. General Accounting Office, "Public-Private Mix: Extent of Contracting Out for Real Property Management Services in GSA," GAO/GGD-94-126, May 1994.
- 9 See Ronald D. Utt, "Cutting the Deficit and Improving Services by Contracting Out," Heritage Foundation *Backgrounders* No. 1022, March 10, 1995, for a more detailed discussion of government contracting out opportunities.

More than a decade ago, we and GSA's internal auditors reported on problems related to ineffective project design and planning and the overall management of contract modifications. Although GSA has been working on these problems, it has been unable to fully resolve them.<sup>10</sup>

Emphasizing the difficulty that GSA still has in reforming itself, even when problems and recommendations are revealed to it, and even when an extended period of time is allowed for improvement, the GAO concludes:

GSA's construction program continues to have significant problems. Construction contracts experience substantial growth, many contract changes that contribute to cost growth are authorized to overcome design and planning problems, and incomplete and inaccurate data—combined with lack of criteria for measuring and evaluating cost growth—impedes effective oversight. These problems are not new and, in fact, GSA has faced recurring criticism because of problems associated with the management and administration of contract modifications.<sup>11</sup>

**Opportunities for Reducing Rents.** Real estate professionals have argued recently that the GSA has failed to take full advantage of the weak commercial real estate market and the federal government's excellent bargaining position to renegotiate its long-term leases for millions of dollars of annual savings. Since the late 1980s, office vacancy rates have remained high throughout the country, many buildings have been sold at prices well below replacement costs, and rent levels have been depressed. With current market rents for office space now much lower than they were several years ago when the leases were signed, financially strong tenants like the federal government can renegotiate leases on more favorable terms and at substantial savings to the federal budget and the taxpayer.

As a result of the Vice President's earlier proposals for competition between GSA and private sector providers, several major property management companies have reviewed the opportunities and concluded that annual rent savings of as high as 25 percent could be achieved through renegotiation and through such other means as challenging local assessments for reduced taxes. Indeed, so great and so certain are these potential savings that these firms have proposed taking over GSA's property management functions at no direct cost to the government, paying themselves only from the savings they achieve for the taxpayer.

How would this work? Typically, the government's property manager would approach the landlord with a proposal to extend the current lease in return for a lower rent today and for the duration of the lease as extended. For example, if an agency paid \$2 million a month in rent, the new manager's compensation might be set at one-third of the savings obtained from current rent levels. The manager might propose to the landlord a rent reduction to \$1.5 million with a five-year lease extension. If the landlord accepted, the agency would have its effective monthly rent reduced to \$1,665,000 from \$2,000,000,

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<sup>10</sup> U.S. General Accounting Office, "General Services Administration: Better Data and Oversight Needed to Improve Construction Management," GAO/GGD-94-145, June 1994, p. 1.

<sup>11</sup> *Ibid.*, p. 16.

while the new property manager would receive a fee of \$165,000 per month, equal to one-third of the savings.

At present, such renegotiations are common in the private sector in a “soft” property market and work to the benefit of both the landlord and tenant during a difficult commercial market. But GSA, as a nonprofit monopolist, has no financial incentive or competitive pressure to engage in the extra effort such negotiations require. If GSA successfully renegotiated leases, all savings would revert to the U.S. Treasury rather than to GSA. Thus, millions of dollars in potential annual savings are foregone because there is no real competition for the right to manage the government’s vast real estate holdings.

**Costly Office Supplies.** GSA has attempted to be competitive by making major changes in its office supply and distribution operations. Previously, GSA sold its products to agency offices through costly, low-volume supply stores located in each agency, but most of these have been closed in favor of catalogue sales direct from warehouses. Despite this change, the evidence indicates that, at best, GSA’s pricing is on a par with that of its private sector competitors—even though the private sector suppliers pay federal, state, and local taxes and GSA does not.

In principle, GSA should be able to offer the best prices because of its vast buying power, its ability to buy directly from manufacturers on negotiated terms, and its exemption from business taxes and other fees. But GSA must contend with an uncompetitive and inefficient supply system that adds costs to all goods sold and raises the government’s prices to prevailing market prices or more. In 1992 the GAO investigated GSA’s supply services and found that as much as \$107 million per year could be saved (in addition to a one-time saving of up to \$240 million) if products were shipped to agencies from private sector suppliers directly rather than through GSA depots, which add substantially to costs and overhead. According to the GAO’s report, customer agencies pay, on average, nearly three times as much in processing costs for orders filled through GSA depots as they pay for those filled directly by suppliers.<sup>12</sup>

The table on the following page provides a few cost comparisons between the GSA catalogue and a private supplier—Viking Office Products—that offers comparable commonly used products through catalogue sales.

As the selection of products demonstrates, prices available from at least one private sector supplier specializing in catalogue sales are not materially different from those available from the nonprofit GSA, and in many cases the private sector product is less expensive. There appears to be very little justification for GSA to continue this service through its Federal Supply Service. Continuing to do so merely provides unfair competition to taxpaying private sector providers.

Unlike most other support services, GSA’s Information Resources Management Service has been forced by marketplace realities to give up its monopoly over the sale of computers and peripheral equipment and provide agencies with waivers which allow them to

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12 U.S. General Accounting Office, “General Services Administration: Increased Direct Delivery of Supplies Could Save Millions,” GAO/GGD-93-32, December 1992, pp. 2-3.

### Office Supply Price Comparison

<b>GSA Product</b>	<b>GSA Price</b>	<b>Viking Price</b>	<b>Viking Product</b>
Generic ball point pen	\$2.21 dz.	\$0.89 dz.	Bic ball point pen
Covered folding file	\$6.99 pc.	\$5.99 pc.	Covered folding file
Uncovered folding file	\$5.95 pc.	\$5.87 pc.	Uncovered folding file
Desk top, 12 digit, paper tape, calculator	\$39.97	\$39.97	T.I. Desk top, 12 digit, paper tape, calculator
Elec. pencil sharpener	\$20.45	\$17.45	Elec. pencil sharpener
3M double-sided, high density, 3.5" discs	\$0.805 ea.	\$0.79 ea.	3M double-sided, high density, 3.5" discs
Plain copier paper, 8.5" x 11", 20lb.	\$26.00 per 10 rm	\$26.90 per 10 rm	Plain copier paper, 8.5" x 11", 20 lb.

Source: Catalogue of Viking Office Products, June 30, 1995, and *Supply Catalogue*, U.S. General Services Administration, Federal Supply Service, June 1994.

purchase computers directly from private sector providers. Because computer technology, prices, and products change so quickly, the GSA, hobbled by the complex, bureaucratic federal procurement system, is unable to provide state-of-the-art products at current market prices. Thus, as a result of past agency dissatisfaction, the GSA now must compete with private sector providers for the government's computer and software business.

## REFORMING GSA THROUGH MARKET COMPETITION

GSA's waiver of its monopoly on sales of computers to government agencies should be extended to all products and services, and GSA should be required to compete with private sector providers for all of these agencies' business. The record demonstrates that GSA's attempts to reform itself while maintaining its monopoly have not been successful. Many management problems identified more than a decade ago still exist today. As Vice President Gore's National Performance Review observed:

It is not enough that GSA become a better monopoly; true change will not occur until agencies are free to choose where and how they spend their money.<sup>13</sup>

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**13** *Creating a Government That Works Better and Costs Less: The General Services Administration*, p. 10.



The NPR went on to recommend that GSA transfer authority, revise regulations, and develop legislation that would allow government agencies the freedom to choose where they buy or rent when acquiring office space, building services, basic supplies and equipment, telecommunications services, and computer equipment.

The NPR's recommendations are a commendable starting point. But the question remains: Why should the federal government be cleaning buildings, selling paper clips, operating e-mail systems, or doing all of the other routine commercial things that it does? All of these are support functions. They are neither uniquely governmental nor essential to the nation's well-being. They are commonly available from competitive private companies at lower costs. For these reasons, the GSA should be restructured along functional product/service lines and separated into a series of independent bureaus that operate as businesses in such areas as building services, supplies, telecommunications, property disposition, and information systems.

Once GSA's functional areas are reorganized to resemble free-standing government corporations, and once the government supply market has been opened to full and open competition, each of these corporations should be privatized, with the existing employees receiving preference in acquiring the business in whole or in part. One mechanism that could be used to accomplish this task is the Federal Employee Direct Corporate Ownership Opportunity Plan (FED CO-OP). Created by the U.S. Office of Personnel Management during the Reagan Administration, FED CO-OP allows federal employees to participate directly in the benefits from privatization of their divisions, departments, and agencies. Developed in accordance with existing civil service law and consistent with federal conflict of interest prohibitions, the program is a form of contracting out that allows affected employees to participate in an Employee Stock Ownership Plan (ESOP) with the winning contractor, so that they can participate directly in the profits of firms that win contracts to take over government's commercial activities. The program also provides guaranteed employment for a limited period of time and high quality out-placement services for employees who leave the new firm within the first year after privatization.

## CONCLUSION

Of all of the agencies and departments that have been discussed for privatization this year, the GSA would be one of the easiest to privatize. Its many services are available from the private sector, whose more successful firms offer a blueprint for how a privatized GSA could survive and thrive in a competitive environment. Moreover, because of the routine and commercial nature of most of its operations, as well as the performance benchmarks provided by its private sector counterparts, GSA is amenable to forms of privatization that allow for substantial and active participation by the existing federal workforce. Thus, besides saving a considerable sum for the taxpayer, privatization of the GSA could become a model for many of the other privatizations lawmakers and Administration officials say they intend to pursue.

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