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Testimony

Before the Subcommittee on Civil Service
Committee on Government Reform and Oversight
House of Representatives

For Release on Delivery
Expected at
9:30 a.m. EST
Wednesday
March 29, 1995

GOVERNMENT
CONTRACTORS

An Overview of the
Federal Contracting-Out
Program

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GOVERNMENT CONTRACTORS
AN OVERVIEW OF THE FEDERAL CONTRACTING-OUT PROGRAM

Summary of Statement by
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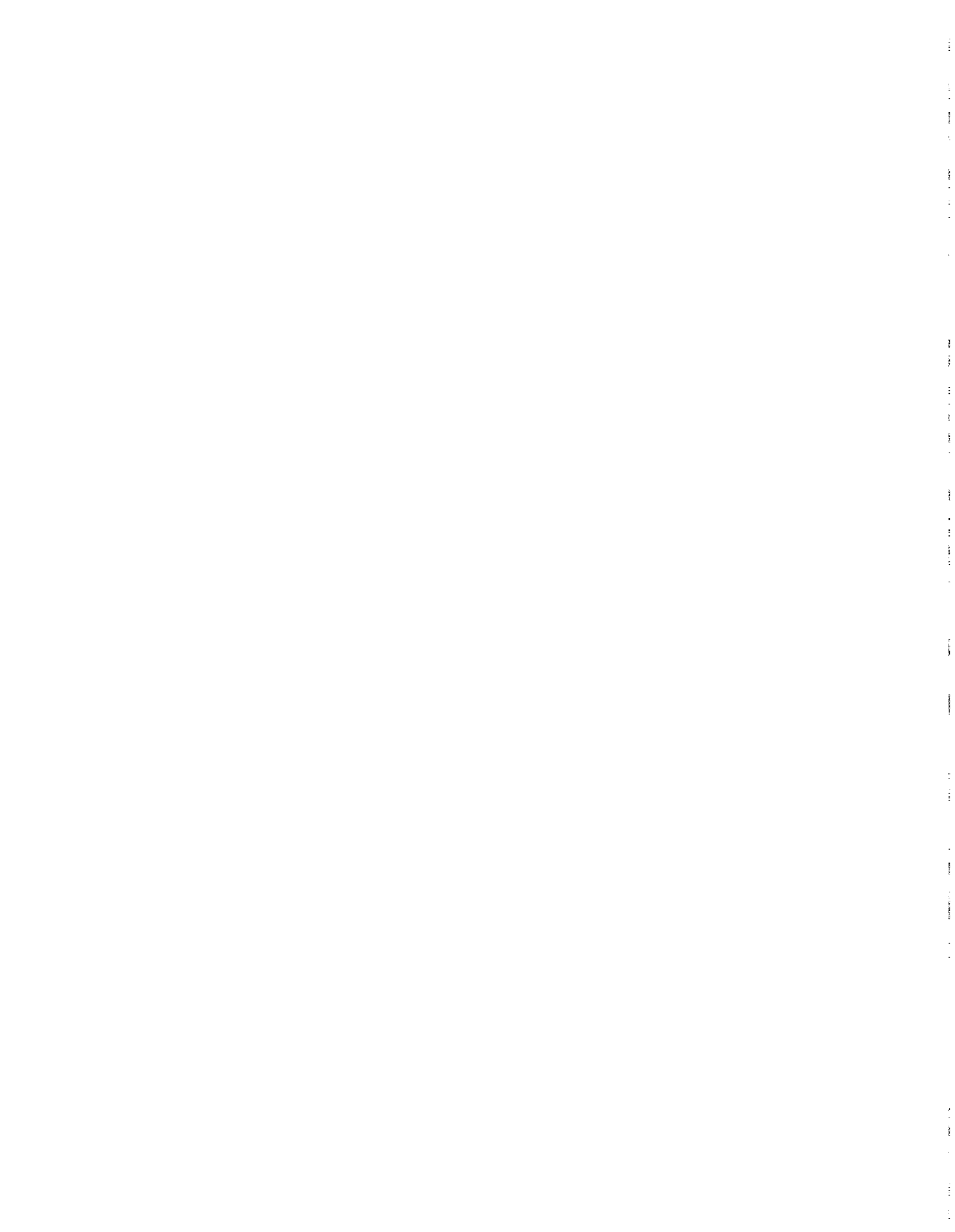
GAO has done a large body of work on federal contracting-out and has drawn on this work to (1) provide a brief history of the contracting-out program, (2) discuss the effect of contracting-out decisions on federal employees, (3) examine the effectiveness of contracting-out decisions, and (4) describe legislative or any other impediments to the program's ability to promote the effective and efficient operation of government agencies.

Office of Management and Budget Circular A-76 is the federal policy that governs how contracting-out decisions are made in the government. The 40-year policy encourages government agencies to rely on the private sector for commercial goods and services. Since 1967, the objective of the A-76 program has been to achieve efficiencies by encouraging competition between the federal workforce and the private sector for providing commercial services. More recent revisions to the circular have more clearly detailed how cost studies were to be carried out, specified activities that were "inherently governmental" and should only be performed by federal employees, and extended the cost study requirement for advisory and assistance services.

Circular A-76 offers a number of provisions designed to protect the rights of federal employees adversely affected by contracting-out decisions, such as requiring that federal agencies exert maximum effort to find other jobs for these employees. GAO notes that while its earlier reports found that a significant number of displaced federal workers found employment in another government job, the current downsizing environment may not provide the same opportunities.

GAO found that evaluating the overall effectiveness of A-76 decisions and verifying the estimated savings reported by agencies is extremely difficult. GAO cannot prove or disprove that the results of federal agencies' A-76 decisions have been beneficial and cost-effective.

The A-76 program has never had legislative authorization. In fact, Congress has enacted many restrictions on A-76 studies and on contracting out jobs presently held by federal employees. These restrictions generally fall into one of the following three categories: prohibitions on contracting out specific activities, minimum staffing requirements, and restrictive requirements regarding cost studies. Personnel ceilings imposed during the budget process are sometimes an impediment to choosing the option of federal performance when that is more cost-effective.



Mr. Chairman and Members of the Subcommittee:

Thank you for this opportunity to testify on the Subcommittee's oversight of federal contracting-out policies and their implementation over the years. You asked us to (1) give a brief history of the contracting-out program, (2) discuss what problems have surfaced among federal employees affected by contracting-out decisions, (3) examine the basis for measuring the performance of the contracting-out program, and (4) describe any legislative or other impediments to its success at promoting effective and efficient operations of government agencies.

We have done a large body of work on contracting-out. The attachment to my statement lists some of the most relevant products we have issued since 1981. I will draw on this body of work to respond to your questions.

History of the Contracting-Out Program

The federal government contracts for a wide variety of goods and services over the course of a year. Approximately \$108 billion per year is spent for service contracts. The practice of entering into service contracts that are the result of decisions to convert work performed by federal employees to contract is commonly known as contracting-out.

Office of Management and Budget (OMB) Circular A-76 is the policy that governs how contracting-out decisions are made in the federal government. As a general policy, presidential administrations since 1955 have encouraged federal agencies to rely on the private sector for commercial goods and services. Since 1967, the objective of the A-76 program has been to achieve efficiencies by encouraging competition between the federal workforce and the private sector for providing commercial services needed by government agencies. More recent revisions to the circular have more clearly detailed how cost studies were to be carried out; specified activities that were "inherently governmental" and should be performed only by federal employees; and through a rescission of Circular A-120, which covered the provision of advisory and assistance services, extended to them by implication the cost study requirement.

As Congress considers the proposals of the Contract With America and of the National Performance Review (NPR) to downsize the federal government, contracting issues have assumed renewed prominence since the use of contractors may be a substitute for government employment. We believe that contractors can provide valuable services to the government. We have long held that the concept of encouraging competition is a sensible management objective that can contribute to more efficient and effective government operations and potentially result in significant savings. However, despite its appeal on a conceptual level, the A-76 program has suffered from a number of implementation

problems that raise questions on the amount of savings actually achieved and that prevent governmentwide acceptance.

The A-76 program has been and continues to be controversial. In more than 100 reviews we and others have done, managers accepted its objectives of seeking efficiencies and cost savings, but they also said that the program is time-consuming, difficult to implement, disruptive, and threatening to both managers and employees.

Effects on Employees

The circular contains a number of provisions designed to protect the rights of federal employees affected by contracting-out decisions. First, unless a waiver is received, any activity consisting of more than 10 full-time equivalent jobs (FTE), must undergo a cost study, and the study's results must indicate that contracting-out would result in more than 10 percent savings over comparable in-house costs before the activity can be converted. Federal employees may appeal these decisions to the agency performing the cost study if they believe that the cost study was faulty.

Secondly, under A-76, once the decision to contract out is made, federal agencies must exert maximum effort to find other jobs for adversely affected employees. These efforts include giving them priority consideration for available positions within the agency, establishing reemployment priority lists, paying reasonable costs for training and relocation, and coordinating with the Office of Personnel Management (OPM) to provide access to governmentwide placement programs. The winning contractor must also give adversely affected employees the right of first refusal for positions for which they are qualified.

These policy provisions were strengthened by the Federal Workforce Restructuring Act of 1994 (P.L. 103-226). This act prohibits agencies from contracting out when the resulting FTE reduction is applied to the goal of reducing the executive branch by 272,900 FTEs or when a buyout is accepted, unless an A-76 cost study shows that there is a clear financial advantage to the government.

Despite these protections, the A-76 program adversely affects workers' morale and productivity. Our work has shown that because employees affected by an A-76 study are uncertain about their current employment, employee anxiety can begin as soon as the study is announced. Some affected employees begin to look for new jobs, reducing individual and organizational productivity and frequently resulting in the loss of good employees.

The cost studies required by Circular A-76 are in practice mostly done by managers and operational workers rather than trained management analysts. They are required to develop detailed work statements and analyses--tasks they are often not skilled in, may never do again, and frequently are assigned as extra duties. The absence of workload data and adequate cost accounting systems makes the task all the more difficult. The time it takes to do A-76 studies has contributed to disruption in the workplace. Cost studies completed by the Department of Defense (DOD) between 1978 and 1986 took an average of 2 years to complete. When we checked DOD's database in 1989, we found 940 cost studies in process. Of these, 411, or 44 percent, were started in 1983 or earlier and had been in process at least 6 years.

We have not done any recent work on the question of what happens to displaced federal workers under the A-76 program. However, several reports that we did in the 1980s may provide some insight. For example, in a 1985 report on the program's impact in DOD,¹ we found that the majority of federal workers whose jobs had been contracted out obtained other federal employment, most often at the same installation. We found that of 2,535 DOD employees we sampled who worked in activities that were contracted out in fiscal year 1983, 74 percent had found other government jobs, most often at the same installation; 7 percent went to work for the contractor; 5 percent were involuntarily separated; and most of the remaining 14 percent resigned or retired. Of those who obtained other government positions, about 56 percent received lower grades, and about 44 percent received the same or higher grades.

In early 1985, we followed up by questionnaire with those employees who had been involuntarily separated or had gone to work for contractors. Of those respondents who were involuntarily separated, over half were reemployed with the federal government. Over half also said that they had received unemployment compensation and/or public assistance. Fifty-three percent who went to work for contractors said they had received lower wages, and most reported that contractor benefits were not as good as their government benefits.

It is worth noting, however, that although our earlier reports indicated that a significant number of displaced workers found employment in another government job, the current downsizing environment may not provide the same opportunities. For example, OPM operates an interagency placement program to assist separated employees. Under this program, agencies are required to give priority to separated employees when filling positions through

¹DOD.Functions Contracted Out Under OMB Circular A-76: Contract Cost Increases and the Effects on Federal Employees (GAO/NSIAD-85-49, Apr. 15, 1985.

competitive appointments. According to OPM, between the program's inception in December 1993 and September 16, 1994, from an inventory of 2,018 registrants, agencies made 204 job offers. Among other things, OPM attributes the low number to the fact that agency downsizing has substantially reduced the number of vacancies.

Effectiveness of A-76 Decisions

During the long history of our work in this area, we have consistently found that evaluating the overall effectiveness of contracting-out decisions and verifying the estimated savings reported by agencies is extremely difficult after the fact. As a result, we cannot convincingly prove nor disprove that the results of federal agencies' contracting-out decisions have been beneficial and cost-effective.

In previous reports, we expressed concerns about the implementation of A-76 and the lack of complete and reliable data on the extent to which estimated savings have been realized.² For example, our 1990 evaluation of DOD savings data showed that neither DOD nor OMB had reliable data on which to assess the soundness of savings estimates or knew the extent to which expected savings were realized. At the time of our reviews, DOD did not routinely collect and analyze cost information to monitor actual operations after a cost study had been made. In addition, DOD's database on costs contained inaccurate and incomplete information. If contracts were subsequently modified, or in-house organizations were revised from the configurations used in the comparison of government and contractor costs, this information was not available for post-study analysis. Poor contract administration, including poorly worded performance work statements, contributed to contract revisions and cost escalations that quickly outdated comparisons with the precontract performance of the functions.

In an attempt to address some of the broader performance questions, we began looking at the overall contracting experience of the General Services Administration (GSA) at the request of Senator James Inhofe. GSA began systematically reviewing its real property services in 1982 using the guidelines in Circular A-76. In a report released last year,³ we were able to report on the overall extent of contracting-out by the agency and to

²See, for example, Achieving Cost Efficiencies in Commercial Activities (GAO/T-GGD-90-35, Apr. 25, 1990) and OMB Circular A-76: DOD's Reported Savings Figures Are Incomplete and Inaccurate (GAO/GGD-90-58, Mar. 15, 1990).

³Public-Private Mix: Extent of Contracting Out for Real Property Management Services in GSA (GAO/GGD-94-126BR, May 16, 1994).

identify the results of individual contracting decisions and the reported savings. However, for the reasons that follow, we have, thus far, not been able to provide a clear assessment of whether GSA has realized the expected savings and benefits from the activities contracted out or retained as a result of this process.

There is no common baseline available to evaluate subsequent performance of either contract or in-house services. As a result, we have not been able to compare the actual costs of these activities with what could have been the cost if other options had been chosen. However, even if such baseline data were available, we found that post-decision comparisons would be extremely difficult, if not impossible in some cases, because most activities do not remain static over time.

While Circular A-76 contains a list of typical commercial activities and requires agencies to compile an inventory of all government activities that are commercial in nature and could be contracted out, these listings or inventories are not current and may not be comprehensive. To our knowledge, no comprehensive inventory exists that identifies activities for which government agencies compete with private contractors or identifies which agencies perform these activities in-house and which perform them through contract.

It would be ideal for cost comparison purposes, Mr. Chairman, if an inventory existed of activities performed both under contract and by federal employees under similar conditions, with good cost data on each. Such an inventory could be the basis for establishing cost and performance benchmarks to evaluate the effectiveness of contracting-out decisions and, perhaps, even streamlining the A-76 process. However, such an inventory could be compiled only if similar activities were performed in both the public and private sectors. In addition, it could be costly and difficult to maintain.

In isolated cases, we have been able to (1) obtain good cost data for similar activities performed by both government employees and private contractors under similar conditions and (2) perform equitable post-decision cost comparisons. For example, in 1992 we reviewed the Postal Service's initiative to procure postage stamps from the private sector and determined that the private sector was a lower cost source than the Bureau of Engraving and Printing for seven of the eight pairs of postage stamps we examined.⁴ In this review, we were able to control for such factors as stamp size, printing method, and quantity produced and compare government and private sector costs. The cost comparison

⁴Postage Stamp Production: Private Sector Can Be a Lower Cost Optional Source (GAO/GGD-93-18, Oct. 30, 1992).

revealed that except for one case, private sector-produced stamps ranged from 6.8 to 62.4 percent lower than the cost of government-produced stamps.

Legislative Impediments

Observing the absence of definitive evidence to support projected cost savings and management improvements and being frequently contacted by constituents upset by the process, Congress generally has been concerned about the impact of contracting-out on agency operations and skeptical of efforts to accelerate contracting of activities being done by federal employees. The A-76 program has never had legislative authorization. In fact, over the years, Congress has enacted many restrictions on A-76 studies and on contracting-out jobs presently held by federal employees. While we could not find a comprehensive list of these restrictions, the restrictions generally fall into one of three categories:

- Prohibitions on contracting-out specific activities. For example, GSA is prohibited from contracting out for custodians, guards, elevator operators, and messengers unless the contract is to a sheltered workshop employing the severely handicapped. Similarly, the Farmers Home Administration is prohibited from contracting with private debt collection firms to collect delinquent payments. The Department of Commerce is prohibited from contracting out any part of the National Technical Information Service or from selling, leasing, or transferring any part of the weather satellite system.
- Minimum staffing requirements. Minimum staffing requirements create a level that effectively restricts contracting-out if contracting-out causes the agency to fall below that level. Minimum employment levels exist at the Department of Agriculture's Stabilization and Conservation Service, and its Soil Conservation Service.
- Restrictive requirements. For example, DOD may not use its funds to complete any A-76 cost study that is more than 24 months old and involves a single activity or that is more than 48 months old if it involves multiple activities.

It is worth noting that in addition to restrictions on contracting-out, there can be similar restrictions on performing activities in-house. For example, we have found that the personnel ceilings set by OMB frequently have the effect of encouraging agencies to contract out regardless of the results of cost, policy, or high-risk studies. Many of the examples of this phenomenon are in the newer, more scientifically oriented agencies such as the Environmental Protection Agency, National Aeronautics and Space Administration, and the Department of

Energy,⁵ rather than in old-line agencies whose organizational principles and base employment levels were established before aggregate federal employment became a sensitive national issue.

Competition and Flexibility
to Manage the Government's Work

As I have mentioned, the goal of the A-76 program is to achieve efficiencies by encouraging competition between the federal workforce and private sector for providing services needed by government agencies. This goal, I believe, is shared by both political parties and recently endorsed by the NPR which, among other things, advocated

- exposing agency operations to competition--with other agencies and private companies and
- providing agencies with the flexibility to obtain services from the best possible source.

To achieve the A-76 program's goal, our work has shown that once agencies consider the comparative costs of contracting-out versus using in-house personnel and relevant noncost factors, the agencies then need to have the flexibility to have the work performed in the most cost-effective manner.⁶ Because of the federal downsizing in progress, agencies may lack the necessary flexibility to perform activities in the manner that is most beneficial to the government. The NPR also recognized this lack of flexibility and suggested eliminating personnel ceilings and allowing federal managers to manage to their budgets--using ceilings on operation costs to control spending. The NPR recognized that personnel ceilings could cause agencies to contract out work that could be done more efficiently in-house.

As Congress and the executive branch continue to revisit issues associated with contracting-out and Circular A-76, we should not lose sight of the underlying objectives of seeking greater effectiveness and efficiency in government operations. Despite the problems experienced in the implementation of Circular A-76,

⁵Federal Contracting: Cost-Effective Contract Management Requires Sustained Commitment (GAO/T-RCED-93-2, Dec. 3, 1992); Government Contractors: Are Service Contractors Performing Inherently Governmental Functions? (GAO/GGD-29-11, Nov. 18, 1991); Energy Management: Using DOE Employees Can Reduce Costs for Some Support Services (GAO/RCED-91-186, Aug. 16, 1991).

⁶Government Contractors: Contracting-Out Implications of Streamlining Agency Operations (GAO/T-GGD-95-4, Oct. 5, 1994).

the basic policy of relying on competition to guide procurement decisions in those markets where competition exists makes sense and is generally accepted. We also need to recognize the importance of the A-76 policy in encouraging agencies to systematically review the potential costs of their activities and to consider alternatives. Any prospective revision of Circular A-76 and federal contracting policies should seek to preserve the benefits of fair competition while addressing the concerns of all parties--managers, federal employees, contractors, and taxpayers--about the impediments to its effective implementation.

This concludes my prepared statement, Mr. Chairman. I will be pleased to answer any questions you or the Members of the Subcommittee may have.

RELATED GAO PRODUCTS

Government Contractors: Contracting-Out Implications of Streamlining Agency Operations (GAO/T-GGD-95-4, Oct. 5, 1994).

Air Traffic Control: Status of FAA's Plans to Close and Contract Out Low-Activity Towers (GAO/RCED-94-265, Sept. 12, 1994).

Navy Maintenance: Assessment of the Public and Private Shipyard Competition Program (GAO/NSIAD-94-184, May 25, 1994).

Public-Private Mix: Extent of Contracting-Out for Real Property Management Services in GSA (GAO/GGD-94-126BR, May 16, 1994).

Department of Energy: Challenges to Implementing Contract Reform (GAO/RCED-94-150, Mar. 21, 1994).

Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees (GAO/GGD-94-95, Mar. 10, 1994).

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A-76 Program Issues (GAO/T-GGD-90-12, Dec. 5, 1989).

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Army Procurement: Fort Benjamin Harrison's Commercial Activity Study Should Be Redone or Updated (GAO/NSIAD-89-90, Feb. 24, 1989).

Federal Productivity: DOD's Experience in Contracting-Out Commercially Available Activities (GAO/GGD-89-6, Nov. 28, 1988).

Army Procurement: No Savings From Contracting for Support Services at Fort Eustis, Virginia (GAO/NSIAD-89-25, Oct. 31, 1988).

Air Force Contracting: Contracting For Maintenance of Training Aircraft at Columbus Air Force Base (GAO/NSIAD-88-136BR, Apr. 6, 1988).

Federal Productivity: DOD Functions With Savings Potential From Private Sector Cost Comparisons (GAO/GGD-88-63FS, Apr. 8, 1988).

Contracting-Out for Commercial Activities and Services Under OMB Circular A-76 (GAO/T-GGD-88-7, Jan. 7, 1988).

Federal Workforce: Provisions for Comparing Government and Contractor Retirement Costs Should Be Changed (GAO/GGD-88-25, Dec. 17, 1987).

Federal Productivity: Potential Savings From Private Sector Cost Comparisons (GAO/GGD-87-30, Dec. 31, 1986).

DOD Functions Contracted Out Under OMB Circular A-76: Costs and Status of Certain Displaced Employees (GAO/NSIAD-85-90, July 12, 1985).

Information From Previous Reports On Various Aspects of Contracting-Out Under OMB Circular A-76 (GAO/NSIAD-85-107, July 5, 1985).

DOD Functions Contracted Out Under OMB Circular A-76: Contract Cost Increases And The Effects On Federal Employees (GAO/NSIAD-85-49, Apr. 15, 1985).

Increased Use of Productivity Management Can Help Control Government Costs (GAO/AFMD-84-11, Nov. 10, 1983).

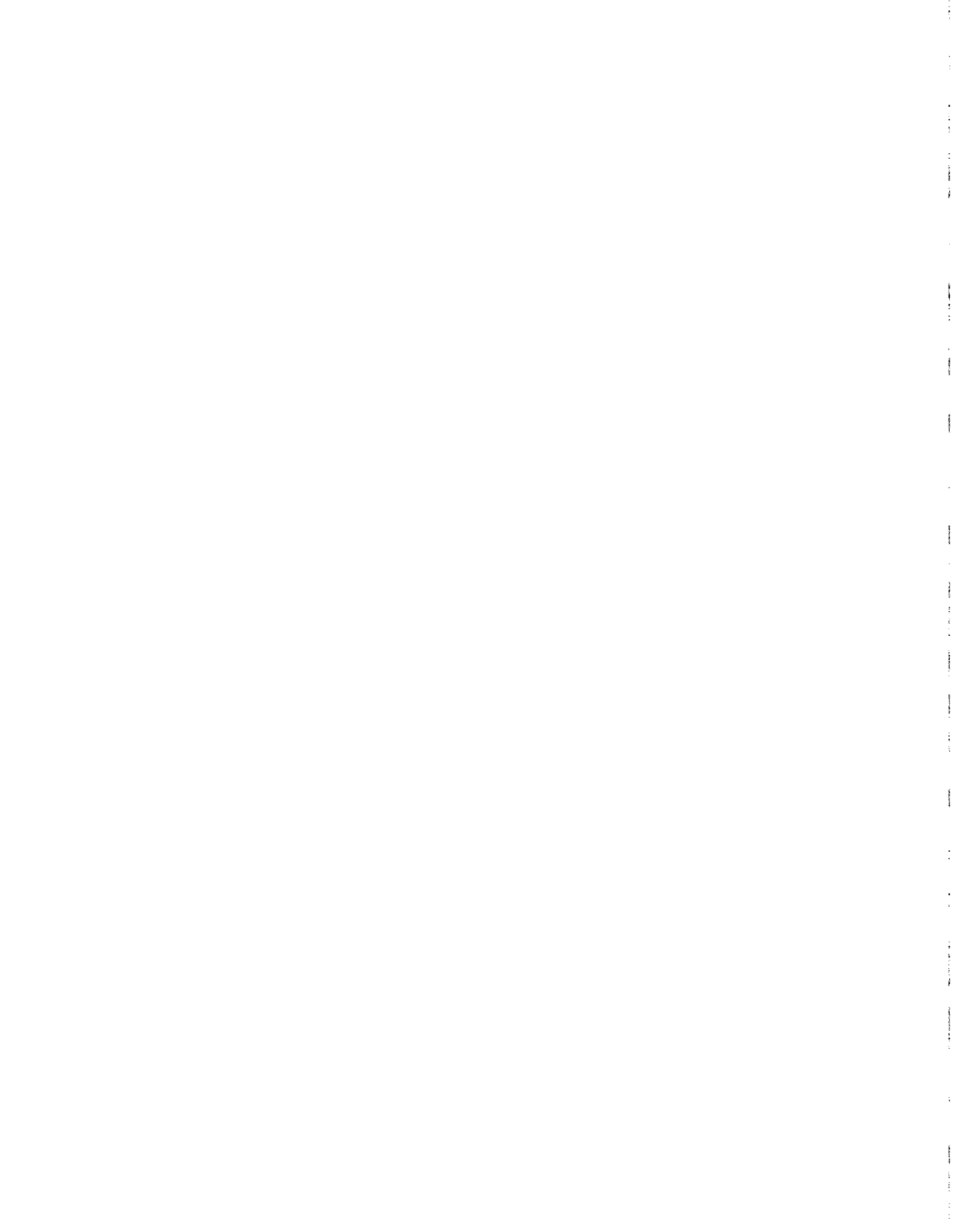
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