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FEDERAL CONTRACTING

Comments on S. 1724, The Freedom From Government Competition Act

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Statement

Federal Contracting: Comments on S. 1724, the Freedom From Government Competition Act

Mr. Chairman and Members of the Committee:

I am pleased to be here today to assist the Committee in its consideration of S. 1724, the Freedom From Government Competition Act. The bill would require that the government procure from the private sector the goods and services it needs to carry out its functions, with a few specified exceptions. We believe that our extensive body of work on government contracting permits some observations and suggests some questions that the Committee might find useful.

Contracting Is Already Extensive

For more than 40 years, it has been government policy to rely on the private sector for commercial goods and services. Office of Management and Budget (OMB) Circular A-76 is the federal policy that governs how contracting out decisions are made. 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. While we have often commented on the cumbersome nature of the circular and its drawn-out disruptiveness in application, we have also consistently endorsed the concept of encouraging competition as a sensible management approach that can lead to more efficient and effective government operations.

OMB's rigid controls over personnel ceilings have caused government agencies to rely increasingly on contracting out as a major tool of government. Agencies created in the past 2 or 3 decades, such as the Department of Energy (DOE), the National Aeronautics and Space Administration, the Environmental Protection Agency, and the Health Care Financing Administration, typically have relied from the start on contracting out most of their work rather than performing it directly. Contractors have almost completely replaced federal employees in some functions, such as cleaning services, travel management, and most recently personnel security investigations. Employment at the General Services Administration (GSA) has fallen from 35,800 in 1980 to 16,200 in the fiscal year 1996 budget. The federal workforce today stands at slightly fewer than 2 million, and the estimated $115 billion personnel costs for federal employees compares to fiscal year 1995 obligations of about $65 billion for the purchase of goods, and $116 billion for construction, R&D, and other service contracts.

Policy Changes From Enactment of S. 1724

The Freedom From Government Competition Act would greatly increase the proportion of government activity carried out by private contractors. Section 3 of S. 1724 would essentially replace Circular A-76's policy of competition with a rule that "each agency shall obtain all goods and services necessary for or beneficial to the accomplishment of authorized functions by procurement from private sources." There are only three specific exceptions to this general rule: (1) when the goods or services required are inherently governmental, (2) when government performance is necessary in the interests of national security, or (3) when commercial practices cannot satisfy "unique requirements of the agency."

Under these exceptions, activities exempt from the contracting requirement are likely to be substantially reduced from current practice. Section 7 (b) of the bill provides a definition of inherently governmental functions that is drawn from but considerably less qualified than the definition provided in OMB Policy Letter 92-1, which we presume it would replace. Policy Letter 92-1 also provides several other examples that seem to address the exemption under S. 1724 dealing with national security. For example, in the letter, OMB lists as inherently governmental (1) the command of military forces, (2) the formulation and conduct of foreign relations, and (3) the direction and control of intelligence operations.

The exemption for cases where "commercial practices are not sufficient to satisfy unique requirements of the agency for the goods and services" could take two meanings. First, the good or service itself might be unique to the government and, therefore, not available commercially. Given the current broad use of contracting for goods and services, such exceptions would be rare. Even postage stamps are today produced by contractors in competition with the Bureau of Engraving and Printing. Second, the characteristics of the good or service might be unique to the government, e.g., the level of reliability. However, Department of Defense (DOD) procurements have for years included such unique requirements. Although under section 5 of the bill OMB is to issue regulations, there appears to be little, if any, flexibility for OMB to deviate from the general rule and its three specified exemptions.

The issue of contracting out has given rise to a number of policy debates over the years. The nondiscretionary nature of the general rule in S. 1724 would have the effect of settling these debates, almost always in favor of contracting out. There are several considerations that weigh in these debates under current policy, yet would not be cause for exemptions under S. 1724. Some examples follow.

Negative Cost Comparisons

Current government policy requires contracting out decisions to be made on the basis of cost comparisons, i.e., contracts are to be let when it is less expensive to do so, but (in general) not when contracting costs more than government performance. The proposed conversion could entail significant additional costs to the government if the performance of certain functions or activities by government employees would be less costly than contracting. Our work has uncovered many such cases where government performance was more cost-effective than contractor performance and overall shows no clear-cut cost advantage to either contractors or the government. There are examples of cost savings on both sides.[1] Our review of the depot maintenance public-private competition program revealed that 67 percent of the 95 non-ship competitions were won by DOD depots—with winning public sector offers averaging 40-percent less than their closest private sector competitor.[2] Over the history of the A-76 program, government performance won about 50 percent of the cost comparisons. Early on in the program, private sector contractors won over half of the competed activities, but as the most obvious targets were converted, the proportion of instances where government performance was competitive has increased.

Absence of Effective Competition

The private sector's capacity and willingness to provide all goods and services is not always clear—at least at a reasonable price. In reviewing efforts to contract out commercial activities, we have observed that competition for all activities in all locations can be limited. In 31 percent of the solicitations we looked at in a random selection of Public Buildings Service commercial activities from 1982 to 1992, there was only one, or no, technically responsive and financially responsible offeror for the activity.[3] Also, if one contractor dominates the federal market for a particular function in an area or region, this can put the government at risk in terms of both cost and performance. For 23 percent of the competitions we

[1]Government Contractors: An Overview of the Federal Contracting-Out Program (GAO/T-GGD-95-131, Mar. 29, 1995); Government Contractors: Measuring Costs of Service Contractors Versus Federal Employees (GAO/GGD-94-95, Mar. 10, 1994); Public-Private Mix: Effectiveness and Performance of GSA's In-House and Contracted Services (GAO/GGD-95-204, Sept. 29, 1995); Postage Stamp Production: Private Sector Can Be a Lower Cost Optional Source (GAO/GGD-93-18, Oct. 30, 1992); and Energy Management: Using DOE Employees Can Reduce Costs for Some Support Services (GAO/RCED-91-186, Aug. 16, 1991).

[2]Defense Depot Maintenance: Privatization and the Debate Over the Public-Private Mix (GAO/T-NSIAD-96-148, Apr. 17, 1996).

[3]Public-Private Mix: Effectiveness and Performance of GSA's In-House and Contracted Services (GAO/GGD-95-204, Sept. 29, 1995).

reviewed for depot maintenance services, there were no private sector offerors, and for another 35 percent, only one private sector offeror.[4]

Quasi-Private Sources

The bill does not define “private sources,” and a clarification might be needed if Congress believed agencies should be able to use the services of federally funded research and development centers; government corporations; mixed-ownership enterprises; and perhaps the U.S. Postal Service, which competes for government business in several of its markets, such as overnight delivery and package delivery.

Benchmark Capacity

In contracting out functions, some cities have found that continuing to retain at least a small, in-house operation provides a useful benchmark for determining whether contracted services are being provided at a reasonable cost and level of quality. For instance, such in-house capacity provides some assurance that contractors do not initially bid below cost and subsequently raise fees after the government has become fully dependent on the contractor. Retaining some modicum of capacity within the federal government for various contracted functions may be similarly desirable.

Public Buildings

As a general matter, we note that no definition of goods is provided in the bill. Since the government has few operations that result in the production of “goods,” the primary application of the bill to physical goods could involve the inventory of public buildings. GSA owns about 53 percent of its space and leases the rest. Our work has shown that leasing office space is cost-effective for short-term space needs but that ownership of federal buildings can pay off in the long run. While many of these facilities may have a market in the private sector, a massive divestiture over the short term could raise a number of issues. For example, since asset sales are not scorable as budget savings, proceeds from these sales could not be used to offset any new leasing costs.

Other considerations that today occasionally lead to decisions not to contract out include services below a minimum value threshold where contracting could be cumbersome or inappropriate; a situation where flexibility is essential to the performance of a function, making it difficult to specify contract requirements in output form; and when some modicum

[4] Defense Depot Maintenance: Commission on Roles and Mission’s Privatization Assumptions Are Questionable (GAO/NSIAD-96-161, July 15, 1996).

of government capability would help provide government employees technical expertise to judge private sector performance.

Conversions to Contract Performance Could Pose Daunting Implementation Challenge

In our view, the practical challenge of converting nonexempt government activities to private sector performance should not be underestimated. This task may impose a substantial contracting workload on federal agencies within a relatively short time frame. OMB would be charged with developing a schedule to transfer all government activities that are inconsistent with the bill's requirements to the private sector. The schedule is to provide for the completion of the transfer within 5 years after OMB's report is transmitted to Congress. The existing contract administration capacity of federal agencies may be overwhelmed by such a large-scale, short-term conversion.

Converting all government functions targeted for contracting out within 6 years seems like a very optimistic expectation. First, translating a broad list of commercial functions into specific procurement actions could prove difficult and time-consuming. The government's experience with the A-76 inventory of commercial activities provides some evidence and insights into this process. Quite simply, it takes time to identify and review specific activities. For example, GSA took 11 years to finish reviewing and soliciting the activities in its A-76 inventory, even though most were directly converted to contracts instead of going through formal cost-comparison studies. There were 10 broad functions represented in the inventory, but those functions involved almost 900 separate activities. In general, OMB has had difficulty getting federal departments and agencies to meet even minimal goals for reviewing commercial activities in their inventories.

Second, despite recent reforms to the federal procurement process, soliciting and awarding contracts takes time. For large contracts it can take over a year between the original procurement request and the final approval of a contract and notice to proceed. Other state, local, and foreign governments that have initiated aggressive contracting-out programs have experienced frustrating delays.

A third factor that has been a long-standing concern for us is that conversion to contract performance requires considerable contract management capability. To start, an agency must have adequate capacity and expertise to successfully carry out the solicitation process, from defining the scope of the contract, to soliciting the requirement, to evaluating cost and technical proposals of interested offerors. Then the

government must be able to effectively administer, monitor, and audit contracts once they are awarded. However, OMB, agency inspector general offices, and we have identified serious shortcomings in the contract management practices and capacities of federal agencies. Dramatically increasing the existing contracting burden of federal agencies without first addressing these weaknesses may be risky.

A common criticism has been that agencies have not given sufficient management attention to contract administration. Emphasis is placed on the award of contracts, not on ensuring that the terms of the contract are met or that the contract is properly managed after it is awarded. In past products summarizing work on governmentwide contract management, we identified major problem areas, such as ineffective contract administration, insufficient oversight of contract auditing, and lack of high-level management attention to and accountability for contract management.[5] An interagency SWAT team created by OMB to examine and assess contract administration and auditing practices of 12 civilian agencies found serious deficiencies in contract administration and oversight.[6] The OMB report concluded that the problems resulted from inadequate management attention, ambiguous regulatory guidance, ineffective procedures, inadequate resources, and poor communication between contract administration and audit staffs.

DOE provides an example of an agency that is as heavily dependent on contracting as the rest of the government would be under S. 1724. DOE has more than 110,000 contractor employees, overseen by a federal workforce of about 18,675, a 6-to-1 ratio. Historically, these contractors have worked largely without any financial risk, had little fear of competition, and got paid even if they performed poorly; DOE oversaw them under a policy of least interference.[7] We declared DOE's contract management a high-risk area because of its high vulnerability to waste, fraud, abuse, and mismanagement. The recent Secretaries of Energy have declared reform of contract management practices a major management priority.

[5]Government Earns Low Marks on Proper Use of Consultants (GAO/FPCD 80-48, June 16, 1980); Civilian Agency Procurement: Improvements Needed in Contracting and Contract Administration (GAO/GGD-89-109, Sept. 5, 1989); and Federal Contracting: Cost-Effective Contract Management Requires Sustained Commitment (GAO/T-RCED-93-2, Dec. 3, 1992).

[6]Summary Report of the SWAT Team on Civilian Agency Contracting, Office of Management and Budget (Washington, D.C.: Dec. 3, 1992).

[7]Department of Energy: Observations on the Future of DOE (GAO/T-RCED-96-224, July 23, 1996).

The effects of recent federal downsizing may exacerbate these persistent contract management problems. Agencies may have lost valuable contract management and procurement personnel who have been differentially targeted in recent downsizing efforts as excess layers of middle management. We have anecdotal evidence of this diminishing capacity from a number of recent and ongoing reviews at various agencies.

In conclusion, Mr. Chairman, striking a proper balance between the public and private sector provision of goods and services to the American people is an enduring and perhaps the central issue in American politics and public policy. The Freedom From Government Competition Act would sharply change current policy, which does not have the weight of legislative authority. We believe that Congress is the proper forum to address such fundamental questions, and we hope that our testimony today has raised some good questions for the Committee to consider in its deliberations on the proposed act.

That concludes my prepared statement. I would be pleased to answer any questions the Committee may have.

Related GAO Products

Defense Depot Maintenance: Commission on Roles and Mission's Privatization Assumptions Are Questionable (GAO/NSIAD-96-161, July 15, 1996).

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