

THE POLITICS OF COMPETITIVE SOURCING:  
COST SAVINGS, TRANSACTION COSTS, TRADE-OFFS  
AND TRADITIONAL PUBLIC VALUES

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ABSTRACT

This dissertation examined the impact of costs savings on public-private competitions and the underlying forces driving competitive sourcing policy. This research is significant because it challenged the assumption of thirty percent savings when conducting a standard public-private competition. Also important is that this dissertation closely analyzed whether cost savings was the primary force driving competitive sourcing policy.

The methodology used in this dissertation was a mixed model, which employed both quantitative analyses and qualitative interviewing. The quantitative model analyzed data on public-private competitions conducted on commercial

activities in the Department of Defense from 1979-1994. This analysis also included transaction costs that accounted for contract support and government administration involved in the competitive sourcing process. The qualitative interviews asked two groups of federal government personnel questions regarding their agency experiences with competitive sourcing policy. The first group consisted of personnel directly involved in the implementation of competitive sourcing. The second group included Competitive Sourcing Officials (CSOs) or their designated agency representative(s). Additionally there was a historical content analysis that examined both the evolution of public values through government contracting and the development of competitive sourcing policy.

The findings from this dissertation indicate three overarching themes. First, transaction costs matter and may dramatically impact the amount of cost savings produced through competitive sourcing. Second, the thirty percent cost savings figure reported in a number of studies could not be replicated, but it should be noted that savings did

occur on a much smaller scale. Third, cost savings are not the only force driving competitive sourcing policy. Politics, public values and competing organizational goals have also played an active role in the development of competitive sourcing. A tangential theme of some importance was the representation of cost savings as a public value. Overall this research allows for a better understanding of the transaction costs, trade-offs and politics involved in the federal government's competitive sourcing policy.

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## CHAPTER ONE:

### INTRODUCTION

#### Overview

The desire for cost savings and efficiency in the provision of federal services has been a pervasive theme running throughout many quarters of government. Some believe that contracting for services with the private sector saves money and promotes efficiency. Others are less enamored with the idea of using contractors to provide services traditionally performed by government. Moreover, they fear that this situation will cause a loss of government control and oversight. Reconciling these opposing points of view has become a challenge for policy-makers seeking to infuse the federal government with the use of public-private competitions.

In the President's Management Agenda (PMA) President George W. Bush stated, "government should be market-based, we should not be afraid of competition, innovation and choice. I will open the government to the discipline of

competition" (Bush, 2001). Competitive sourcing is the formal policy initiative that directs the federal government to conduct public-private competitions for commercial activities.

Angela Styles the former Administrator for OMB's Office of Federal Procurement Policy (OFPP) stated in testimony before the U.S. Senate's Committee on Governmental Affairs, "experience demonstrates that the use of the public-private sector competition consistently reduces the cost of public performance by more than thirty percent" (Styles, 2002). However, in the most recent report on competitive sourcing OMB's saving projections had dropped to around fifteen percent (OMB, 2004). Additionally, other reports had claimed that the talk of great cost savings did not always add up (GAO, 2001a; Sawicky, 2003).

This dissertation will seek to unravel the controversy surrounding cost savings and better understand the factors driving competitive sourcing policy. The remainder of this chapter presents a brief background on the problems analyzed in this study, the research questions, an overview of methodology, a definition of key terms and an outline of the forthcoming chapters.

The Challenges of Competitive Sourcing

This dissertation used a mixed model approach to thoroughly examine competitive sourcing. The following includes a brief discussion on the quantitative and qualitative problems addressed in this study.

*Cost Savings Controversy*

The quantitative portion of the dissertation examined the cost savings estimates generated through the use of competitive sourcing. This detailed analysis of cost savings was important since the foundation of the competitive sourcing policy rests largely on the accuracy of two studies conducted by the Center for Naval Analyses (CNA). The 1997 study, *Bidding Behavior in DoD's Commercial Activities Competitions* presents an econometric model that is the basis of the oft-quoted thirty percent savings figure. The 2001 CNA study, *Long Run Costs and Performance Effects of Competitive Sourcing* is primarily qualitative and reaffirms the savings figures based on an analysis of sixteen public-private competitions.

Additional research conducted by the RAND Corporation and the IBM Endowment for Government again validated these cost savings estimates without a substantive evaluation of

CNA's findings. While both studies confirmed the savings, questions arose regarding the costs included in the CAN analysis. Moreover, the RAND researchers noted:

There are reasons to believe that the current expectations of savings from competitive sourcing are overly optimistic with regard to the process of conducting these competitions as well as the savings generated from those that are completed (Gates and Robberts 2000).

The estimated savings generated from the use of competitive sourcing does not come without a fair amount of controversy. Defining the actual savings generated by competitive sourcing has been problematic. The thirty percent savings widely quoted from the CNA study completed in 1997 did not control for the costs of each A-76 study, the 'soft cushion' that would be required to separate federal employees and the expense of oversight responsibilities (Gates and Robberts 2000). These omitted variables may have had a significant impact on the cost savings reported in the study.

Also important to note is that some of the assumptions within these studies have been questioned by both the Government Accountability Office (GAO) and the Economic Policy Institute (EPI). Yet, to this date a replication of the data has not been completed. This study analyzed the

accuracy of these savings projections and whether they can be sustained over long periods of time.

#### *Identifying Factors Motivating Policy Evolution*

Competitive sourcing is a public policy that strives to achieve cost savings whenever possible. However, the public environment in which competitive sourcing operates, may have played a key role in the development of the policy. If this is in fact the case, then competitive sourcing while focused on the achievement of cost savings through public-private competitions, may be orthogonally related to a number of divergent public values. Yet the relevance and impact of these issues to competitive sourcing has not been comprehensively studied.

The means to achieving a greater understanding of competitive sourcing in this portion of the dissertation study was derived from historical analysis and personal interviews. Both of which sought to unravel the underlying force(s) driving competitive sourcing. These efforts also helped to identify challenges involved in the policy implementation process.

Research Questions

This dissertation studied two primary research questions, which examined cost savings and the factor(s) driving competitive sourcing. The research questions follow:

- 1) How much cost savings can realistically be attributed to the use of competitive sourcing?
- 2) Are cost savings the primary force driving competitive sourcing policy?

Methodology

The research design for this dissertation employed a mixed methodology that required both qualitative and quantitative areas of study. This mixed model methodology was necessary to provide a thorough analysis of the quantitative model of savings and to examine qualitative factors affecting the evolution of competitive sourcing policy. The use of mixed methods provided a triangulating effect that looked at both the convergence of results and complementarity, which allowed for examination of overlapping phenomenon and expansion of the scope of the project (Tashakkori and Teddlie 1998).

The quantitative study attempted to replicate cost savings estimates produced by CNA. Moreover, the data used in the quantitative portion of the dissertation was also provided by CNA. This data was generated from the Department of Defense's (DoD) Commercial Activity Management Information System (CAMIS) database. More specifically, the data included 2,126 A-76 competitions conducted in DoD between 1979-1994. There was also the addition of relevant transaction cost data included in the model. The techniques of analysis used in the study employed both cross-tabulations and multivariate regression. A more detailed presentation of the methodology used for the quantitative model is provided in chapter seven.

The use of qualitative methods in this dissertation included both historical content analysis and personal interviews. The historical content analysis was principally refined to the initial chapters of the project, which examined the evolution of contracting and competitive sourcing. Whereas, the personal interviews were performed in the later portion of the study on two groups of government personnel. The first group consisted of government personnel directly involved in recent A-76

competition(s). The second group interviewed was composed of agency Competitive Sourcing Official (CSOs) or their designated representatives. Interview questions and propositions were developed as methodological comparison points. It should also be noted that many of the interviewees desired some level of confidentiality. This was granted by the researcher and later reflected in citations that provided only the year of the interview. The researcher felt this allowed for a more free flowing discussion about competitive sourcing. A more focused discussion on qualitative methodology is provided in chapter seven.

#### Definition of Terms

The definition of a number of important terms is necessary for a thorough understanding of competitive sourcing. Table 1.1 on the next page provides a listing of these terms.

Table 1.1\* Definitions of Key Terms

A-76 Study	A formal evaluation of sources to provide a commercial activity that use pre-established rules. OMB Circular A-76 is the policy that emphasizes the need for the federal government to rely on commercial sources for the provision of goods and services. A-76 is now used synonymously with competitive sourcing.
Commercial Activity	A specific task or grouping of tasks that provides a specialized capability, service or product based on a recurring government requirement. These are generally activities obtainable from a commercial source.
Competitive Sourcing	A policy that involves conducting public-private competitions to compare the performance of a government organization with that of the private sector or other non-federal organizations.
Competitive Sourcing Official (CSO)	An inherently governmental agency official responsible for the implementation of OMB Circular A-76 within an agency. The person is generally an Assistant Secretary level appointee.
Contracting In	The use of another government organization or agency to perform a function that was considered for contracting.
Contracting Out	The use of a contractor to provide service delivery while the government maintains overall accountability and responsibility.
Inherently Governmental	An activity that is so intimately related to the public interest, as to mandate performance by government personnel.
Most Efficient Organization (MEO)	The staffing plan of an agency tender, developed to represent the agency's most efficient and cost effective organization. A MEO is required for a standard competition any may include a mix of government personnel and MEO subcontracts.
Outsourcing	The transfer of a function that had been performed by government employees to performance by contract or non-profit bidders. A function goes to the private sector without the opportunity for the public sector to compete.
Privatization	A federal agency decision to change a government owned and government operated commercial activity or enterprise to private sector control and ownership.
Public-Private Competitions	These are competitions between the public and private sector over the provision of commercial activities
Savings	This generally refers to the cost savings generated from an A-76 competition.

\*OMB 2003

Outline of Forthcoming Chapters

The research begins in chapter two with a historical content analysis examining whether cost savings and efficiency were the primary concerns of contracting in the federal government. Chapter two also addressed the possible evolution of public values through government contracting. Chapter three employed a historical analysis and chronology to study the development of public-private competitions through the lens of competitive sourcing policy. Chapter four presents an overview of the process and procedure, which are involved during the execution of OMB Circular A-76. Additionally chapter four provides a presentation on a number of challenges confronting competitive sourcing policy.

Chapter five examines the theory behind public-private competitions. Moreover it breaks down the literature into four specific areas; privatization, contracting-out, transaction cost studies and competitive sourcing studies. Next, chapter six provides a thorough analysis behind the problems and controversy surrounding competitive sourcing.

In chapter seven the mixed model methodology used in the dissertation is discussed. This is followed in chapter eight with a presentation on hypotheses and propositions.

Chapter eight also includes the results produced from the statistical analyses and personal interviews. Finally, chapter nine provides a discussion on the key findings from both the quantitative and qualitative research. Chapter nine also includes sections on the limitations to the study, areas for future research and a brief conclusion.

CHAPTER 2

GOVERNMENT CONTRACTING IN THE PAST AND PRESENT:

AN EVOLUTION OF PUBLIC VALUES

*Introduction*

Contracting has been an integral part of the American experience since the birth of our nation. Back then, General George Washington relied on hand written contracts with merchants, tradesman and farmers to provide provisions and armaments for the Continental Army. Today, the complexity of contracting with the federal government has increased exponentially. Yet, the ubiquity of the contractual relationship persists as a powerful force shaping the federal government. This may be attributed to the evolution of a public value system, which for the most part has engendered trust and confidence in the American system of contracting. This chapter will look at the history of government contracting in terms of public values like capacity, regularity, accountability, equity, integrity, transparency and efficiency.

This chapter provides important historical background on the development of competitive sourcing through the lens of government contracting. Competitive sourcing is legally rooted in Bureau of Budget Bulletin 55-4, but an understanding of some of the key moments in the history of government contracting provides important insights into an evolution of public values. Thus, an understanding of competitive sourcing begins with an examination of government contracting. This chapter provides detailed discussion on the development of public values in government contracting, which are also directly relevant to competitive sourcing.

### Capacity

The debate over whether to provide public services with in-house government personnel or to rely on the use of private sector contractors has been part of American political discourse for over two hundred years. The crux of this debate revolves around the need for a public capacity to provide goods and services. Over the course of history, the discussion over capacity has run the gamut from the nationalization of entire industries to the virtual complete reliance on contractors. Competitive

sourcing is a policy that tries to encapsulate the debate over capacity using cost comparison information between in-house bidders and private contractors. Yet understanding government contracting from a historical perspective adds key insights into the value of capacity.

#### *Early Concerns Over Capacity*

The concern over capacity goes back to the Revolutionary War when General George Washington's Continental Army was desperate for supplies. The local farmers and merchants would oftentimes raise the prices of needed foodstuffs to excessive rates. This would force Washington into a decision on whether to impress the goods outright or pay the farmers' high prices (Nagle, 1999). Washington would generally pay the lofty prices but this raised questions over wartime profiteering. "Washington believed the scarcity of forage was artificially created by persons monopolizing the supply to raise prices and thereby profit from the Continental Army's distress" (Nagle 1999, 44).

The Continental Congress' proposed remedy to this situation was a system of contracts administered by Robert Morris. He stated:

Experience has sooner or later pointed out contracts with private men of substance and talents equal to the undertaking as the cheapest, most certain, and, consequently, the best method of obtaining those articles, which are necessary for the subsistence, covering, clothing, and moving of an Army (Risch 1981, 8).

Thus, contractors became responsible for the capacity to supply the Continental Army. However, many viewed the contractors contemptuously, as greedy merchants bent on self-interest, offering nothing more than poor performance and steep prices (Nagle 1999).

In 1783, after the close of the Revolutionary War Alexander Hamilton argued for "the public manufacture of arms, powder, etc" (Matloff 1968, 108). He recognized that to maintain independence the U.S. needed to cultivate it's own arms industry. Similar sentiments were echoed in 1793 by Secretary of the War Henry Knox, when he told Congress "the bargain price of European arms mattered little compared with the solid advantages which would result from extending and perfecting the means upon which our safety may ultimately depend" (Matloff 1968, 108). The result was the establishment of public armories in Springfield, Massachusetts and Harpers Ferry, West Virginia.

During the War of 1812, capacity again became a concern when the contracting system virtually broke down. Callendar Irvine the Commissary General for Purchases

argued that shoddy clothing was the direct result of contractors that neglected quality and paid slave wages to their workers (Nagle, 1999). Irvine charged that these workers were "pinched almost to death... they were paid scarcely enough to give them salt for their marsh" (Risch 1981, 146-147). Irvine initiated a public system of production for uniforms, so that the government would not have to rely wholly on contractors. Yet, there was another role for capacity to play in the development of contracting.

Alexander Hamilton had previously realized the need for a public and private capacity in the arms industry. The necessity to develop private capacity was fostered through the use of educational orders.

These were contracts with promising manufacturers to educate them in the making of essential items and to help them prepare their factories and work forces in case of an emergency (Nagle 1999, 90).

Although some like Irvine emphatically stated "we cannot rely upon contractors for arms" (Joy 1976, 148). Many others like President James Madison and Alexander Hamilton understood the need for the development of private capacity through contracts in order to stimulate economic growth and innovation.

*The Steel of Capacity*

Capacity again came to the forefront of discussion in 1913, when the steel industry threatened to withhold armor plate production for Navy battleships. One of the problems was that there were only three steel companies that could produce the needed armor plates. When this was tied to a poor incentive structure each contractor chose to bid a mutually acceptable high price for Navy work (Nagle, 1999). Another problem was the challenge of creating competition between these bidders. The fear was if one steel company consistently won government bids the others would move into new markets. If this occurred it could create a situation where the government might be dependent on only one steel producer with essentially no competition and little incentive to maintain cutting edge technology.

The Secretary of the Navy Josephus Daniels and many in Congress knew something had to be done to correct this situation. Thus, a plan for the public provision of steel making was set into place. Secretary Daniels felt so strongly about this situation that he commented:

It appears on further investigation that there is a combination, conspiracy or collusion amongst the steel manufacturers to such an extent that the government cannot secure steel products at a reasonable price and on bids that are actually competitive. I am inclined to believe that the only method by which Government can compel actual competition will be by establishing its own facilities for the manufacture of armor plate, guns forgings and other steel products. (Hessen 1975, 219).

Congress later appropriated money to start up a steel plant in South Charleston, West Virginia.

#### *Capacity During the Interwar Period*

Prior to World War II (WWII) there were concerns over the costs and profits achieved through the letting of air manufacturing contracts for the Army and Navy. In 1934, Chair of House Naval Affairs Committee Carl Vinson launched a congressional investigation. As Vinson said:

We want to know what profits these people make and we want to know whether there is favoritism or trickery in obtaining contracts... we want a clear picture of those companies that sell almost exclusively to the government (Rutkowski 1966, 67-69).

The investigation found that several large corporations had monopolized Army and Navy air manufacturing contracts through smaller contractors and that profits earned were not included by these parent corporations because of loopholes in existing income tax law (Simonson, 1968). Excessive profits were soon discovered by virtually all of the major contractors. Congressional indignation over the

findings of this investigation resulted in the Vinson-Trammel Act.

The Vinson-Trammel Act expanded the public capacity to provide operations at Naval Aircraft Factories (NAF). More specifically, it required the Navy to build at least 10 percent of all of its aircraft at NAFs (Nagle, 1999). For those contracts that were let to the private sector the Vinson-Trammel Act set additional requirements. Moreover, it placed strict limits on profits from Navy contracts and mandated complete access for government audit and inspection activities. Thus, the existing public capacity provided a congressional lever against contractor improprieties and helped force compliance.

During this time there were also festering allegations of exorbitant profiteering from World War I (WWI) contracts. The Nye Committee investigated and found that a dependent relationship existed between contractors and many war mobilization agencies, most notably the Armed Services. Its final report was released in 1936, with the recommendation for part to full nationalization of many wartime industries, thereby increasing public capacity. The Nye Committee hoped that this would rid the country of

an "unhealthy alliance" between contractors and the government (Cypher, 1973).

#### *Capacity Conclusion*

The need for some level of public capacity has been an important part of the transformation of the United States from an agrarian society to a modern industrialized nation. Capacity has been used to create needed jobs through the formation of the Civilian Conservation Corps and other social programs during the Depression of the 1930s. It has served to stimulate innovation and technology in private enterprises like the airline industry and arms industry. There has also been the need for some form of public capacity to serve as a benchmark for reasonable costs and in some instances to provide a lever of competition against private contractors. Capacity is closely linked to the public value of regularity, which will be the focus of the next section.

#### Regularity

An increased reliance on contracting sometimes creates a situation that places government officials in the unenviable position of not having the expertise to intelligently buy or monitor needed goods and services.

"The presumption of regularity assumes that officials should possess the skills and experience needed to supervise and evaluate work performed by government and contractor personnel" (Guttman 2004, 330). Another part of regularity is concerned with the rule of law. Moreover, public officials should be subject to laws that limit their authority and make them accountable to the public they serve (Wang, 2000). Thus, regularity seems to be the nexus between capacity and oversight.

The need and desire for regularity has been reflected throughout the history of government contracting. In many instances, the federal government tried to employ individuals with knowledge and proficiency in a specific area that was directly germane to the letting of a contract (Nagle, 1999). This became a larger concern as the scope and breadth of contracting grew after World War II (WWII) under the guise of the military industrial complex.

#### *Public Law*

The public law tradition of regularity assumes that a public official is accountable for the work performed by the government or contractor under the law. In 1884, *Moffat v. U.S.* (112 U.S. 24):

The presumption as to regularity of the proceedings.. is founded upon the theory that every officer charged with supervision, and acting under obligation of his oath, will due his duty, and is indulged as a protection against collateral attacks of third parties.

The presumption of regularity was again found in 1926, *U.S. v. Chemical Foundation Inc.* (272 U.S. 1). "The presumption of regularity supports the official acts of public officers and, in the absence of clear evidence to the contrary, courts presume they have properly discharged their duties". Regularity was again found in *U.S. Postal Service v. Gregory* (534 U.S. 1 [2001]), "we note that regularity attaches to the actions of government agencies.

Another aspect of regularity is that public law may not have to directly apply to a contractor as long as there is a government official that can be held accountable. Furthermore, this public official is obligated to represent the interests of the public, the contractor and the agency (Cooper, 2002). The recent challenge encountered with regularity has been the movement of work to a contractor workforce that avoids public constraints under the auspices of increased performance (Gilmour and Jensen, 1998).

#### *The Bell Report*

In 1962 President Kennedy's Bureau of Budget Director David Bell led a task force to review the experience of the

government in using contracts with private institutions and enterprises that were performing work for public purposes (Danhof, 1968). The "Bell Report" found three major findings:

- 1) declared that reliance on contractors and grantees blurred the traditional dividing line between the public and private sectors of our Nation
- 2) deemed it axiomatic that government officials must do the work and maintain the competence required to account for all government work
- 3) warned that, without corrective action, a brain drain into the contractor workforce would result (Guttman 2004, 327).

The warnings of the Bell Report alerted many to the dangers that could be created by dependence on contractors. "The report pointed out that there must be sufficient technical competence within the government so that outside technical advice does not become de facto decision making" (Danhof 1968, 120).

#### *Inherently Governmental Functions*

Regularity was formalized to some degree in 1979 under OMB Circular A-76, when some federal functions were seen as being inherently "governmental in nature". This changed in 1992 with the release of Office of Federal Procurement Policy Letter 92-1.

An inherently governmental function is a function that is so intimately related to the public interest as to mandate performance by Government employees. These functions include those activities that require either the exercise of discretion in applying Government authority or the making of value judgments in making decisions for the Government (OFPP, 1992).

Although the definition of inherently governmental function is fairly broad it does provide general guidelines for agency decision-making regarding regularity. Moreover, maintaining some level of regularity is essential to any discussion on accountability, which will be the focus of the next section.

### Accountability

The subject of accountability has long been the source of much discussion within the realm of government contracting. "Accountability is a core value in democracy. A democratic government exercises power on behalf of its citizens, who have a legitimate interest in what is done in their names" (Davies 2001, 76). Accountability as a whole, places external checks on federal contracting activity to ensure trust and to prevent malfeasance in the public interest (Rosenbloom, 2000). Some of the external checks developed to prevent abuse in government contracting have come in the form of congressional oversight,

standardization of procurement practices and agency reorganization and centralization.

The need for accountability in government was discussed openly by James Madison in *The Federalist Papers*:

If angels were to govern men, neither external or internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: You must first enable the government to control the governed; and in the next place oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity for auxiliary precautions (Madison, 1961).

Madison's statement may have in part been influenced by troubles with contracting for the Continental Army during the Revolutionary War. During this period, the majority of government contracts were problematic because of scandal, profiteering and conflicts of interest with public officials (Nagle, 1999). Something had to be done to ensure accountability became an important value to be upheld by those involved with government contracting.

### *Investigations*

Congressional oversight became a mainstay in ensuring accountability in the government contracting process. The first congressional investigation examined the events surrounding the failure of the St. Clair expedition in 1792. A large part of the investigation dealt with "the

gross and various mismanagements and neglects in the Quartermaster's and contractor's departments" (Kreidberg and Henry 1955, 29). The findings showed that poor mobilization planning and contractor self-interest may have been the primary causes for the expedition's failure.

The next major investigation involved the Indian Trust Fund Scandal of 1860. "More than anything else in the history of government contracting this scandal seared in the public's mind with the conviction that contractors were unscrupulous scoundrels interested only in money" (Nagle 1999, 150). Some viewed this scandal as an accountability breakdown between high-ranking public officials.

In the years following the Indian Trust Fund Scandal there seems to be a shift to a committee oriented system of congressional investigations involving contracting. Many of the more notable congressional committees and commissions investigating government contracting sought actual reforms. The Van Wyck Commission investigated charges of fraud during the Civil War and saw the passing of an anti-fraud act that required all contracts to be written and signed. In 1934, Senator Hugo Black oversaw a committee investigating price and route fixing for airmail contracts, in what would later be called the "spoils

conference". The end result was the cancellation of all airmail contracts and the Black-McKellar Act, which required a separation between airline companies and aircraft manufacturers. The interim fix to keep airmail service going was the use of Army and Navy pilots.

In 1934, the Nye Committee investigated allegations that defense contractors lobbied for U.S. entry into World War I, as a means to increase their profits. This was later called the "merchants of death" theory of war, but the Nye Committee could not firmly substantiate any of the claims. However, this did contribute to the increased congressional scrutiny over defense contractors.

During World War II, the Truman Committee investigated government contracting and made some interesting findings. "It has been the policy of the Army and Navy to let contracts to big contractors and to big business because it is the easy way out" (Kaufman 1972, 134). In other words a small percentage of contractors saw an inordinate share of wartime profits. After World War II, Truman wrote:

I have had considerable experience in letting public contracts and have never yet found a contractor who, if not watched would leave the government holding the bag. We are not doing him a favor if we do not watch him (Wiltz 1975, 2124).

The Murray Committee investigated the concentration of contracting with large firms like General Motors, General

Electric and DuPont. The end result was legislation that resulted in the Small Business Mobilization Act of 1942. This bill attempted to mobilize the production capacity of small businesses and later led to the enactment of the Small Business Act of 1953.

*Standardization and Centralization*

The standardization of contracting was an important step in the establishment of an accountability system that included procedures and inspections for government agents. Standardization evolved out of an act regulating the Ordnance Department in 1815. This act included provisions for the chief of ordnance to "draw up a system of regulations for the uniformity of all arms ordnance, ordnance stores, implements and apparatus" (Smith 1985, 43-44). Additionally, it included the use of 'artificers' or government agents to oversee the contracts. Standardization was also needed to ensure uniformity and quality standards with the advent of mass production techniques used for publicly contracted goods like guns.

Standardization allowed for the development of inspection procedures designed to measure contractor work. Moreover, Eli Whitney's mass production capability and

Simeon North's use of interchangeable parts in the manufacturing of rifles required a standardized contracting vehicle. A U.S. Army contract issued in 1828 stated "said rifles shall have perfect uniformity of their respective component parts" (Fuller 1946, 152). Another important point in the standardization of contracts came from the Postal Regulations of 1859. These regulations required contract bidders to adhere strictly with posted advertisements and to use the Postal Department's printed forms for bid submissions. Additionally, bids could not be withdrawn after being submitted and each bid had to be guaranteed by two public officials (Nagle 1999).

The Civil War started a trend in contracting that showed a strong preference for results and efficiency at the expense of accountability. In short, if military exigency required an item, than many if not all of the normal contracting procedures were suspended and immediate purchase could be authorized from virtually any source. In these case(s) accountability seemed to be traded off for immediate results. However, with the suspension of accountability standards and procedures there seems to be a corresponding increase in fraud and profiteering (Davies 2001).

The importance of accountability evolved from standardization of individual contracts to the need for centralized controls over all government procurement activity. In 1893, the Dockery Commission noted a lack of control and coordination over federal procurement processes. "The Dockery Commission found government paying too much for the same articles and first advanced the concept of commonality - standardizing government specifications and then making quantity buys" (Reeves 7, 1996). Congress amended the governing statute by stipulating one bid for each agency and by requiring a three member Board of Awards to look over contractor proposals.

The changes made by the Dockery Commission did not work as well as planned, which led to President Theodore Roosevelt's formation of the Keep Commission. The Keep Commission complained about a poorly administered contracting system that lacked purchasing coordination and standardized procurement practices. The end result was the centralized purchasing of government supplies via the creation of the General Schedule of Supplies in 1909 through Executive Order 1071. This was followed by the establishment of the General Supply Committee in 1910. The

result was the standardization of procurement procedures and the mandatory use of government forms to ensure bidder accountability via a tighter control on agency discretion (Whelan and Nagle 2002).

After World War II accountability again came to the forefront of concern in government contracting. The Armed Service Procurement Act (ASPA) was passed in 1947 and was immediately followed by the joint service issuance of the Armed Service Procurement Regulation (APSR) in 1948. The ASPA sought to standardize procurement practices throughout the military and the APSR became the universally accepted guidance governing defense contracting (Reeves 1996). Although standardization in contracting was very important, the lack of centralized control became a major area of concern for ensuring accountability.

The first Hoover Commission was formed in 1947, to examine issues involving government management and structure. One of its primary findings was that the nation was "not getting its money worth of defense because of waste and inefficiency" (Reeves 1996, 13). There was a subsequent recommendation for centralized control and "full authority for the procurement and management of supplies and materials" to be vested in the newly created

Office of the Secretary of Defense (National Security Organization Report 1949, 8-18). The Hoover Commission's recommendations led to the Federal Property and Administrative Services Act (FPASA) of 1949, which in turn created the General Services Administration (GSA). The GSA helped centralize the purchase of supplies for civilian agencies and sought to create a guiding procurement statute similar to the ASPA.

Twenty years later the Commission on Government Procurement was formed to analyze problems in government contracting. They again found, a lack of uniformity and standardization amongst federal agencies as key contributors to an inefficient contracting system. The following is an excerpt from the Commission's findings:

Procurement regulations, practices and procedures are relatively uncoordinated and often inconsistent. The volume of extensive paperwork swells yearly and procurement procedures grow more complicated every day (Commission of Government Procurement 1972).

Moreover, this commission found a maze of procurement regulations that stymied contracting efficiency. There was also a clear absence of any unifying policy that would bind government procurement together. One of the commission's primary recommendations was the creation of the Office of Federal Procurement Policy (OFPP) to act as a policy coordinator for all government procurement activity. This

was enacted by the OFPP Act of 1974. There was also a recommendation for a unified and reduced set of procurement regulations that would be applicable for both civilian and military agencies. This was established by the enactment of the Federal Acquisition Regulation (FAR) system in 1980.

The trend in federal contracting over the last decade has seen a strong tendency to favor efficiency at the expense of some measure of public accountability. This business like approach to government, advocated by Vice President Al Gore's National Performance Review (NPR) included cutting red tape and streamlining procedures. More specifically acquisition rules and regulations came under sharp attack. At roughly the same time in 1993 the Section 800 Panel was tasked "to review all acquisition laws applicable to DoD and make recommendations for repeal or amendments of laws unnecessary to the buyer-seller relationship" (Van Opstal 1995, 49). As a result many acquisition laws were repealed and others significantly amended.

The face of accountability in government contracting changed with the enactment of the Federal Acquisition Streamlining Act (FASA) in 1994 and the Federal Acquisition Reform Act (FARA) more commonly as the Clinger-Cohen Act in

1996. FASA reduced oversight on large contracts in part by reducing requirements established by the Truth in Negotiations Act. FARA greatly relaxed acquisition oversight and broadly interpreted the term commercial items to allow more vendors to enter the government market.

This section began with a prescient quote from James Madison on the importance of an accountable government. Accountability in the form of oversight through investigation and standardization has provided the foundation for a stable and trusted system of government contracting. Yet, recent legislation and reforms aimed at decoupling oversight mechanisms in favor of a more business-like efficient system of government contracting may have detrimental consequences in the future. Viewing accountability as an avoidable cost may risk the integrity of an ever-evolving system of government contracting. The value of integrity is the focus of the next section.

### Integrity

The success of contracting in the federal government is predicated on the integrity of all involved in the process. Integrity is a recognized value in the acquisition process that strives to reduce the likelihood

of corruption (Kelman, 1990). Integrity for public officials means maintaining and ensuring the public's trust. Integrity is a vital component in federal contracting that has evolved since the birth of our nation.

### *Integrity in the Early Years*

During the early years of government contracting, problems with integrity generally stemmed from conflicts of interest. The days of the Revolutionary War were fraught with merchants serving both the public and private sectors. Rather than divide their private business from their public duties, many contractor-agents pursued both interests concurrently (Nagle 1999). Moreover, this appeared to be a commonly accepted practice during the eighteenth and early nineteenth centuries as nepotism and overt favoritism were part of the nascent federal contracting system. In some instances there was public outrage, but overall this practice was generally a condoned part of government procurement.

The first remedy to this situation was the Official Not To Benefit statute passed by Congress in 1808. This statute banned members of Congress from directly or indirectly contracting with the government. Furthermore,

it required this prohibition to be written into all federal contracts. It also mandated that department secretaries must produce annual reports on contracts (Booth, 1982). Congress followed this by passing the first government wide procurement statute in 1809. This act authorized only appointed government agents to procure supplies, disburse money and make contracts. Furthermore, these agents were extraordinarily powerful because they could perform all the aforementioned functions. The importance and power of these government agent positions was underscored by the joint legislative-executive control that was exerted over the appointment process (Nagle, 1999).

The early years of government contracting played host to a number of challenges for ensuring the preservation of integrity. During the War of 1812, General Winfield Scott commented on integrity when he wrote:

In time of war contractors may betray an army; they are not confidential and responsible agents appointed by the government. The principal only is known to the war office, and therefore may be supposed to be free from this objection; but his deputies and issuing agents are appointed without the concurrence or knowledge of the general or government (Huston 1966, 114-115).

General Scott's statement points to the inherent challenges of monitoring integrity for both contractors and government agents.

*Blurring of Roles*

The blurring of roles may also be problematic for maintaining confidence in the government contracting system. This first occurred on a wide scale during America's westward expansion in the 1830s. The Army sent their engineers to help build railroads and work alongside contractors. The problem appeared when the Army engineers started working for the railroad companies for additional compensation and the public's interest became the private's interest. The Act of 1838 forbade Army engineers from working for private companies (Hill, 1957). Yet, the problem of blurring has remained to some degree with the advent of the defense industrial complex at the close of World War II.

*Defining Standards*

Mandating integrity through the use of detailed procedures again came to the vanguard of concern with the publication of the Armed Service Procurement Regulation (ASPR) in 1948. Moreover, President Truman's concerns over federal contracting compelled him to write the following to the Secretary of Defense in 1948:

I am asking you to specify detailed standards to guide your procurement officers... It is of great importance in procurement matters to establish standards and definitions to guide all personnel who have authority to place contracts (Nagle 1987, 64).

The procurement regulations promulgated in the ASPR provided detailed guidance to those involved with government contracting. Later, the creation of the Office of Federal Procurement Policy (OFPP) led to a set of uniform procurement procedures offered under the Federal Acquisition Regulation.

### *Scandal*

The soaring defense budgets of the 1980s led to an increased use of contractors and an overwhelmed government contracting system. This in turn caused fraying lines of accountability and integrity in the acquisition process. The end result was an increase in waste, abuse and scandal. An FBI investigation into fraud, bribery and the improper disclosure of competitive information within defense contracting led to a sting called Operation Ill Wind (Nagle, 1999). Many high ranking public officials and private executives were arrested during this operation. Ill Wind exposed the preferential treatment received by some contractors. There were also inappropriate disclosures of competitive and (in some instances) classified information.

Congress responded to Ill Wind and the other scandals of the 1980s by enacting the Procurement Integrity Act. This statute outlawed the disclosure of sensitive procurement information. It also imposed fines and criminal penalties on those found in violation of the act (41 U.S.C. 423). The Procurement Integrity Act led to intense congressional management over procurement and the criminalization of illegal acquisition behavior.

#### *Revolving Door*

Another important facet of integrity involves the "revolving door" of employees in the government and private sector. The revolving door is the back and forth movement of employees between government and contractor (Daley and Amey, 2004). Assuring integrity over the revolving door means understanding conflicts of interest that may arise if public officials favor one organization over another. It also means understanding the limits on gifts and other benefits that can be provided by a contractor in an effort to win government business.

The U.S. Code provides guidance on ethical standards with regards to representational activity, financial interests, outside compensation and use of information.

Although, lax enforcement over the revolving door has led some legislators to call for broadening the reach of the Procurement Integrity Act and stricter standards on employee conduct (Gruber and Cahlink, 2004). Yet, the value of integrity can only be realized if transparency is protected and provided. Transparency will be the focus of the next section.

### Transparency

The importance of transparency as a public value can readily be seen in government contracting. As Supreme Court Justice Louis Brandeis stated in *Buckley v. American Constitutional Law Foundation* (525 U.S. 223) "sunlight is said to be the best of disinfectants; electric light the most efficient policeman". Transparency in its purest form opens the government to public inquiry. The challenge in government contracting is understanding the merger of public values and private sector principles. "Governmental management tends to be exposed to public scrutiny and to be more open, while private business management is more private... and less exposed to public review" (Allison 1979, 136).

A better understanding of transparency is revealed through an examination of the evolution of government contracting. It is also important to realize that some measure of transparency is necessary for the government to succeed (Rosenbloom 2002). Some of the levers used to ensure transparency in government contracting include: advertising, the keeping of receipts and records, whistleblower provisions, certified cost and pricing data and freedom of information requests.

#### *Advertising*

One of the roots of transparency in government contracting can be found in the Act of 1792, which established the Office of the Postmaster General. The section of this statute involving mail delivery contracts, required 'public notice' in at least one or more newspapers published in Washington D.C. and in at least one or more newspapers in the state or states where the mail contracts were to be performed (Nagle 1999). The requirement for public notice was a positive step toward transparency and a move away from the charges of favoritism and fraud that plagued government contracting throughout the Revolutionary War period.

Incremental steps in the evolution of transparency in government contracting occurred slowly, first on an agency level and then toward specific government-wide activities. The Army's General Regulations of 1825, required advertising for the purchase of supplies as long as this was practicable. Additionally, a record of all bid proposals would be prepared and access would be granted to those bidders that lost a competition for a contract (Whelan and Nagle 2002). In 1836, Congress required the Post Office to use formal advertising procedures for the letting of government contracts. Finally, Congress passed an act in 1842 that required government printing contracts to be advertised in principal newspapers for a period of not less than four weeks. These piece meal steps allowed for more advertising in government contracting and paved the way for more comprehensive reforms.

The watershed statute requiring formal advertising for all government supplies and services was passed as the Civil Sundry Appropriations Act in 1861. The intent of formal advertising was to ensure a competitive and transparent contracting process for all areas of the government. Section 3709 of the Revised Statutes mandated the following:

All purchases and contracts for supplies or services, in any of the departments of Government, except for personal services, shall be made by formal advertising a sufficient time previously for proposals respecting the same, when the public exigencies do not require the immediate delivery of the articles or performance of the service (Nagle 1987, 32).

Thus, advertising now provided one tool to help assure transparency in the federal government.

Advertising was also important in ensuring that contractors met with certain design specifications. As technology advanced the need to provide explicit details to guarantee specific safety standards and performance criteria increased. The Air Corps Act of 1926 highlighted this situation and "required the advertisement of such a competition and the publication of detailed specifications of the kind and quantity of aircraft desired" (Whelan and Nagle 2002). Providing required specifications in the advertisement for the contract solicitation was another means to safeguard transparency.

#### *Record Keeping*

Another important step toward a transparent contracting process involved record keeping and receipts. An 1846 act required stringent accounting of receipts and payments. This act was signed into law as an effort to prevent embezzlement and fraudulent activity (Risch 1962).

Moreover, this statute provided a necessary step in advancing a more transparent system of accounting for public funds used in government contracting.

The availability of records moved forward with the written provisions stipulated in the Civil and Sundry Appropriations Act of 1861. Under this act a list of bid proposals for public contracts had to be made accessible to all bidders at the completion of the bid competition (USD AT&L 2004). The provisions regarding access to competitor's information and specifications were also incorporated into the Air Corps Act of 1926. This act mandated government access to inspect plants and audit the records-receipts of all aircraft manufacturers (Whelan and Nagle 2002).

#### *Whistle Blower/False Claims Act*

Another important element in maintaining a transparent system of government contracting was the False Claims Act of 1863. The advent of the Civil War required the use of a myriad of contractors to support the Union Army. Unfortunately, some contractors were unscrupulous profiteers that defrauded the government. Union soldiers were subjected to moth eaten blankets, fetid provisions,

shoddy uniforms and armament crates shipped full of sawdust rather than guns or ammunition (TAF 2004). By 1863, President Lincoln had seen enough and strongly encouraged Congress to remedy this situation through the passage of the False Claims Act, also known as Lincoln's law.

The False Claims Act was important because it established the first official whistle blower statute to be used in government contracting. It also contained "qui tam" provisions, which allowed private citizens to sue, on the government's behalf, companies and individuals that were defrauding the government. Additionally, it provided monetary incentives for the public to police unlawful activity. The Latin translation of the abbreviated phrase "qui tam" means "he who brings an action for the king as well as for himself" (Philips and Cohen 2004). This act imposed criminal and civil penalties for the filing of false claims against the government. Moreover, the person(s) who filed suits, formally known as "relators", were entitled to fifty percent of the amount recovered by the government (Philips and Cohen 2004).

The False Claims Act was amended in 1943. The changes significantly decreased the relator's reward and required that lawsuits could not be based on information already in

possession of the government (Philips and Cohen 2004). The amended act seemed to disincentivize future litigation until a subsequent amendment was passed.

The False Claims Amendment Acts of 1986 were an important check against the 1980s military build-up, which heavily relied on defense contractors. The power of the act was restored by easing the government's burden of proof, raising civil penalties, increasing the relator's share of monetary recovery and increasing the number of investigators and prosecutors (Nagle 1999). The result was a significant increase in both substantive lawsuits and government recovery from contractor wrongdoing. The revitalized use of the False Claims Act has provided a powerful tool in assuring public confidence and transparency in government contracting.

#### *Truth in Negotiations Act*

The Truth in Negotiations Act (TINA) of 1962 was passed by Congress to provide for full and fair disclosure by contractors in negotiations with the federal government. TINA was the result of Congressional concerns over excessive profits through the use of negotiated procurements. The most significant provision included in

TINA is the requirement that contractors submit current, complete, and accurate cost and pricing data (Whelan and Nagle 2002). Additionally, TINA required certification of cost and pricing data for negotiated procurements above a defined threshold.

TINA was initially opposed by DoD and the White House as unnecessary because of data requirements added to the ASPR. However, Congress insisted on passage of TINA after investigations revealed that many negotiated acquisitions in the military did not contain the requisite cost and pricing data (Nagle 1999). The provisions of TINA that require disclosure and certification of cost and pricing information provide an important means for safeguarding transparency in government contracting.

#### *Freedom of Information Act*

Transparency took an important step forward with the passing of the Freedom of Information Act (FOIA) in 1966. As Francis Rourke (1960) said, "nothing could be more axiomatic for a democracy than the principle of exposing the process of government to relentless public criticism and scrutiny". FOIA is primarily focused on allowing public access to information on government activity.

However, FOIA can get more complex when dealing with access to information involved with the contracting for government services and products. This is mainly because contractors are not subject to the same level of scrutiny that is applied to the government. In some instances contractors are afforded protections not available to the federal government. Furthermore, what a contractor deems as proprietary information and property, are generally not publicly available and may be protected under the Trade Secrets Act (Guttman 2004).

The initial intent behind FOIA was to allow the public access to government information and data. Yet, as Guttman remarks (2004), "FOIA applies to agency records, and contractors are not agencies under the law, regardless of their decision making role". Additionally, courts seem to protect the autonomy of private organizations to allow them efficiencies, which are sometimes impeded by government constraints (Gilmour and Jensen 1998). There may also be a challenge from an implied "wall of privity" between primary contractors and subcontractors (Whelan and Nagle 2002). In essence, this means that FOIA provisions may not be fully applicable and that petitioners may face significant access challenges.

Many of the basic tenets of FOIA have been challenged by contractors. Yet, FOIA remains an important source for accessing public information. All justifications for sole source procurements are available through the FOIA process (Kelman 1990, 18). Also important is the Shelby Amendment to FOIA, which provided for greater access to data from third party government sources.

One of the most recent successes in the fight for transparency occurred in 2003, *R&W Flammann GmbH v. U.S.* (CAFC No. 03-5014). Flammann sought to prevent FOIA disclosure of cost and price information under the Trade Secrets Act. The Court of Federal Claims ruled for Flammann, but in August 2003 the Appeals Court for the Federal Circuit reversed this decision. In the ruling the "Federal Circuit indicated that regulations requiring fairness in the procurement process do not trump statutory requirements under FOIA" (*R&W Flammann GmbH v. U.S.*, CAFC No. 03-5014 [2003]).

### Equity

The evolution of federal contacting has ensured that equity remains an important public value. Equity in government contracting is preserved by ensuring that all

bidders have fair access to competition for government business (Kelman 1990). Yet, there is another important component to equity that involves leveling the playing field for disadvantaged groups and those with special needs. In 1972, the Procurement Commission Report found that federal contracts are let for social as well as economic purposes (Holifield 1975). This revelation underscored the importance of equity in federal contracting.

#### *Fairness and Equity*

Early concerns over equity stemmed from nepotism and corruption. In fact these were so commonplace, they appeared to be the hallmark of government contracting during the Revolutionary War period. Congress passed the Act of 1809 to remedy this situation. This act was passed to give the United States the "benefit of competition" and by stating that open purchase provisions were to be exceptions to competed advertised procurements (Nagle 1999). Congress reiterated this same message with the issuance of the General Regulations of 1825 and 1861. In these regulations Congress required more specifics, like the requirement for formal advertising and lists of the

names and terms of all bidders (Nagle 1999). Through these additional provisions Congress sought to ensure fairness in the contracting process.

The courts also became involved in establishing the importance of equity. A U.S. Supreme Court decision in 1940 stated:

The purpose of statutes requiring the award of contracts to the lowest responsible bidder, after advertising, is to give all persons equal right to compete for Government contracts, to prevent unjust favoritism, collusion or fraud in awarding Government contracts and to secure for the Government the benefits that flow from free and unrestricted competition (Sherman 1979, 79).

This decision provided a strong warning against untoward contracting activity.

In 1984 Congress passed the Competition in Contracting Act (CICA) to ensure "fair and open competition" in virtually all areas of federal contracting activity (10 U.S.C. 2306). CICA required strict guidelines for advertising and sought to remove impediments to open competition. Over time, a clear pattern has developed with Congress acting repeatedly to assure fair and open competition in federal contracting.

### *Social Equity*

Another important consideration comes in the form of social equity. During the Great Depression contracts

became a means of putting the unemployed back to work. It was hoped that government could stimulate growth in the private sector and help re-stabilize the struggling economy. To this end, a number of statutes were put into place to protect American workers. The Davis-Bacon Act of 1931, sought prevailing wages for those that worked on public works projects. The Walsh-Healy Public Contracts Act of 1936 required minimum wages rates and working hours for those working on projects that exceeded a \$10,000 threshold. Likewise, the Wagner-O'Day Act of 1938 directed procurement of products and services from both Federal Prison Industries and workshops for the blind (Whelan and Nagle 2002). Also important was Executive Order (EO) 8802, signed by President Franklin Delano Roosevelt on June 25, 1941. EO 8802 required all defense contractors not to discriminate against employees on grounds of race, color, creed or national origin (Nagle 1987, 246).

In the last half of the twentieth century equity in federal contracting was broadened to include a wider range of social concerns. This includes compliance with the Civil Rights Act of 1964 and the requirement that contractors shall not discriminate on the grounds of race, color, or national origin in the selection of

subcontractors. In 1965, the signing of Executive Order 11246 promulgated equal employment opportunity and affirmative action guidelines for federal contractors (Department of Labor 2004). It also established the U.S. Department of Labor's Office of Federal Contract Compliance Programs (OFCCP). Additionally, concerns over social equity saw the emergence of public policy that assisted disadvantaged business enterprises, energy conservation, service-disabled veterans and veteran's employment opportunities.

Equity is a public value that ensures fairness in federal contracting. "Equity in law is justice based on fairness" (Rosenbloom 2002, 603). Thus, the establishment of equity based on free and open competition became a key tenet in federal contracting. As time progressed many statutes and policies placed a priority on ensuring social equity by carving out a new niche for the use of federal contracts. In essence, federal contracts became a primary vehicle for ensuring the preservation of equity in the workforce. However, equity was sometimes placed in a background role, especially when national exigencies dictated that values like economy and efficiency were necessary to move to the forefront of government

contracting. Economy, efficiency and cost effectiveness will be the focus of the next section.

#### Economy, Efficiency and Cost Effectiveness

Two of the most important public values involved in government contracting are economy and efficiency. Economy generally refers to the best use of available resources (Stiglitz 2000; Hirsch 1999). Economy can be achieved through the preservation of scarce resources. Whereas, achieving a universal consensus on the definition of efficiency is a bit more challenging. In general, efficiency means getting the most out of a given input (Okun 1975; Stiglitz 2000; Rosenbloom and Kravchuk 2002; Cooper 2003). However, Donahue defines efficiency on two dimensions "getting the right things done and getting them done at minimum cost" (Donahue 1989, 85). Moreover, Kelman combines economy and efficiency, as "the ability to procure at the lowest possible price for goods or services of the quality desired" (Kelman 1990, 11).

The recent merger between economy and efficiency in government contracting leads to the significance of cost effectiveness (Rosenbloom 2002). This is a public value that has appreciably gained in importance since the advent

of the New Public Management (NPM). Effectiveness as a whole is the relationship between the means and goals of a specific program or contract (Kettl 1993; Raadschelders, 2003). Cost effectiveness in government contracting is the primary motivation behind the policy of competitive sourcing that will be discussed in the next chapter. However, understanding the development of public values like economy and efficiency provides a necessary guide to the more recent emergence of cost effectiveness.

The federal government has relied on contractors since the days of the Revolutionary War. A primary reason for the development of this relationship revolves around gains in efficiency and economy achieved through the use of private contractors. From a historical perspective, government's need for specific services and products has been a main driver of private sector innovation and efficiency. Furthermore, government has acted as "the great accelerator" in stimulating and investing in the growth of contracting and private enterprise, through its monopoly on coercion and great fund of tax revenues (Toffler 1980). Thus, the quest for efficiency and economy in government contracting has resulted in technological advancements that

have pushed the United States to the vanguard of industrialized nations.

#### *Mass Production and Uniformity*

The first strong glimpse of efficiency in government contracting came in the letting of an armaments contract to Eli Whitney. On May 1, 1798, Whitney wrote a prescient letter to then Secretary of the Treasury Oliver Wolcott that talked of a more efficient production process:

I am persuaded that machinery moved by water, adapted to this business, would greatly diminish the labor and facilitate the manufacture of this article. Machines for forging, rolling, floating, boring, grinding, polishing, etc., may be made use of to advantage (Fuller 1946, 33).

Whitney's development of mass production techniques was instrumental in the winning of two successive musket contracts in 1798. He also received some monetary assistance from the federal government to buy needed production resources. The forwarding of money to contractors was a practice initially established by Alexander Hamilton in hopes of nurturing American private enterprise (Nagle 1999).

Another government contractor, Simeon North, was at the heart of gains in the economy of production. In 1813, North received a contract for 20 thousand pistols that required "any part of one pistol may be fitted to any other

pistol" (Huston 1966, 116). North's next contract utilized interchangeable parts to copy rifles that were produced by another weapons manufacturer. In 1828, a formal clause in the contract read:

And it is further agreed, that said rifles shall have that perfect uniformity of their respective component parts, that any one part or all parts of either, or any one of the rifles, may be exchanged for its corresponding part or parts, in either or any other rifle, made or to be made under this agreement (Fuller 1946, 152).

After North's successes, uniformity became a primary feature in government contracts. Uniformity allowed economy of resources through the productions of specialized tools and gauges. Nagle (1999, 113) comments, "that the uniformity placed on government contractors required interchangeable parts and formed the basis for the American system of manufacturing".

#### *Spread of Knowledge*

The provision of guns and munitions through public armories also had an effect on efficiency in government contracting. Public armories were initially required to ensure capacity for vital goods and stores necessary for national defense. Although, one of the most important benefits of national armories may have been their willingness to openly share information with contractors (Smith 1985). This policy of open information allowed for

a virtually free exchange of knowledge between the public and private sector. It also produced individuals that could be trained at a national armory and then migrate into the private sector with needed skills and information.

The result of this diffusion of knowledge allowed individuals to use their skills in uniformity and interchangeable parts for a myriad of purposes like the development of machine tools. Moreover, complementary industries sprung up in close proximity to public armories. The placement of the Springfield armory in Springfield Massachusetts helped establish the north as an industrial power. Thus, the spread of knowledge and information at public armories coupled with the need for interchangeable parts led to the development of machine tools and specialized instruments (Toffler 1980). These advancements were directly related to the need for economy and efficiency required by government contracts.

#### *Mass Produced Markets and Materiel*

The emergence of an American arms industry stimulated by government contracts in the early nineteenth century led to the opening of foreign military markets and the advancement of new uses of technology. Nations like

England, Russia and Spain were now purchasing American arms and sought to learn more about mass production and interchangeable parts. Moreover, the government contract with Samuel Colt for the mass production of the revolver in 1848, yielded great gains in efficiency and economy of the arms manufacturing process. Colt used advertising to gain national exposure and then mastered techniques that are now referred to as economies of scale and learning curve. Colt understood that if the first revolver cost \$1000 to produce, the second revolver would cost \$800, and this downward trend would continue as management techniques improved (Nagle 1999). Colt's desire to fulfill his government contract focused on efficiencies in the management process and the economy of limited resources.

The frenetic pace of procurement and desire for mass produced materiel in the Civil War led to further expansion of government contracting. Except now, government contracting was not solely centered on the production of arms but also the need for a myriad of supplies to support the Union Army in the field (Risch 1962). Government contracts demanded mass-produced goods like shoes, clothes and jackets. The need to fulfill these contracts quickly

and efficiently resulted in standardized measurements and sizes.

#### *Early Transportation*

Government contracting also led to advancements in transportation. Postal contracts helped foster the demand for roadways, canals and railroads that opened the west to expansion. All of these modes of transportation were in part funded through the letting of government contracts. The first flight produced by the Wright Brothers in 1903, near Kitty Hawk, North Carolina, was in part spurred by the desire for government contracts. In 1905, the War Department began to offer contracts for aircraft and dirigibles in hopes of greater combat efficiency (Solibakke 1976). The Navy followed suit, but required aircraft that would fly off the decks of ships. Henceforth, naval aviation was born with the first flight from the deck of the USS Birmingham on November 14, 1910. In 1918, the U.S. Post Office called for bids to provide airmail service on specific routes, "once established, it is to remain a permanent service" (Leary 1985, 25). This sent a strong message to the fledgling air industry that the government

would help cultivate a new market in return for efficient service and economy of resources.

*Scientific Management and the Reform Movement*

The political reformers and the scientific management advocates of the late nineteenth and early twentieth centuries also had an affect on the emergence of efficiency in government contracting. This was largely the result of the expanding need for government to administer resources to a growing population base and an increasingly industrialized society. As a result of these shifts, the role of contracting began to expand as well, especially with the winds of World War I looming on the horizon. As Woodrow Wilson wrote:

It is the object of administrative study to discover, first, what government can properly and successfully do, and, secondly, how it can do these proper things with the utmost possible efficiency and at the least possible cost either of money or of energy (Wilson, 1941).

Frank Goodnow, Leonard White and other reformers continued to move Wilson's belief in the value of efficiency toward the forefront of concern in government. Similarly, the scientific management movement of Frederick Taylor strove for the "one best way" to perform work in the most efficient manner (Taylor 1911).

The turn of the century reform movement lead to an interesting paradox. To gain efficiency some governments chose to provide a public capacity of service rather than use contracts. As history shows the reform movement was in part predicated on rooting out the ills of political corruption, which in some instances meant the removal of the use of contracts. The head of the Chicago Board of Health stated in 1892, "there are few if any redeeming qualities attached to the contract system" (Melosi 1980, 29). Mayor Hazen Pingree the progressive reformer of Detroit commented in 1895: "Most of our troubles can be traced to the temptations which are offered to city officials when franchises are sought by wealthy corporations or contracts are let for public works" (Holli 1969, 163). Yet, fears over the growing size of government coupled with the desire for efficiency through competition assured a strong role for private contractors.

The preoccupation with efficiency in government continued through the 1930s. Luther Gulick and Lyndall Urwick called efficiency "the axiom number one in the value scale of administration" (1937, 32). There was also President's Franklin Delano Roosevelt's Brownlow Committee in 1937, which examined the reorganization of the federal

government in terms of economy and efficiency. The need for the Brownlow Commission was directly related to the rapid growth in size of the federal government in the 1930s. The Brownlow Committee concluded that "real efficiency... must be built into the structure of government just as it is built into a piece of machinery" (1937). Government contracting emerged as a potential buffer to the continued expansion of the federal government.

#### *Efficiency Through Mobilization*

The emphasis on efficiency in government continued through World War I (WWI). In fact the mobilization efforts for WWI demanded the establishment of the War Industries Board (WIB) under investment maven Bernard Baruch. The WIB organized American industry for mobilization. President Woodrow Wilson felt the WIB would efficiently organize industry and provide the administration with substantial powers over contractors and entire industries (Higgs 1987). The WIB encouraged contractors to provide needed war materiel, voluntarily out of patriotism for the military in the field regardless of profit (Higgs 1987). The WIB possessed an extraordinary amount of power over contractors. It could deny transport

via the railroads, withhold fuel, prohibit international trade and as a last recourse nationalize industry through its federal agencies. "The military so often commandeered plants that the WIB often had to restrain rather than request this ultimate sanction" (Nagle 1999, 283).

Another important WIB function was setting prices for many large industries like steel, chemicals and textiles. Price controls in these areas caused profit margins to shrink to some degree and this generally allowed these industries to avoid the threat of nationalization (Higgs 1987). Attempts at efficiency through price controls did not preclude many contractors from earning exorbitant profits from the war effort. This was later called the merchants of death theory for war and was investigated by the Nye Committee.

The WIB also demanded efficiency from contractors through a priority system. Barnard Baruch stated, "the most important instrument of control, was the power to determine priority... the power to determine who gets what and when" (Huston 1966, 316). The priority system allowed government to place classifications and grades on the importance of many industries.

The interwar period saw the desire for efficiency again emerge as a key issue in government contracting. This time the focus was turned on the development of the aircraft industry. In 1924, the Lampert Committee investigated the air industry and found that "technical development of aircraft was proceeding at very unsatisfactory rates... largely because of the destructive system of competitive bidding". The Lampert Committee's primary recommendation was to "recognize the manufacturer's proprietary interest in its designs and permit the purchase of air material without competitive bidding" (McNaugher 1989, 26-27). Many in industry and government were also highly critical of an inefficient competitive bidding system more concerned with the lowest cost rather than the highest quality. However, Congress refused to budge and maintained the requirement for competitive bidding.

The mobilization for World War II (WWII) saw the view of government contracting change from the "merchants of death" to the "arsenal of democracy". Almost everything during the WWII mobilization period was related to assuring efficiency in government contracting. The need for immediate access to a myriad of war fighting resources placed contractors at the heart of the mobilization effort.

Mass production and assembly line techniques were used to maximize efficiency and provide economy of limited resources. The government poured money into contracting and the need for hundreds of thousands of American workers sprang up virtually over night. The fulfillment of wartime contracts played a part in ending the depression.

The requirement to maximize speed and efficiency for wartime contracting displaced the protections of many legal safeguards. The negotiated contract replaced much of the structure required for formal advertised procurements. Negotiations and incentive structures became the mainstay in government contracting. The Split Award Act of 1940 allowed government to fund the development of two or three military designs and then choose the best option. "The winning firm would have monopoly production rights to its design and the losing firm would be reimbursed for at least part of its development costs" (Nagle 1999, 386).

The Act to Expedite Naval Shipbuilding and the Act to Expedite the Strengthening of the National Defense were passed by Congress in 1940. Both acts virtually eliminated the requirement for competitive bidding and advertising, which greatly quickened the pace of wartime procurement (Miller 1949). The Revenue Act of 1940, provided

contractors with significant tax incentives for building new facilities that would support the war effort. The Assignment of Claims Act of 1940, stimulated contractor investment by easing bank credit requirements and allowing the assignment of claims under government contracts (41 U.S.C 15).

The mobilization preparations for WWII also required a high level of centralization and coordination. Many thought a structure similar to the WIB of WWI would be a useful means to gain efficiencies from industry contractors. President Franklin Delano Roosevelt (FDR) signed Executive Order (EO) 8629 on January 7, 1941, which created the Office of Production Management (OPM). The OPM managed the priorities system and the assignment of all major wartime contracts (Miller 1949). Priorities Regulation Number 1 stated, "all industry must... take the war business offered. Every worker and every factory, every bit of material and every machine is now part of the war program" (WPB 1942).

President Roosevelt's signing of EO 9040 in 1942 replaced the OPM with the War Production Board (WPB). The WPB would direct contracting, steer production, set priorities and allocate resources. The powers of the WPB

included suspension of orders, seizure of property and nationalization of individual contractors or entire industries. Economy and efficiency were the intended desire of WPB Directive Number 2, which mandated that government contracts must consider speed of delivery, conservation of facilities and choosing firms that needed a minimal amount of equipment and machinery (Miller 1949). Also important was the Office of Price Administration (OPA) that was established by the Emergency Price Control Act in 1942. OPA would closely monitor inflation, while also attempting to control prices and rents.

The primary means by which FDR secured broad powers over mobilization and the economy were through the enactment of the First and Second War Powers Acts. The First War Powers Act was passed in 1941, this permitted the President to award contracts and procure "without regard to the provisions of law when necessary to facilitate prosecution of the War" (USD AT&L 2004, 1). The enactment of the Second War Powers Act in 1942 gave FDR significant power and control over wartime resources. "The President (FDR) may allocate such material or facilities in such a manner, upon such conditions and to such extent as he will deem necessary and appropriate" (Higgs 1987, 206). The

extensive authority provided by each respective War Powers Act allowed FDR to "win the war... forget about all this legal foolishness" (Nagle 1999, 409).

The end of WWII brought fears of a possible post war depression. Many contractors were afraid they would rapidly lose business after the war and force workers back to the unemployment lines. The Contract Settlement Act of 1944, provided quick and equitable settlements for terminated war contracts (Connery, 1951). The passage of this act significantly eased these concerns through the provision of termination financing. It also allowed for an efficient and coordinated means for the cancellation of over 60 thousand contracts worth \$7.3 billion in two days, upon the announcement of the victory over Japan (Connery, 1951).

#### *Efficiency in the Military Industrial Complex*

After the close of WWII many contractors were looking at consumer applications for their goods, but some were examining ways to sustain contractual relationships with the military and government. Likewise, many in the military felt preserving the research and development that helped America win the war was crucial to the defense of

democracy. The formal beginning of the military industrial complex was in part the result of efficiencies achieved through government contracting. "Not only had government shifted its attitude toward business; business had also shifted its attitude toward government" (Nagle 1999, 443). This translated into a tacit acceptance by industry of some sort of government intervention and control in contracting. Thus, the close relationship between government and contractors emerged, General Eisenhower in 1946 called it the "military industrial complex".

Over the next fifty years government contracting as a whole, moved away from the wartime requirement for maximization of economy and efficiency. During this time, other important values like transparency, equity and accountability became important focal points for government contracting. In his 1961 farewell speech President Dwight David Eisenhower offered a stark warning against a heavy reliance on the military industrial complex:

This conjunction of an immense military establishment and a large arms industry is new in the American experience. Yet we must not fail to comprehend its grave implications. The total influence - economic, political, even spiritual - is felt in every city, every Statehouse, every office of the federal government. We recognize the imperative need for this development. In the councils of government, we must guard against the acquisition of unwarranted influence, whether sought or unsought, by the military-industrial complex. Our toil resources and livelihood are involved; so is the very structure of our society. The potential for the disastrous rise of misplaced power exists and will persist. We must never let the weight of this combination endanger our liberties or democratic processes (Eisenhower, 1961).

Eisenhower's concern over the emergence of a permanent defense establishment was largely based on the closeness of the government-contractor relationship. Also important is that government contracting had become a major factor driving the U.S. economy (Cooper, 2003).

#### *Efficiency and the Beginning of Public-Private Competitions*

The large post WWII bureaucracy and the emergence of the military industrial complex caused some policy-makers to look at different methods of achieving efficiency in government. Bureau of Budget Bulletin 55-4 was the first policy that directly mentioned a clear preference for private sector contractors to provide commercial activities for government services. This was followed by a revised policy under OMB Circular A-76, which called for public and private competitions for commercial activities that were currently provided by government employees. Later, this

policy was renamed competitive sourcing and the focus was directed toward cost savings and effectiveness in the provision of government services. Chapter three will provide a detailed discussion on the history of competitive sourcing policy.

*New Public Management and Cost Effectiveness*

The period that ranged from 1945-1993 played host to a number of Congressional Committees and Presidential Commissions that focused on government contracting. There were the Hoover Commissions I (1947-1949) and II (1952-1955), the Rockefeller Committee (1953), the Fitzhugh Commission (1969), the Commission on Government Procurement (1969), the Grace Commission (1982-1983) and the Packard Commission (1984-1986). The central theme for all of these committees and commissions was reforming an inefficient government acquisition system. In 1988, House Armed Service Committee Chairman Les Aspin commented that "perhaps the next executive commission on acquisition should be created, not to propose reforms but to implement them" (House 1988a).

In the decades that followed WWII there was a proliferation of rules and laws governing federal

contracting. Many of these concentrated on reestablishing a positive role in government contracting for public values like transparency, equity, integrity, accountability, capacity and regularity. However, ensuring these public values dragged down the overall speed and efficiency of the contracting process. Moreover, after a number of scandals in the 1980s, there were questions over the viability of using numerous regulations to guarantee public values in the contracting process (Cooper 2003).

At the same time, there was also an increasing tendency to rely on contractors for the provision of a multitude of government services. This meant that more contractors were faced with what many perceived as a mountain of procurement regulations. Moreover a state of seemingly mutual dependence between government and contractors emerged. Many agencies were becoming reliant on contractors to conduct numerous functions. On the other hand, contractors were becoming reliant on government for business, profits and largesse outside of the commercial marketplace (Reich 1964).

In 1992, the release of *Reinventing Government* by David Osborne and Ted Gaebler had a dramatic affect on reform in government. Osborne and Gaebler called for

government to include market like competitions for goods and services and to concentrate on "steering rather than rowing" when it comes to the administration of services. At virtually the same time the New Public Management (NPM) was borne out of the desire to fix a broken government throughout many corners of the world. The NPM was directly relevant to government contracting because it focused on downsizing and contracting out of services.

In 1993, Vice President Al Gore's National Performance Review (NPR) sought fundamental change throughout government. The NPR was openly critical of government acquisition and called for the adoption of businesslike processes, the move away from rules and toward guiding principles, empowering decision-making at lower levels and ensuring streamlined procedures (Gore 1993). A primary focus of the NPR was to reform government contracting, as the mounting frustrations over a sea of regulations, scandals, and system inefficiencies had gone too far.

By the mid 1990s procurement reform was in full swing. The Section 800 Panel loosened the grip of constraining acquisition rules and regulations. Likewise, the Federal Acquisition Streamlining Act (FASA) and the Federal Acquisition Reform Act (FARA) eased legal

requirements for contractors. This was accomplished by relaxing policy mandates, which governed competition and oversight (Reeves 1996). Additionally, government's access to private sector goods and services was improved by a streamlined purchasing and acquisition process.

#### *The Value of Cost Savings*

One of the cumulative affects of the NPM and the NPR was the desire to restore economy and efficiency in government contracting. Yet, there was also a merging of sorts between economy and efficiency, which yielded an over-arching concern for cost savings and effectiveness. This was facilitated by widespread support for the increased use of OMB Circular A-76. A policy that is focused on achieving cost savings through public-private competitions in the provision of government services. A-76 was later renamed competitive sourcing by the OMB under President George W. Bush (Bush 2001).

Competitive sourcing becomes very important when considering the position of many contractors at the end of the Cold War. Contractors could compete for government work via competitive sourcing as long as their bids provided cost savings beyond policy thresholds. Thus, the

value of cost savings became paramount to contractors trying to make inroads into the government market. Competitive sourcing has placed cost savings on the center stage of competing public values. Competitive sourcing will be the focus of the next chapter.

### Conclusion

The history of government contracting is a study in the evolution of public values. This is extraordinarily important when realizing, that "values are the very fabric of society and possibly the most basic reason for the existence of government" (Raadschelders 2003, 52). The evolution of these values is marked by the ebb and flow of cycles. These are generally dictated by the will of the populace, politics, national exigency, changes in technology and innovation. The evolution of government contracting depicts exchanges and trade-offs between competing public values like capacity, regularity, accountability, integrity, transparency, equity, economy, efficiency and cost savings.

These exchanges and trade-offs between values provide a necessary tension that moves government toward a state of balance. The "big tradeoff" between equality and

efficiency is one of many value exchanges that occur naturally in government contracting (Okun 1975). These exchanges can in part be attributed to the differing motivations and goals of the public and private sectors. Additionally, there is the realization that values imbued through statutes and policies are not free (Kovacic 1997). This is important when prioritizing and choosing between competing values. As the former Head of the Office of Federal Procurement Policy Dr. Stephen Kelman commented:

I am suggesting that too much weight is currently placed on equity and integrity at the expense of other values, such as the substantive quality of procurement performance... and the efficiency of the system (OFPP 2000, 9).

Kelman's preference appears to favor efficiency over other values. However, the cost of trade-offs should not only be measured monetarily but also on a societal level.

Thus government contracting must contend with values that are meant for the overall good of the public. In some instances this may translate to favoring efficiency over accountability. In other instances equity may become more important than economy. The important point here is that our democracy has allowed for an evolution of public values. Embracing these trade-offs between values allows for important political discourse, which reaffirms the people's belief in a stable and balanced government. The

next chapter will concentrate on the history and development of competitive sourcing and the emerging value of cost savings.

CHAPTER 3:  
THE DEVELOPMENT OF COMPETITIVE SOURCING POLICY:  
PUBLIC VALUES AND POLITICAL DISCOURSE

Introduction

This chapter will follow the emergence of competitive sourcing from primordial conceptual form to its current status as one of the most important policies in the 2001 President's Management Agenda. The primary focus will be on the development of competitive sourcing through a close examination of legislation, executive orders, congressional committee hearings and testimony. There will also be brief discussions on policy revisions, economics and politics. Additionally, this chapter depicts the evolution of cost savings as a public value through the lens of competitive sourcing. It should be remembered that the primary difference between competitive sourcing and general government contracting is that the former allows the public sector a means to compete for specific government activities with private sector contractors.

The Makings of a Policy

The history of competitive sourcing can be seen as far back as Revolutionary War era debates, which focused on the choice between the public or private sector provision of goods and services for the federal government. During the early years of our nation the federal government helped stimulate private enterprise by providing monetary incentives and by allowing a virtual free flow of information between the public and private sectors (Nagle 1999). Yet, as the country changed, the federal government's role in contracting also evolved.

*Growing Pains*

The major growth in the size of the federal government occurred during the 1930s. This massive administrative expansion under President Franklin Delano Roosevelt (FDR) resulted in the creation of some 100 agencies and a countless number of government jobs (Rosenbloom 2003). This exponential increase in the size of government in large part created the modern U.S. bureaucracy and helped usher in the need for more contracting with the private sector. However, some in Congress and industry were

fearful that the rapid growth in the size of the federal government was now infringing upon private enterprise and basic commercial activities.

One reason for this was the passage of the Economy Act (31 U.S.C. 1535) in 1932. The Economy Act allows for the transaction and procurement of good and services between federal agencies. It was passed to cut government expenses, but also important was the prevailing belief by many in Congress "that private industry should not be called upon to perform what government agencies can do more cheaply for each other" (31 U.S.C. 1535). Moreover, many thought the Economy Act would provide economies of scale and eliminate overlapping activities in the federal government (DoD 2000). However, many industry contractors felt the Economy Act helped grow the size of government by foregoing business contracting opportunities with private sector enterprise.

The Shannon Committee, named after Representative John B. Shannon, was a special congressional committee called upon to investigate "government competition with private enterprise and all other questions in relation thereto that would aid the Congress in any needed remedial legislation" (House 1933). The committee was formed after many leaders

of business and industry protested over direct competition from government providers of goods and services. Moreover many of these leaders believed that the passing of recent legislation fostered the government's ability to compete and in some instances replace the private sector in the contract marketplace. Legislation like the National Defense Act of 1920, the Economy Act of 1932 and the Vinson-Trammel Act of 1933, received harsh criticism from testimony given during the Shannon Committee's hearings.

The findings from the Shannon Committee focused on government competition and "the pernicious results for individual enterprise and the self preservation of individual and independent corporate communities" (House 1933). The Shannon Committee made wide-ranging recommendations that called for the immediate suspension of some government manufacturing operations and called for an examination of the federal government's actual costs. More specifically, "the committee believed that by exposing all costs, the government would uncover the hidden costs, which would reveal many overpriced governmental activities then justified on the basis of economy" (Nagle 1999, 363). If government operations cost more, than the public provision

of service should be abandoned or devoted to some other purpose (House 1933).

Ultimately, none of the Shannon Committee's recommendations came to fruition, but the importance of the committee led many industry contractors to vigilantly guard against further government encroachment into the private marketplace. In the decades following the Shannon Committee, there were a number of congressional inquiries that sought to prevent government competition with private sector contractors (Woodward 1992). This persistent application of political pressure from industry contractors was an important factor leading to the first vestiges of competitive sourcing.

#### *Government Personnel Freeze*

The government personnel freeze put in place during 1951, also played a role in the emergence of competitive sourcing. Congressman Jamie Whitten concerned over the growth of government attached an amendment to the Supplemental Appropriations Act of 1951. "This amendment placed a ceiling on total federal civilian employment, while freezing the creation of new permanent positions" (Light 1999, 99). The amendment, which would later be

called the Whitten Amendment focused attention the longstanding concern over the size of the federal workforce.

President Harry Truman's issuance of Executive Order (EO) 10180 amplified the effects of the freeze on federal government employment. EO 10180 called for "all appointments in the executive branch of the Government to be made on a non-permanent basis except those of Presidential appointees and postmasters in all classes of post offices" (EO 1950). Whitten followed EO 10180 by attaching a mandate to the Third Supplemental Appropriations Act of 1952, which called for all new federal appointments to be placed in an indefinite or temporary status (Light 1999).

The effect of these actions had an immediate impact on the size of the federal government workforce. Light (1999) reports that the number of federal positions fell from 1.5 million in 1950 to 1.15 million in 1953, excluding those employed by the U.S. Post Office. A shrinking federal workforce meant that the same level of government work would have to be performed through a different means. This translated into more opportunities for government

contractors, but also helped create the atmosphere that generated competitive sourcing.

*DoD Starts the Ball Rolling*

The Department of Defense (DoD) indirectly started the ball rolling on competitive sourcing, a pattern that has continued through today. In 1952, the DoD issued Directive 4000.8, which sought to overhaul the defense procurement system. One of the discussions in DoD Directive 4000.8, concentrated on the migration of commercial and industrial activities/facilities out of the military and into the private sector where warranted (Woodward 1992). "Such facilities and activities will not be continued in operation... where served by existing facilities or where private facilities are available" (DoD 1952).

In 1954, this directive was superseded by DoD Directive 4100.15, which directly addressed concerns over "insufficient private facilities, probability of delay in meeting government needs and substantial savings accruing to the government" (DoD 1954). The prevailing belief behind DoD Directive 4100.15 is encapsulated in the following excerpt from a discussion that took place at the Industrial College of the Armed Forces (ICAF) on 20 January 1954:

We depend for our military effort, and for every other effort, on our free and competitive economy. It is that economy which is going to give us the sinews to fight with. We must do everything we can to keep it growing and strong... In considering this business of military necessity we must weigh full, the needs of the economy (McCawley 1954).

Also important was the specter of the Cold War and fears of spreading socialism. All of these factors played a role in the push to move virtually every commercial activity into the private sector.

Eisenhower and Bureau of Budget Bulletin 55-4

When Dwight David Eisenhower was elected President the growth of bureaucracy had continued virtually unabated for twenty years. In 1954, President Eisenhower set the United States on a course to elevate private competition within the public sector when he uttered, "this budget marks the beginning of a movement to shift to ... private enterprise federal activities which can be more appropriately and efficiently carried on that way" (Wildermuth 1970). What followed was a flurry of activity at the Bureau of Budget (BoB) that focused on pushing long-standing government activities into the hands of civilian contractors (Wildermuth 1970).

*Bureau of Budget Bulletin 55-4*

The Eisenhower Administration's official policy position on commercial activities in the federal government came with the release of Bureau of Budget Bulletin 55-4 in 1955. The following passage from BoB 55-4 forms the basis of competitive sourcing:

It is the general policy of the administration 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 produced from private enterprise through ordinary business channels (BoB 1955).

The over-arching policy was governed by an unyielding belief in the American system of free enterprise as can be seen in the following excerpt:

In the process of governing, the Government should not compete with its citizens. The competitive enterprise system, characterized by individual freedom and initiative, is the primary source of national economic growth. In recognition of this principle, it has been and continues to be the general policy of the Government to rely on commercial sources to supply the products and services the government needs (BoB 1955).

The Bureau of Budget Bulletin 55-4 sent a clear message that government was not to compete or encroach upon commercial activities that could be provided by private sector contractors. Moreover, the clear intent of BoB 55-4 was that commercial activities in the federal government were to become the primary purview of the private sector.

Another important part of BoB 55-4 was that each agency head was supposed to inventory all agency commercial and industrial activities that fell within the parameters of the bulletin. Also important was that cost and savings estimates attributed to work provided by the government or contractor, were not directly emphasized. In fact, cost was only one factor for consideration and was not to be the central focus for an agency's final decision (Wildermuth 1970). BoB 55-4 emphasized the following:

Since cost should not usually be the deciding factor in determining whether to continue the operation as a direct government operation, the decision statement should show both the results of the comparative cost analysis and the elements which have been used in determining government cost, both as a direct operation and if the product is secured from private industry (BoB 1955).

#### *Other Relevant Bureau of Budget Bulletins*

The Bureau of Budget Bulletin 55-4 was accompanied by a number of other bulletins and reports. In 1956, the BoB published a report titled, *Inventory of Certain Commercial-Industrial Activities of the Government*. This report evaluated BoB 55-4 and claimed, "this is another step in the administration's long-term program to eliminate unnecessary government competition with our free enterprise system" (BoB 1956). Additionally, BoB Bulletin 57-7 was published on February 5, 1957. This was essentially a

restatement of BoB 55-4, but provided details on when it was appropriate for agency heads to make exceptions to the use of the private enterprise system. It also provided more information on initial cost comparison concepts.

The Bureau of Budget Bulletin 60-2 was released on September 21, 1959. This bulletin provided amplifying details on the use of cost comparisons. Although, interestingly costs were actually de-emphasized to some degree as can be seen below:

The admissibility of relatively large and disproportionate higher costs as a possible compelling reason for continued government operation does not alter the general policy which establishes a presumption in favor of government procurement from commercial sources and does not prohibit procurement from more costly commercial sources (BoB 1959).

There was no mistaking the tenor of BoB 60-2, as each agency was to contract out if at all possible (Wildermuth 1970). The next step in the evolution of competitive sourcing was the move from Eisenhower's BoB 55-4 to President Johnson's Circular A-76.

#### The Emergence of A-76

The release of Bureau of Budget Circular A-76 was a shift from the BoB 55-4, in that it looked first to private enterprise but also included room for choosing the in-house government provision of service. The start of this shift

occurred with President John F. Kennedy's letter of July 31, 1961, to then Director of the Bureau of Budget David Bell. President Kennedy stated, "after a decade or more of experiences with contracts, I think it would be desirable to review the effectiveness of this means of accomplishing the Government's purposes" (Kennedy 1961). This review later formed the thrust behind the Bell Commission, which looked at how contractors effect government operations.

The testimony of Deputy Bureau of Budget Director Elmer Staats before the Joint Economic Committee in 1963 reveals waning support for the pro-private enterprise and contractor sentiments of the Eisenhower Administration. In fact, it appears that the Kennedy Administration favored strict cost comparison analysis as can be seen below:

We have placed increased emphasis on using government installations and staffs rather than commercial or contractual arrangements when commercial operations are clearly more costly. Most of the goods and services needed by the government will continue to be obtained from commercial or private sector sources, but when it is clear that a direct operation by the Government will save money when all pertinent factors are considered, we believe an operation by the government is warranted (House 1963).

Also important was the 1964 revelation by the House Committee on Post Office and Civil Service that "the committee does not believe that the true cost comparison is

being carried on today as it could or should be" (House 1964).

By 1966 many felt that a change in policy that started with BoB 55-4 was needed. The Johnson Administration issued the Bureau of Budget Circular A-76 as a codification of the formal cost comparison process between public and private sectors. Also the movement from bulletin to circular meant that A-76 was meant to be a long-standing policy. Cost savings became the ideal of the A-76 process. Moreover, a new emphasis was placed on the efficiency and effectiveness of agency wide programs rather than strict reliance on private sector contractors (Wildermuth 1970). Overall, Circular A-76 concentrated on the need for the federal government to rely on commercial sources for the provision of goods and services, but it also made it permissible for the government to retain an activity if cost savings could be achieved.

#### Competitive Sourcing and Incremental Changes

There have been many changes to Circular A-76 over the past four decades. The circular was revised in 1967 to tweak language on the cost analysis process. In 1979, the Office of Management and Budget (OMB) Circular A-76

underwent a major revision, which included a handbook of procedures for conducting cost comparison studies. At this time, many in OMB fully embraced A-76 as the practical application of President Carter's focus on rational decision-making and good government. This also marks the first time that serious agency implementation efforts began. Moreover some feel 1979 represents the effective beginning of a cogent competitive sourcing policy (Woodward 1992).

In 1983, the circular was again revised through an updated handbook. Additionally, there were provisions requiring the government to conduct efficiency studies on commercial activities, which would result in the agency's Most Efficient Organization (MEO) (OMB 1983). The formation of the MEO allowed agency employees the ability to better compete with private sector contractors during A-76 competitions.

A major revision to the supplemental handbook occurred in 1996 with the inclusion of the definition of inherently governmental functions. Also incorporated were detailed cost factors to be used in public-private cost comparisons. The modification of the handbook can in large part be

attributed to Vice President Al Gore's National Performance Review and a new focus on results in government.

The 1999 A-76 revision emphasized the need to improve performance work statements and the competitive sourcing process. Yet it also provided a clear statement of the revision's intent:

Circular A-76 is not designed to simply contract out. Rather it is designed to: 1) Balance the interests of the parties to a make or buy decision; 2) Provide a level playing field between public and private offerors to a competition; and 3) Encourage competition and choice in the management and performance of commercial activities. It is designed to empower Federal managers to make sound and justifiable business decisions (OMB, 1999).

A discussion on the 2003 revision of A-76 will be provided later in this chapter.

#### Policy and Law Complements to Competitive Sourcing

The development of competitive sourcing policy was shaped, to some extent, by President Reagan's 1987 issuance of Executive Order 12615 on the *Performance of Commercial Activities*. The Reagan Administration was striving to breathe life into a policy that had been unofficially ignored by many federal agencies. The following is a passage from Executive Order 12615:

Agency heads shall ensure that new Federal Government requirements for commercial activities are provided by private industry, except where statute or national security requires government performance or where private industry costs are unreasonable...include in agency budget proposals the expected savings from the privatization of commercial activities... (Executive Order 1987).

The problem with Executive Order 12615 was that approximately one month later, Congress amended the DoD authorization bill by allowing military base commanders to adopt their own policies regarding OMB Circular A-76 (Dudley 1990). This was a significant departure from the policy promulgated in EO 12615. This may have been a contributing factor to agency inaction over competitive sourcing until the mid 1990s (GAO 1998a). However, the release of this executive order did help heighten awareness over the performance of commercial activities in the public sector.

*Congressional Involvement and the Nichols Amendment*  
Congress became intimately involved in A-76 with the passing of 10 U.S.C. 2461 on July 19, 1988. This legally codified commercial or industrial type functions and required studies and reports before conversion to contractor performance (10 U.S.C 2461). Also in 1988 Congress enacted 10 U.S.C 2468, which delegated authority

over commercial activity studies to base commanders. What followed, were hearings before the House Armed Services Committee's Subcommittee of Investigation in 1988. These focused on Section 1111 of the Defense Appropriations Act also called the Nichols Amendment. An excerpt from Chairman Nichols's opening remarks follows:

On the one hand, Congress was telling DoD to delegate authority for the implementation of commercial activities to the base commander so he could make a decision based on the best judgment on how to carry out the mission in his particular installation. On the other hand, the President was telling DoD to triple the commercial activity reviews... the subcommittee indicated strongly where DoD should put its primary emphasis. We believe now as we did then, the law takes precedence over an executive order (House 1988b)

The contentiousness over competitive sourcing has sometimes placed this policy squarely on the political battlefield between the competing branches of government.

#### *Inherently Governmental Functions*

An integral part of competitive sourcing is the definition of "inherently governmental function" as promulgated in Office of Federal Procurement Policy (OFPP) Letter 92-1.

As a matter of policy an inherently governmental function is a function that is so intimately related to the public interest as to mandate performance by government employees. These functions include those activities that require the exercise of discretion in applying government authority or the making of value judgments in making decisions for the government (OFPP 1992).

The vagaries implied in the definition of inherently governmental function has been the source of some consternation for both the public and private sectors. The following is a brief list of some of the activities involving inherently governmental functions:

- (1) Binding the United States to take or not take to take some action by contract, policy, regulation, authorization, order, or otherwise;
- (2) Determining, protecting, and advancing economic, political, territorial, property, or other interests by military or diplomatic action, civil or criminal judicial proceedings, contract management or otherwise;
- (3) Significantly affecting the life, liberty, or property of private persons; or
- (4) Exerting ultimate control over the acquisition, use, or disposition of United States property (real or personal, tangible or intangible), including establishing policies or procedures for the collection, control, or disbursement of appropriated and other federal funds (OMB 2003a).

The "inherently governmental function" provision is one of the primary reasons for fairly fuzzy agency interpretations of competitive sourcing. In many instances this fuzziness has helped the bureaucracy stifle the use of the competitive sourcing initiative (Peckenpaugh, 2001).

*The Court Weighs-In: Diebold v. U.S.*

In 1991, a group of civilian employees at Fort Campbell, Kentucky, challenged the Army's A-76 performance decision to award base food services to private contractors. "The district court dismissed the complaint,

finding it had no jurisdiction under the Administrative Procedure Act (APA) because the Army's decision was committed to agency discretion" (Harney 1998, 102). Subsequently, the employees appealed this decision.

In *Diebold v. U.S.* (947 F.2d 787[1991]), the U.S. Sixth Circuit Court of Appeals reversed the decision and concluded that the federal employees had standing. The Sixth Circuit relied heavily on the 1979 Office of Federal Procurement Policy Act Amendments (OFPPAA) (Harney 1998). Moreover the court found that the OFPPAA defined U.S. procurement policy in terms of economy, efficiency, and cost savings.

Thus, evidence that an agency did not follow Circular A-76 cost calculation directives, that it did not include all costs made necessary by contracting out, and that the agency will not save the ten percent required to justify the contracting-out decision could support a claim that the agency was not complying with statutory directives to pursue economy and efficiency and to contract-out commercial activities if contracting-out will cost less than in-house production -the law to be applied (*Diebold v. U.S.* (947 F.2d 787[1991])).

The Sixth Circuit Court also ruled that OMB Circular A-76 carries the "force of law". More specifically, the Court found that OMB Circular A-76 directly follows 10 U.S.C 2426, which provides "specific statutory command to pursue economy and efficiency in federal agency procurement that carries the force of law". The court went on to state

that Circular A-76 reaches the status of "enforceable regulation" when it enters the procurement process. This decision codified cost savings as a necessary part of an "enforceable" competitive sourcing policy.

*Freedom From Government Competition*

The Freedom From Government Competition Act was introduced in 1996, amidst mounting political pressure from private industry and growing frustrations with inefficient government. The overarching goal of this act was to dramatically increase the proportion of government commercial activities performed by private contractors. Section 3 of S. 1724 stated "each agency shall obtain all goods and services necessary for or beneficial to the accomplishment of authorized functions by procurement from private sources" (GAO 1996). The Freedom From Government Competition Act would obviate from the current A-76 policy requirements to conduct cost comparisons and base performance decisions on cost savings (GAO 1996). Essentially, the Freedom From Government Competition Act would replace OMB Circular A-76.

After stiff political resistance the Freedom From Government Act was revised in 1997. Senator Craig Thomas

reintroduced the act as S. 314 on February 12, 1997. Moreover, Senator Thomas claimed that OMB Circular A-76 was routinely ignored by executive agencies (Senate 1997). The language in this bill was softened somewhat, but it would still require the vast majority of commercial activities in government to be provided solely by private contractors (GAO 1997). Also important to note is that this act would have virtually prohibited all competitive sourcing activity in the federal government (CRS 2001).

The Freedom From Government Competition Act was eventually struck down. In testimony before the Joint House and Senate Hearing on Revisions to the Freedom From Government Competition Act, Deputy OMB Director G. Edward Deseve stated:

Government must be permitted to choose the alternative - public or private - which is the most cost effective and in the best interest of saving taxpayer's money. In so doing, the process must be fair and equitable to all interested parties... We do not believe that the proposed revisions will achieve the quality or cost savings goals that you are seeking (Congress 1998).

Another problem was that this act probably could not provide for effective political discussion (GAO 1997). Also important was considering the implications of conflicting statutes like the Economy Act and the Government Performance and Results Act. In comments made before the Subcommittee on Oversight of Government

Management, Restructuring and the District of Columbia, the Director of the Federal Management and Workforce Issues at the General Accounting Office stated:

Striking a proper balance between the public and the private sector provision of goods and services to the American people is among the most enduring issues in American politics and public policy. The Freedom From Government Competition Act would redirect current policy... We believe that Congress is the proper forum to address such fundamental questions (GAO 1997).

*The Federal Activities Inventory Reform Act*

In 1998, Congress passed the Federal Activities Inventory Reform (FAIR) Act. The FAIR states:

The head of each executive agency shall submit to the Director of OMB a list of activities performed by Federal Government sources for the executive agency, that are not inherently governmental functions (FAIR, 1998).

Additionally, the FAIR provides for the release of this list of activities to the public in the *Federal Register*. The idea behind the FAIR was that it would help encourage agency competitions and provide for a more transparent process. Also important is that the FAIR required an appeals process for those that seek to challenge the inventory. The FAIR provides significant credibility to competitive sourcing because it is enforced by law and requires agency compliance.

Competitive Sourcing Today: Some Old and Some New

The current version of competitive sourcing was made public on May 29, 2003. The release of the new A-76 policy came after President George W. Bush made competitive sourcing one of his top priorities in the President's Management Agenda (PMA) in 2001. "Government should be market-based, we should not be afraid of competition, innovation, and choice. I will open the government to the discipline of competition" (Bush 2001). Bush's support for competitive sourcing in the PMA added strong support to OMB's efforts to inject performance, efficiency and cost savings into agency programs (OMB 2003b). Overall, the basics of competitive sourcing have remained the same. The primary focus remains on public-private competitions for commercial activities performed by the government. However, this latest version has incorporated some fairly significant changes.

*Policy Dilution*

One of the changes in today's competitive sourcing policy included diluting verbiage from BoB 55-4 that many thought sacrosanct. "In the process of governing, the

government should not compete with its citizens..." (BoB 1955). Today's policy reads:

The longstanding policy of the federal government has been to rely on the private sector for needed commercial services. To ensure that the American people receive maximum value for their tax dollars, commercial activities should be subject to the forces of competition (OMB 2003).

The difference between these statements seems to shift the focus from Eisenhower's preference of outsourcing whenever possible, to a more nuanced form of public-private competition based on the idea that cost savings provide immediate value to government. The current policy seems to adhere to private sector competition with less conviction and calls for more of a salutary competition based on cost savings (Schooner 2004). Yet, it is also important to realize that there is significant political pressure to rapidly expand the aggregate number of A-76 competitions conducted throughout government.

#### *Best Value*

The new competitive sourcing policy embraces the concept of best value, which recognizes that the lowest cost alternative is not always the best choice. The Federal Acquisition Regulation (FAR) defines best value as "the expected outcome of an acquisition, that in the

government's estimation, provides the greatest overall benefit in response to the requirement" (FAR 1997, 2.101).

The best value methodology allows performance and quality to factor heavily into the sourcing decision as well as cost efficiencies (DeMaio and Badolato 2003). The 2003 version of OMB Circular A-76 allows for a source selection tradeoff to occur in a standard competition if the agency desires to consider factors other than lowest cost (OMB 2003). The best value-lowest cost tradeoff closely follows guidance set forth in Section 15.101 of the FAR.

In different types of acquisitions, the relative importance of cost or price may vary. For example, in acquisitions where the requirement is clearly definable and the risk of unsuccessful contract performance is minimal, cost or price may play a dominant role in source selection. The less definitive the requirement, the more development work required, or the greater the performance risk, the more technical or past performance considerations may play a dominant role in source selection (FAR 1997).

An agency can use a best value trade-off in a standard competition if the study involves: information technology; commercial activities performed by the private sector; new requirements; or segregated expansions (OMB 2003). However, it is important to note that there seems to be an emerging dichotomy between the best value and low cost methods of conducting a competition (Harney 1998).

*Competitive Sourcing Officials*

Another major change established appointments for Competitive Sourcing Officials (CSOs). The CSO is responsible for competitive sourcing activities within each agency. The intent of appointing a CSO is to increase centralized agency oversight and promote fairness and trust in the competitive sourcing process (OMB 2003). CSOs are later used for interviews in the qualitative methodology portion of the dissertation.

*The Politics of Reform and Cache*

The government reform efforts of the early 1990s were inspired in part by the widespread acceptance of the New Public Management (NPM). The NPM favored downsizing, deregulation, devolution and contracting as vehicles for limiting the growth of inefficient government (Cooper 2003). Likewise, the release of David Osborne and Ted Gaebler's *Reinventing Government* also had a significant impact on moving government toward a focus on results, entrepreneurship, economy and efficiency (Kettl, 2002). A few of Osborne and Gaebler's main tenets spoke directly to competitive sourcing, "steering, not rowing" and the use of

market-like competition in the provision of goods and services (Rosenbloom and Kravchuk 2002).

Then in 1993, Vice President Al Gore's National Performance Review (NPR) sought "a new customer service contract with the American people, a new guarantee of effective, efficient and responsive government" (Gore 1993). At approximately the same time, many of the federal procurement statutes were relaxed or streamlined to facilitate contractor access to government markets. The underlying premise for many of these efforts was achieving cost savings in government.

#### *The Politics of Reform*

Many in politics embraced the government reform themes of the early 1990s. President Clinton stated, "our goal is to make the entire federal government both less expensive and more efficient, and to change the culture of our bureaucracy away from complacency and entitlement toward initiative and empowerment" (Clinton 1993). "In 1995, congressional and administration initiatives placed more emphasis on A-76 competitions as a means of achieving greater economies and efficiencies in operations" (GAO 2000). Most of the resulting A-76 studies occurred in DoD.

However, President George W. Bush intends sweeping reforms for all of bureaucracy. "Government should be market based -- we should not be afraid of competition, innovation and choice. I will open the government to the discipline of competition" (Bush 2001). Increased use of competitive sourcing will be the primary vehicle by which cost savings and efficiency are achieved (GAO 2000).

The much-ballyhooed competitive sourcing successes in the Department of Defense have attached dollar signs to government savings. Moreover, the executive branch hopes these savings will be replicated throughout the entire bureaucracy. It appears these positive quantifiable results from the Presidents' initiatives provide a great impetus for garnering executive power and political cache (Neustadt 1990). Thus, when strong political support for competitive sourcing was coupled with positive results from recent academic studies, an environment was created that valued costs savings as a virtual public ideal.

#### *Illusions of Small Government*

On the surface, competitive sourcing provides a legal and relatively expedient means for creating smaller government. The 'illusion of small government' creates

incentives for various political players to favor the movement of government work to the private sector. These incentives may be control, re-election or the simple realization that advocating for big government may not be politically advantageous (Light 1990). Moreover, competitive sourcing may allow politicians a plausible means to straddle the line between competing government and contractor constituencies, through support for a policy of fair and open competition. There is also the belief that contracts can be used to reward constituents as a form of political patronage (Sharkansky 1980).

The paradoxical illusion represents the fact that 'smaller government' is usually followed by actual growth in the provision of government services via private sector contractors. A recent study has shown that since 1999 federal employment has fallen by roughly fifty thousand positions while contract and grant related government work has increased by approximately 1.1 million jobs (Light 2004). Yet analyzing the putative cost savings from the movement of public function to the private sector has proven difficult, as there is no central agency coordinating this activity.

The Peace Dividend and Contractor Consolidation

Market forces have also played a key role in the shaping of the competitive sourcing policy. The growth in the number of A-76 competitions may in part be attributed to the end of the Cold War. The dramatic downsizing that occurred in the military and defense related industries after the Cold War resulted in the 'peace dividend'. The peace dividend is defined as the sum of resources no longer claimed by the military and available for non-military purposes (Gold 2000). The immediate effect of the peace dividend was a reduction in the budgets of the Department of Defense (DoD) and Department of Energy and the paying down of the federal deficit (Gold 2000). The reduction in defense budgets created a need in DoD for the use of cost saving measures like A-76. DoD has heavily employed the A-76 process as a means to cut costs and better align mission priorities (Gates and Robbert 2000).

Another factor affecting the increase in A-76 competitions was corporate consolidation in the military-industrial complex. When the Cold War ended, the large defense contractors faced shrinking defense budgets. Many defense contractors were forced to make strategic choices regarding the redeployment of financial and physical assets

and migrate to other civilian markets, or stick to the defense markets and try to gain market shares in other service-related activities (Oden et al. 2000). Many have chosen to engage in competitive sourcing in hopes of increasing workload and gaining a larger share of the government market.

#### Public Choice and Privatization

Public choice theory and privatization also played roles in the development of competitive sourcing. Public choice is the merging of economics with politics. It endorses the use of competition to stimulate government efficiency as a mechanism to avoid government failure (Forrer and Kee 2004). Some public choice theorists like Gordon Tullock, James Buchanan and William Niskanen prefer the use of contracts to provide government activities rather than direct government provision of services. This is because they feel that private contracts offer a more efficient means of accomplishing government work and avoid the rent seeking behavior of special interest groups (Tullock 2002). Moreover there is a sense that government could be broken up into small units of individual contracts that would be competed for bid (Tullock 2002). Some public

choice advocates feel that competitive sourcing doesn't go far enough and that the entire program should be streamlined. Overall the prevailing view seems to support competitive sourcing because it moves in a seemingly positive direction for a more efficient government.

The advocates of privatization played a part in the rise of competitive sourcing as well. They showed that market competition could provide an alternative to the direct government provision of services. "The primary goal of any privatization effort is, or should be, to introduce competition and market forces in the delivery of public services" (Savas 1987, 2002). What privatization means to many is reduced costs, improved service, increased management flexibility, specialized expertise and decreased public monopoly inefficiencies (Savas 1987; Donahue 1989; Kettl 1993; Von Slyke 2003). The hope of realizing these benefits and achieving cost savings is part of the reason that competitive sourcing is such an attractive policy option.

### Governance

The move toward public policy that uses business and entrepreneurial approaches like competitive sourcing has

caused a shift in government's role away from traditional mechanisms of vertical authority, power and accountability. Today, governance is the popular term that describes a focus on governing mechanisms that do not rest solely on the authority and sanction of government (Milward and Provan 2000; Kettl 2002; Cooper 2003). This means that government now has the responsibility for arranging, coordinating, integrating and overseeing networks of partnerships with varying types of agents (Durant and Warber 2001; Donahue and Nye 2002). This may mean that government authority and accountability over contractors will become more horizontal and decentralized.

Some feel that devolving function and authority creates serious challenges with accountability and oversight (Sclar 2001; Kettl 2002). Competitive sourcing is at the crossroads of this debate because it offers a means for either the public or private provision of services, under the auspices of saving taxpayer's money. A shift away from traditional hierarchical government and towards more flexible structures of governance is inspired primarily on the premise of implied cost savings.

Conclusion

The development of competitive sourcing policy provides strong insights into two important themes. First, there is the emergence of cost savings as a public value. This follows Woodrow Wilson's prescient comments that "government should strive to conduct its work with the utmost efficiency and the least possible cost in either money or energy" (Wilson 1887, 197). The history of competitive sourcing shows the initial focus of BoB 55-4 was to divest in government function and to embrace contracting-out for service whenever possible. However, a pragmatic shift in policy during the early 1960s made the cost comparison the center of gravity in competitive sourcing decisions. Since then, the achievement of cost savings has been emphasized in virtually all A-76 revisions and has been legitimated in one form or another by all of the branches in the federal government.

The second theme reflects the nature of politics and finds a myriad of forces acting on competitive sourcing policy. The inescapable reality is that for all of the emphasis placed on cost savings and efficiency in government, there seems to be reciprocal trade-offs between public values that creates necessary tensions within

government. It must be remembered that government is stable because there are checks and balances and an active separation of powers system. Likewise, it is important to realize that the different branches of government seem to advocate for competing public values, which as Justice Louis Brandeis stated in *Myers v. U.S.* promotes an "inevitable friction" (272 U.S. 52, 293 [1926]). This friction is readily evident when considering the socio-economic statutes that must be considered in leveling the competitive sourcing playing field. Ultimately, the development of competitive sourcing reflects the necessary friction that resonates through the competing voices and values of political discourse.

## CHAPTER 4:

### MASTERING THE PROCESS AND UNDERSTANDING THE CHALLENGES

#### *Introduction*

This chapter will focus on understanding the A-76 process and looking at the challenges to competitive sourcing policy. The first section will provide details and definitions relevant to competitive sourcing. The second section will examine the current status of agency implementation efforts of OMB Circular A-76. Finally, there will be a discussion on the primary challenges that face competitive sourcing policy.

#### *Defining the Terms*

To fully grapple with competitive sourcing it is important to first understand the language surrounding the policy. This is needed because the terms involved are based on techniques and practices more commonly found in the private sector (deLeon and Denhardt 2000). It is also

important to realize that competitive sourcing is the only process that allows public sector employees an opportunity to compete with private contractors (GAO 2002a). Table 4.1 provides a quick primer on terms that are associated with competitive sourcing:

Table 4.1\* Definitions of Key Terms

A-76 Study	A formal evaluation of sources to provide a commercial activity that use pre-established rules. OMB Circular A-76 is the policy that emphasizes the need for the federal government to rely on commercial sources for the provision of goods and services. A-76 is now used synonymously with competitive sourcing.
Commercial Activity	A specific task or grouping of tasks that provides a specialized capability, service or product based on a recurring government requirement. These are generally activities obtainable from a commercial source.
Competitive Sourcing	A policy that involves conducting public-private competitions to compare the performance of a government organization with that of the private sector or other non-federal organizations.
Competitive Sourcing Official (CSO)	An inherently governmental agency official responsible for the implementation of OMB Circular A-76 within an agency. The person is generally an Assistant Secretary level appointee.
Contracting In	The use of another government organization or agency to perform a function that was considered for contracting.
Contracting Out	The use of a contractor to provide service delivery while the government maintains overall accountability and responsibility.
Inherently Governmental	An activity that is so intimately related to the public interest, as to mandate performance by government personnel.
Most Efficient Organization (MEO)	The staffing plan of an agency tender, developed to represent the agency's most efficient and cost effective organization. A MEO is required for a standard competition any may include a mix of government personnel and MEO subcontracts.
Outsourcing	The transfer of a function that had been performed by government employees to performance by contract or non-profit bidders. A function goes to the private sector without the opportunity for the public sector to compete.
Privatization	A federal agency decision to change a government owned and government operated commercial activity or enterprise to private sector control and ownership.
Public-Private Competitions	These are competitions between the public and private sector over the provision of commercial activities
Savings	This generally refers to the cost savings generated from an A-76 competition.

\*OMB 2003

Understanding the Process

The competitive sourcing process begins with Federal Activities Inventory Reform (FAIR) Act compliance. The FAIR sets June 30 of each year as the submission deadline for an inventory of commercial activities performed by agency personnel, an inventory of inherently governmental functions and an inventory summary report (OMB 2003a). After OMB reviews the list it is sent to Congress and made public in the *Federal Register*. The private sector can review the list and challenge either the omission or the inclusion of a particular activity (GAO, 2002b).

*Packaging Phase*

The A-76 process begins with a packaging phase, which is a preliminary research analysis. This is used to determine the appropriate grouping of activities and the incumbent's baseline costs (OMB 2003b). There is also a determination made on whether a streamlined or standard competition will be conducted. Also important is that the Competitive Sourcing Official (CSO) appoints other inherently governmental officials to administer the A-76 competitions.

*Announcement Phase*

The announcement phase is where the news of an A-76 competition is released to the affected workforce, the Congress and the general public (DoD 2003). Additionally a twelve-month time limit is placed on the competition. The public announcement date has been designated as the start date for an A-76 competition (OMB 2003).

*Determining the Type of Competition*

The next step in the competitive sourcing process is determining the type of competition to be used. A streamlined competition can be conducted for commercial activities, which involve 65 or fewer full time equivalents (FTEs). Streamlined competitions are to be completed within 90 calendar days, although extensions may be approved. Also important to note is that they do not generally include a cost saving threshold, unless otherwise stipulated (FAC 2004).

The standard competition is generally used for commercial activity studies involving 65 FTEs or greater. This type of competition can take up to 12 months but extensions may be granted when necessary. Additionally, all standard competitions must include a conversion

differential "that requires the non-federal bidder to show incremental savings of lesser of \$10 million or ten percent of personnel related costs to contract out the work" (FAC 2004, 19). The conversion differential should capture non-quantifiable costs related to an A-76 conversion (OMB 2003a).

#### *Performance Work Statement*

This is followed by the development of a performance work statement, which becomes part of the Request For Proposal (RFP). The PWS defines the work that needs to be conducted (OMB 2003a). It also looks at workload data and gathers additional information need to compose the PWS.

#### *Solicitation and Quality Assurance*

The solicitation phase is where the type of contract to use and the acquisition procedures are determined. This is the step where the RFP is released. This phase also includes the Quality Assurance Surveillance Plan (QASP), which sets the performance measurement criteria and the associated costs with monitoring (OMB 2003a).

*Government Management Plan and the MEO*

The next major step in the process is putting together the government management plan. This is where the government determines the organizational structures needed to perform the activity in an efficient and cost effective manner (DoD 2003). The government management plan includes the Most Efficient Organization (MEO); the In-House Cost Estimate (IHCE); the Technical Performance Plan (TPP); and the Transition Plan (TP). The MEO allows employees to restructure themselves to be as competitive as possible (OMB 2003a).

*Independent Review and Negotiations*

After the government management plan has been submitted an independent review takes place to certify the data and ensure government can perform the work as stipulated in the PWS. The negotiation phase allows discussions between the Contracting Officer and the offerors, in case of any questions with their respective proposals (OMB 2003a). This is also where the Contracting Officer selects the single contractor that will compete with the MEO (DoD 2003).

*Cost Comparison*

In this phase the Contracting Officer makes a tentative decision between the MEO and the other offeror. This is also where any best value trade-offs would be considered in a standard competition. Trade-offs may be considered for "information technology activities, commercial activities performed by a private sector source, new requirements or segregable expansions" (FAR 1997, 15.101). Additionally, special considerations are taken into account like conversion differentials and/or any deficiencies in an existing offer (OMB 2003a).

*Performance Decision*

In this phase the performance decision is certified by the Source Selection Authority and the Contracting Officer (OMB 2003a). Then a public announcement of the performance decision is released. Moreover, debriefings will be conducted for all relevant parties. Finally, the agency implements the performance decision.

*Post Competition and Accountability*

This is where agencies involved with the competition process, post their best practices and lessons learned. Agencies will also be required to track the execution of A-76 competitions, perform monitoring and submit quarterly competitive sourcing reports. If necessary, terminations would be conducted in the post competition phase.

*Contests*

In this phase a directly interested party may contest a standard competition. The primary reasons for a contest generally focus on issues with a solicitation, performance decision and/or termination. "No parties may contest any aspect of a streamlined competition" (OMB 2003, B-20).

*Where do we stand today with Competitive Sourcing?*

The September 30, 2004, OMB scorecard from the results.gov website reports mixed results from the current status of competitive sourcing. Of the twenty-six agencies listed on the President's Management Agenda (PMA) scorecard for competitive sourcing: six agencies were reported in the green category; twelve in yellow; and eight in the red category (OMB 2004c). Green indicates implementation is

going as planned, yellow points to some slippage and red means the program is in serious jeopardy (OMB 2004c). All told, competitive sourcing has moved significantly forward since 2003, when virtually all agencies were in the red category. Although, it is important to note that OMB's grading criteria moved away from numerical targets to customized agency specific goals (Gruber 2003). This shift may have had some effect on the current agency grades.

A broad based evaluation of today's competitive sourcing policy would most likely indicate mixed results. However, if competitive sourcing was appraised by cost savings alone many would argue that the policy is an unmitigated success. A snapshot of the fiscal year 2003 agency competitive sourcing efforts demonstrates a \$12,000 net cost savings per FTE (OMB 2004a). The aggregated projections indicate that competitive sourcing will yield \$1.1 billion in cost savings over the next three to five years (OMB 2004b). Moreover, projected cost savings for some agencies may have been higher with wider implementation efforts. Yet, the overall agency results are uneven. Many agencies have captured impressive cost savings, while others have struggled to find success (OMB 2004a).

When evaluating competitive sourcing on terms other than cost savings, a somewhat muddled picture emerges. An example can be seen with the development of workforce inventories that differentiate between commercial activities and inherently governmental functions (GAO 2004a). There appear to be wide differences between agencies on what constitutes an inherently governmental function. Moreover, agencies are subject to constant change and operate "under OMB guidance focused more on meeting milestones than achieving desired outcomes" (GAO 2004a, 11). Additionally, ensuring experienced personnel are trained and resourced appropriately is an important aspect of competitive sourcing policy that needs to be considered further (GAO 2004a). The challenges of competitive sourcing policy today lead to the questions for tomorrow.

#### Questions for Tomorrow

The competitive sourcing policy will have a far ranging impact on the operation of the federal government in the future. Competitive sourcing has generated a number of issues that will need to be discussed by the general populace and our policy-makers. These issues relate to

the desired size of the federal government, the level of accountability preferred from private contractors performing public functions, the type of competition to be used, the type of government that is desired, and the safeguarding of constitutional protections and their consistent application to private contractors performing public functions.

*Type of Government?*

What type of government, do we the people want? One that is based on economy, efficiency and cost savings or one that is based on accountability, equity and responsiveness? There is no doubt that economy and efficiency will save the taxpayer money in the short term, but what price will be paid in the long term. There is also nothing wrong with desiring economy, efficiency and cost savings from government. However, we must realize that the government envisioned by James Madison in the *Federalist Papers* was one that was primarily concerned with being responsive to the checks and balances of the separation of powers systems. Of course government is also responsive and representative to the people who elected it.

However, as federal jobs are cut and moved to the private sector, the government will most likely become less representative of the people it serves. The benefits of a representative bureaucracy are that it mirrors the U.S. population by assuring people from all walks of life access to the policymaking process (Naff and Crum 2000). Also, important is that government becomes more transparent when it is subjected to oversight by Congress and the Courts through constitutional and administrative law statutes. Bureaucracy is representative and responsive to the different branches of government and the varying interests that it serves.

The checks and balances of the American constitutional system reflect our desire to reduce the arbitrariness of official rule. That desire is based squarely on the premise that inefficiency is a small price to pay for freedom and responsiveness... It is not hyperbole to say that the constitutional order is animated by the desire to make the government inefficient (Wilson 1989).

Yet, an efficient, responsive, representative and cost savings alternative may be allowing the majority of the federal bureaucracy to go through the most efficient organization process. This may allow for cost savings while also maintaining public sector representativeness and responsiveness. But this begs the question: "if the government could manage a task in such a manner, why has it not done so previously?" (Schooner 2004, 273-274).

*Size of Government?*

One of the primary questions that must be asked is, what size government do we the people want? President Bush states that we want a "citizen-centered, not bureaucracy centered government," but he avoids discussing the size of government (Bush 2001). The meaning of his comments are open to interpretation, but they seem to indicate more reliance on the private sector through the competitive sourcing initiative. This ultimately means basing federal workforce decisions on uncertain cost savings data, as we will see in the next chapter. Moreover, as the bureaucracy becomes smaller the overall representativeness may decrease. However, there should be savings to be reaped with a smaller government. Yet we don't know how much savings, because there is very little reliable information on the number of employees performing federal services in the private sector. "It is not clear what the definition of the federal workforce should include" (Panetta 1993, 1). The true size of government (including contractor personnel) in 1999 was roughly 17 million employees, about eight times larger than the civil service workforce (Light 2000). If we don't know the true size of government, how do we know there are true cost savings?

*Type of Accountability?*

Another important question that needs to be examined is, what type of accountability do we the people want? One of the bigger fears with expanding the use of contracting via competitive sourcing is the devolution of oversight and accountability to private contractors. While the level of contracting has been steadily rising, some argue the level of government's contract management capacity has not kept pace (Kettl 1993). As mentioned previously contract oversight is a problem that has plagued many executive agencies. The GAO found the following:

The government's long standing difficulties with managing service contracts have not changed, and its clear that agencies are not doing all they can to ensure that they are acquiring services that meet their needs in a cost-effective manner (GAO 2001, 5).

One reason is the acquisition reforms in the mid 1990s have eased some contract oversight requirements. Further complicating the problem is the use of subcontractors. Load shedding is the shifting of reporting and monitoring functions from the government to their contractors. The risks of accountability loom large (Sanger 2001). Since subcontractor oversight is the purview of the contractor, the federal government loses some element of control over the accountability process.

The human capital problems in the acquisition workforce are having a negative impact on contract oversight. Especially when we consider that 69% of the federal acquisition workforce, which provide invaluable contract administration and oversight functions will be eligible to retire by 2005 (OPM 2001). A proactive stance is necessary to surmount these oversight challenges. As Herman Finer argued, accountability had to flow from control by outside forces with legal oversight powers, such as Congress the President and the courts (Kettl 2002; Finer 1941). Outside forces and opposition may be able to assist in the oversight process.

Governments that face opposition to contracting may respond by investing in the various components of capacity to justify their decision to contract out and to police contractors to prevent problems that would fuel future opposition (Brown and Potoski 2003a). There is no time like the present to examine contract accountability standards and make earnest strides to revitalize the acquisition workforce.

*Type of Competition*

The recent revisions to OMB Circular A-76 allows for the use of either streamlined or standard competitions. As mentioned previously, streamlined competitions involve sixty-five or fewer FTEs and are required to be completed in ninety days or less. Also important is that streamlined competitions may be based on the cost estimate of the original activity and don't require the development of an agency's MEO. Moreover the agency is allowed to estimate a contract price by using either market research or by soliciting cost proposals (OMB 2003a). The development of both of these estimates is left to agency discretion within the parameters of OMB Circular A-76.

When examining recent source selection activity we see that in fiscal year 2003, agencies choose to conduct 570 streamlined competitions vs. 92 standard competitions (OMB 2004a). These figures may depict an agency preference for the less rigorous streamlined competition process. Furthermore, this process is generally less time intensive, less costly and allows the agency a great deal of discretion in source selection decisions. A recent GAO decision on a federal employee protest follows:

Protest filed by federal employees on behalf of other federal employees who assert that they were directly affected by agency's decision made pursuant to a streamlined competition under OMB A-76 as revised on May 23, 2003, to contract for the work, rather than to continue to perform the work in-house, is dismissed because, as permitted under the Circular's streamlined procedures, the decision to contract out the work was based on the agency's internal analysis... (GAO 2004b, 1).

The revised OMB Circular A-76 makes it clear that "no parties may contest any aspect of a streamlined competition" (OMB 2003a, B-20). As can be seen, the use of streamlined competitions allows a great deal of agency decision-making discretion in source selections. A potential challenge for the future will be monitoring the type of competitions chosen and determining if greater agency scrutiny is warranted.

The recent OMB Circular A-76 revision endorses the use of best value source selections when practicable. The choice between a low cost or best value source selection methodology, raises some interesting issues when deciding on the provision of services for the federal government. The standard low cost source selection criterion for A-76 emphasizes the achievement of cost savings. Whereas, in a best value competition an agency may trade-off cost and technical considerations specified in the evaluation criteria (Peckinpaugh and Goldstein 1993). The Federal Acquisition Regulation (FAR) defines best value "as the

expected outcome of an acquisition that provides the greatest overall value for an agency (FAR 1997, 2.101). Some factors like cost, quality and performance must always be evaluated in a best value source selection (OMB 2003a). However, "an agency may tradeoff cost and non-cost factors to select the best value offer, which may not always be the lowest priced offer" (Harney 1998, 70).

A report by the Committee on Government Operations in the U.S. House of Representatives stated the following about best value source selections:

A recent phenomenon in federal procurement is the movement toward "best value" procurements. The Committee is, of course, in favor of the federal government getting the "best value" for the taxpayers' money. In the peculiar world of federal procurement, however, "best value" all too often has come to mean something quite different from the government getting a bargain. Typically it means a procurement in which price is a negligible or even zero-weight source selection factor and the evaluation criteria are so flexible that award is left up to the total discretion of the agency (House 1991, 20).

In most cases, best value source selections allow the agency more discretion than low cost competitions. There is also the claim that best value has helped level the playing field between offerors because the agency can better understand varying aspects of competing proposals (GAO 1998b). Yet there is no escaping the weight placed on cost savings, especially when considering that private offerors must still beat the MEO's price by ten percent (Harney 1998).

Choosing between best value and low cost source selection criteria highlights three important challenges for competitive sourcing. The first is ensuring specific cost evaluation factors are considered for both offerors. Moreover, competitions could be unfairly skewed by considering quality and cost for one offeror and cost only for the other (Harney 1998). It seems the writing of OMB Circular A-76 appears to lean toward cost savings. The second challenge comes in gaming the system. In best value some amount of subjectivity will most likely enter into the sourcing decision. This could be construed by a losing offeror, as gaming the system, because of varying weights placed on different evaluation criteria. Also important is that any best value offer could still lose on cost because of the conversion differential (Harney 1998). Finally, if low cost is repeatedly placed before best value, how will offerors be encouraged to submit best value proposals.

Ultimately it appears that best value is a step in the right direction. Moreover, best value may broaden sourcing decisions through consideration of non-cost factors and by allowing trade-offs between competing evaluation criteria. Yet, in the bigger picture we must consider whether the emphasis on cost savings places competitive sourcing at

odds with non-cost considerations like promoting quality and ensuring accountability?

*Level of Constitutional Protections?*

Does competitive sourcing allow we the people, an appropriate level of constitutional protection? The citizenry is protected by the Constitution and public law, but less protective and restrictive rules apply to private parties (Gilmour and Jensen 1998). The answer is easy for those services and functions that stay in government. However, one of the attractive features of using a private contractor is that it does not have to comply with the same statutory requirements as those found in the public sector. If private actors are not subject to rules set for government action, delegating authority to private parties may allow government to do through them what it cannot do for itself (Starr 1989). Moreover, Mays (1995) states the following:

When private actors, rather than governmental agencies, perform the same function as the government, they are not necessarily subject to the same constitutional restraints. Therefore, transferring governmental services to private corporations will diminish the constitutional protections afforded individuals (Mays 1995).

The doctrine of state action determines whether a private entity is considered a state actor (governmental

actor) for constitutional purposes and thereby constrained by the Constitution (Rosenbloom 2004). This is important because if the private contractor is deemed a state actor, they are bound by constitutional law. "Unfortunately for those who like their constitutional law to come with bright lines, determining what constitutes state action is often a matter of normative judgment" (Rosenbloom 2003).

Then there is the question of transparency and access to information under the Freedom of Information Act (FOIA). "FOIA embodies the democratic-constitutional value of government transparency" (Piotrowski and Rosenbloom 2002, 649). Whether private contractors have to comply with FOIA is somewhat muddled. The Paperwork Reduction Act of 1995 HR 830 Section 3518(f), eliminates the right of the public to obtain government computer records held by contractors when value added services have been provided to the government (TAP 1995). The problem is that value added seems to be open to interpretation and may only mean basic data manipulation. In an era of downsizing and greater reliance upon private contractors, citizens will have to rely upon government bureaucrats to negotiate public disclosure rights every time a new contract is written (TAP 1995). "This is because most statutes providing for

freedom of access to government documents do not explicitly grant access to documents in the hands of private entities" (Feiser 2000).

Conversely, what requires private contractors to protect information that is now proprietary? These challenges will place increased importance on the doctrine of state action. As Rosenbloom states:

If the widespread outsourcing and development of public-private partnerships of the 1990s continue, then the state action doctrine will probably be further applied, perhaps in ways that dampen private parties' interest in contracting or partnering with government (Rosenbloom 2003, 50).

The requirements for competitive sourcing in the future may need to include constitutional protections like FOIA and other necessary safeguards, which improve government accountability and transparency for those 'serving' the public interest.

### Conclusion

Competitive sourcing is about much more than achieving cost savings. It is about competing theories of government. On the one side, there are those espousing economy, efficiency, cost savings and an entrepreneurial government. On the other side, there are those looking for accountability, equity, representativeness, participation,

transparency and responsiveness to define government. Within the policy itself, the choice between a streamlined or standard competition and a best value or low cost source selection provides a microcosm of competing public values. From an empirical point of view we do not have enough information to know if competitive sourcing will consistently reduce the costs of government. So, we the people must make an informed choice by understanding the challenges and controversies surrounding competitive sourcing. One simple adage may summarize our current condition 'you get what you pay for'. If that is truly the case, why should we assume that governing in the least provides government at it's best?

CHAPTER 5:  
A REVIEW OF THEORY  
AND EXISTING RESEARCH

Introduction

The foundation of today's competitive sourcing policy rests on the premise that public-private competitions for government's commercial activities will yield cost savings. This chapter will begin by examining the theory behind competitive sourcing. This will be followed by a review of the empirical studies and cases that have focused on public-private competitions. The literature discussed in this chapter was chosen for review because it was consistently cited in discussions involving public-private competitions and cost savings for the provision of government services. The purpose of this chapter is to provide an overview of the theories and studies that relate to competitive sourcing.

Public-Private Competition Theory

There are a number of overarching theories that discuss public-private competitions. The three primary theories are focused on public choice, transaction costs and ownership. Additionally, Osborne and Gaebler's book *Reinventing Government*, the National Performance Review (NPR) and the New Public Management (NPM) should also be factored into a discussion on the impetus behind competitive sourcing.

*Public Choice*

Public choice theory focuses on the self-interest, incentives and discretion of politicians, bureaucrats, special interest groups and voters. In 1971, William Niskanen's theory of the budget-maximizing bureaucrat assumed a self-interested rational actor, which created a semblance of congressional dependence for personal benefit (Niskanen 1971). Niskanen's later writing modified this theory and provided a number of competing hypotheses like the overspending hypothesis, the production inefficiency hypothesis, the oversupply hypothesis, the overcapitalization hypothesis and the bureaucratic structure hypothesis (Niskanen 1975).

Niskanen and other public choice advocates like Gordon Tullock (1965), Joseph Monsen and Anthony Downs (1965) considered self-interested behavior as a bureaucratic norm. In terms of public-private competitions, public choice has examined the government supply of services on both an organization level and on an individual level. However, the insertion of market-like competitions into the provision of government services in many cases has somewhat undercut the monopolistic tendencies of public bureaucracies and may change the predispositions of interested actors (Schwartz 1994).

#### *Transaction Costs*

Another important theory posits that transaction costs are an important consideration in the provision of services. Ronald Coase (1937) formulated a theory that involved transaction costs for inputs like capital, land, labor, specialized knowledge and services. Coase was concerned with costs for information and contractual arrangement (Coase 1937). Coase theorized that organizations emerge based on efficiency. "Economic agents arrange production within firms - they substitute authority relations for market relation - in order to reduce

transaction costs and produce more efficiently" (Moe 1984, 743).

The transaction cost approach is focused on the transference and exchange of organizational goods or services (Williamson 1981). More specifically it concentrates on the friction that occurs in exchange relationships. "Transaction costs are the costs of specifying and enforcing the contracts that underlie exchange and therefore compromise all the costs of political and economic organization that permit economies to capture gains from trade" (North 1984, 7). The early advocates of the transaction cost approach realized that economic efficiency was not independent of internal structure (Chandler 1962; Williamson 1981). As Kenneth Arrow (1969) noted "market failure is not absolute; it is better to consider a broader category, that of transaction costs, which in general impede and sometimes completely block the formation of markets" (48).

The transaction costs approach also considers the cost of writing and enforcing contracts (Williamson 1981; North 1984). There is the additional consideration that human agents do not possess perfect information and are subject to some form of bounded rationality (Simon 1978). This in

turn may lead to incomplete contracting. Thus, transaction cost theory includes aspects of uncertainty, frequency of transactions and asset specificity (Williamson 1996). In relation to competitive sourcing, the addition of transaction costs may lessen the amount of cost savings achieved through public-private competitions.

#### *Ownership and Property Rights*

Ownership theory assumes that the public provision of service is inherently inefficient when compared to the private sector. The primary reasons behind the assumption of public inefficiency are a lack of incentives, diverse public policy objectives and little fear of public sector insolvency (Alchian and Demsetz 1972; Vickers and Yarrow 1991; Vining and Boardman 1992; Blom-Hansen 2003). Moreover, the diffuse number of citizen-owners often find it challenging to monitor bureaucrats in a public firm especially if there is no ownership transferability (Borcherding and Besocke 2002). It should be noted that ownership theory is a byproduct of transaction costs theory.

Ownership may also be important "if government is actually prepared to award contracts to private firms, this

demonstrates that "public" providers have no greater property right to perform the service than a "private" firm" (Vining and Boardman 1992, 213). Some feel this may be equivalent to saying there is little to no difference between the public and private provision of service (Vining and Weimer 1990). Proponents claim an added benefit of privatization and contracting is that it "works" to control political discretion (Boycko et al. 1996). Therefore, the introduction of competition through competitive sourcing should create efficiencies, which generate costs savings

#### *Reform Movements*

The reform movements that affected the federal government in the early 1990s were on the periphery of the theory surrounding competitive sourcing. It is important to note that the coalescing of an empirical theory behind the New Public Management (NPM), the National Performance Review (NPR) and the *Reinventing Government* phenomenon has yet to emerge. Although, these reform efforts did contribute to the increased interest and use of market-like competition involving the provision of government goods and services. They were also predicated on an apolitical business type of approach to government (Rosenbloom and

Kravchuk 2002). Moreover, the reformers presumed a virtual interchangeability between the public and private sector provision of service. In most instances these reform efforts would tend to embrace competitive sourcing as a means to better government.

#### *Empirical Studies and Cases*

This section of the chapter will review a variety of empirical studies and cases that have examined cost savings through contracting and competitive sourcing. The early studies seem to emphasize direct comparisons between the public and private sector provision of services. In order to embrace the broader picture of cost savings associated with government contracting, studies will be grouped into four subsections. These subsections cover topical areas in privatization, contracting-out, transactions costs and competitive sourcing.

#### *Privatization Studies*

The first group of studies analyzes cost savings in contracting through the use of privatization. Privatization is defined as "a federal agency decision to change a government owned and government operated

commercial activity or enterprise to private sector control and ownership" (FAC 2004). The main reason many governments choose privatization over the public provision of service is the belief that the shift in provider will create cost savings (Savas 1987; Donahue 1989; Lopez-de-Silanes et al. 1996).

In 1971, David Davies conducted one of the first privatization studies, on airlines in Australia. His article "The Efficiency of Public vs. Private Firms, The Case of Two Australian Airlines in the *Journal of Law and Economics*" used general statistics like tons of freight carried, number of passengers carried and revenue earned per employee as comparison points between two airlines. These general comparisons between the public and private airline were conducted over a ten-year period. The study revealed increased cost savings by the private carrier. Davies (1971) concludes, "the data support the contention that the private company is more economically efficient than the public firm" (165). However, he goes on to state that political and non-economic considerations may also factor into the decision-making choice between the public or private provision of services (Davies 1971).

Roger Ahlbrandt's widely quoted 1973 study on "Efficiency in the Provision of Fire Services" in *Public Choice* compared data from a private fire service provider in Scottsdale, Arizona with publicly provided fire protection in the Seattle-King County, Washington area. Linear regression was used to determine that a private fire services contractor was forty seven percent less expensive than publicly provided fire protection (Ahlbrandt 1973). The study also pointed to lower contractor overhead costs and innovations like part time fire fighters and modified pumper trucks. Additionally, Ahlbrandt (1973) noted that the scales of operation differ because the non-economic constraints between the two providers differ. He also wrote that the public service provider might maximize a wide set of goals and objectives rather than focusing primarily on cost savings. Finally, the study cautioned against generalizing from only one observation (Ahlbrandt 1973).

Douglas Caves and Laurits Christensen studied the "Relative Efficiency of Public and Private Firms in a Competitive Environment: The Case of Canadian Railroads" in a 1980 article in the *Journal of Political Economy*. Caves and Christenson performed a case study in which differing

property rights (public and private) were isolated from regulation and noncompetitive markets (Caves and Christensen 1980). This case study used cross-sectional data from 1956, 1963 and 1974. From these data an index of total factor productivity estimates was used to compare both railroads. "Our principal conclusion is that public ownership is not inherently less efficient than private ownership" (Caves and Christensen 1980, 974). The researchers also noted that there may be criteria other than efficiency that affect the preference for public or private ownership.

James McDavid's 1981 study on the Canadian privatization of waste removal in *Public Administration Review* focused on survey data from 109 city managers and administrators. McDavid's findings revealed higher costs for the twenty-six municipal cases and the lowest cost for private refuse collection (McDavid 1985). He also conducted a case study on refuse collection in two suburbs of Vancouver, British Columbia. He found the introduction of competition into both communities lowered the cost of refuse collection. McDavid's most notable finding may have been that efficiency is most likely achieved through competition rather than through inherent capabilities in

the public or private provision of waste collection services (McDavid 1985).

Scott Atkinson and Robert Halvorsen conducted a study in 1986 on "The Relative Efficiency of Public and Private Firms in a Regulated Environment: The Case of U.S. Electric Utilities". Atkinson and Halvorsen reviewed a large number of empirical studies looking at efficiency in the utilities industry and found that many of these models were inadequately specified. Moreover, "previous empirical studies yield conflicting evidence on the relative efficiency of publicly-owned and privately-owned utilities" (Atkinson and Halvorsen 1986, 287). Atkinson and Halvorsen used parametric approximations in their model to find that public and privately provided utilities were "equally cost inefficient" (Atkinson and Halvorsen 1986).

Another study in 1986 by James Perry and Timlynn Babitsky looked at urban bus transit, this would later appear in the *Public Administration Review*. Perry and Babitsky used multivariate regression to compare varying ownership and management arrangements against variables like output per dollar, vehicle efficiency and maintenance efficiency. They found that the privately owned transit systems performed better on output per dollar (Perry and

Babitsky 1986). However their results also stated that contractor managed systems were no more efficient than publicly managed systems and this was replicated over three different variables (Perry and Babitsky 1986). Additionally they note the public sector's "unique social role" may influence transit efficiency.

The 1987 release of *Privatization - The Key to Better Government* by Emanuel Savas, may have helped energize some of the force behind the privatization movement in the United States. In this book Savas defines privatization and then assesses it from a theoretical perspective. He also looks at survey data and a few studies on contracting to draw comparisons between the functions offered in the public and private sectors. Moreover he develops a list of functions and services like refuse collection, communications and water treatment that could be considered for privatization. Savas admits there are research limitations within his book. "Nevertheless the evidence from the studies...leads one to conclude that the private sector generally can deliver so-called public services more efficiently and more effectively than government" (Savas 1987, 172). In the formal conclusion of the book Savas

(1987) states "privatization is the key to both limited and better government" (288).

Ronald Moe wrote, "Exploring the Limits of Privatization" in 1987, to highlight the role public law plays in the privatization movement. Moe suggests that the neglected roots of privatization and public administration can be found in public law (Moe 1987). Additionally, he argues against the notion that the public and private sectors are alike in terms of efficiency and economic incentives. "A line must separate that which is public, or governmental and that which is private... the fundamental basis of this line to be found in public law, not in economics or behavioral theories" (Moe 1987, 454). Moe also examines accountability, corruption and capacity as necessary considerations in the privatization equation. Finally, Moe comments that privatization "must come to grips" with the need to integrate economic theory and public law (Moe 1987).

In 1989, John Donahue's *The Privatization Decision* was released. Donahue's work created a theoretical framework for privatization and it examined public functions that were being performed in the private sector on a trial basis. Donahue closely focused on the case of refuse

collection and summarized the findings of seven studies. Two of the studies were not conclusive but the remaining studies showed a consistent pattern - "contractors are cheapest" (Donahue 1989). A number of other public functions were also considered but the summary data seemed inconclusive and the discussion typically focused on the market environment for each service. Donahue offers three primary findings; government must specify what it needs, the contracting process is too complicated, and competition helps assure efficiency (Donahue 1989). Also of note is Donahue's mention of the importance of public values like accountability, fairness and due process. Yet, he states these are often at odds with the administrative flexibility needed for privatization... "different organizational designs have different virtues and defects" (Donahue 1989, 216).

Giovanni De Fraja's 1991 analysis in *The Journal of Industrial Economics* presents a different view of privatization. De Fraja's basic hypothesis claims that the profit motive is a more effective means of reducing inefficiencies in production... a more efficient firm improves industry efficiency (DeFraja 1991). De Fraja creates a model to test whether an oligopolistic interaction between two firms in the pubic and private

sector leads to gains in overall industry efficiency. De Fraja finds "far from privatization improving efficiency and reducing waste, it may yield the opposite results of a reduction in industry efficiency" (De Fraja 1991, 319). Moreover the social role of a public firm may actually create greater efficiency and savings industry wide. This is because a "public firm instructed by government to maximize social welfare...authorized to run at a budget loss, cares less about cost efficiency and reduces its price, which in turn stimulates private industry to improve efficiency" (De Fraja 1991, 320).

David Morgan's article in 1992 on the Pitfalls of Privatization: Contracting Without Competition in the *American Review of Public Administration*, examines a case study on the Oklahoma City sewage treatment plants. Morgan finds a situation where Oklahoma City is faced with rising costs and lack of competition for their sewage treatment. He finds the city under privatization was paying 26%-126% more than other cities with similar facilities (Morgan 1992). Morgan concludes that "scholars and academicians may have oversold competition and its attendant cost savings as the main benefit and primary motivation for privatization" (Morgan 1992, 265). He also contends that

developing some level of public capacity and control is important in the provision of government services through contract mechanisms.

Rowan Miranda and Allan Lerner's 1995 study "Bureaucracy, Organizational Redundancy and the Privatization of Public Services" in *Public Administration Review* examined the effects redundancy in services have on efficiency. Redundancy was defined as the use of more than one organization to provide services, which generally consisted of public and private capacity. Miranda and Rowan used data from a 1982 International City/County Management Association (ICMA) survey. Moreover, they used regression analysis to determine that redundancy in public and private capacity can be cost effective. They also stated that the use of both government and private markets might improve service delivery (Miranda and Lerner 1995).

The 1996 article "Privatization in the United States" by Florencio Lopez de Silanes, Andrei Schleifer and Robert Vishny in the *RAND Journal of Economics* looks at the political determinants of privatization. The author's examine how the choice in provision of service is made between in-house government and private sector providers. They do this by testing three types of determinants;

efficiency, political patronage and ideology against cross sectional census data on the most commonly provided public services. Their methodology uses probit and linear regression to determine the results. "The evidence suggests that political factors are important" (Lopez de Silanes et al. 1996, 168). They also find that privatization is in part determined by trade-offs in political costs and benefits. "This political tradeoff, and not just the efficiency and ideological factors, is likely to determine the decision" (Lopez de Silanes et al. 1996, 168). In this study, politics as well as cost savings and efficiency are central factors in the contracting decision.

Lawrence Martin's discussion in "Public-Private Competition - A Public Employee Alternative to Privatization" in the *Review of Public Personnel Administration* examines six case studies where public-private competitions have occurred. Martin asks whether public employees can compete with the private sector contractors. In his conclusion he writes, "based on the evidence that could be accessed, the answer to this question appears to be a qualified, yes" (Martin 1999, 68). Moreover, the aggregated data from the case studies

indicates that public sector employees have "held their own" against private contractors in head to head public-private competitions (Martin 1999).

In 1999, Jocelyn Johnston and Barbara Romzek's study on "Contracting and Accountability in State Medicaid Reform: Rhetoric, Theories and Reality" in *Public Administration Review* examined the role played by contract management in the provision of social services in Kansas. Johnston and Romzek conducted thirty-seven personal interviews amongst two groups of personnel involved in implementing the privatization of social services. They found that the market competition generally used as a lever to discipline contractors is somewhat lacking in the social services environment. This finding indicates that the complexity involved in the social services case has strained the contract management and accountability structures within the state of Kansas. Moreover, Kansas reduced the capacity of their social service agency "by shifting responsibility to a nonprofit interest group" (Johnston and Romzek 1999, 395).

The release of Elliot Sclar's *You Don't Always Get What You Pay For: The Economics of Privatization* scrutinized the successes of privatization in the United

States. Sclar sought to critically examine why privatization in the form of public contracting often "bogs down". He did this by analyzing the theory behind privatization and through the presentation of a number of case studies. Furthermore, the majority of case studies depicted market imperfections, which in turn limited competition and constrained or in some cases eliminated any cost savings. Additionally, he discussed the need to consider transaction costs in all privatization efforts. "The bottom line is public contracting continues to be cumbersome and expensive... there is an ongoing trade-off between risk of moral hazard and the cost of effective oversight" (Sclar 2001, 155). Also important to note is Sclar's feeling that the public sector remains a principal provider of service because it would be too expensive to replace it through wholesale contracting (Sclar 2001).

A briefing paper on "Privatization and the Market Role of Local Government" by Mildred Warner and Amir Hefetz of the Economic Policy Institute examined longitudinal survey data from ICMA from 1982 to 1997. This study revealed limited growth for privatization over a sixteen-year period. Additionally, "most governments that contract out also contract back in" (Warner and Hefetz 2001, 19). They

find that a government may sometimes let a contract to develop in-house capacity to provide the needed service. Also privatization is a limited tool because it requires structuring a market, monitoring and competition. "Even when privatization is possible, governments often must remain providers in the market to ensure competitive contracts and cost savings" (Warner and Hefetz 2001, 19). Overall this study seeks a balance between the public and private provision of services.

David Van Slyke's 2003 article "The Mythology of Privatization in Contracting for Social Services" in *Public Administration Review* examines the competitive environment and capacity to contract for social services. Van Slyke used a fifteen question survey instrument to interview thirty-five public and non-profit managers. His findings point to considerations other than cost savings and competition as reasons to privatize. Moreover, politics appears to be one of the motivations behind the decision to privatize services. He also finds that "administrative costs associated with privatization in developing competition and providing oversight is seldom figured into the cost savings calculus" (Van Slyke 2003, 308). He concludes by stating that government should invest in

public management capacity and adhere to contractual requirements because these help create smart public buyers (Van Slyke 2003).

#### *Contracting Out*

The next grouping of studies presented focus on contracting out. The Office of Management and Budget (OMB) defines contracting-out as the use of a contractor to provide service delivery while the government maintains overall accountability and responsibility (OMB 2003). Many believe contracting-out generates cost savings in the provision of government services.

James T. Bennett and Manuel Johnson's 1979 article in *Public Choice* analyzed garbage collection in Fairfax County, Virginia. Bennett and Johnson conducted a case study that compared the public and private provision of trash collection. Their data revealed the public price for garbage collection was \$86 per year, but when adding in property taxes that cost rose to \$126.80 per year. Conversely the average private refuse collector charged between \$88-96 per year. Through multivariate regression they found a statistically significant outcome that points to the private sector as the cheaper provider of service.

They also determine that while the government provider of service is inefficient, the general public as a whole can deduct refuse collection charges from their federal income taxes when service is provided by the public sector (Bennett and Johnson 1979). This consideration may somewhat diffuse the amount of savings reported.

Another early study on contracting out was written in 1980 by Patricia Florestano and Stephen Gordon. Their article in *Public Administration Review* titled "Public vs. Private: Small Government Contracting with the Private Sector" examined contracting by small municipalities of 50,000 and under. Florestano and Gordon sent a four-page questionnaire to 803 members of the National Institute of Government Purchasing. However, their findings were based on only eighty-nine responses. The results showed that the majority of contracts are let for professional and/or housekeeping services. They also found that the decision to contract for services like refuse collection and road construction was generally based on past performance rather than cost. Additionally the decision to contract for professional services was based on competence rather than price. Overall, they believe there is potential for contracting out, but they can't say definitively that

contracting for public services is "the panacea for budgetary constraints that many observers have suggested" (Florestano and Gordon 1980, 33).

David Lowery examined contracting through the lens of benefits and costs to society. His article "The Political Incentives of Government Contracting" analyzed data on 690 municipalities from the state of Michigan using linear regression techniques. Lowery's model found that contracting has a negative impact on assessing service performance. Moreover, "contracting in service assessment leads to both lower costs and lower-quality service performance" (Lowery 1982, 525). Lowery also contends that public choice theory may not be generalizable to goods and services viewed as costs to society (Lowery 1982). Moreover his "messy conclusion" finds that "public provision may be necessary for some goods and services if the collective benefits from these goods and services is to be realized" (Lowery 1982, 527).

In 1984 Ruth DeHoog's book *Contracting Out For Human Services* examined the state of Michigan's experiences with contracting out in two different state departments. DeHoog's methodology employed personal interviews with a number of contracting officials, specialists and

contractors. DeHoog's findings indicate that a lack of competition was found to be problematic and that contract awards were sometimes made to those that did not always consider government priorities. Moreover, the decision making process for the two departments varied, one favored contracting because it viewed its role as more of a policy coordinator, while the other based contracting decisions on reputation and experience (DeHoog 1984). Costs were rarely figured into the contracting decision and oversight was viewed by many as ineffective. Politics and competing goals were also problematic with many policy actors not interested in cutting cost or improving quality (DeHoog 1984).

James Ferris and Elizabeth Graddy's 1986 article "Contracting Out: For What? With Whom?" in the *Public Administration Review* develops a two-stage model for determining contracting-out decisions. Data for the study was drawn from the 1982 ICMA local and county government survey. The first stage looks at production choices; in-house provision, joint provision, or contracting out. The findings reveal that no one variable in the model dominated the predictions for contracting-out. The second stage model tested sector choice and found that community level

factors like fiscal stress, politics and availability of contractors influence the decision on whether to contract-out. Ferris and Graddy also discuss the potential of cost savings from contracting-out and the trade-off between government and private sector control in the provision of services (Ferris and Graddy 1986).

The 1990 study by Fred Becker and A.J. Mackelprang in the *American Review of Public Administration* looked at how state legislators view the contracting out of public functions. To accomplish this they sent surveys to every state legislator in all fifty states with 740 returned for a less than ten percent response rate. They used multivariate regression to determine that many state legislators have "strong reservations" about using contractors for taxation, regulation and public safety (Becker and Mackelprang 1990). Moreover they saw non-critical services as being more positively viewed for contracting out. Overall, state legislators in this study would probably not consider contracting out unless there are clear gains in efficiency and/or effectiveness. Additionally, they viewed coercive powers and taxation as mandatory functions of government (Becker and Mackelprang 1990).

The 1991 article "A Leaner, Tougher Public Management? Public Agency Competition With Private Contractors" by John Rehfuss in *Public Administration Quarterly* discusses the impact that competition has on public agencies. Rehfuss finds that the likelihood of public-private competition is increasing. The decision between the competing sectors may occur by a comparison of costs or by a restructuring of personnel. One of the primary findings from this article is that values may differ between agencies that focus on being either public or competitive (Rehfuss 1991). Moreover, he finds that traditional public agencies emphasize accountability, hierarchy, stability and limited competition. Whereas, competitive agencies emphasize efficiency, clients, adaptation and increased competition (Rehfuss 1991). "The benefits of aggressive, competitive agency behavior are usually paid for by some loss of accountability, equity and predictability" (Rehfuss 1991, 248).

Harry Kitchen's 1992 study titled "Urban Transit Provision in Ontario: A Public/Private Sector Cost Comparison" in *Public Finance Quarterly* sought to find statistically significant differences in operating costs for transit services provided via differing government

organizational modes. This study included few independent variables in the multivariate regression comparison of three municipalities from 1982-1985. The results indicate that the public provision of service was generally more costly per unit than the private provision of service (Kitchens 1992). Kitchens also finds that the data suggests the cost differential may be partially attributed to higher wages for public employees and/or higher per unit maintenance costs. Finally, Kitchens (1992) notes that a lack of profit motive and no ownership control may help create inefficiencies in the public provision of service.

Werner Hirsch's article "Contracting Out By Urban Government" in the *Urban Affairs Review* evaluates the recent literature on contracting out in the urban environment. Hirsch divides many of the theoretical studies on contracting-out into categories that focus on agency problems, competition and efficiency, externalities and transaction costs. He also looks at studies that emphasize cost savings and determines, that as a whole, many suffer from selection bias because they are based on the private firm's lowest winning cost (Hirsch 1995). Hirsch also allows for values other than cost savings to enter into the contracting out equation. These values

generally include accountability, equity and tax revenue to a lesser degree (Hirsch 1995).

In 1997, "The Proper Scope of Government: Theory and Application to Prisons" was published in the *Quarterly Journal of Economics*. This article written by Oliver Hart, Andrei Shleifer and Robert Vishny examined the question, when should government provide in-house service and when should it contract out for the provision of services. The authors create a decision-making model, which includes factors like residual ownership, benefits to society and costs. The results of the model favor in-house provision of service when non-contractible costs affect quality (contractual incompleteness), when quality is not important and when corruption is a problem. Conversely, privatization is stronger when costs can be controlled through contracts, innovation is important and when patronage in government is a problem (Hart et al. 1997). The in-house provision of services should include services like foreign policy, police, military and prisons. Privatized functions would include refuse collection, mass produced goods and schools (Hart et al. 1997).

George Boyne's 1998 article "Bureaucratic Theory Meets Reality: Public Choice and Service Contracting in U.S.

Local Government" in *Public Administration Review* evaluates the evidence from previous studies that compares public and private provision of services. One of the primary hypotheses that Boyne looks at is the contention that contracting leads to cost savings and greater program efficiency. Boyne states "claims that empirical studies find consistently and without exception that contracting is more efficient than local supply are demonstrably untrue" (Boyne 1998, 482). Moreover, of the studies reviewed only half indicated cost savings and higher efficiency. Boyne also criticizes methodological flaws and small sample sizes in many of these studies. He concludes by stating that some of the public choice assumptions and claims may be misleading (Boyne 1998).

A 1998 study by Brent Steel and Carolyn Long in *Public Administration Quarterly* examined road maintenance and construction in thirty-three Oregon counties. Steel and Long sent questionnaires to various county public works officials in the spring of 1992. The findings indicate that the bidding environment effects the number of bids received, i.e. a greater number of bids were received in metropolitan areas and if the size of the project was large. The findings show that more than half the counties

felt that greater competition didn't necessarily lead to least cost. Additionally, "the data reveal that savings, if any, may be partially or fully offset by the cost of the contracting process, specification, contract monitoring and conflict resolution" (Steel and Long 1998, 249). There was also consensus that counties must maintain some form of in-house capacity to conduct maintenance and oversight. Moreover, in-house capacity helped ensure least cost and the offering of quality services (Steel and Long 1998).

A 2003 article in *Public Choice* by Jens Blom-Hansen uses a multivariate regression model to determine cost savings in road maintenance. Additionally he discusses cost savings in terms of ownership (private or public) and level of competition. Blom-Hansen's model depicts costs savings when including private involvement in road maintenance. Moreover these cost savings were achieved over time. Blum-Hansen also examines public-private competition for road maintenance and determines that competition seems to increase efficiency and the likelihood of cost savings. He also notes that cost savings are not the only value pursued by government, but they should be given strong consideration in making public-private decisions (Blom-Hansen 2003).

*Transaction Cost Studies*

This section reviews studies that concentrate on transaction costs in public-private competitions. As mentioned in the theory section, the transaction costs approach considers the costs of information, contractual arrangement and the friction that occurs in exchange relationships (Coase 1937; Williamson 1981; North 1984).

In 1987, David Sappington and Joseph Stiglitz's seminal article "Privatization, Information and Incentives" in the *Journal of Policy Analysis and Management* analyzed privatization in terms of transaction costs. They begin by looking at the difference between public and private ownership. Moreover with public enterprise government retains the authority to intervene and make policy changes if necessary. Whereas with private production government's right are much more limited (Sappington and Stiglitz 1987). They also state that government's decision to produce a service is based on three primary concerns; economic efficiency, equity and rent extraction. But all three come with transaction costs related to limited competition, asymmetry of information and measurement problems. Additionally it is not costless to write contracts. "In

fact, contracts may be very costly to negotiate, and many contingencies are virtually impossible to foresee" (Sappington and Stiglitz 1987, 574). They are also concerned with a private contractor's incentives to fulfill the "social interest", especially when there is limited competition and it is not profitable to do so (Sappington and Stiglitz 1987).

Jeffrey Dubin and Peter Navarro's 1988 study on refuse collection in the *Journal of Law, Economics and Organization* examined the relative efficiency of differing modes of service provision. These modes included municipal provision, franchising, contract provider (with competition), private monopoly. The results of the model indicate that efficiency must be looked at from a dynamic framework that considers initial market organization on cost rather than focusing exclusively on static market organization (Dubin and Navarro 1988). Furthermore, if one looks at the market as a means to make choices from imperfect information, then contract bidding is the ideal arrangement to be chosen. However, if a community understands that inefficiency costs are related to service provision then it may be presumed that individuals are

concerned with other more long-run benefits than cost savings (Dubin and Navarro 1988).

In 1991, James Ferris and Elizabeth Graddy's article "Production Costs, Transaction Costs, and Local Government Contractor Choice" in *Economic Inquiry* examined the significance of production costs and transaction cost on the decisions of local governments to contract-out. Ferris and Graddy used data from a 1982 ICMA survey and the 1983 County and City Data Book. Moreover, they used multinomial logit to determine that production costs (cost of producing a service) did affect contractor choice. They also found that transaction costs (cost of monitoring a contract) are a primary concern of local governments. Additionally, this analysis revealed that cost savings credited to for-profit contractors may be overstated. Whereas, the government and/or not-for-profit providers of service may lower transaction costs (Ferris and Graddy 1991). "The recognition that service delivery costs entail both production and transaction is essential to understanding the balancing act that local governments face between cost savings and accountability" (Ferris and Graddy 1991, 553).

Michael Nelson's study "Municipal Government Approaches to Service Delivery" in *Economic Inquiry*

analyzes the make or buy decision faced by many local governments. Nelson creates a model from 1992 ICMA data on municipal government service delivery. The findings from Nelson's model shows that the government provision of service may not be as inefficient as many studies indicate. This is because many studies do not consider transaction costs and they may be overstating cost savings associated with the external delivery of service (Nelson 1997). Also important, Nelson's study finds that government is less likely to use external service delivery options in environments that are heterogeneous. This may mean that diversity factors in the population may affect the service delivery option chosen by a municipal government (Nelson 1997).

Trevor Brown and Matthew Potoski conducted a study in 2003 on contract-management capacity in local governments. Brown and Potoski used data from the 1992 and 1997 ICMA survey of municipal and county governments to create a model that examined management capacity and transaction costs. They found that governments increase oversight activities when the use of private contractors increases (Brown and Potoski 2003b). Moreover, "contracting transaction costs are higher when governments contract for

public goods with private contractors (Brown and Potoski 2003, 160). Also important is that governments appear to adjust oversight capacity with the emergence of contractor problems.

Another 2003 study on contracting-out was conducted by Richard Feiock and Hee-Soun Jang. Feiock and Jang used regression analysis on data from the 1997 ICMA local government survey to determine if specific conditions affect a local government's choice of service provider. They found efficiency gains in the non-profit sector but the overall results were not uniform. Moreover, gauging efficiency by cost savings alone may not applicable in certain service areas like health and human services. Overall the results indicate, "local contracting choices are affected by both cost savings and client satisfaction of service quality" (Feiock and Jang 2003, 30).

#### *Competitive Sourcing Studies*

The final section focuses on studies that analyze savings attributed to the competitive sourcing program. It should be mentioned that the first widely reported studies on competitive sourcing appear in the late 1980s. Also important to note is that many of the studies that appear

in this section were generated from contractor based profit research centers.

Paul Carrick's 1988 article "New Evidence of Government Efficiency" in the *Journal of Policy Analysis and Management* examines efficiency gained through the use of the A-76 program. Carrick's study analyzes data from the Navy's commercial activities program after both the contractor and government have formed their most efficient organizations. Additionally, Carrick's data looks at 455 competitions between the public and private sector. Carrick claims that the government provision of service can be as efficient or superior to private sector contractors (Carrick 1988). He concludes by stating that efficiency in government can be achieved by creating better incentives for public managers (Carrick 1988).

Another article in 1988, this one by Michal Tingle, reviewed the success of the Reagan Administration's privatization efforts through the lens of the A-76 program. Tingle compiled findings from a number of studies and noted the complexity in gaining good cost comparisons. Moreover, there were challenges with methodology like basing savings estimates on only roughly assumed projections. He also found that baseline savings might underestimate the work

provided by federal employees (Tingle 1988). Additionally there were concerns that the contractor's bid was a "buy-in" that may be based on suspect data in order to gain new contracting business (Tingle 1988).

The first widely quoted study that presented large cost savings for the federal government appeared in 1998. This study came from the Center for Naval Analyses (CNA) and was titled, *Bidding Behavior in DoD's Commercial Activities Competitions*. The researchers in this study used econometric estimating equations to produce large-scale savings. A heading of a subsection in this report states, "Will the program (A-76) produce thirty percent savings? We find no evidence to suggest that savings will be substantially lower. Three recently completed Navy A-76 competitions resulted in savings of at least thirty percent" (Snyder, Trost, & Trunkey 1997, 9-10). The study also states, that "from 1979 to 1994, the Department of Defense (DoD) completed 2,195 A-76 competitions that resulted in recurring annual savings of approximately \$1.5 billion" (Snyder et al. 1997). The impressive findings on cost savings in this report make it one of the most frequently quoted competitive sourcing studies. This seemingly sacrosanct thirty percent cost savings figure

anchors the argument for many policy analysts, which advocate the aggressive use of competitive sourcing.

The Center for Naval Analyses followed up the 1998 report in 2001 with a study titled, *Long-Run Costs and Performance Effects of Competitive Sourcing*. The findings of this report indicate that savings achieved from competitive sourcing are real and sustained over time (Clark, Rosenblum, Coast & Smallwood, 2001). The methods used in this study included interviews, a document review and descriptive data analysis. Overall CNA reported:

For the sample of sixteen competitions... the expected savings for this group were thirty-five percent for the first competition period, with an effective savings rate of thirty-four percent (indicating that savings are not degrading over the first competition period)" (Clark et al. 2001, 51).

The impressive findings found in this study bolstered the savings claims from the 1998 report and provided strong rationale for the increased use of competitive sourcing throughout the federal government.

Another frequently cited report on cost savings from competitive sourcing comes from the RAND Corporation. This report released in 2000 is titled, *Personnel Savings in Competitively Sourced DoD Activities: Are They Real? Will They Last?* This study examined the implementation of six recent A-76 competitions via a case study analysis that consisted of a thorough document review and interviews.

"We found that the projected cost savings are substantial in both in-house and contractor wins, ranging from thirty-sixty percent ... projected savings stem largely from using fewer people to do the job" (Gates and Robberts 2000, 14). Interpreting these results seems fairly easy on the surface because the cost savings estimates produced in the 1998 CNA study were replicated, and in some instances increased by the RAND study. However, when reading the entire report the findings seem to shift a little bit. This study tells two stories: one of robust savings estimates, while the other talks of the possible limitations of competitive sourcing. As Gates and Robberts state, "there are reasons to believe that the current expectations of savings from competitive sourcing are overly optimistic with regard to the process of conducting these competitions as well as the savings generated from those that are completed" (2000, 6).

Major George Coggins conducted a research report on competitive sourcing for the Air Command and Staff College's Air University in April 2000. Coggins examined cost growth in competitive sourcing contracts using a case study methodology. Coggins found that \$31 million of cost growth could be attributed to Department of Labor increases mandated under the Davis-Bacon Act and the Service Contract

Act (Coggins 2000). Another \$77 million was attributed to changes to "within scope work requirements" (Coggins 2000). Also important is that contract cost growth may invalidate initial cost savings estimate from baseline data. Coggins (2000) concludes by determining there is not enough information to reliably predict cost savings through competitive sourcing.

In June 2003, a report from the IBM Endowment for the Business of Government was released, which again repeated the average cost savings from competitive sourcing as approximately thirty-one percent per competition (Gansler and Lipitz, 2003). This study titled *Moving Toward Market-Based Government: The Changing Role of Government as the Provider*, was provided the oft-quoted thirty-one percent savings figure from the previously mentioned CNA studies. This report is a combination of case studies and other frequently cited works that support a strong role for accentuating the business aspects of government. The predominant theme in this study requires the public sector to evolve by wholeheartedly selecting the forward thinking business model of government. Finally, the authors claim that the use of contracting, franchising and other entrepreneurial endeavors will increase the market-based

approach in government and enable better overall management capacity (Gansler and Lipitz, 2003).

Jacques Gansler and William Lucyshyn conducted a 2004 study on competitive sourcing titled "Competitive Sourcing: What Happens to the Federal Employees". Gansler and Lucyshyn analyzed ten years of data from the Commercial Activities Management Information System (CAMIS). Moreover, they examined the impact of competitive sourcing on federal employees. Gansler and Lucyshyn made three primary findings; 1) competition results in savings, 2) there are few involuntary separations of federal employees and 3) the government is winning its share of competitions (Gansler and Lucyshyn 2004). Although, it is important to note that there were some inconsistencies from the CAMIS data and other "various factors" affecting federal employees were not examined in any detail (Gansler and Lucyshyn 2004)

### Conclusion

The theories and studies reviewed in this chapter offer no clear-cut answers or solutions to the questions surrounding cost savings achieved through public-private competitions. In fact, one of the important findings from

this chapter is the diversity of results that can be gleaned from a review of the literature. Many of these may be important in their own right, but this may indicate that there is no one best way to analyze competitive sourcing.

As Emanuel Savas clearly comments, "no universal and generalizable conclusions can be drawn..." (Savas 1982, 111).

Another important finding is that most of the literature acknowledges that cost savings is not the only point of emphasis when considering public-private competitions. The next chapter will provide detailed analysis of the research problem that lies at the heart of this dissertation.

CHAPTER SIX:  
COMPETITIVE SOURCING CONTROVERSY  
RECOGNIZING THE PROBLEMS  
AND IDENTIFYING THE QUESTIONS

Introduction

This chapter will discuss the primary problems associated with competitive sourcing policy. The first section of the chapter will focus on the credibility of cost savings estimates and other relevant challenges with competitive sourcing studies. The next section will examine some of the public value concerns with cost savings, as they are related to competitive sourcing. Finally, there will be a discussion of political transaction costs and the association of other public values acting on competitive sourcing policy. In the end of this chapter the primary research questions for this dissertation will be re-introduced. It should also be noted that the studies analyzed in this chapter were repeatedly cited in reports from the Office of Management

and Budget (OMB), Government Accountability Office (GAO) and the Department of Defense (DoD).

Credible Cost Savings Estimates?

The review of previous research presented in the last chapter identified a potentially problematic challenge to the efficacy of competitive sourcing policy. Some studies showed wide scale savings through public-private competitions. Whereas, in other studies and cases cost savings did not materialize. Put simply, there does not appear to be enough evidence to determine if cost savings can consistently be achieved (Caves and Christensen 1980; Savas 1982; Kettl 1993; Hirsch 1995; Boyne 1998; Hodge 1999; Sclar 2001; Sawicky 2003). As Coggins (2000) states in his analysis of competitive sourcing "the jury is still out" (30).

However, it should be noted that the review of previous literature examined a wide cross-section of theory and studies, which highlighted the achievement of cost savings through the use of public-private competitions, rather than focusing solely on competitive sourcing. In this section the emphasis will be placed on a critical analysis of the attainment of cost savings through

competitive sourcing. There will also be a discussion on some of the other concerns that affect competitive sourcing policy.

#### *A Brief Review of Competitive Sourcing Studies*

The findings on cost savings attributed to a few studies specifically related to competitive sourcing have been impressive. The 1998 Center for Naval Analyses (CNA) study titled *Bidding Behavior in DoD's Commercial Activities Competitions* reported savings of thirty percent or greater (Snyder et al. 1998). This was followed up by a RAND study released in 2000, *Personnel Savings in Competitively Sourced DoD Activities: Are They Real? Will They Last?*, which replicated the initial savings estimates provided by CNA through six case studies (Gates and Robberts 2000). Finally, another CNA study conducted in 2001, *Long-Run Costs and Performance Effects of Competitive Sourcing* indicated that cost savings achieved through competitive sourcing were real and sustained over time (Clark et al. 2001). There were two additional studies through the IBM Endowment for the Business of Government that also reported savings but these had little affect on the release of the revised competitive sourcing policy.

*Cost Savings Controversy*

The estimated savings generated from the use of competitive sourcing does not come without a fair amount of controversy. Defining the actual savings generated by competitive sourcing has been problematic. The thirty percent savings widely quoted from the CNA study completed in 1997 did not control for the costs of each A-76 study, the 'soft cushion' that would be required to separate federal employees and the expense of oversight responsibilities (Gates and Robberts, 2000). These omitted variables may have a significant impact on the cost savings reported in the study. Also important to note is that many studies that present wide scale savings, focus on outsourcing for discrete functions like refuse collection, cleaning or maintenance on a local level. Although, these studies may not have strong generalizability for most of the federal government (Boyne 1998; Hodge 1999).

Another potential problem is that many of the studies examining cost savings through competitive sourcing are based on models and statistical projections rather than actual data (Markusen 2001; Sawicky 2003). This point was underscored by the GAO in 1999 when they reported:

Estimates of savings in the twenty to thirty percent range or higher have been cited in some assessments of previous competitive sourcing studies, but often have been based on initial savings estimates from previous competitions, rather than on actual savings over time (GAO 1999, 4).

It further appears that the lack of actual performance data may further hinder the credibility of cost savings findings in some competitive sourcing studies. After all some studies assess the promise of savings vs. their actual achievement (Markusen 2001).

The findings in CNA's 2001 study were also problematic. This report was based on sixteen case studies; fourteen were won by contractors and the other two by public employees. CNA openly admits bias in the study as seen in the following quote:

We included only two in-house wins in our analysis because good documentation of the post-competition costs was very scarce. These two wins are probably self-selecting and because good documentation exists, we can probably assume that the functions are well managed. As a result, they may demonstrate higher savings than we would have found had we been able to analyze a larger sample of in-house wins. The contract wins we analyzed may also be self selecting because we dropped eleven contracts from the analysis due to missing data or because the contracts were later combined with other contracts and it became impossible to track changes in cost (Clark et al. 2001, 68).

As can be seen, exclusion of data was a problem in the 2001 study. CNA did not include forty-nine competitions because of insufficient data and they excluded all small jobs, defined as twenty or fewer workers because they "typically" generate smaller cost savings (Sawicky 2003). Also troubling was the puzzling distinction raised between

observed and effective costs. The observed costs aren't actual costs but they are derived from a model of costs based on experience applied to hypothetical situations (Sawicky, 2003). This seems to run counter to CNA's claims that these costs were actually observed in real-time cases.

Another concern was raised with the finding that cost savings are achieved by reductions in personnel costs (Gates and Robberts 2000). On the surface this make sense, especially when considering that competitive sourcing is about completing, at least the same amount of work, with fewer personnel. Thus, fewer people should result in decreased costs. However, the Gates and Robberts study looked at only labor costs. From this perspective they determined that a contractor's flexibility to downgrade the skill level and wages of an employee led to increased personnel efficiencies (Gates and Robberts 2000). Although, there may be other considerations that this study should have taken into account. One of these is ensuring qualified personnel can perform basic required functions. Additionally the offering of lower wages and fewer benefits may be problematic, especially if these costs are passed on to another agency or government program (Sawicky 2003). Overall, emphasizing savings related only to labor costs

considers only part of the total costs associated with a competitive sourcing study.

#### *A FAIR Process?*

Choosing functions to compete and sustaining an expected level of savings may also be a difficult task. One of the primary concerns is the consistent application of administrative law and procedure. It appears that many federal agencies do not interpret the Federal Activities Inventory Reform (FAIR) Act or the term 'inherently governmental function' in the same manner and some use the FAIR as a means for identifying an agency's core mission functions (Light 2000). For example, there is probably little commonality between the bureaucratic culture in the Department of Defense and the Department of Housing and Urban Development and this has caused wide disparities in agency FAIR submissions. The Comptroller General David Walker recently stated "one question that has to be on the table is what is a reasonable way to go about defining inherently governmental. It's not well defined today and arguably not being consistently applied by agencies today" (Peckenpaugh 2001, 1). This in turn results in

inconsistent A-76 comparisons and difficulty in selecting functions to compete.

#### *Accessing Information*

Access to information, which many contractors view as proprietary, seems to offer a strong challenge to the transparency of the competitive sourcing process (Markusen 2001). Additionally, the Freedom of Information Act (FOIA) generally does not apply to work accomplished by contractors (Guttman 2002). As a result, public access to pertinent information on a contractor's costs and performance may not be available, unless these requirements were expressly stipulated in the initial writing of a contract.

#### *Identifying Functions*

Also worthy of consideration is that some work categorized as commercial may not be separated from inherently governmental or exempted work (GAO 2001b). When taking into account organizations like DoD that have been aggressively engaged in A-76 since the mid-1990s, there may be fewer commercial activities to choose from in the future. "DoD completed studies on 71,000 positions

between fiscal years 1997-2002, and found it increasingly difficult to identify study candidates over time" (GAO 2003, 6). This may reveal that commercial activities, which are the easiest to compete will become increasingly difficult to identify as DoD moves closer and closer to its 'inherently governmental' functions. This is a trend that may develop in other agencies as they delve deeper into competitive sourcing.

#### *Data Problems*

Competitive sourcing has other problems like data availability. In terms of data analysis researchers at CNA have questioned the information available for study as seen below:

Although DoD has collected some data on the results from earlier A-76 competitions, there are no centrally collected data that track actual cost and performance after the competition is completed... For these reasons we have little data on the longer-term impact on cost and performance (Clark et al. 2001, 8).

Problems with the Commercial Activities Management Information System (CAMIS) were found when the system did not always record information on completed competitions. There was also accuracy limitations found within the database, a problem that has plagued CAMIS for over a decade (GAO 2000).

*Mortgaging Savings*

There are questions surrounding the use of A-76 cost savings that have not yet been realized. DoD reprogrammed approximately \$11.2 billion of these anticipated savings into its modernization accounts, spread over future years' planning period (GAO 2001b). However, if the savings don't materialize then DoD will have to either reprogram this money to balance its books or delay modernization plans. It is also interesting to ask what has happened to all of the savings already claimed through the use of competitive sourcing? If agencies have not returned these savings to the federal government, were they reinvested into other agency programs? (Kettl 1993; Sawicky 2003).

*Study Time*

The length of time it takes to complete a competitive sourcing study may impact the rate of cost savings. The most recently available data indicates that studies take about twenty-four months for a single function study and twenty-seven months for multifunction studies (GAO 2001b). These studies must include protest and appeal times. In most cases these long time frames are required to ensure due process under the law. OMB's new competitive sourcing

policy requires studies to be completed within twelve months unless a waiver is attained from the agency Competitive Sourcing Official (CSO) (OMB 2003). Since time is money some agencies are already complaining that they have aggressive ongoing competition programs, but they lack sufficient resources and staff to conduct more studies in the future (GAO 2001b).

#### *Human Capital*

Human capital is a concern for a public acquisition community that may already be seriously challenged by a burgeoning competitive sourcing program. The GAO reports that at DoD:

Eleven consecutive years of downsizing produced serious imbalances in the skills and experience of the highly talented and specialized civilian acquisition workforce, putting DoD on the verge of a retirement driven talent drain" (GAO 2001a, 7).

Therefore, the consideration of costs for developing human capital may be as important as the costs of direct contract oversight. Moreover, a recent DoD Inspector General Report claimed that pressure to outsource for services led to increased costs:

DoD acquisition organizations stated that reductions in in-house... support personnel required them to contract for additional services, such as engineering and logistical analysis, that the Government once would have provided. As a result technical support costs increased because... obtaining contract support was more expensive than obtaining in-house ... support... Contract labor rates are significantly higher (\$20,000 to \$180,000) per staff year than rates... charged for the same service performed by Government employees (DoD IG 2000, 18).

Also important is that a recent GAO report claimed that costs for oversight are not currently factored into the A-76 process. Nor are the contract monitoring costs subtracted from the expected savings produced by each study (GAO 2001a).

Competitive sourcing is about achieving savings and efficiency, but it also has far greater ramifications for government operations in the future. The federal government is heavily reliant on three studies produced from contractors to justify a competitive sourcing policy based on cost savings. Albeit, there are a greater number of studies that show cost savings when looking at the bulk of the literature related to public-private competitions. However, this also means there are a larger number of studies that question the attainment of cost savings through public-private competitions. The point here is that there may be much more to competitive sourcing than only cost savings.

Questioning the Value of Cost Savings

An important aspect of competitive sourcing has been the development of cost savings as a public value. As seen in the previous chapters, this occurred through the evolution of policy from its nascent beginnings in Bureau of Budget Bulletin 55-4 through the current Office of Management and Budget (OMB) Circular A-76 revision in 2003. It should be remembered that the development of the cost comparison was to be a politically neutral means of balancing the interests of both the public and private sectors while also safeguarding taxpayer's money (OMB 1999). In essence, competition was supposed to drive down the costs provided by the final two bidders in the cost comparison phase.

*Direct Conversions*

One of the challenges that affected competitive sourcing prior to the recent revision was the use of the direct conversion process. This generally involved competitions where work could be directly converted without cost comparison if a function involved ten or fewer full-time equivalents (FTEs) (OMB 1999). From fiscal year 1997-

2001 the Department of Defense (DoD) conducted 418 direct conversions compared to 314 standard competitions (GAO 2002). DoD's penchant to use direct conversions probably makes sense when considering only the costs incurred by conducting a study for so few FTEs. However, removing competition from competitive sourcing seems to defeat the purpose of the policy. Moreover little data could be found to substantiate cost savings through the direct conversion process. However, direct conversion data were available on both the number of decisions and number of positions involved. DoD data revealed that 51 decisions (12%) covering 171 positions (2%) were kept in-house, whereas 362 decisions (87%) covering 7,922 positions (98%) were moved to private contractors (GAO 2002b). Overall, this data seems to indicate a preference for the movement of work to private contractors when using the direct conversion process.

#### *Streamlined Competitions*

After the 2003 revision of OMB Circular A-76 the direct conversion process was removed and essentially replaced by a streamlined competition process that involves 65 or fewer FTEs. Moreover, the streamlined competition

process requires a cost and performance evaluation against market benchmarks but does not mandate an agency to develop its most efficient organization (MEO) (OMB 2003a). "In fiscal year 2003 agencies completed 570 streamlined competitions and 92 standard competitions" (OMB 2004a, 7). It appears that many agencies prefer the less stringent standards for streamlined competitions, which most likely translates into greater discretion in workforce decisions. "Cost comparisons can now be as simple as quoting a bidder's price and filling out a one page form" (DeMaio and Bandalato 2003, 2). The use of streamlined competitions may be faster and more efficient than standard competitions, but OMB acknowledges that agencies are frequently not following successful streamlined competition practices (OMB 2004a).

The revised policy on streamlined competitions lacks a number of features to ensure "sound" agency sourcing decisions (Walker 2004). Possibly most important, is there is no prohibition on dividing functions to meet or come underneath the 65 FTE threshold. "We at GAO have expressed concern that, in the absence of an express prohibition, agencies could arbitrarily split functions to circumvent the 65 FTE ceiling..." (Walker 2004, 308). Greater

agency discretion in this area could lead to an efficient means for parcelling out government functions and avoiding the more rigorous requirements of the standard competition process.

Also of concern is that challenges of streamlined competitions are no longer permitted under the revised competitive sourcing policy. The removal of an effective means to challenge agency decisions may create concerns over fairness, accountability, equity and transparency. "While efficiency and flexibility are often desirable, it looks like transparency could be lost with streamlined competitions" (Walker 2004, 309). Particularly troubling is that in fiscal year 2004, agencies chose to use streamlined competitions over eighty six percent of the time. This situation should be monitored closely to see if a trend favoring the use of streamlined competitions emerges over time. The heavy use of streamlined competitions in the future may compromise more than just cost savings, but non-tangible public values like transparency and accountability, which rest at the heart of the legitimacy of competitive sourcing policy.

Ultimately, the questions that surround the cost savings achieved through competitive sourcing may act to

destabilize the foundation of the policy. These questions are particularly troubling when large-scale policy decisions are based on the assumption of cost savings through public-private competitions. Moreover, the President's Management Agenda states, "historically, the government has realized cost savings in a range of twenty to fifty percent when federal and private sector service providers compete to perform these functions" (Bush 2002, 17). Yet, these projections may not be accurate or reliable. At this point there should be little question that the achievement of cost savings is a public value. The bigger concern may require recalibrating the legitimacy of cost savings through competitive sourcing. This is a point that will be explored in more detail in the next section.

#### Political Transaction Costs

Many believe the focus of competitive sourcing policy is in the achievement of cost savings. Moreover there are those that contend the assurance of economic efficiency through cost savings policies like competitive sourcing should "trump" all other conflicting public values (McGarity 1998). In fact, some researchers were so

enamored with the savings projections from competitive sourcing that they did not consider the cost of holding competitions (GAO 1999). While there is no question that cost savings are important, there also appears to be more going on than a uni-dimensional emphasis on one public value. After all, many of the studies presented in the last chapter seemed to indicate that there was more at work in a public-private competition than achieving cost savings. The same may hold true when focusing explicitly on competitive sourcing.

#### *Valuing Transaction Costs*

A full examination of competitive sourcing may provide important insights into the relationships between competing values. The cost of which seem to go unconsidered. As Schooner (2004) comments, "most troubling is the government's unwillingness to appreciate the policy's costs" (265). A careful analysis is warranted, when many think transaction costs will reduce the efficiency of the competitive processes, which are prescribed through the implementation of competitive sourcing policy (Williamson 1975; Kettl 1993).

Thus, an assumption of a costless system of public-private competitions appears to be an administrative fiction. When looking at competitive sourcing from a transaction cost perspective, the cost of conducting a study becomes an essential part of the decision-making process. As Coase (1960) states:

In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on (Coase 1960, 7).

The process Coase alludes to may be directly applicable to a consideration of public values such as transparency, equity, accountability, capacity and integrity. Moreover, the cost of these public values in the administrative state is not free (Kovacic 1997).

### *Blurry Interfaces*

The ramifications of competitive sourcing can readily be seen when considering the interface between government and contractors. It appears that competitive sourcing may somewhat muddle a clear delineation point between the public and private sectors. In some instances it is difficult to tell where government ends and the private sector begins. This situation has been referred to as the

"margins of government", the "hollow state" or the "shadow government" (Sharkansky 1980; Light 1999; Milward and Provan 2000). Whatever its nomenclature, there are a diversity of opinions on what its affect on government will ultimately be. Some believe that the movement of public work into the private sector via contracting allows government greater control over its agenda and priorities (Donahue 1989; Savas 1987, 2002). Others argue it may in fact limit control and create concerns over public accountability (DeHoog 1984; Kettl 1993; Cooper 2000; Durant and Warber 2001).

Another plausible affect may be a tacit support for a policy, which provides patronage through the awarding of contracts (Sharkansky 1980). This becomes important when considering that the primary concern of politicians may not be cost savings or efficiency, but quite possibly inefficiency if it translates to patronage in a home state or district (Moe 1984). Additionally, there may be concerns over the devolution of functions and blurring of roles between the government and private contractors (Kettl 2002). Also important is that the shrinking government through competitive sourcing appears to be good politics. "The Bush Administration today favors outsourcing because,

like its Democratic predecessor, it wants to tout the elimination of government employees" (Schooner 2004, 275).

*Targeting Cost Savings: A Case of Political Motivation?*

The confluence of forces acting on competitive sourcing has strained the focus on cost savings and may sound the death knell for those that think in terms of a politics-administration dichotomy. As had been recently evidenced in the reform movements of the early 1990s, which called for government to become more business-like. The move away from a uni-dimensional focus on cost savings became a central concern when considering the 2001 case involving mandatory competitive sourcing targets.

On March 9, 2001, OMB sent a memorandum to all Agency Heads requiring them to compete or directly convert to contractors at least five percent of their commercial activities by the end of fiscal year 2002 (OMB 2001). Later OMB increased the competitive sourcing targets to ten percent in 2003 and fifteen percent in 2004. OMB has been silent on how it determined its numeric targets and faces a significant problem in legitimizing their position because there has been no analysis produced to support the proposed competitive sourcing quotas (Agresta 2001). But suffice it

to say that the rationale behind the memo was the reinvigoration of an ailing A-76 process in hopes that this would generate cost savings through an increased use of competitive sourcing. Or was this the true motivation behind the release of the memo?

Some feel that this was merely an attempt by OMB to ensure campaign promises were met (Agresta 2001). The Comptroller General David Walker stated:

It is clear that the administration's initial goals in this area were arbitrary and, therefore inappropriate. They were based upon a presidential campaign promise. They were obviously not the result of sophisticated analysis. In my view, therefore, they clearly violated one of the principles that the panel (Commercial Activities Panel) unanimously agreed to, including those panel members from the administration (Walker 2004, 306).

It appears that the specter of politics may have entered into the decision-making calculus of those establishing mandatory competitive sourcing targets.

The response from Congress was swift as Rep. Tom Davis, R-VA, testified on June 28, 2001, "there is nothing that says that to arbitrarily assign federal agencies target figures is the best means to ensure cost savings for the government" (U.S. House 2001). The Comptroller General testified "the use of percentage goals for agency competitive sourcing targets is inappropriate and counterproductive to the government's recruiting efforts" (GAO 2002). Then on July 24, 2002, by a vote of

261-166, the House agreed to an amendment to the Treasury-Postal Appropriations bill (HR 5120) prohibiting the OMB, or any other federal agency, from using numerical quotas, targets and goals for the outsourcing of jobs to the private sector (Human Events 2002). The Commercial Activities Panel's recommendations also discouraged the use of arbitrary competitive sourcing targets. In 2003 OMB moved to remove the competitive sourcing targets. "With experience, OMB recognized that its initial numerically-based directions were inadequate" (OMB 2003, 5). However, competitive sourcing scorecard targets have remained in place.

A consideration of the case involving numerical targets indicates that politics was in fact a major factor in the removal of agency sourcing targets. "Until the political pressure became unbearable, the administration repeatedly offered eye-popping quotas for the number of employees to be cut" (Schooner 2004, 276). If this is a valid assumption, then the politics of this case may lead to the consideration of a different set of public values (Rosenbloom and Kravchuk 2001). However, it should be noted that cost savings remains an integral component of virtually any discussion on competitive sourcing.

Conclusion

The critical analysis of competitive sourcing studies presented in this chapter may have exposed weaknesses that are problematic to a public policy that is founded on the achievement of cost savings. Another challenge found in the extant research is the lack of any detailed discussion on the affect that public values have on competitive sourcing. It would seem the achievement of cost savings does not happen in isolation and that further research on broader policy ramifications is warranted. Overall, these problems point to a gap in the literature, which requires further investigation. From the preceding discussion two research questions have been developed that will become the focus of the remainder of this project. The next chapters in this dissertation will present methodology, results and discussion.

*Research Questions*

Question 1) How much cost savings can realistically be attributed to the use of competitive sourcing?

Question 2) Are cost savings the primary force driving competitive sourcing policy?

## CHAPTER 7

### METHODS AND HYPOTHESES

#### Introduction

The research design applied in this dissertation follows a mixed methodology embedded within an overarching historical case study on competitive sourcing. As Yin (2003) states, "case studies are the preferred strategies when how or why questions are being posed, when the researcher has little control over events, and when the focus is on a contemporary phenomenon within a real life context"(1). The research within this dissertation falls within the context of Yin's case study framework.

Although, it should be noted that mixed methods play a significant role in determining whether competitive sourcing, can attain expected cost savings and what role competing public values might play in the A-76 process. "Mixed method studies are those that combine the qualitative and quantitative approaches into the research methodology..." (Tashakkori and Teddlie 1998, 17). This

chapter will include discussion on research design, data and sampling, definition of variables and data analysis.

### Research Design

The approach taken in this dissertation allowed for the triangulation of research methods. Triangulation means the mixing of both qualitative and quantitative methods (Tashakkori and Teddlie 1998). As can be seen below the beginning of the dissertation follows a historical case study perspective. Yet there is also a quantitative model that is used to answer research questions involving cost savings. The remaining questions are answered qualitatively through personal interviews with those involved in the competitive sourcing process. The research design in this dissertation follows a sequential mixed method design. "The researcher conducts a qualitative phase and then a separate quantitative phase or vice versa" (Tashakkori and Teddlie 1998, 46). The primary purpose of the project is to better understand and explain competitive sourcing in terms of cost savings and the impact of competing public values.

This dissertation began by employing a historical perspective in chapter two through an analysis on the

evolution of values in government contracting. "Placing politics in time - systematically situating particular moments in a temporal sequence of events and processes - can greatly enrich our understanding of complex social dynamics" (Pierson 2000, 72). Understanding the history of evolving public values is a central theme that runs throughout this dissertation. Chapters three and four followed the same structure but focused on the development of cost savings as a public value and an analysis of competitive sourcing policy. The difference in these chapters was the need to also consider wide ranging contemporary events and differing sources of evidence (Yin 2003). The early chapters of this dissertation have been used to provide sufficient context to appropriately understand the research environment.

The quantitative model used in this study attempts to replicate cost savings estimates provided by a previous report on public-private competitions. A primary focus of this study was based on cost savings that might be achieved by competing all commercial activity functions with no cancellations. This project emphasized the observed costs generated from actual A-76 competitions. Thus, a number of transaction costs were included into the baseline cost

estimates. This is important in this study because transaction costs are considered as proxies for a number of public values. Quantitative methods are then used to help explain the association between variables used in the model (Gujarati 2003). More specifics will be provided on data and methods of analysis later in this chapter.

The qualitative portion of the study sequentially used results attained from the quantitative model. Many case studies employ open-ended interviews to gather information and opinions (Yin 2003). This study used open-ended interviews to gain key insights on competitive sourcing. More specifically the case of competitive sourcing will employ "evaluation interviews in an attempt to learn whether this program is living up to expectations" (Rubin and Rubin 1995, 27). This phase of the research included interviews with Competitive Sourcing Officials (CSOs) and implementation personnel directly involved in the competitive sourcing process.

#### Data and Sampling

The examination of competitive sourcing in this dissertation required a rather flexible research design and a number of varying data sources. It should be remembered

that the strength of a case study is predicated on the use of multiple sources of evidence (Yin 2003). Moreover, the pragmatist paradigm that allows for both quantitative and qualitative research should add richness and value to a study (Tashakkori and Teddlie 1998). This section will include detailed discussions on the data and sample selection techniques that were used in this project.

#### *Data*

The research conducted in this dissertation used both quantitative and qualitative methods. The data collected for the quantitative portion of this study was gathered from two existing statistical databases. The qualitative research was gathered through personal interviews, archival analysis and a review of historical documentation.

#### Quantitative Data:

The quantitative data was provided from two primary sources, the Center for Naval Analyses (CNA) and the Department of Defense's (DoD) Commercial Activities Management Information System (CAMIS). It should be noted that CAMIS data was provided directly to CNA for study. The data used in the study included a comprehensive list of

A-76 competitions conducted between 1978 and 1994. Thus, the findings of this study are based on data that was initially extracted from the CAMIS database by CNA.

This is important when considering the reliability of the data used in this study. As Babbie states "your first protection against the problems of reliability in the analysis of existing statistics is awareness of the problems" (Babbie 1998, 323). CNA itself has been fairly critical of data derived from CAMIS:

The competition data are missing some key pieces of information such as the number of bidders, re-competition data, capital costs, overhead costs, workload, quality... There are also many fields where the data is so poor that they are almost useless. These include the data on study costs, study length, personnel separations... (Trunkey et al. 1998, 37).

Additionally, GAO has repeatedly questioned the accuracy of CAMIS and called for needed system upgrades. Yet, there have been recent efforts to improve CAMIS and it still offers the only DoD database on A-76 competitions. Also important is that there is very little quantitative data available on A-76 outside of DoD.

#### Qualitative Data:

In the qualitative portion of the study some of the data was gathered through the use of personal interviews. Moreover, these were open-ended interviews conducted with

both Competitive Sourcing Officials (CSOs) and implementation personnel directly involved in the A-76 process. These interviews were primarily used to add insights and context to varying aspects of competitive sourcing. Many of those interviewed desired confidentiality prior to the interview session.

Another qualitative method of data collection used in this project included the review of archival records. Archival records are broadly defined within the parameters of organizational records, lists and survey data (Yin 2003). The majority of the archival records used in this study, required analysis of individual A-76 competitions and organizational listings of personnel assigned to various functions required during a competition. Although, some caution was taken during this review, because as Yin (2003) states, "most archival records were produced for a specific purpose and a specific audience" (89).

The other means of qualitative data collection included the heavy use of documentation. In most instances this documentation was of a historical nature and included testimony, reports, memoranda, bulletins, circulars and other official administrative records. It should be remembered that the early chapters of this dissertation

emphasized the use of historical documentation. In many cases this was necessary to corroborate and augment evidence from a myriad of sources (Yin 2003).

#### *Sampling and Replication*

The sample selection process completed on the quantitative model analyzed the number of individual A-76 competitions to be used in the study. Initially the data in the model contained the entire population of standard commercial activity competitions (4,311) that were going to be conducted within DoD between 1979-1994. This was then narrowed down to A-76 competitions (3,548) that were actually initiated. Subsequently, forty percent of these competitions were cancelled for various reasons. This subset of cancelled competitions was not included in the model used in this dissertation. Although, it could be argued that some level of transaction costs were incurred by the government if these competitions were in fact initiated.

After reducing the number of competitions that were directly applicable for use in the study, a sample of 2,126 standard A-76 competitions remained. All of these were competitions conducted between 1979-1994. As noted

previously this sample was gathered directly from CNA and indirectly from CAMIS. This dissertation is focused on the actual observed costs and savings generated by individual DoD activities and entered into CAMIS. Thus, it is important to note that some of the individual baseline cost data reported in CAMIS and used in this study may have been based on projections of actual costs and workload.

Sample selection for the personal interviews employed both purposive sampling and convenience sampling. Purposive sampling was used because selection of individuals was based on specific questions/purposes and on information available about these individuals (Tashakkori and Teddlie 1998). Purposive sampling directly applied to the interviews conducted with CSOs or their designated representatives. Whereas, both purposive and convenience sampling were used for the interviews conducted with the personnel directly involved in the A-76 process. The use of convenience sampling was based on the availability and ease of data collection (Tashakkori and Teddlie 1998). It should be noted that no random sampling techniques were used during the interview portion of this dissertation.

The quantitative and qualitative sections of the project were then brought together within a case study framework. From this perspective it is important to note that both literal and theoretical replication were used. Literal replication when predicting similar results and theoretical replication when predicting contrasting results (Yin 2003). The case study on competitive sourcing used in this dissertation achieved both literal and theoretical replication in both methodological areas.

#### Defining Variables

In this section the variables used in the study will be presented. The examination of the quantitative model will focus on three types of variables; dependent variables, independent variables and control variables. The qualitative portion of the dissertation does not emphasize variables per se, but does stress the use of propositions as useful constructs within a case study. These propositions will be reported in the data analysis section.

The discussion here begins with a look at dependent variables. This will be followed by an analysis of independent variables and control variables. Also included

is a separate discussion on the development of transaction cost variables. It should be noted that many of the variables presented here were drawn directly from CNA studies on competitive sourcing. However, many of the transaction cost variables were developed during the writing of this study so that they could be directly included in the quantitative model.

#### *Dependent Variables*

The two dependent variables used in this study represent the dollars saved (in thousands) through the use of A-76 and transaction costs. The cost savings variable was created by the "difference between the baseline cost of performing the function in-house and the winning bid" (Snyder et al. 1996, 8). The research in this dissertation focused on overall cost savings because it was felt this gave a better representation of dollars saved through the use of competitive sourcing. Transaction costs represent the other dependent variable used in testing the quantitative model. There is a more detailed discussion on the development of the transaction cost variable below. Moreover, specific hypothesis testing information will be provided in the data analysis section.

*Independent Variables*

The independent variables used in the model included two groups of dummy variables. These are artificial variables constructed with a one or zero, one indicating the presence of a specific attribute and zero denoting the absence of the attribute (Gujarati 2003). The first group is composed of varying types of functions that were involved in A-76 competitions. The following is a list of the function types used in this study: Base/Installation Services; Social Services; Health Services; Intermediate Maintenance; Depot Maintenance; Real Property Maintenance; Research Support; Training; Data Processing and Other Manufacturing Operations. The second group of dummy variables was used to indicate the military branch of service where an A-76 competition took place: Navy; Army; Air Force; Marine Corps; and/or Department of Defense (DoD) Agencies.

*Control Variables*

The control variables for mean family income, unemployment rate, urban density and college education were based on geographic location of a competed activity. More

specifically, these control variables were based on the location of the specific installation conducting an A-76 competition. The value of the control variables was held constant to allow a better understanding of the association between the independent and dependent variables (Agresti and Finlay 1999). The measure used to approximate mean family income is dollars, while the remaining variables are measured in percentages. It should be noted that these control variables attempt to capture the local socio-economic conditions that may affect bids tendered by the contractor and the in-house team. In essence these control variables are intended to provide more information on local base conditions. Also of interest is that CNA used 1990 census data in the development of these variables.

The President's party variable was generated in an effort to discover possible political trends associated with competitive sourcing. For this variable, one represents a Republican President and zero denotes a President that is a Democrat. Also of interest was the time trend variable, which captured the "competition's vintage" or the overall length of the competition in years and potential growth rate.

*Transaction Costs*

The introduction of transaction costs into the quantitative model was an important step in development of the study. Transaction costs are the costs of information, organizational arrangement and overall friction created by elements in the competitive sourcing process. Transaction costs provide friction, which can sometimes be used as a proxy for a number of public values like accountability, transparency, integrity and equity.

The following two variables were created to better account for transaction costs that occur during an A-76 competition. The first was the addition of overhead costs while the second was cost of conducting the study itself. It should be noted that there may be additional transaction costs that are directly relevant to competitive sourcing but were beyond the scope of this study.

**Overhead Costs:**

One of the costs that will be included in a replication of the original study is a constant overhead rate. Overhead was generally defined as the salaries, equipment, space and other activities related to headquarters management types of functions (OMB 1996). The

overhead rate generated by the Office of Management and Budget (OMB) has been the source of some debate. This is largely because of the arbitrary manner in which OMB chose the twelve percent overhead rate:

It (OMB) lacked meaningful information on which to develop a standard overhead rate... absent this information OMB selected a single overhead rate of twelve percent, a rate that was near the midpoint of overhead rates suggested by Government agencies and private sector groups. While the twelve percent rate represents a move toward including overhead costs in government estimates, until actual overhead rates are captured, the magnitude of savings expected will be uncertain and the results of A-76 studies are apt to be controversial (DoD IG 2003, 21).

There are admitted weaknesses to the overhead rate chosen by OMB. However, it still symbolizes an attempt to capture transaction costs, which represent an important part of the competitive sourcing process.

The inclusion of a standard overhead rate for A-76 competitions prior to 1996 was not consistently applied across most studies. In fact there were some instances where overhead rates were not included as costs because they were difficult to quantify across specific functions. "When agencies did include overhead costs, they generally ranged from one to three percent" (DoD IG 2003, 21). CNA has stated, "It is estimated that during the 1978-1994 period the in-house team used an overhead rate of about five percent on average" (Snyder et al. 1998, 3).

This study will make the assumption that CNA included a five percent overhead rate on the 1978-1994 commercial activities data. Moreover, this study will include the twelve percent overhead rate that was established in 1996. This will be accomplished by assuming five percent and then adding an additional seven percent to cost estimates from the original data. These additional overhead costs are necessary to gain a better understanding of costs savings that can be achieved through competitive sourcing. Overhead does not include the costs incurred in administering an A-76 competition.

#### Competition Costs

This study asserts that the full costs of administering an A-76 competition should be taken into account when considering the savings derived from competitive sourcing. The costs of conducting a study can be broken into two primary components; contractor support and government administration.

- (1) Contractor support - This cost refers to the "typical budget-planning figure used for consultant support, travel, training and temporary duty per announced full time equivalent (FTE)" (DoD 2004).

(2) Government administration - This represents the costs of the agency CSO, the Agency Tender Official (ATO), the formation of the MEO, and the other competition officials needed to complete a standard A-76 cost study (Nelson 2002; OMB 2003). It should be noted that the bulk of the early A-76 studies included little if any costs for an A-76 competition. In this dissertation both of these costs will be added together to account for necessary transaction costs, which should be included in any cost savings estimates attributed to competitive sourcing.

This dissertation defines transaction costs as those costs incurred during an A-76 competition. These costs specifically include expense elements for both contractor support and government administration. However, some transactions costs were not included in the analysis in this dissertation. The cost of preliminary planning or feasibility analysis for an A-76 competition was not included. More specifically these are costs used to determine the baseline costs and the type of competition to be used (OMB 2003a). Additionally the costs incurred for post competition accountability were not included. These costs generally include submission of best practices

lessons learned information, execution tracking of a competition, competitive sourcing quarterly report, monitoring performance, monitoring option years and the follow-on competition, and terminations (OMB 2003a).

There were also no transaction costs assigned to the transparency lost between government and primary contractors. Additionally, the imposed wall of privity between government and subcontractors was not considered. Congressional oversight was not accounted for in this model either. In fact the assignment of monetary costs to these public values was not within the scope of this dissertation.

*Contractor Support Costs.* The addition of contractor support costs was examined through a review of OMB policy, GAO reports and a large number of competitive sourcing studies. The variance in costs attributed to contractor support ranged from thirteen hundred dollars per FTE to twelve thousand dollars per FTE and higher (GAO 2002c; OMB 2004d). The contractor support cost that will be used in this study will be placed conservatively at five thousand dollars per FTE. In fact, OMB lists the average incremental cost per FTE studied at five thousand dollars

(OMB 2004). This figure is corroborated by a number of other competitive sourcing studies (Funk 1999; Nelson 2002; Gansler and Lippitz 2003).

It is interesting to note that DoD lists four thousand dollars per FTE as the contractor support costs per study. Additionally, it should be mentioned that Appendix D of OMB's 2004 Competitive Sourcing Report lists \$6,344 as the average cost of contractor support per FTE in a standard competition. When considering the relevance of these two figures it would appear that the cost savings attributed to the 2003 competitive sourcing data is overstated. Contractor support costs are in most instances now included in A-76 competitions.

*Government Administration Costs.* The derivation of government administration costs is more complex because these are not officially recognized as attributable to the cost of a competitive sourcing study. Although one could argue that the government administration costs of an A-76 study are more important than contractor supports costs, it should be remembered that a competition must include government personnel. They include the following positions: Competitive Sourcing Official (CSO); Agency

Tender Official (ATO); Contracting Officer; Performance Work Statement (PWS) Team Leader; Human Resource Advisor (HRA); Source Selection Evaluation Board (SSEB); and the Most Efficient Organization (MEO) Team. Moreover, the majority of these positions need to be inherently governmental functions. Also important is that the expenditure of work in these positions would seem to indicate transaction costs that are directly relevant to cost of a competitive sourcing study. Note that many of these personnel are temporarily assigned full time to ensure the efficient administration of the competitive sourcing program.

The current policy position on government administration costs incurred during an A-76 study was presented in an OMB Memorandum dated February 26, 2004. Attachment B of this memo stated, "Exclude costs of in-house staff that may have spent time on the competition during regular working hours... Exclude costs of central program oversight for competitive sourcing...(OMB 2004a). With this phraseology OMB instructed agencies to omit the costs of in-house staff working on A-76 competitions. Moreover an OMB official commented that the salaries of employees working on A-76 studies do not qualify as

expenses directly attributable to competitive sourcing (Gruber 2004).

The addition of government administration costs to an A-76 competition would seem to be key part of ensuring "cost realism" in the competitive sourcing process. Yet, there has been no attempt to capture these transaction costs. A 1999 Government Accounting Office (GAO) report claimed, "DoD's savings projections have not adequately accounted for the cost of conducting the competitions. These costs could significantly reduce DoD's expected savings in the short term" (GAO 1999).

There have been a number of calls to include these costs as a necessary part of an A-76 cost comparison. In 2000, S. 2422 sought to amend the Federal Activities Inventory Reform (FAIR) Act to consider all costs in the conduct of public-private competitions (Grasso 2003, 21). The GAO again mentioned A-76 costs when they reported, "DoD's savings estimates did not take into consideration the costs of conducting the studies and implementing the results, which of course must be offset before net savings begin to accrue" (GAO 2002, 9). The Department of Defense's Inspector General (DoD IG) stated "A-76 savings estimates did not reflect the study and implementation

costs, which offset savings for the short term" (DoD IG 2003, 16). Additionally, the Congressional Research Service (CRS) reported that some members of Congress felt the costs savings attained through competitive sourcing were at best "debatable" (Grasso 2003).

This dissertation assumes that the government administration of an A-76 competition does add to the overall transaction costs involved in the completion of a study. Thus, an expense factor related to these costs will be developed by examining data involved with similar costs and through interviews with a number of personnel involved in the administration of A-76 competitions. It should be noted that references quantifying government administration costs for A-76 competitions were difficult to attain. This might be because studying these transactions provides legitimacy to claims that these are costs directly attributable to the A-76 process.

Archival analysis did provide a reference to a DoD memorandum from 2000 that acknowledged the cost of an A-76 competition. DoD provided a somewhat ambiguous reference to a factor of one percent of full year's costs, which might be applied as the price of administering an

A-76 competition (Gallay 2002). The challenge here is that the one percent figure cannot be directly attributed to either contract support or government administration costs. Moreover, there seems to be little amplifying information on the development of this one percent cost factor.

A study by RAND in 1997 discussed competition costs in more detail. "According to CAMIS, the cost per completed study ranged from \$13,000 to \$766,000, with a mean of \$140,000 and a median of \$40,000" (Baldwin et al. 1996, 10). RAND also analyzed twenty studies from 1996 and developed a regression estimate of \$85,000 per fifty authorizations and \$130,000 per one hundred authorizations. These figures were not adjusted for inflation or wage fluctuations, but they at least acknowledge that a portion of study costs might be attributed to the opportunity cost of redirected government staff. RAND concluded that individual agencies may face "substantial uncertainty" surrounding the costs of administering competitive sourcing studies (Baldwin et al. 1996).

A CNA study from 1996 discussed the need to use a six thousand dollar per FTE figure to cover the costs of an A-76 competition. Interestingly, CNA attributed only two thousand dollars to twenty hours of contractor costs

(Trunkey et al. 1998). Although not directly stated, it could be realistically assumed that the remaining four thousand dollars could be applied to government administration costs. This is especially relevant when CNA does allow that government provides essential support to the success of a competition. Additionally, a study completed by the Congressional Budget Office (CBO) found transaction costs equaling a possible ten percent of overall operating costs (CBO 1997). The challenge here is that there is no clear guidance on the costs of government administration during an A-76 competition.

The next step was to interview some of the personnel that are directly involved in the A-76 implementation process. More discussion on interview methodology appears later in this chapter. Interviews of eleven personnel directly involved in recent A-76 competitions revealed that the majority of interviewees worked virtually full time on these competitions. In fact it was suggested that their salaries should be added together and multiplied by the number of months of a competition. If applied in this manner government administration costs could become cost prohibitive. The interviewer did ask if the \$4000/FTE figure used by DoD for contactor support should also be

applied to government administration costs. Almost all of the respondents felt this would be a conservative estimation of government personnel costs. In fact the majority felt there should be a monthly cost vs. a standard per FTE rate.

After a consideration of both the literature and the interviews a five thousand dollar per FTE cost for government administration was chosen. This was largely because this figure represented the midpoint between the low costs gathered from the archival analysis and the rather high cost projections generated during the interviews. This figure was added to the contractor cost figure of five thousand dollars to develop a total competition cost of ten thousand dollars per FTE. This new figure was added to the model as the per FTE costs of conducting an A-76 competition.

#### *Other Transaction Costs*

A discussion on transaction costs involved in competitive sourcing would be incomplete without mention of the A-76 conversion differential and labor cost adjustments. Both of these have the potential to add transaction costs to the competitive sourcing equation. It

should be noted that it may also be important to consider additional transaction costs not covered in this discussion.

#### Conversion Differential:

The conversion differential is important because it represents an attempt to capture non-quantifiable costs like workplace disruption, reduced productivity and learning curve that occurs when a contractor wins an A-76 competition (OMB 2003a). The use of standard A-76 competitions must include conversion differentials as part of the overall price analyses to better adjust for cost realism. "The conversion differential is a cost that is the lesser of ten percent of the MEO's personnel related costs or ten million dollars over all the performance periods stated in the solicitation" (OMB 2003a, B-16). Essentially, this differential translates into somewhat of a buffer for the in-house MEO. "OMB established this minimum cost differential to ensure that the government would not convert performance for marginal savings" (GAO 2002, 3). It might also be argued that the assignment of actual cost factors may offer a better approximation of expenses related to the conversion differential.

In this dissertation the conversion differential is considered a transaction cost. This is based largely on the consideration of both overhead costs and study costs in terms of a reduced margin of savings for both the contractor and in-house team. A reduced margin of savings, in most instances, directly benefits the in-house team because it may bring studies once considered contractible within the limits of the conversion differential threshold. The impact of the conversion differential will be more fully considered in the next chapter.

#### Wages and Benefits:

Transaction costs that also deserve mentioning are those costs attributed to wage increases. Economic price adjustments related to wages are also made for the in-house team. Also important to consider are increases in work-scope that may require a contract modification and additional work to be completed.

In a review of twenty competitive sourcing contracts the Department of Defense Inspector General (DoD IG) found that cost growth occurred in all twenty contracts (DoD IG 1995). The impact of these increases on cost savings achieved through competitive sourcing may confound the

savings that are actually observed and overall invalidate the original cost comparison process (Coggins 2000).

### Data Analysis

The data analysis section includes discussions on both quantitative and qualitative techniques of analysis. "Data analysis consists of examining, categorizing, tabulating, testing, or otherwise recombining both quantitative and qualitative evidence to address the initial propositions of a study" (Yin 2003, 109). The quantitative portion begins with a statement on the hypothesis being tested and then considers the method used to complete the data analysis. The qualitative portion discusses the relevant propositions and the techniques of analysis used herein.

#### Quantitative Data Analysis

The analysis of the quantitative model begins with a statement on the hypotheses examined in this dissertation. Hypotheses are italicized and followed by a discussion on the method of data analysis.

Hypothesis One:

*As transactions costs are accounted for, there will be decreases in total savings and savings per billet.* This hypothesis depicts the directly observed effects from including transaction costs as part of the competitive sourcing process. Cross-tabulations were used as the method of analysis for this hypothesis. The use of cross-tabulations allows for the display of the joint distribution of values in table format by listing the categories of variables on one side of the table and the levels for the other variables across the top (Johnson et al. 2001, 340).

Hypothesis Two:

*As transaction costs increase the percentage of A-76 competitions with no savings will also increase.* This hypothesis seeks to determine whether there is a proportional relationship between increased transaction costs and an increased percentage of A-76 competitions with no savings. It should be noted that the determination of no savings is realized when an A-76 competition reflects either a negative number or a zero in the total savings

column. The method of analysis for hypothesis two was cross-tabulations.

Hypothesis Three:

*As the number of transaction costs increase, government becomes less likely to contract out.* This hypothesis examines the effect transaction costs have on the government's decision to contract out for the provision of services. Hypothesis three employs cross-tabulations as the primary method of analysis. It should be noted that a t-Test was also used to determine if there was statistically significant difference between the estimated number of competitions won between the government and contractor, when considering the conversion differential as a transaction cost.

Hypothesis Four:

*As transactions cost increase, there will be a subsequent decrease in total savings.* This hypothesis tests the effects of transaction costs as they relate to the initial savings estimates provided by CNA. Hypothesis four was tested using multivariate regression as savings from competitive sourcing were regressed onto transaction

costs and a number of other independent variables.

"Regression analysis is concerned with the study of the dependence of one variable, on other variables, the independent (explanatory) variables" (Gujarati 2003, 18).

The following is the specification for the model that tested hypothesis five:

$$E(Y) = \alpha + B_1X_1 + B_2X_2 + \dots B_kX_k + \mu$$

The first variable in the model  $E(Y)$  describes the expected value of the dependent variable when considering the effect of the independent variables, which are represented by  $X_1\dots$

$X_K$ . The independent variables are held constant to determine the association with the dependent variable.

The  $\alpha$ , symbolizes the intercept term, where the dependent variable intersects the y-axis. The  $\mu$ , represents the disturbance/stochastic term that captures any of the omitted variables that are not included within the constraints of the model (Gujarati 2003; Kennedy 1998; Agresti and Finlay 1997).

The use of this model allowed for the testing of the adjusted savings estimate on the specific commercial activity functions. This model used robust standard errors to control for heteroskedasticity. This was done to

control for the difference in the variance of errors for each observation (Langbein 2005). Also important is that fixed effects for each year were used to control for the effects of time periods. Finally, the base services dummy was dropped and serves as reference for the function type variables and the Navy was used as reference for the branch of service variables.

#### Hypothesis Five:

*As transaction costs increase there will be a rise in the number of billets in an A-76 competition.* Hypothesis five looks at the relationship that competitions have on individual commercial activity functions and branch of service variables. Multivariate regression was the data analysis technique used to test this hypothesis.

The specification of the multivariate regression model used to test hypothesis six follows:

$$E(Y) = \alpha + B_1X_1 + B_2X_2 \dots + B_kX_k + \mu$$

As in hypothesis five, the use of robust standard errors, fixed effects and reference variables were included in the multivariate data analysis.

### *Qualitative Data Analysis*

The use of qualitative data analysis techniques varies somewhat from the quantitative hypothesis testing presented above. As Palmquist (2004) states, qualitative study involves empirical research in which the researcher explores relationships using textual, rather than quantitative data. The subsections below will include a brief overview of the qualitative portions of study, a listing of study propositions, and the relevant analysis strategies.

#### **Overview:**

The qualitative data analysis portion included personal interviews with two groups of personnel. The first group consisted of a number of Competitive Sourcing Officials (CSOs) or their designated representatives. The selection of CSOs for interviews follows the promulgation of OMB's July 2003 report titled *Competitive Sourcing: Conducting Public-Private Competition in a Reasoned and Responsible Manner*. Moreover, CSOs were chosen as the focus of the interviews because they are Assistant Secretary or an equivalent level official that have been designated by the agency head to implement the competitive

sourcing program (OMB 2003a). CSOs are also high enough within each respective organization to understand the policy issues surrounding competitive sourcing.

The second group of personnel selected for interview included eleven implementation personnel directly involved in the day-to-day operations of standard A-76 competitions. This group provided information that was directly relevant to the creation of the transaction costs variables and also provided opinions on the functional implementation of competitive sourcing policy. It should be remembered for both sets of interviews that transaction costs may sometimes be used as proxies to represent public values. This is one of the reasons why a consideration of transactions costs may be applicable and relevant to interviews with both groups of personnel.

#### Interview Questions:

The following questions were developed for use in the qualitative interviews with CSOs and with the implementation personnel directly involved in the A-76 process.

Questions for Competitive Sourcing Officials:

*Question 1.* Why do you think competitive sourcing has been politically controversial?

*Question 2.* What has been the greatest lesson learned from the competitive sourcing process within your organization?

*Question 3.* How important are cost savings to competitive sourcing?

*Question 4.* Has competitive sourcing affected the shaping of human capital (government employees) within your agency?

*Question 5.* How is competitive sourcing being measured within your agency?

Questions for A-76 Implementation Personnel:

*Question 1.* Does competitive sourcing consistently achieve between twenty and thirty percent savings?

*Question 2.* Should costs for competitive sourcing include both contractor and government administration costs?

*Question 3.* What are the per FTE competition costs of including government administration in competitive sourcing?

*Question 4.* Do you think the policy of competitive sourcing is based more on management efficiency, politics or something else?

Interview Propositions:

The use of personal interviews falls within the realm of qualitative research. "Qualitative studies ultimately aim to describe and explain a pattern of relationships, which can be done only with a set of conceptually specified analytic categories" (Huberman and Miles 1994, 431). These "patterns of relationships" can be developed in more detail by stipulating propositions to be used in the case study. These propositions direct attention to something that should be examined more closely (Yin 2003). The general analytic strategy offered for both groups employs the use of propositions as reference points to help guide the direction of the study. The specific qualitative data analysis techniques used pattern-matching logic. "This form of logic compares an empirically based pattern with a predicted one" (Yin 2003, 116). The propositions generated for each group are listed below.

Propositions for Competitive Sourcing Officials Interviews:

*Proposition 1.* . Competitive sourcing is controversial because it is political and involves different congressional constituencies.

*Proposition 2.* Competitive sourcing has been an effective tool embraced by our organization.

*Proposition 3.* Cost savings are the primary motivation behind competitive sourcing.

*Proposition 4.* Competitive sourcing has been a tool used to help reshape our agency.

*Proposition 5.* Competitive sourcing is being measured externally through OMB's government scorecard.

Propositions for A-76 Implementation Personnel:

*Proposition 1.* Competitive sourcing consistently achieves between twenty and thirty percent cost savings.

*Proposition 2.* Costs for competitive sourcing should include both contractor and government administration costs.

*Proposition 3.* The government administration costs attributed to an A-76 competition should be set at approximately \$4000 per FTE.

*Proposition 4.* Competitive sourcing is tool that involves both management and politics.

Interview Process:

An essential part of the qualitative study was based on personal focused interviews. These qualitative interviews required intense listening, intellectual curiosity and a keen understanding of what people were trying to tell you (Rubin and Rubin 1995). One of the keys to gaining good information through the use of interviews came in deciphering what the interviewees were trying to say. Some interviewees were very straightforward while others offered more guarded positions. The interviews were open ended and evaluative in nature. The topical interview was used to gain better insights into competitive sourcing. "Topical interviews are more narrowly focused on a particular event or process, and are concerned with what happened, when and why" (Rubin and Rubin 1995, 28).

The interview sessions generally lasted between forty five minutes to one hour. However, the length of each interview session was dictated by the respondent's availability and the length of each response. At the beginning of each session the interviewer offered

confidentiality to the interviewee(s) and there was a brief discussion on informed consent. Also important is that the researcher discussed the use of interviews with the American University Compliance Coordinator. The Compliance Coordinator felt this dissertation did not constitute, "human subjects research", and that it did not need approval from the Institutional Review Board (IRB).

The interviewees were asked prior to the beginning of each interview if they would consent to being recorded. Some in the CSO group agreed to be taped, while others discouraged it. A few of the CSO and/or Director's of Competitive Sourcing included public affairs personnel and/or legal counsel as part of the interview process. The group consisting of personnel directly involved in A-76 implementation generally did not want to be recorded and preferred confidentiality. The question and propositions used in the interviews can be found in Appendix A and B. These questions were developed and pre-tested by a group of government and contract employees attending American University. There were also a few Department of Navy personnel involved in the pre-test process. The propositions listed above were used as comparison points for data analysis.

### Content Analysis:

The use of documentation, archival records and historical analysis composed the majority of the first part of this dissertation. Content analysis offered a useful means of analyzing qualitative data in general and provided a mechanism for comparative analysis (Patton 1990).

"Although a historical/comparative analysis might include content analysis, it is not limited to only these communications" (Babbie 1998, 308). The chronological placement of legislation, testimony, articles and other related material on competitive sourcing helped provide the genesis of chapters two, three and four.

As mentioned previously, pattern matching looked at the comparison of empirically based patterns with predicted ones (Yin 2003, 116). The use of pattern matching helped provide reference comparisons for the multiple sources of data used in this dissertation. Finding patterns amidst the documentation, archival records and historical data on government contracting and competitive sourcing helped reveal the affect of public values. Moreover, this strengthened the case study by providing both data and methodological triangulation. Also important was that

triangulation sought the convergence of multiple results (Tashakkori and Teddlie 1998).

### Conclusion

This chapter examined the methodology used in conducting this dissertation. It included specific discussion on research design, data and sampling, definition of variables and data analysis. The next chapter will focus on findings generated from quantitative and qualitative testing.

## CHAPTER 8

### RESULTS AND FINDINGS

#### Introduction

This dissertation has examined competitive sourcing in terms of cost savings and public values. In this chapter the results from the mixed methods model used in this dissertation are presented. The quantitative results on cost savings will be presented first. This will be followed by the findings produced from two groups of qualitative interviews.

#### Quantitative Results

This section will begin with a presentation of general descriptive statistics. This will be followed by the results generated from the cross-tabulations used for hypotheses one, two and three. Then the multivariate regression results for the testing of hypotheses four and five are presented.

*Descriptive Statistics*

Table one presents the entire population of A-76 competitions from 1979-1994 prior to the consideration of cancellation rate or data problems. The number column represents the number of competitions per category. Total billets reflect all of the billets in a particular category. Percentage military is the percentage of billets that are classified as military rather than civilian.

Table 8.1 Full Sample of Initiated Competitions - 1979-1994			
	Number	Total Billets	Percentage Military
By Branch of Service			
DoD Agencies	204	5,293	.1
Army	769	52,318	11.8
Air Force	1,150	40,510	34.7
Marines	122	6,515	25.2
Navy	1,303	40,494	15.0
By Size (persons)			
1-10	1,379	7,539	12.7
11-50	1,554	36,339	13.2
51-100	292	20,196	12.2
101-150	122	14,675	16.2
151-200	65	11,357	13.5
More than 200	136	55,024	28.7
By Function Type			
Base Services	968	44,496	10.1
Social Services	376	14,163	11.9
Health Services	114	2,595	26.8
Intermediate Maint	245	28,433	35.7
Depot Maintenance	29	2,067	.1
Real Property Maint	444	16,921	6.0
Research Support	29	1,759	50.9
Training	56	3,229	66.8
Data Processing	265	6,762	12.5
Other Manufacturing	1,022	24,705	24.2
Total	3,548	145,130	19.2

\*Table 8.1 is based on CNA summary data.

The descriptive statistics provided in Table 8.1, show wide variability in A-76 usage patterns between the branches of service and function types. Moreover, eighty three percent of the initiated A-76 competitions fell within either the 1-10 or 11-50 size categories. This may be important when considering that smaller competitions tend to generate less cost savings than larger competitions.

Table 8.2 provides descriptive statistics on the number of competitions that were actually completed during the period spanning 1979-1994. It is important to note that these numbers take into account cancellations, data issues and other miscellaneous problems. The resulting number of competitions studied in this dissertation is 2,126.

The descriptive statistics provided here show the strong effect that cancellation rate and a small number of miscellaneous problems had on the actual number of competitions used in this study. Table 8.2 shows the overall number of competitions decreasing by over forty percent. Likewise, the total billets available for study decreased by over forty five percent. The percentage of military billets slightly increased, but this can most

likely be attributed to the effect the Marine Corps variable had on the rest of the group. It could be assumed that the high cancellation rate reported in Table 8.2 did cause the government to incur some level of transaction costs. This becomes important when considering that initiated competitions most likely require some level of expensed work by all parties involved in an A-76

Table 8.2 - Sample of Completed Competitions

	Number	Total Billets	Percentage Military	
<b>By Service Branch</b>				
DoD Agencies	54 (73.5)	1,571 (70.3)	.3	(.2)
Army	461 (40.4)	24,250 (53.6)	15.1	(3.4)
Air Force	760 (33.9)	26,780 (33.9)	32.2	(+2.4)
Marines	44 (63.9)	1,448 (77.8)	10.8	(+14.4)
Navy	807 (38.1)	25,614 (45.1)	18.8	(3.8)
<b>By Size</b>				
1-10	857 (37.9)	4,764 (36.8)	11.0	(+1.8)
11-50	936 (39.8)	21,549 (40.7)	11.2	(+2.0)
51-100	178 (39.0)	12,370 (38.8)	13.3	(1.1)
101-150	56 (54.1)	6,638 (54.8)	17.0	(.8)
151-200	33 (49.2)	5,778 (49.1)	11.8	(1.7)
More than 200	66 (51.5)	28,564 (48.1)	38.2	(9.5)
<b>By Function Type</b>				
Base Services	673 (30.5)	28,119 (36.8)	10.1	(0.0)
Social Services	234 (37.8)	4,245 (70.0)	12.4	(.6)
Health Services	31 (72.8)	518 (80.0)	19.5	(+7.3)
Intermediate Maint	162 (33.9)	15,731 (44.7)	45.7	(10.0)
Depot Maintenance	9 (68.9)	555 (73.1)	0.0	(+0.1)
Real Property Maint	320 (27.9)	10,715 (36.7)	8.3	(2.3)
Research Support	12 (58.6)	984 (44.1)	76.2	(25.3)
Training	8 (85.7)	1,232 (61.8)	91.9	(25.1)
Data Processing	95 (64.2)	2,153 (68.2)	14.3	(1.8)
Other Manufacturing	582 (43.1)	15,411 (37.6)	22.9	(+1.3)
<b>Total</b>	<b>2,126 (40.1)</b>	<b>79,663 (45.1)</b>	<b>20.9</b>	<b>(+1.7)</b>

\*Parentheses indicate a negative change (unless otherwise noted) from the data presented in Table 1 on the full set of competitions.

competition. Thus, it may be difficult to assume a frictionless system that does not cost taxpayer's money.

#### *Cross Tabulations*

The first group of hypotheses were analyzed through the use of cross tabulations. *Hypothesis one stated, as transaction costs are accounted for, there will be decreases in total savings and savings per billet.* Table 8.3 focused on the cost savings that were achieved when transaction costs were included on a full time equivalent basis (FTE). Moreover, after including transaction costs on a five thousand dollar per FTE basis, total savings decreased by thirty four percent. When considering the full transaction cost figure (includes both contractor support and government administration) of ten thousand dollar per FTE the amount of total savings decreased by sixty two percent. In some instances negative savings were recorded as the costs of administering competitive sourcing programs. The rationale for this goes back to the assumption that competitive sourcing is not a frictionless zero cost policy. Overall, if an A-76 competition is initiated and/or completed with no resulting savings the costing of these competitions should still occur.

Table 8.3 - Savings with Transaction Costs			
	Transaction Costs		
	0	\$5000	\$10,000
By Service Branch			
DoD Agencies	17,285	8,220	365
Army	430,329	278,956	157,706
Air Force	570,958	397,091	263,221
Marines	25,091	16,095	8,855
Navy	413,273	256,274	128,204
By Size			
1-10	76,372	47,186	23,376
11-50	380,578	246,192	138,447
51-100	191,872	116,591	54,741
101-150	125,177	81,812	48,622
151-200	103,917	64,775	35,885
More than 200	583,742	400,060	257,240
By Function Type			
Base Services	515,041	338,393	197,798
Social Services	68,163	42,166	20,941
Health Services	4,099	1,222	(1,368)
Intermediate Maint.	285,162	186,546	107,891
Depot Maintenance	4,791	1,680	(1,095)
Real Property Maint.	209,210	140,990	87,415
Research Support	68,041	58,358	53,438
Training	21,421	13,762	7,602
Data Processing	22,869	10,503	(262)
Other Manufacturing	258,141	163,016	85,991
Total Savings	1,456,937	956,636	558,351

\*Savings (thousand FY 1996 dollars annually)

The data presented in Table 8.4 also applied to hypothesis one. Only this time the results pertain directly to a decreasing trend in the savings achieved through competitive sourcing on a per billet basis. This makes sense when considering that transaction costs should be inversely proportional to savings. Table 8.4 observes the negative affect of growing transaction costs on total

savings. Additionally, there were negative savings per billet for several function type variables. This again indicated competitions that did not result in cost savings.

Table 8.4 - Savings per Billet			
	Transaction Costs		
	0	\$5000	\$10,000
By Service Branch			
DoD Agencies	11.0	5.2	.2
Army	17.7	11.5	6.5
Air Force	21.3	14.8	9.9
Marines	17.3	11.1	6.1
Navy	18.1	10.0	5.1
By Size			
1-10	16.0	9.9	4.9
11-50	17.7	11.4	6.5
51-100	15.5	9.4	4.4
101-150	18.6	12.3	7.2
151-200	17.4	11.2	6.2
More than 200	20.4	14.0	9.0
By Function Type			
Base Services	18.3	12.0	7.1
Social Services	16.1	9.9	4.8
Health Services	7.9	2.4	(2.6)
Intermediate Maint.	18.1	11.9	6.9
Depot Maintenance	8.6	3.0	(1.0)
Real Property Maint.	19.5	13.1	8.2
Research Support	69.1	59.3	54.4
Training	17.4	11.2	6.3
Data Processing	10.6	4.9	(0.1)
Other Manufacturing	16.8	10.6	5.8
Total Savings	18.2	11.8	6.9

\*Savings (thousand FY 1996 dollars annually). Parentheses indicate negative numbers.

#### Hypothesis Two:

The cross tabulation results for hypothesis two are reported in Table 8.5. A restatement of hypothesis two follows: *As transaction costs increase the percentage of*

A-76 competitions with no savings will also increase.

Table 8.5 below reports an increasing trend of A-76 competitions with no savings. In this instance an increase in transaction costs is directly proportional to the rise in the number of competitions with no savings. Table 8.5 shows the percentage of competitions with no savings rising to almost fifty two percent under the \$10,000 per FTE category. This more than doubles the initial twenty two

Table 8.5 - Percentage of Competitions with No Savings

	0	Transaction Costs \$5000	\$10,000
<b>By Service Branch</b>			
DoD Agencies	14.8	20.4	40.7
Army	22.3	31.9	48.4
Air Force	15.8	23.0	40.5
Marines	27.3	36.4	45.5
Navy	27.8	37.7	57.0
<b>By Size</b>			
1-10	37.2	43.2	60.6
11-50	13.7	24.6	42.9
51-100	7.9	19.7	38.2
101-150	3.6	16.1	30.4
151-200	9.1	15.2	30.2
More than 200	1.5	9.1	25.8
<b>By Function Type</b>			
Base Services	25.0	33.4	50.2
Social Services	15.4	18.4	33.3
Health Services	41.9	66.7	74.2
Intermediate Maint.	22.8	27.2	40.7
Depot Maintenance	33.3	44.4	66.7
Real Property Maint.	17.5	25.3	38.4
Research Support	8.3	8.3	16.7
Training	0.0	25.0	62.5
Data Processing	33.7	51.6	78.9
Other Manufacturing	20.8	31.8	54.5
<b>Total Savings</b>	<b>22.0</b>	<b>33.2</b>	<b>51.6</b>

percent figure offered with zero transaction costs.

Hypothesis Three:

Table 8.6 provides the cross-tabulation results for hypothesis three. A restatement of this hypothesis follows: *As the number of transaction costs increase, government becomes less likely to contract out.* The findings in Table 8.6 indicate that the ten percent rule when considered as a transaction cost in an A-76 competition does effect the service provider chosen. The cross-tabulations below report that the decision to use government in-house services would decrease to thirty eight percent if the ten percent rule were not employed. Also interesting to note was that a t-Test conducted to compare government and contractor means was found to be statistically significant at the ( $p \leq .05$ ) level. The results for the t-Test can be found in Appendix C.

Table 8.6 - Ten Percent Rule and Transaction Costs		
Service Provider	A-76 Competitions	
	With Rule	Without Rule**
Government (In-House)	1052 (49.5)	806 (37.9)
Contract	1074 (50.5)	1320 (62.1)
Total Competitions	2126	2126

\*Parentheses indicate percentage of competitions. \*\*The differences between these means are statistically significant.

*Multivariate Regression*

The method of analysis employed for the next two hypotheses was multivariate regression. Hypothesis five follows: *As transactions cost increase, there will be a subsequent decrease in total savings.* Table 8.7 reports the ordinary least squares (OLS) estimates when regressing total savings on transaction costs and other independent variables. The functional form of the regression equation follows:

$$\text{TOTAL SAVINGS} = \alpha + \beta_1 \text{TRANSACTION COSTS} + \beta_2 \text{SOCIAL SERVICES} + \beta_3 \text{HEALTH SEVICES} + \beta_4 \text{INTERMEDIATE MAINTENANCE} + \beta_5 \text{DEPOT MAINTENANCE} + \beta_6 \text{RESEARCH SUPPORT} + \beta_7 \text{OTHER MANUFACTURING OPERATIONS} + \beta_8 \text{TRAINING} + \beta_9 \text{DATA PROCESSING} + \beta_{10} \text{REAL PROPERTY} + \beta_{11} \text{DOD AGENCIES} + \beta_{12} \text{ARMY} + \beta_{13} \text{AIR FORCE} + \beta_{14} \text{MARINE CORPS} + \beta_{15} \text{PRESIDENT'S PARTY} + \beta_{16} \text{URBAN DENSITY} + \beta_{17} \text{UNEMPLOYMENT} + \beta_{18} \text{COLLLEGE} + \beta_{19} \text{MEAN INCOME} + \beta_{20} \text{TREND YEAR 1977} + \mu.$$

The findings from Table 8.7 indicate there is a statistically significant effect of total savings on transaction costs at the ( $p \geq .002$ ) level. More specifically, when holding all other variables constant, for every \$1.00 increase in transaction costs, total savings decreased by \$3.03. This was an expected result,

which reflects the strong effect that transaction costs have on savings.

Table 8.7 - Regression of Total Savings on Transaction Costs, Function Type Dummies, Branch of Service, President's Party, Urban Density, Unemployment, College Education and Mean Income				
Independent Var.	Coeff.	Std. Error	Robust T-stat.	Prob.
Transaction Costs	-3.03	.9582	-3.16	.002
Social Services	-61.5	236.4	-1.75	.081
Health Services	-115.6	82.6	-1.82	.071
Intermed. Maint.	154.9	214.1	.72	.469
Depot Maintenance	246.8	318.4	.78	.438
Research Support	3420.7	3297.2	1.04	.300
Other Mfg. Ops.	-35.94	14.8	-2.44	.015
Training	1039.2	1018.2	1.02	.308
Data Processing	-160.4	77.1	-2.08	.036
Real Property	-29.9	11.2	-2.67	.008
DoD Agencies	-196.2	92.1	-2.13	.033
Army	165.4	158.6	1.04	.297
Air Force	-213.9	102.4	-2.09	.037
Marine Corps	25.25	110.2	.23	.819
President's Party	-72.9	67.9	-1.07	.284
Urban Density	357.4	316.8	1.13	.259
Unemployment	79.1	1813.3	.04	.965
College	-2093.8	1280.4	-1.64	.102
Mean Income	12.45	9.3	1.35	.179
Trend Year 1977	4.91	2.23	2.20	.028
Constant	403.8	756.7	.53	.594
N Observations	2124			
F (21, 2102)	106.6			
F Probability	.000			
R Squared	.5179			

\*Savings (thousand FY 1996 dollars annually).

There was also statistical significance found in some of the function type variables. When holding all other variables constant, a one-unit increase in social services decreased savings by over \$61 thousand ( $p \leq .081$ ) when considering the base case of installation services.

The finding of decreased savings was also found in functions like health services, other manufacturing operations, data processing and real property management. It must be remembered that the following function type variables are compared against the base case of installation services. Holding all other variables constant, for every one unit increase in health service related functions, there is a corresponding decrease of over \$115 thousand ( $p \leq .000$ ) in savings. The effect on health services seems to be very strong when considering there were only thirty-one A-76 competitions and \$4.11 million in savings. Likewise, there was a decrease in savings of almost \$36 thousand ( $p \leq .015$ ) for other manufacturing operations. The remaining statistically significant function variable findings included reduced savings of \$160 thousand for data processing ( $p \leq .036$ ) and almost \$30 thousand for Please note all of these findings are compared against the base case of installation services.

The two branch of service variables with statistically significant findings were DoD Agencies and the Air Force. When holding all other variables constant, a one unit increase in functions provided by DoD agencies resulted in

a \$196 thousand decrease in savings costs when compared with the Navy branch of service variable ( $p \leq .033$ ). Similarly, a one-unit increase in functions provided by the Air Force resulted in a reduction of almost \$214 thousand ( $p \leq .037$ ).

The only control variable found to be statistically significant was college education. Holding all other variables constant a one-unit increase in college education reduced savings by 2.09 million ( $p \leq .102$ ). It should be noted that the college education variable is marginally significant. Finally, the trend year variable was statistically significant. If holding all other variables constant, the time trend indicates that for every one-year increase, the growth rate for savings increased by 4.9 percent ( $p \leq .028$ ).

#### Hypothesis Five:

The results for the next hypothesis are again examined through multivariate regression. A restatement of hypothesis five follows: *As transaction costs increase there will be a rise in the number of billets in an A-76 competition.*

The findings for hypothesis five are presented in Table 8.8. The functional form of the regression equation is provided next:  $\text{BASELINE COMPETITION BILLETS} = \alpha + \beta_1 \text{TRANSACTION COSTS} + \beta_2 \text{SOCIAL SERVICES} + \beta_3 \text{HEALTH SERVICES}$   
 $+ \beta_4 \text{INTERMEDIATE MAINTENANCE} + \beta_5 \text{DEPOT MAINTENANCE} +$   
 $\beta_6 \text{RESEARCH SUPPORT} + \beta_7 \text{OTHER MANUFACTURING OPERATIONS} +$   
 $\beta_8 \text{TRAINING} + \beta_9 \text{DATA PROCESSING} + \beta_{10} \text{REAL PROPERTY} + \beta_{11} \text{DOD AGENCIES} +$   
 $\beta_{12} \text{ARMY} + \beta_{13} \text{AIR FORCE} + \beta_{14} \text{MARINE CORPS} +$   
 $\beta_{15} \text{PRESIDENT'S PARTY} + \beta_{16} \text{URBAN DENSITY} + \beta_{17} \text{UNEMPLOYMENT} +$   
 $\beta_{18} \text{COLLLEGE} + \beta_{19} \text{MEAN INCOME} + \beta_{20} \text{TREND YEAR 1977} + \mu.$

The results from Table 8.8 indicate that there is a statistically significant effect when regressing baseline competitions on transaction costs. When holding all other variables constant a one unit increase in transaction costs increase baseline billets in a competition by four at the ( $p \le .000$ ) level. This finding is significant when considering that over forty percent of the A-76 studies used in this project were generated from competitions that included ten or fewer full time equivalents (FTEs).

The analysis of the function type dummy variables reveals statistically significant findings for health services, depot maintenance and real property management.

More specifically, when holding all other variables constant, for every one-unit increase in A-76 competitions for health services, baseline billets in a competition decreased by 3.2 FTEs ( $p \leq .058$ ), when compared to the base installation reference variable. Conversely, a one-unit increase in depot maintenance led to an increase of 19.7 billets in a competition ( $p \leq .065$ ). The real property management variable was also significant. This finding indicates that, when holding all other variables constant, a one unit increase in real property management decreases billets in a competition by 4.9 FTEs ( $p \leq .000$ ). All of these findings must be compared against the installation services reference variable.

There were also a number of branch of service variables found to be statistically significant. More specifically, when holding all other variables constant, a one unit increase in A-76 competitions in the Army revealed a decrease of 3.5 baseline billets ( $p \leq .010$ ) in a competition when compared to the Navy reference variable. The Air Force variable was also significant, but here the finding indicates that a one-unit increase in Air Force competitions leads to a 2.5 billet increase per competition ( $p \leq .009$ ). Likewise, when holding all other variables

constant a one unit increase in Marine Corps competitions led to an 4.3 billet increase per competition ( $p \leq .033$ ). All of the branch of service variables were compared against the Navy reference variable. It should also be noted that none of the control variables were found to be statistically significant.

Table 8.8 - Regression of Baseline Billets in a Competition on Transaction Costs, Function Type Dummies, Branch of Service, President's Party, Urban Density, Unemployment, College Education and Mean Income

Independent Var.	Coeff.	Std. Error	T-stat.	Prob.
Transaction Costs	4.06	1.19	3.41	.000
Social Services	-.662	1.79	-.37	.712
Health Services	-3.19	1.68	-1.90	.058
Intermed. Maint.	-.218	2.77	-.08	.937
Depot Maintenance	19.7	10.67	1.84	.065
Research Support	-12.6	9.92	-1.27	.203
Other Mfg. Ops.	-.633	1.10	-.58	.565
Training	23.2	22.59	1.03	.305
Data Processing	.868	1.09	.79	.428
Real Property	-4.91	1.15	-4.26	.000
DoD Agencies	-.096	2.57	-.04	.970
Army	-3.54	1.38	-2.57	.010
Air Force	2.51	.965	2.60	.009
Marine Corps	4.31	2.02	2.13	.033
President's Party	-.088	.061	-1.47	.142
Urban Density	-2.79	2.12	-1.32	.188
Unemployment	30.1	26.5	1.14	.255
College	9.51	9.33	1.02	.308
Mean Income	-.146	.092	-1.58	.114
Trend Year 1977	-.078	.241	-.32	.746
Constant	4.94	4.53	1.09	.276
N Observations	2124			
F (20, 2103)	97.20			
F Probability	.000			
R Squared	.9518			

Qualitative Results

This section will provide the results produced from the qualitative interviewing. The first part of this section presents the results from the interviews conducted with implementation personnel that are directly involved in the competitive sourcing process. This will be followed by the findings developed from interviews with the Competitive Sourcing Officials (CSOs) or their designated representative(s). The format for this section will include questions, propositions and then results.

*Group One - Implementation Personnel*

The first group of interviews involved federal government employees directly involved in the implementation of competitive sourcing. This group consisted of eleven personnel. The interview sessions used a focus group format. Prior to the interview session the respondents were asked whether they minded being recorded and/or identified. The bulk of the implementation personnel preferred confidentiality. Thus, the location, agency and names of personnel directly involved in the interview session will not be identified in this project.

The demographics of the first group are reported in the tables below.

Table 8.9 - Years of Federal Service		
Years	Frequency	Percent
1-5 years	1	9.1
6-10 years	1	9.1
11-15 years	2	18.1
16-20 years	3	27.3
21-25 years	3	27.3
More than 25 years	1	9.1
Total	11	100

Table 8.10 - Education Level		
Degree	Frequency	Percent
High School	2	18.1
Some College	3	27.3
Baccalaureate	5	45.5
Master's or Higher	1	9.1
Total	11	100

#### Questions and Propositions for Implementation Personnel:

The following questions and propositions were posed to respondents during each interview session.

#### Question 1: Proposition and Results

*Question 1.* Does competitive sourcing consistently achieve between twenty and thirty percent savings?

*Proposition 1.* Competitive sourcing consistently achieves between twenty and thirty percent cost savings.

*Results 1.* The results for Question 1 revealed that the majority of those interviewed felt that the average A-76 competition does not consistently achieve twenty to thirty percent savings. Although it should be noted that two people felt that savings are achieved when focusing strictly on the requirements set forth by the revised OMB Circular A-76. However, both also felt some costs were not being captured by the current policy. There was one person that abstained from commenting on this question because they felt they needed more background to provide an answer.

Overall, there seems to be a large divergence of opinion when comparing the actual results with the proposition that savings of twenty to thirty percent are consistently achieved through competitive sourcing. The pattern reported here seems to indicate that twenty to thirty percent savings is not consistently achieved. Additionally many interviewees cited concerns over additional costs, the potential loss in the provision of the same level of quality in services, control and oversight.

Question 2: Proposition and Results

*Question 2.* Should costs for competitive sourcing include both contractor and government administration costs?

*Proposition 2.* Costs for competitive sourcing should include both contractor and government administration costs.

*Results 2.* The results for question two depict that ten people felt that both contractor and government administration costs should be included in an A-76 competition. The one person that disagreed argued that these costs should not be included in the A-76 process because these expenses were not expressly confined within the structure of OMB Circular A-76. Thus they should not be included as costs attributed to a competition.

The proposition for question two, which argued for the addition of government administration costs was supported by almost all of the interviewees. In fact, the respondent that initially opposed the inclusion of government administration costs was later convinced by the group that these costs were in fact a relevant part of the competitive sourcing process. Although, it should be noted the researcher did not change the initial results for this

proposition. This was largely because of the impact peer pressure may have played on the interviewee's decision. Overall, the congruence displayed for proposition two seems to indicate that government administration costs should be included when examining the costs of the competitive sourcing process.

### Question 3: Proposition and Results

*Question 3.* What are the per FTE competition costs of including government administration in competitive sourcing?

*Proposition 3.* The government administration costs attributed to an A-76 competition should be set at approximately \$4000 per FTE.

*Results 3.* This question evoked strong discussion over the exact amount of costs, which should be used during an A-76 competition. The majority felt that government administration costs should be placed at \$5000 or greater per FTE. Moreover, they argued that the lost time from an individual's regular position should be deducted directly from any savings reported. Additionally, this group felt that personnel supporting A-76 competitions in a peripheral

capacity are not accounted for, nor are the costs of some of the government's socio-economic programs.

Conversely, two individuals disagreed with the majority position and advocated for government administration costs to be set no higher than \$2500 per FTE or less. It should be noted that both conceded that some level of government costs should be considered in an A-76 competition even though this was not expressly authorized within OMB Circular A-76. One person abstained from the discussion on grounds that the issue over government administration costs was a political issue beyond their pay grade.

The research proposition for question three was not supported by the majority of respondents. In fact no one agreed with the \$4000 per FTE level of government administration costs. Moreover, there seemed to be a divergence of opinion on the exact amount of costs. Although most thought that the \$5000 per FTE amount was fair, but too low. Overall, ten of the eleven interviewees agreed that some amount of government administration costs should be captured within the competitive sourcing process.

**Question 4: Proposition and Results**

*Question 4.* Do you think the policy of competitive sourcing is based more on management efficiency, politics or something else?

*Proposition 4.* Competitive sourcing is a tool that involves both management and politics.

*Results 4.* This question sparked a lot of discussion behind the intent of the competitive sourcing program.

Seven individuals felt that both politics and management efficiency played a significant role in competitive sourcing policy. In fact, there was a side discussion on the battle being waged over competitive sourcing between contractors and union representatives. A few individuals indicated that contractors had discussed the possibility of future employment with a number of government employees. A number of others stated that they had heard of instances where the union had discouraged participation in A-76. In both cases, there was no further elaboration when the interviewer asked for more specifics.

There also seemed to be a somewhat polarizing effect produced by this question. Two individuals took the politics position, while two others advocated for the management efficiency position. The two respondents that

argued from the politics side repeatedly stated that competitive sourcing was motivated by deals made between government and business with little concern for public employees. Conversely, the two interviewees from the management efficiency perspective stated that competitive sourcing was good business for the government. This was especially true if the specific service could be produced cheaper in the private sector. Both of the pro-efficiency interviewees thought that competitive sourcing was a better alternative than straight contracting-out because government still had a chance to retain a service in-house.

The group discussion then turned to what might be referred to as a not-in-my-backyard train of thought. The majority felt that competitive sourcing did not directly apply to them. Interestingly, some seemed to feel that competitive sourcing was more applicable to lower level government scale positions and virtually all wage grade positions. However, there seemed to be genuine concern when the researcher presented the interviewees with the prospect of lost employment from an unsuccessful A-76 bid. More specifically, the majority felt that wages, benefits and job security would be diminished for a federal worker accepting a position with a contractor. Additionally, the

issue of quality was raised and there were strong concerns over the incentive of a contractor's workforce to provide the same level of service with reduced wages and benefits. A number of respondents felt, "you get what you pay for", when using a contractor workforce. Yet, these same concerns were not raised until the group was presented with the prospect of losing their own jobs through an A-76 competition.

The research proposition for question four, that competitive sourcing involved both politics and management efficiency was supported by the majority of respondents. However, it should be noted this question elicited strong discussion and seemed to have a polarizing effect on a small number of the interviewees. On the whole, politics appears to be one of the primary forces driving competitive sourcing. Even those advocating the straight management efficiency position conceded that there was some pressure to compete a large number of functions in order to achieve a targeted goal. Thus, a broader discussion on the role politics plays on competitive sourcing may be warranted.

*Group Two - Competitive Sourcing Officials*

The interviews with CSOs or in most instances their designated representatives offered a somewhat different perspective on competitive sourcing. The majority of these interviews were personal and on one on one basis. In a couple of cases, other individuals directly involved in competitive sourcing process were included in the interviews. In two other instances legal counsel and/or public affairs personnel were included in the interview process. There was no use of tape recording after the first few interviewees expressed this preference. Also interviewees were told that their responses were non-attributional. Thus, no reference to specific persons involved in the interviews will be provided. However, Appendix D includes a list of virtually all of the agencies that participated in this study.

The demographics of this group appear in the tables below. Also, demographic information was provided only on the primary interviewee. There were a total of eleven interviews conducted for this portion of the study. However, please note one respondent did not provide any demographic information and preferred their agency to remain anonymous. Thus the tables below reflect only ten

personnel. Additionally two of the interviewees decided to submit written comments and correspond via e-mail. The interviews varied in time from thirty minutes to two and half hours.

Table 8.11 - Years of Federal Service

Years	Frequency	Percent
11-15 years	2	20
16-20 years	0	0
20-25 years	1	10
26-30 years	5	50
More than 30 years	2	20
Total	10	100

Table 8.12 - Years involved with A-76

Years	Frequency	Percent
1-5 years	2	20
6-10 years	3	30
11-15 years	1	10
16-20 years	2	20
21-25 years	1	10
More than 25 years	1	10
Total	10	100

Table 8.13 - Education Level

Degree	Frequency	Percent
Baccalaureate	1	10
Baccalaureate with some Master's work	2	20
Master's or higher	7	70
Total	10	100

#### Questions and Propositions for CSOs or Representatives:

The following questions and propositions were posed to respondents during each interview session.

### Question 1: Proposition and Results

*Question 1.* Why do you think competitive sourcing has been politically controversial?

*Proposition 1.* Competitive sourcing is controversial because it is political and involves different congressional constituencies.

*Results 1.* The results for Question 1 revealed that all interviewees felt that competitive sourcing was politically controversial. However, there seemed to be a difference of opinion on the source of the controversy. The overwhelming majority felt that political patronage was a primary reason for controversy. One respondent commented that it all goes back to the adage that "all politics are local" (2005i). In essence, members of Congress in states or districts with large numbers of government employees are more apt to oppose efforts to take away a constituent's job. Likewise, those members that are being actively lobbied by contractor interests may be more likely to push for more private sector involvement in the provision of government commercial activities. Many of the interviewees cited numerous examples of lobbying efforts and campaign contributions by unions and contractors that were aimed at garnering congressional support for their own interests.

There was also strong support for the notion that the political controversy from competitive sourcing stems from the nature of federal employment. In fact over forty five percent of the respondents cited that the federal workforce was an additional source of controversy. Some interviewees stated that federal workers felt there was a "sense of entitlement" or an "implied contract" that the government would be a safe and stable place to work and that their positions should not be subjected to public-private competitions (2005f). Thus, the advent of competitive sourcing in non-Department of Defense civilian agencies has been met with "much angst" and the feeling amongst some government workers, "how dare you tell me to do this" (2005g).

Additionally, the categorization of the federal workforce into a forced dichotomy between inherently governmental and non-inherently governmental functions has been divisive. Some believe that this designation is tied to how their positions are "valued" by their agencies. In this situation a position designated as non-inherently governmental may be perceived to be of less organizational importance than one coded as inherently governmental.

Differences in ideology were offered as potential source of political controversy by just over half of the interviewees. One interviewee commented, "competitive sourcing is the classic case of government asking itself what it should be" (2005h)? Another stated that the primary reason for controversy is the "checks and balances between Congress and the President" (2005b). There was also support for the traditional opinion that Democrats are more likely to support government employees and "big government". In contrast, Republicans will push for a private enterprise position supporting the use of contracting and a limited role for government. It should be noted that the majority of interviewees considered ideology different from politics in their responses.

Another source of controversy seems to come from the degree of emotional and organizational stress associated with competitive sourcing. One interviewee stated, "competitive sourcing is hard to do and it requires tough choices" (2005i). While a different respondent commented, "nobody wants to be the bad guy, but there is the realization that someone is going to lose their job" (2005d). The difficulty of competitive sourcing can come from the "emotional side" of things where "cost

savings and efficiencies are gained by people losing their jobs" (2005c). A number of interviewees also indicated there can be a considerable amount of "pushback" and "resistance" from within an agency's organizational culture. Especially when "higher level" individuals within the federal workforce feel threatened by competitive sourcing activities.

Over thirty percent of the interviewees indicated that structural problems within the policy itself were a source of political controversy. "There is no consistency in the current approach to competitive sourcing". Another interviewee stated:

The policy never got off on the right foot. The initial release of competitive sourcing was launched through the PMA (President's Management Agenda) with no foundation. Many knew the rigid targets and quotas required by the first release were not well thought out and were probably motivated by something other than organizational efficiency (2005j).

However, targets and quotas were not the only structural challenges for competitive sourcing. One interview commented, "We never truly know if we have achieved savings because all of the relevant costs of administering a competition are not fully considered" (2005d). Another stated "success in competitive sourcing is a matter of where someone draws the line on allowable costs" (2005k). A

few interviewees mentioned concerns over the government's most efficient organization (MEO) :

It is a fallacy to say that the MEO will do the same level of work because there is a strong tendency to push and use the MEO more because it is an in-house government asset. When compared to a contractor workforce that only is required to do what is stated specifically in a contract unless there is a change order for additional monies (2005j).

An additional reason offered for political controversy through competitive sourcing was technological innovation. In some agencies the same number of workers are no longer required because of technological advancements that allow for a smaller workforce. As one interviewee stated, "there is not much you can do when workload goes away and the environment changes" (2005a).

Also important was that the majority of interviewees discussed programs or areas that had been exempted or in some cases shielded from participation in competitive sourcing. Many agencies had to deal with these programs very delicately. In a few instances members of Congress or high-ranking staff members had to be informed and approve of any competitive sourcing activity in their member's area of interest.

Overall, the results yielded overwhelming support for the research proposition that competitive sourcing is controversial because it is political and involved

different congressional constituencies. However, it should be noted that other findings merit attention as well. These include the nature of federal employment, differences in ideology, emotional and organizational stress, structural problems within the policy, and to a minor extent technological innovation.

#### Question 2: Proposition and Results

*Question 2.* What has been the greatest lesson learned from the competitive sourcing process within your organization?

*Proposition 2.* Competitive sourcing has been an effective tool embraced by our organization.

*Results 2.* Over eighty percent of the interviewees indicated that leadership at the very top of their agencies was needed to move competitive sourcing forward.

"Leadership sets the tone for better or worse" (2005c). Moreover, those at the top must have "the will to compete" (2005c). A few interviewees spoke of involvement as high as the Secretary level. However the majority cited that participation needed to come from the Deputy Secretary level or at least the Undersecretary level. It appears that if support for competitive sourcing is pushed as an

agenda item from lower level appointees "the message becomes noise in the system because it must compete with other policies and the intent is generally lost" (2005k).

One interviewee stated:

Without involvement from the highest level of the agency there is no chance for program success. Many will not listen and it becomes another paper drill competing for my time. But if top leadership takes competitive sourcing seriously and continually revisits the policy it has a good chance at success (2005b).

Also important was that with active leadership, access to resources and support for competitive sourcing became much easier for those involved in policy implementation.

Another important lesson learned was that communication at all levels of the organization must be an active component of competitive sourcing policy. It appears that active communication allows for a better chance to counter efforts put in place by those resisting organizational change. One interviewee repeatedly stated, "competitive sourcing must tell a story" (2005i). Others echoed this same sentiment and one person commented, "good communication allows us to tell the positive stories about saving jobs that otherwise would have been completely outsourced and saving programs that might have been otherwise lost because of low funding priorities" (2005f).

There was also a group of interviewees that discussed the need to understand varying aspects of control as an

important lesson learned. A number of respondents spoke of the importance of centralized control over the competitive sourcing process as "essential to making the program work effectively" (2005f). Many felt that one centralized agency process obviates the need for competing processes in lower level organizational structures. Moreover, this should allow for economies of scale to target larger competitions.

Although, this issue does highlight the challenge of gaining effective control over the process especially when there are lower level agencies with their own appropriation lines. One interviewee stated:

The sub-agencies have their own appropriation lines from Congress and most of the time feel little incentive to participate unless their budgets are hurting. If this is the case, sometimes they will lobby Congress on their own behalf and use politics to move around competitive sourcing requirements. Many simply don't see the savings associated with competitive sourcing and believe it has little consequences for their organizations (2005j).

Another interviewee spoke of the tendency for agency managers to "prefer the convenience of simple authority to make or not make personnel decisions to any form of fact based or competitively based process" (2005h). Additionally one respondent stated, "control is an issue for many because it is easier to own the employees than spend money to issue a change order that requires the altering of a contract" (2005k).

The use of competitive sourcing as a tool for the agency was mentioned as an important lesson learned by close to fifty percent of the interviewees. A number of interviewees indicated that competitive sourcing should be closely tied with human capital efforts. "Competitive sourcing offers an opportunity to do general workforce planning" (2005i). Another interviewee acknowledged that, "competitive sourcing has highlighted the realization that there is no cohesive government workforce planning strategy" (2005b). Both views draw attention to the need for workforce planning in the federal government. Additionally, the use of feasibility studies was mentioned as means to include cost/benefit analysis in the determination of commercial activities warranting an A-76 competition.

The findings produced weaker than anticipated results for the support of proposition two. The most important lesson learned from competitive sourcing in this study was the need for active leadership at the highest levels of the agency. The next most frequently cited lesson learned was the need for good organizational communication. This was followed closely by the need to understand different aspects of organizational control. Finally, the use of

competitive sourcing as an effective tool embraced by each agency was the last lesson learned cited by multiple interviewees. This was not the expected result, but it is an important finding that emphasizes the effect agency leadership can have on the success of competitive sourcing.

### Question 3: Proposition and Results

*Question 3.* How important are cost savings to competitive sourcing?

*Proposition 3.* Cost savings are the primary motivation behind competitive sourcing.

*Results 3.* The results for question three reveal that cost savings are an important force behind competitive sourcing. Virtually all of the interviewees mentioned cost savings in some form or another. The difference came in the weight each respondent assigned to the importance of cost savings. Over fifty percent of the respondents indicated that costs savings provided the primary justification and legitimacy behind the competitive sourcing program. "Cost savings are the fundamental purpose of competitive sourcing" (2005c). Another asserted, "it's simple you can't do competitive sourcing without showing cost savings because of the politics surrounding the

program" (2005k). One interviewee also acknowledged, "cost savings are important, but the value placed on cost savings depends on where you sit in the organization" (2005b).

Another finding frequently cited by many interviewees was the importance of making the agency go through the "rigor of the competitive sourcing process" (2005d). Many of these respondents equated the process of competitive sourcing with a chance to reengineer and improve performance within their organizations. One interviewee stated, "it is the process that causes change and it is the process that is important" (2005h). Others echoed this sentiment "going through the A-76 process may be just as important as cost savings especially when it gets employees to change the way they think about the organization" (2005d). Another respondent commented, "the study process can be used as a tool to reengineer the workforce, increase performance and fill skill gaps" (2005a).

A smaller group of interviewees indicated that an agencies budget situation was another important rationale behind the use of competitive sourcing. "If your agency has been hit with budget cuts, then using competitive sourcing as a tool to generate cost savings becomes a

higher priority within the organization" (2005b). Another respondent stated, "cost savings and efficiencies matter more when budgets are scrutinized" (2005c). A few other individuals indicated that the recouping of money through A-76 doesn't seem to have a high priority when agency funding is at a high level. "A big money budget environment may not foster a cost savings or efficiency environment" (2005c).

It is also important to note that the discussion on cost savings from proposition three generated some additional conversation on the costs associated with the competitive sourcing process. One interviewee mentioned that, "cost savings should include an accurate accounting of the full costs of conducting the competitive sourcing program" (2005d). While another commented, "the costs used to approximate cost savings are somewhat diluted because they do not take into account all of the costs of conducting a competition" (2005j). Finally, one respondent referred to cost savings as an "arbitrary line in the sand that moves as the politics of the situation dictate" (2005k).

Overall, a slight majority support the research proposition that cost savings are the primary motivation

behind competitive sourcing. Cost savings were repeatedly mentioned as a key element driving the legitimacy of the competitive sourcing program. However if the response from one interviewee that offered a tie between cost savings and the agencies financial position is removed, the "rigor of the competition process" response gains the slight majority. Although for purposes of the research the competition process ranked a close second, with many interviewees viewing competitive sourcing as a tool to reengineer their organizations and change the mindset therein. Additionally, the budget situation within an agency may provide some of the motivation behind competitive sourcing efforts. The side conversation on transaction costs associated with competitive sourcing, seems to indicate that the controversy surrounding cost savings is still of relevant interest.

#### Question 4: Proposition and Results

*Question 4. Has competitive sourcing affected the shaping of human capital (government employees) within your agency?*

*Proposition 4. Competitive sourcing has been a tool used to help reshape our agency.*

*Results 4.* The findings for proposition four indicate that competitive sourcing is a tool that can be used by an agency to shape their human capital. In fact, all of the interviewees talked about competitive sourcing as a tool that can be used to better manage an agencies workforce. One interviewee stated, "yes, we use competitive sourcing as a tool that works hand in hand with our human capital plan" (2005d). The primary difference seemed to be tied to an agencies experience level with competitive sourcing. Agencies that have been involved in competitive sourcing for a longer period of time seemed to talk about finer details of the program. As one respondent stated, "we are using the contractor workforce to supplement skills and gain greater workforce flexibility in a number of areas" (2005c).

The majority of interviewees are still early on in their use of competitive sourcing as a tool to shape agency human capital. "We are starting to look more in-depth at human capital now" (2005f). One respondent stated, "We are not there yet with active shaping of human capital. We must move beyond the meeting and get into implementation and execution" (2005i). Another commented, "it is beginning to be part of the longer term strategic planning

process" (2005h). While still another stated, "yes to some extent. However we are still working on our tie between competitive sourcing and human capital" (2005j).

The findings for question four indicate strong support for the research proposition that competitive sourcing has been a tool used to help reshape our agency. Many of interviewees felt that one of the strongest contributions provided by competitive sourcing has been forcing agencies to think actively about the structure and composition of their workforces. It should also be noted that many of the agencies involved in this study are still in the infancy of their competitive sourcing programs.

#### Question 5: Proposition and Results

*Question 5.* How is competitive sourcing being measured within your agency?

*Proposition 5.* Competitive sourcing is being measured externally through OMB's government scorecard.

*Results 5.* Virtually all of the interviewees indicated that competitive sourcing was being measured by OMB's scorecard. Many also discussed the importance of moving to green on the scorecard. Furthermore, over seventy percent of the respondents had experienced some

level of political pressure to move forward with the competitive sourcing agenda. Some felt that scorecard pressure might be useful if it helps move the implementation of competitive sourcing forward. One interviewee stated, "there is political pressure to succeed, we are seeing agencies saying how can we do this program" (2005f). An additional respondent said, "scorecard pressure is there, no question, but some of this has been positive because it causes us to think about how we can do this program better" (2005k).

Others talked about scorecard pressure in terms on increasing the number of competitions within agencies. One respondent stated, "we need to conduct competitions to get credit so that's what we do" (2005a). Another commented, "there is constant pressure to generate more competitions and to produce a better scorecard" (2005b). An additional respondent stated "getting credit for a competition becomes an end in and of itself to get OMB credit" (2005j). One interviewee summarized the situation as the following:

It's like balancing tension. We need to be conducting competitions to move to green but we also need to make sure we aren't over-zealous in our approach and this means making sure a competition is the right thing to do for the organization (2005b).

There also seems to be a number of agencies moving forward with their own internal scorecards and other types of assessment tools. More than fifty percent of the respondents mentioned some other means of tracking agency success for competitive sourcing. One interviewee mentioned, "our internal scorecard allows for back and forth between the agency competitive sourcing office and the field" (2005f). Also discussed was "the use of baseline costs as a means of comparison with the winning bid" (2005g). Additionally the use of agency feasibility assessments was mentioned as another way to measure an agencies success in competitive sourcing.

Although, it should be noted that the use of feasibility assessments for measuring an agencies performance generated broad grounds for discussion by a number of interviewees. Some felt strongly that feasibility assessments should be counted as a form of internal metric. Conversely, others stated that this was a requirement not a measure of competitive sourcing effectiveness. A few of the respondents noted that, "competition times will take just as long because feasibility reviews incorporate the front side planning piece that used to be counted within the A-76 competition

timeframe" (2005g). Another respondent echoed the same sentiment, "all told competition times will probably take about the same length of time" (2005k).

Another group of interviewees felt that the PMA scorecard is only one way at measuring the success of competitive sourcing because it primarily focuses on the number of competitions produced by an agency. Some expressed frustration over the reporting requirements. One individual stated, "we should be trying to measure the value we are getting from competitive sourcing. If it means more bang for the buck great, but if it means less quality and services then we should readjust" (2005k). Another commented, "in the future OMB should be looking at efficiencies and process improvements" (2005j). One person acknowledged, "standards in the scorecard have eroded somewhat and this may be pushing more agencies into the green category" (2005c). While other agencies were very content with the OMB scorecard, "you seem to forget too many reporting requirements creates more work for an agency" (2005b).

Overall there was strong support for the research proposition that competitive sourcing is being measured primarily by OMB's government scorecard. The majority of

interviewees supported the notion that the scorecard has been used to examine the success of competitive sourcing. Although, many noted that political pressure was a strong component moving the scorecard forward. Additionally some agencies are creating in-house metrics to evaluate their competitive sourcing programs. There was also some discussion on the scorecard missing the mark and the lowering of standards to allow more agencies to move to green. All told, the scorecard seems to be driving political pressure, which in turn has had an effect on competitive sourcing activity.

### Conclusion

The findings from the quantitative model indicate that the inclusion of transaction costs in competitive sourcing negatively effect cost savings. The qualitative interviews provided support for the notion that politics has played a strong role in the evolution of competitive sourcing policy. A more thorough summary and discussion are offered in the next chapter.

CHAPTER 9  
DISCUSSION AND CONCLUSION

Introduction

This chapter of the dissertation is split into a section on discussion and another on conclusion. The discussion section is composed of subsections, which present an overview of the research design, main findings, implications of the research, limitations of the study and potential areas for future research. Additionally, this chapter will include a conclusion section that summarizes the dissertation.

Discussion

The discussion section brings together and summarizes the results of the dissertation. It also allowed for the opportunity to provide relevant insights on findings and implications contained within the research.

*Overview of Research Design*

This dissertation employed a mixed model methodology embedded within a historical case study. This design was necessary to develop and understand the competitive sourcing policy environment. Then, a discussion on issues and challenges in competitive sourcing was presented. The mixed methodology allowed for an exploration of answers for both quantitative and qualitative research questions. The quantitative model examined how much cost savings could realistically be attributed to the use of competitive sourcing? Whereas, the qualitative research question examined the driving force(s) behind competitive sourcing policy.

The first part of this dissertation used chronology and historical content analysis to place government contracting within the realm of public values. Moreover, this same approach was used to present the evolution of public-private competitions via competitive sourcing policy. This framework was also used to examine the roles played by cost savings and the friction between competing public values.

The main thrust behind the competitive sourcing initiative seems to be predicated on cost savings that are

estimated at around thirty percent per competition. The quantitative model contained in this dissertation tested the amount of savings that could be realistically achieved when including transaction costs in the competitive sourcing equation. More specifically, the model tested commercial activities data gathered within the Department of Defense (DoD) between 1979-1994.

The other portion of the model incorporated two groups of qualitative interviews. The first group was composed of personnel directly involved in the implementation of recent A-76 competitions. These interviews were primarily designed to discuss the development of transaction costs that were later included in the quantitative model. The second group consisted of Competitive Sourcing Officials (CSOs) or in most instances their designated representatives. The interviews for this group emphasized the driving forces behind the competitive sourcing initiative. It should be noted that in many instances CSOs deferred these interviews to their Directors of Competitive Sourcing, which were generally SES level equivalents.

*Answering the Research Questions:*

*A Presentation of Key Findings*

The research presented in this dissertation provides key insights into a better understanding of competitive sourcing. The findings below were developed trying to answer and better understand the following research questions.

Question 1) How much cost savings can realistically be attributed to the use of competitive sourcing?

Question 2) Are cost savings the primary force driving competitive sourcing policy?

**Cost Savings: A Transaction of Success?**

The biggest finding that emerged from the quantitative portion of the dissertation was that the thirty percent cost savings estimates could not be replicated when including transaction costs in the model. The initial assumptions of a zero transaction cost frictionless system of competition produced cost savings of over \$1.45 billion. However, with inclusion of transaction costs the savings attributed to competitive sourcing declined precipitously.

When assuming a five thousand dollar per FTE (Full Time Equivalent) transaction costs figures, savings drop to \$956 million a 34.7 percent decrease in savings. Likewise, the ten thousand dollar per FTE costs drive savings down to \$558 million, which is a decrease of almost 62 percent.

The cost savings per billet also decreased substantially when including transaction costs. The initial model placed the average cost savings at over \$18 thousand per billet. These savings dropped to \$11.8 thousand with five thousand dollars in transaction costs and \$6.9 thousand when using the ten thousand dollar per FTE figure. An additional finding was that the use of transactions costs seemed to lead to a substantial rise in the number of competitions with no cost savings. By and large the consideration of transaction costs seems to represent the potential for a substantial decline in cost savings.

This research then produced a statistically significant finding from a comparison of means between total savings and total savings with transaction costs. A finding that was explored in more detail using multivariate regression. Further analysis tested the effect of total savings on transaction costs. The regression results

provided statistically significant support for the hypothesis that as transactions cost increase, there will be a subsequent decrease in total savings. This is important when considering OMB's plan to conduct an increasing number of competitions. More competitions may lead to greater transaction costs and less cost savings. Additionally, the growth rate of cost savings was predicted in a number of previous models to be placed at approximately 30 percent. However, the growth rate for savings in this study was approximately 4.9 percent.

Also tested was the hypothesis that as transaction costs increase there will be a rise in the number of billets involved in an A-76 competition. The transaction costs variable was statistically significant and led to a rise in the number of billets included in an A-76 competition. Additionally some of the function type dummy variables and the majority of the branch of service variables were found to be statistically significant when testing this hypothesis.

Overall, these findings show that transaction costs are an important and relevant element of competitive sourcing. When they are removed there seems to be an assumption of a friction-less process of public-private

competitions that lead to significant cost savings. Conversely, when transaction costs are included, the friction of the competition process is applied and there is a reduction in the amount of cost savings. These findings make sense when considering that a transparent, fair and accountable process costs money, but ensures integrity and trust in the government process.

It is important to note that the findings in this dissertation still demonstrate that competitive sourcing saves the government money. However, in most cases the addition of transaction costs may produce a substantial decrease in cost savings estimates. This finding also illustrates the frailties within a policy that may not adequately account for costs. Moreover, it may point to the arbitrariness of a policy that is driven by more than only the achievement of cost savings.

#### Understanding the Forces Behind the Policy:

##### A Qualitative Examination

The key qualitative findings for this dissertation are broken historical analysis and personal interviews. Both reveal important insights into a broader understanding of competitive sourcing policy.

*Historical Insights.* The key qualitative findings from the historical content analysis indicated that there was more driving competitive sourcing than only cost savings. The historical content analysis revealed that government contracting evolved hand in hand with a number of competing public values like transparency, accountability, equity, integrity, regularity, capacity, economy, efficiency and cost savings. It should be acknowledged that contracting with the federal government is somewhat different than the structure of public-private competitions espoused in OMB Circular A-76. Although, competitive sourcing follows virtually all of the same dictates and requirements found within the Federal Acquisition Regulation.

Thus, there seems to be a strong parallel between the development of federal contracting and competitive sourcing. Yet have both been driven by competing forces and values? The answer with government contracting is a resounding yes. However, competitive sourcing on the surface seems to be focused primarily on cost savings. Although, when the development of the policy is examined in

detail there again appeared to be evidence of competing forces and values.

During the initiation of the policy in the mid 1950s, President Eisenhower seemed more interested in using OMB Circular A-76 as a tool of planned divestiture to move commercial work performed in the government to private enterprise whenever possible. Whereas, the Kennedy Administration preferred to use competitive sourcing as means to keep work in-house unless there were clearly identified cost savings. There were also a number of statutes and court cases that affected varying aspects of competitive sourcing. There can be no escaping the reality that politics had played a key role in shaping competitive sourcing. Cost savings are important, but this research indicated that politics seemed to be a primary driver of competitive sourcing policy.

*Implementation Personnel Interviews.* The interviews were broken into two groups. The first group consisted of individuals closely involved with A-76 competitions. The interview findings from these personnel were used mainly as a means to build transaction cost factors into the quantitative model. Moreover, this group of interviewees

provided strong support for the premise that transaction costs are very important to the amount of cost savings that can be achieved through competitive sourcing. In fact, this group helped establish the costs associated with both contractor support and government administration. This finding was very important to the research because it involved those directly involved in A-76 and confirmed the importance of transaction costs.

This group was also asked about the force(s) driving competitive sourcing. There responses indicated no clear consensus on one finding. The answer most frequently cited was that both politics and management efficiency played a role in competitive sourcing policy. Though the main focus for this group was on the impact of transaction costs. The responses provided here depict support for the notion that competitive sourcing is a policy that is about more than only cost savings.

*CSO Interviews.* The primary confirmatory analysis for this study came from the personal interviews conducted with CSOs or in most instances their designated representatives. The five questions and propositions asked during these interviews were used to gather together the information

needed to answer research question two: *Are cost savings the primary force driving competitive sourcing policy?* The overall answer from the personal interviews is no. Although, most interviewees mentioned cost savings as being very important to the measurable success of competitive sourcing.

The broader perspective reveals a policy that is highly influenced by politics. Although, the politics involved with competitive sourcing appears to have many levels. At the macro level there was mention of constituent lobbying efforts affecting members of Congress. In fact the vast majority of interviewees revealed specific programs that were excepted from competitive sourcing at the behest of an interested member of Congress or an Administration Official. Also on this level there was discussion over political ideology as a potential force behind competitive sourcing. The typical "big government" vs. "small government" was offered as a factor motivating competitive sourcing. Finally, there appeared to be a political migration of sorts from the targets and quotas initially required by OMB to a more politically salutary scorecard based on the number of competitions and to some extent cost savings.

On a micro level there were issues concerning a perceived sense of entitlement from federal workers and the divisiveness of a policy that separates them into "inherently governmental" or "non-inherently governmental" functions. At this level there was also mention of agency avoidance of competitive sourcing because it involved "hard organizational choices". There was also the sentiment offered by some that, "competitive sourcing is only one of many number one priorities that move the agency" (2005k).

When asking about the greatest lesson learned from competitive sourcing in their agencies, the majority of interviewees responded with the need for the involvement of top leadership. This was followed closely by the necessity for good organizational communication. Both responses seemed to indicate the level within the agency needed to move the policy forward. Also important to note was the discussion on organizational control and the politics involved with competing sub-agencies. Yet, the most interesting result may have come from the lack of discussion that was generated on competitive sourcing as an administrative tool to be used and embraced by the organization.

The discussion on the importance of cost savings to competitive sourcing was also interesting. Virtually all of the respondents mentioned cost savings in one form or another, but the conviction attached to their responses varied. On the surface it seemed this question would produce a very predictable response. Although this was not the case, many interviewees cited that going through the A-76 process was equally important to the achievement of cost savings. Many thought going through "the rigor of the process" for public-private competitions might be another means of producing organizational change. Additionally, there was some discussion on the importance of the agencies financial situation to their receptivity to aggressively administering the competitive sourcing program. Thus, cost savings while seemingly important to the legitimacy of the competitive sourcing program faced stiff competition from a rival explanation based on producing organizational change.

Another finding worth noting was that many interviewees looked at competitive sourcing as a means to conduct agency-wide workforce planning. This would come form the integration of competitive sourcing with an agency's human capital plan. Many agencies do not seem to

be at this stage yet, but this does point to another force acting on competitive sourcing policy.

The final question examined the measurement of competitive sourcing within agencies. The topical answer offered by the majority of the interviewees was that the primary measuring stick of competitive sourcing came from OMB's government scorecard. There was also talk of internal metrics offered at some agencies. An interesting discussion point that was offered by the majority of interviewees was the political pressure to move the agencies scorecard to green in the competitive sourcing area. Many cited some level of pressure to conduct competitions to move the scorecard forward. Others saw this pressure as positive because it generally produced good results and progress. A few respondents offered that OMB had lowered some of its initial standards to make green more achievable by the agencies. Here again politics seems to emerge as force affecting competitive sourcing.

There were number of other findings that were not explicitly mentioned in the study but are important in their own right. One of these is that virtually all of the individuals interviewed seemed genuinely concerned about doing the right thing for their agency and the people

therein. They also frequently mentioned that competitive sourcing was difficult because of the sensitivities involved with the potential loss of government jobs. In fact many interviewees repeatedly mentioned the desire to ensure a fair and open competition process.

Another was that transaction costs are a very real and relevant part of competitive sourcing. Moreover, there was a feeling that cost savings were dependent on where you draw the line on transaction costs. The desire for more savings might see the removal or avoidance of some of the transaction costs involved in the competitive sourcing process. Also, interesting was the finding that there has been a recent trend for less competition from private contractors because of high competition costs and marginal profits. These findings point to the importance of transaction costs in competitive sourcing.

Also interesting was that there was very little mention or concern with accommodating the New Public Management (NPM) or the National Performance Review (NPR). This may point to the reform role assumed by the President's Management Agenda, but it could also represent a move away from large-scale coordinated government reform efforts. More attention may now be focused on the success

of uni-dimensional policy efforts like competitive sourcing. In fact some interviewees discussed the level in the agency that was most likely to produce policy success. Many pointed to the Undersecretary level as the lowest level where a policy like competitive sourcing would be taken seriously by the lower echelon appointees and management personnel within the agency.

The last finding that should be mentioned was the general concern most of the interviewees had for the status of the federal acquisition workforce. Some mentioned that the looming retirement drain in the acquisition community may again lengthen the lines of oversight and diffuse accountability. Thus, the planned increases in contracting through competitive sourcing and direct outsourcing, may create a tenuous oversight position for many executive agencies. Also mentioned was the possible detrimental impact of a robust budget situation and heavy reliance on contractors with a declining acquisition workforce.

Overall, the personal interviews revealed a number of forces acting on competitive sourcing policy. While cost savings are of specific tangible importance to the program, there is much more at work here than initially thought. Politics has played a very important role in competitive

sourcing. Some argue that politics is of the utmost importance, but there were other factors like leadership, control, process, measurement, oversight and people that have also had a strong impact on competitive sourcing.

### *Implications of the Study*

The specific focus of this dissertation was on validating the level of cost savings expected from competitive sourcing and trying to determine whether cost savings were in fact the primary force driving the policy. The implications for this research provide strong support for the contention that transaction costs are an important element in the public-private competition process. Although it should be noted that public choice theory, ownership theory and the reform movements, like NPM and NPR have also played a role in the development of public-private competition theory.

The transaction costs approach represents the cost of information, contractual arrangement and friction that occurs in exchange relationships (Coase 1937; Williamson 1981; North 1984). In this dissertation the addition of transaction costs for contract support and government administration decreased the amount of total savings

provided by the initial CNA model. In some instances the effect of transaction costs dramatically reduced the amount of cost savings.

The literature on transaction cost indicates that the inclusion of these costs can be substantial and lead to an overstatement of cost savings (Nelson 1997). This generally occurs because transaction costs tend to incorporate a balance between values like cost savings and efficiency on one hand and equity and accountability on the other (Sappington and Stiglitz 1987; Dubin and Navarro 1988; Ferris and Graddy 1991). Thus the insertion of transaction costs allows for the friction of public values to be applied to the public-private competition process.

This is important when considering the initial estimates of an average thirty percent savings per competition through competitive sourcing (Snyder et al. 1997; Clark et al. 2001; Gansler and Lipitz 2003). Also, impressive were cost savings figures estimated at over five billion dollars and growing. Yet, there were doubts that these cost savings figures could be consistently achieved (Kettl 1993; Hirsch 1995; Boyne 1998; Hodge 1999; GAO 1999; Sclar 2001; Sawicky 2003). Moreover, the addition of this study adds another voice of pragmatism to the discussion

over cost savings. However, it is important to remember that the model produced in this dissertation still yielded cost savings through competitive sourcing, but at a dramatically reduced rate when considering the addition of transaction costs.

Competitive sourcing remains an important policy that should be used to generate public-private competitions to increase cost savings and efficiencies. Yet the evidence from this research supports the notion that competitive sourcing does not operate in a vacuum only concerned with cost savings. The historical content analysis and personal interviews confirmed the belief that the involvement of politics meant that other public values were active drivers impacting competitive sourcing policy (Agresta 2001; Rosenbloom and Kravchuk 2001; Schooner 2004; Walker 2004). Many studies on public-private competitions confirmed the important role played by politics, social goals and public values (Davies 1971; Florestano and Gordon 1980; Donahue 1989; Rehfuss 1991; De Fraja 1991; Morgan 1992; Hirsch 1995; Van Slyke 2003). In fact some studies talked about the trade-offs between competing public values, which are sometimes imposed by the political situation (De Hoog 1984;

Ferris and Graddy 1986; Lopez De Silanes et al. 1996; Warner and Hefretz 2001).

#### *Limitations of the Study*

This subsection will identify limitations associated with this dissertation research. More specifically, there were a few structural and validity concerns that will be addressed below.

The primary structural limitation in the study stemmed from the heavy reliance on data drawn from the Commercial Activities Management Information System (CAMIS). Concerns over the reliability of CAMIS were repeatedly mentioned in documentation, interviews and archival analysis. This database was used multiple times by CNA to generate a number of studies on competitive sourcing. The challenge is that this same "flawed" CAMIS database formed the basis for the quantitative research presented in this study.

The generalizability of this dissertation faces two challenges. The first is the overall generalizability of the quantitative portion of the study to non-DoD agencies. This is important when considering that the entire sample used in the quantitative model was from DoD. The other challenge appears when looking at the timeframe from whence

the data was generated. One might argue that the commercial activities data used in this study from 1979-1994 may not be applicable to more recent competitive sourcing activity.

The qualitative interviews presented a concern over sampling. Those chosen for interviews were not randomly selected. They were selected based on expertise and familiarity with the competitive sourcing program. This may also present a challenge to the overall representativeness of both interview groups. Moreover, this a factor that may warrant further consideration when looking at the results produced from the qualitative interviews.

Another limitation that might affect internal validity was the extreme savings recorded for a small number of A-76 competitions. These large savings occurred for functions like research support and to a lesser degree training. This may cause some concern over whether the savings produced by these functions were aberrations that will return closer to the average or continue to produce long-term savings.

Also important was that the selection of variables for the multivariate regression model and the t-Tests may

differ outside of the independent variable(s). These differences may account for some of the observed differences in the dependent variable (Langbein 2005). This may be the case when using a comparison of means or the multivariate regression model, as was used in this dissertation. Thus, it cannot be ruled out that factors not accounted for, may also be impacting the findings produced in this study.

The randomness of human behavior may also represent a limitation within the study. "Randomness in human behavior is one source of random measurement error, not due to the measurement process but due to the behavior of what is measured" (Langbein 2005). Furthermore, it cannot be ruled out that some of the responses given during the qualitative interviews possessed some elements of randomness. This may have been more pertinent to the first group of respondents that were interviewed in a focus group type of setting. Although, unbeknownst to the interviewer, group roles and norms may have affected some of the responses provided during the interviews.

*Future Research Opportunities*

This subsection contains a discussion on future opportunities that would expand upon the research presented in this dissertation. One of the greatest opportunities would most likely come from increased access to A-76 data. More specifically, an examination of costs savings achieved through competitive sourcing in all federal agencies. This would allow for greater insights into government-wide A-76 activity and practices. Additionally, access to data following the release of the 2003 revision to OMB Circular A-76 may offer more precise cost savings estimates.

Another important consideration would be the inclusion of transaction costs for both contractor support and government administration. These transaction costs would also include costs of pre-competition planning feasibility analyses and post contract accountability/monitoring. There would also be additional transaction costs computed for terminations, contests and disputes. The estimation of the overall transaction costs attributed to competitive sourcing policy would go a long way in the determination of cost savings. Further research in this area would greatly enhance more accurate savings estimates and would allow for

detailed analysis of the effect of transaction costs on cost savings.

An in-depth examination of the effect that specific public values have on competitive sourcing might also warrant future research opportunities. For example, the capacity of the federal acquisition workforce is a key component to the success of competitive sourcing. Yet, the effect of the erosion of the acquisition workforce may reveal powerful insights into the government's capacity to handle a potential increase in competitive sourcing activity. Another important consideration is oversight capability. In fact some would say capacity and oversight go hand-in-hand. Moreover, it could be argued that with reduced acquisition workforce capacity there might be less oversight of programs like competitive sourcing. On the other hand, some argue that new contracting vehicles like performance-based contracts will decrease the number of management personnel required, while also maintaining strong oversight and performance standards.

Transparency is another area that could be examined more closely. Moreover, transparency may have a deterrent factor that is not easily measured in terms of costs or cost savings. In fact many public values are not easily

quantified because of their far-reaching impact in providing stable government. However, trade-offs between public values in competitive sourcing do seem to occur and further exploration in this area may be warranted.

A closer examination of the frequency and data on streamlined competitions could also provide invaluable clues on the future of competitive sourcing. More study in this area could look at the rationale behind an agencies decision to use streamlined competitions over standard competitions. Also important would be analyzing the effect that streamlined competitions have on cost savings and traditional public values like transparency, equity and accountability.

Another area within competitive sourcing that is ripe for study is a closer look at the use of inherently governmental functions. Moreover, many have theorized that there may be little commonality in the application or formal use of inherently governmental functions. An analysis of agency FAIR submissions may reveal trends and/or functions that are more likely to be designated as inherently governmental functions. This analysis could be made more useful by examining patterns in the grade level of these functions as well. This type of study may

ultimately lead to a more accurate topical definition of inherently governmental functions.

The inclusion of interview questions that more precisely assesses the level of cost savings achieved at agencies through competitive sourcing might also be useful. This might allow the interviewer to evaluate both the CSOs familiarity with competitive sourcing and the importance placed on the generation of cost savings at individual agencies. It should be noted that this was attempted during the first iteration of qualitative interviews, but questions were later revised because of a perceived lack of familiarity with the competitive sourcing program.

The use of qualitative interviews also presents an opportunity to more thoroughly explore the effect competitive sourcing has on competing public values. The interview questions used in this dissertation only scratched the surface of a deeper understanding of the role played by public values. In fact future research may want to consider the benefits of public values in the competitive sourcing milieu and how these might be used to actively increase policy acceptance and implementation.

Conclusion

This study has presented a critical examination of competitive sourcing that has included historical analysis, quantitative modeling and personal interviews. Overall, there are three overarching themes reported in this dissertation. First, transaction costs matter and may dramatically impact the amount of cost savings produced through competitive sourcing. Second, the thirty percent cost savings figure reported in a number of studies could not be replicated, but it should be noted that savings did occur on a much smaller scale. Third, cost savings are not the only force driving competitive sourcing policy. Politics, public values and competing organizational goals have also played an active part in the development of competitive sourcing. Additionally, a tangential theme of some importance was the representation of cost savings as a public value.

The examination of competitive sourcing in this study seems to have come full circle. The beginning chapters of this dissertation discussed the balance and trade-offs between competing public values. Here again, the policy of competitive sourcing appears to be focused on cost savings

but responsible to political influence. As Hans Linde wrote:

The search for a goal beyond the enacted policy itself will be illusory because a policy often results from the accommodation of competing and inconsistent values, or because it simply intends to favor one interest at the expense of another, or because it represents only a judgment of the justice or equities in the immediate issue without intending to accomplish any further aim (Linde 1976, 212).

In the end, competitive sourcing represents a policy intended to emphasize the achievement of cost savings through public-private competitions in the federal government. Yet, the relevance of transaction costs lowers the value of cost savings. Their presence also helps restore the seemingly forgotten costs associated with some public values. It must be remembered when broken down to the lowest level competitive sourcing deals with people competing for their jobs. Additionally, it involves competition between a public and private sector driven by different motivations. Also important is that competitive sourcing appears to be inextricably linked to competing branches of government and competing ideology. What is left is the "inevitable friction" provided by politics, trade-offs, transaction costs and public values.

## APPENDIX A

### INTERVIEW QUESTIONS AND PROPOSITIONS

#### FOR IMPLEMENTATION PERSONNEL

*Question 1.* Does competitive sourcing consistently achieve between twenty and thirty percent savings?

*Proposition 1.* Competitive sourcing consistently achieves between twenty and thirty percent cost savings.

*Question 2.* Should costs for competitive sourcing include both contractor and government administration costs?

*Proposition 2.* Costs for competitive sourcing should include both contractor and government administration costs.

*Question 3.* What are the per FTE competition costs of including government administration in competitive sourcing?

*Proposition 3.* The government administration costs attributed to an A-76 competition should be set at approximately \$4000 per FTE.

*Question 4.* Do you think the policy of competitive sourcing is based more on management efficiency, politics or something else?

*Proposition 4.* Competitive sourcing is tool that involves both management and politics.

APPENDIX B  
INTERVIEW QUESTIONS AND PROPOSITIONS  
FOR COMPETITIVE SOURCING OFFICIALS

*Question 1.* Why do you think competitive sourcing has been politically controversial?

*Proposition 1.* Competitive sourcing is controversial because it is political and involves different congressional constituencies.

*Question 2.* What has been the greatest lesson learned from the competitive sourcing process within your organization?

*Proposition 2.* Competitive sourcing has been an effective tool embraced by our organization.

*Question 3.* How important are cost savings to competitive sourcing?

*Proposition 3.* Cost savings are the primary motivation behind competitive sourcing.

*Question 4.* Has competitive sourcing affected the shaping of human capital (government employees) within your agency?

*Proposition 4.* Competitive sourcing has been a tool used to help reshape our agency.

*Question 5.* How is competitive sourcing being measured within your agency?

*Proposition 5.* Competitive sourcing is being measured externally through OMB's government scorecard.

## APPENDIX C

### T-TEST RESULTS

#### Paired t Test for: Total Savings and Total Adjusted Savings

Variable	Obs	Mean	Std. Err.	Std. Dev.
totsav	2127	1369.945	687.1943	31693
totsav~u	2127	525.0128	266.2099	12277.44
-----				-
diff	2127	844.9324	422.8871	19503.31
-----				-

Ho: mean(totsav - totsavstu) = mean(diff) = 0

Ha: mean(diff)<0      Ha: mean(diff) != 0      Ha: mean(diff)>0  
 t = 1.9980      t = 1.9980      t = 1.9980  
 P < t = 0.9771      P > |t| = 0.0458      P > t = 0.0229

#### Paired t test for Ten Percent Rule and No Rule

Variable	Obs	Mean	Std. Err.	Std. Dev.
No Rule	2127	1.242125	.6208595	28.63367
10% Rule	2127	1.006112	.5029362	23.19512
-----+-----				-
diff	2127	.2360132	.1181584	5.449396
-----				-

Ho: mean(even - 10%rule) = mean(diff) = 0

Ha: mean(diff)<0      Ha: mean(diff) != 0      Ha: mean(diff)>0  
 t = 1.9974      t = 1.9974      t = 1.9974  
 P < t = 0.9770      P > |t| = 0.0459      P > t = 0.0230

APPENDIX D  
LIST OF AGENCIES PARTICIPATING IN  
COMPETITIVE SOURCING INTERVIEWS

Department of Agriculture  
Department of Commerce  
Department of Defense  
Department of Energy  
Department of Homeland Security  
Department of Interior  
Department of Labor  
Department of Transportation  
Department of Treasury  
Department of Veteran Affairs  
Anonymous U.S. Department

## APPENDIX E

February 15, 2005

Dear Agency Competitive Sourcing Official:

I am a third year doctoral student currently undertaking dissertation research on competitive sourcing. The purpose of my project is to conduct case study research on an assessment of competitive sourcing from the perspective of leaders currently involved in policy implementation. I am targeting agency Competitive Sourcing Officials (CSOs) and Directors of Competitive Sourcing for interview because I believe each possesses a unique position and broad perspective on the overall ramifications of competitive sourcing policy. Please note these interviews are an important part of my dissertation project that is being conducted for the School of Public Affairs at American University, Washington D.C.

Please understand that your participation in the interview process is voluntary and that all responses will be treated with complete confidentiality. The interview process will consist of only five questions and should take no longer than thirty minutes to complete. Also important is that your responses are for research purposes only and there are no right or wrong answers.

If you have any questions please contact me at (xxx)xxx-xxxx or reply via this e-mail. I appreciate your participation and look forward to meeting with you in the near future. If we could set an interview date for sometime next week that would be great. I will do my best to accommodate your schedule. Thank you for your time and consideration.

Sincerely,

Glen Diehl  
Doctoral Candidate

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