

Does Privatization at the Federal Level Serve the Public Good?

Running Head: DOES PRIVATIZATION AT THE FEDERAL LEVEL SERVE THE
PUBLIC GOOD?

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Abstract

What, where, when and whether to contract out public services to the private sector has been a contentious debate in our nation for decades. Issues of cost, efficiency, access and benefit to the public, surround the debate. In this paper, I look at the issue of privatization of public services at the federal level, to determine whether this growing practice lives up to its promise to serve the public good.

Does Privatization at the Federal Level Serve the Public Good?

Issue Background

Privatization, for the purposes of this paper, is defined as the contracting out of government services to the private sector. According to Swoboda, the objective of government contracting is to,

...acquire goods and services and to carry out the use of those services in a manner that enhances access, competition, visibility and fairness and results in best value or, if appropriate, the optimal balance of overall benefits to the people (Swoboda, 2008b, p.2)

Privatization, by all accounts, is not a new concept. A background paper by the Urban Institute states that privatization efforts have typically increased in periods of both government expansions (The Progressive Era of the late 19th Century, The New Deal and The Great Society), in order to fill the gap between government capacity and needed services. And then again, during periods of government contraction (The Reagan Era, Welfare Reform) in order to reduce costs and increase efficiency during periods of reduced government funding (Nightingale & Pindus, 1997).

Privatization efforts began a significant upswing when then newly elected President, Ronald Reagan, launched an anti-government campaign announcing, “Government is not the solution to our problems. Government is the problem” (Reagan, 1981, para. 8). From there, Reagan “made the discussion of privatization a legitimate part of public policy decision making...{using} economic policies that effectively starved governments of the funds they would need to maintain or expand programs” (Seader, 2002. pp. 1-2).

President Clinton, responding to the public’s mood, continued the momentum gained in public-private partnerships by the Reagan-Bush Administrations by signing *The Personal Responsibility and Work Opportunity Reconciliation Act of 1996*. This act removed previous restrictions on states’ efforts to contract out welfare services to the

private sector, and greatly expanded new markets for private companies through the outsourcing of public social services. According to Nightingale and Pindus, “Now that welfare agencies can contract out the entire welfare system, including intake and eligibility determination, large for-profit companies are moving into the welfare service delivery market...” (1997, p. 4).

The Bush Administration

The current Bush administration has greatly accelerated the privatization efforts of previous administrations. The U.S. federal government is now the largest single purchaser of goods and services in the world, with dollar amounts more than doubling from \$203.1 billion in 2000 to over \$400 billion in 2006. (Walker, 2007b; Waxman, 2007b). Now, nearly 40% of every discretionary dollar spent by Congress goes to government contractors (Waxman, 2007b). This is due, in part, to changes in the Office of Management and Budget (OMB) Circular A-76, which governs the federal contracting process.

Under OMB Circular A-76, federal contracting rules were revised in 2002, when the Bush White House added language to “Presume all activities are commercial in nature unless an activity is justified as inherently governmental” (OMB Circular A-76 Revised, November 12, 2002, p.1) and should, therefore, be subject to competition from the private sector. The purpose of this revision was “to put commercial activities now performed by government out for public-private competition” (Walker, 2007a, p.1). However, after more than two decades of privatization efforts, serious questions still remain about which sector is best equipped to provide services to the public, and whether or not privatization serves the public good.

Does Privatization at the Federal Level Serve the Public Good?

Arguments in Favor of Privatization

Supporters of privatization maintain that it will cut costs, increase efficiency and improve quality of service. The major arguments supporting privatization are that:

- The federal government is bloated and inefficient.
- Federal employees are lazy and unresponsive.
- Inserting market-based reforms through the contracting process will increase competition for government services resulting in improved quality at lower costs.
- The private sector is more capable of innovations, which can increase efficiency and lower costs.
- The private sector can help government increase capacity.
- The private sector can provide clients with more choice for less cost.
- Less government is better. (Kamensky & Morales, 2006; Nightingale & Pindus, 1997; The Reason Foundation).

Arguments Against Privatization

Though less well known, the arguments against privatization of government services are numerous as well, including:

- Reduction of good government jobs in favor of lower paying jobs with fewer benefits.
- Abdicates government responsibilities to the private sector, whose motives are profit, not public good.
- High potential for corruption, waste, fraud, conflicts of interest and cost overruns.
- Any cost savings are directed towards enhancing corporate profit needs, not lowering taxpayers' costs.

Does Privatization at the Federal Level Serve the Public Good?

- Decreases government accountability and citizen participation.
- Inadequate oversight and taxpayer protections in place.
- Great temptation to maximize profits by reducing access and quality of services.

(Dannin, n.d.; Hefetz & Warner, 2004; Nightingale & Pindus, 1997, Opdyke, 1999).

Beyond Ideology

When looking at which sector is best equipped to provide services to the public, both the private and the public sectors have their strengths and weaknesses. According to Hefetz and Warner, the push for privatization occurred because of “government failure to meet economic and organizational efficiency. However, the need for public goods provision arises from market failure, and contract markets exhibit many of these same failures” (2004, p. 172).

In other words:

Business does some things better than government, but government does some things better than business. The public sector tends to be better, for instance, at policy management, regulation, and ensuring equity, preventing discrimination or exploitation, ensuring continuity and stability of services, and ensuring social cohesion... Business tends to be better at performing economic tasks, innovating, replicating successful experiments, adapting to rapid change, abandoning unsuccessful or obsolete activities, and performing complex or technical tasks (Osborne and Gaebler, 1992, as cited by Nightingale & Pindus, 1997, p. 11).

Privatization appears to work best, according to Swoboda, in areas where,

Services, which have large equipment and material requirements, are labor intensive, and have capacity utilization problems are more likely to be contracted out. For example, within public works there are several services: residential solid waste collection, street repair, tree trimming/planting, cemetery administration/maintenance, bus system operations/maintenance, paratransit systems operations/maintenance, and street light operation. These services have common traits: the output is tangible; there is sufficient availability of private firms that could deliver the service; the services are labor intensive; and there are no moral or equity issues involved (Swoboda, 2008b, p. 6).

Does Privatization at the Federal Level Serve the Public Good?

The problem is that privatization has now gone well beyond simple “straightforward or specialized services such as refuse collection, data processing, payment processing or computer system design” (Nightingale & Pindus, 1997, p. 11), and has extended into the wholesale outsourcing of complicated government functions such as foster care, welfare services, and important military functions (GAO, 2005; Humphrey, Turnbull, & Turnbull III, 2006; Nightingale & Pindus, 1997). Large corporate conglomerates such as IBM, Lockheed Martin and EDS are now bidding to take over the welfare services of entire states. “...some large companies see a potentially multibillion-dollar industry that could run entire welfare programs for states and counties” (Bernstein, 1996 as cited by Nightingale & Pindus, 1997, p.4). This leads to concerns over maintaining access to necessary government services and the very functions of government itself, in addition to questions on the private sector’s ability to provide for the public good. “...governments are more than a business; they reflect collective identity, respond to diversity and promote social equity” (Box, 1999 as cited in Hefetz & Warner, p. 174).

Sandra Opdycke in her book, *No One Was Turned Away: The Role of Public Hospitals in New York City since 1900*, explains that public institutions are of value to society because of their inclusiveness, continuity, responsiveness, and visibility; the expectation that they will adhere to these standards and uphold the public good. (1999). “Private institutions, by contrast, may choose to follow these principles, but they are much freer to ignore them when they find it necessary or appropriate” (Opdycke, 1999. p. 4). There are considerable concerns around the private sector’s ability to successfully fill the many roles of government in the privatization process, and meet public needs.

The Illogical Logic of Privatization

The primary argument in favor of privatization is that,

By allowing the private sector to compete for service contracts, the government introduces competition into a previously monopoly-driven area. The public can benefit from competition in reduced service delivery costs, improved service quality, and improved morale of public employees and managers (Seader, 2002, p.6)

However, a careful examination of the logic behind the arguments in favor of privatization reveal serious flaws. In the area of cost, for example, services provided by the public sector need only cover costs. Services provided by the private sector need to cover costs *and* make a profit. “Simple logic should tell us it’s impossible for the private sector to deliver the same service for less and make a profit as well” (Dannin, n.d., p. 4).

Increased competition and efficiency are reportedly why the private sector can provide services for less money than a government monopoly. However, according to a *U.S. House Oversight Committee* Report, nearly half of all federal contracts awarded in 2006 were no-bid contracts (Waxman, June 2007b) effectively transferring responsibility for services from one monopoly (government) to another (a sole corporation). These “monopoly contracts” (contracts without competition) remove incentives to cut costs and improve service. Widely used in Iraq with companies such as Haliburton, Bechtel, Parsons and Blackwell,

The value of federal contracts awarded without full and open competition has more than tripled since 2000. For the first time on record, more than half of federal procurement spending was awarded through no-bid and limited-competition contracts in 2006.... {including} 187 contracts valued at \$1.1 trillion that have been plagued by waste, fraud, abuse, or mismanagement (Waxman, June 2007b, p.i).

Many Republicans are also concerned by this growing trend. “Sen. John McCain, R-Ariz., criticized the Defense Department’s inability to hold down costs on its programs,

especially those awarded as sole-source contracts” (Castelli, 2008, para. 11). Competition as a reason to privatize government services makes little sense when there is little or no competition present.

The Gray Zone

However, the issue of competition and no bid contracts is not entirely clear-cut. Outside the more ideological, black and white arguments (competition is good; no bid contracts are bad) lies a considerable amount of gray.

In an online interview with John Kamensky, Senior Fellow at the IBM Center for the Business of Government, a former member of the GAO, and Deputy Director of Al Gore’s Partnership for Reinventing Government, some of these complexities were explained,

The lack of real competition is a concern, but from a government program manager's perspective, the contracting rules are getting more complex so he or she is being given the incentive to award a master contract vehicle with one company and then do non-competitive task orders so they can get what they need when they need it (Kamensky, J., Personal Communication, February 1, 2008).

William Woods, Director of Acquisition and Sourcing Management for the GAO, was less troubled by noncompetitive procurements in areas where little or no competition for an item exists. “The Government needs certain specialized products and services. What are we supposed to do? Not everyone can make fighter jets” (Woods, W., Personal Communication, February 4, 2008).

Some disagree, “There is a limited pool of people who can build jet fighters, but that doesn’t mean you shouldn’t force competition,” said Adam Hughes, fiscal policy director for OMBWatch. “If only one bid is submitted, go to the companies and say, ‘Were you aware of this?’ and ‘Do you want to bid?’”(Castelli, 2008).

Does Privatization at the Federal Level Serve the Public Good?

The practicality of this suggestion, however, is open to debate. Much of what is not competed in DoD contracts involve patented items that would require DoD to purchase the patents and provide them to other manufacturers, who would then need to ramp up their manufacturing in an effort to submit a competitive bid, explained Ray Bjorklund, chief knowledge officer and senior vice president of FedSources Inc., a market research firm. “That’s cost-prohibitive even before other factors, such as the time it would take for a new vendor to manufacture the necessary equipment” (Bjorklund as cited in Castelli, 2008, para. 16).

Still, the lack of competitive bidding is troubling for many, particularly as this practice is on the rise. Henry Waxman, Chair of the House Oversight Committee, tried to put the issue of competition into perspective:

...there's nothing wrong with it if we're getting a better deal. Often times we can contract out the work and pay a lower price and get good quality. But we're now at the point of four hundred billion dollars contracted out each year. Two hundred billion dollars of which goes to contractors without any competition (Waxman interviewed by Moyers, February 3, 2008, Retrieved from <http://www.pbs.org/moyers/journal/02012008/watch3.html>).

The competitive gray zone appears to exist, but how much can and should be tolerated, is far from resolved.

How Has Privatization Worked?

Evidence and Oversight

Often, whether or not privatization is serving the public good comes down to the issue of oversight. There is general agreement that rigorous oversight is a critical component of any privatization effort, “...the key factor is whether there is clear accountability for results, clear criteria in contracts and clear public objectives” (Nightingale & Pindus, 1997, p.2). Performance based measuring tools need to be in place. “Weak monitoring

Does Privatization at the Federal Level Serve the Public Good?

control will yield lower than expected savings” (Sclar, 2000 & Siefal, 1999 as cited in Hefetz & Warner, 2004). Or, in the words of Oversight Committee Chair Waxman “If no one thinks they're being watched and being held accountable, they think they can get away with anything” (Waxman as aired on Moyers, February 1, 2009, Retrieved from <http://www.pbs.org/moyers/journal/02012008/profile.html#tools>)

It appears, however, that the federal government was not prepared to monitor the rapid increase of contract services that occurred under the current Bush Administration. The House Oversight Committee reported in June of 2007 that the number of federal acquisition experts has remained the same despite a doubling of acquisition contract from \$203.1 billion in 2000 to \$412.1 billion in 2006 (Waxman, 2007b).

Lack of adequate oversight and contract procedures are also a problem according to the GAO, “Agencies continue to experience poor acquisition outcomes in buying goods and services in part because of challenges in setting contract requirements, using the appropriate contract with the right incentives, and ensuring sufficient oversight” (Walker, 2007b, cover page).

In addition, even when audits revealed serious problems with procurement procedures and costs, some agencies and departments failed to take action to correct the problems. Speed as a priority over cost containment or accountability, were often cited. GAO Report 06-996, on the Department of Homeland Security’s use of interagency contracts states:

As of July 2005 DHS has required planning and analysis of alternatives for all acquisitions. In this review, we found that in all four cases for which an analysis of alternatives was required, it was not conducted. DHS officials said benefits of speed and convenience—not total value including cost—have often driven decisions to choose these types of contracts. (GAO, September 2006, cover page).

And again in GAO Report 08-54 (November 2006) on potential waste and fraud in Medicare and Medicaid Services surrounding the new prescription drug benefit plan:

CMS (Centers for Medicare and Medicaid Services) management has not allocated sufficient resources, both staff and funding, to keep pace with recent increases in contract awards and adequately perform contract and contractor oversight. This operating environment created vulnerabilities in the contracting process. Specifically, CMS did not adequately fulfill critical contractor oversight, such as working with contractors to establish indirect cost rates. (GAO, November 2007, cover page).

Lack of accountability, cost overruns and contractor performance appear to be major problems in the privatization process. Agency resistance to GAO oversight and recommendations for improving these areas, remain reasons for concern. An earlier GAO report revealed, “The State Department disagreed with our recommendation to explore options to assist contractors in obtaining security, citing potential liability concerns, and did not take a position on our recommendation to account and plan for security costs” (GAO, July, 2005, cover page). And, in 2006, “DHS does not systematically monitor its total spending on interagency contacts and does not assess the outcomes of its use of this contracting method” (GAO, September 2006, cover page).

Turning Point

Evidence that privatization was not working as planned continued to mount. A turning point occurred in the election of 2006, with Democrats taking control of both the House and Senate. Henry Waxman, now Chairman of *The House Committee on Oversight and Government Reform*, began hearings to investigate allegations of waste, fraud and abuse in federal contracts. In June 2006, The Committee released a report entitled *Dollars, Not Sense: Government Contracting under the Bush Administration*, based on a review of over 500 government audits, reports and investigations. Among the findings were that:

Does Privatization at the Federal Level Serve the Public Good?

- Billions of dollars of taxpayers' money had been squandered on government contracts including 118 federal contracts worth \$745.5 billion that had been found by government officials to include significant waste, fraud, abuse, or mismanagement.
- Reasons for such abuse included poor planning, noncompetitive awards, abuse of contract flexibilities, inadequate oversight, and corruption in contracts as far ranging as Homeland Security, Hurricane Katrina, and rebuilding Iraq.
- Reliance on abuse-prone contract types was increasing including the use of cost-based and no-bid contracts.
- Contractor payments and bonuses were often made without review of contractor performance, even in cases where government auditors identified extensive overcharging.
- Poor contract planning and inadequate contract oversight were rampant. Between the years 2000 and 2005, acquisition officers experienced an average 83% increase in the value of contracts they were to oversee per person, with no additional support. Contractors were also being hired to oversee other contracts where there were obvious conflicts of interest. (Waxman, 2006).

A follow-up report was issued by the committee in June of 2007 which found:

- Contracting problems identified the year before had increased.
- Annual federal procurement spending increased to over \$400 billion, more than half of which — over \$200 billion in new contracts — were awarded without full and open competition.

Does Privatization at the Federal Level Serve the Public Good?

- The total number of no-bid contracts found to include significant waste, fraud and abusive by government investigators and auditors increased from 118 in 2005 to 187 in 2006, and equaled \$1.1 trillion taxpayer dollars.
- Inadequate contract management and insufficient acquisition personnel with poor training continued to be a large problem.
- The number of acquisition officers actually declined slightly between 2000 and 2006, despite a doubling of acquisition contract spending. (Waxman, 2007b).

At a speech on federal contracting on May 14, 2007, Congressman Waxman stated:

...federal procurement decisions affect the lives of every American. Contractors have become a “shadow government,” an enormous workforce of hundreds of thousands of people who perform a vast array of government functions. Lockheed Martin, the largest federal contractor, receives more federal dollars than the Commerce Department, the Interior Department, and Congress combined... This surge in contract spending has enriched private contractors, but it has come at a steep cost to taxpayers through rising waste, fraud, abuse, and mismanagement. (Waxman, 2007a, para. 3).

At the same time, Comptroller General, David Walker presented a report entitled, *Federal Acquisitions and Contracting: Systemic Challenges Need Attention* (Walker, 2007b) outlining numerous concerns with the federal contracting process also described in the Waxman report. In testimony before the *Senate Committee on Homeland Security and Governmental Affairs*, Walker stated that,

The federal government needs to engage in a fundamental and comprehensive re-examination of the federal government’s overall approach to contracting. This includes when and on what basis the government should contract... We should have zero tolerance for waste and mismanagement in times of surplus or deficit...(Walker, 2007b, pp. 16-17).

Necessary Changes

Comptroller Walker has been very clear about the changes needed to improve the privatization/contracting out process at the federal level. These include:

Does Privatization at the Federal Level Serve the Public Good?

1. Separating wants from need. Agencies must do a better job linking their budgets to their strategic goals, particularly with respect to limited resources. Collective, rather than individual agency needs should be respected, with appropriate policies and procedures followed. Congress should be discouraged from requiring agencies to purchase unnecessary items that primarily benefit their congressional districts.

2. Establishing and supporting realistic program requirements. Expectations of performance, production and cost should be realistic and requirements clearly spelled out. Performance Management tools should be utilized including GAO Reports:

Standards for Internal Control in the Federal Government (GAO/AIMD-00-21.3.1, November 1999) and *The Internal Control Management and Evaluation Tool (GAO-01-10089, August, 2001)*.

3. Using contractors in appropriate circumstances and contracts as a management tool. Once the decision to use a contractor has been made, agencies must clearly spell out specific contract requirements, expectations, identify outcomes, timelines, specify cost limitations, incentives, and provide proper oversight. Complexity of projects must be fully disclosed, while risk and responsibilities between the contractor and the agency must be appropriately and specifically spelled out.

4. Creating a capable workforce and holding it accountable. While the rate of acquisition and contracting has doubled since 2000, the number of acquisition officers has actually declined. The government should do more to recruit and train people with the skills and authority required to fully oversee the government contracting process. As systems, contracts and technology changes, so must the skills of those overseeing government contracts. Acquisition contracting represents a growing function of public

Does Privatization at the Federal Level Serve the Public Good?

administration management, and should become a regular part of their training. (Walker, July 2007).

Conclusion

The privatization of public services can result in cost savings and increased quality for members of the public, under certain circumstances. These include: Careful consideration of which functions can safely and effectively be contracted out and which should remain in-house, availability of adequate competitors for contracted functions, use of detailed and concise contracts that include strong performance measures, and rigorous government oversight.

Unfortunately, in too many cases, these necessary precautions have not occurred. As a result, privatization efforts at the federal level, as they are currently being conducted, have become a boom to industry at taxpayers' expense. More Congressional oversight is required in order to enforce GAO recommendations and protect the public's interests. Ideologies must be discarded, and facts carefully examined, if privatization is to work to the public's benefit. According to Kamensky,

The important thing isn't the contracting out but rather the threat of competition, which forces governmental units to rethink what they do, reorganize, and offer a better approach to services. This results in savings even when the government unit wins the competition...There are instances where competitive sourcing does make good business sense, especially in areas where the government does not have the infrastructure or competence to do the work. But the politicization of the tool has made it difficult to use. (Kamensky, J., Personal Communication, February 1, 2008).

Does Privatization at the Federal Level Serve the Public Good?

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