

Admitting a Bad Influence: Contracting the Public Service

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ABSTRACT

Emulation of the private sector is a longstanding controversy in public administration, but could it constitute a bad influence, of the kind that parents seek to guard against by scrutinizing their children's peers? Effectiveness provides a perspective on how helpful or harmful private sector influence has been for the public service. The practice of contracting-out under the A-76 process receives particular scrutiny relative to maintaining the effectiveness of public agencies. A second perspective on private sector influence examines, through the theoretical perspective of transaction-cost economics, the promise of cost savings that justified recent acceleration of contracting-out. The author, himself a government contractor, also bases his analysis on personal experience.

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Key Words: Contracting out; Privatization; A-76; Baumol's disease; Transaction-cost economics.

A HYPOTHETICAL DIALOGUE

Once their children have achieved health, good deportment, and basic moral, social, and academic training, the next hurdle for many parents becomes the competing (corrupting?) influence of friends, peers, romantic interests, and others beyond the nuclear family. The trap for good children presented by bad companions may be found in literature from *Pinocchio* to *Oliver Twist* to *The Reivers*. In this symposium, Charles Goodsell's psychoanalysis of public administration (PA) reminds us how important emulating business practices has been throughout the history of our field. A canon of PA, Woodrow Wilson's "The Study of Administration," illustrates how emulation may even extend to a killer's proficiency in knife-sharpening without impugning the aims of the earnest observer.^[1] But if PA matured in the company of ruthless, amoral actors, how do we suppose that those responsible for its character would view such influence? If they (we?) felt as parents do, then emulation of that kind would be discouraged, even proscribed. Nonetheless, business—not amoral but given to appalling lapses uncovered a century ago by the Progressive "muckrakers" and resurfacing recently in the indictments of Enron and WorldCom executives—has consistently been held up as the ideal for public organizations to follow. Such abuses aside, anti-social practices of business over time prompted regulations concerning workplace safety, consumer protection, financial reporting, and the environment. Uneven performance as "corporate citizen" would seem to disqualify the business world as a model for quintessentially public-spirited government organizations, but that has not stopped comparisons unflattering to the public sector, centered on efficiency and innovation. Donald Kettl warns of the complexities and challenges of "administration by proxy."^[2] Debunking private sector superiority is one of the central themes engaging Goodsell's *The Case for the Bureaucracy*.^[3] Perhaps exhortations to retain the capacity to govern from PA's stalwart supporters bear reinforcement from an antagonistic quarter.

Hypothesizing a frank exchange between public servants and private contractors— notwithstanding the latter's reputation as "beltway bandits"—what topics should be discussed? I suggest two: What makes government contractors effective? And where do "savings" to be realized

from contracting government functions emanate? The potential value of such a dialogue lies in its capacity to demystify the private sector's presumed advantage in accomplishing governmental functions. The potential exists to alleviate the inferiority complex that Goodsell diagnoses by exposing the private sector, so often suggested as a model for public organizations, as unequal to the most difficult problems we face. The utility of this hypothetical dialogue is matched by its improbability. Government contractors—beginning with the author—could be found who would confront the contradictions and implications of our work, but seldom for attribution. By definition the “shadow government” eschews the spotlight.

WHAT MAKES CONTRACTORS EFFECTIVE?

The question of what makes government contractors effective can be approached in precisely the terms appropriate for examining public sector employee effectiveness. In *The Human Resource Crisis in the Public Sector*, Larry Lane and Jim Wolf view this effectiveness through four lenses, three of which pertain to the existing workforce: energy, commitment, and competence.¹⁴ (The remaining lens, flow, pertains to establishment of the workforce, e.g., recruitment and retention.) Lane and Wolf demonstrate how energy and commitment are subject to the political and organizational environment, and identify demotivating practices within the public sector that frustrate achievement of employee potential:

The logic of economics as market transaction, management as command and control, and politics as the struggle for immediate partisan advantage dominate the cultures of most federal organizations. The resulting effects of self-interest and compliance not only block the constructive release of human energy, . . . but also weaken opportunities for community and commitment (see p. 145¹⁴).

Contractors are scarcely strangers to the effects of self-interest. If anything, the private-sector suffers more immediately from the superseding influence of market-based economics, lacking even vestiges—contractors do not take oaths—meant to remind federal workers of their constitutional duty. Compliance, however, contributes part of the explanation for contractor effectiveness. Contractors are less handicapped by a compliance-based culture. Notwithstanding rules about time

reporting, expense recording, and responding to requests for proposal, the ethos of legality does not permeate government suppliers, which owe their origin to commercial charters rather than congressional authorizations.

Government agencies, by contrast, are bombarded by external requirements. In their update on the human capital situation, Lane, Wolf, and Woodard implicate a "report card" mentality, typified by the Government Performance and Results Act. As new sets of rules and oversight supplant the former, and agencies are publicly assessed as to their lack of compliance, public sector energy and commitment dry up. In a recent presidential budget only one agency was found to be making satisfactory progress in its report cards, while 13 were given partial credit and all the rest rated as failures: Lane et al. comment, "It does not take much imagination to conclude that if practically everyone fails the test, not much energy to perform will be derived from the report card process."⁽⁵⁾

In stark contrast, most of the contractors supporting these agencies have more achievable objectives, i.e., business profitability and growth. An aggressive new push for competitive sourcing, one of five items in the President's Management Agenda, lends these business goals considerable assistance. Performance-based contracts, approximately one-quarter of the total large contracts (greater than \$25,000) awarded by the federal government in 2002, fail to divert the focus on profitability because the scope of most contractor activity is too narrow to be meaningfully associated with the strategic goals and performance measurements of an agency.⁽⁶⁾ An exception brought to light under tragic circumstances is the United Space Alliance (USA) contract with the National Aeronautics and Space Administration (NASA), the terms of which require the return of \$70 million in past incentive fees as a result of the Space Shuttle Columbia disaster.⁽⁷⁾

Indeed, NASA provides an apt example for the final perspective on effectiveness: competence. Howard McCurdy traces NASA's conversion from scientific juggernaut to program management organization, requiring that engineers learn to manage contracts.⁽⁸⁾ This trend has continued to the extent that compensation for civil servants now represents approximately one-eighth of its total expenditures, realized through more than a one-fourth reduction in civil service workforce from 1993 to 2000.⁽⁹⁾ The issue arose before the Columbia Accident Investigation Board, which is looking into not only the proximate causes of the disaster, but the underlying factors as well, as to whether NASA retained insight into the technologies that kept the space shuttle flying in addition to its formal oversight role. A critical determination for

establishing the "insight" vs. "oversight" issue was the testimony by the USA (contractor) president that: "the subsystem manager role transitioned to the contractor, where the technical expertise was."^[10] Replacing NASA employees, contractors chaired the panels and boards responsible, for example, for the Thermal Protection System.

This evolution illustrates the trend marked by Lane et al., visible via their lens of competence: "The contract relationship makes federal agency workers 'once removed' from agency processes and program delivery."^[11] In such arrangements, mission-specific competence can only reside with the contractor, if at all, because civil servants lack "hands-on" expertise. Of the three lenses employed to examine the effectiveness of contractors and public servants, this one provides the clearest instance of intentionally diminished governmental capability. But all of the lenses reveal a consistent explanation for contractor effectiveness: the lack of impediments heaped on the public servant as a matter of course.

WHAT SAVINGS ARE TO BE REALIZED?

Yet something even bigger may be at stake here. The Office of Management and Budget's (OMB) Circular A-76 serves as an appropriate symbol of policies that shrink and fragment the public sector. Larkin Dudley enounces the A-76 instructions on converting government functions to commercial activity within a dialogue on what is truly ("inherently") government's role:

As contracting, partnerships, franchises, and vouchers have become common means of providing services, the political dialogue intensifies around which means are more efficient. This focus on means blinds us to the processes of redefinition of *governmental* itself that have accompanied the new experiments in service provision.^[12]

The urgency of questioning the appropriateness of contracting out government services grows as President George W. Bush's OMB redoubles privatization efforts. Declaring the commercial nature of 850,000 federal government positions, proposed revisions to the A-76 process promise to accelerate "competitive sourcing" through many expedients, not least of which is the presumption that "all activities are commercial in nature unless an activity is justified as inherently governmental."^[13] To be required to justify each responsibility on pain

of its removal to the private sector constitutes the ultimate vote of "no confidence" in government.

What could be the rationale for questioning government's role in its traditional sphere? We should not be surprised to find that it is the promised savings and efficiencies attributed to the competitive marketplace. But such an assertion should not pass unchallenged. Accordingly, I now examine the question of the source of private sector savings.

There are as many contracted duties as there are contractors, yet the author as a contractor himself can bring admittedly unscientific personal experience to the matter. The source of savings is, simply put, things not done. This result could be guessed by examining the structure of public and private sector costs. Both begin with salaries and fringe and other benefits, and include the cost of facilities, equipment, and utilities, which are presumably comparable. But for the private contractor only, other costs also accrue: fee (profit) as well as general and administrative costs, including finance and accounting, contracts/legal support, and marketing. These additional elements ("load" in the contracting vernacular) can be compounded by subcontract arrangements between multiple firms working together, escalating labor costs far beyond that of comparably salaried agency employees.

My illustration of how "savings" are achieved from contracted services despite higher unit cost is based on a prosaic activity: purchasing. Once they have established a need and secured the funding, agencies usually proceed with a "sources sought" announcement through widely published media, its purpose being to alert the vendor community to the sales opportunity and to afford the government the widest possible range of solutions. The practical effect of such an announcement is to subject subsequent actions, by both agency and bidders, to the strict discipline of the formal procurement process. Another means of obtaining comparable insight into the range of available products is for the procuring agency to hire a private contractor to survey the commercial marketplace. These efforts, if properly conducted, preclude general awareness of an imminent purchase. Such "blind" inquiries by the contractor do not reveal the procuring agency, nor do they entail formal demonstrations of product capabilities, relying instead on proxies for quality and capability such as wide usage and on published marketing materials. Substituting such an "independent" survey for a formal announcement, though permissible, induces untoward consequences. First, the breadth of solutions is constrained by limiting research and subsequent purchase to bidders already available to the government through pre-existing "schedules." Next, the legislative intent to maximize competition is skirted. Last, the administrative discretion to examine potential sources is

exercised by the contractor. Of course, government personnel have the flexibility *de jure* to follow the same steps, but, as Steven Kelman points out, they are discouraged from exercising discretion, especially in procurements (despite liberalization during his term as OMB's procurement chief).¹⁵⁴ Even though my example, by its banality, may fail to alarm or outrage, by having a contractor do what public servants could do for themselves were they trusted and staffed for this purpose, we reach the same result as when the USA shuttle manager displaces the government from its accustomed role.

LESSONS OF TRANSACTION-COST ECONOMICS

While maintaining the theme of counsel taken "outside of the fold," I broaden the context of this discussion by analyzing the underpinnings of contracting government functions from a perspective often unflattering to public organizations, transaction-cost economics. Oliver Williamson provides a theoretical justification of hierarchical (bureaucratic) span to gain the efficiencies of fluid exchange between trusted parties, in cases where high asset specificity (the space shuttle provides a ready example) otherwise tends to inflate the contract costs associated with an arms-length relationship between supplier and procurer. Williamson shows that the intensive negotiation and monitoring that a highly co-dependent relationship requires are better served by internal, low-powered incentives, such as annual salaries and future promotions, because these encourage the cooperation needed to respond to ambiguity.¹⁵⁵ The external, market equivalent of low-powered incentives, cost-plus contracting, fails to work as well because supplier and procurer are under divided control, and the supplier, as an autonomous firm, "can take its assets and flee." The lesson for those eager to recast the role of government—"steering not rowing" in the reinvention cant—is that "incentives and governance structures that are observed to work well in one organizational milieu do not transfer uncritically to others."¹⁵⁶

Cost-plus contracting is very common in the federal government. Excluding supplies, which are almost always purchased by quote, in 2002 approximately half of its large purchases—amounting to nearly \$80 billion—were by this means.¹⁵⁷ Yet concluding that cost-plus contracting always represents diseconomy is no more sound than maintaining, as an article of faith, that contracting-out is a sure source of savings. But as wholesale privatization appears to be the order of the day, let us direct economic theory toward a scenario of runaway competition to examine the implications for government under the proposed A-76 regulations.

Daniel Patrick Moynihan, steeped in the inherent challenges of government as a scholar, administrator, and U.S. Senator, invoked "Baumol's disease" to explain the cost pressures on public functions. This is a reference to William Baumol's proof of the resistance of personal services functions to capital improvement efficiencies. Moynihan understood the escalating costs of public services as a foregone conclusion because service-intensive activities "migrate to the public sector in order to survive."¹⁸ But if one ventures to couple Baumol's theory of services resistant to efficiencies with inexorable pressure to contract-out, a pernicious "musical chairs" scenario could unfold, in which vendors identify and pursue pockets of activity conducive to profitable exploitation, leaving to the government those functions most susceptible to Baumol's disease. Vendors protecting their profitable niches can then negotiate the scope of performance to protect against cost overruns. So much the better! exhorts the privatization enthusiast. If the goal, however, is to minimize the overall cost of the mission, then the cost of ensuring performance—absorbed by the agency as contract monitor and surety—must be included.

As predicted by transaction-cost economics, the balkanized public domain that emerges from such piecemeal outsourcing outlined above would yield advantages to suppliers. They could capture transitory savings between contracting cycles, exploit mission-critical expertise to ward off rival vendors, and devise creative performance criteria to insulate profit. Absent rehabilitation, private prisons could be as profitable as hotels, with more predictable occupancy rates. Absent teaching, corporate schools could manage more and more students, who would bear responsibility for their own education through self-paced instruction. In the face of this, public organizations that retained direct mission responsibility would face tough challenges requiring dedicated personal services under steadily mounting costs. The cost implications of such a patchwork government—half rich and half poor—would represent only part of the problem. The latitude for coordinated action would be confined within each compartmented activity—governmental or contracted—because any broader efforts would introduce both contractual issues and competitive ones, as the incentive for overall improvement fell prey to the unwillingness to transfer costs.

QUESTIONING THE STAMPEDE

Due to the wide-ranging nature of the issues addressed and cursory treatment of each, the foregoing responses to stylized questions about

contracting the public service serve to illustrate rather than demonstrate. Nonetheless, equally cursory analysis stands behind the stampede to contract out, lending value to countervailing arguments, even if only to give pause or raise questions to be explored more carefully. Perhaps such explorations will lead to a revelation that such private-sector encroachment is often dubious in its effect, both practical and constitutional: not a partnership, nor part of the solution, but debilitating and warranting opposition by all means at hand. To build confidence for Goodsell's public administration to come into its own, or to join the chorus for Rabin's call to arms (see below), lending my assistance to debunking privatization myths is a public service that this government contractor provides without fee or reservation.

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