



Testimony Before the GAO Commercial Activities Panel *June 11, 2001*

Prepared Remarks

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Thank you for inviting Reason Public Policy Institute to comment on the important issues this panel is examining relating to federal outsourcing initiatives. For more than twenty years, RPPI has been actively engaged in the study and promotion of a wide range of government management and performance innovations, with particular emphasis in the areas of outsourcing, contracting, and procurement.

My testimony today reflects my own work on government performance issues as well RPPI's extensive research base into both "successful" and "failed" outsourcing initiatives from federal, state and local levels of government.

Understanding the Flaws in the Current Federal Processes for Outsourcing will Assist in Articulating New Policies and Principles

In establishing new principles and revising policies to govern agency decisions on whether particular government functions should be performed by the public sector or the private sector, it is important to understand and recognize the seriously flawed policies and implementation approaches that exist in the current system. As the panel is probably already quite aware, these flaws include:

- ❑ Competitions that take years to complete at a high cost per position studied
- ❑ Contentious disagreements between contractors and unions over agency outsourcing definitions, decisions and outcomes of competitions
- ❑ Severe disparities in categorization of activities; a position at one agency is deemed "inherently governmental" while the same position is deemed to be a "commercial activity" at another agency
- ❑ Inadequate cost accounting systems that make cost comparisons suspect at best
- ❑ Inflexible employee benefit systems that hamper transitions between the public and private sectors and penalize employees in the process

Overall, it is our view that the most common flaw in the current system is an over-emphasis on using outsourcing to "cut costs" rather than to "enhance performance" of the agency. This fatal flaw has

far-reaching impacts on all aspects of the outsourcing process. Until this fundamental flaw is remedied, outsourcing initiatives will fall short of expectations.

Outsourcing PROCESSES Need to Evaluate PERFORMANCE

In our research into the differences between outsourcing projects deemed “failures” versus those deemed “successful,” several critical success factors were often seen as important to ensuring the effective management of outsourcing processes and evaluating potential sourcing options. These include:

- ❑ **Clear Strategic Logic:** Successful outsourcing projects begin with the establishment of a clear “strategic logic” for the agency that is cascaded clearly down to performance expectations for every program and function within the agency.
- ❑ **Reliable Financial Information:** Projects have adequate and accurate cost information, usually provided by systems that use activity-based costing or other mature accounting practices.
- ❑ **Emphasis on Redesign/Re-engineering:** Agency leadership aggressively pursues a “redesign” option allowing agency operations to be re-engineered prior to the competition. (As our research uncovered, in many cases, regardless of which side won the competition, the agency emerged better off as a result of its redesign efforts.)
- ❑ **Performance Measurement:** Successful projects define and monitor clear measures of performance both during the competition phase and after. These performance measures are vital tools to clarify expectations, ensure “value-based” comparisons and improve accountability and daily management after final contracts are awarded.

Assuming these four principles are actively implemented by the agency, the only other ingredient needed is an open, fair and transparent process through which the employee and contractor bids can be solicited and evaluated using these criteria.

Outsourcing DECISIONS should Emphasize PERFORMANCE

It is important to be clear on what should motivate an agency to consider outsourcing. From our research into “successful” and “failed” projects, we have found that “cutting costs” was often the primary motivator of “failed” projects and usually not the primary motivator of “successful” projects. The primary motivators of successful projects include:

- ❑ **Enhancing focus on core mission:** The agency turned to outsourcing to “clear the deck” of extraneous activities to focus on a limited number of functions that were of the most strategic importance to the agency’s mission.
- ❑ **Flexibility and speed:** The agency wanted “just-in-time” access to services and products through a vendor relationship.
- ❑ **Improved quality:** The agency determined outsourcing would improve the performance/quality of the service.
- ❑ **Access to personnel or skills:** The agency found it could not recruit and retain the necessary human capital to continue providing the service internally...or discovered the service was seasonal in nature making the maintenance of a full-time staff year round inefficient.
- ❑ **Innovation:** The agency determined that internal controls or processes that stifled innovation and created inefficiencies could be avoided by removing the service from the public sector.

Of all of the studies into costs that we have seen, ample evidence indicates outsourcing usually results in cost savings. At the very minimum, outsourcing provides better performance at contained or in a few cases slightly higher costs. Agencies that went into outsourcing initiatives motivated merely by a desire to “cut costs” typically were disappointed...both during the competition phase and afterwards. Cost reductions, when they do happen, should be seen as a welcome side benefit rather than the primary motivator.

Performance Principles Should Guide the Commercial Activities Panel's Deliberations

From a practical perspective, debating and refining definitions of “inherently governmental” vs. “commercial” activities may serve little purpose other than to provide fresh ammunition for both sides of the outsourcing debate to impede outsourcing or to keep agencies’ feet to the fire to get out of commercial activities. A more lasting contribution to the debate can be made by this panel if clear “performance principles” are devised that will help agencies position outsourcing as a part of their strategic plan.

While RPPI is an advocate of government outsourcing in many areas, we do not blindly endorse outsourcing across the board for all functions of government. Outsourcing is not and should not be seen as an “end” in itself; it is a tool (one of many) for improving government performance. It is our strong view that agencies must make a clear and compelling “performance” case for outsourcing.

If such a case cannot be made, then outsourcing should not occur. When the case can be made, we need the systems and processes to allow outsourcing to proceed forward unencumbered and effectively transition activities, materials and personnel to new entities providing the service.

Over the past few years, driven mainly by the passage of the landmark Government Performance and Results Act, performance-based government concepts have begun to be implemented in agency systems for operations, budgeting, human resources and contract management. It is my sincere hope that this panel will be credited with beginning the federal government’s move into a new “performance-based” era for federal outsourcing.