



Insourcing

How Bringing Back Essential Federal Jobs
Can Save Taxpayer Dollars and Improve Services

Pratap Chatterjee March 2012



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doing what works

CAP's Doing What Works project promotes government reform to efficiently allocate scarce resources and achieve greater results for the American people. This project specifically has three key objectives:

- Eliminating or redesigning misguided spending programs and tax expenditures, focused on priority areas such as health care, energy, and education
- Boosting government productivity by streamlining management and strengthening operations in the areas of human resources, information technology, and procurement
- Building a foundation for smarter decision-making by enhancing transparency and performance measurement and evaluation

This paper is one in a series of reports examining government accountability and efficiency.

Contents

1 Introduction and summary

3 Federal contractor landscape

4 Cost savings

10 Conclusion

10 Recommendations for reform

12 About the author and acknowledgements

13 Endnotes

Introduction and summary

At a time when deficit reduction is a national priority bordering on obsession, there is a relatively painless way for the federal government to save millions of dollars while at the same time ensuring contractors do not perform inherently governmental functions—simply bring specific key jobs back into the public domain.

In recent years a practice known as “insourcing”—where government agencies move work back in-house—has been gaining traction. Insourcing has been successfully embraced by a number of federal agencies, including the Department of Homeland Security, the Internal Revenue Service, and the U.S. Army, reversing a longstanding trend that saw more and more federal work going to private contractors. Why is federal insourcing a good thing? Here are three reasons why we believe returning certain government jobs to the public domain makes sense:

- ***Insourcing saves money.*** The information technology division of U.S. Customs and Border Protection at the Department of Homeland Security estimated that it saved \$27 million in 2010 out of a budget of \$400 million by taking 200 private contractors and giving those same individuals government jobs.¹ Likewise, approximately half of the 17,000 jobs that the Department of Defense brought back in-house in 2010 were done simply because the Pentagon was able to save money.² In a similar move the Internal Revenue Service abandoned experiments with outsourcing debt collection after the agency calculated that contractors brought in less revenue than federal employees.³
- ***Contractors should not perform some jobs.*** Contractors are sometimes hired to do work that the government considers an inherent public duty such as making decisions on federal matters. Such jobs should be returned to the public sector. Tax collection is one task that has been ruled inherently governmental because of the potential conflicts of interest, but the task has occasionally been outsourced. Another task with a potential conflict of interest is contractor oversight of other contractors. This often occurs in unexpected and extraordinary situations such as the response in the wake of Hurricane Katrina

and the reconstruction effort in Iraq, but it also occurs when there is a freeze in federal hiring. Encouraging federal agencies to hire in-house staff to conduct such key governmental tasks will improve the quality of such work.

- ***Agencies can lose vital in-house skills through outsourcing.*** When the Bush administration decided to hire contract interrogators during the Iraq war, it spurred trained personnel to quit the military in order to benefit from the higher pay and flexible lifestyles afforded contractor employees. The same was true in other government sectors such as intelligence and foreign policy. Experts are understandably concerned about the long-term impact of this trend. Mark Lowenthal, a former CIA assistant director, told Congress during a 2011 hearing that his agency was now relying on staff with less than five years experience— “It’s the least experienced analytical staff since 1947, and this demographic trend will play out in years to come.”⁴ Ensuring the right balance of contractors and government personnel in the federal workforce must remain a key federal goal.

To be sure, the idea of expanding government and hiring more bureaucrats at a time when budgets are tight may seem wasteful, but it is more practical and simple than one might expect. Insourcing often results in the individual contractor being hired to do the same work in the very same office under a more direct chain of command. Eliminating the need to pay for the additional layer of corporate bureaucracy that comes with the hiring of a contractor not only saves money, but it can also improve services to the taxpayer if done wisely.

Federal contractor landscape

Recent statistics from the Office of Personnel Management, or OPM, put the number of workers on the federal payroll at 2 million, compared to 7.6 million contractors—a ratio of almost 4-to-1, an all-time high.⁵ With this in mind, several important questions need to be asked:

- Is outsourcing always a good idea?
- Do contractors always save money or does the opposite sometimes occur?
- Does the use of contractors sometimes give a for-profit entity power over public services in a way that would be detrimental to the greater good?
- Does the use of contractors make citizens hostage to the vagaries of supply and demand that may degrade our access at a critical moment in time?

Most people believe there are some jobs, such as running a city or making foreign policy decisions, that the private sector should never undertake. Elected or appointed officials perform these jobs because they involve making decisions on behalf of the public good.

With other jobs, however, the answer can be fluid. Running garbage services on a military base in peacetime, for example, might be done by the private sector to allow soldiers to spend more time in necessary training. On the other hand, private-sector employees may not be the best choice on a small military outpost in a war zone, even if anyone would be willing to do the job, because the cost of protecting those private workers could well be more expensive than assigning the task to soldiers.

The Office of Management and Budget’s Circular A-76 is a key test of whether the government should use a contractor or a federal employee for any given job.⁶ The rules, originally written in 1966, require federal agencies to determine whether the private sector can do the same job for less money. This 46-year-old memo also introduced the idea of making sure that “inherently governmental” work stayed off-limits to private contractors.

Over time, however, lawmakers allowed and even required more and more federal work to be handed over to contractors. The Federal Activities Inventory Reform, or FAIR, Act of 1998 instructed government agencies to issue an annual inventory of their service contracts explaining which federal activities were not inherently governmental, the number of jobs that were available, and the name of the contact person in charge of the specified activities.⁷

Despite the guidelines, confusion over whether or not tasks are inherently governmental has persisted over the years. In October 2011 the White House Office of Management and Budget, or OMB, revised the guidelines on this subject, giving examples of what it considered “inherently governmental” and absolutely off limits for contractors.⁸ The guidelines also defined “closely associated” functions that could be done by contractors so long as there was appropriate oversight. Finally, the memo defined the term “critical functions”—work that is essential to an agency’s core mission and operations.

Yet the debate continues, particularly given that a number of the inherently governmental, closely associated, and critical-function jobs as defined by the OMB 2011 memo are already being conducted by contractors. Adding to the discourse is the fact that the use of contractors is often arguably more expensive than using federal employees, which is hard to defend in an era of high government debt.

Cost savings

Since the A-76 rule was enacted in 1966, a steady drumbeat of calls for smaller government has resulted in more and more federal work being outsourced. This profitable business model has also spurred an active campaign against insourcing. Recently a newly established industry group called the Business Coalition for Fair Competition, or BCFC, which is run by the public relations firm John M. Palatiello & Associates, has launched a campaign claiming that insourcing is “stealing private sector jobs and creating more expensive government jobs.”⁹

Nothing could be further from the truth. A comprehensive study by the Project On Government Oversight has debunked this notion that government jobs are always more expensive. The study, “Bad Business: Billions of Dollars Wasted on Hiring Contractors,”¹⁰ calculated that the federal government was paying nearly twice as much—1.83 times—more for contracted services on an average than if it hired federal workers, even after accounting for long-term employee benefits.

While many government employees are certainly paid a higher salary and better benefits than the average contractor, the cheaper salary of the contractor was more than offset by the fact that the government had to pay for overhead, executive compensation, and profits of the contractor's employer.

Perhaps the most interesting discovery was that contractors charge less for the very same services when working in the private sector than when they worked for government, suggesting that contractors are prone to overcharging the government.

Accountants and auditors, for example, typically earn less than \$100,000 in the private sector and \$119,000 on an average as federal employees, but they charge the federal government nearly \$300,000 as federal contractors.¹¹ Sometimes a government job pays better than a private-sector one, but government contractors are still the most expensive by far. Consider that the average government lawyer earns \$175,081, the average private-sector lawyer earns \$220,924, but contract lawyers working for the federal government bill the government an average of \$554,923.¹² Indeed, a contract law clerk often charges the government more than it would cost to hire a federal lawyer.¹³

The opportunity for saving when comparing contractors to federal employees doing the same job has been demonstrated a number of times. A recent Department of Defense study of the 17,000 jobs that were insourced by the agency in 2010 showed that the majority of the 4,732 Air Force jobs converted, almost all the 620 jobs at the Defense Finance and Accounting Services, as well as many of the 2,728 Navy jobs insourced, were done solely on basis of cost savings. All told, the Pentagon calculated that half of the jobs converted were done so to save money.¹⁴

Other agencies are also discovering that hiring-in individuals who are already doing federal work on behalf of a contractor can result in cost savings simply by eliminating the middleman. Bob Neubert, executive director of the enterprise networks and technology support division of Customs and Border Protection at DHS, told *Federal Computer Week* that his division saved \$27 million in 2010 out of a budget of \$400 million by making 200 contractors federal employees. The savings were achieved not by paying them less, but instead by not having to pay an outside company for their services.¹⁵

Indeed, the competition between the private sector and the public sector has repeatedly shown that outsourcing does not necessarily save money. The OMB reported that federal agencies conducted 1,375 A-76 tests between 2003 and 2007

resulting in savings of \$1.88 billion. In 83 percent of the cases, as measured by the total jobs competed, the federal government was able to do the work cheaper, rather than the other way around.¹⁶ Sometimes this was a result of re-engineering the workforce, but that is still an argument for better human-resources management rather than an argument to use outside contractors.

One of the justifications that contractors often use to make their case is that they are more efficient than government workers. Given the vast cost differences cited earlier, it would seem that such claims need to be measured very carefully to arrive at a definitive answer. One study did exactly that—a 2006 experiment conducted by the IRS called the Private Debt Collection initiative, which offered contractors a 25 percent incentive to bring in so-called “simple” cases.¹⁷

In 2008 the initiative was scrapped when an IRS review found that it cost three times as much to hire private debt collectors as it did to use federal employees.¹⁸ Further, the less expensive government employees were able to resolve more delinquent tax cases because they had more authority to garnish wages. Conversely, cutting back on tax collection has also been found to be penny-wise but pound-foolish. A recent decision by officials in Jefferson County, Alabama, to lay off four employees saved the government \$180,000 a year but threatened the collection of \$2.7 million from delinquent taxpayers.¹⁹

That’s not to say that contractors are always much more expensive. In fact at the lower end of the pay scale, contractors can be quite a bit cheaper because they pay workers minimum wage and low or no benefits. Of course that is not exactly a recommended policy, if only because many of these workers are likely to rely more heavily on the government for social services as a result. A 2006 report by the labor union UNITE HERE found that each 100-person factory making uniforms for the U.S. military was eligible for approximately \$292,000 in public assistance a year.²⁰

Conflicts of interest

Contractors are often hired to oversee other contractors in rapid response operations where the government does not have the staff to take on unexpected responsibilities. This was true after the invasions of Afghanistan and Iraq and in the response to Hurricane Katrina. The Federal Acquisition Regulation maintains that such work is “closely associated” with government but not “inherently governmental.” Such a bureaucratic approach is fraught with conflicts of interest since many of these contractors routinely bid on both supervision and implementation contracts.

The State Department, for example, paid out \$700,000 to a “personal services contractor” to conduct oversight of other contractors that were working on a criminal-justice development program in Iraq.²¹ Meanwhile, the U.S. Army spent \$62 million on contractors to oversee the \$7.6 billion Logistics Civil Augmentation Program, or LOGCAP, contracts in Afghanistan and Iraq.²² And in Afghanistan, Aegis, a British security company, was asked to provide oversight over other “close protection” security contractors despite the fact that it had a contract to do “close protection” in Iraq.²³

Dig a little deeper and the use of contractors to oversee other contractors turns out to be even more commonplace because of the extensive use of prime contractors who in turn farm out work to subcontractors. One outlandish example of this practice played out in Florida in the aftermath of Hurricane Katrina in 2005. As reported by NBC News, a Florida company, AshBritt Inc., was paid \$500 million to remove hurricane debris at a rate of \$23 per cubic yard. According to NBC, Ash Britt subcontracted the work to C&B Enterprises Inc., which was paid \$9 a cubic yard. C&B in turn hired Amlee Transportation Inc. for \$8 a cubic yard, which in turn hired Chris Hessler Inc. for \$7 a cubic yard, who hired a man named Les Nirdlinger who was paid \$3 a cubic yard to do the actual work.²⁴

Subcontracting has always been a common practice and is neither illegal nor necessarily bad. Manufacturers of specialized equipment, for example, rely heavily on subcontractors to supply parts. But when manual labor is performed under numerous layers of management, it suggests oversight has been abdicated at tremendous cost to the taxpayer. Here again, eliminating the middleman of outside contractors could save the taxpayer a great deal of money. Certainly the federal government does not need to hire federal workers simply to haul debris, but it does need to oversee such work to make sure it gets the best value for its taxpayer dollar.

The flawed use of contractors is not confined to disaster response. A 2011 Government Accountability Office study of “service contract inventories” that are intended to identify “inherently governmental” tasks found 2,357 contractors doing work for the U.S. Army that is supposed to be reserved exclusively for federal employees. Another 1,877 contractors were doing “unauthorized personal services” for the Army, while 45,934 contractors were doing Army jobs that are considered closely associated with inherently governmental functions that require strict oversight and management.²⁵

This should not be happening. If the “service contract inventories” were properly maintained with accurate data on the cost of these contracts, it should be possible

to identify contractors that are inappropriately performing “inherently governmental” or “closely associated” functions as well as contracts that cost too much. In fact a bipartisan letter to the Secretary of Defense this past November has urged the Pentagon to “improve the inventory as a reliable and complete data set.”²⁶

Eliminating conflicts of interest will take time, but is essential to ensure compliance with the law. Unfortunately Congress has often acted to thwart this goal by threatening to freeze all federal hiring.²⁷ The result is that agencies turn to outside contractors and end up spending more instead of less, as we noted previously.

Of course, hiring caps are not the only reason for using contractors instead of federal employees. Sometimes the federal hiring process is so bureaucratic and time consuming that agencies turn to contractors simply to meet crucial staffing needs.²⁸

Loss of expertise

Yet another negative consequence of relying too heavily on contractors is that the federal government becomes subject to supply and demand and the whims of market forces that determine contractor pay rates. So long as there is adequate competition, this is not a problem. But it is also important to note that the market supplies only what is in demand.

At the State Department or the CIA, for example, personnel are expected to rotate through different regions and divisions. As they progress in their careers, these individuals become experienced in a variety of diplomatic or intelligence skills as well as understanding the nuances of cultures, history, and politics in many different countries. On the other hand, contractors do not necessarily rotate staff as extensively, but instead respond just to demand. Thus with the outbreak of the Iraq war in 2003, Iraq experts were in demand, but conversely Tunisian or Libyan experts weren't in demand. This lack of demand meant that contractors had their staffs focus on learning about and understanding Iraq, which resulted in the slow loss in expertise of countries like Tunisia or Libya that could have been useful during the Arab Spring in 2011.

The problem is not, of course, solely the fault of contractors. Bill Golden, a former military intelligence analyst who runs IntelligenceCareers.com, says that the shortage of qualified interrogators in the wake of 9/11 was a direct consequence of poor planning following the end of the Cold War. “The military worked as hard as it could to create a brain drain (with the conclusion of the Cold War) by moving qualified intelligence people into other jobs, who then quit. As a result by

September 11, 2001, there was no one left who had a clue,” Golden told this writer in 2005. “Now they are rushing to catch up and create 9,000 new specialists, but it takes at least five years to become really experienced. What we have now is a nursery full of babies in the army.”²⁹

In the meantime, the military turned to contract interrogators who were pressed into service quickly at high salaries to work at places like the Abu Ghraib prison in Iraq. The urgent need for interrogators and the easy availability of these jobs resulted in many just-trained military interrogators quitting the service to sign on with contractors.³⁰ As a result the government ended up paying more money to hire the very people it had just trained in addition to exacerbating the downward spiral in terms of the experience of military interrogators. Golden says he noticed that the pool of applicants he was interviewing went from 5 to 10 years of experience to three to five over a couple of years.³¹

The contracting companies also typically oversell their expertise by padding bids with resumes from people that aren’t on staff and that they haven’t hired yet. Former CIA assistant director Lowenthal notes that winning contractors poach senior staff from government, leaving agencies staffed with low-level junior employees. “It’s the least experienced analytical staff since 1947, and this demographic trend will play out in years to come,” Lowenthal told Congress at a 2011 hearing.³²

A recent freeze on the military hiring civilians has similarly impacted federal work by creating a shortage of experienced personnel for key positions that are either inherently governmental or closely associated jobs. The Pentagon, for example, now depends heavily on contractors to oversee weapons development because of the civilian workforce hiring freeze.³³ As many as two out of every three staff at the Pentagon’s developmental test and evaluation office are contractors, and five out of every six staff at its system-engineering office are contractors. With no access to sufficient federal staff, the office has simply cut back on testing. A recent GAO study noted that in 2010, 36 percent of programs received no support from the testing office.³⁴

Commenting on the testing situation, officials at the National Academy of Sciences note that the Department of Defense “cannot outsource its technical and program management experience and intellect and still expect to acquire new systems that are both effective and affordable.”³⁵

Allowing federal agencies to insource such inherently governmental work should improve both the quantity and quality of oversight of other contractors.

Conclusion

Recommendations for reform

In light of the various problems and challenges related to an overreliance on private companies to conduct government work as detailed in this report, we believe it is incumbent on the federal government to reform the current contractor system with an eye to adopting a more flexible approach to insourcing jobs. Specifically, we recommend the following:

- Contracts with companies that perform inherently governmental work should be flagged and allowed to lapse or be canceled. The individuals who are doing this work can be hired as federal employees with no loss in service delivery if they are found qualified to do the work. Equally, federal employees must adequately supervise jobs closely associated to inherently governmental work.
- Subcontracting must be studied more closely. If prime contractors are adding multiple layers of management bureaucracy that do not add value, this must be addressed and remedied. The federal government should minimize occurrences of contractors supervising other contractors to instances of benign influence and should not permit it in any other circumstances.
- When federal employees can perform a job for less money than the contractor billing rate, the job should be considered for insourcing. One way to accomplish this is to regularly examine the “service contract inventory” data that every agency is required to maintain for the billing rates rather than just salary data, which demonstrates the cost of using contractors. It must be noted that these data are often poor quality and need to be improved. Changes to what data are collected and how they are analyzed will need to be done by the OMB or by legislative change to the FAIR Act.
- Ensuring the right balance of contractors and government personnel in the federal workforce must remain a key federal goal. Agencies should ensure

that turning to the contractor workforce does not hobble the government in mission-critical work.

- Last but not least, the federal hiring process must continue to be examined and improved. The Obama administration has made important efforts to streamline the federal hiring process.³⁶ But shortsighted money-saving practices in Congress like a hiring freeze sometimes protect less-than-qualified workers and deny opportunities to skilled personnel. Agencies often turn to contractors, not simply because they are either less expensive or better, but because it is easier and quicker to hire or fire contractors than it is a government employee. If the “service contract inventories” are properly maintained, it will be possible to estimate the true costs of outsourcing.

Finally, insourcing offers the federal government the opportunity to save significant real dollars at a time of constrained budgets. Just as important as saving money, it is critical to ensure that the public good is not left to either chance or to the pursuit of profit.

About the author

Pratap Chatterjee, a former Visiting Fellow at the Center for American Progress, is a journalist and the author of two books on military contracting—*Iraq, Inc.* (Seven Stories Press, 2004) and *Halliburton's Army* (Nation Books, 2009).

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