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February 2, 2009

Congressional Research Service

Report RL30574

*DEFENSE OUTSOURCING: OMB CIRCULAR A-76
POLICY AND OPTIONS FOR
CONGRESS-PROCEEDINGS OF A CRS SEMINAR*

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Updated May 30, 2000

Abstract. On April 13, 2000, the Congressional Research Service sponsored a policy seminar entitled "Defense Outsourcing OMB Circular A-76 and Options for Congress." This report summarizes that seminar. It focuses on DOD's efforts to encourage greater use of the Circular as a mechanism for increased competition in the marketplace.

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Defense Outsourcing: OMB Circular A-76 Policy And Options for Congress — Proceedings of a CRS Seminar

May 30, 2000

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Defense Outsourcing: OMB Circular A-76 Policy and Options for Congress — Proceedings of a CRS Seminar

Summary

On April 13, 2000, the Congressional Research Service sponsored a policy seminar, for Members of Congress and staff, entitled “Defense Outsourcing: OMB Circular A-76 and Options for Congress.” This report summarizes that seminar.

The Office of Management and Budget (OMB) Circular A-76 has long been viewed, by some, as a management reform tool to facilitate government outsourcing. The policy of transferring to the private sector functions performed by government employees dates back to the Eisenhower Administration. In 1966, the effort was codified through OMB Circular A-76. Executive branch agencies, like the Department of Defense (DOD), have relied on the Circular’s guidelines and procedures for determining whether commercial activities should be performed by the private sector, or by government sources. Since the end of the Cold War, DOD has substantially reduced its force structure; however, defense operations and support costs have not diminished proportionately to the size of the force. As a result, DOD has sought to reduce spending to achieve greater savings to finance weapons and military equipment modernization. Without additional base realignment and closures (BRAC), DOD seeks savings through a greater reliance on managed competitions through application of OMB Circular A-76.

This seminar focused on DOD’s efforts to encourage greater use of the Circular as a mechanism for increased competition in the marketplace. The seminar panel comprised a senior DOD official, the President and Chief Executive Officer of a defense trade association, and a defense policy analyst from the largest national labor organization serving federal employees. In preparation for the seminar, each panelist was asked to address three questions regarding Circular policy:

- 1) Does the use of OMB Circular A-76, in contracting DOD activities, save money? Are there performance metrics in place to determine what the savings really are?
- 2) Is OMB Circular A-76 the only viable option to reduce costs?
- 3) How will outsourcing affect U.S. national security and the U.S. military’s war-fighting capability?

In their presentations and discussions, every member of the panel agreed that the Clinton Administration has sought to revise OMB Circular A-76 as a way to reduce government costs and increase the government’s efficiency. Panelists praised certain aspects of OMB Circular A-76 because of its organization and level of detail. However, there was a spirited debate between panelists and seminar attendees on the inherent problems with the Circular, how to fix them, and other options to reduce costs. The panel viewed OMB Circular A-76 policy and process as flawed, and described the process as onerous and adversarial. Panelists spoke forcefully about the urgent need to change the way that the government conducts its business; in many respects, the seminar presentations and ensuing discussions extended beyond OMB Circular A-76; they encompassed the future direction of competitive outsourcing within DOD.

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Defense Outsourcing: The OMB Circular A-76 Policy and Options for Congress — Proceedings of a CRS Seminar

Introduction

On April 13, 2000, the Congressional Research Service, sponsored a seminar entitled “Defense Outsourcing: The OMB Circular A-76¹ Policy and Options for Congress,” for Members of Congress and professional staff. Outsourcing through the Office of Personnel Management (OMB) Circular A-76 has been viewed, by some, as a management reform tool to facilitate government outsourcing and privatization.

The policy of transferring to the private sector functions performed by government employees dates back to the Eisenhower Administration. The policy was developed, over time, in order provide a solid framework for OMB Circular A-76. OMB Circular A-76 was codified in 1966, revised in 1983 and 1999. Executive branch agencies, like the Department of Defense (DOD), have relied on the Circular’s guidance and procedures for determining whether commercial activities should be performed by the private business sector, or by government sources. Since the end of the Cold War, DOD has substantially reduced its force structure; however, defense operations and support costs have not diminished proportionately to the size of the force. As a result, DOD must further reduce spending to achieve greater savings to finance weapons and military equipment modernization. Without additional base realignment and closures (BRAC), DOD sought savings through a greater reliance on managed competitions through OMB Circular A-76.

OMB Circular A-76 provides an analytical framework on which the government bases its decision on who is best to perform the work. The Circular outlines a very formal, intricate, and often lengthy process for conducting managed competitions to facilitate the outsourcing of federal government activities considered commercial, or *not inherently governmental*. DOD has encouraged greater use of OMB Circular A-76 as a mechanism for increased competition for federal contracts and has placed considerable emphasis on competitive sourcing programs.

¹ U.S. Executive Office of the President, Office of Management and Budget, *Performance of Commercial Activities*, Circular No. A-76 (Washington: Aug. 4, 1983, rev. June 14, 1999) Available on the internet at [<http://www.whitehouse.gov/OMB/circulars/a076/a076.html>]. For further discussion of OMB Circular A-76, see CRS Report RL30392, *Defense Outsourcing: OMB Circular A-76 Policy*, by Valerie Bailey Grasso.

The defense seminar panel was composed of a senior DOD official, the President and Chief Executive Officer of a defense trade association, and a defense policy analyst and procurement specialist, representing the largest national labor organization serving Federal employees. Panelists presented their views and engaged in discussion with congressional and legislative branch staff members.

Seminar Panelists

Panelists	Title
Joseph K. Sikes	Director, Competitive Sourcing and Privatization, Office of the Deputy Under Secretary of Defense (Installations)
Richard Hearney	President and CEO, Business Executives for National Security
Wiley Pearson	Defense Policy Analyst and Procurement Specialist, American Federation of Government Employees
Valerie Bailey Grasso	Moderator

Questions Addressed At The Seminar:

1. Does use of OMB Circular A-76, in contracting DOD activities, save money? Are there performance metrics in place to determine what the savings really are?
2. Is OMB Circular A-76 the only viable option to reduce costs?
3. How will outsourcing affect U.S. national security and the U.S. military's war-fighting capability?

Basic Themes

Every member of the panel agreed that the Clinton Administration has sought to revise OMB Circular A-76 as a way to reduce government costs and increase efficiency. In their presentations and discussions, panelists praised certain aspects of OMB Circular A-76 because of its organization and level of detail (an OMB policy memorandum, accompanied by a supplemental handbook, outlines the process for the government as well as the private sector.) This level of detail helps all parties to understand and follow the rules.

No one on the panel recommended completely abandoning use of the Circular. There was a spirited debate, however, between panelists and seminar participants, on the inherent problems with the Circular, how to fix them, and other options to reduce costs. The panel viewed OMB Circular A-76 policy and process as flawed, and described the process as onerous and adversarial. The panelists, three retired military officers, spoke forcefully about the urgent need to change the way that the government conducts its business; in many respects, the seminar presentations and ensuing discussions extended beyond OMB Circular A-76; they encompassed the future direction of competitive outsourcing within DOD.

Does Use Of OMB Circular A-76, In DOD Contracting Activities, Save Money? Are There Performance Metrics In Place To Determine What The Savings Really Are?

Panelists expressed strong disagreement over whether the use of OMB Circular A-76, in DOD contracting activities, saves money. Every panelist expressed the opinion that DOD did not know, and could not prove, whether the policy saved money. Some panelists cited published government audits of recent outsourcing competitions citing costs savings achieved through use of OMB Circular A-76, although one panelist simply stated “*And I would agree that it’s really hard to figure out what those savings are.*” Another panelist reported that since 1988, DOD has failed to release any information on the impact of downsizing on displaced federal workers. He firmly believed that any savings realized were achieved by undercutting the wages and benefits of federal employees. Citing a recent General Accounting Office study to support his premise, the panelist stated that DOD did not consider the long-term costs of downsizing the workforce — to include the administrative costs of personnel separations (including payment of lump sum leave balances and retirement benefits) — when calculating the savings gained from managed competitions. Further, the panelist stated that, in his opinion, most federal government work performed by contractors is never subjected to the OMB Circular A-76 process, and that most federal government contracts are awarded without benefit of public-private competitions.

All panelists agreed that no appropriate performance metrics, or standards of measurement, were in place to measure savings; they agreed that DOD did not have a tracking mechanism in place to determine how much money is saved over the total life cycle of a defense procurement contract. All expressed the view that the government was generally ill-equipped to perform accurate cost-accounting procedures, and did not fully know the actual defense procurement contract costs. One panelist opined that such contract costs could increase for a variety of reasons. He stated that the costs rise, in some cases, because DOD has not accurately defined what work needs to be performed, or that DOD later revises the contract’s stated mission or purpose. Another panelist offered that the OMB Circular A-76 process is a “cost comparison study,” and the policy only compares contract costs, not what would necessarily represent the long-term “best value” to the federal government. Still, another panelist believed that the Federal Activities Inventory Reform (FAIR)

Act² does require federal agencies to conduct an inventory of work performed by federal employees, but did not require that contractors conduct a similar inventory of work, even though, in his opinion, approximately two-thirds of the functions of the federal government are estimated to be contracted out.

OMB Circular A-76 requires that cost comparison studies (proposals made by the government or the private sector for federal contracts) include a 12% across-the-board, overhead rate.³ Panelists disagreed over the use of a 12% rate. Some panelists believed that the rate was too low, and that the low overhead rate gives the government an automatic advantage in formulating lower bids. The administrative and overhead rate varies by industry; for example, the information technology industry uses a 40% overhead rate as a standard rate. One panelist expressed the opinion that

a flat 12% rate on overhead is a little bit suspect. We ought to have a little bit more refinement and be able to bear down and find out what those actual costs are ... have a good solid competition and then a good accounting both for the government, if they win a competition, or for the private sector, if they win a competition that the figure of 12% administrative/overhead costs was an arbitrary number.

Another panelist, in response, explained that the 12% rate was a compromise rate; that it was the result of a long-fought negotiation between the government and the private sector. He offered this assessment:

The problem is, when you try to figure out what the right number is, immediately you re-engage with everybody because it's being skewed to the benefit of whoever it is that thinks they're being disadvantaged. And so what would happen is we're going around in circles. We do need to figure out how to do that ... There should be an honest broker that could sit there and figure out what the exact, right amount was.

Panelists were in agreement that the OMB Circular A-76 process costs too much and takes too long to complete. One recent cost-comparison study conducted by the U.S. Army revealed that most single function competitions take about two years to complete, while multifunction competitions take about four years to complete. This length of time was viewed as unacceptable, and not in line with current private sector business practices. One panelist asserted that the decision cycle time (length of time it takes to make a business decision) needed to be reduced, and that the decision making process needed acceleration. He made the comparison between the decision process in the private sector to that within DOD:

² The Federal Activities Inventory Reform Act of 1998 (FAIR), Public Law 105-270, requires each federal agency to submit annually, by June 30, to the Office of Management and Budget, an inventory of all commercial activities performed by in-house federal employees. For further discussion of the FAIR Act, see CRS Report RS20440, *Fair Act Inventory of Commercial Activities Performed In-House: Federal Personnel Agencies*, by Barbara L. Schwemle.

³ For a discussion of overhead rates, see *Part II - Preparing the In-house and Contract Cost Estimates. OMB Circular A-76 Revised Supplemental Handbook*.

I've been talking to people out in Silicon Valley and they talk about moving at internet speed. And they made the comparison about decision processes in DOD, in particular. And they said by the time DOD makes a decision, we have come up with an idea, developed the idea, formed a company, gone public, sold the company, and are working on the next idea and DOD still has not made a decision. I think we have to find ways to try to accelerate the process a bit if at all possible.

Is OMB Circular A-76 The Only Viable Option To Reduce Costs?

Within OMB Circular A-76 regulations, DOD may authorize cost comparison waivers (waiving the need to conduct a competition) and direct conversions to, or from, the in-house government entity to a private sector contract.⁴ Panelists were in agreement that the standard OMB Circular A-76 process was not the only option available to DOD. They proposed options considered viable within, as well as outside, the boundaries of current policy.

Within current policy, government functions that involve 10 or fewer full-time equivalents (FTE)⁵ may be converted without a cost comparison study, if the contracting officer determines that potential contract proposals would provide required levels of service quality at fair and reasonable prices. Functions that involve 11 or more FTEs may be converted without cost comparison study, if fair and reasonable prices can be obtained through competitive award, and all directly affected federal employees serving on permanent appointments are reassigned to other comparable federal positions for which they are qualified.

A second option offered by a panelist would be to raise the threshold of the number of positions required for competition, currently set at 11, by nearly tenfold, so that about 80% of the anticipated outsourcing studies would be exempt from Circular requirements. He suggested that by raising the threshold, DOD would conduct larger cost comparison studies, and could benefit from economies of scale not achieved with the smaller studies. He offered this assessment:

You might compete whole bases or regions. The Defense Science Board, I believe, in 1996 recommended that each service identify two bases and enter into a pilot program and see how it works. But we need a catalyst to get this going, and a pilot program may very well be that.

A third option would be to award contracts based on the best value to the government, not just based on initial purchase price, and establish performance

⁴ U.S. Executive Office of the President, Office of Management and Budget, *Performance of Commercial Activities - Part I, Section E. Agency Cost Comparison Waivers*, Circular No. A-76 (Washington: Aug. 4, 1983, rev. June 14, 1999)

⁵ The term FTE represents a statistical computation, including all time worked, and is used for budgetary and staffing projections. The computation bears minimal relation to the number of actual personnel, because it includes hours worked on full-time, part-time, and intermittent schedules. It also includes hours worked by all personnel, regardless of their length of service. For further discussion, please refer to CRS Issue Brief 10024, *Federal Civilian Employees and the FY2000 Budget*, by Sharon Gressle.

incentives and/or penalties to the contract winner. The panelist suggested that again DOD could authorize the use of pilot or demonstration projects, on a smaller level, to provide a testing ground for the “best value” concept.

Outside of OMB Circular A-76, some panelists raised a newer initiative, first introduced by the U.S. Navy, called strategic sourcing. Strategic sourcing is considered to be a more broad-based alternative to OMB Circular A-76. The Navy sought to review all of its functions, not just those commercial in nature, to develop a plan to streamline the entire organization. The Navy, reportedly the first federal group to begin development on a strategic sourcing guide and a strategic sourcing managerial support center, has stated that it could reorganize its workforce and workflow so that the projected 64,000 commercial jobs targeted for managed competitions could be eliminated in-house, avoiding managed competition, and still produce the projected savings. One panelist supported the idea, and offered the following comment:

...instead of sitting there and trying to argue about which positions were commercial and then trying to figure out how to package them into competitions, we should be looking at what we do - what the functions are. Not just limiting it to basically the third of the civilian workforce that was stamped as commercial, but looking at our whole workforce, military and civilian, what functions they do and what's the best way to provide that function.

However, among other panelists, strategic sourcing was viewed as less well-defined than OMB Circular A-76, needing more fine-tuning and clarification.

How Will Outsourcing Affect U.S. National Security And The U.S. Military's War-fighting Capability?

Panelists were asked to consider this question, based on their practical and operational knowledge, as well as their past careers as active-duty military officers, some with military conflict experience. One panelist expressed the opinion that outsourcing adversely affected U.S. national security because it “disrupted and demoralized” the federal civilian workforce. Given his observation that “72% of the defense workforce, right now, is at least 41 years old,” he challenged federal managers to re-shape and rejuvenate the federal civilian workforce by ensuring that federal employees are “*motivated, stable, competent, and competitively paid.*” Stating that the national defense was indeed threatened by “throwing public employees out on the street,” he argued that the real question is “*how do we recruit, train, and retain the federal workforce needed for the nation's security in the 21st century?*” In his opinion, the current debate over outsourcing is a distraction away from a more important debate over weapon system acquisition; he felt that policymakers should focus on “*how do we prepare and equip the armed forces, in a very new, different, and challenging post-Cold War mission?*”

Another panelist offered that, during his military combat experience, contractors were an integral part of combat support activities on the battlefield. He urged that DOD spend the time now to revise competitive outsourcing strategies, rather than wait until the United States is engaged in a major conflict. In his opinion, the use of

private sector contractors had a positive effect on national security, and enhanced the military's war-fighting capability.

One panelist viewed the introduction of H.R. 3766, the Truth, Responsibility and Accountability in Contracting Act (TRAC), as a constructive way of addressing perceived inequities in the government's outsourcing and privatization policy. The bill was introduced on February 29, 2000 by Representative Albert Wynn, and referred to the House Government Reform Committee. TRAC would impose a temporary suspension on new contracting activities until some corrective action is taken, and require federal agencies to monitor contract costs and savings from outsourcing initiatives. The bill would prevent agencies from outsourcing without benefit of public-private competitions, and allow agencies to hire additional federal employees, in some circumstances. It would require federal agencies to develop a centralized contracting reporting system, and study government outsourcing's effect on wages and benefits.