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# **Annual Privatization Report 2017**

## **Federal Government Privatization**

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**(Note: Portions of this report have been published previously in various editions of Reason Foundation's Privatization and Government Reform Newsletter and related articles, as well as other Reason Foundation publications.)**

# 1. Federal Government Privatization Update

Privatization was never a management or reform priority, nor an ideological tenet, of the Obama administration. In fact, a White House that earlier in its tenure emphasized “insourcing”—or converting commercial contracts to performance by government employees—succeeded in implementing a reduction in contracting with the private sector.<sup>1</sup> Congress, regardless of the party in power, mostly has worked in the same direction, rejecting most privatization and competitive sourcing attempts categorically. Nevertheless, progress was made on a smattering of ad hoc initiatives in the federal government to transfer functions to the private sector in 2016, the Obama administration’s last year in office.

Contractors working with major federal agencies delivered \$438 billion in products and services in fiscal 2015, a 24% decrease from fiscal 2011, according to a report by the Government Accountability Office (GAO).<sup>2</sup> The report found that the decline occurred mostly at the Defense Department, which saw total contracting—that is, for procurement and for services—fall by 31% in that period.<sup>3</sup>

A couple of other GAO reports found that the Department of Defense (DoD) met its goal to cut its civilian workforce by 6.8% from fiscal 2012 to 2017, under congressionally mandated sequestration cuts, reaching 7.1% according to DoD estimates.<sup>4</sup> However, it failed to meet the mark on contractors, despite pressure from Congress to reverse that trend. DoD cut its service contract spending by \$3.2 billion between fiscal 2012 and 2014, meeting 80% of the sequestration goal of \$4.1 billion.<sup>5</sup> Then, after initially expecting to increase its contractor spending by \$1.2 billion between fiscal 2014 and 2016, DoD ended up cutting spending by over \$800 million. Even still, DoD only cut 5% of its contracted services, failing to meet its sequestration-imposed goal of 6.4%.<sup>6</sup>

As the agency with the largest discretionary budget in the federal government, the Department of Defense is home to the greatest privatization opportunities.

For more than a decade, the Pentagon has successfully privatized military family housing. As a landlord, Uncle Sam had an inventory of about 257,000 family housing units around the globe, of which about 75% are being turned over to private developers and owners.<sup>7</sup> Building on this success, Defense officials are now seeking other infrastructure assets to subject to public-private partnerships, such as awarding a 50-year, \$600-million contract to American States Water company to operate and maintain water, wastewater, and water treatment facilities at Fort Riley, Kansas.<sup>8</sup>

Since the housing program began in 1996, 94% of privatized homes on-base met the Defense Department’s housing standards, while only 22% of homes complied when the government was in charge.<sup>9</sup> Despite the positive initial results, Congress is seeking a review of the program’s fiscal health and long-term viability, especially in response to possible changes in how service members receive their housing allowances.

In other DoD developments, the Defense Information Systems Agency (DISA) announced it would rely on the private sector for a previously in-house operation, a suite of cloud services known as milCloud.<sup>10</sup> The

next generation of milCloud will permit commercial information technology firms to compete to provide support services for what will be a contractor-operated, government-owned capability.

Privatization initiatives in 2016 were not limited to Defense activities. Several civilian agencies also turned to private enterprise for troubled, costly, or inefficient activities.

The General Services Administration (GSA) witnessed greater efficiency, as well as cost savings, after vacillating on government versus contractor performance of program administration for an Army childcare subsidy program. A backlog of nearly 26,000 service requests was reduced by 90% as a result of resuming the use of a contractor to administer the program.<sup>11</sup>

Tax collection by the Internal Revenue Service has been another political football, with differing factions in Congress and the executive branch arguing over whether government employees or private bill collectors are the appropriate party to collect back taxes. In 2016, the pendulum swung back to the private sector as Congress voted to partially outsource the activity.<sup>12</sup> The program began in April, after the IRS chose CBE Group, Conserve, Performant, and Pioneer to perform collections services.<sup>13</sup>

Cybersecurity has become a major focus in the news media, with attacks on large corporations, government agencies and other institutions. Recognizing that government cannot provide the tools needed by small business, the Small Business Administration sought the assistance of private sector contractors to train entrepreneurs on cyber protection activities.<sup>14</sup>

As a result of scandal in the health care system of the Veterans Administration (VA) that dominated the news for more than a year, efforts to provide more private treatment options continued in 2016. The Veterans Choice program, a pilot that provides private care access to veterans who live more than 40 miles away from a VHA facility or need assistance in under 30 days, was extended by Congress. A VA report called for more private options, but fell short of recommending privatization of the VA health care system.<sup>15</sup> Additionally, in light of a continuing treatment backlog, the VA announced plans to outsource more disability examinations.<sup>16</sup>

Veteran health care was not the only government-run medical program to turn to the private sector. The Indian Health Service (IHS), an agency within the Department of Health and Human Services responsible for providing federal health services to American Indians and Alaska Natives, began a program to privatize management of emergency rooms on three reservations—Rosebud Hospital and Pine Ridge Hospital in South Dakota and Omaha Winnebago Hospital in Nebraska.<sup>17</sup>

The IHS hopes to improve patient wait times through higher staffing levels and improved record-keeping after an April 2016 GAO report found the IHS's records system incapable of tracking wait times of patients, resulting in long waits—an outcome accentuated by inadequate staffing levels.<sup>18</sup>

These activities, as well as those listed below, were the exception rather than the rule, due to a congressionally imposed moratorium on public-private cost comparisons and competitions, which the

Obama administration supported. Such a process, known as Office of Management and Budget circular A-76, cannot be implemented by agencies due to an appropriations bill rider enacted in 2009.<sup>19</sup>

The Trump administration signaled some intent to revamp competitive sourcing in March 2017 by issuing an executive order calling for Director of the Office of Management and Budget Mick Mulvaney to issue a broad plan to reorganize the entire executive branch—including competitive sourcing for positions, where agreed upon by OMB and Agency leaders.<sup>20</sup>

Congress stands mostly alone in wanting to keep competitive sourcing halted, as officials in many agencies, even during the mostly anti-privatization Obama administration, have noted that the practice saves money and improves government service delivery—regardless of whether service delivery is ultimately entrusted with the public or private sector. According to OMB figures, competitive sourcing from FY 2002 to FY 2007 saved \$7 billion.<sup>21</sup> DoD leaders have long called on Congress to start competitive sourcing; transportation officials are trying to make rules more friendly to public-private partnerships in conjunction with competitive sourcing.<sup>22</sup> Meanwhile, officials in the Department of Education find over half of its functions appropriate for private sector competition, with many other Obama-era agency leaders labeling at least one-fifth of their functions appropriate for competitive sourcing.<sup>23</sup>

## 2. Federal Government Privatization News and Notes

Other 2016 federal privatization highlights include:

- The National Park Service relaxed rules on donor recognition that could allow corporate sponsors to fund items within national parks.<sup>24</sup>
- The National Oceanic and Atmospheric Administration (NOAA) created a pilot program to make better use of commercial weather data.<sup>25</sup>
- The National Gallery of Art sought vendors to manage its information security risks in order to meet cybersecurity standards established by the Office of Management and Budget for all federal agencies and entities.<sup>26</sup>
- The General Services Administration (GSA) announced a \$149-million contract award to IBM to modernize its human resources systems and create a private-sector shared services provider, despite a 2013 OMB mandate that established a preference for agencies to consider federal shared services providers within the government.<sup>27</sup>
- The National Aeronautics and Space Administration (NASA) continued to explore increased reliance on the private sector, announcing plans to privatize the International Space Station in August 2016.<sup>28</sup> NASA also announced through an RFP released in February that it seeks to enter PPPs for developing commercial space technologies in the areas of small launch vehicles, reliable electronics, advanced communications, and in-space propulsions.<sup>29</sup>



## About the Authors

**John M. Palatiello** is president of the Business Coalition for Fair Competition (BCFC, [www.governmentcompetition.org](http://www.governmentcompetition.org)), an organization that comprises trade associations, businesses, and organizations dedicated to free enterprise, relief from unfair government-sponsored competition, and maximum government reliance on the private sector. He is also president and owner of John M. Palatiello & Associates, Inc. ([www.jmpa.us](http://www.jmpa.us)), a public affairs consulting firm located in Reston, Virginia providing government affairs and association management services to firms and organizations, with a specialization that includes the privatization market.

John has served as chairman of the Procurement and Privatization Council of the U.S. Chamber of Commerce, and currently serves on the Chamber's Small Business Council. He has also been a frequent witness before Congress on the need for reform to eliminate various forms of unfair government competition with private sector firms. He formerly served as executive director of America Moving Forward, an association of firms involved in public-private partnerships ("P3s") for financing, building, and operating toll roads and other surface transportation infrastructure.

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Prior to joining Reason, Austill worked with policy in a variety of settings—nonprofits, on Capitol Hill, and in fundraising—where areas of focus included small business regulation, privatization, health care, and labor. Before moving to the D.C. area in early 2009, he worked for five years in the financial services industry, mostly in wealth management.

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