



**EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503**

January 25, 2005

The Honorable Richard B. Cheney
President of the Senate
Washington, DC 20510

Dear Mr. President:

I am pleased to provide you with an update on the Administration's competitive sourcing initiative. This letter and the enclosed tables highlight the results of agencies' competitive sourcing efforts for fiscal year (FY) 2004 and compare these results to those achieved in FY 2003.

Our report is based on data developed by agencies whose competitive sourcing efforts are tracked under the President's Management Agenda (PMA). The agencies are individually reporting their data to Congress in accordance with section 647(b) of the Transportation, Treasury, and Independent Agencies Appropriations Act, FY 2004 (Division F of the Consolidated Appropriations Act, P.L. 108-199) and guidance developed by the Office of Management and Budget (OMB) to ensure consistent and clear reporting.

Significant savings projected for completed competitions

Fifty years ago this month, President Eisenhower established a policy requiring federal agencies to determine whether the commercial activities performed by their employees could be provided more efficiently by the private sector. President Eisenhower's policy was the precursor to the principle of using competition to bring cost control to the daily tasks that support government operations. Thanks to the disciplines and habits instilled by the PMA, public-private competition is now proving its worth as a critical management tool for both reducing costs and accelerating the pace at which agencies improve efficiency and eliminate wasteful processes.

According to agency data, departments completed 217 competitions in FY 2004. These competitions are collectively estimated to generate net savings, or cost avoidance, of approximately \$1.4 billion over three to five years. One-time, out-of-pocket expenses associated with these efforts were \$74 million, and fixed costs to provide central direction and oversight were roughly \$36 million – a modest investment for an impressive return. When combined with the \$1.1 billion expected from competitions completed last year, the competitive sourcing initiative has positioned agencies to save more than \$2.5 billion for redirection to higher priorities. This equates to about \$552 million in annualized gross savings. Based on the number

of commercial positions identified in agency inventories as suitable for competition, competitive sourcing has the potential to generate in excess of \$5 billion in annual savings and/or cost avoidance. See Table 1-1 for a breakdown of activity by type of competition and number of full-time-equivalent employees (FTEs) studied. See Table 1-2 and Table 2-1 for additional summary figures on costs and savings.

Better results from smarter use of competition

Equally significant are the advances agencies have made in their ability to increase efficiency and cost savings through the appropriate use of competition. Experience, dedicated management attention, and the careful selection of activities for competition have helped agencies enhance their return on investment for our taxpayers. For example, in FY 2003, the average savings per FTE studied was about \$12,000. For competitions completed just one year later, this figure climbed to approximately \$22,000, better than an 85 percent improvement. Taking into account that the government pays roughly \$80,000 per civilian FTE annually in salary and benefits, competitive sourcing is now yielding over 27 percent in savings, on average, per FTE studied, up from 15 percent in FY 2003.¹

Table 2-2 identifies two trends that appear to be closely linked with the improved results. First, civilian agencies, like the Department of Defense (DOD), are relying on standard competitions, where federal employees are routinely afforded the opportunity to identify better and more cost-effective business practices and public and private sector sources compete head-to-head. Competition has allowed agencies to implement long-overdue reengineering efforts and cost-savings measures, all of which inure to the benefit of the taxpayers.

Second, agencies are turning to larger competitions. The average size of a competition has increased from 27 FTEs in FY 2003 to 58 FTEs in FY 2004. Larger competitions allow agencies to package activities across regions or by business line. As noted in Table 2-3, seven agencies reported savings increases of more than \$10 million, including two (the Department of Agriculture (USDA) and the Social Security Administration) that had reported net losses in FY 2003. Six of these agencies completed at least one competition involving 65 or more FTEs. In the case of Agriculture, the Forest Service conducted a 1,200 FTE service-wide competition for information technology that is expected to produce more than \$145 million in savings over a five-year period. This impressive result stands in contrast to challenges the Forest Service experienced in FY 2003, which resulted in net losses from competitions.

In fact, no agency that completed competitions in FY 2004 experienced an aggregate net loss for their efforts. Only the Department of Veterans Affairs (VA) reported a drop in

¹ Savings per FTE and the savings rate improve to over \$22,000 and 28 percent, respectively, if five competitions completed in the first quarter of FY 2004, but included in OMB's 2003 report, are added to the FY 2004 figures.

cumulative savings of \$10 million or more. However, statutory restrictions have effectively halted competitive sourcing at VA.²

Government employees continue to succeed in competitions

Competition results from FY 2004 should dispel any fears that employees are disadvantaged by the changes OMB instituted in 2003 to improve the competition process and increase the consideration of best value when making selections between public and private sources. In FY 2004, government employees were selected to perform work involving approximately 91 percent of the more than 12,500 FTEs competed. This percentage is about the same as that reported from FY 2003 competitions. Despite concerns that “cost-quality” tradeoffs would harm federal employees, over 95 percent of such tradeoffs completed in FY 2004 resulted in agency decisions to retain work in house.³

In addition, every agency that conducted competitions reported taking steps to address workforce needs. Steps may vary, but generally include: timing competitions to minimize workforce disruptions, involving human resource advisors to assist employees as they reorganize their operations, and exploring opportunities to provide “soft landings” for directly affected employees.⁴

Legislative constraints limit potential for savings

Despite the growing success of competitive sourcing, a number of legislative barriers continue to limit its application. Barriers included in FY 2005 agency appropriations:

² VA has previously estimated a potential cost savings of more than \$1.3 billion over a 5-year period if the Department were permitted to conduct competitions. This figure was based on the Department's 2003 FAIR inventory. After its 2004 inventory is published, VA will conduct a review of its commercial activities in coordination with OMB and intends to revise its competitive sourcing plan based on this review. In addition, if the Department is authorized to conduct competitions, it will update its plan annually based on experience, capacity, and an improved understanding both of the marketplace and its workforce. (VA's plan will include a project plan to address activities, costs, savings, and general timelines for competition.)

³ This data point does not take into account science competitions conducted by the National Aeronautics and Space Administration (NASA) pursuant to a deviation where its scientists compete with members throughout the scientific community (i.e., industry, academia, and other institutions) to perform world class science projects. Awards are not winner-take-all and may be made to a combination of in-house scientists and private sector sources to pursue promising R&D efforts.

⁴ A recently released study concluded that of the more than 65,000 civilian positions studied at DOD since 1995, only 5 percent were reduced through the involuntary separation of federal employees. See *Competitive Sourcing: What Happens to Federal Employees?* IBM Endowment for the Business of Government (October 2004).

- place small businesses at a competitive disadvantage in DOD competitions by restricting the type of health benefits plans they provide to their own employees when performing work for the Department, potentially skew competitions in favor of in-house performance, and undermine the Department's efforts to redirect its workforce to core military activities;
- restrict resources available to conduct competitive sourcing activities at the Forest Service and the Department of the Interior (DOI), despite the fact that competitions completed by these organizations in FY 2004 are expected to net approximately \$178 million in taxpayer savings over the next several years (\$162 million at the Forest Service and \$16 million at DOI);
- thwart the Department of Homeland Security's ability to use competition to select the public or private sector provider that can most effectively help the Department make necessary improvements in its dissemination of immigration information; and
- block USDA from improving the efficiency and cost-effectiveness of its rural development and farm loan programs.

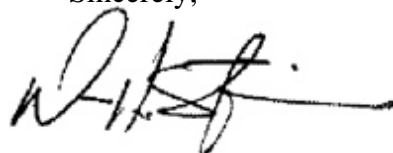
We urge Congress to remove these legislative restrictions as well as to appropriate funds to permit VA to proceed with competitions for its commercial operations that are suitable for private sector performance. The experience of the last two years makes clear that agencies are becoming increasingly skilled at comparing private sector capabilities and costs to those of federal employees on a fair and level playing field. The results also confirm that competitive sourcing, when properly used, helps agencies reduce costs and improve performance.

For our part, we will be reviewing agency practices to determine whether agencies are taking appropriate steps to encourage private sector participation in competitions. This review will not change our commitment to ensuring that federal employees have the opportunity to compete effectively and fairly in all public-private competitions.

Next month, OMB will submit a more detailed report discussing agencies' competitive sourcing achievements for FY 2004. As you review the report and the summary data enclosed with this letter, we hope you will conclude, as we have, that the disciplines and habits agencies

have adopted to implement competitive sourcing have made the federal government more results-oriented. We look forward to working with Congress as we continue to pursue this important endeavor.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Safavian", with a long horizontal flourish extending to the right.

David H. Safavian
Administrator

Enclosure

Identical Letter Sent to:

The Honorable Richard D. Cheney

The Honorable J. Dennis Hastert

The Honorable C.W. "Bill" Young

The Honorable David R. Obey

The Honorable Ted Stevens

The Honorable Robert C. Byrd

The Honorable Susan Collins

The Honorable Joseph I. Lieberman,

The Honorable Thomas M. Davis

The Honorable Henry A. Waxman

Competitive Sourcing at a Glance

Table 1-1. Activity in FY 2003 & 2004

Element	FY 2003	FY 2004
Completed Competitions		
Total competitions completed	662	217
Streamlined	570	116 ^a
Standard	92	101 ^{a,b}
Total FTEs competed	17,595^c	12,573^c
Streamlined	5,474	1,201
Standard	12,121	11,372 ^b
% of competitions where agency determined best result provided in-house (based on FTE studied)	89%	91%
Announced Competitions		
Total competitions announced	73	76
Streamlined	17	27
Standard	56	49
Total FTE in announced competitions	7,385	9,654
Streamlined	302	396
Standard	7,083	9,258

^a Includes streamlined and standard competitions conducted under the revised Circular and streamlined and standard cost comparisons conducted under the old Circular A-76.

^b Excludes 5 competitions completed by the Departments of Energy (DOE), Health and Human Services (HHS), Justice (DOJ), and Commerce (DOC), and the Office of Personnel Management (OPM), respectively, that were assessed in the FY 2003 report (involving a cumulative total of 1240 FTEs); also excludes DOD "direct conversions" (despite the name, DOD does not convert activities to private sector performance until after having considered the cost of in-house performance, as required by 10 U.S.C. 2462).

^c According to the 2003 Federal Activities Inventory Reform (FAIR) Act inventories of agencies tracked by the PMA, there were approximately 375,000 FTEs identified as suitable for competition. Thus, 4.7% the FTEs potentially eligible for competition were competed in 2003 and 3.4% were competed in 2004.

Competitive Sourcing at a Glance
(continued)

Table 1-2. Investments & Results in FY 2003 & 2004

Element	FY 2003	FY 2004
Incremental (out-of-pocket) costs^a		
Cost directly attributable to conducting <i>completed</i> competitions	\$88 million	\$74 million
Cost directly attributable to conducting <i>announced</i> competitions	\$15 million	\$19 million
Average incremental cost per FTE studied	\$5,000	\$6,000 ^b
Fixed costs for central direction & oversight		
Total fixed costs	Data not collected	\$36 million
Results from completed assessments^c		
Gross savings (over 3-5 years)	\$1.2 billion	\$1.5 billion
Net savings (over 3-5 years)	\$1.1 billion	\$1.4 billion ^d
Annualized gross savings	\$237 million	\$285 million
Annualized net savings per FTE	\$12,000	\$22,000

^aThese are one-time expenses.

^bThe increase from FY 2003 to FY 2004 likely reflects the increased use of standard competitions (versus streamlined competitions).

^cAggregate cost and savings figures were derived from agency calculations made in accordance with the general methodologies described in OMB Memorandum M-05-01.

^dTotal net savings = total gross savings less total incremental costs.

Promising Trends: FY 2003 to FY 2004*

**Table 2-1. Estimated Savings from Completed Competitions
(all PMA agencies)**

Savings	FY 2003	FY 2004	Two Year Total
Gross	\$1.2 billion	\$1.5 billion	\$2.7 billion
Net	\$1.1 billion	\$1.4 billion	\$2.5 billion
Annualized gross	\$237 million	\$285 million	\$522 million
Annualized net per FTE ^a	\$12,000	\$22,000 ^b	

^a These figures do not reflect fixed costs.

^b This figure does not reflect the savings achieved under 5 standard competitions completed by DOE, HHS, DOJ, DOC, and OPM, respectively, that were covered in OMB's FY 2003 report. If these 5 competitions were added, the annualized net per FTE would be over \$22,000.

**Table 2-2. Strategic Adjustments & Associated Results
(all PMA agencies)**

Factor	FY 2003	FY 2004	% Change
Average Size of Competition	27 FTEs	58 FTEs	+115
% FTEs studied through Standard Competition (Civilian Agencies) ^c	38%	79%	+107
Savings Rate per FTE Studied^d	15%	27%^e	+81

^c Standard competitions require that: (i) in-house providers develop a reorganization plan and bid their "most efficient organization", (ii) agencies issue solicitations for head-to-head competition between the public and private sectors, and (iii) competitions show an estimated savings of at least 10% before work is converted from public to private (or private to public) sector performance. DOD has traditionally relied on these strategic practices for the vast majority of its competitions (approximately 98% of its FTEs studied in FY 2004). Civilian agencies, which opted for paper streamlined competitions in FY 2003 are increasingly adopting the more strategic practices involved with standard competitions.

^d This rate assumes the government pays roughly \$80,000 per civilian FTE annually in salary and benefits. OMB's Budget Database was used to determine the average cost of a civilian FTE.

^e If the 5 standard competitions completed in the first quarter of FY 2004 were added, the saving rate would increase to 28%.

* Except as noted, these aggregate figures were derived from agency calculations made in accordance with the general methodologies described in OMB Memoranda M-05-01 and M-04-07.

Promising Trends: FY 2003 to FY 2004
(continued)

Table 2-3. Getting on Track: Agencies Reporting Savings Increases of more than \$10 Million from FY 03 to FY 04*

Agency	Total Anticipated Net Savings from Completed Competitions	
	FY 2003	FY 2004
Agriculture	-\$3,596,000	\$173,932,000
Education	No competitions completed	\$87,448,000
DHS	No competitions completed	\$11,009,000
Interior	\$3,258,000	\$16,378,000
Treasury	\$253,000	\$217,867,000
GSA	\$6,211,000	\$18,339,000
SSA	-\$78,000	\$35,979,000

*No agency reported negative net savings for competitions completed in FY 04. Only VA reported a decrease in savings of more than \$10 million. VA's efforts have been halted by statutory restrictions. DOD reported a net savings increase of approximately \$8 million. However, projected savings data was not available for 6 completed competitions as of the date of this letter. It should also be noted that statutory restrictions have effectively precluded DOD from announcing new competitions under revisions to OMB Circular A-76 for much of FY 04.