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February 2, 2009

Congressional Research Service

Report RL31024

*The Federal Activities Inventory Reform Act and Circular  
A-76*

L. Elaine Halchin, Government and Finance Division

April 6, 2007

**Abstract.** This report begins with a history of Circular A-76, a review of the its key components, and an assessment of the implementation of the circular. The section on FAIR describes how it emerged from a series of compromises, explains the statute's key provisions, and reviews the implementation process, including guidance issued by OMB. The final section addresses recent initiatives, notably the President's competitive sourcing initiative and the Commercial Activities Panel.

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# The Federal Activities Inventory Reform Act and Circular A-76

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April 6, 2007

<http://wikileaks.org/wiki/CRS-RL31024>

Congressional Research Service

7-5700

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RL31024

## Summary

The Federal Activities Inventory Reform Act of 1998 (FAIR) (P.L. 105-270) and Office of Management and Budget (OMB) Circular A-76 are intertwined. Given the Bush Administration's emphasis on competitive sourcing, which is one of the elements of the President's Management Agenda, Congress may wish to revisit FAIR and Circular A-76.

FAIR is, in some respects, an extension of Circular A-76, and it was implemented through a 1999 revision to the circular. FAIR levies a statutory requirement on agencies to provide inventories of commercial activities, provides a challenge and appeal process, and statutorily defines "inherently governmental" activities (i.e., functions unsuitable for contracting out). FAIR does not require agencies to compete or convert directly any of the activities listed on their inventories. Although the initial implementation of FAIR was successful with regard to compiling annual inventories, it revealed areas needing improvement. OMB responded, in 2000, 2002, and 2003, with additional guidance.

Initially issued in 1966, OMB Circular A-76 rests on a policy of subjecting commercial activities to public-private competition. Circular A-76 requires agencies to submit annual inventories of their commercial activities and inherently governmental activities to the federal budget agency and provides guidance for agencies to use in determining whether to "make or buy" a particular commercial service. A "commercial activity" is a good or service that could be obtained from the private sector and that is not inherently governmental. The essence of an inherently governmental activity is that it involves the discretionary exercise of government authority or monetary commitments.

Early in 2001, two initiatives related to Circular A-76 and FAIR began. The Bush Administration initially directed agencies to compete a certain percentage of the full-time equivalents listed on their commercial inventories. In summer 2003, the Administration eliminated these targets and instead encouraged agencies to develop their own competitive sourcing goals. Additionally, Congress directed the then-General Accounting Office to establish a panel to examine Circular A-76 and FAIR. The Commercial Activities Panel (CAP), which was convened by GAO, issued its report on April 30, 2002. Following the release of this report, and as part of the Administration's competitive sourcing initiative, OMB issued a revised circular in May 2003.

This report begins with a brief history of Circular A-76, a review of the its key components, and an assessment of the implementation of the circular. The section on FAIR describes how it emerged from a series of compromises, explains the statute's key provisions, and reviews the implementation process, including guidance issued by OMB. The final section addresses recent initiatives, notably the President's competitive sourcing initiative and the Commercial Activities Panel. This report will be updated as additional information about the initiative becomes available.

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## Background

In some cases, the government does not have to consider whether it should make or buy goods and services. Private companies build tanks and buildings, manufacture pens and copy machines, and make tools and military uniforms. Because the government does not produce these items, and has neither the capability nor the interest to do so, it procures them from private industry. But in those cases where both government and industry are capable of providing the same, or comparable, commercial goods and services,<sup>1</sup> government is faced with the “make or buy” decision.

Guidance for agencies on how to resolve the “make or buy” question is found in Office of Management Budget (OMB) Circular A-76. The circular was issued initially in 1966 and has since been revised several times.<sup>2</sup> The 1999 revision was used to implement the Federal Activities Inventory Reform Act of 1998<sup>3</sup> (FAIR). FAIR requires agencies to compile inventories of their functions that could be performed by government or the private sector. While Circular A-76 required, for a number of years, that agencies submit inventories, it was not until the enactment of FAIR that inventories became a statutory requirement and that agency participation became widespread. The 2003 revision, among other things, required agencies to submit inventories of their inherently governmental activities; eliminated direct conversions (that is, functions that met certain requirements could be converted to the private sector without the agency having to hold a public-private competition for each function); and established specific time frames for the completion of standard and streamlined competitions.

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<sup>1</sup> A “commercial activity” is a good or service that could be obtained from the private sector and that is not inherently governmental. Photography, data processing, and management support services are examples of categories of commercial activities. An inherently governmental activity “is a function that is so intimately related to the public interest as to mandate performance by Government employees. These functions include those activities that require either the exercise of discretion in applying Government authority or the making of value judgments in making decisions for the Government. Governmental functions normally fall into two categories: (1) The act of governing, i.e., the discretionary exercise of Government authority, and (2) monetary transactions and entitlements.” (U.S. Office of Management and Budget, “Policy Letter on Inherently Governmental Functions,” *Federal Register*, vol. 57, no. 190, Sept. 30, 1992, p. 45100.) While the policy letter includes a list of activities considered to be inherently governmental (Appendix A) and a list of activities not considered to be inherently governmental (Appendix B), it also provides guidelines for determining whether a function is inherently governmental or not. First, “not every exercise of discretion is evidence” that a function is inherently governmental. Second, several factors should be considered in determining whether a transfer of official responsibility would take place with the contracting out of a particular function. (Ibid., p. 45101.) While the policy letter distills the essence of the term “inherently governmental,” this concept is still broad enough to be open to interpretation and controversy.

<sup>2</sup> The *Federal Register* entries for major revisions to Circular A-76 and/or the Supplemental Handbook are: vol. 44, no. 67, Apr. 5, 1979, pp. 20558-20566; vol. 48, no. 159, Aug. 16, 1983, pp. 37110-37116; vol. 61, no. 63, April 1, 1996, pp. 14338-14346; vol. 64, no. 121, June 24, 1999, pp. 33927-33935; vol. 65, no. 175, p. 54568, Sep. 8, 2000; and vol. 68, no. 103, pp. 32134-32142. Revisions have been used to clarify and interpret policy and to streamline and improve the cost comparison process through the addition, elimination, and updating of requirements, procedures, and data (e.g., cost factors). Key changes include the initial publication of the Supplemental Handbook (1979); incorporating the language of government reinvention (1996); and implementing FAIR (1999).

<sup>3</sup> P.L. 105-270 (Oct. 19, 1998), 112 Stat. 2382, 31 U.S.C. § 501 note.

This report covers the policy history of competitive sourcing and outsourcing,<sup>4</sup> the development over time of two vehicles (Circular A-76 and FAIR) central to public-private competition and contracting out, and other significant initiatives. Because Circular A-76 is a precursor to FAIR, the report begins with a review of the origins of Circular A-76, a description of the circular's components and related issues, and a discussion of its implementation. Next, the report summarizes the history of FAIR, explains its provisions, and describes its implementation and revisions. The report concludes with an overview of significant initiatives.

## OMB Circular A-76

### Origins

Competition between government and the private sector has been a policy issue for many years. Efforts to create, in the 1930s, a committee on “government competition with private enterprise”<sup>5</sup> in the House of Representatives were followed, in the 1950s, by initiatives with a similar focus.<sup>6</sup> In 1953, the Intergovernmental Relations Subcommittee of the House Committee on Government Operations “reported that the number of [commercial and industrial] activities conducted by Government agencies posed a real threat to private industry and imperiled the tax structure” and “recommended that ‘a permanent, vigorous, preventive and corrective program be inaugurated....’”<sup>7</sup> According to the Commission on Government Procurement, the Commissions on Organization of the Executive Branch of Government, in both the 1949 report (First Hoover Commission) and 1955 report (Second Hoover Commission), addressed the issue of competition between the government and private businesses.<sup>8</sup> The Second Hoover Commission developed 22 recommendations aimed at moderating government competition with the private sector.<sup>9</sup> Between 1953 and 1960, the Senate Select Committee on Small Business held several hearings on government activities that competed with business.<sup>10</sup>

President Dwight D. Eisenhower’s Administration issued several policy statements supporting the notion that the federal government should rely on the private sector to provide needed goods and services. The Bureau of the Budget, predecessor of OMB, issued, in 1955, Bulletin Number 55-4,

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<sup>4</sup> Competitive sourcing refers to selecting a source—government agency or private sector contractor—through a competitive process, such as the one established by Circular A-76. Outsourcing, or contracting out, refers specifically to awarding a contract to a private sector source. This distinction has not always been acknowledged or noticed. References to A-76 may characterize it as a vehicle for outsourcing or, alternatively, as a means for conducting public-private competitions. The different ways in which A-76 is portrayed may result from a conflation of the terms “outsourcing” and “competitive outsourcing” or may reflect different goals that people have for the program. The term “privatization” is not used in this report because, for some, it applies specifically and exclusively to the government divestiture of a function or agency.

<sup>5</sup> Commission on Government Procurement, *Report*, vol. 1, (Washington: GPO, 1972), p. 57.

<sup>6</sup> In this context, government competes with private sector sources in traditional fashion in the marketplace. Government competition with the private sector also occurs under the auspices of Circular A-76, which is referred to as a “competitive process” or “public-private competition,” for the provision of services to the government itself.

<sup>7</sup> Commission on Government Procurement, *Report*, vol. 1, (Washington: GPO, 1972), p. 58.

<sup>8</sup> *Ibid.*

<sup>9</sup> Commission on Organization of the Executive Branch of the Government, “Business Enterprises,” report to Congress, 1955.

<sup>10</sup> Commission on Government Procurement, *Report*, vol. 1, (Washington: GPO, 1972), p. 58.

which stated: “It is the general policy of the administration that the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels.”<sup>11</sup> Two subsequent bulletins, Numbers 57-7 (February 5, 1957) and 60-2 (September 21, 1959), reiterated this policy of governmental reliance on the private sector.

Government policymakers’ interest in reducing competition between government and the private sector might have been tempered somewhat, in the years following the issuance of the three Bureau of the Budget bulletins, by contracting-related problems or issues that surfaced in the 1960s. The problems or issues included concern for how government employees were affected by the contracting out of government functions; a study of contract personnel at an Air Force base that revealed the contract was more costly than using government employees; an opinion from the general counsel of the Civil Service Commission that stated it was illegal for government employees to directly supervise contract employees; and a Department of Defense (DOD) study that found “that many service contracts were in conflict with Civil Service laws and were also more costly than in-house performance.”<sup>12</sup>

Mindful of the promise of relying on the private sector to provide goods and services, and perhaps the potential pitfalls as well, President Lyndon B. Johnson’s Administration continued what the Eisenhower Administration had begun, and developed the first permanent directive dealing with the issue of governmental reliance on the private sector. Published in 1966, Bureau of the Budget Circular A-76 provided guidance designed to aid agencies in determining whether to make or buy needed goods and services. President Johnson explained in a memorandum to departments and agencies that “uniform guidelines and principles” were needed “to conduct the affairs of the Government on an orderly basis; to limit budgetary costs; and to maintain the Government’s policy of reliance upon private enterprise.”<sup>13</sup> In issuing Circular A-76, the “Administration came to grips ... with a [l]ong-smoldering controversy over Federal competition with private industry....”<sup>14</sup>

## Key Components

Although Circular A-76 has been revised many times, its chief components, except where noted otherwise, have remained stable. They are a policy statement, a requirement for agencies to submit inventories of their commercial activities to OMB, and guidance for determining who—government agency or private business—will perform commercial activities.

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<sup>11</sup> Information about the bulletin was obtained from the U.S. Office of Management and Budget, Office of Federal Procurement Policy.

<sup>12</sup> Commission on Government Procurement, *Report*, vol. 1, (Washington: GPO, 1972), p. 58.

<sup>13</sup> U.S. President (Johnson), “Memorandum Announcing Revised Guidelines Governing Development by the Government of Products or Services for Its Own Use,” *Public Papers of the Presidents of the United States*, Book I, 1967, p. 269.

<sup>14</sup> Frank C. Porter, “New Guidelines Issued on U.S. Procurement,” *Washington Post*, Mar. 4, 1966, p. A5. Porter also reported: “Business spokesmen have long contended that the Federal Government, taking advantage of its tax-free, non-profit status, competes unfairly with private enterprise in many areas” (ibid.).

## Policy Statement

Circular A-76 has included an explanation of its origins and in doing so reiterated the policy presented initially in the three Bureau of the Budget bulletins issued in the 1950s. As stated in the 1979 revision to the circular, the policy was:

In a democratic free enterprise economic system, the Government should not compete with its citizens. The private enterprise system, characterized by individual freedom and initiative, is the primary source of national economic strength. In recognition of this principle, it has been and continues to be the general policy of the Government to rely on competitive private enterprise to supply the products and services it needs.<sup>15</sup>

Substantively, the policy of Circular A-76 remained the same through the 1999 revision. In this revision to the circular, only a few words were changed.

In the process of governing, the Government should not compete with its citizens. The competitive enterprise system, characterized by individual freedom and initiative, is the primary source of national economic strength. In recognition of this principle, it has been and continues to be the general policy of the Government to rely on commercial sources to supply the products and services the Government needs.<sup>16</sup>

Arguably, the policy statement found in the 2003 revision retained the basic thrust of earlier policy statements, but is worded differently. It reads, in part:

The longstanding policy of the federal government has been to rely on the private sector for needed commercial services. To ensure that the American people receive maximum value for their tax dollars, commercial activities should be subject to the forces of competition.<sup>17</sup>

As of 1979, the circular also stated that it is the policy of the federal government to retain governmental functions in-house and to consider comparative costs.<sup>18</sup> In discussing this proposed revision, an entry in the *Federal Register* in 1978 stated:

The current Circular A-76 states the Government's general policy of relying on the private sector to supply its needs. The draft revision expands this policy statement to recognize that 'governmental functions' must be performed by Government personnel, and that the taxpayer is entitled to economy in Government, which requires appropriate emphasis on comparative cost.<sup>19</sup>

The expanded policy statement was incorporated in the 1979 revision of the circular and remained unchanged through the 1999 circular: "It is the policy of the United States Government to: *achieve economy and enhance productivity, retain governmental functions in-house, and rely*

<sup>15</sup> U.S. Office of Management and Budget, "Acquiring of Commercial of [sic] Industrial Products and Services Needed by the Government; Policy Revision," *Federal Register*, vol. 44, no. 67, Apr. 5, 1979, pp. 20556-20557.

<sup>16</sup> U.S. Office of Management and Budget, "Implementation of the Federal Activities Inventory Reform Act of 1998 (P.L. 105-270) ('FAIR Act')," *Federal Register*, vol. 64, no. 121, June 24, 1999, p. 33931.

<sup>17</sup> U.S. Office of Management and Budget, *Circular No. A-76 (Revised)*, May 29, 2003, p. 1, available at [http://www.whitehouse.gov/omb/circulars/a076/a76\\_incl\\_tech\\_correction.pdf](http://www.whitehouse.gov/omb/circulars/a076/a76_incl_tech_correction.pdf).

<sup>18</sup> U.S. Office of Management and Budget, "Acquiring of Commercial of [sic] Industrial Products and Services Needed by the Government; Policy Revision," *Federal Register*, vol. 44, no. 67, Apr. 5, 1979, p. 20558.

<sup>19</sup> U.S. Office of Management and Budget, "Proposed Policy Revision," *Federal Register*, vol. 43, no. 163, Aug. 22, 1978, p. 37410.

on the commercial sector.”<sup>20</sup> In the 2003 circular, inherently governmental activities are addressed in this fashion: “In accordance with this circular ... agencies shall: **a.** Identify all activities performed by government personnel as either commercial or inherently governmental. **b.** Perform inherently governmental activities with government personnel.”<sup>21</sup>

## Commercial Activities Inventories

The requirement for agencies to compile inventories of their commercial activities was established by the original circular. Under the heading of “administering the policy,” the Bureau of the Budget wrote in 1966:

Each agency will compile and maintain an inventory of its commercial or industrial activities having an annual output of products or services costing \$50,000 or more or a capital investment of \$25,000 or more. In addition to such general descriptive information as may be appropriate, the inventory should include for each activity the amount of the Government’s capital investment, the amount paid annually for the products or services involved, and the basis upon which the activity is being continued under the provisions of this [1966] Circular. The general descriptive information needed for identifying each activity should be included in the inventory by June 30, 1966.<sup>22</sup>

A significant change to this requirement occurred with the issuance of the 2003 revision to the circular, which requires agencies to also submit inventories of their inherently governmental activities annually to OMB.<sup>23</sup>

## Competitive Process

Although Circular A-76 did not require agencies to conduct cost comparisons,<sup>24</sup> it provided a competitive process, sometimes referred to as public-private competition, to be used in determining who would supply commercial goods and services. The competitive, or cost comparison, process consists of three stages: developing a performance work statement (PWS), which describes the work to be done; designing the most efficient organization (MEO), which, in effect, becomes the government’s bid; and comparing the government’s and contractors’ bids to determine who can perform the work most efficiently.

Circular A-76 generated both praise and concerns. Some have applauded the program for its chief feature, competition, which promises to yield increased efficiency, cost savings, better quality products, and more innovation. Even groups that recognized these benefits, however, had concerns: “Many contractors have complained that the A-76 process gives public workers an

<sup>20</sup> U.S. Office of Management and Budget, “Implementation of the Federal Activities Inventory Reform Act of 1998 (P.L. 105-270) (‘FAIR Act’),” *Federal Register*, vol. 64, no. 121, June 24, 1999, p. 33931.

<sup>21</sup> U.S. Office of Management and Budget, *Circular No. A-76 (Revised)*, May 29, 2003, p. 1. (boldface in original)

<sup>22</sup> Executive Office of the President, Bureau of the Budget, “Circular No. A-76,” Mar. 3, 1966, p. 6.

<sup>23</sup> U.S. Office of Management and Budget, *Circular No. A-76 (Revised)*, May 29, 2003, pp. A-1-A-4.

<sup>24</sup> Two Presidents, Ronald Reagan and George W. Bush, took steps to require agencies to conduct cost comparison studies. President Reagan signed an executive order to this effect in 1987 (see “Implementation” under “OMB Circular A-76”). Under President Bush, the Office of Management and Budget initially released guidance that required agencies to compete a certain percentage of their positions that perform commercial activities. This requirement later was abandoned in favor of agency-specific targets. See below, “Competitive Sourcing Initiative,” for more information about the Bush Administration’s efforts in this area.

advantage, while federal unions have complained that the process tilts the playing field in favor of the private sector.”<sup>25</sup> The fact that agencies are not required by statute to conduct cost comparison studies is another source of dispute. For agency heads and managers, this fact means they have latitude to decide how to manage their agencies’ activities, workload, and personnel. The maintenance and exercise of agency discretion means, on the other hand, that the private sector is not assured of access to new contracting opportunities.

## Implementation

Implementation of Circular A-76 has not always proceeded smoothly. In the early days of the A-76 program, implementation was hampered, and deemed inequitable, because of procedural problems. GAO reported, in 1972, that, with a few exceptions, “there were no explanations supporting local recommendations that in-house performance of activities be continued. Recommendations often were based on the reviewer’s personal knowledge, and there was no evidence of the factors that had been considered.”<sup>26</sup> This problem was acknowledged, several years later, in written comments accompanying a proposed revision: “Agency implementation of OMB Circular A-76 has been heavily criticized as inconsistent and frequently inequitable.”<sup>27</sup> A remedy was offered, in 1979, with the publication of the Supplemental Handbook; its purpose was to effect changes “intended to promote more effective and consistent implementation.”<sup>28</sup> Implementation problems reportedly were the catalyst for another revision four years later. In announcing a proposed change to Circular A-76 in 1983, OMB noted: “This proposed revision greatly simplifies and shortens the cost comparison procedures and clarifies and strengthens other procedures in the Circular that unnecessarily impede its implementation.”<sup>29</sup> Continuing with the same theme, a 1995 *Federal Register* entry explained the need for a revision to Circular A-76: “The proposed revision improves upon existing guidance that may have made the cost comparison process unnecessarily difficult or lead [*sic*] to less than optimal outcomes.”<sup>30</sup>

Another implementation issue has been the degree of agency participation in the A-76 program. Participation rates, particularly among civilian agencies, have been somewhat low. Prior to the enactment of FAIR, which made the submission of inventories a statutory requirement, some agencies failed to submit inventories or failed to submit them on time. In 1971, OMB gathered data on the status of A-76 efforts and discovered that 16% of agency activities had not been reviewed despite the fact that the deadline had been June 30, 1968.<sup>31</sup> The number of cost comparison studies declined during the 1990s. In June 1996, OMB requested that agencies submit

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<sup>25</sup> Brian Friel, “Study Promotes Fairness in A-76 Competitions,” *GovExec.com*, Daily Briefing, Dec. 23, 1999, available at <http://www.govexec.com/dailyfed/1299/122399b1.htm>.

<sup>26</sup> *Ibid.*

<sup>27</sup> U.S. Office of Management and Budget, “Proposed Changes in Policy of Government Reliance on Private Enterprise,” *Federal Register*, vol. 42, no. 224, Nov. 21, 1977, p. 59817.

<sup>28</sup> U.S. Office of Management and Budget, “Circular No. A-76, Revised.” *Federal Register*, vol. 44, No. 67, Apr. 5, 1967, p. 20557. The Supplemental Handbook is available at <http://www.whitehouse.gov/omb/circulars/a076supp.pdf>.

<sup>29</sup> U.S. Office of Management and Budget, “Invitation for Public Comment, Proposed Revision to OMB Circular No. A-76 ‘Performance of Commercial Activities’,” *Federal Register*, vol. 48, no. 8, Jan. 12, 1983, p. 1376.

<sup>30</sup> U.S. Office of Management and Budget, “Notice of Request for Comments on the Proposed Revision to the OMB Circular No. A-76 ‘Performance of Commercial Activities’,” *Revised Supplemental Handbook*, *Federal Register*, vol. 60, no. 204, Oct. 23, 1995, p. 54394.

<sup>31</sup> Commission on Government Procurement, *Report*, vol. 1, (Washington: GPO, 1972), p. 59.

their inventories by September 13, 1996. Six of the 24 largest agencies had not submitted their inventories as of April 1998.<sup>32</sup> GAO reported, in 1998, that

There has been minimal A-76 activity among many agencies since the late 1980s, with some major civilian agencies, such as the Departments of Education, Housing and Urban Development, and Justice, reporting that they have not studied any positions under A-76 in the past 11 years. Moreover, despite OMB's intention that the March 1996 revision to the A-76 Supplemental Handbook would make A-76 a more attractive vehicle for agencies to use, no significant increase in efforts under A-76 among civilian agencies are readily evident.<sup>33</sup>

A 1987 executive order that levied a cost comparison quota on agencies apparently had little effect, either, on agency participation.<sup>34</sup>

Several factors may have contributed to the relatively low participation rate, including legislative opposition. Members of Congress hold diverse views on competitive sourcing and outsourcing. In addition to voicing their concerns, congressional opponents have sponsored successful legislation that levied restrictions on the application of Circular A-76. These included "prohibitions on contracting-out specific activities" and requirements to maintain minimum staffing levels in certain functions.<sup>35</sup> For example, P.L. 102-555 prohibited the sale or commercialization of any portion of the weather satellite systems operated by the Department of Commerce; 10 U.S.C. 114(a)(2) prohibited the contracting out of Department of Defense research and development activities; and 43 U.S.C. 1707(204)(a) required that the Bureau of Land Management be managed directly by federal employees.<sup>36</sup>

Although Circular A-76 promised increased efficiency and cost savings, which made it appealing on a conceptual level, in practice its appeal apparently was diminished by a litany of problems experienced by agencies.<sup>37</sup> Anticipated benefits were overshadowed by agency managers' experiences: they found the program to be "time-consuming, difficult to implement, disruptive, and threatening to both managers and employees,"<sup>38</sup> as well as expensive and complicated.<sup>39</sup> The expense to agencies includes study costs and may include transition costs. Within the Department of Defense, estimates of study costs ranged from \$1,500 to \$8,500 per position studied. GAO's review of a sample of completed A-76 studies found that the per position cost ranged from \$364

<sup>32</sup> U.S. General Accounting Office, *OMB Circular A-76: Oversight and Implementation Issues*, Testimony, T-GGD-98-146 (Washington: June 4, 1998), p. 6.

<sup>33</sup> *Ibid.*, pp. 3-4.

<sup>34</sup> One provision of the executive order signed by President Ronald Reagan required that each agency, "beginning with Fiscal year 1989, conduct annual [cost comparison] studies of not less than 3 % of the department or agency's total civilian population, until all identified potential commercial activities have been studied." (U.S. President (Reagan), "Performance of Commercial Activities," Executive Order 12615, *Federal Register*, vol. 52, no. 225, Nov. 23, 1987, p. 44853.)

<sup>35</sup> U.S. General Accounting Office, *Government Contractors: An Overview of the Federal Contracting-Out Program*, Testimony, T-GGD-95-131 (Washington: March 29, 1995), p. 6.

<sup>36</sup> U.S. Congress, House Committee on Government Reform and Oversight, Subcommittee on Civil Service, *Contracting Out: Summary and Overview*, hearing, 104<sup>th</sup> Cong., 1<sup>st</sup> sess., Mar. 29, 1995 (Washington: GPO, 1995), pp. 47-48.

<sup>37</sup> U.S. General Accounting Office, *Government Contractors: An Overview of the Federal Contracting-Out Program*, Testimony, T-GGD-95-131 (Washington: Mar. 29, 1995), p. 1.

<sup>38</sup> *Ibid.*, p. 2.

<sup>39</sup> Tichakorn Hill, "Rules Are Roadblock to Agency Outsourcing," *Federal Times*, vol. 36, no. 39, Oct. 30, 2000, p. 1.

to \$9,000.<sup>40</sup> Transition costs<sup>41</sup> for the Department of Defense were estimated to reach \$1,288,000 for FY1997 through FY2005.<sup>42</sup>

According to GAO, the inability of government to calculate accurately the cost of its functions and to verify the savings realized from cost comparisons has undermined a major selling point of Circular A-76. In turn, this could have been a disincentive to agency participation. In 1998, GAO reported that the government did not have complete cost data. Without this data, it was difficult to calculate accurately the cost of a government function. One result was an increased “difficulty [in] carrying out the A-76 competitive process.”<sup>43</sup> With regard to savings, GAO was unable to verify “that the results of Federal agencies’ contracting out decisions have been beneficial and cost-effective in the aggregate.”<sup>44</sup> One specific problem was that claims about savings usually were based on initial estimates instead of updated, or actual, figures.<sup>45</sup>

OMB took several steps to encourage agencies to use Circular A-76, though some judged OMB’s actions as insufficient. OMB asserted that the purpose of the circular was not to convert work from one source to another. Rather, OMB saw it as one of many tools<sup>46</sup> and a means for agencies to develop the most efficient organization. At least some agencies shared OMB’s perspective that the A-76 program was one tool among many available to them.

The availability of an array of management tools, coupled with real or perceived A-76 implementation problems, might have affected agencies’ participation in the A-76 program. At a congressional hearing, W. Scott Gould, chief financial officer and assistant secretary for administration, U.S. Department of Commerce, described some of the tools available to his agency:

A-76 is one valuable tool among many for achieving our cost efficiency and management performance goals. I wish to emphasize that over the past 6 years we have added many such tools to our toolbox as we collectively explore ways to make government more efficient and effective . . . Throughout the first Clinton administration, while the Office of Management and Budget was revising the A-76 supplemental handbook, we at Commerce shifted our emphasis to the principles of government-wide reinvention. [Commerce also explored]

<sup>40</sup> U.S. General Accounting Office, *DOD Competitive Sourcing: Some Progress, but Continuing Challenges Remain in Meeting Program Goals*, GAO Report NSIAD-00-106, (Washington: Aug. 8, 2000), p. 16.

<sup>41</sup> Transition costs include separation costs for civilian employees who lose their jobs either because an activity was contracted out or because an activity that remained in-house requires a reduced work force.

<sup>42</sup> U.S. General Accounting Office, *DOD Competitive Sourcing: Some Progress, but Continuing Challenges Remain in Meeting Program Goals*, GAO Report NSIAD-00-106, (Washington: Aug. 8, 2000), p. 15.

<sup>43</sup> U.S. General Accounting Office, *OMB Circular A-76: Oversight and Implementation Issues*, Testimony, T-GGD-98-146 (Washington: June 4, 1998), p. 9.

<sup>44</sup> U.S. Congress, House Committee on Government Reform and Oversight, Subcommittee on Civil Service, *Contracting Out: Summary and Overview*, hearing, 104<sup>th</sup> Cong., 1<sup>st</sup> sess., Mar. 29, 1995 (Washington: GPO, 1995), pp. 10-11.

<sup>45</sup> U.S. General Accounting Office, *OMB Circular A-76: Oversight and Implementation Issues*, Testimony, T-GGD-98-146 (Washington: June 4, 1998), p. 3. Although the problems discussed here might detract from the appeal of Circular A-76 for some, GAO has reported how the A-76 program can benefit government nonetheless: “Agencies’ experiences with A-76 suggest that competition is a key to realizing savings, whether functions are eventually performed by private sector sources or remain in-house . . . There appears to be a clear consensus, which we share, that savings are possible when agencies undertake a disciplined approach, such as that called for under A-76, to review their operations and implement the changes to become more efficient themselves or contract with the private sector for services.” (p.3.)

<sup>46</sup> U.S. General Accounting Office, *OMB Circular A-76: Oversight and Implementation Issues*, Testimony, T-GGD-98-146 (Washington: June 4, 1998), p. 2.

downsizing, reengineering, reinvention labs, performance-based organizations, franchise funds and customer service improvement.<sup>47</sup>

Union opposition probably has played a role, albeit an indirect one, in depressing participation in the A-76 program. Although supportive of public-private competition, such as that provided for by Circular A-76, unions have been vocal and persistent in objecting to outsourcing. While testifying at a joint congressional hearing, Robert M. Tobias, former national president of the National Treasury Employees Union, offered this assessment:

Contracting out is not a panacea. It is not even an end in itself. It is a process. One that, in fact, has been used with alarming frequency in recent years as evidenced by the vast sums of money the federal government spends on contract services each year. It has led to documented waste, fraud and abuse and has, more often than not, been accomplished absent the most basic checks and balances.<sup>48</sup>

The annals of contracting out are replete with examples of contracting out being done to avoid Unions, to undermine pay and benefits of employees and generally shortchange workers.<sup>49</sup>

In charging that government contracts are too costly, the National Federation of Federal Employees argued that “contractors often are not prepared to do the job, and then the government has to pay for training for them; government employees sometimes have to redo work a contractor did; and contractors omit some costs from their bids.”<sup>50</sup> Unions also have challenged some of the claims and assumptions made by and about the private sector. In a portion of his testimony before a subcommittee of the Senate Committee on Governmental Affairs, the former national president of AFGE argued:

Just because contractors are hard-working taxpayers ... does not mean that they have some entitlement to funds in the public purse. After all, Federal employees are also hard-working taxpayers. And just because agencies with managers and rank-and-file employees, often working together in partnership, are more successful competitors in the A-76 process does not necessarily mean that the system has suddenly become defective. And just because contractors are not winning as many A-76 competitions now as they had in years past does not necessarily mean that they are being victimized by biased public-private competitions.<sup>51</sup>

<sup>47</sup> U.S. Congress, Senate Committee on Governmental Affairs, Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, *Competition for Commercial Activities in the Federal Government*, hearing, 105<sup>th</sup> Cong., 2<sup>nd</sup> sess., June 4, 1998 (Washington: GPO, 1998), p. 19.

<sup>48</sup> U.S. Congress, Senate Committee on Governmental Affairs, Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, and House Committee on Government Reform and Oversight, Subcommittee on Government Management, Information, and Technology, *A Free Market Approach to Federal Contracting: The Fair Competition Act of 1998 and the Competition in Commercial Activities [Act] of 1998*, March 24, 1998 hearing, 105<sup>th</sup> Cong., 2<sup>nd</sup> sess., Mar. 24, 1998 (Washington: GPO, 1998), p. 100.

<sup>49</sup> *Ibid.*, p. 112.

<sup>50</sup> U.S. Congress, Senate Committee on Governmental Affairs, Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, and House Committee on Government Reform and Oversight, Subcommittee on Government Management, Information, and Technology, *A Free Market Approach to Federal Contracting: The Fair Competition Act of 1998 and the Competition in Commercial Activities [Act] of 1998*, March 24, 1998 hearing, 105<sup>th</sup> Cong., 2<sup>nd</sup> sess., Mar. 24, 1998 (Washington: GPO, 1998), pp. 392-393.

<sup>51</sup> U.S. Congress, Senate Committee on Governmental Affairs, Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, *S. 314—Freedom from Government Competition Act*, hearing, 105<sup>th</sup> Cong., 1<sup>st</sup> sess., June 18, 1997 (Washington: GPO, 1997), p. 41.

# Federal Activities Inventory Reform Act<sup>52</sup>

## Background

It took several decades to enact legislation giving a statutory foundation to Circular A-76. The bill that led to FAIR emerged from a series of compromises.

As introduced by Senator Craig Thomas, on February 12, 1997, during the first session of the 105<sup>th</sup> Congress, S. 314 was an effort to enact a “Freedom from Government Competition” statute. As introduced, S. 314 would have prohibited agencies from beginning or carrying out “any activity to provide any products or services that can be provided by the private sector,” and it also would have prohibited agencies from obtaining “any goods or services from or [providing] any goods or services to any other governmental entity.” Exceptions would have been allowed for inherently governmental goods and services; goods or services having to do with national security; when it was determined that the federal government was the “best value source” for the goods or services; or when private sector sources were unable to meet the agency’s requirements.

S. 314 was reported to the Senate by the Committee on Governmental Affairs. on July 28, 1998. When S. 314 emerged from the committee, it was very different from the bill that Senator Thomas had introduced nearly 18 months earlier. S. 314 reported to the Senate with an amendment to the title and an amendment in the nature of a substitute that “represented an agreement reached among members of the Committee.”<sup>53</sup> The Federal Activities Inventory Reform Act represented a compromise between at least two different points of view. Federal employee unions were “happy that the bill [did] not mandate contracting out, while the business coalition consider[ed] the act a step toward more outsourcing of government business.”<sup>54</sup>

S. 314, as amended, was passed by the Senate on July 30, 1998 by unanimous consent. Senator Thomas and Senator Fred Thompson were the only Members to comment on the bill. Senator Thomas offered a brief history of S. 314 and the rationale for the measure<sup>55</sup> while Senator Thompson noted that the bill as introduced “has had [a] long and contentious past,” but the measure that passed represented a consensus.<sup>56</sup>

On July 31, 1998, the engrossed Senate bill was sent to the House of Representatives, where it was referred to the Committee on Government Reform and Oversight. The measure was called up, considered, and passed by the House on October 5, 1998. Discussion about the relative merits and drawbacks of S. 314 preceded its passage by the House. Congressman John J. Duncan, Jr.,

<sup>52</sup> P.L. 105-270, Oct. 19, 1998, 112 Stat. 2382, 31 U.S.C. 501 note, S. 314 (105<sup>th</sup> Congress). H.R. 716 was the companion bill.

<sup>53</sup> U.S. Congress, Senate Committee on Governmental Affairs, *Federal Activities Inventory Reform Act of 1998*, p. 8.

<sup>54</sup> Brian Friel, “Bill Creates Outsourcing Target Lists,” *Government Executive*, Daily Briefing, July 16, 1998, available at <http://www.govexec.com/dailyfed/0798/071698b2.htm>.

<sup>55</sup> “Federal Activities Inventory Reform Act of 1998,” remarks in the Senate, *Congressional Record*, July 28, 1998, p. S 9104, available at [http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=1998\\_record&page=S9104&position=all](http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=1998_record&page=S9104&position=all).

<sup>56</sup> “Federal Activities Inventory Reform Act of 1998,” remarks in the Senate, *Congressional Record*, July 30, 1998, p. S 9505, available at [http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=1998\\_record&page=S9505&position=all](http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=1998_record&page=S9505&position=all).

noted the legislation was “a modest proposal” that would “help eliminate some government competition with small business” and that it had the support of over 100 organizations.<sup>57</sup> Concerned that the bill was “the first step down the road towards privatizing much of the Federal Government,” Congressman Dennis J. Kucinich objected to S. 314.<sup>58</sup> He argued that the bill erroneously assumed that the federal workforce is too large and the federal government does not do enough contracting.<sup>59</sup> He also questioned the appropriateness of allowing the private sector, whose goal it is to make a profit, to take over some functions performed by government.<sup>60</sup>

After S. 314 was agreed to by a voice vote in the House on October 5, 1998, it was presented to President William J. Clinton on October 8, 1998. He signed it on October 19, 1998.

## Provisions

FAIR and Circular A-76 are intertwined, as evidenced by the 1999 revision to Circular A-76 that implemented FAIR. The circular also provides the competitive process that agency heads must use when they consider contracting out commercial activities identified in their annual inventories under FAIR. FAIR reinforces selected features of A-76, such as the definition of “inherently governmental” and the requirement for agencies to prepare and submit inventories of their commercial activities to OMB.

## Inventories

FAIR requires agencies to compile, annually, a list of commercial activities performed by their employees and submit it to OMB by the end of the third quarter of each fiscal year (June 30). Each entry shall include:

- (1) organization unit
- (2) state(s) and location(s) where the activity is performed
- (3) the number of full-time employees who perform the activity
- (4) activity function code
- (5) reason code
- (6) the fiscal year the activity first appeared on a FAIR inventory
- (7) a point of contact within the agency
- (8) the year a cost comparison or conversion was performed (if applicable)

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<sup>57</sup> “Federal Activities Inventory Reform Act of 1998,” remarks in the House, *Congressional Record*, Oct. 5, 1998, p. H 9448, available at [http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=1998\\_record&page=H9448&position=all](http://frwebgate.access.gpo.gov/cgi-bin/getpage.cgi?dbname=1998_record&page=H9448&position=all).

<sup>58</sup> *Ibid.*, p. H9448.

<sup>59</sup> *Ibid.*, p. H9449.

<sup>60</sup> *Ibid.* An example of congressional opposition in the 107<sup>th</sup> Congress to the push for outsourcing can be found in the form of H.R. 721 or S. 1152. Each measure emphasized “Truthfulness, Responsibility, and Accountability in Contracting” (TRAC).

- (9) the amount of civilian FTE savings (if applicable)
- (10) the estimated annualized cost comparison dollar savings (if applicable)
- (11) the date a post-Most Efficient Organization (MEO) performance review was completed (if applicable).<sup>61</sup>

Function codes are used to characterize the type of work employees perform.<sup>62</sup> Although only commercial activities are included on agency inventories, this does not mean that all of the activities listed are eligible for cost comparison or direct conversion. Eight of the nine reason codes indicate an activity might not be eligible for a specific reason.<sup>63</sup> For example, a function may be exempted by the agency, an executive order, a waiver, legislation, or OMB. Functions that already have been included in a cost study, and were retained in-house as a result, also are exempt.

After OMB's review and consultation, an agency head is required to make the inventory available to the public and send a copy to Congress. OMB is to publish a notice in the *Federal Register* that the list is available. If any changes occur after initial publication of the list, an agency head is required to make the changes available to the public and submit a list of the changes to Congress. OMB publishes a notice in the *Federal Register*.

## Challenges and Appeals

Interested parties, such as contractors, federal employees, federal labor unions, or business or professional associations, may appeal the omission of an activity from, or the inclusion of an activity on, an agency's list. Challenges must be submitted to the agency within 30 working days after a notice that the list is available has been published in the *Federal Register*. An agency must decide the challenge and respond in writing to the requester within 28 working days<sup>64</sup> of receiving the challenge. An interested party may appeal an adverse decision to the head of an agency within 10 working days after receiving the ruling on the challenge. The agency head has 10 working days to respond in writing.

## Competition

FAIR does not require agencies to compete or convert directly any of the activities listed on their inventories. However, the act does require an agency head to review the list within a reasonable amount of time after it has been made available to the public. If he or she considers contracting out an activity on the list, the agency must use a competitive process, such as A-76, to determine who will provide the service or good. This requirement includes a caveat, though, which allows

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<sup>61</sup> U.S. Office of Management and Budget, *Circular No. A-76 Revised Supplemental Handbook, Performance of Commercial Activities*, March 1996 (updated June 1999), p. 38.

<sup>62</sup> See *Ibid.*, pp. 41-44.

<sup>63</sup> *Ibid.*, p. 39.

<sup>64</sup> Initial guidance on the challenge and appeals process stated that the 30-day period (see preceding sentence in text) and 28-day period were calendar days. After the first round of inventories had been completed, OMB changed the two periods to working days. (U.S. Office of Management and Budget, "Issuance of OMB Circular A-76 Transmittal Memorandum No. 22," *Federal Register*, vol. 65, no. 175, Sept. 8, 2000, p. 54570.)

for exceptions as set forth in another statute, an executive order, regulations, or an executive branch circular.

## Definition of Inherently Governmental

A significant feature of FAIR is that it statutorily defines “inherently governmental.” The FAIR definition states that an inherently governmental function is one “that is so intimately related to the public interest as to require performance by Federal Government employees.” The definition includes a passage that identifies the circumstances under which the interpretation and execution of the laws of the United States are considered inherently governmental; a list of functions normally not considered to be inherently governmental; and two categories into which inherently governmental activities normally fall (the act of governing, and monetary transactions and entitlements).

## Applicability

FAIR applies to executive civilian and military departments and agencies. The General Accounting Office, government corporations, nonappropriated funds instrumentalities, and certain DOD depot-level maintenance and repair functions are exempt from FAIR. Executive agencies that have fewer than 100 full-time employees also are exempt, unless they plan to conduct public-private competitions, and then they must prepare and submit inventories of their commercial activities.<sup>65</sup>

## Implementation

The FAIR Act took effect on October 1, 1998, and the first year’s inventories were due June 30, 1999. OMB issued proposed regulations in March 1999 to implement FAIR through revisions to Circular A-76 and the Supplemental Handbook.<sup>66</sup> OMB issues guidance on FAIR inventories annually, which is available at <http://www.whitehouse.gov/omb/procurement/fair-index.html>.

Although not required by FAIR to submit inventories of their inherently governmental activities, agencies, beginning in 2001, have been required by OMB to submit these inventories along with their commercial activities inventories each year. As with commercial activities inventories, inherently governmental activities inventories are made available to Congress and the public; and, furthermore, agencies must prepare written justifications for activities designated as inherently governmental.<sup>67</sup>

Initially, businesses and trade and professional associations were disappointed and frustrated that not as many activities had been identified as eligible for competition as they had expected or would have liked. The number of potential contracting opportunities was reduced by agencies’ actions. First, agencies identified their inherently government activities, thus removing those activities from consideration as potential candidates for competitive sourcing. About one-third of the challenges filed by industry in response to the 1999 inventories targeted activities that had

<sup>65</sup> Sec. 840 of P.L. 109-115, which amends P.L. 105-270.

<sup>66</sup> U.S. Office of Management and Budget, “Implementation of the Federal Activities Inventory Reform Act of 1998 (P.L. 105-270) (‘The FAIR Act’),” *Federal Register*, vol. 64, no. 39, Mar. 1, 1999, p. 10031.

<sup>67</sup> CRS Report RL32017, *Office of Management and Budget Circular A-76: Selected Issues*, by L. Elaine Halchin.

been left off agencies' inventories.<sup>68</sup> Secondly, in the course of assigning reason codes to commercial activities, agencies exempted some of these functions from consideration for cost study or direct conversion. A comparison between the total number of commercial activities reported and the number eligible for the A-76 program showed that many activities were declared exempt. Industry representatives argued that reason codes were used to shield commercial functions from A-76.<sup>69</sup> The executive director of the Management Association for Private Photogrammetric Surveys argued, after the 1999 lists had been released, that too many positions on the lists were "untouchable," and added:

That was never in the law. It's either commercial or inherently governmental. OMB has far overstepped its legislative authority by allowing agencies to classify over 600,000 positions as commercial that the agencies also say are out of bounds.<sup>70</sup>

As noted above, beginning in 2001, OMB requires agencies to prepare and submit lists of their inherently governmental activities, and OMB's refinement of this policy over the years may have helped to alleviate concerns about the completeness and availability of agencies' inventories. Initially, the only requirement regarding inherently governmental functions was for agencies to submit their inventories of these functions to OMB. As a result of subsequent policy changes by OMB, notably changes effected by the 2003 revision to Circular A-76, inherently governmental inventories are made available to the public; interested parties may challenge activities that are included on, or omitted from, such lists; and a designated agency official must prepare written justifications for activities designated as inherently governmental.<sup>71</sup>

OMB's policy on commercial activities that carry reason code A also may help to alleviate concerns about how agencies use their inventories. Each commercial activity is assigned one of six reason codes which, in short, indicate whether an activity is available or is not available for public-private competition. The six reason codes are as follows:

- A—"The commercial activity is not appropriate for private sector performance pursuant to a written determination by the CSO [the agency's competitive sourcing official]."
- B—"The commercial activity is suitable for a streamlined or standard competition."
- C—"The commercial activity is the subject of an in-progress streamlined or standard competition."
- D—"The commercial activity is performed by government personnel as the result of a standard or streamlined competition ... within the past five years."
- E—"The commercial activity is pending an agency approved restructuring decision (e.g., closure, realignment)."

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<sup>68</sup> U.S. General Accounting Office, *Competitive Contracting: Agencies Upheld Few Challenges and Appeals Under the FAIR Act*, GAO Report GAO/GGD/NSIAD-00-244 (Washington: Sept. 29, 2000), p. 9.

<sup>69</sup> *Ibid.*, p. 11.

<sup>70</sup> Brian Friel, "Agencies Make Few Changes to Outsourcing Lists."

<sup>71</sup> U.S. Office of Management and Budget, Circular A-76, pp. A-1-A-4.

- F—“The commercial activity is performed by government personnel due to a statutory prohibition against private sector performance.”<sup>72</sup>

Circular A-76 requires agencies to prepare and, upon request, make available to the public and OMB written justifications for activities that carry reason code A.<sup>73</sup> Additional guidance issued by OMB in 2005 and 2006 requires agencies to include the written justifications with the inventories they submit to OMB. Additionally, OMB personnel may “request that agencies refine previously submitted justifications for ... reason code A functions if there are questions.”<sup>74</sup>

Unions also have been unhappy with FAIR. Testifying before a subcommittee of the House Committee on Government Reform in 1999, an officer of the American Federation of Government Employees expressed his concern that the private sector was likely to use FAIR inventories as “shopping catalogues.”<sup>75</sup> Part of the concern was that, eventually, FAIR could lead to an increase in contracting out.<sup>76</sup> Comments by industry representatives probably have helped to fuel this concern. As the first commercial activities inventories were being released in fall 1999, a representative of the U.S. Chamber of Commerce, after praising FAIR for its role in generating the inventories, added: “Information is a dangerous thing. You’ll see some increasing pressure from the private sector and Congress to compete the work or outsource it directly....”<sup>77</sup>

Another criticism levied at FAIR by unions is that the legislation requires agencies to report information about their federal employee workforces, but there is no requirement for contractors to report on the size and scope of their workforces. Colleen M. Kelley, national president, National Treasury Employees Union, has argued: “To make public an inventory of the in-house workforce while systematically ignoring the contract workforce presents a skewed picture of the actual work being performed on the federal government’s behalf.”<sup>78</sup>

## Other Competitive Sourcing Initiatives

Issues of public-private competition and contracting out continue to evolve. The Bush Administration is moving ahead with plans to promote competitive sourcing. Within President Bush’s first three months in office, OMB issued three memoranda aimed at, among other things, expanding the use of the A-76 program and FAIR. In accordance with legislation passed during the 106<sup>th</sup> Congress, GAO convened a panel in May 2001 to examine both the circular and FAIR. The panel’s report was released in April 2002. OMB made significant changes to Circular A-76 in

<sup>72</sup> Ibid., p. A-3.

<sup>73</sup> Ibid.

<sup>74</sup> Clay Johnson III, Deputy Director for Management, U.S. Office of Management and Budget, “2006 Inventories of Commercial and Inherently Governmental Activities,” memorandum M-06-08, Mar. 8, 2006, available at <http://www.whitehouse.gov/omb/memoranda/fy2006/m-06-08.pdf>.

<sup>75</sup> U.S. Congress, House Committee on Government Reform, Subcommittee on Government Management, Information, and Technology, *The Implementation of the Federal Activities Inventory Reform Act*, hearing, 106<sup>th</sup> Cong., 1<sup>st</sup> sess., Oct. 28, 1999, (Washington: GPO, 1999), p. 31.

<sup>76</sup> Ibid.

<sup>77</sup> Brian Friel, “Contractors Eye Job Lists; Agencies Try to Retain Work,” *GovExec.com*, Daily Briefing, Oct. 4, 1999, available at <http://www.govexec.com/dailyfed/1099/100499b1.htm>.

<sup>78</sup> U.S. Congress, House Committee on Government Reform, Subcommittee on Government Management, Information, and Technology, *The Implementation of the Federal Activities Inventory Reform Act*, hearing, 106<sup>th</sup> Cong., 1<sup>st</sup> sess., Oct. 28, 1999 (Washington: GPO, 1999), pp. 55-56.

2003, releasing its revision May 29, 2003. A statutory reporting requirement was enacted during the 109<sup>th</sup> Congress, and other legislation that includes one or more competitive sourcing provisions has been enacted since the 106<sup>th</sup> Congress.

## Bush Administration's Competitive Sourcing Initiative<sup>79</sup>

Following up on a position he took during his presidential campaign,<sup>80</sup> President Bush, in early 2001, directed executive agencies and departments to plan for competing some of the commercial activities listed on their FAIR inventories.<sup>81</sup> An OMB memorandum, issued February 14, 2001, notified agencies and departments that the President envisioned a government that would be citizen-based, results-oriented, and market-driven. The five governmentwide reforms announced in the memorandum were: “delaying management levels to streamline organizations; reducing erroneous payments to beneficiaries and other recipients of government funds; making greater use of performance-based contracts; expanding the application of on-line procurement and other E-Government services and information; and, expanding A-76 competitions and more accurate FAIR Act inventories.”<sup>82</sup> Agencies were instructed to include performance goals for these reforms in the performance plans they submit under the Government Performance and Results Act (GPRA) of 1993.<sup>83</sup> A major feature of the Administration's competitive sourcing initiative has been OMB efforts to increase agency involvement in public-private competitions. Detailed information about these efforts may be found in CRS Report RL32079, *Federal Contracting of Commercial Activities: Competitive Sourcing Targets*.

## Commercial Activities Panel (CAP)

During the 106<sup>th</sup> Congress, Senator John Warner proposed an amendment to S. 2549,<sup>84</sup> S.Amdt. 3464, that directed the General Accounting Office to create a panel to study Circular A-76 and related issues. Taking note of concerns voiced by federal employee unions and private industry about Circular A-76, Senator Warner concluded that an objective, systematic study of the competitive sourcing process was needed.

Section 832 of P.L. 106-398<sup>85</sup> contains the Warner amendment (which was originally designated Section 814) with clarifying language added by the House of Representatives. The House added a

<sup>79</sup> This initiative is part of the President's Management Agenda, which is reviewed in CRS Report RS21416, *The President's Management Agenda: A Brief Introduction*, by Virginia A. McMurtry.

<sup>80</sup> In a speech on June 9, 2000, then presidential candidate Bush said: “Today, hundreds of thousands of full-time federal employees perform tasks that could be done by the private sector. I will put as many of these tasks as possible up for competitive bidding. If the private sector can do a better job, it should get the contract.” (Tichakorn Hill, “OMB Plans To Compete 400,000 More Jobs,” *Federal Times*, vol. 37, no. 3, Feb. 19, 2001, p. 1.)

<sup>81</sup> These initiatives were incorporated in *The President's Management Agenda*, which was released by the Executive Office of the President and OMB in August 2001.

<sup>82</sup> U.S. Office of Management and Budget, “Performance Goals and Management Initiatives for the FY 2002 Budget,” Memorandum M-01-11, Feb. 14, 2001, p. 2. Available at <http://www.whitehouse.gov/omb/memoranda/m01-11.html>.

<sup>83</sup> 5 U.S.C. prec. 301, 306; 31 U.S.C. 1101 & nt, 1105, 1115-19, prec. 9701, 9703-4; 39 U.S.C. prec. 2001, 2801-05. P.L. 103-62, 107 Stat. 285; P.L. 103-62; 107 Stat. 285.

<sup>84</sup> S. 2549 was a defense authorization bill. It was incorporated as an amendment into the bill, H.R. 4205, that passed as the Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398, 114 Stat. 1654A-1, at 1654A).

<sup>85</sup> Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001; 114 Stat. 1654A-1, at 1654A-221.

list of topics for the panel to study; specified that the panel would include the Department of Defense and the Office of Management and Budget; explicitly identified the comptroller general, or his designee, as the chairman of the panel; and added to the instructions for report preparation and submission a deadline and a requirement to report recommended changes.

Section 832 directed GAO to establish a panel of experts to examine Circular A-76 and FAIR and report its findings to Congress no later than May 1, 2002. The topics and issues studied by the panel included:<sup>86</sup>

- (1) procedures for determining whether functions should continue to be performed by Government personnel;
- (2) procedures for comparing the costs of performance of functions by Government personnel and the costs of performance of such functions by Federal contractors;
- (3) implementation by the Department of Defense of the Federal Activities Inventory Reform Act of 1998 (P.L. 105-270; 31 U.S.C. 501 note);<sup>87</sup>
- (4) procedures of the Department of Defense for public-private competitions pursuant to the Office of Management and Budget Circular A-76.

The comptroller general was directed to ensure that the Department of Defense, private industry, federal labor organizations, and OMB “receive fair representation” on the panel and that other interested parties have the opportunity to submit information and their views. Comptroller General David M. Walker chose to chair the Commercial Activities Panel (CAP), and he appointed these individuals to serve on it:<sup>88</sup>

- Dr. Frank A. Camm, senior economist, RAND
- Mark Filteau, president, Johnson Controls World Services
- Stephen Goldsmith, former mayor of Indianapolis
- Bobby L. Harnage Sr., national president, American Federation of Government Employees
- Colleen M. Kelley, national president, National Treasury Employees Union
- Sean O’Keefe, administrator, National Aeronautics and Space Administration
- Angela Styles, administrator, Office of Federal Procurement Policy<sup>89</sup>
- Senator David Pryor (retired), director, Institute of Politics, Harvard University
- Stan Z. Soloway, president, Professional Services Council

<sup>86</sup> Section 832(a) of P.L. 106-398.

<sup>87</sup> Despite the fact that the Department of Defense is featured in this list, the scope of the panel’s work is governmentwide.

<sup>88</sup> U.S. General Accounting Office, “Commercial Activities Panel,” *Federal Register*, vol. 66, no. 74, April 17, 2001, p. 19786.

<sup>89</sup> Sean O’Keefe served as OMB’s representative to the panel through December 2001. After he took over as administrator of NASA, Angela Styles replaced him on the panel.

- Robert M. Tobias, distinguished adjunct professor, and director of the Institute for the Study of Public Policy Implementation, American University
- Kay Coles James, director, Office of Personnel Management
- Edward C. Aldridge, under secretary of defense for acquisition and technology

The initial meeting of the panel, which focused on organizational issues, was held on May 8, 2001, in Washington, D.C.<sup>90</sup> CAP held 11 meetings, including three public hearings, during its year-long study. On April 30, 2002, the panel issued its report, *Improving the Sourcing Decisions of the Government*, which covers the current sourcing system, trends and challenges, and the panel's review, findings, and four recommendations. The report also includes individual statements from the panel members.

The panel recommended that the government adopt a set of 10 sourcing principles, make limited changes to Circular A-76, develop and demonstrate an integrated competition process that would draw from both the FAR and Circular A-76, and promote the development of high-performing organizations (HPOs).<sup>91</sup> The 10 sourcing principles are

- Support agency missions, goals, and objectives.
- Be consistent with human capital practices designed to attract, motivate, retain, and reward a high-performance federal workforce.
- Recognize that inherently governmental and certain other functions should be performed by federal workers.
- Create incentives and processes to foster high-performing, efficient and effective organizations throughout the federal government.
- Be based on a clear, transparent, and consistently applied process.
- Avoid arbitrary full-time equivalent (FTE) or other arbitrary numerical goals.
- Establish a process that, for activities that may be performed by either the public or the private sector, would permit public and private sources to participate in competitions for work currently performed in-house, work currently contracted to the private sector, and new work, consistent with these guiding principles.
- Ensure that, when competitions are held, they are conducted as fairly, effectively, and efficiently as possible.
- Ensure that competitions involve a process that considers both quality and cost factors.
- Provide for accountability in connection with all sourcing decisions.

In addition to recommending that government adopt these sourcing principles, the panel incorporated them into its three other recommendations.<sup>92</sup>

<sup>90</sup> U.S. General Accounting Office, "Formation of the Commercial Activities Panel," press advisory, Apr. 16, 2001.

<sup>91</sup> Commercial Activities Panel, *Improving the Sourcing Decisions of the Government* (Washington: U.S. General Accounting Office, 2002), pp. 46-53.

<sup>92</sup> *Ibid.*, pp. 46-49.

In its recommendation for making limited changes to Circular A-76, the panel identified 14 items and described, briefly, what needs to be done in each area. The thrust of making limited changes is to provide greater accuracy and enhanced accountability, and ensure greater fairness. A key feature of this recommendation is the expectation that the changes could be implemented expeditiously and without legislation.<sup>93</sup>

The integrated competition process, the panel's third recommendation, would be based on the Federal Acquisition Regulation (FAR) and would incorporate some elements of Circular A-76. Drawing from the FAR, for example, could result in the same evaluation team reviewing all proposals and the elimination from consideration of any proposals judged to have no reasonable chance of being selected.<sup>94</sup> The panel recommended that the integrated competition process borrow from the circular, among other things, the concept of the most efficient organization and the A-76 cost conversion differential.<sup>95</sup>

Separate and distinct from the issue of competitive sourcing, the panel recommended that government promote the development of high-performing organizations (HPOs).<sup>96</sup> The panel also stated, though, that an organization or work center designated as an HPO could be exempted from competitive sourcing for a specified period of time.

## 2003 Revision to Circular A-76

The most recent revision to the circular was issued by OMB on May 29, 2003. In addition to replacing the 1999 version, OMB indicated that the 2003 revision

supersedes and rescinds ... OMB Circular No. A-76 Revised Supplemental Handbook (Revised 2000), March 1996; OMB Circular No. A-76 Transmittal Memoranda Nos. 1-25; and Office of Federal Procurement Policy (OFPP) Policy Letter 92-1, *Inherently Governmental Functions*, September 23, 1992.<sup>97</sup>

Some of the major changes effected by the 2003 revision include the elimination of direct conversions, the modification of the definition of "inherently governmental," identifying the government's response to a solicitation as an "agency tender," and removing the guarantee that an agency tender will still be under consideration when the performance decision is made. For detailed information about the 2003 circular, see CRS Report RL32017, *Office of Management and Budget Circular A-76: Selected Issues*, by L. Elaine Halchin.

<sup>93</sup> Commercial Activities Panel, *Improving the Sourcing Decisions of the Government*, pp. 51-52.

<sup>94</sup> *Ibid.*, p. 50.

<sup>95</sup> *Ibid.*

<sup>96</sup> Commercial Activities Panel, *Improving the Sourcing Decisions of the Government*, pp. 52-53, 82-84. One definition of HPOs states that they "are groups of employees who produce desired goods or services at higher quality with the same or fewer resources. Their productivity and quality improve continuously, from day to day, week to week, and year to year, leading to the achievement of their mission." (Jack A. Briziu, et al., *Creating High-Performance Government Organizations* (San Francisco: Jossey-Bass, 1998), p. 11. Another, process-oriented definition states that an HPO is "an organizational system that continually aligns its strategy, goals, objectives, and internal operations with the demands of its external environment to maximize organizational performance." (Bradley L. Kirkman, Kevin B. Lowe, and Dianne P. Young, *High-Performance Work Organizations: Definitions, Practices, and an Annotated Bibliography* (Greensboro, NC: Center for Creative Leadership, 1999), p. 8 (italics in original).

<sup>97</sup> U.S. Office of Management and Budget, "Performance of Commercial Activities," *Federal Register*, vol. 68, no. 103, May 20, 2003, p. 32134 (italics in original).

## Congressional Reporting Requirement

Under Section 647(b) of P.L. 108-199, agencies are required to submit to Congress by December 31 of each year a report on their competitive sourcing activities. Additionally, agencies are required to submit their reports to, and have them cleared by, OMB prior to transmitting their reports to Congress.<sup>98</sup> Each agency report is to include:

- (1) the total number of competitions completed;
- (2) the total number of competitions announced, together with a list of the activities covered by such competitions;
- (3) the total number (expressed as a full-time employee equivalent number) of the Federal employees studied under completed competitions;
- (4) the total number (expressed as a full-time employee equivalent number) of the Federal employees that are being studied under competitions announced but not completed;
- (5) the incremental cost directly attributable to conducting the competitions identified under paragraphs (1) and (2), including costs attributable to paying outside consultants and contractors;
- (6) an estimate of the total anticipated savings, or a quantifiable description of improvements in service or performance, derived from completed competitions;
- (7) actual savings, or a quantifiable description of improvements in service or performance, derived from the implementation of competitions completed after May 29, 2003;
- (8) the total projected number (expressed as a full-time employee equivalent number) of the Federal employees that are to be covered by competitions scheduled to be announced in the fiscal year covered by the next report required under this section; and
- (9) a general description of how the competitive sourcing decisionmaking processes of the executive agency are aligned with the strategic workforce plan of that executive agency.<sup>99</sup>

OMB also provides a consolidated report to Congress on agency competitive sourcing efforts.<sup>100</sup>

## Competitive Sourcing Statutes and Provisions

Following the enactment of FAIR in 1998 and the passage of legislation in the 106<sup>th</sup> Congress that established the Commercial Activities Panel, there have been a number of bills passed—notably, appropriations bills—in subsequent Congresses that include one or more competitive sourcing provisions. Competitive sourcing targets and funding limits on competitive sourcing activities are examples of procedures or policies that have been addressed by one or more statutes. For

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<sup>98</sup> Paul A. Denett, Administrator, Office of Federal Procurement Policy, *Report to Congress on FY2006 Competitive Sourcing Efforts*, memorandum M-01-01, Oct. 5, 2006, available at <http://www.whitehouse.gov/omb/memoranda/fy2007/m07-01.pdf>.

<sup>99</sup> Sec. 647(b) of P.L. 108-199.

<sup>100</sup> OMB's competitive sourcing reports are available at [http://www.whitehouse.gov/omb/procurement/index\\_comp\\_sourcing.html](http://www.whitehouse.gov/omb/procurement/index_comp_sourcing.html).

additional information, see CRS Report RL32833, *Competitive Sourcing Statutes and Statutory Provisions*, by L. Elaine Halchin.

## **Conclusion**

The Federal Activities Inventory Reform Act of 1998 is a significant legislative initiative in a long line of efforts aimed at encouraging the competitive sourcing and outsourcing of commercial activities. Coupled with Circular A-76, it provides the means for cataloguing government activities, as either inherently governmental or commercial, and for conducting cost comparison studies, or converting commercial functions directly to contract.

Nearly a half century has passed since the Bureau of the Budget issued its first bulletins on the policy of governmental reliance on the private sector, and as a principle the policy appears to be firmly entrenched. Although Congress acted in 1998 to provide statutory backing to the policy in FAIR, debate continued on how best to implement the policy and promote agency participation. The ongoing debate over public-private competition and contracting out reflects, in some instances, a fundamental disagreement over the so-called division of labor between government and the private sector and the implications that might follow from particular arrangements. Congress may wish to examine this issue, including FAIR and Circular A-76, in light of the Bush Administration's policies on competitive sourcing.

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