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POLICY NOTE

# How Competitive Contracting Can Help Balance the Budget without Raising Taxes

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### Key Findings

1. Competitive contracting at the state and local level has resulted in documented savings nationally ranging from 10% to 20%.
2. Before 2002, Washington state agencies were barred by law from competitively bidding any public services that had traditionally been provided by state employees.
3. In 2002, the legislature passed the Personnel System Reform Act that provided beginning in July 2005, agency managers could seek competitive bids to lower the cost of delivering services to the public
4. A 2007 performance audit conducted by the Joint Legislative Audit and Review Committee (JLARC), however, found "…few agencies have competitively contracted for services in the 16 months since receiving authorization to do so.
5. A 2009 WPC survey of 20 state agencies found little contracting is occurring under the 2002 law.

## Introduction

Washington lawmakers again face a multi-billion dollar budget deficit, meaning they will either increase the amount of money they collect from citizens each year, or re-evaluate the way they deliver core services to the public. Increasing taxes during a recession would add economic hardship, while changing the way services are delivered offers part of the solution to closing the deficit without raising taxes.

One tool available for improving service delivery is Washington's competitive contracting law, passed as part of civil service reform and signed by Governor Gary Locke in 2002. The legislature and Governor Locke authorized state agencies to open up public work traditionally held as an in-house government monopoly to competitive bids from the open market. Public employees are encouraged to participate in the bidding process, because the intent of the law is not to benefit private companies, but to secure the best service for the public no matter who does the work.

In practice, however, state managers rarely exercise their statutory contracting out authority, meaning an important provision of the 2002 civil service law remains largely unused.

With the current budget crisis, lawmakers and the governor should take full advantage of every opportunity to promote the efficient delivery of routine state services, so tax money can be freed up to fund high-priority core functions of government. State elected leaders should fix weaknesses in the contracting out law, and direct agency managers to use competition to reduce the cost of operating state programs.

Specifically, state leaders should simplify the operation of the 2002 competitive contracting law and, like other states, create a Government Competition Council to assist managers in identifying public services that could be improved through competitive contracting. This study presents recommendations showing how these policy goals can be achieved.

## Taxpayer Savings from Competitive Pricing are 10% to 20%

Most state work is done on a monopoly basis; only in-house public sector workers are permitted to perform most services, no matter what waste or inefficiency it may involve. Leaders of public sector unions strongly support

the monopoly policy, because a portion of all public money paid in salaries is transferred to their unions in the form of mandatory monthly dues.

The burden of this restrictive policy is felt every day by ordinary taxpayers who must bear the cost of maintaining a full-time government workforce regardless of the amount of work needed to provide services. Without the benefits of competition, state agencies spend more than they need to for routine work, often paying well above what private companies do to get the same job done.

Dozens of states and cities across the country have cut costs and improved service by opening government work to competition. Research by the Reason Foundation finds that competitive contracting at the state and local level has resulted in documented savings ranging from 10% to 20% (Reason Foundation analysts note this is a conservative estimate).[1]

Independent reviews of real-world experience in Massachusetts found that competitive bidding generated savings of over 20%, with a higher level of service to the public than the agency was able to achieve under the previous in-house monopoly. Texas, Virginia and a number of other states have seen similar gains from competitive contracting policies, helping to ease the pressure on overstrained state budgets.[2]

The option seeking competitive pricing gives program managers greater flexibility in working with scarce public resources. Competition achieves higher efficiency by allowing managers to choose the best-cost option while delivering better-quality service to the public. Even when work is not selected for competitive bidding, the very possibility tends to drive down the cost of an agency's in-house operations, as state workers are motivated to find better ways to serve the public at lower cost.

## Effort to End the Ban on Contracting out

Before 2002, state agencies were barred by law from competitively bidding any public services that had traditionally been provided by state employees. The ban stemmed from a court ruling in the 1978 Spokane Community College case which blocked administrators from hiring a private company to clean newly-constructed school buildings and using the savings to augment the college's education programs. Public-sector union leaders filed the lawsuit to prevent college administrators from loosening the in-house monopoly on janitorial work.

Union leaders sought to have the legislature make the ruling binding on all state agencies, colleges and universities. The legislature soon codified the Spokane decision, establishing a state-wide rule that any work historically performed by state workers always had to always be performed by state workers.[3] College presidents and agency managers were not allowed to consider bids from private companies, even if the same amount and quality of work could be achieved at lower cost to taxpayers.

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[1] "Streamlining San Diego: Achieving Taxpayer Savings and Government Reforms Through Managed Competition," by Geoffrey F. Segal, Adam B. Summers, Leonard C. Gilroy, AICP and W. Erik Bruvold, Reason Foundation, September 2007, at www.reason.org/files/db38316bd23c0beef9d021a9fd7af1ea.pdf.

[2] "From Public to Private: The Massachusetts Experience 1991 – 1993," by David Gown et al., John F. Kennedy School of Government, Cambridge Massachusetts, 1993, page 40, and "Independent Assessment of Massachusetts Highway Maintenance Privatization Programs," Coopers and Lybrand LLP, June 1996.

[3] *Washington Federation of State Employees v. Spokane Community College*, 90 Wash. 2d 698, 585 P. 2d 474 (1978) and codified by the legislature as Revised Code of Washington 41.06.380.

The ban on contracting out public services remained in place until 2002, when the legislature passed the Personnel System Reform Act.[4] The new law provided that, beginning in July 2005, agency managers could seek competitive bids to lower the cost of delivering services to the public.

The competitive contracting provision was part of a political compromise crafted to gain bipartisan support for the bill. For years a top lobbying priority for public-sector union leaders had been to secure a mandatory collective bargaining law, so they could seek pay and benefit increases directly from the governor, instead of going through the normal legislative process. Democratic and Republican members of the legislature agreed that the collective bargaining provision could pass if union leaders agreed to include contracting out authority as well.

Bill sponsors believed that the higher salary and benefits costs resulting from mandatory collective bargaining would be off-set by the greater efficiency gained from ending the monopoly on delivering public services.

In the years since, however, only half of the bill's intent has been accomplished. Public-sector salary and benefit costs have increased, but artificial limitations on the use of competitive contracting have prevented the expected savings from being realized. The primary reason is that an agency's contracting out authority is itself subject to mandatory collective bargaining.

Not surprisingly, union leaders seeking to maintain an in-house monopoly generally make bargaining away their agency's contracting out authority a top negotiating priority. On the whole, they have been successful at inducing state managers to maintain the ban on contracting out.

A 2007 performance audit conducted by the Joint Legislative Audit and Review Committee (JLARC) found that:

> "…few agencies have competitively contracted for services in the 16 months since receiving authorization to do so. Agency managers reported two main reasons for not competitively contracting. First, managers perceive the process itself to be complicated and confusing, providing a disincentive to pursue competitive contracting.
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> Second, competitive contracting is a subject of collective bargaining, which creates additional challenges by requiring labor negotiations. Managers must bargain, at a minimum, the impacts of competitive contracting. Additionally, some agency collective bargaining agreements include provisions which prohibit agencies from competitively contracting."[5]

## Survey of Agency Use of Competitive Bidding

In a 2009 update of the JLARC audit, Washington Policy Center asked the state Office of Financial Management's contract division how many personal service contracts have been requested or approved by agencies under the "Civil Service Competition" provision of the 2002 law. The answer was zero.[6]

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[4] Substitute House Bill 1268, "Personnel System Reform Act of 2002," signed by Governor Locke on April 13, 2002.
[5] "Performance Audit of the Implementation of Competitive Contracting," Joint Legislative Audit and Review Committee (JLARC), January 2007.
[6] "Re: JLARC contracting audit," e-mail to the author from Laura Wood, Contract Staff Consultant, Office of Financial Management, July 8, 2009.

Washington Policy Center analysts then conducted a direct survey of twenty state agencies to determine whether and to what extent managers were using their competitive bidding authority under the 2002 law. The agencies included in the survey were:

- Department of Personnel,
- Department of Social and Health Services,
- Department of Ecology,
- Department of Employment Security,
- Department of Revenue,
- Department of Commerce,
- Department of Licensing,
- Department of Natural Resources,
- Department of Labor and Industries,
- Department of Fish and Wildlife,
- Department of Health,
- Department of General Administration,
- Office of Superintendent of Public Instruction,
- State Health Care Authority,
- The State Patrol,
- State Parks,
- Evergreen State College,
- Washington State University,
- Western Washington University,
- University of Washington.

Of all the agencies surveyed, only the Health Care Authority reported it had used competitive contracting under the 2002 law. Typical of agency responses was this answer from Washington State University:

> "I have been advised that WSU has not executed any contracts under this 2002 Civil Service Reform/RCW 41.06.142 process. It's apparently a complicated process and the administrative decision was made early on that WSU would not participate or take any action that would implicate this process (i.e., contract for purchased services that would displace classified staff)."[7]

The primary flaw lawmakers included in the 2002 civil service law was making an agency's contracting out authority subject to collective bargaining. Public-sector unions have a strong financial incentive to induce agency managers to surrender their ability to seek lower prices, because the agency's work is then reserved for union members, regardless of cost to taxpayers.

## Union Challenge of State Competitive Bidding Rules

In addition to using the collective bargaining process, leaders of one public-sector union filed suit against the state to stop a competitive bidding process from being put in place. In 2008, leaders of the Washington Federation of State Employees (WFSE) sued to strike down three competitive bidding rules drafted by managers of the Department of General Administration. Department officials drafted the rules to help agencies implement the competitive contracting provisions of the 2002 civil service reform law. The Department was not soliciting bids or selecting which public services might be opened to competitive pricing.

[7] "Response to request for information," e-mail to the author from Linda Nelson, Public Records Coordinator, Washington State University, July 28, 2009.

In their lawsuit, union leaders essentially sought to re-instate the ban on contracting out that existed before the legislature passed the 2002 law.[8] They argued that General Administration managers had exceeded their statutory authority in adopting the competitive contracting rules.

In arguing on behalf of taxpayers, attorneys for the state explained that lawmakers included mandatory collective bargaining and ending the ban on contracting out in the same bill as part of an agreement made in the legislature and with Governor Locke.

> ". . . the Federation [union] argued that RCW 41.06.142 was intended to continue in place the statutory and judicial restrictions against contracting out that were in place prior to the 2002 act. The Federation is incorrect in this assertion.
>
> As discussed above, the 2002 reform act rested on three 'legs': Granting greater collective bargaining rights to state employees; removing the general restriction against state agencies to contracting for services customarily and historically performed by civil service employees; and making various changes to the civil service system. The Federation's view that the 2002 reform act essentially retained the severe limitations on contracting out that were in existence prior to 2002 fails to acknowledge the political trade-offs that made passage of the 2002 act possible."[9]

The state further explained that lawmakers included mandatory collective bargaining and ending the ban on contracting out in the same bill because they wanted the two policies to work together:

> "In exchange for full-scope collective bargaining, which some unions had been seeking for decades, state agencies got most of the restrictions lifted on contracting out civil service work. The legislature did not retain the general prohibition against agencies contracting for services customarily and historically performed by civil service employees. On the contrary, it repealed the statute (former RCW 41.06.380) that had embodied that general prohibition."[10]

Thurston County Superior Court Judge Chris Wickham ruled in favor of the union. The state, acting on behalf of taxpayers, appealed, but the ruling was affirmed by the Appeals Court Division II in 2009.

The courts' decision to strike down the General Administration's competitive bidding process, combined with the obstacle created by making contracting out authority subject to collective bargaining, explains why competitive pricing and lower cost public services, though existing on paper, have never been put into practice.

## Examples of States that Have Benefitted from Competitive Pricing

Washington lags considerably behind most other states in using competition to improve service and reduce costs in delivering public services. Rather than starting from scratch, Washington officials can learn important lessons from the experiences of other states. Three examples are described below.

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[8] At issue were the meaning of Washington Administrative Code provisions 236-51-006, 236-51-010(11) and 236-51-225.

[9] Washington State Attorney General legal brief in *Washington Federation of State Employees v. Department of General Administration,* October 8, 2008 at www.washingtonpolicy.org/Centers/government/WFSEvGAbrief.pdf.

[10] Ibid..

**Florida** – In 2006, lawmakers in Florida created the Council on Efficient Government to help managers at state agencies focus their public workforce on carrying out each agency's core mission, while hiring outside contractors to perform lower-priority work. The Council's goal is to "... deliver services by outsourcing or contracting with private sector vendors whenever vendors can more effectively and efficiently provide services and reduce the overall cost of government." [11]

The Council evaluates state services for feasibility and cost-effectiveness before any public work is considered for competitive bidding. If a bidding process would not reduce costs to the public, the work is not contracted out. The Council saved Florida taxpayers $53 million in 2008.

**Texas** – In 1993, Texas lawmakers created the Council on Competitive Government to identify opportunities within state agencies to lower costs through competition. The legislature gave the Council instruction to "... identify, study and finally determine if a service performed by one or more state agencies may be better provided through alternate service methods, including competition with state agencies that provide the service or commercially available sources."[12] In implementing this strategy the Council saved the people of Texas tens of millions of dollar over the years; saving $21 million in 2008 alone.

**Louisiana** – In 2009, lawmakers in Louisiana created the Commission on Streamlining Government. Commission members review each state agency's functions, programs and services to see if they fit one of five criteria for reducing costs. Commissioners determine whether a program can be: 1) eliminated; 2) streamlined; 3) consolidated; 4) privatized; or 5) outsourced.[13]

The Commission's overall goal is to reduce the size of government and lower the financial burden the state places on its citizens. Lawmakers have given the Commission the responsibility of finding $802 million in savings in 2010-11 budget while maintaining core services to the public.[14]

## Proposed Competition Council in Washington

Following the successful example of other states, Washington senators Linda Evans Parlette and Joe Zarelli introduced a bill in Olympia to create a Washington Competition Council.[15]

The bill proposes that a Competition Council would be established within the Office of Financial Management and would conduct a thorough review to: 1) examine the commercial activities being done by state employees; 2) identify programs in which state agencies take business opportunities away from private companies; 3) develop proposals to preserve and promote the role of private enterprise in the state; 4) encourage the creation of new businesses and jobs in Washington.

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[11] Florida Council on Efficient Government at http://dms.myflorida.com/other_programs/council_on_efficient_government.
[12] Texas Council on Competitive Government at www.ccg.state.tx.us/principles.html.
[13] Louisiana Senate Bill 261of 2009 at www.legis.state.la.us/billdata/streamdocument.asp?did=668938.
[14] "Streamlining Government Commission Accepts First Recommendations to Make State Government More Efficient," Louisiana Commission on Streamlining Government, Senator Jack Donahue, Chairman, October 13, 2009 at http://senate.legis.state.la.us/streamline/releases/2009/10-13-2009.pdf
[15] Senate Bill 5409, "Creating a Washington competition council," introduced January 21, 2009, at http://apps.leg.wa.gov/documents/billdocs/2009-10/Pdf/Digests/Senate/5409.DIG.pdf.

The Council's mission would be to identify opportunities for state agencies to contract out commercial activities in ways that reduce costs for taxpayers and provide a measurable benefit to the people of the state. The Director of the Office of Financial Management would be required to report to the legislature the budget savings achieved through competitive pricing. Consistent with the experiences of other states, Washington officials could expect to reduce the cost of delivering services contracted by 10% to 20%.

## Conclusion

The benefits of competitive pricing that the legislature and Governor Locke expected to achieve from the Personnel System Reform Act of 2002 have not been realized. A performance audit investigation by JLARC staff, supported by Washington Policy Center's independent survey of major agencies, finds that state managers have done almost nothing over a seven year period to carry out the legislature's intended competitive pricing policy.

This is not because agency managers are not interested in lowering the cost of delivering public services. State employees routinely looks for ways to do their jobs better and to make their agency's budget go farther. The reason is that managers face two insurmountable obstacles in seeking savings from ending in-house monopolies and moving to competition.

First, the 2002 law made competitive bidding subject to mandatory collective bargaining negotiations. Leaders of public sector unions have made no secret of their stout opposition to any form of competition, seeing the possibility of contracting out as threatening their access to government workers. Among the key provisions of most mandatory collective bargaining agreements adopted since 2002 is the restriction or elimination of an agency's ability to seek lower prices through competition.

Second, a successful 2008 lawsuit filed against the state by leaders of public sector unions has made it difficult or impossible for an agency to implement a competition program if a state worker might become a "displaced employee" as a result. Given these severe limitations, competitive bidding in Washington remains an impressive management tool in theory but is completely useless in practice.

## Policy Recommendations:

Lawmakers in Olympia can gain the benefits of competition and fully implement the intent of the 2002 civil service law by adopting the following policy recommendations.

1. Lawmakers should simplify the 2002 competitive contracting law while removing the requirement that contracting be subject to collective bargaining negotiations with public sector unions. This would allow managers to use all the tools the legislature has provided to deliver services to the public in a way that makes best use of taxpayer money.

2. Lawmakers should create a Washington Competition Council to provide agencies assistance in identifying services that could benefit from competitive contracting and report these savings to the legislature and the public.

Public employees should be encouraged to participate in competitive bidding processes, but union leaders should not be able to exercise a veto over

a management decision that a public service can be improved and streamlined through price competition. Adopting a formal Competition Council would help agency managers identify cost savings and public services that could be improved through competitive contracting.

Letting state agencies use competitive pricing to lower the cost of delivering public services, and at the same time improve service quality, is one of the reforms necessary to solving the state's long-term deficit problem. Properly implemented, a well-managed competitive pricing policy would lead to a more cohesive state government that focuses on core services, while using competition to tap the efficiencies of the open marketplace.

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