

Federal Agency Insourcing: Why Government Costs So Much

March 2011 By Daniel Gouré

Over the past two years, the Obama administration has constructed a maze of executive orders, directives, regulations and findings all for the purpose of reversing more than a decade of outsourcing government work to the private sector.

The policy is now insourcing, which is the replacement of private sector workers with government employees. The overall effect is that tens of thousands, maybe even hundreds of thousands, of jobs that were once in the private sector have migrated into the public domain with all the attendant disruption of ongoing work and additional costs.

In 2009, Secretary of Defense Robert Gates went well beyond the administration's campaign to protect work deemed inherently governmental when he announced a major policy shift that sought to reduce the department's reliance on private contractors and increase the number of government employees involved in oversight, management and planning of defense activities and procurement programs.

One stated objective of the secretary's program was to save money by shifting work done by the private sector into the public defense industrial base. Defense Department components used the secretary's directives on insourcing to bring work successfully performed by the private sector or by collaborative public-private teams back within the government.

Central to the logic that underpinned the Defense Department's insourcing campaign was the assertion that such work could be performed more cheaply by the public defense industrial base. Pentagon sources estimated an average savings of \$44,000 a year for every contractor it replaces with full-time federal personnel. One government insourcing directive asserted that the public defense industrial base was 40 percent cheaper than the comparable private sector. Business case analyses conducted by the Defense Department on maintenance and support work appeared to confirm the assertion of a cost differential in favor of the public work force.

Yet, readily available public data strongly refutes assertions that the public sector work force is cheaper than its private sector counterparts. A study by the Cato Institute using federal government data concluded that in 2009, the average federal civilian wage was \$81,258 per year, compared with \$50,462 in the private sector. Using similar data, USA Today also reported a significant gap between public and private sector workers. Moreover, the gap between average federal salaries and those in the private sector is widening. In 2000, federal workers earned \$51,518 compared to the private sector's \$38,862 or a differential of approximately 40 percent. By 2009, that gap had widened to more than 60 percent.

Not only do federal workers receive higher salaries than their private sector counterparts, but they also receive more in benefits. USA Today reported that based on data from the Bureau of Economic Analysis, federal workers "earned average pay and benefits of \$123,049 in 2009 while private workers made \$61,051 in total compensation." In addition, "the federal compensation advantage has grown from \$30,415 in 2000 to \$61,998 last year." According to the Center for Data Analysis, the average private-sector employer pays \$9,882 per employee in annual benefits, while the federal government pays an average of \$32,115 per employee.

In addition to the extreme value of benefits received, federal workers also pay considerably less for benefits such as health care. In his Jan. 6 statement on the defense budget and efficiency measures, Gates noted that the current TRICARE enrollment fee was \$460 a year for the basic family plan and has not been raised since 1995. He noted that the average cost to federal civilian workers for their health care benefits was \$5,000. This may seem like a lot of money. However, according to an industry study, the average cost of a family plan in the private sector is over \$6,300. So, federal workers gain twice; they pay less for better benefits.

Federal workers enjoy a range of benefits far in excess qualitatively as well as quantitatively as compared to their private sector counterparts. For example, the typical government employee gets a guaranteed defined benefit pension under very generous terms, while the private sector norm is a 401(K) defined contribution plan that is subject to the ups and downs of the economy. Federal workers also have access to an array of benefits rarely matched in the private sector. These include:

- FEHBP Health Care (no waiting period or eligibility requirements)
- Thrift Savings Plan + 5% Agency Match
- FERS Defined Pension Benefit Program (Full retirement and pension at age of 56 possible with 30 years' service)
- Leave (0-2 years: 13 days; 3-15 years: 20 days; >15 years: 26 days)
- Holiday Pay (10 days/year)
- Service Credit for Unused Sick Leave
- Public Transportation Reimbursement
- Life Insurance
- Long-term Care Insurance

A 2007 study of the federal work force by the Congressional Budget Office provides at least a partial explanation why it is on average more expensive than the comparable private sector personnel. According to the CBO, the federal work force had a "higher concentration — relative to the private sector — of jobs among management, professional, and related occupational categories. Correspondingly, because people in such occupations tend to be older, more experienced, and more highly educated, the average age and educational attainment of federal workers are higher than those of private-sector workers."

Given the structure of the federal pay system and the rewards that accrue to individuals based on seniority, time in service and educational attainment, it is not surprising that average salaries exceed those in the private sector. It is also worth noting that since the CBO report was written, the characteristics to which it referred and that caused the average salaries of government workers to exceed those of the private sector have become even more pronounced.

The differential between public and private wage rates exists across multiple occupations. This includes blue collar and skilled artisan trades where education and age differences matter little, if at all, to actual performance. USA Today noted that the federal pay premium cut across all job categories — white-collar, blue-collar, management, professional, technical and low-skill. In all, 180 job categories paid better average salaries in the federal government (83 percent) while only 36 job categories paid better in the private sector (17 percent). The Cato Institute's study confirmed the advantage federal workers had across salary categories. "In 2008, federal civilian workers had the seventh-highest average compensation level of the 72 industries. The federal work force had a higher average compensation level than such high-skill industries as computer systems design, chemical products and legal services."

The cost differential between private sector workers and active-duty military personnel performing commercial functions is even more dramatic than that between public and private sector civilians. The Congressional Research Service estimated the average total annual cost for military personnel is \$160,000 and the total bill for uniform personnel performing commercial functions is some \$54 billion a year.

Even the Defense Department is beginning to recognize the reality that the federal work force, both civilian and military components, is extremely expensive. There is also a growing realization that traditional labor force cost estimating procedures do not adequately reflect the true costs of federal workers. A 2010 memorandum by the office of Cost Estimation and Program Evaluation on estimating the full cost of civilian and military manpower noted: "The DoD composite rates, as published by the USD(C)/CFO, used to calculate manpower costs for program and budget submissions do not account for the full costs of military or DoD civilian personnel. For example, the outlays for compensation costs and for retirement and medical accrual accounts for active duty (AD) military personnel represent only a fraction of total Federal outlays."

The huge differential between public and private sector workers' wages and benefits is one major

reason why the cost of government is so high. It also makes it impossible to give credence to Pentagon claims that insourcing will save money.

The private defense industrial base sector clearly has a labor price advantage over its public sector counterpart, particularly when wages and benefits both are included in the comparison. In addition, private companies have repeatedly demonstrated that they also can save money in others ways such as through astute management of their supply chains, predictive maintenance techniques and the application of principles of performance-based logistics.