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LEGISLATIVE MEMO

# Would the "Taxpayer Protection Act" really protect taxpayers?

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## Key Findings

1. A 2011 law was enacted that required up to six activities every two years to be open to private sector competition.
2. A 2012 law was approved that centralized the state's procurement and purchasing authority and enacted an array of procurement reforms.
3. HB 2743 considered this year had additional contracting changes but also contained provisions that would have been a barrier to competitive contracting and run counter to the state's sensible 2011 and 2012 procurement reforms.
4. It is clear that the intention of HB 2743 was not to protect taxpayers, contrary to the express title of the bill, but to raise barriers to competitive contracting for state services in order to protect existing public sector jobs.

Washington taxpayers may have just dodged a bullet in the legislature on state government contracting issues, though policymakers should be wary in case the issue resurfaces again in future legislative sessions.

After passing the House, the Senate opted not to advance the so-called "Taxpayer Protection Act" (House Bill 2743) introduced by Rep. Sam Hunt (D-Tumwater), which would have primarily made several subtle, but important, amendments to statutes enacted in 2011 and 2012 that were designed to facilitate more competitive contracting for state services under a new Department of Enterprise Services (DES) responsible for adopting uniform policies and procedures for state agency procurement and contract management.

For background, Senate Bill 5931 created DES in 2011 and required the state's Office of Financial Management (OFM) to select six activities under the scope of DES every two years to open to private sector competition (see WPC's Jason Mercier's writeup[1]). In 2012, House Bill 2452 went a step further by centralizing the state's procurement and purchasing authority under DES and enacting an array of procurement reforms, including:

- Requiring DES to maintain an annual list of all current state agency contracts;
- Establishing a mandatory agency training program for best practices in procurement;
- Tightening contractor oversight;
- Encouraging agencies to maximize the use of performance-based contracts; and

1 "Governor signs agency consolidation/ contracting reform," by Jason Mercier, Washington Policy Center blog, June 20, 2011, at http://www.washingtonpolicy.org/blog/post/governor-signs-agency-consolidationcontracting-reform.

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- Authorizing “best value” contracting that allows agencies to evaluate bids across a wider range of factors (for example, service quality, experience, etc.) than cost alone.

This year’s HB 2743 mostly consisted of tweaks to the 2011 and 2012 bills. Some of the changes proposed by HB 2743 were fairly innocuous, such as requiring agencies to monitor their performance-based contracts to ensure compliance with performance standards—which one would expect anyway, since existing law makes remuneration for performance-based contracts “contingent on the contractor achieving performance outcomes”—or requiring the state to debar contractors with criminal convictions related to contracting or labor practices in the last five years.

However, HB 2743 contained three very problematic elements that would have been a barrier to competitive contracting, would have run counter to the state’s sensible 2011 and 2012 procurement reforms, and were ultimately designed to elevate the economic interests of government employee unions over the public interests of taxpayers.

### Ten Percent Cost Savings Mandate

The most significant change proposed in the bill was to amend the 2011 statute to restrict DES from contracting out functions identified by OFM unless it would achieve cost savings of ten percent or more of the contract value. According to proponents, the ten percent mandate would provide some cushion to allow the state to recover the costs of contract monitoring and other related costs. However, this requirement is problematic for several reasons:

- The ten percent cost savings mandate reduces all contracting decisions down to a simple matter of cost. While costs are important, they should not be the only factor in considering the merits of contracting out. In fact, there has been a pronounced shift away from overly simplistic “low-bid” contracting in recent decades to “best value” approaches in contracting. The best value approach bases procurement decisions on a mix of considerations, including costs, service quality, speed/timeliness, risk transfer, access to specialized skills, and more. In fact, the 2012 law in Washington specifically states that, “[i]n determining the lowest responsive and responsible bidder, an agency may consider best value criteria,” and outlines several criteria agencies can use to introduce flexibility and ensure smart purchasing decisions. HB 2743’s ten percent savings mandate would have run counter to these best value provisions and limited agencies’ flexibility, ultimately to the detriment of taxpayers.
- Even if best value contracting were not a consideration, a ten percent cost savings threshold is a puzzlingly arbitrary limit. First, typical contract monitoring costs tend to account for less than one to two percent of the contract value in most contracts. Second, such an arbitrary limit presumes that, for example, an eight percent reduction in costs to taxpayers would not be worth pursuing. In other words, a bill called the “Taxpayer Protection Act” would force state officials to reject potential cost savings if the savings did not meet some arbitrary percentage threshold.

Readers should ask themselves a simple thought question—if your employer offered you an eight percent pay raise, would you refuse until the employer increased that

number to ten percent? For most people the question would seem absurd. Similarly, taxpayers should not subject cost savings opportunities to such artificial and arbitrary percentage limits.

### Disparate treatment of performance monitoring

In calculating cost savings to determine when the ten percent threshold is met, HB 2743 would have required DES to factor in the cost of the agency staff time and resources needed to monitor the contract and ensure compliance with its performance standards. On the surface, this may seem reasonable, since monitoring and enforcing the terms of contracts is part of the cost of contracting out.

However, the presumption that competitive contracting for state services brings a *new* cost in terms of monitoring an outside contractor's performance implies that state agencies are not incurring similar costs to monitor the performance of state employees.

In other words, the bill implies that agency managers should care more about making sure outside contractors are held accountable than government workers. Taxpayers should be concerned about such a double standard. If performance truly matters, then agencies should be spending money to monitor outcomes *regardless of whether the service is performed by an in-house government worker or an outside contractor.* Thus, the costs of contract and performance monitoring should be similar across both sectors, not a cost that is exclusively applied to the private side of the ledger.

Further, if agencies are ignoring their own in-house performance—and would thus incur "new" costs by contracting out —then shouldn't the enhanced accountability be considered a benefit of privatization to taxpayers, as opposed to simply being considered a cost? The so-called "Taxpayer Protection Act" would only require consideration of the costs associated with the monitoring aspect of privatization, without accounting for the corresponding benefits of enhanced performance monitoring. In this way, the bill would stack the deck in favor of the economic interests of public sector unions and unfairly cast privatization in a dim light.

### Unfair public/private cost comparisons

Lastly, prior to issuing a request for proposals to contract out an existing activity, HB 2743 would have required state agencies to conduct a public/private cost comparison. This "comprehensive impact assessment" would include: (1) an estimate of the in-house costs of public employee service provision, (2) an estimate of the costs associated with contracting out; (3) a statement of the performance objectives to be achieved through contracting out; and (4) an assessment of the potential adverse impacts of contracting out, such as loss of employment, effect on social services and public assistance programs, economic impacts on local businesses and local tax revenues, and environmental impacts.

However, such mandates on contracting out are not necessary. Items 1, 2 and 3 are routine parts of the procurement process already, and they are already complicated by a few key factors:

- The public and private sectors have fundamentally different accounting systems, and cost comparisons between the two are often more art than science. Governments typically do not calculate the fully-allocated costs of service delivery. While agency budgets typically cover major operating costs (for example, staffing, supplies, etc.), some costs—including risk management, pensions and other post-employment benefits,

information technology, payroll, accounting and human resources—are paid for out of other agencies' budgets, making it likely that any one agency will underestimate the true cost to taxpayers of public sector service delivery by ignoring overhead costs paid by others.

- By contrast, private contractors include all of the relevant costs—direct service delivery costs, overhead, employee benefits, legal, etc.—up front in their bids. To have a level playing field where apples-to-apples cost comparisons can be made, it is essential that both sides are presenting a transparent set of fully loaded costs. HB 2743 does not address this issue, leaving significant latitude for the public sector to game the numbers and make a ten percent cost savings threshold difficult or impossible to hit. The result would be a competitive contracting policy that is stacked permanently in favor of the economic interests of public sector unions.
- Identifying key performance measures is critical in contracting, but any impact assessment should not only note the performance that would be required of contractors, but also identify *how the public sector would be held to the same standard* if an agency decides not to contract out. Again, HB 2743 would have imposed a higher standard on private contractors than on public employees with regard to meeting performance standards. Again, the result would be a policy that fails to protect the interests of taxpayers.

However, the most problematic element of the proposed impact assessment is item 4, the assessment of the "potential adverse impacts" of contracting. The bill text presupposes that any potential positive impacts of contracting either cannot exist, or if they do, should not be equally considered. This is a flawed and fundamentally unserious provision if the goal of the bill is to help agency managers make smart contracting decisions.

The best example comes with the treatment of taxes, as the bill would implicitly require the impact assessment to account for the potential loss of state and local tax revenue from eliminated state employee positions. However, the analysis would not similarly credit private contractors for any new tax revenues generated for the state and local governments as a result of contracting out.

Overall, if the policy goal of HB 2743 was to provide fair and accurate public/private cost comparisons, the comprehensive impact assessment envisioned in the bill would fail miserably.

## Conclusion

Considering all these factors, it is clear that the intention of HB 2743 was not to protect taxpayers, contrary to the express title of the bill, but to raise barriers to competitive contracting for state services in order to protect existing public sector jobs. Legislators in the senate were wise to be wary, as they avoided undermining their very sensible procurement reforms in 2011 and 2012 just as they're starting to be implemented.

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