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ISSUE BRIEF

Procurement Cost Analyses and the Decision to Contract

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In April 2024, the U.S. Office of Management and Budget reformed the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (2 C.F.R 200, referred to as the "Uniform Guidance"), which is the federal regulation that applies to almost all federal pass-through grants to state and local governments. These regulations are important because they set rules and conditions related to contracting and procurement for every federally appropriated grant dollar. Many state and local governmental entities use federal grant money to procure a wide range of goods and services. One of the new provisions of the Uniform Guidance requires localities and states using federal dollars for contracting to perform a "cost-benefit or price analysis," [1] making it imperative that local and state jurisdictions have a routine process for this type of evaluation to ensure that contracting decisions are in the public's best interest.

> The decision of whether to perform or operate a public function publicly in-house or contract it out is a critical choice that can have long-term and far-reaching consequences.

Specifically, the new guidance states that, "*The recipient or subrecipient must perform a cost-benefit or price analysis for every procurement transaction, including contract modifications, in excess of the Simplified Acquisition Threshold. The method and degree of analysis conducted depend on the facts surrounding the particular procurement transaction. For example, the recipient or subrecipient should consider potential workforce impacts in their analysis if the procurement transaction will displace public sector employees. However, as a starting point, the recipient or subrecipient must develop their own estimates before receiving bids or proposals.*"[2] This requirement is mandatory for all federal awards issued on or after October 1, 2024. However, states and localities can utilize the type of robust cost analysis described in this brief for any contracting decision using federal grant award dollars issued prior to October 1, 2024.[3]

The decision of whether to perform or operate a public function publicly in-house or contract it out is a critical choice that can have long-term and far-reaching consequences. Given the importance of this decision and the updated federal requirements, it is critical that governmental entities ask the necessary questions and perform important quantitative and qualitative analyses to better understand potential costs, risks, and benefits of various service delivery approaches. While some states and localities already have requirements around contracting cost analyses that meet the updated federal requirements, other jurisdictions may have requirements that can be improved or may not have any requirements related to contract cost analyses at all. This brief explores why cost analyses comparing service delivery options should be a standard part of any potential procurement engagement and discusses best practices in how to conceptualize and design and/or improve the cost analysis process.

The first part of this guide discusses the important questions that governmental entities should ask to understand why contracting is being considered in the first place. Thoughtful deliberation of these questions can help governmental entities explore possible solutions to issues that may be occurring with a public service or function. The second and main part of the guide discusses why a cost analysis comparing service delivery options is a critical part of any procurement process and includes best practices and examples of how various jurisdictions have or have not implemented these practices. The last part pivots to discussing why and how an impact analysis that compares the social, economic, and environmental costs and benefits of various service delivery methods is another meaningful part of any analysis. It allows for a fuller picture of the potential impacts on and consequences for the public beyond the financial costs of operating the service or function.

This publication is intended for government administrators, contract management staff, policymakers, advocates, and any other stakeholders who seek to ensure that contracting decisions are sound and that public funds are spent to equitably advance and improve public services, operations, and programs. Public entities at all levels of government that engage in procurement should have requirements for a standard cost analysis that occurs before a contract is signed.

This brief is not intended to be a how-to guide and does not prescribe a specific methodology for governmental entities engaging in any analyses related to their procurement decisions. Anyone using this report should consult legal counsel before implementing any of the recommendations.

PART 1: Understanding Why Contracting is Being Considered

Before the procurement process begins, it is important for governmental entities to have a thorough understanding of why it is seeking to contract and whether a proposed contract will meet public needs. Contracting decisions can have profound impacts on public goods and services, making it critical that a governmental entity engage in meaningful analysis and preparation before jumping into the procurement process. Public input is vital to answering these questions. Generally, governmental entities should be able to answer questions such as:[4]

- Why do we want to contract?
- What are we trying to accomplish with this contract?
- Are there other ways to accomplish this goal?
- Why this scope for the proposed contract? Are there other contract scopes that are more appropriate?
- Who is defining what the future of this public good or service looks like?

Specifically, one of the first decisions that a jurisdiction should make before it begins the procurement process is whether the good or service should be contracted out. This means that the governmental entity should have a thorough understanding of the issue or problem it seeks to address and identify possible solutions to the problem. The governmental entity must also be capable of and have the capacity to engage in this analysis, evaluate possibilities, and ultimately implement a solution. In many cases, governmental entities use contracting as a default approach for solving problems with public services and operations without any analysis of potential solutions, including those that do not include contracting out. For example, governmental entities looking to contract out a service in an attempt to save money might examine ideas from frontline workers for increased internal efficiencies before deciding to contract out the service.

One way to ensure that public solutions are identified and considered is to require the development of an improved public service delivery option for inclusion in the cost analysis. In almost all jurisdictions that perform cost analyses for informing procurement decisions, the analysis examines two options of service delivery: public versus private. Jurisdictions can consider a third option – public service delivery as it can feasibly be improved – to ensure that public alternatives are explored. Examining how the service or good could be improved if it stayed under public provision may be a way to solve the problem in a way that doesn't involve contracting and is less risky and more financially prudent.

PART 2: Comparing Costs of Various Service Delivery Options

After answering the questions posed above, if contracting is determined to be a possible solution, the government entity should perform an analysis to understand the potential costs or savings of contracting by comparing public provision of the service or function with the estimated cost of providing the service or function through the private sector. Anticipated cost savings is the most cited rationale for many types of contracting.[5] However, jurisdictions may not require or perform any pre-procurement analysis and/or never investigate claims that contracting will save money and/or improve quality. This lack of pre-procurement analysis and planning increases the chance that a jurisdiction signs a contract or privatizes a public function that could increase costs. Such an analysis can help identify whether contracting for or privatizing a service could truly save money, and whether the service could be better performed by public sector staff.

Note that for the ease of understanding the concept, this brief uses the term "service" and "public service" to describe what is being contracted out. However, any aspect(s) of a public service, good, project, operation, activity, etc. could be the subject of this type of analysis.

What Should a Cost Analysis Include?

A cost analysis that compares various service delivery options should at a minimum compare the full costs associated with delivering a public good or service publicly versus privately. This will help determine whether there is any likely cost savings associated with the contracting option. One important lens in which to view cost savings is that of "avoidable costs," meaning understanding what costs the governmental entity would "avoid" or save if the service is contracted out.

An Avoidable Cost Analysis method can be used to estimate such savings. As Columbia University Professor Elliott Sclar, explains, "If there is no avoidable cost savings in the short run, it is unlikely…that there will ever be any real savings from the privatization in the long run."[6] The avoidable cost of the activity plus or minus the new costs associated with the contract, such as contract administration and oversight, should be compared to the contract price.[7]

The first important consideration is determining what costs should be captured and used in the analysis. Accurately identifying direct, indirect, and other types of costs is a critical starting point and can greatly impact the outcome of the analysis.

Of note, the Activity Based Cost accounting method or "ABC" accounting can help governmental entities identify the costs, including direct and indirect costs associated with a public service. This method can complement an Avoidable Cost Analysis approach. Specifically, ABC accounting can be useful for identifying the particular activities that make up the public service being analyzed and assigning costs to these activities. This can help ensure accuracy since sometimes direct and indirect costs for a specific service can be difficult to parse in the typical line items found in an agency or department budget.[8] More information about how ABC accounting can be used in contract cost analyses can be found in Sclar's book, *You Don't Always Get What You Pay For* (Cornell University Press).

Calculating Costs of Public Sector Service Delivery

Typically, the cost of public service provision can be calculated by adding together the direct and avoidable indirect costs associated with the public service, function, or activity.

Direct Costs

The most obvious expenses to include in any calculation of the costs of a public service are direct costs, which are costs that are fully attributable to the public service that is being analyzed. These costs would completely be avoided by the governmental entity if the service is contracted out. Direct costs include salaries, wages, and benefits (such as health and retirement benefits) of employees delivering the service or performing the function. Employee costs included in this calculation are costs associated with employees that spend all their time working on the public service in question.

Direct costs can also include items like the cost of supplies, materials, travel, rent, utilities, or communication if these costs are 100 percent expended in support of the service being analyzed. For example, if the governmental entity rents an entire facility for the service in question, the rent associated with that facility should be included in the calculation.

Indirect/Overhead Costs

Another important type of costs to include in the calculation of the cost of public service provision is indirect costs, also called overhead costs. Indirect costs are costs that support multiple public services or goods, including the public service or function being analyzed. For example, indirect costs could include the public function's share of the cost of utilities, supplies, or shared technological or data collection systems, if these costs overall support multiple functions in a public agency. Similarly, indirect costs could also include the cost of personnel that work on more than one public good or service, such as human resources staff, information technology (IT) staff, legal staff, finance staff, and others.

Unlike direct costs that are automatically considered "avoidable" costs for the governmental entity, each identified indirect cost should be analyzed to determine whether the governmental entity would avoid the expense if the public service is contracted. For example, if a full-time IT worker's time is split evenly between serving the technology needs of three different programs, including the program that is being considered for contracting out, the employee compensation costs based on the proportion of the time spent working on the program that is the subject of the cost analysis (i.e. 1/3 of the employee's compensation costs), would not be included in the calculation of indirect costs if the IT worker's full-time workload is simply adjusted to split their time evenly between the two remaining public programs. In this case, contracting out the third program would not save the governmental entity any money on the IT worker's compensation since it is still paying for the IT worker's full-time compensation.

On the other hand, if a third-party database is shared between three programs, and the governmental entity pays for the database based on how many users use the database, the program's share of the cost of the database may be included in calculation of indirect costs since the cost to the governmental entity would presumably decrease if the program in question is contracted, thus allowing the governmental entity to "avoid" part of the cost of the database.

For indirect costs that are identified as avoidable, analysts should calculate how much of the particular indirect cost is used by the service in question. Indirect costs must be allocated proportionately to the public service, such as through full-time equivalent (FTE) personnel, dollar amount, or square feet, etc., depending on what is an appropriate unit of measurement.

California's state law that sets forth its cost analysis requirements[9] addresses the issue of indirect costs explicitly:

> *19130(B): In comparing costs, there shall not be included the state's indirect overhead costs unless these costs can be attributed solely to the function in question and would not exist if that function was not performed in state service. Indirect overhead costs shall mean the pro rata share of existing administrative salaries and benefits, rent, equipment costs, utilities, and materials.*

Calculating Costs of Private Service Delivery

For private service provision, the easiest way to estimate costs is to simply use the proposed total contract cost that a bidder or potential bidder has provided. However, there are some cautions and issues with this approach.

First, it is important to understand how a total proposed contract cost is broken down so that not only the overall costs of public and private service provision can be compared, but that the individual components or line items of the service can also be compared. Some states, such as Oregon, require that certain cost categories are broken out when estimating the costs of proposed private service provision. Being able to compare the cost of specific components of the overall costs can shed light on how the actual service delivery will compare.

For example, if a private service delivery labor cost estimate is lower than public service delivery labor costs, analysts can ask deeper questions about why employee wage totals will be lower under the private service delivery scenario: Are fewer employees going to be used? Will wages decrease for workers? Might that have an impact on employee turnover? Jurisdictions may decide that cost savings that may negatively impact the quality of the service, or the quality of jobs associated with the service, are not worth the decrease in labor costs. Some states and localities have provisions that try to limit this dynamic. For example, contracting laws in Oregon and California similarly specify that an agency cannot approve a contract if the sole reason for cost savings is that contractor labor costs are less than agency labor costs.[10] California further specifies that contracts will only be approved if the contractor's wages are at the industry's level and do not significantly undercut state pay rates.[11]

It is also critical to understand the scope of the service being offered by a bidder or potential bidder. This information can reveal whether the cost analysis is comparing service delivery options that are the same or similar in scope. For example, studies of custodial contracting in Oregon found that contractors often do not provide the same scope of services as those performed by in-house public custodial employees.[12]

Before contracting out, the governmental entity can request a complete list of activities or duties that the contractor included in their contract cost proposal. This can be compared with the current activities and duties, and performance standards for in-house service provision. If the proposed contracted scope of service is less than what is carried out by public in-house staff, the governmental entity will likely have to incur the costs of filling in these scope gaps, especially if they are important or essential to the service that is being proposed for contracting. Experts advise that these expected costs that the governmental entity will incur be included in the cost analysis. If these costs are not accounted for, they may become "surprise" costs after a contract is signed, eating away at any expected cost savings.

Calculating Additional Costs that the Public Entity will Incur through Private Service Delivery

One common problem in cost analyses is that the analysis fails to identify the full scope of costs that the public entity will incur if the service is contracted. By not accounting for these costs, contracting out may seem like a more cost-effective option, but true cost savings may not actually occur. These transitional, administrative, and other supportive costs should be identified and incorporated into the analysis either by subtracting them from the total cost of public service provision or adding them to the cost of private service provision.

For example, the public entity incurs costs related to contract administration. These include one-time costs associated with the procurement process, such as development of an RFP, evaluation of bids, contract negotiations, and contract development. Contract administration also includes on-going costs, such as the processing of contractor invoices. Similarly, the public entity incurs costs related to on-going contract monitoring and oversight. Contract oversight is a critical component of effective contract management, but these costs are often not included in these types of cost analyses. For example, researchers from Rutgers University examining contract oversight in the state of New Jersey interviewed state agency officials and found that "every official [they] interviewed confirmed that to their knowledge costing was not done in any systematic way."[13] In the cost analyses that were identified by New Jersey state agency officials and shared with researchers, the cost of contract oversight was not included in the calculation of the cost of contracting.[14]

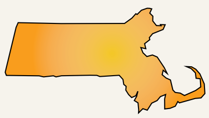
Numerous studies, from academia and the Government Finance Officers Association, show that the cost of contract administration is typically around 20 percent of the price of the contract.[15] Some jurisdictions have guidelines for calculating costs related to contract administration and/or contract oversight. For example, the state of Connecticut Office of Policy and Management's Privatization Contracts Policies and Procedures Manual includes a staffing formula table to help determine the appropriate level of contract management staff.[16] The federal Office of Budget and Management also has a staffing formula calculating the ratio of full-time equivalent (FTE) contract management staff to the size of the contract (OMB Circular A-76 Revised – Attachment C).[17]

The costs of contract administration and oversight may also be informed by past costs associated with similar contracts that the public entity has engaged in. However, it is important for public entities to evaluate whether the level of oversight provided in those comparable contracts was sufficient. This can help determine whether the costs are appropriate to use in the analysis. Costs of oversight may also vary depending on the type of service or good that is being contracted out. As one academic researcher explains, "More intense monitoring is called for when the contracted good is vital and service disruption has substantial deleterious consequences. Similarly, monitoring is needed more when the contractor's incentive and ability to cheat is powerful, hence, the cost of monitoring can be significant." For a deeper discussion of considerations in government contract oversight, see In the Public Interest's publication, **"Standing Guard: How Unaccountable Contracting Fails Governments and Taxpayers."**

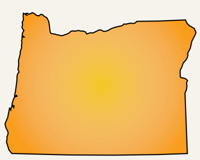
Other costs that the public entity may incur are transition costs, which include one-time costs that typically occur at the beginning of a contract engagement, such as training contractor employees or moving equipment. Additionally, there may be costs associated with public resources that a contractor will utilize on a short-term or on-going basis, such as the use of government facilities, equipment, machinery, technological or data systems, supplies, etc. The public entity may retain some management duties related to the service or function that need to be factored into the cost of private provision, since the public entity is not avoiding these costs by contracting out.

Examples of State Cost Analysis Requirements

Some state laws require that public agencies perform a cost analysis before approving a contract (or for contracts over a certain dollar threshold). These laws may specify the types of costs that must be included in the analysis and give general directions for how an analysis should be performed. Greater specificity in how an analysis should be performed ensures that agencies or departments across a jurisdiction are using a uniform process to make contracting decisions.



For example, Massachusetts's Pacheco Law[18] contains several important responsible contracting requirements, including an analysis comparing the costs of providing the service in-house with a contractor's bid for providing the service. The law applies to contracts currently over $678,044.08 (this amount is adjusted each year). The cost analysis requirement directs the agency to prepare an estimate of the service being performed in-house in the most cost-efficient manner. The cost of public service provision must include direct and indirect costs of the service. The agency must also prepare an estimate of the contract cost, which must include the costs of transition from public to private operation, including additional unemployment and retirement benefits and contract monitoring and administration costs that the public entity will incur. The law also requires that the contract cost be increased by the amount of income tax revenue that will be lost to the state due to the elimination of public agency employees. The cost estimates of public and private service provision are then compared.



Oregon's law (ORS 279B.033)[19] also gives specific direction for performing the required cost analysis to understand whether contracting will cost less than performing the service with state agency personnel and resources. The agency is directed to estimate the public agency's cost of service provision, including the salary or wages and benefit costs, including employees who supervise or monitor the performance of the service, any material costs, and other miscellaneous costs related to providing the service. Of note, the law also specifies that the public agency should not include indirect costs unless those costs are attributable solely to performing the service. The law directs the public agency to estimate the costs of a potential contract to perform the service, including salary or wage, and benefit costs, any material costs, and other miscellaneous costs related to providing the service, including foreseeable fluctuations in costs of any items covered in the analysis over the proposed contract term. The public agency can only move forward with the procurement if it is more expensive for the public agency to provide the service in-house.

Importantly, both laws contain provisions that seek to limit deriving contracting cost savings through reduced labor costs. Massachusetts's law requires that state contractors pay their employees performing the public service a rate that is comparable to regular public agency employees or the average private sector wage rate. Additionally, state contractors are required to pay a percentage of the costs of health insurance that is comparable to the percentage paid by the commonwealth for state employees.[20] Oregon's law specifies that the agency cannot approve a contract if the sole reason for cost savings is that contractor labor costs are less than agency labor costs.[21] However, Oregon's law does not necessarily prevent cost savings derived from reduced worker wages and benefits, but it prohibits reduced worker compensation as the only source of cost savings. This may not be sufficiently strong language if a governmental entity seeks to protect from economic harm workers being paid with public dollars and performing public functions.

Other Important Considerations

What is the Time Frame for the Analysis?

One important consideration is the time frame of the analysis. In many cases, jurisdictions that require a cost analysis do not specify the time frame for which the analysis must cover for the cost comparison. Comparing public and private service provision for the first year of the contract may give an idea of short-term cost implications, but it is important to see how a cost comparison may change over the course of the entire contract term. Certain costs may start out at one level and increase or decrease over the course of the contract. For example, required cost of living adjustments may increase labor costs over a multi-year period, the number and mix of staffing positions may change as a new program grows over the proposed contract term, the need for trainings may decrease over time, or the need for paper materials may decrease as records become electronic. The costs of these types of anticipated changes over the course of the contract should be considered and incorporated when they can be reasonably estimated.

Additionally, there may be cost implications that fall after the proposed contract term. While these may be difficult, if not impossible, to incorporate into a cost analysis, they can be identified and considered when deciding between public and private service provision. For example, a long-term contract may result in the loss of public sector capacity and expertise over time, or the loss of expensive equipment that is critical to performing a service. Once a contract term is complete, a governmental entity may no longer have the option of performing the service in-house anymore without large start-up costs. This is one way that government entities can get locked into long-term contracted out service provision (either through contract renewals or rebids), since it would be cost prohibitive to bring the service back in-house. Governmental entities should look beyond the contract term to understand how the act of contracting could impact future costs and options.

The costs of these types of anticipated changes over the course of the contract should be considered and incorporated when they can be reasonably estimated.

What About Contingent Costs in a Potential Contract?

A contingency is a "possible future event or condition arising from presently known or unknown causes, the outcome of which cannot be precisely determined at the present time."[22] Contingent events or conditions can impact the future cost of a contract. As a hypothetical example, a contingent event could be the loss of a legal dispute that a contractor is involved in, which would result in the contractor being forced to change practices in a way that is more costly. Contingent costs may be able to be estimated if the contingent event is known. But some contingent costs will not be able to be estimated, regardless of whether the contingency is known or unknown.

It is tricky to know whether to include contingent costs in a cost analysis; some jurisdictions may have specific guidelines in addressing this. For example, the state of Hawaii directs its procurement staff to include known contingent costs in an analysis if the contingency can be reasonably estimated. But if the contingency cannot be reasonably estimated or it is unknown, it should not be included in a cost analysis.[23] Instead, contingent costs and how they will be treated once they can be estimated or calculated can be addressed in the contract if the governmental entity chooses private service provision.

How Accurate is Contractor Cost Estimate Data?

The accuracy of any cost analysis is only as accurate as the data used in the analysis. It is critical that financial and pricing data used for calculating the costs of both public and private service delivery options are derived from quality sources that accurately represent true costs. A governmental entity has a higher degree of control over its sources of cost data for public service provision since much of this data typically comes from internal calculations of the actual past costs of performing the service. On the other hand, a governmental entity sometimes must rely on contractor or industry data for estimating components of private service provision. Governmental entities must ensure that data relied on from contractors, potential contractors, industry groups, and other external sources are accurate and reasonable. The Organisation for Economic Co-operation and Development (OECD) in its publication, "Preventing Corruption on Public Procurement," warns that if contractors fail to disclose accurate cost or pricing data in their proposals, contracts may result in increased costs to the governmental entity.[24] Without accurate data, the outcome of a cost analysis may be flawed and point to the wrong service delivery decision.

There are numerous ways that costs can be estimated, and knowing how a private entity derived an estimate is important in determining the reliability and likely accuracy of a given cost estimate. The federal government requires that cost estimates related to contracting are derived from a generally accepted method that is "equitable and is consistently applied."[25] For example, the state of Hawaii explains that costs can be estimated by[26]:

- consulting with industry experts and deriving cost estimates based on their experience and knowledge;
- using a method where costs for a service or good are estimated using comparisons with the cost of completing similar tasks under past or current contracts;
- conducting a thorough review of all components, processes, and tasks related to a service or good by using data from accounting systems and other sources to determine the costs of the service or good.

The state of Connecticut gives guidance to contracting agencies for approaches that can be used to gather data to inform cost estimates, including[27]:

- using the current price of recent bids for similar services;
- using the cost of similar existing contracted services;
- obtaining examples of contracted services and their costs in similar states;
- issuing a Request for Information (RFI) to test the market's approach regarding the most cost-effective methods of delivering these services.

While one generally accepted cost estimation method is not inherently better than the others, there may be tradeoffs around ease of estimation, speed, and accuracy. Additionally, a given method may be more appropriate depending on what data is available. The larger point is that a governmental entity should understand what cost estimation methods were used when relying on cost data from private entities, and whether those methods were reasonable and sound.

Beyond understanding and identifying cost estimation methods, it is also important to ensure that data provided by bidders or potential bidders is not defective. Contractors that under- or over-estimate cost estimates may face penalties, depending on the state law. The state of Hawaii's State Procurement Office's training on cost analyses identifies three types of defective data: data that are not accurate, data that are not complete, and data that are not current.[28] One important reason for ensuring that a governmental entity is performing a pre-procurement cost analysis that relies on accurate, complete, and current data is that it not only helps inform the decision of whether to contract, it also provides meaningful data if the decision is made to contract. This data can help the governmental entity to identify defective (or deceptive) data that a contractor may later use when charging or invoicing the government entity during the contracting term. For example, contractors may bill the governmental entity for higher operating costs, but accurate data and estimates used in a cost analysis can be used as comparison to actual costs and alert the governmental entity to cost overruns.

The larger point is that a governmental entity should understand what cost estimation methods were used when relying on cost data from private entities, and whether those methods were reasonable and sound.

Are there opportunities for public participation?

Lastly, public input and participation, especially of those who are most impacted by or rely on the public good or service in question, is critical in any planning and pre-procurement stages. Contracting necessarily means inserting private interests in the provision of public goods and services and it is essential that the public voice in determining the future of public goods and service, regardless of delivery method, is valued and respected.

PART 3: Social, Economic, and Environmental Impact Analysis

In addition to a cost analysis, governmental entities should perform an impact analysis that examines the social, economic, and environmental impacts of a proposed contract, especially for contracts that could have broad impacts on the community. This process must be transparent and public to ensure that all critical impacts are captured in an analysis, and to determine whether the impacts for a given proposal are positive or negative, especially for those most impacted. This type of analysis should examine the potential impacts listed below, as appropriate (although this list is not intended as a complete nor exhaustive list and should be adapted to the particular public good or service in question).[29]

- **The potential or expected impacts on people utilizing the service**

  There may be potential or expected changes in the service once it is contracted provided that could impact the people who utilize the service. These potential or expected impacts, positive or negative, should be identified.

  It should be noted that proposed contracts that have potential negative impacts on people utilizing the service or asset, or that impact certain groups' access to the service or asset, should be given extra scrutiny. In contracts dealing with vulnerable populations or children, it is especially important that a proposed contract not change the mission of the service or program, and that user access is in no way, even potentially, compromised. The ability of workers to successfully provide services to vulnerable populations dealing with complex problems can be severely compromised if staffing is reduced or caseloads are increased under a contract. The ability to design contracts that prevent this from occurring is very difficult, if not impossible in some situations, and governmental entities should refrain from outsourcing in these contexts, regardless of anticipated cost savings.

- **The potential or expected change in the racial, gender, or socioeconomic mix of people utilizing the service**

  The transition to private service delivery could have potential impacts on how different groups of people utilize the service, changing the demographics of the people using the service. These negative or positive impacts should be identified.

- **The potential or expected impacts on other governmental budgets**

  Contracting a service out could have impacts on other parts of the jurisdiction's budget. For example, in some contracts, cost savings may be derived in part by paying lower wages and/or providing minimal benefits. The costs of filling in income gaps are shifted to another part of the jurisdiction's budget (or another jurisdiction's budget) through increased use of public assistance programs. In some cases, contractor employees are forced to turn to public social safety net programs, such as the Supplemental Nutrition Assistance Program (SNAP), the Special Supplemental Nutrition Program for Women, Infants and Children (WIC), the Temporary Assistance for Needy Families (TANF) program, the Earned Income Tax Credit (EITC), and other programs. When contractors fail to provide health insurance for their employees, or if the cost of buying into the employer's plan is too expensive, workers and their families may enroll in public programs, such as Medicaid or the state Children's Health Insurance Program (CHIP).

- **The potential or expected change in staffing and personnel for the affected positions**

  Contracting a public good or service could have impacts on the staffing. Some contractors may increase or decrease staffing for a given service, and understanding how those changes could impact the quality of the service is an important consideration. In addition to the number of workers, understanding the impact of workforce related issues, such as training, career advancement opportunities, and worker safety measures can be useful lines of inquiry.

- **The potential or expected change in wages and benefits for affected workers**

  Governments at all levels have long provided jobs with family-supporting wages and important benefits such as health insurance and sick leave. In doing so, governments have historically created intentional "ladders of opportunity" to allow workers and their families to reach the middle class.[30] Following contracting, some contracted positions in some job categories may offer lower wages, reduced benefits, and little or no retirement security. Identifying and documenting these changes are important steps in deciding whether cost savings derived at least in part by reduced worker compensation is acceptable to the governmental entity.

- **The potential or expected change in the racial and gender mix of workforce**

  In some job categories, the potential change in wages and benefits for workers discussed above disproportionately impacts women and Black workers, both of whom are employed by the public sector at high rates.[31] The public sector is the third largest employer of working women, regardless of race. For Black workers, the public sector is the most important source of employment, as approximately one in five black workers hold jobs in government. Black Americans are 30 percent more likely than non-Black Americans to work in the public sector.[32] In general, workers in the public sector are better able to progress upwardly within a job classification than workers employed by private contractors.[33] Due to their prevalence in public sector jobs, Black and women workers are more likely to be affected when jobs are outsourced to companies that pay reduced wages and benefits. If a contract displaces public sector employees, understanding how the demographics of the workforce will change is important in assessing social impacts.

- **The potential or expected impact of contracting if workers will not live in the jurisdiction**

  Some contracts may replace public sector workers who live in the jurisdiction they serve with private sector workers who live outside the jurisdiction. Identifying potential or expected social and economic impacts on the jurisdiction may reveal broader ramifications of a contract. For example, if a contractor hires workers outside of the jurisdiction, there could be negative tax revenue implications. Massachusetts state law requires the calculation of any lost public revenues incurred through the loss of income tax if public employee positions are eliminated and the positions are displaced out of the state as a result of contracting. This is considered a cost to the state in the required cost analyses for privatization contracts.[34]

- **The potential or expected economic impact on local businesses**

  Contracting may result in positive or negative impacts on local businesses. Research shows that some contracts can result in the loss of revenues for local business in the jurisdiction. For example, some local businesses may have been suppliers supporting in-house service provision. The new contractor providing the service may supply the service itself, especially if is a large national corporation. In addition, if workers earn less under the contract, they may spend less in local retail and dining establishments. Research shows that as workers' income changes, the mix of sales at various businesses will change. At lower incomes, more workers may shop at 'big box' discount stores than did before, and fewer with local merchants.[35]

- **The potential or expected environmental impacts**

  It is important to understand the baseline environmental impacts of the service or good in question and how those impacts might change under private service provision. The types of materials used, the type of processes used, or the types of sustainability measures undertaken under private service provision could have positive or negative environmental impacts. While less environmentally friendly materials or approaches may be less costly, governmental entities should take a longer-term view of costs. A more sustainable product may cost more in the short-term, but the long-term aggregate benefits to the community and/or to the local environment for consistently making sustainable purchasing choices may more than make up for the price difference. In assessing environmental impacts, King County, Washington requires that agencies "Think beyond purchase price [to] consider the life cycle of goods and services including the costs and environmental impacts associated with raw material extraction, manufacturing, packaging, distribution, use, maintenance, and disposal of the product."[36]

While this type of impact analysis should be standard practice in many jurisdictions, some jurisdictions do already require some sort of supplemental analysis. For example, the state of Connecticut requires agencies to perform an analysis for proposed privatization contracts that identifies quantitative and qualitative risks and benefits of the contract that may not be captured in the required cost comparison analysis. Specifically, the state defines "'benefits'
to mean any desirable outcomes that are expected to result from a contract while 'risks' involve potential undesirable outcomes."[37] This could include many of the potential impacts listed above.

The city of Washington, D.C. requires, in addition to a cost analysis, an assessment of the impacts of a privatization contract on the jurisdiction's economic and tax base, including the effects on employment opportunities for D.C. residents, business creation, business development, and business retention. The assessment also includes the expected impact on the quality of goods or services provided, including performance targets and requirements for the contractor and potential effects of the contract on the health and safety of D.C. residents.[38]

The state of Wisconsin allows for "mitigating factors" to be considered in an analysis. This includes risk factors such as the possibility that a private firm may fail to provide the service the agency has guaranteed, reduce services if financial losses occur, or compromise confidential information. Other mitigating factors include whether the service is a short-term or ongoing need, and legal factors such as whether contracting would affect access to the service, among other important considerations. While this is not the same types of analysis as the impact analysis described above, the state allows other non-financial information, risks, and impacts to be part of the service delivery decision-making process.[39]

Conclusion

Given that the revised cost analysis requirement in the updated OMB Uniform Guidance will soon be mandatory for localities and states that are contracting using federal grant dollars, jurisdictions should review any of their current cost analysis rules or approaches to ensure that they have a standard and robust cost analysis procedure to compare the costs of public and private service provision. This is critical to making sound contracting decisions and accurately assessing whether contracting will truly lead to cost savings. Augmenting a cost analysis with an initial review of why contracting is being considered and any potential alternatives at the front end is key to ensuring that contracting will address the problems the governmental entity seeks to solve. Lastly, a social, economic, and environmental impact analysis can provide a fuller picture of the potential impacts on and consequences for the public beyond the financial costs of operating the service or function.

Social, economic, and environmental impact analysis can provide a fuller picture of the potential impacts on and consequences for the public beyond the financial costs of operating the service or function.

For additional information about this and other important updates to the OMB Uniform Guidance, please visit the Local Opportunities Coalition's website at **https://localopportunities.org/**.

This coalition, of which In the Public Interest is a member, has been instrumental in successfully advocating for updates to the Uniform Guidance that allow localities and states to use procurement as a tool to improve job creation, job quality, and worker equity on work procured with federal grant dollars.

For additional information about other best practices in procurement, please see ITPI's report, "Harnessing the Power of Procurement: Issues, Considerations, and Best Practices to Advance Equity in the Contracting of Public Goods and Services."

Endnotes

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[18] MA General Laws Part I, Title II, Chapter 7, Section 54.

[19] ORS 279B.033.

[20] MA General Laws Part I, Title II, Chapter 7, Section 54.

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[23] Ibid.

[24] OECD, "Preventing Corruption in Public Procurement," 2016.

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