



# Outsourcing and Privatizing Information Technology

## Re-examining the "Savings"

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*The Department of Defense has taken about 80 percent of the government cutbacks since the end of the Cold War. As a result, information technology (IT) outsourcing and privatization has become a popular means to lower the cost of labor devoted to perform computer-related functions. This article advances a labor theory of value to explain the source of the profit and cost savings that underwrite outsourcing and privatization as popular financial tactics. This labor theory uses several private and public industry examples to promote its thesis and also explains the impact of U.S. industry's use of foreign programmers to reduce or cap wages. A case is made that outsourcing and privatization undermine long-term economic stability, ultimately weakening national security institutions dependant on IT.*

Outback-stricken employees in both the public and the private sector are worried, and rightly so, about information technology outsourcing and privatization (ITO&P). The problem has reached its apex at the Department of Defense (DoD) where many government technologists face the prospect of contractorization as military budgets become more austere and personnel cuts increasingly severe.

Since the Cold War's end, DoD has borne about 80 percent of all government cutbacks, which, after four rounds of base closures, have resulted in the loss of approximately 355,000 civilian and 743,000 military jobs since the early 1990s. This means more competition for private technology workers and less security for mid- and lower-level defense employees who still perform DoD information technology (IT) tasks.

All defense IT workers know jobs are made and lost after leaders embrace or rebuke ITO&P. But they wonder about the financial mechanics and the art of and their part in this big financial deal. Nowhere are the battle lines more apparent and consequential to DoD's future than in the struggle between public and private employees for government IT work.

The heavy cuts in DoD's permanent work force have still failed to generate savings enough to offset planned pro-

urement expenditures called for under the May 1997 Quadrennial Defense Review (QDR). In June 1998, 15 business leaders from the Business Executives for National Security (BENS), a group of U.S. defense contractor executives, declared that DoD could make up the procurement shortfall of around \$15 billion through more aggressive outsourcing. John Lis, a BENS policy associate, in a recent issue of *Defense News* suggests that more contracting-out in payroll, utilities, information systems, housing, and other base support functions would save billions of dollars. DoD's 1998 procurement budget is \$45 billion, while it requires \$60 billion to fund "all of its authorized procurement programs," according to the article [1].

We can conclude with confidence from this that programming, networking, webmaster, and other IT skills will continue to migrate from DoD to the public sector, at least in the short term. And this will occur despite the actions of some agencies like NASA to federalize private contractors at high grades to keep them focused on intra-agency IT projects.

### Outsourcing and Privatization – Differences and Commonalities

#### Outsourcing

This brand of economic determinism is a form of contracting-out that promises a satisfactory level of accuracy, quality,

timeliness, etc., while shunting native talent to core tasks. Outsourcing-type contracts can be government-to-government, government-to-private, or private-to-private arrangements.<sup>1</sup> It is mainly the potential of reducing labor costs that compels many a chief information officer, entrepreneur, or government executive to tinker with outsourcing.

#### Privatization

Economist Calvin A. Kent's still-timely definition in *Entrepreneurship and the Privatizing of Government* tells us that privatization "refers to the transfer of functions previously performed exclusively by government, usually at zero or below full-cost prices, to the private sector at prices that clear the market and reflect the full costs of production." [2]

In a shortsighted pursuit of profits, government employees are often *right-out-the-door-sized* from secure positions and flung into the private sector, often flooding a given labor market, flattening wages, and forcing public and private sector employees into intense competition for limited positions. In the last analysis, it is precisely this competition that lowers the cost of available labor and thus provides the lion's share of company outsourcing profits.

Reducing the costs of labor for competent code writers, systems integrators, and information specialists—in a word, every genre of technologist—is the

heart and soul of any success that ITO&P can claim for stakeholders and shareholders.

## Outsourcing Information Technology – IT Is a Small World

One of the bellwether battles over public vs. private work is being fought in the technology arena. *Federal Computer Week* reported on June 8, 1998 that the Office of Management and Budget is pushing for a new list of government activities that might be outsourced. Similarly, industry has been lobbying hard to revamp OMB Circular A-76, the federal guidebook covering public vs. private competitions for work, to expand and strengthen enforcement options. Edward DeSeve, acting deputy director for management at OMB, speaking at a recent conference sponsored by the Professional Services Council, explained that DoD has outsourced 150,000 full-time positions and saved \$6.4 billion in the process [3]. Obviously, the trend toward outsourcing is continuing, mission-related IT requirements are increasing, and government staff continues to decline. In the last analysis, capitalizing on less expensive labor makes ITO&P pay.

The hocus-pocus at work behind the recent "job creating" move in Pennsylvania to outsource mainframe work will not hold up under close scrutiny by those technologists who understand outsourcing's true source of value—reducing the labor expense of technologists! Pennsylvania's state government officials hail the move to consolidate and outsource work performed by 23 state data centers. According to *Government Computer News/State & Local*, Pennsylvania's well-meaning but uninformed officials claim savings of \$127 million over the next five years and \$25 million annually for the other two years of the contract [4]. The contract is worth about a half billion dollars over its life. Only at the end of the article does one find the human cost: "The commonwealth will encourage the contractor to hire the 370 data center employees who will be displaced by the new setup. ..."—this is what it is all about. Butchering the decent salaries of the current and necessar-

ily voiceless IT workers will offset any losses that the outsourcing strategy might otherwise pass on to the state—yes, they will show a profit. The displaced will seek—quietly—acceptance in the new company that gets the outsourced work. Even those who receive higher wages in the short term will sacrifice their health benefits, their state retirement options, their decent working hours, and job security. The economic analysis behind the venture—in this case conducted by well-paid and well-known industry supporter KPMG Peat Marwick of New York, cannot be expected to concede anything to government IT employees—quite the reverse.

State governments all over America, like the federal government, look to capitalize on perceived savings through privatizing and outsourcing IT. Orchestrated by Chief Information Officer Elizabeth Boatman, a significant part of the privatization effort currently under way in Chicago's city government involves contracting-out departmental IT functions. Targets include arrest process computerization, legal case management, and financial systems. The work is frequently repetitive and labor-intensive, choice breeding grounds for privatization and outsourcing projects. The primary motivation to go private in this case is the lure of short-term cost reductions (the largest expenses are usually personnel-related) through a strategic decision to purchase rather than grow expertise. In an interview with *Government Computer News/State & Local*, Boatman stated, "Privatization has hinged on issues of cost. ... We've also had a difficult time competing with private industry for good IT employees. Retraining the ones we do have is costly, and we simply don't have time to wait for the payoff." In general, specialized service capabilities, economies of scale, niche advantages, and the flexibility of private employees over public employees factor heavily into the privatization decision. But the greatest attraction remains the potential to reduce labor expenses to achieve management goals. The largest part of the city's IT spending (30 percent of the \$64 million calendar year

1998 budget) is devoted to personnel [5]. Boatman has discovered that privatization, like outsourcing, delivers a blacker bottom line via the "pink-slip approach." Interestingly, professional service companies are beginning to admit that they do not know if customers are saving money, breaking even, or expending more to transfer functions out-of-house for the cause of ITO&P. In reality, most companies are "exploring outsourcing services for cost predictability" rather than for assurances that outsourcing costs less [6].

Consider, too, the recent decision by pharmaceutical maker Eli Lilly & Co. to outsource its on-line health-care network to IT giant EDS. Eli Lilly decided to shed undesirably expensive payroll by effectively putting IT workers into the company that receives the outsourced project. Eli Lilly staff who attempt to follow their jobs will look for employment with EDS. Those newly created job seekers will be "offered jobs at EDS based on skills" according to an EDS spokeswoman [7]. It is a short-term, stock-enhancing, win-win for both companies—EDS gets a labor pool hungry for work; Eli Lilly reduces its costly rolls. The unionless (over 85 percent of the U.S. work force) watch their wages stay flat or decrease as they unwittingly saturate the available labor pool.

Another labor-cheapening tactic particularly effective against permanent DoD IT staff is importing foreign IT employees. Roy Beck, editor of *The Social Contract* magazine, has written that instead of training their own cadre of technologists, Microsoft Corp. prefers to "import tens of thousands of foreign programmers" or ship work overseas because wages are lower [8]. In his book, *The Case Against Immigration*, Beck cites the 1990 census, which found foreign-born IT workers in Silicon Valley will work for nearly "\$7,000 less than did natives of the same age and level of education." [9] He also reveals that computer and software makers have a willing cooperative accomplice—universities attempt to artificially keep wages low. Beck writes that many institutions of higher learning "have kept their Ph.D. numbers up by

increasingly turning to foreign students. So the universities crank out far more scientists than are needed for industry, the U.S. government, and for university professorships. The glut works further to the universities' advantages because there is a large pool of scientists willing to continue to work for low wages in postdoctoral research positions for another three to six years. The universities, therefore, gain an even larger low-paid work force." [10] This too is the real value of ITO&P outsourcing: a slashed labor cost.

Technically minded immigrant labor, particularly from China, Pakistan, and India, will work for far less than U.S. citizens when a potential green card is part of their employment package. Now that Congress is being told by information systems giants like Intel and Microsoft that foreign IT worker quotas must be increased to assure a flow of new program and network administrators, unorganized American computer specialists will be more amenable to bargaining. The *Wall Street Journal* recently discussed how high-technology companies have asked for an exception to immigrant quota levels to permit more foreign IT workers into the country. Intel's president, Craig Barrett, contends that if federal limits on technical immigrant personnel remain at current levels, "the talent will go where the opportunities are, even if that is offshore." [11] Indeed, *Business Week's* chief economist, William Wolman, similarly discovered with co-author Anne Colamosca in their new book *The Judas Economy* that when capital learns that it can outsource for computer programmers and code writers in Beijing and New Delhi at one-third the wage of similarly skilled U.S. IT workers, stockholders will demand that capital fly to China and India [12]. Not long will the remaining community of civilian and military technolo-

gists at DoD have to wait until this strain of outsourcing visits them.

## Conclusion

In no department in the federal sector are the ravages of ITO&P more apparent than in DoD. Many thousands of defense industry and government IT workers worldwide have suffered the effects of blind contracting-out, outsourcing, and privatization. When the vogue of outsourcing and privatization fades away, its legacy will be one of short-term fiscal advantage, long-term economic instability, and ultimately a weakening of national security institutions—all at the expense of the average technology workers from whom ITO&P draws its chief source of value and profit. ♦

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10. *ibid.*, p. 150.
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## Note

1. See Daniel Minoli's *Analyzing Outsourcing*, McGraw-Hill, 1995. This is one of the few texts available that rely heavily on mathematical models. It is an indispensable text for those interested in further study of outsourcing particularly as it impacts IT. See review of this work in the *Army RD&A* magazine, May-June 1998, p. 45.