

# FISCAL POLICY INSTITUTE

11 Park Place, Suite 701, New York, NY 10007

212-721-5624 [www.fiscalpolicy.org](http://www.fiscalpolicy.org)

Testimony of  
James A. Parrott, Ph.D.  
Deputy Director and Chief Economist  
Fiscal Policy Institute

Before the  
New York City Council  
Committee on Civil Service and Labor and  
Committee on Contracts

## **Outsourcing Public Services to the Private Sector**

New York City  
May 7, 2009

Good morning, my name is James Parrott, Deputy Director and Chief Economist of the Fiscal Policy Institute (FPI). The Fiscal Policy Institute is a nonpartisan research and education organization that focuses on the broad range of tax, budget, economic and related public policy issues that affect the quality of life and the economic well-being of New York City and State residents. FPI regularly prepares reports on the state of the New York City economy and the economic condition of workers and their families, and on city budget and tax policy issues. Thank you for the opportunity to testify today.

I want to make three broad points on the question of outsourcing of public services to the private sector.

1—Contracting in offers considerable budget savings, greater efficiency and quality in the delivery of city-funded services.

2—Contracting in serves a critical New York City economic need in promoting better quality jobs for New Yorkers and discouraging illegal misclassification of workers as independent contractors.

3—The Council should consider how to reform the contracting process and decision-making in order to ensure that city-funded services are delivered in a more cost effective manner that also enhances the quality of the jobs needed to deliver those services.

One of the fastest growing expenditure areas in the city's operating budget is for contractual services. The mayor's executive budget includes \$9.25 billion for contracted-out services spread across over 17,500 contracts. This amount exceeds the budgeted amounts for pensions, fringe benefits, Medicaid or debt service. Roughly 70 percent of the contract budget goes toward a range of social and health services and youth and student related services like pupil transportation. Much of the balance, however, is for various personal, professional and maintenance services, many of which could be performed by city employees. These include clerical functions, cleaning and security services, and accounting, engineering, architectural, computer-related and computer maintenance services.

I have not attempted to develop a precise estimate but I would suggest that, conservatively, at least \$500 million to \$700 million in such contracted services in the operating budget could be performed by city employees. This estimate does not extend to contracted professional services that are funded under the capital budget.

In a 2005 study we conducted of professional services contracting out by New York State, we estimated that the state could easily save up to \$500 million a year by increasing the state's workforce in the fields involved and reducing cost-ineffective contracting out. Our study drew upon earlier analyses by state comptrollers Edward Regan and Carl McCall, and a study by the accounting giant KPMG prepared for the New York State Department of Transportation. We found that the use of outside contractors cost the state from 50 percent more in the case of legal services to 500 percent more for computer consultants.<sup>1</sup>

In its recent study of contracting out by New York City, District Council 37 examined 10 contracts in a range of personnel and professional services and compared the costs of using outside contractors vs. the fully loaded costs of hiring city employees to perform the same tasks. For just these 10 contract areas, D.C. 37 estimated that the city could save \$130 million over three years.<sup>2</sup>

The total savings to the City could be much greater if opportunities for contracting in public services on a cost-effective basis were systematically pursued across all areas personal and professional service areas, including those funded through the capital budget.

Contracting in has the potential to benefit not only the city budget and taxpayers, but also the workers who provide New York City's public services. While the total cost of a service contract usually exceeds the cost of service provision using city employees, contract workers utilized by the contractor are not necessarily paid more than city employees, sometimes they are, but in the case of contracts outside the professional services area, they rarely are. And regardless of whether they are professionals or non-

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<sup>1</sup> Fiscal Policy Institute, *Privatization without Competition Equals Huge Losses: How the New York State Government Wastes Hundreds of Millions of Dollars without Increasing Service Quality*, June 2005.

<sup>2</sup> District Council 37, AFSCME, *Massive Waste at a Time of Need. An Examination of New York City's Contracting Out of Public Services with Recommendations for Savings*, February 2009.

professionals, contract employees rarely enjoy decent health insurance coverage and other fringe benefits. Service contracts with for-profit providers are more costly because of the very high costs of overhead and profit margins.

The employees of city contractors are typically not represented by a labor union. And increasingly, for many low- and mid-level New York City workers, not having a union means they have few or no health and other fringe benefits. In some cases, it also means they are not covered by critical social insurance programs—Social Security, unemployment insurance, workers' compensation, and disability insurance. These vital social insurance protections have long been taken for granted in the United States. Yet, increasingly, many workers in New York and other states find themselves misclassified by their employers as independent contractors. Following this practice, such employers do not pay into these social insurance programs on behalf of their workers in order to minimize their payroll costs. This is illegal in most cases, but government enforcement has been lax for most of the past decade.<sup>3</sup>

A Cornell University study examined state unemployment insurance audits and estimated that nearly one out of every ten New York workers were misclassified by their employers as independent contractors.<sup>4</sup> In examining the apparent growth in the use of misclassified independent contractors by industry in New York, we found substantial growth in many of the same areas where there has been a growth in contracting out city services.<sup>5</sup> Our research has also documented a sizable problem in the use of misclassified independent contractors in the New York City construction industry, including the city-subsidized affordable housing sector.<sup>6</sup>

It is impossible to say how widespread the misuse of independent contractors might be among city contractors, but this is an area that warrants a systematic review.

More broadly, the Council should consider how to reform the contracting process and decision-making regarding contracting out in order to ensure that city-funded services are delivered in a more cost effective manner. At the state level, the Governor issued Executive Order 6, "Ensuring the Cost-Effectiveness of Contracts for Personal Services" in June of 2008. This executive order established three criteria that an agency needed to assess before public service delivery could be contracted out:

- 1) The contractor can carry out the task more efficiently or effectively than state employees,
  - 2) The contractor can carry out the task for lower cost than such state employees;
- or

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<sup>3</sup> On the growth in misclassification in New York, see FPI's *The State of Working New York 2007*, September 2007.

<sup>4</sup> Linda H. Donahue, James Ryan Lamare, and Fred B. Kotler, *The Cost of Worker Misclassification in New York State*, Cornell University ILR School, February 2007.

<sup>5</sup> FPI, *The State of Working New York 2007*, p. 22.

<sup>6</sup> FPI, *The Underground Economy in New York City's Affordable Housing Construction Industry*, April 2007; and *Building Up New York, Tearing Down Job Quality: Taxpayer Impact of Worsening Employment Practices in the New York City Construction Industry*, December 2007.

3) The contract is necessary to protect public health or safety, or for some other compelling reason.

Executive Order 6 is a good start at the state level but could be more effective if the inter-agency task force that oversees its implementation included representatives of the Comptroller and the legislature.

In the wake of a 2003 analysis by D.C. 37 that documented the excessive cost of various cases of contracting out, and following Department of Investigations findings of improprieties with various contracts for computer consulting, the city's Department of Information Technology and Telecommunications (DoITT) began reducing its use of outside consultants. New civil service titles for IT professionals were created and the technical training of DoITT staff was expanded. Nearly 500 computer consultants were converted to city employees and the City realized substantial cost savings.

However, the agency apparently backed away from this initiative in 2006 and increased spending on IT consulting contracts even though the hourly rate for contract consultants is at least two to three times the fully loaded cost of using city employees according to the latest D.C. 37 analysis.<sup>7</sup> It is also likely that with a city hiring freeze in effect, agencies will turn to outside contractors to deliver city services. In such cases, the hiring freeze, intended to hold the line on budget spending, will instead result in greater overall spending.

There needs to be greater oversight of New York City contracting practices. We would urge the Council to further explore how to ensure that city-funded services are delivered in a more cost effective manner that also enhances the quality of the jobs needed to deliver those services.

Thank you.

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<sup>7</sup> District Council 37, *Massive Waste at a Time of Need*, pp. 18-19.