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ECONOMIC IMPACT OF FEDERAL SUPPLY  
AND SERVICE ACTIVITIES

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REPORT

OF THE  
SUBCOMMITTEE ON DEFENSE PROCUREMENT  
TO THE  
JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES



SEPTEMBER 1964

Printed for the use of the Joint Economic Committee

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## LETTER OF TRANSMITTAL

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SEPTEMBER 3, 1964.

*To Members of the Joint Economic Committee:*

Transmitted herewith is a report of the Subcommittee on Defense Procurement on the "Economic Impact of Federal Supply and Service Activities."

As in previous hearings and reports, the subcommittee has focused its efforts on economic subjects and has avoided such military matters as strategy, weapons systems, disarmament, etc.

I wish to express my appreciation for the excellent cooperation given by other members of the subcommittee and to the personnel of all agencies who have rendered valuable assistance in many ways in the preparation of the staff report, the hearings, and the field investigations upon which this report is based.

I would be remiss if I did not make special mention of the cooperation received from Secretary of Defense McNamara and Thomas D. Morris, the Assistant for Supply and Logistics, whose contributions to economy and efficiency in the Defense Department have been without parallel.

Special commendation must also be accorded to Comptroller General Joseph Campbell and his staff for the splendid special reports they have made at our request and for the regular reports issued almost daily during the past 4 years on subjects related to our investigations. The validity of the reports is proved by their general acceptance by those to whom they are directed.

PAUL H. DOUGLAS,  
*Chairman, Subcommittee on Defense Procurement.*

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# ECONOMIC IMPACT OF FEDERAL SUPPLY AND SERVICE ACTIVITIES

## INTRODUCTION

This report is largely a review of action taken on the recommendations and conclusions in the subcommittee's reports of October 1960<sup>1</sup> and July 1963<sup>2</sup> with some supplemental data provided by current investigations and hearings.<sup>3</sup>

Special consideration is given in this report to specific recommendations of the Comptroller General of the United States, who was requested to analyze the hundreds of reports issued by the General Accounting Office (GAO) during the past several years and to furnish the subcommittee a priority listing of ways and means to improve—

- (a) Defense procurement;
- (b) Standardization and elimination of items;
- (c) Management of automatic data processing equipment;
- (d) Management of military commissaries.

There have been some significant developments during the past year which will materially improve the effectiveness and efficiency in the Government's supply and services activities. These include the Department of Defense (DOD) cost reduction program, the continued progress of the Defense Supply Agency (DSA), the creation of a Consolidated Contract Administration in the DOD linking it to the DSA missions under the management of the Director of the DSA, and the issuance of a joint General Services Administration (GSA)—DSA plan for an integrated Federal supply and services system as intended by the basic General Services Administration Act of 1949, and very recently the initiation of a more potent standardization program in the DOD. (See app. 1, p. 16.)

The development of a civilian-military supply and services plan calls for full consideration of two fundamental issues which were raised during the hearings:

(a) What activities must be conducted by the Government itself and why? (The Bureau of the Budget is working on agency instructions covering part of this subject.)

(b) Of these, which must be conducted by military agencies and military personnel; and which by civilian agencies?

The testimony of Secretary of Defense McNamara shows great progress in the DOD through its cost reduction program. A release dated July 7, 1964, shows even greater progress. The new long-range

<sup>1</sup> Report, October 1960: "Economic Aspects of Military Procurement and Supply," report of the Subcommittee on Defense Procurement to the Joint Economic Committee, Congress of the United States, 86th Cong., 2d sess. (Hereinafter called "Report, October 1960.")

<sup>2</sup> Report, July 1963: "Impact of Military Supply and Service Activities on the Economy," report of the Subcommittee on Defense Procurement to the Joint Economic Committee, Congress of the United States, 88th Cong., 1st sess., July 1963. (Hereinafter called "Report, July 1963.")

<sup>3</sup> Hearings, 1964: "Impact of Military and Related Civilian Supply and Service Activities on the Economy," hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 88th Cong., 2d sess., Apr. 16 and 21, 1964. (Hereinafter called "Hearings, 1964.")

goal is an annual savings of \$4.6 billion by fiscal 1968 and each year thereafter. The actual savings in fiscal 1964 were \$2.5 billion. (See app. 2, p. 17, for details.)

Secretary McNamara's contributions to improved organization and management in the Department of Defense have been extraordinary. Basic reorganization in the Departments of the Army and the Navy, the establishment of the Defense Supply Agency, the Defense Intelligence Agency, the Consolidated Contract Administration, and the highly successful cost reduction program which is detailed in appendix 2, are only some of his outstanding accomplishments.

Secretary McNamara and his staff have met with members of the subcommittee from time to time since January 1961 to discuss subjects of mutual concern. The Secretary has been most cooperative in initiating and in pressing projects suggested by the subcommittee. He and Assistant Secretary Morris have also given serious consideration to the subcommittee's reports and recommendations, and have adopted many of them.

Further recommendations and constructive criticisms contained in this report, therefore, must be considered against the background of the remarkable accomplishments already achieved by the Secretary in the face of the herculean tasks and the many entrenched interests which confronted him upon his assumption of office.

GSA Administrator Boutin's testimony also reflects large economies in the general service areas of the Government—common supplies, motor pools, utilities management, use of surpluses, etc. Mr. Boutin testified that the GSA has saved the Government about \$5 billion in its 15 years of life and expects another \$5 billion savings in the next 4 years.<sup>4</sup>

Despite the commendable progress that has been achieved in the last few years, there should be no complacency at this time.

The constant barrage of GAO reports which are case studies of a relatively few contracts and transactions out of an estimated 8 million annual actions reflects the need for broader, swifter action to improve systems, practices, and organizations so that many corrections will flow from one change.

The subcommittee is disappointed at the DOD's inability to increase advertised competitive bidding. Eighty-seven percent of defense procurement was performed by negotiation in fiscal 1963—up slightly from 1962.<sup>5</sup>

The Comptroller General also testified that the vital standardization program has been lagging<sup>6</sup> and the subcommittee strongly approves current efforts to strengthen it.

There was general agreement by the witnesses before the subcommittee that improvement is needed in the development of engineering drawings and the development of a complete data package to increase advertised bidding and to secure the benefits therefrom.<sup>7</sup>

The military property holdings, both real and personal, continue to increase year by year despite the closing of installations and the undoubted economies that have been achieved. At the end of fiscal 1963, the real property holdings were up \$1 billion to \$36.6 billion and

<sup>4</sup> Hearings, 1964, p. 195.

<sup>5</sup> Staff Materials, 1964: "Background Material on Economic Aspects of Military Procurement and Supply—1964," materials prepared for the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 88th Cong., 2d sess., April 1964 (hereinafter called "Staff Materials, 1964"), p. 23.

<sup>6</sup> Hearings, 1964, pp. 133-137.

<sup>7</sup> Hearings, 1964, pp. 11, 81, 96, 138, 205.

personal holdings increased by \$5 billion to \$134.8 billion, with a grand total for both of \$171.4 billion—an astronomical sum.<sup>8</sup>

Too many decisions are too long pending in the executive branch, thus indicating a split responsibility and lack of top guidance.<sup>9</sup>

Conceivably, an effective and efficient defense organization, with all activities stripped therefrom not requiring military personnel as in stores, accounting, auditing, commissaries, PX's, etc., could have a heavy impact on military personnel requirements and on expenditures.

The question is often raised as to the eventual impact upon the economy of conversion from emergency to peacetime conditions and the closing of unneeded bases, installations, facilities, and contracts by the defense agencies. Other committees are considering these very important questions.

This subcommittee and the full committee have taken the position that our economy can and should bear all our needed defense costs, but should not be burdened with nonessentials which waste our substance and deprive meritorious military and civilian programs—Federal, State, and local—of economic lifeblood. There should be sufficient collective wisdom and fortitude to make needed changes without economic calamity. It should be recalled that the expenditures for military services dropped from \$84.6 billion in fiscal 1945 to \$11 billion in fiscal 1948.

#### COMMENTS ON PREVIOUS SUBCOMMITTEE RECOMMENDATIONS

In its October 1960 report, the subcommittee strongly recommended the creation of a Common Supply Agency at the level of the Office of the Secretary of Defense. This was accomplished in the creation of the DSA, which became operational January 1, 1962, under its first Director, Lt. Gen. A. T. McNamara.<sup>10</sup>

Among other things, the Agency in its short life has made a sizable contribution to the DOD cost reduction program by assuming numerous assigned functions with an estimated personnel reduction of 5,675 as of June 30, 1964. Storage locations have been reduced from 77 to 29. The stock fund inventories have been reduced by \$500 million by attrition of stocks. Centrally managed items have risen from 87,000 in January 1962 to an estimated 1,379,000 at end fiscal 1964.<sup>11</sup>

According to General McNamara's testimony in the April 1964 hearings, savings for fiscal 1964 were estimated to be \$60 million annually.

As indicated above, the consolidated contract administration functions are now linked to the missions of the DSA and placed under the Director of the DSA.<sup>12</sup> (See app. 2, p. 17.) It is noted that to date the contract audit functions have not been consolidated. As indicated in previous hearings and reports, this is a potentially important area.

Secretary McNamara testified in the April 1964 hearings that 150 field offices employing 20,000 people will be consolidated with 1,800 fewer employees at an annual saving of about \$1 million.

<sup>8</sup> Staff Materials, 1964, p. 5. See also, Hearings, 1964, p. 232.

<sup>9</sup> Hearings, 1964, pp. 175-176, 178, 194, 197-198, 221.

<sup>10</sup> Report, October 1960, pp. XI-XII.

<sup>11</sup> Hearings, 1964, pp. 103-126.

<sup>12</sup> Hearings, 1964, pp. 30, 33, 80, 96, 122.

Investigations at several of the DSA operating units reveal an exceptionally enthusiastic personnel convinced they are engaged in a worthwhile program. These people are striving to find ways and means to contribute to the DOD cost reduction program.

#### FURTHER RECOMMENDATIONS

##### NEED TO RESTUDY ASSIGNMENT OF MANAGEMENT OF ITEMS AS BETWEEN THE DSA AND THE SERVICES

While the DSA planned to manage 1,379,000 of the 3,900,000 items in the DOD supply systems, there continues to be duplication of management effort for identical or closely related items in many classes as between other services and the DSA.

Since the services are permitted to retain item management on the basis of whether or not they are "weapons related," it is recommended that the Office of Secretary of Defense (OSD) make the division of responsibility on the basis of effectiveness, efficiency, and economy in the light of developments in improved inventory controls and advanced systems of distribution.

##### STANDARDIZATION OF ITEMS

Chairman Douglas stated at the beginning of the April 1964 hearings:

\* \* \* we have sought to get the optimum of standardization in organization, procedures, forms, items, and so forth. I stress "optimum" with the realization that standardization on the lowest denominator may be ruinous, but this is no excuse for wanton proliferation.

We have sought to compile a list of common activities—not that there is such duplication in each as to require centralization or standardization, but that *there may be possibilities for improvement.*<sup>13</sup> [Italics added.]

The Chairman's letter of March 18, 1964, to Comptroller General Campbell (see app. 3, p. 24) stated in part:

Your findings and views on progress being made in the standardization and elimination of items in military and related civilian supply organizations will also be appreciated.

Mr. Campbell testified at some length on this point and his conclusion was:

We do not believe the defense standardization program has received the emphasis and strong central direction it requires to achieve its objectives or to realize the economies that could result from aggressive direction by the Department of Defense.<sup>14</sup>

This is a serious deficiency in the conduct of a most important function.

The Comptroller General cited numerous examples of failure to standardize on comparatively simple common-type items due to the lack of the exercise of the power of decision at a level above the competing services.

He also testified that there has been some overstatement of accomplishment on standardization in reports to the Congress pursuant to law.

<sup>13</sup> Hearings, 1964, p. 2.

<sup>14</sup> Hearings, 1964, pp. 133-137.



The subcommittee was impressed by these views in a key area so important in increasing competitive bidding and small business participation; in reducing purchases, shipping, and storage; in obtaining greater utilization and cross-servicing; and in reducing the volume of surpluses.

#### RECOMMENDATION

The subcommittee urges that the Secretary of Defense bring this problem under more decisive control so that accelerated progress may be achieved. Since standardization, as Secretary McNamara previously advised this subcommittee, must begin in the research and development stage,<sup>15</sup> it is necessary that the views of research and development as well as production, supply, and service people be merged in the final decisions.<sup>16</sup>

#### NEED TO IMPROVE CONTRACTING

As noted above, the DOD has taken a major step to improve contract administration. This step should reduce personnel and facilities, promote standardization of methods, forms, and procedures, eliminate overlapping groups of plant inspectors and expeditors, give the Government better control over contractor inventory including machine tools, automatic data processing equipment, expedite payments to contractors, and eliminate time-consuming renegotiations.

It should also enable the Government to more readily capture know-how existing in drawings and other sources which were created at public expense and are vitally needed in further contracting.

Of even greater importance than "contract administration" is improvement in "contract formulation" which requires among other things:

1. More advertised bidding.
2. Better engineering data and specifications.
3. Utilization of existing inventories and Government-furnished stocks—direct procurement.

##### *1. More advertised bidding*

A century of experiences, many not savory, compelled the Federal Government to develop what is known as Revised Statute 3709 with the intent as expressed by the Comptroller General of the United States in 34 Comp. Gen. 551:

The courts and accounting officers of the Government have frequently and consistently held that section 3709, Revised Statutes, was designed to give all persons equal right to compete for Government business, to secure to the Government the benefits which flow from competition, to prevent unjust favoritism by representatives of the Government in making purchases for public account, and to prevent collusion and fraud in procuring supplies or letting contracts.

This statute was superseded insofar as the military departments, the Coast Guard, and the NACA were concerned by the Armed Services Procurement Act of 1947<sup>17</sup> which also provided that adver-

<sup>15</sup> Hearings, 1963: "Impact of Military Supply and Service Activities on the Economy," hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 88th Cong., 1st sess., Mar. 23, 29, and Apr. 1, 1963, p. 6. (Hereinafter called "Hearings, 1963.")

<sup>16</sup> NOTE.—On June 12, 1964, Secretary McNamara established an Office of Technical Data and Standardization Policy. (See app. 4, p. 25.)

<sup>17</sup> Public Law 413, 80th Cong., 2d sess.

tised bidding should be the rule and not the exception in its application. Section 2(c) states:

All purchases and contracts for supplies and services shall be made by advertising, as provided in section 3, except that such purchases and contracts may be negotiated by the agency head without advertising if \* \* \*.

(Seventeen exceptions are listed in the preceding section.)

As the subcommittee report of October 1960<sup>18</sup> pointed out, the exception to the advertised bid rule for fiscal years 1951 through 1959 was 86.6 percent of procurement actions of almost \$208 billion. Adherence to the rule was only 13.4 percent.

For the fiscal years 1960 through 1963 the percentages of negotiated bids by dollar volume have been 86, 88, 86.9, and 87 percent, respectively, for an average of 86.7 percent<sup>19</sup> on total procurement actions of \$97.6 billion. Adherence to the rule for this period was only 13.3 percent.

When President Truman signed the Armed Services Procurement Act of 1947 he warned the recipients of the authority to negotiate contracts to use it sparingly, prophesying that its improper use "will lead to excessive placement of contracts by negotiation and undue reliance upon large concerns, and this must not occur."<sup>20</sup>

But it has occurred, as is evident from the fact that in fiscal 1963 negotiated bids accounted for 87 percent of the total, and 100 companies and their subsidiaries received net contract awards of \$19.09 billion, or 73.9 percent of the \$25.834 billion total. Five companies received 23.2 percent, 10 received 34.1 percent, 23 received 50.1 percent, and 50 received 65.6 percent.

In fiscal 1962, the hundred largest companies received 72.3 percent, and in fiscal 1959 it was 73.8 percent.

So, in sum—for fiscal 1963, almost three-fourths of the volume was negotiated and almost three-fourths of the volume went to 100 concerns.

President Truman's prescience in 1947 was unbelievably accurate.

## 2. *Better engineering data and specifications*

Since there has been a consistent record of negotiation of the bulk of defense requirements with the large contractors who gain thereby the experience, know-how, rights, etc., and become entrenched, it is necessary that the trend be reversed.

It is noted that 42 percent of the procurements of the DSA are by advertised means as are about 92 percent of the purchases of the GSA. This is so since these agencies generally procure standardized items.

This illustrates the importance of accelerating the standardization of items program, including those that are components of complex systems. It may be impossible to make a detailed specification of an entire end item but it is not impossible to do so for many of its parts. It is a question of breaking them out for separate treatment. This is being done, but on a meager scale.

This points to the need for the Government to obtain the use of engineering drawings and other data which have been financed at public expense but which the Government has not obtained nor organized for its own use, and so is often deprived of the use of its own data and sometimes actually repurchases it.<sup>21</sup>

<sup>18</sup> Report, October 1960, p. 25.

<sup>19</sup> Staff Materials, 1964, p. 23.

<sup>20</sup> Report, October 1960 p. 95.

<sup>21</sup> Hearings, 1964, pp. 137-140.

The Comptroller General stated that there is the tendency for some contractors to improperly indicate broad proprietary rights on drawings, which places the burden on the Government to disprove and often goes unchallenged. The stewardship of drawings and other "know-how" that belong to the public is as vital a responsibility as inventory control of supply items or public lands.

In a prepared statement, the Comptroller General testified:

As a result, the Government is being deprived of the use of a great bulk of the data acquired and delivered under negotiated production and supply contracts. We believe that firm measures should be taken to avoid or substantially limit the acceptance of drawings and data on which the Government's right to use such drawings and data is restricted. The contractors should also be required to submit required data promptly or be subject to penalties.

In one of our reports (B-146734, dated June 25, 1963) we disclosed that the Government gradually lost its capability to use technical data for competitive procurement of replacement spare parts for gas turbine engines developed at Government expense. When entering into and administering follow-on production contracts, the Department of the Navy failed to acquire unlimited rights to use current data which gradually replaced the unrestricted data initially acquired.

In another case (B-146035, dated Dec. 31, 1963) we found that the Navy contracted to pay a contractor \$1,010,000 for a technical data package although it had already acquired, under prior contracts, unlimited rights to use all significant data included in the data package.

Perhaps no point was stressed so much during the subcommittee's 1964 hearings as the need to have an adequate package of engineering drawings and detailed specifications in order that genuine advertised competitive bidding might be achieved with all the benefits flowing therefrom.<sup>22</sup>

The subcommittee recommends that a major effort be made to protect the Government's rights to know-how resulting from Government expense and to obtain, catalog, and organize this material so that it will be available for the Government's own future use.

### *3. Utilization of existing inventories and Government-furnished stocks— Direct procurement*

Senator Douglas posed a basic question to the Comptroller General:

During the past 4 years, you have given this committee around 300 reports dealing with the problems of military procurement and handling of supplies. Now, from these reports, from your experience, what would you say are the priority needs and ways in which these activities could be improved?<sup>23</sup>

Mr. Campbell replied:

Mr. Chairman, I would say that the area of defense operations we believe most deserving of immediate consideration, and one that can be undertaken even under the Department's existing legal authority, would be to increase substantially the amount of Government-furnished material supplied contractors. This is a subject to which I have referred today quite frequently. We think this should have first priority.

Chairman DOUGLAS. That is, the handling of contracts.

Mr. CAMPBELL. Direct Government procurement of components and assemblies and the utilization of excess stocks of spare parts and supplies in the production of end items would greatly reduce the costs of such items to the Government, narrow the base on which the prime contractors' profits are calculated thereby bringing the profit base more nearly in line with their contribution to the contract work, provide an opportunity for a wider diffusion of Government contract work throughout the whole of the business community; I think this is very important, to provide the Government with a source for direct procurement of spare parts requirements, again at reduced cost. As pointed out in my statement, in several

<sup>22</sup> Hearings, 1964, pp. 11, 81, 96, 138, 139, 205.

<sup>23</sup> Hearings, 1964, pp. 171-172.

of our reports and as is becoming increasingly apparent, from our work, opportunities for immediate savings in this area are tremendous.

The second area is related to this first, and that is covered, referred to in a report released on Monday of this week.<sup>24</sup> We pointed out that the Air Force is incurring millions of dollars of unnecessary cost for the purchases of substantial quantities of titanium and aluminum, although the Government already owns and is storing at considerable cost large quantities of these materials which are surplus in its current stockpile requirements.

Those two areas, I think, are of immediate concern.

Chairman DOUGLAS. Very important. I hadn't realized that the Air Force was purchasing titanium and aluminum. The stockpiles of these are huge, as I understand it.

Mr. CAMPBELL. And their purchases are huge.

Representative CURTIS. Mr. Chairman, a question I wanted to ask and had forgotten was brought up by your first answer to this business of direct procurement.

Mr. Campbell, you make this remark: "To the extent that increased competition has been achieved, in many cases it appears to have been accomplished by various means of describing the items short of providing detailed engineering data."

In this business of breakout, or whatever they want to call it, of dealing directly with components, and so on, it seems to me the key item is engineering data, and frequently, engineering drawings and their specifications. Am I in accord with your thinking?

Mr. CAMPBELL. Quite correct.

Representative CURTIS. I was trying to make a point of that during the interrogation this morning of Secretary McNamara, and there seems to be agreement there, too. This is what seems to be lacking.

#### *Direct procurement*

Mr. Campbell testified further:<sup>25</sup>

The Government should engage in more direct procurement. Oftentimes, in the production of equipment, Government contract administrators will permit contractors to buy parts or subassemblies which are either regularly stocked or are being bought concurrently by the military departments. For various reasons, the Government is frequently able to acquire this material at prices substantially lower than prices offered by the suppliers to contractors producing the equipment on which it is to be installed.

In these cases we believe it would be prudent for the Government to furnish the material to the contractors and thus reduce production costs and contract prices.

In one report we disclosed that, although the military services were buying and had the capability to furnish certain types of electronic equipment for the modification of SA-16 aircraft, the modification contractor was authorized by the Air Force contract administrators to purchase the needed equipment.

The Air Force did not furnish the contractor with pertinent information on past, current, and planned purchases of this equipment by the military services. Prices obtained by the contractor were about 61 percent higher than prices currently being obtained by the Air Force and Navy for like equipment. The total additional cost to the Government resulting from this price differential was about \$1,150,000.

The Government frequently can obtain better prices through direct purchases than do contractors purchasing for the Government. This fact is borne out in our report on a review of increased costs resulting from the procurement of spare parts by the Air Force under contracts for related aeronautical equipment, submitted to the Congress in January 1964.

Generally, when a new item of equipment is purchased, it is a practice to purchase from the equipment contractor a complete range of spare parts to assure support of the equipment for an initial operating period, usually 1 year. Our report showed that the Government has incurred unnecessary costs estimated at over \$18 million during the years 1959 through 1961. This was because the Air Force purchased spare parts, costing over \$50 million, under contracts for related equipment, although the parts could have been purchased under spare parts contracts, generally from other suppliers, for about \$32 million. These

<sup>24</sup> B-125071, dated Apr. 13, 1964.

<sup>25</sup> Hearings, 1964, pp. 140-143.

parts were of the type that had been purchased previously by the Air Force, either under parts contracts or under earlier equipment contracts, and additional parts needed could have been obtained under parts contracts at substantially lower costs.

Chairman DOUGLAS. Mr. Campbell, how do you account for the fact that the Government can generally obtain better prices through direct purchases than contractors purchasing for the Government?

Mr. CAMPBELL. My impression is that the Government is in a better position to negotiate with the supplier directly. One reason is the volume of purchases involved as against the smaller volume for which the individual contractor would be forced to negotiate.

Chairman DOUGLAS. Secretary McNamara has, of course, reduced the volume of cost-plus-fixed-fee contracts. But to the degree that they still exist, this results, does it not, in a higher price paid by principal contractors?

Mr. CAMPBELL. That is correct. I should also say, Mr. Chairman, that in direct purchase, of course, you eliminate the markup which the prime contractor would add to the source price.

Chairman DOUGLAS. That is the point that Senator McClellan made in dealing with one of the airplane companies.<sup>25</sup>

Mr. CAMPBELL. With respect to excess stocks of Government-owned supplies and their use in the procurement of end items of equipment, one of the reports which was furnished for the consideration of this subcommittee last year disclosed that the Navy had about \$2.2 million worth of excess spare parts and assemblies for F-8U type aircraft which could have been transferred to a contractor as Government-furnished material for use in production of new aircraft of the same type.<sup>27</sup>

As stated in our report submitted to the Congress in February 1963, the Navy had no established procedures for identifying such excesses and arranging for their transfer and use in current production of aircraft. We found that about \$1.9 million worth of excess spare parts and assemblies could have been used in aircraft production during the fiscal years 1960, 1961, and 1962.

After we brought this matter to its attention, the Navy transferred \$893,000 worth of the excesses for use in production of aircraft ordered in fiscal year 1962 and planned to transfer about \$789,000 worth for use in fiscal year 1963.

We made a followup review of the Navy's fiscal year 1963 plans to use the excess spare parts and assemblies. We found that \$294,000 worth of excess items were usable in the production of S-2 type aircraft and a contractor had informed the Navy that it could use \$107,000 worth in the production of Navy orders. However, because the Navy delayed so long in furnishing the excess items to the contractor, production schedules would not permit it to await the transfer of the parts and assemblies.

After we inquired into the matter, the Navy took action to determine the quantities of excess items that could be made available for use in the production of aircraft during fiscal years 1964 and 1965, and planned to use \$288,000 worth of the excesses. However, in the meantime, an additional \$298,000 worth of spare parts and assemblies usable on S-2 type aircraft became excess to Navy needs, thereby increasing the amount of the excesses from \$294,000 to about \$592,000.

In another report we disclosed that the Army had incurred an estimated \$1.4 million of unnecessary costs in the production of Nike-Hercules missiles through its failure to recognize the availability of excess missile components and to provide these to the missile contractor for use in production. These excess components were transponders which had been acquired for use as spares but were no longer needed for this purpose.

Chairman DOUGLAS. You will forgive me, Mr. Campbell, if I constantly raise questions. Earlier, you modestly claim a savings which you made here, included in the \$206 million, or economies which you said had been effected through your suggestion.

Mr. CAMPBELL. These items would be in our report for fiscal year 1964. They are not in the \$206 million amount which I mentioned earlier.

Chairman DOUGLAS. Presumably, and in fact, at Battle Creek, they attempt to get a record of the stocks in all services and balance those against the requirements of all services and effect transfers. Couldn't the Battle Creek agency be used to accomplish a better balance of stock as against requirements?

<sup>25</sup> See S. Rept. 970, 88th Cong., 2d sess., "Pyramiding of Profits and Costs in the Missile Procurement Program," report of Committee on Government Operations, U.S. Senate, 1964.

<sup>27</sup> See Comptroller General's Report B-146727, Feb. 15, 1963.

Mr. CAMPBELL. I think it could. Of course, Mr. Chairman, the examples that I give here do not encompass very large figures. You realize that we do not get into too many items. This is only an indication, and you might have to multiply this by many times to arrive at the real loss.

Chairman DOUGLAS. I suppose Battle Creek uses computers. I should think that the use of computers would permit the surpluses and deficits to be identified.

Mr. CAMPBELL. Yes, sir.

As to other areas indicating need for better contract administration, briefly, other areas in which our reports of the past 12 months indicate a need for stricter contract administration by Government personnel and recognition by contractors of their responsibility to provide the Government with its requirements at minimum cost are illustrated by the following examples:

1. In 15 reports we disclosed excessive prices totaling about \$12 million, were negotiated with prime contractors.

2. In eight reports we disclosed excessive prices negotiated by prime contractors with subcontractors. In five cases excessive prices totaled \$2 million. In three cases the subcontractor's profits ranged from 38 to 51 percent of production costs.

Representative GRIFFITHS: May I ask you, Mr. Campbell, do you have any suggestion for ways in which this could be stopped, the excessive charges of the subcontractor?

Mr. CAMPBELL. Mrs. Griffiths, there is no question but that this is a matter of contract administration, of capable conscientious administration of the contract, running right through the prime contractor's operations down through the subcontractors.

#### RECOMMENDATION

The subcommittee is in complete accord with the Comptroller General's recommendation that the Government should use its available resources, including supplies, equipment, drawings, stockpile materials, etc., before acquiring more either through its own services or through its contractor-agents. This is only commonsense.

It must be realized, however, that the matching of requirements against resources necessitates the existence of adequate management control over both requirements determination and inventories so they may be matched against each other.

In the past it has been impossible to do this matching in the absence of an adequate catalog with the stocks under the divided custody of many agencies in many separate places. But a usable catalog has been made at a cost of more than \$200 million and the use of automatic data processing now makes it possible to maintain up-to-date inventories of all items cataloged in the military systems. Requirements can be matched against total inventories and not merely against the long stocks declared by holding agencies desirous of being self-sufficient. When this is done, the extent of utilization of inventories should greatly increase and surplus disposals will also decrease.

#### SHORT-SHELF-LIFE ITEMS

There are many items in Federal stocks which are subject to spoilage, deterioration, and obsolescence and are known as short-shelf-life items. Common items in this category are rubber goods, paints, lacquers, varnishes, photographic films, papers, drugs, batteries, and, of course, food. Some of these items are dated by the manufacturer in order to assure full use of the product.

The subcommittee has collected samples of some of these items after the goods were declared surplus to Government needs and made available to educational institutions generally for salvage value.

The losses from short-shelf-life items in the past have run into millions of dollars annually, and the subcommittee raised the issue at hearings in 1961.<sup>28</sup>

It appears that the problem is far from solved since the recent transfer of responsibility for management of paints from the DSA to the GSA reveals that of the inventory transferred 5.7 percent valued at \$350,560 was unusable. (See app. 5, p. 25.)

#### RECOMMENDATION

It is therefore recommended that the GSA and the DSA set up a joint project to identify and use throughout the Government the existing short-shelf-life items now in stock and to devise ways and means to reduce losses from these items in the future. The subcommittee will expect a full reporting on this subject at its hearings next year. The GAO is also requested to check into this subject and to report to the subcommittee by March 1965.

#### COMMON SERVICES—AUTOMATIC DATA PROCESSING (ADP)

The subcommittee recommended in its July 1963 report<sup>29</sup> that prompt and thorough hearings be held on pending bills (H.R. 5171 [Brooks] and S. 1577 [Douglas]) in order that more economy and efficiency be injected into the management of automatic data-processing equipment by the executive agencies.

While no legislative action has been taken to date, witnesses from the DOD, the GSA, the GAO, and the Bureau of the Budget (BOB) testified that some progress was made during the past year.<sup>30</sup>

The Comptroller General advised the subcommittee, however, that:

The kind of management needed to take full advantage of these possibilities for economy in procurement and utilization of automatic data-processing equipment can only be achieved if the responsibility is centralized and appropriate authority provided to make such management effective.

The subcommittee noted from the testimony received during the April 1964 hearings that split responsibility exists in this area and should be clarified. This is another instance of long-deferred decision-making in an area of expenditures and investments amounting to hundreds of millions of dollars annually and steadily growing for the past decade.

#### COMMERCIAL-INDUSTRIAL ACTIVITIES OF GOVERNMENT

In its report of July 1963 the subcommittee recommended that the BOB monitor an intensive two-way program under Bulletin 60-2<sup>31</sup> which was then undergoing revision:

First, all new activities proposed to be started should be carefully screened on the basis of essentiality. Second, those in existence should be identified, listed, and eliminated or curtailed in scope. Again, the basis for continuation should be essentiality. (Page 19.)

<sup>28</sup> Hearings, 1961: "Progress Made by the Department of Defense in Reducing the Impact of Military Procurement on the Economy," hearing before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 87th Cong., 1st sess., June 12, 1961, pp. 53-54. (Hereinafter called "Hearings, June 12, 1961.")

<sup>29</sup> Report, July 1963, p. 13.

<sup>30</sup> Hearings, 1964, pp. 79, 86, 146-150; 192-193; 223-228.

<sup>31</sup> See Report, July 1963, pp. 52-55 for text.

The subcommittee also recommended—

\* \* \* that a vigorous recruiting and training program be instituted so the Government will have the in-house capability to obtain what it needs from industry and know that what is received meets the specifications. (Page 19.)

During the subcommittee's April 1964 hearings, the subject of Government competition with private industry and the impact on the tax base was raised by a number of witnesses as to microwave systems, printing, editorial services, employment services, aerospace services, shipbuilding and repair, engineering services, photogrammetric services, floral services, and commissaries.

While the BOB has still not issued the long-pending revision of its instructions for the guidance of executive agencies, the subcommittee reaffirms its previous recommendations.

### MILITARY COMMISSARIES

The subcommittee's report of July 1963<sup>32</sup> revealed that sales at military commissary stores in the United States for the last reporting period were \$659,385,000, thus making them one of the Nation's largest retailing organizations. As stated in the report, the DOD Appropriation Act since fiscal 1954 has carried restrictive, authorizing language:

*Provided further,* That no appropriation contained in this Act shall be available in connection with the operation of commissary stores within the continental United States unless the Secretary of Defense has certified that items normally procured from commissary stores are not otherwise available at a reasonable distance and a reasonable price in satisfactory quality and quantity to the military and civilian employees of the Department of Defense.

The number of commissaries increased from 211 at June 30, 1953, to 285 in January 1963, and for the 8 in the Metropolitan Washington area the military services certified that 6 were continued in operation in 1963 because commercial prices were judged to be unreasonable, and 2 were maintained because of unreasonable prices and unreasonable distances to commercial facilities under regulations issued by the DOD to implement the congressional intent.

The GAO was therefore requested to make a detailed investigation and report on military commissary stores.<sup>33</sup> The full report is included in the subcommittee hearings,<sup>34</sup> and the Comptroller General's summary of the report in a letter of transmittal is included in the appendix of this report (see app. 6, p. 26) as is a review of the report specifically requested of the DOD (see app. 7, p. 27).

### CONCLUSION AND RECOMMENDATION

It is the responsibility of the Comptroller General of the United States under the authority of the Budget and Accounting Act of 1921 (31 U.S.C. 53) to interpret the legality of the receipt, expenditure, and application of public funds.

The Comptroller General's letter to the subcommittee (see app. 6, p. 26) makes the unequivocal statement:

The authorization of commissary stores has continued each year because the criteria established by the Department of Defense defeat the purpose of the law.

<sup>32</sup> Report, July 1963, p. 16.

<sup>33</sup> Report, July 1963, p. 17.

<sup>34</sup> Hearings, 1964, pp. 349-362.



The Comptroller General suggests that this subcommittee consider recommending to the Congress the enactment of legislation to establish precise conditions under which the operation of military commissary stores may be authorized.

The subcommittee considers this suggestion to be appropriate and recommends that the executive branch through regular channels transmit to the Congress draft legislation covering the numerous facets of this problem.

#### REVIEW OF ALL COMMON SERVICE ACTIVITIES PURSUANT TO THE McCORMACK-CURTIS AMENDMENT

As noted above, Chairman Douglas stated at the beginning of the subcommittee's 1964 hearings: <sup>35</sup>

We have sought to compile a list of common activities—not that there is such duplication in each as to require centralization or standardization, but that there may be possibilities for improvement.

The subcommittee notes that considerable progress has been made by the DOD in recent years in the consolidation of common activities in the fields of supply, contract administration, communications, intelligence, transportation, etc.

But the potential of consolidation of common supply and service activities has only been scratched in the DOD <sup>36</sup> and in the Government. The subcommittee renews its previous recommendation that, as a part of the cost reduction program, a systematic program be pushed in the DOD to establish priorities for the study and analysis of common service activities and determinations made as to the most appropriate way to manage each in terms of effectiveness, economy, and efficiency as contemplated by the McCormack-Curtis Amendment. And as a part of the federalwide plan, the BOB and GSA should keep in close liaison with the DOD program to insure that government-wide application is given to activities warranting such action.

#### GENERAL

##### PROCUREMENT ADVISORY CENTER <sup>37</sup>

The subcommittee was urged in connection with its hearings in April 1964 to take steps to assure the preservation of the Procurement Advisory Center, which was operated for many years by the Department of the Army, then by the Small Business Administration in 1962, and discontinued, in part, effective May 22, 1964.

The executive agencies concerned with this Center are of the opinion that its full continuance was not justified in the Government's interest. The subcommittee has not received sufficient evidence, in its judgment, to override this position. However, the GSA is requested, pursuant to its authority under the Federal Property and Administrative Services Act of 1949, to review the situation so it may be assured that ample information is available to potential bidders and others, so that the public's best interests are served.

<sup>35</sup> Hearings, 1964, p. 2.

<sup>36</sup> Report, July 1963, see p. 10, for partial listing.

<sup>37</sup> Hearings, 1964, pp. 52, 267-286.

“BUY AMERICAN” ACT (41 U.S.C. 10 a-d)

Members of the subcommittee have been interested in the application of the so-called “Buy American” Act (41 U.S.C. 10 a-d) and its impact on prices paid by the Government for items of supply. As a partial basis for future consideration of the subject, the subcommittee is interested in developing the following points:

1. How does the lack of uniformity in the application of differentials pursuant to the “Buy American” Act affect prices paid by the Government?
2. How much does it cost through the “Buy American” Act procedure to save a dollar in balance of payments?

The GAO is requested to look into these two questions in connection with its regular investigations, if possible, and advise the subcommittee of its findings by March 1965.

RELATIONSHIPS BETWEEN PRIME CONTRACTORS AND SUBCONTRACTORS

During the subcommittee’s April 1964 hearings, Congresswoman Griffiths, in questioning defense witnesses, expressed concern that subcontractors were often subjected to arbitrary treatment by prime contractors and not afforded adequate protection by the contracting agencies of the Government.

Time did not permit a full development of this subject at the hearings. The GAO is therefore requested to check the case material available and further develop the subject for hearings in March 1965.

STOCK FUNDS

The subcommittee report of October 1960 was critical of the misuse of stock funds in the DOD and recommended that the BOB, the DOD, and the GAO come to a decision as to the proper use of stock funds and rescind funds not absolutely justified.<sup>38</sup>

Chairman Douglas expressed his concern about the matter to Secretary-designate McNamara by letter dated December 30, 1960.<sup>39</sup>

Subsequently, the GAO was requested to study the stock fund system and report to the subcommittee.<sup>40</sup> Two GAO reports revealed improper, even illegal, use of stock funds. The subcommittee, therefore, renewed its previous recommendation on the use of stock funds.<sup>41</sup>

Mr. Elmer B. Staats, Deputy Director of the BOB, advised the subcommittee on April 21, 1964,<sup>42</sup> that criteria have now been developed governing the use of stock funds as follows:

I believe the subcommittee will be interested especially in progress which has been made to refine the criteria for use of stock funds and to improve the management of the funds. As reported to you last year, we participated in developing these criteria which may be summarized as follows:

Items will not be carried in stock funds if they are—

Primary items (tanks, aircraft, and so forth).

Insurance items (items have no predictable failure rate in normal usage but need is critical if failure occurs).

<sup>38</sup> Report, October 1960, pp. XII; 52-53.

<sup>39</sup> Report, July 1963, pp. 39-40.

<sup>40</sup> Hearings, 1963, pp. 121, 160. See also, Hearings, June 12, 1961, p. 155.

<sup>41</sup> Report, July 1963, p. 6.

<sup>42</sup> Hearings, 1964, pp. 216-217.

Directly related to safety of personnel (parachutes, life preservers, and so forth).

Coded for repair at depots (engines, fuel controls, and so forth).

In stages of research and development (new weapons systems, missile components).

Controlled locally at bases which are not otherwise provided with stock fund controls.

Items will be carried in stock fund if none of the conditions listed above apply.

Mr. Staats further advised that stock fund inventories had been reduced from a total capitalization of \$16.429 to \$6.527 billion as of June 30, 1963.

The subcommittee recommends that the new criteria should be in use for at least a year before their effectiveness is evaluated.

# APPENDICES

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## APPENDIX 1

ASSISTANT SECRETARY OF DEFENSE,  
Washington, D.C., June 12, 1964.

Mr. HAROLD H. RUBIN,  
Associate Director, General Accounting Office.

DEAR Mr. RUBIN: This responds to your letter dated April 10, 1964, requesting comments on your draft report entitled "Lack of Progress Under the Defense Standardization Program Resulting in Unnecessary Procurement and Supply Management Costs for Electronic Items Within the Department of Defense" (OSD case No. 1979).

This Office concurs generally in the substance of the report as written. Comments on your specific recommendations follow:

*Recommendation 1.*—That the central management role of the defense standardization activity be strengthened so that this organization can effectively guide, direct, and control the totality of DOD supply standardization effort; and that the DOD standardization activity be required to develop more adequately the policies and procedures necessary for effective work accomplishment, be directed to establish priorities and goals for timely adjustment of item reductions and require departmental compliance therewith, be required to maintain surveillance and exert positive control over work progress, and be given specific authority to make final supply standardization decisions for all items in the military supply system when necessary because of interservice disputes.

*Comment.*—Concur. This recommendation is considered in consonance with studies of this Department which have revealed the need for stronger administration of the standardization program, including a system for programing of defense standardization program work which will provide more meaningful objectives and priorities, facilitate the determination of resource requirements, and inform management as to project status and progress.

*Recommendation 2.*—That an improved reporting system be devised which would include adequate controls to assure reliability of data; that the reporting objectives and procedures be clearly defined and disseminated to all levels of responsibility in the reporting process; and that item reduction accomplishments be reported to the Congress only when an item is removed from the DOD-wide supply system as a result of Defense standardization program actions.

*Comment.*—This Office subscribes to the necessity for better definition of standardization accomplishments and increased reliability of data. The duplicative or repetitive reporting of item reductions by the same military service in subsequent reports is obviously improper and will be corrected by more definitive reporting instructions.

In regard to the reporting of item reductions to the Congress, it is pointed out that in its total context, the standardization process involves many activities throughout the departmental structure. Invariably, it commences with intradepartmental actions which are adopted by other military departments and may be eventually formalized by a DOD standardization project. Item reductions resulting from supply management operations of a standardization type within a specific military department have the same effect as if they resulted from a DOD-initiated standardization project. It is our opinion that the Congress is interested in all reductions, regardless of the origin of the project, and would not wish to ignore reductions resulting from the intradepartmental operations of a sole user, especially since the elimination of the item is reflected in the DOD-wide supply system. In addition, with respect to items used by two or more departments, item reductions by one or more departments but not yet DOD-wide clearly represent real cost savings, and for that reason warrant inclusion in item reduction reports.

It should be noted that the report made to the Congress indicates "item elimination recommendations or decisions." As a matter of economy and good business

practice, the removal of an item from the supply system must await the attrition of existing assets. This may take months or, in some instances, several years after the military supply standard is issued. A current report of item reductions under the DOD cost reduction program, based upon actual withdrawals from the DOD catalog and supply system, is provided this Office on a quarterly basis and is available for reference.

In summary, it is recognized that there is a requirement for improving management practices in the Defense standardization program. The standardization area has been subjected to a critical analysis during the past year and, as indicated previously, recommendations to establish a strong central management group, with overall responsibility to provide positive direction and control for the standardization program, have been made to this Office and to the Office of the Director, Defense Research and Engineering. In this regard, it is advised that a DOD Council on Technical Data and Standardization Policy was established on March 6, 1964. This Council, whose membership includes top-level management within DOD, has responsibility for recommending organizational structure changes and formulating policies in the Defense standardization area. The members are currently studying the standardization program reorganization recommendations presented to the Council and are expected to recommend actions in this matter at an early date.

The interest and comments of your staff in matters contributing to an improved standardization program within the DOD are welcomed. The opportunity to comment on this report in draft form is appreciated.

Sincerely,

PAUL H. RILEY,  
*Deputy Assistant Secretary of Defense (Supply and Services).*

APPENDIX 2

THE WHITE HOUSE,  
*Washington, July 17, 1964.*

I believe you will be interested in reading the attached report from Secretary McNamara on the Defense Department's cost reduction program. It gives me confidence that my pledge to get a dollar's worth of value from every dollar spent can be fulfilled.

LYNDON B. JOHNSON.

THE SECRETARY OF DEFENSE,  
*Washington, July 7, 1964.*

Memorandum for the President.

Subject: Department of Defense cost reduction program—second annual progress report.

Two years ago, and again last year, I reported to President Kennedy the steps being taken by the Department of Defense to improve operating efficiency and reduce costs. I have now completed a review of our progress during fiscal year 1964 and the prospects for further improvements in the years ahead. I find that both are greater than estimated last year:

1. Savings of \$2.5 billion were actually realized during fiscal year 1964, compared with our forecast of \$1.5 billion.
2. Savings of \$4.6 billion a year by fiscal year 1968 and each year thereafter have been set as our new long-range goal—an increase of \$600 million per year over the previous objective.

I want to assure you that these savings are being achieved without any adverse effect on our military strength and combat readiness. Indeed during the last 3 years we have attained:

- a 150-percent increase in the number of nuclear warheads in the strategic alert forces;
- a 60-percent increase in the tactical nuclear forces deployed in Western Europe;
- a 45-percent increase in the number of combat-ready Army divisions;
- a 44-percent increase in the number of tactical fighter squadrons;
- a 75-percent increase in airlift capability;
- a 100-percent increase in general ship construction and conversion to modernize the fleet;
- an 800-percent increase in the Special Forces trained to deal with counter-insurgency threats.

The program of action, which is helping us to achieve our twin objectives of the required military strength at the lowest possible cost, has three parts:

- (1) Buying only what we need to achieve balanced readiness.
- (2) Buying at the lowest sound price.
- (3) Reducing operating costs through termination of unnecessary operations, standardization, and consolidation.

The following discussion highlights some of the actions taken and the savings achieved during the past year:

#### I. BUYING ONLY WHAT WE NEED

Only by careful planning and analysis of our requirements can we avoid making the initial error of buying too much of any one of the 4 million items carried in our inventories (excess stocks resulting from past procurements now total over \$10 billion). Once we overbuy, we not only spend money on inventories which are never used, but we also set in motion a whole train of unnecessary expenditures—for more warehouses, more transportation, and more personnel—ending years later with large surpluses which the Government has to sell for approximately 7 cents on the dollar.

One year ago, we reported that improved requirements planning had enabled us to cancel \$700 million of purchases which would have been made had the planning factors and inventory levels considered necessary in past years remained unchanged. In fiscal year 1964 we increased the level of savings in this area to more than \$1.4 billion—and actions already started should enable us to reach our goal of \$1.7 billion in annual savings by fiscal year 1967.

Some examples of these savings in fiscal year 1964 are:

##### a. Refining requirements calculations

By a more precise analysis of combat effectiveness of individual weapons in relation to the targets to be attacked and the use of more realistic wearout and loss factors based on current standards of reliability, the services were able to make significant reductions in materiel requirements:

(1) The Navy and Air Force found that requirements for air-to-air and air-to-ground missiles and other nonnuclear ordnance could be reduced by over \$160 million based on an analysis of the threat to be countered in relation to weapons effectiveness.

(2) The Navy found that by improving the performance of an existing gyroscope in Polaris submarines, it could cancel procurement of supplementary navigation instruments for which \$44 million had been budgeted.

(3) The Army found that the combat-tested M-2 machinegun would do the job of the more costly M-85 on most combat vehicles, saving \$21 million.

By reducing, in some cases by half, the time required to procure, produce, deliver, and maintain items; by discarding old concepts under which, for some parts, up to twice the quantity actually needed was kept as an insurance reserve; and by basing forecasts on the proven reliability and durability of components and parts—the services were able to make large reductions in inventory requirements for spare parts and supplies. Actions in this category number literally in the hundreds and apply to hundreds of thousands of the items in our supply systems. The following are but a few examples:

(1) Air Force studies revealed that the storage life of the solid-propellant motor for the Minuteman could be safely increased from 3 to 4 years—saving an estimated \$25 million in fiscal year 1964, with predicted reductions in procurement requirements of over \$100 million next year.

(2) The Navy, by adopting more realistic stock levels for fuel controls used on jet aircraft engines, reduced the “new buy” requirements by 297 units costing \$3.2 million.

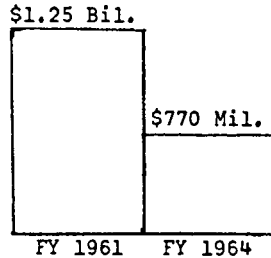
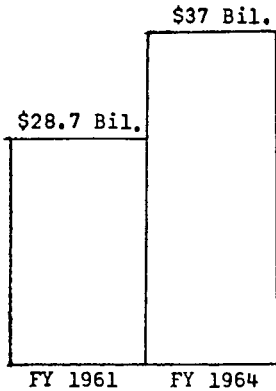
(3) The Army recomputed its mobilization requirements for insect repellents, making reductions of \$1.2 million in fiscal year 1964.

At the same time that we are saving hundreds of millions of dollars in annual procurement costs by better management of what we buy, we are also maintaining exceptionally high levels of operational readiness in our major weapon systems. In fiscal year 1958, for example, 13 percent of Air Force aircraft were out of service because spare parts were not in stock. Today less than 5 percent of the

aircraft, and 3 percent of the missiles, are out of service because of supply deficiencies. This high state of readiness has been maintained during the past 3 years while:

The value of weapons  
in operational use  
has increased by 29%

The annual pur-  
chases of spares  
has decreased by 38%



*b. Increased use of excess inventories*

One of the ways in which we can insure that we buy only what we need is to make maximum use of excess stocks already on hand, which might otherwise lie idle or have to be sold as surplus. Inventory managers in all the services are constantly searching their stocks—and those of other services—to find the same or a usable substitute for items about to be purchased.

Here are some examples of the ingenious ways in which these managers reused excess stocks in lieu of new procurement during the past year:

(1) An inventory manager at the Army Munitions Command suggested the idea of reblending the powder from three excess types of projectiles to produce the propelling charge required for the 175-millimeter projectile. Net saving to the Army was \$5.1 million.

(2) The Navy found a way to recover silver from dental clinics, old batteries, and X-ray film (retrieved from all the services) for reuse in making torpedo batteries. Savings were \$6.1 million last year.

(3) The Marine Corps obtained from excess Army stocks 114,000 projectiles used with the M-103 tank's 120-millimeter gun. Net procurement savings to the Marine Corps were \$10.7 million.

(4) The Defense Supply Agency modified excess trousers to meet new requirements, saving \$452,000 in new procurement.

(5) Recovery and transfer to other programs of excess inventories held by defense contractors has saved an additional \$11 million in fiscal year 1964.

*c. Eliminating goldplating*

As I reported last year, one of the most obvious and continuous sources of savings lies in eliminating unnecessary qualitative features in the millions of parts and items we now stock and in the several hundred thousand new items we add to our inventories each year to support new weapons systems. Both our engineers and our contractors, by constantly challenging design specifications, are producing large savings, often by very simple changes.

It is estimated that changes of this type, initiated in fiscal year 1964, will produce savings of about \$119 million. Some of these savings are described below:

	Unit cost		Savings on current procurement
	Before redesign	After redesign	
1. Transmission for M-113 armored personnel carrier: Substituted modified version of a commercially available unit for a specially designed military transmission.....	\$4,653.00	\$3,276.00	\$3,997,000
2. Wheels for M-151 jeep: Developed a lightweight steel wheel to replace high-cost magnesium wheel. Cost per vehicle.....	116.25	20.70	977,200
3. Diode for the Minuteman missile (several thousand of these specifically designed voltage rectifiers are installed on each missile): Substituted a standard commercial item which was found fully suitable.....	3.18	1.18	2,232,928
4. Personnel identification tag ("dog tag"): Substituted less costly corrosion-resistant steel for an alloy, and relaxed size tolerances.....	0.032	0.016	97,085

In addition to simplifying specifications, the military departments and the Defense Supply Agency are culling out of their stocks unnecessary varieties, sizes, and types of items, and are standardizing on the smallest number which will meet requirements. In fiscal year 1964, 487,000 items were marked for elimination. For example, 145 models of diesel engines, 13 types of electron tubes, and 16 sizes of steel clothing lockers are being eliminated from the inventory. Inventory management and warehousing savings of over \$50 million are anticipated when stocks of these nonstandard items are depleted.

## II. BUYING AT THE LOWEST SOUND PRICE

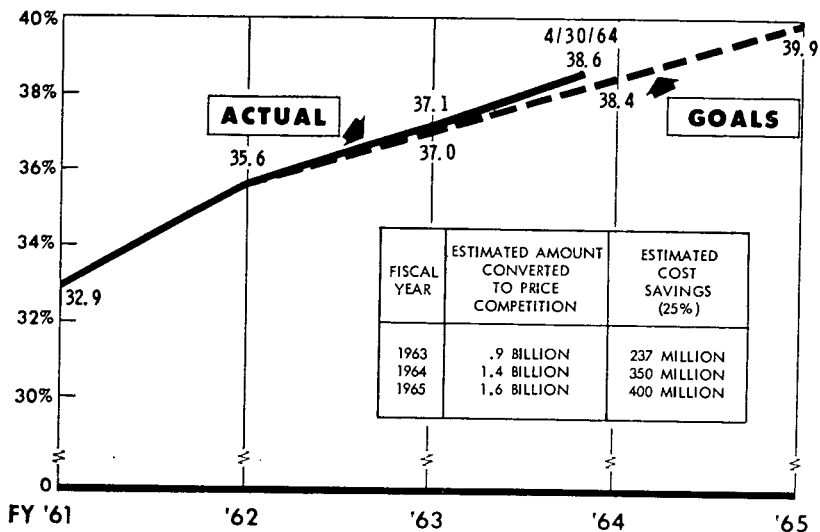
By improving our procurement practices we can save almost as much as we can by improving our methods of determining requirements. Starting in fiscal year 1961, we established specific objectives for our buying offices aimed at obtaining lower procurement costs through two principal improvements: (1) More competitive procurement of military items, and (2) fewer cost-plus-fixed-fee contracts, with greater risk sharing by contractors in the development and production of complex weapons and equipment.

### a. *Shifting from noncompetitive to competitive procurement*

In the first 10 months of fiscal year 1964, 38.6 percent of our prime contracts were awarded on the basis of price competition. As shown in the following chart, this is the highest level of competitive awards on record, substantially above the level of 32.9 percent in 1961, and we are well on the way to meeting our objective of 39.9 percent 1 year from now:



### CONTRACTS AWARDED ON BASIS OF COMPETITION AS A PERCENT OF TOTAL CONTRACT AWARDS



This is a major source of savings. Audits indicate that for every dollar shifted from noncompetitive to competitive procurement we average a net price savings of 25 cents. Frequently, the savings are even greater. An analysis of price reductions on a recent group of awards showed net savings of 31 cents on each dollar shifted. In fiscal year 1964 we estimate that awards made competitively for the first time, illustrations of which are listed below, produced savings of over \$350 million:

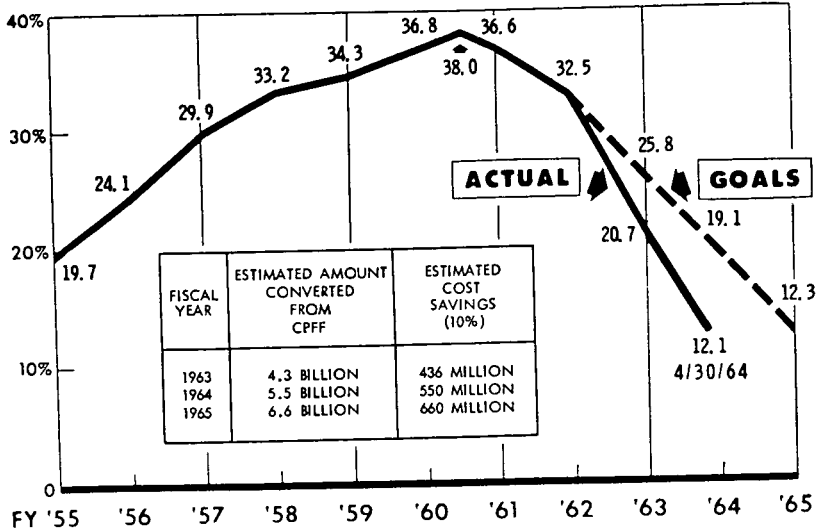
	Noncompetitive price per unit	Competitive price per unit	Percent reduction	Savings
1. Constant speed drive for F-4B aircraft.....	\$7,083	\$4,033	30	\$2,827,250
2. Integrating gyro, missile control system.....	2,500	1,549	38	1,672,809
3. Electron tube (airborne radar sets).....	295	200	32	141,455
4. Sterilizer, surgical instruments.....	358	265	25	52,137
5. Self-locking nut, missile oxidizer gearbox....	27	7	74	29,745

Another innovation in the past year has been the use, in selected cases, of multiyear competitive contracts for major items for which we have firm requirements extending over 2 or more years. This type of contract produces additional price savings by avoiding annual "startup" costs and giving the contractor an incentive to offer a lower price based on the efficiencies which can be achieved over a longer production run. For example, by purchasing our full 3-year requirement for 2½-ton Army trucks at one time, we realized a price reduction of \$209 per unit, or a total saving of \$5.8 million.

*b. Shifting from cost-plus-fixed-fee to fixed-price contracts*

Under CPFF contracts, the Government automatically pays all costs, plus a guaranteed profit. Hence, these contracts provide neither rewards for good management nor penalties for poor management. In addition, they have permitted defense program managers to enter into large development contracts without first developing detailed plans. In many cases, their use has contributed to sizable cost overruns, amounting to as much as 3 to 10 times the initial estimates. For these reasons, drastic restrictions have now been imposed on the use of CPFF contracts. Between 1955 and March 1961, the volume of such contracts rose steadily from 19.7 to 38 percent of total contract awards. As shown in the chart below, the results of our new program have been dramatic—our end objective of 12.3 percent has now been met, 1 year ahead of schedule.

## COST PLUS FIXED FEE CONTRACTS AS A PERCENT OF TOTAL CONTRACT AWARDS



Contracts totaling \$5.5 billion per year have been shifted from CPFF to fixed-price and price-incentive formulas. The benefits of this shift, which began in fiscal year 1962, will be realized progressively over the next several years. At a minimum, our analyses indicate that 10 cents is saved for each dollar shifted from CPFF to other forms of contracts. At least \$100 million in lower procurement costs were realized in fiscal year 1964 from such shifts. These savings result from many factors, including:

1. More detailed precontract planning by engineering and procurement agencies: For example, letter contracts alone, under which work is started before a precise work scope is defined or a price is agreed upon, have been reduced by 75 percent since January 1963—down from \$3.1 billion to \$770 million. The services are now planning contracts for major systems up to 3 years in advance of a award.
2. Fewer and smaller cost overruns: Our records show that CPFF contracts, on the whole, result in sizable cost overruns—at the rate of \$2 in overruns for each \$1 of underruns. In contrast, incentive contracts, on the whole, show a net underrun. For example, the Titan III space booster contract, which is under an incentive arrangement, showed at the end of 17 months an expenditure of \$173.5 million—1 percent under the forecast for that date—with development strictly on schedule.

3. Improved weapon system performance: Because of the more detailed advanced planning required—and the profit rewards and penalties provided by incentive contracts—contractors are more strongly motivated to achieve superior product performance and to meet delivery objectives. This fact is widely recognized by the contractors themselves. A recent case is the contract for the Vela satellite, used to detect nuclear detonations in space, in which the contractor's incentive fee was based on a number of performance factors including the length of time the vehicle performed satisfactorily in orbit. As a result of the spectacular length of life of the first launch, the Air Force was able to reduce the total program cost 32 percent—a saving of \$26 million. The contractor earned \$115,000 in additional fees.

Last December, you and I both wrote to a large number of defense contractors calling on them to accelerate, expand, and intensify their cost reduction efforts. A large, favorable response was received and our principal weapons contractors—operating today mainly under incentive contracts—have agreed to report to us semiannually on their progress in reducing Defense procurement costs. Thus far, reports received from 51 major contractors indicate that they plan to decrease the cost of Defense procurement by 5 to 10 percent. Much of this improvement will result from the use of more competitive and more tightly controlled subcontracts—through which half of the prime contract dollar is spent.

III. REDUCING OPERATING COSTS

The third key objective of the cost reduction program is to increase the efficiency of supply, maintenance, communications, transportation, and general administrative activities. Here, savings realized in fiscal year 1964 exceeded \$650 million, and actions in process will produce future savings of \$1 billion per year.

a. *Terminating unnecessary operations*

Three years ago, at the direction of President Kennedy, a program was begun to identify those installations and field activities which could be consolidated, reduced in scope, or closed without adverse effect on our military readiness. When you assumed office, you reaffirmed the importance of this effort and directed that we accelerate our studies and decisions to terminate unnecessary activities. As shown below, 126 new actions were initiated during the past year, adding substantially to these savings:

	Total through—		Increase
	June 30, 1963	June 30, 1964	
Number of actions.....	430	556	126
Real estate released (acres).....	265,905	697,000	431,095
Industrial plants with commercial potential made available for sale.....	54	61	7
Job positions eliminated.....	53,310	81,600	28,290
Annual operating savings to be realized.....	\$316,000,000	\$568,000,000	\$252,000,000

During the next 2 years, we expect to take additional actions which will increase the annual savings to about \$700 million.

Actions to reduce or close installations are phased over periods as long as 3½ years in order to provide time for the employees and communities affected to make the necessary adjustments with the help of the Government. Our own Office of Economic Adjustment has extended assistance to 29 communities since 1961, many of which are well on the way to developing a stronger and more permanent economic base than that which they had when they were heavily dependent on military spending. Furthermore, we are guaranteeing new job opportunities for career civilian employees who are displaced by base closings, and this practice will be continued in the future.

b. *Consolidation and standardization of operations*

Unnecessary overhead and personnel expenses are being eliminated through the consolidation of common support functions previously performed separately by the military departments, and through the standardization of operating procedures and practices among the military departments.

The Defense Supply Agency—a 30,000-man organization—was formed in January 1962 to integrate the management of 1.6 million items of common supply. It has now accomplished this objective, saving \$40 million in operating expense, in fiscal year 1964. Next year the Agency's savings will be \$55 million. Its staff will number 7,871 fewer personnel than that previously required to perform the same functions—a reduction of 20 percent. Its inventory will be \$512 million less than that maintained for the same supply categories in fiscal year 1961.

We have now turned our attention to a new area. On June 4, 1964, I directed the establishment of a single organization to manage the 150 field offices and 20,000 personnel concerned with the administration of defense contracts after their award, including material inspection, production expediting, industrial security, payment of contractor invoices and a variety of related functions. Responsibility for organizing this new effort over the next 2 years has been assigned to the Defense Supply Agency. Substantial economies—now estimated at \$60 million annually—are expected to result from this consolidation.

c. *Increasing operating efficiency in other support functions*

1. *Communications systems costs.*—By searching out ways to reduce rates, consolidate facilities, and discontinue services not absolutely essential, we realized savings of about \$135 million in fiscal year 1964.

2. *Transportation and traffic management.*—Actions in fiscal year 1964 to extend the use of economy air travel, decrease the cost of household goods shipments,

and obtain more economical rates for commercial airlift to meet peacetime military requirements will produce savings of \$20 million. We expect to double these savings during the next 2 years.

3. *Maintenance management.*—Through improved cost accounting and employee performance standards; elimination of unnecessary inspection of aircraft and other major weapon systems, without in any way reducing safety; repair in our shops of parts which were being discarded and replaced with new parts; greater use of tenant maintenance of family housing; and similar actions, we realized savings of \$114 million in fiscal year 1964. We expect to increase these savings substantially over the next 2 years.

#### IV. SUMMARY

Last July I reported that savings in excess of \$1 billion were realized in fiscal year 1963. Today I can report that savings of \$2.5 billion were realized in fiscal year 1964—65 percent more than estimated 1 year ago. Most encouraging for the future of the program is the fact that the savings are being developed through the vigorous efforts of large numbers of Defense executives and employees—both military and civilian—with magnificent support and assistance from defense contractors. This gives me confidence that we can achieve still higher goals in later years—and I have set a cost reduction target of \$4.6 billion per year to be accomplished by fiscal year 1968.

ROBERT S. McNAMARA.

#### APPENDIX 3

MARCH 18, 1964.

Hon. JOSEPH CAMPBELL,  
*Comptroller General of the United States,*  
*General Accounting Office, Washington, D.C.*

DEAR MR. CAMPBELL: The Subcommittee on Defense Procurement of the Joint Economic Committee will hold hearings on April 16 and 21, 1964, as a followup to those previously held in January 1960, June 1961, and March 1963, on the impact of military supply and service activities and those of related civilian agencies on the economy. The hearings will review progress made since the last hearings and actions taken on the subcommittee recommendations contained in its report of July 1963.

You and your staff are scheduled to testify at 2 p.m., April 16, in room 1202 of the New Senate Office Building.

I have noted with interest that you have issued 120 reports dealing with subjects of concern to the subcommittee during the period March 1, 1963, through February 25, 1964. An index and digest of these reports will appear in a staff report to be issued shortly by the subcommittee. It will be appreciated if you will analyze these reports and especially those of prime significance in their bearing upon organization and management improvement in the areas of supply management and related common services, and advise us as to their implications.

Of particular interest to the subcommittee will be your views on the problems of defense procurement and possible solutions thereto. Your findings and views on progress being made in the standardization and elimination of items in military and related civilian supply organizations will also be appreciated.

The subcommittee will also appreciate your comments on recommendations in its report of July 1963 concerning automatic data processing equipment, military commissaries in the Washington, D.C., area, and such other matters as you may deem of importance to the work of the subcommittee.

You may contact the consultant to the subcommittee, Mr. Ray Ward, phone code 173, extension 8169, if additional information is needed. Please send 100 copies of prepared statements to room G-133, New Senate Office Building, at least 1 day before your appearance.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

APPENDIX 4

THE SECRETARY OF DEFENSE,  
Washington, June 12, 1964.

Memorandum for—

The Secretaries of the Military Departments,  
The Director, Defense Research and Engineering,  
The Chairman, Joint Chiefs of Staff,  
The Assistant Secretaries of Defense,  
The General Counsel,  
The Special Assistant to the Secretary of Defense,  
The Assistants to the Secretary of Defense,  
The Director, Defense Supply Agency.

Subject: Establishment of the Office of Technical Data and Standardization Policy under the Assistant Secretary of Defense (Installations and Logistics).

Reference:

- (a) DOD directive 5105.22, subject: "Defense Supply Agency," dated November 6, 1961.
- (b) DOD directive 5100.36, subject: "DOD Technical Information," dated December 31, 1962.

There is hereby established, reporting directly to the Assistant Secretary of Defense (Installations and Logistics), an Office of Technical Data and Standardization Policy. This Office will be responsible for the administration of (1) the defense standardization program, presently assigned to the Defense Supply Agency by reference (a), and (2) the production engineering and logistics information program, established by reference (b).

Effective this date, Brig. Gen. Allen T. Stanwix-Hay, U.S. Army, is designated to head the Office of Technical Data and Standardization Policy. When General Stanwix-Hay assumes these responsibilities, Col. William S. Collinson, U.S. Air Force, will become Acting Director of the Defense Contract Administration Region (Pilot Test), Philadelphia, Pa.

ROBERT S. McNAMARA.

APPENDIX 5

JUNE 8, 1964.

Mr. BERNARD L. BOUTIN,  
Administrator, General Services Administration,  
Washington, D.C.

DEAR MR. BOUTIN: At hearings of the Subcommittee on Defense Procurement of the Joint Economic Committee on June 12, 1961, we discussed the subject of the losses incurred to the Government from spoilage, deterioration, and obsolescence of short-shelf-life items. We displayed a number of surplus items of film, paper, etc., to illustrate the point. Previously, we had learned that millions of dollars' worth of paint had been declared surplus due to the above causes.

We have assumed that the 1961 hearings would lead to steps to improve the management of short-shelf-life items.

I think one test of this would be a factual report from you as to the volume and condition of paint stocks transferred to GSA from the DOD incident to the assumption of management responsibility of this function recently.

I will appreciate receipt of your report. Copies of this letter are being forwarded to the Bureau of the Budget and Department of Defense for their information.

Faithfully yours,

PAUL H. DOUGLAS.

GENERAL SERVICES ADMINISTRATION,  
Washington, D.C., June 15, 1964.

Hon. PAUL H. DOUGLAS,  
Chairman, Joint Economic Committee,  
Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN: In your letter of June 8, 1964, you discuss the committee's interest in improving the management of short-shelf-life items and ask that GSA furnish the volume and condition of paint stocks transferred to GSA from DOD under the October 1, 1963, transfer of management responsibility for this commodity.

As of the end of May 1964 we have had \$11,998,109 of assets decapitalized to us in FSG-80 (paints and related products). Of this amount we have determined the condition on approximately \$6.1 million. The balance of the assets are located at the Naval Supply Center, Oakland, and in GSA Supply Depot, Bayonne. The condition of these assets is largely undetermined. When this has been done we will submit a report of results to you. Of the \$6.1 million on which we have generally determined condition, we have written off \$350,560 or 5.7 percent representing merchandise that did not meet our quality standards at the time of inspection.

Because of your expressed interest in improving the management of short-shelf-life items, I would like to briefly outline our experience. In June 1961 we installed an in-storage surveillance procedure utilizing ADP. Under this procedure a punchcard is set up for each short-shelf-life item at the time of receipt. The card shows storage location, date of manufacture, expected shelf life and date for reinspection. Prior to the reinspection date, cards are screened against storage location files to determine if the item is still in storage and if so the cards are processed to the quality control organization for in-storage surveillance inspection, determination of condition, and action as appropriate. Our experience in FSG-80 under this procedure is that we were, prior to the transfer from DOD, writing off 1.2 percent of our running inventory value for FSG-80 because of deterioration and spoilage. Our writeoffs for deterioration and spoilage in storage for commodities other than FSG-80 are less than one-tenth of 1 percent of the running inventory value of these commodities. These figures are decidedly below that which is normally expected in the kind of merchandise we handle. However, we are constantly looking for ways to improve our procedure and reduce inventory losses that can be attributed to deterioration and spoilage in storage. You have my assurance that this effort will be continued.

You will be interested to know that we have a joint effort underway with DOD on item simplification and item reduction on some 100,000 items annually for completion during 1970 covering various commodities including paint. We will accelerate our efforts on paint items in order to reduce the number of items in the system. Further, we plan to review all paint specifications annually on high-dollar-volume items and all items at least on a 3-year cycle.

Copies of our reply to you have been furnished the Department of Defense and the Bureau of the Budget.

Sincerely yours,

BERNARD L. BOUTIN, *Administrator.*

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## APPENDIX 6

### MILITARY COMMISSARIES

COMPTROLLER GENERAL OF THE UNITED STATES,  
*Washington, D.C., April 16, 1964.*

HON. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
Congress of the United States.*

DEAR MR. CHAIRMAN: In accordance with a recommendation of your committee in July 1963 and subsequent discussions with your staff, we have made a review of the criteria established by the Secretary of Defense for the authorization of military commissary stores in the continental United States.

Our review discloses that, although competitive food stores are located near most military commissary stores in the United States, commissary stores have continued in operation and increased in number despite the statutory requirement since 1953 that such stores be authorized only if reasonable prices are not otherwise readily available. The authorization of commissary stores has continued each year because the criteria established by the Department of Defense defeat the purpose of the law. Under these criteria, for example, the prices at all commercial food stores surveyed in the United States during recent years have been found to be unreasonable. In view of the strong competition among commercial grocery stores and their resulting low profit margins, it is apparent that the criteria are illogical. We estimate that under any realistic criteria more than half the commissary stores in the United States would be closed.

In addition, the Department of Defense has expended considerable manpower each year conducting surveys at all commissary stores in the United States for

compliance with its criteria, even though it is obvious that such surveys will not in any way restrict commissary operations. The wasted effort connected with these surveys has cost the Government about \$100,000 annually, or about \$1 million since 1953.

Since commissary store sales prices exclude major operating expenses, we have estimated, as explained in the report, that the military commissary store system in the United States results in a loss to the Government of almost \$150 million a year. The justification advanced over the years by the military departments for maintaining a widespread commissary store system has been that the fringe benefit has become, as a practical matter, a part of the pay structure for military personnel and that, consequently, the curtailment of the fringe benefit would represent a reduction in remuneration and would adversely affect the morale of military personnel. While commissary store privileges are available to all military personnel, they obviously are not needed by the vast number of military personnel fed in messhalls, and such personnel would not be affected by limitations on commissary store operations. In any event, we believe that any inadequacy of pay and allowances to military personnel should be brought to the attention of the Congress as a matter to be decided on its merits, apart from the need for commissary stores.

In view of the ineffectiveness of the restriction contained in each annual appropriation law enacted since August 1953 in deterring the continued operation and growth of military commissary stores and in view of the fact that competitive commercial food stores are generally located reasonably close to most military installations in the continental United States, we are suggesting that your committee consider recommending to the Congress the enactment of legislation to establish precise conditions under which the operation of military commissary stores may be authorized. Also, to the extent that the operation of commissary stores may be authorized, the Congress may wish to consider providing for selling prices to be set at the level of competitive commercial retail prices in order to avoid inequities between personnel at installations having commissary stores and personnel at installations not having commissary stores.

Pending action by the Congress to clarify its position with regard to commissary stores, we believe that it would be desirable to omit from future appropriation acts for the Department of Defense the requirement for the annual certification of commissary stores by the Secretary of Defense. This will avoid the expenditure of about \$100,000 a year for surveys of the type now conducted for the purpose of authorizing commissary stores.

At your request, the findings in this report have not been submitted to officials of the Department of Defense for comment. Consequently, we have not obtained any written explanation that they may be able to offer.

We believe that the contents of this report will be of interest to other committees and Members of the Congress. Therefore, as previously agreed with you, we are making our customary distribution of the report.

We trust that the report provides you with the information you require. If we can be of further assistance, please let us know.

Sincerely yours,

JOSEPH CAMPBELL,  
*Comptroller General of the United States.*

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#### APPENDIX 7

ASSISTANT SECRETARY OF DEFENSE,  
*Washington, D.C., June 16, 1964.*

HON. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,  
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: In accordance with your request, the General Accounting Office report to the Joint Economic Committee, subject "Failure To Curtail Operations at Government Expense of Military Stores in Continental United States Where Adequate Commercial Facilities Are Available," has been reviewed within the Department of Defense.

As stated in the report, a subcommittee of the House Armed Services Committee conducted an extensive investigation into the operation of military commissary stores during 1949. On the basis of an agreement reached between the House Armed Services Committee and the military departments, certain criteria were communicated to the services, which authorized the establishment or continued

operation of commissary stores in those cases where available commercial facilities were inadequate or inconvenient, or where the average commercial selling prices of these facilities for comparable items exceeded by 20 percent the cost of such items in the commissary store.

While commissary stores were first examined by the military departments for establishment and/or continued operation under these new criteria in 1950, it was not until passage of the 1954 Department of Defense Appropriations Act that it was required they be certified annually for continued operation by the Secretary of Defense. Since the language in the act was substantially similar to that in the Armed Services Commissary Store Regulations, no essential change in criteria and procedures previously used by the military departments in their yearly examination was necessary, and the term "reasonable price" for purpose of certification has continued to be based on a 20-percent price differential. Congress was aware of this interpretation when they passed the 1954 act and was again informed of this interpretation during the hearings on the 1956 DOD Appropriations Act. Moreover, the Armed Services Committees of the House and the Senate have been kept constantly informed of the Department's policy in this matter.

The commissary privilege for active duty and retired military personnel has had a long history of congressional recognition and sanction, and along with medical care and other benefits of a similar nature, has consistently been taken into consideration in establishing military pay schedules. For example, the privilege was thoroughly considered by the Hook Commission (Advisory Commission on Service Pay appointed by Secretary Forrestal and headed by Mr. Charles R. Hook), which deemed it to be balanced to a large extent by the hardships and disadvantages of military life.

The report of the House Armed Services Committee on H.R. 5007, 81st Congress, the Career Compensation Act of 1949 (Rept. 779), commented that in establishing the pay scales proposed by that bill, the matter of so-called hidden benefits, such as hospitalization, commissary, and post exchange privileges, were considered. The report also reached essentially the same conclusions as the Hook Commission; i.e., that these special benefits were largely balanced out by the special expense of military service. In addition, the Senate Armed Services Committee Report 1255 on H.R. 5715, 82d Congress, the Armed Forces Pay Raise Act of 1952, clearly recognized the commissary privilege as one of the special emoluments of military service.

The importance of commissaries was also recognized by the Defense Advisory Committee on Professional and Technical Compensation in their report to the Secretary of Defense in 1957 (Cordiner Committee report). This Committee recommended that continuing action be taken to reestablish and maintain appropriate fringe benefits for service personnel and their dependents, including adequate commissary facilities. The Committee recommended further that Congress and the public be informed of the significance and relationship of these aspects of service life to the maintenance of an effective military manpower program.

In developing its recommendations to the Secretary of Defense on military pay in 1962, the Defense Study Group on Military Compensation made a dollar valuation of the commissary store benefit to the officer and to the enlisted man. This study group submitted estimates based upon both the cost to the Government and the value received by the individual of the commissary privilege. These estimates were taken into account in developing the military pay proposals which were submitted to the Congress in January 1963.

In summary, the commissary privilege has been assumed and taken into account on every occasion within the past 15 years when the responsible committees of the Congress have considered an adjustment in compensation for the Armed Forces.

It is the continuing view of the Department of Defense that the purchasing power of the dollar of military personnel, who have no choice as to the location of their assignment, should not be reduced by a difference in the cost of food in various geographical areas. The commissary store serves to assist in eliminating this differential by providing food at approximately the same price, regardless of location.

The availability of commissary stores and the implicit belief that such facilities would continue to be available during their term of service and upon retirement, have been a major factor in influencing servicemen to stay on in a career status. This is particularly true of enlisted personnel, who are the hard core of our military forces. Any curtailment in this privilege would hit hardest at the enlisted



man with a family, and it is he who can least afford to lose the benefit. Increasing numbers of servicemen are married, primarily in the lower enlisted grades. For example, in 1955, approximately 37 percent of the enlisted personnel were married. At present approximately 47 percent of the enlisted personnel are married and over 300,000 or 23.2 percent of enlisted personnel in grades E-1, 2, 3, and 4, with less than 4 years' service, are married or drawing dependents' allowances.

The commissary privilege is a substantial one for married men with families. Based on the average differential between commissary prices and supermarket prices, and the average annual family food costs, the annual saving from using the commissary for a family of four would be approximately \$400. To take away that saving, without at the same time offering servicemen an equivalent increase in their compensation, would have an adverse effect on retention rates and particularly on the retention of service people with skills that are equally sought after in civilian life.

The commissary store privilege would be difficult to match through pay increases or changes in other cash benefits. Basic pay increases have never been made proportionate to family size. An increase in allowance for commuted rations would do no good for the enlisted man who is on field rations or overseas while his family is living in the United states. Moreover, any equalizing change in pay or cash benefits would greatly exceed in cost the present cost in appropriated funds for commissary store operations and be virtually impossible to administer on an equitable basis.

The GAO report in estimating that the unrecovered costs to the Government in operating commissary stores totaled \$149 million for fiscal year 1963, based their estimate on the premise that costs of commissary stores should be at least comparable to the costs of highly competitive foodstores. The report further stated that of this amount, \$65 million consisted of pay and allowance of military and civilian employees engaged in operating the stores. The Department of Defense agrees with the \$65 million personnel cost figure but disagrees with the balance of the alleged cost—\$84 million. It is unrealistic to compare all overhead costs in commissary stores to commercial foodstores, since commissary stores do not provide facilities and services comparable to those available in commercial foodstores. For example, line items carried in commissary stores are limited to approximately 28 percent of those carried in most supermarkets. Many services provided by supermarkets, such as check cash services, bagging, carry out, and loading of groceries, are not normally provided by commissary stores. In addition, commissary store operating hours are generally restricted to less than 70 percent of normal commercial hours of operation. According to the Supermarket Institute Report for 1963, commercial supermarket sales per full-time store employee averaged \$57,000 for the year, with sales per square foot of sales space being \$180 for the same period. Like data compiled on military commissary stores, factored to equalize the sales price, reveal that annual sales per employee amount to \$96,720, with sales per square foot being \$423 for the same period.

The Department of Defense appreciates the opportunity to comment on this report.

Sincerely,

NORMAN S. PAUL.

