

# IMPACT OF MILITARY SUPPLY AND SERVICE ACTIVITIES ON THE ECONOMY

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HEARINGS  
BEFORE THE  
SUBCOMMITTEE ON DEFENSE PROCUREMENT  
OF THE  
JOINT ECONOMIC COMMITTEE  
CONGRESS OF THE UNITED STATES  
EIGHTY-EIGHTH CONGRESS  
FIRST SESSION  
PURSUANT TO  
**Sec. 5(a) of Public Law 304**  
**(79th CONGRESS)**

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#### CHRONOLOGICAL REFERENCE TO SUBCOMMITTEE HEARINGS AND REPORTS

- Staff report, 1960: "Background Material on Economic Aspects of Military Procurement and Supply," materials prepared for the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, February 16, 1960, 86th Congress, 2d session.
- Hearings, 1960: "Impact of Defense Procurement," hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, 86th Congress, 2d session, pursuant to section 5(a) of Public Law 304 (79th Congress), January 28, 29, and 30, 1960.
- Report, 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 Congress, 2d session.
- 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 Congress, 1st session, June 12, 1961.
- Staff report, 1963: "Background Material on Economic Aspects of Military Procurement and Supply," materials prepared for the Subcommittee on Defense Procurement of the Joint Economic Committee, Congress of the United States, March 1963.

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# IMPACT OF MILITARY SUPPLY AND SERVICE ACTIVITIES ON THE ECONOMY

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THURSDAY, MARCH 28, 1963

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON DEFENSE PROCUREMENT  
OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met at 9:55 a.m., pursuant to call, in room 318, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senators Douglas, Proxmire, and Javits; and Representative Curtis.

Also present: James W. Knowles, executive director; Ray Ward, economic consultant; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Chairman DOUGLAS. The subcommittee will please come to order.

Secretary McNamara, we know that your time is very precious, so we will start ahead of 10 o'clock.

Secretary McNAMARA. I can certainly wait, Mr. Chairman, for the other members to be present. I am quite willing to do so.

Chairman DOUGLAS. I have a preliminary statement which I am sure they will not feel deprived of for not hearing. I will make it and then you can start at 10 o'clock promptly.

Mr. Secretary, we are delighted to have you come before this committee to give us a progress report on what actions the Department of Defense has taken in the fields of procurement and supply to make these activities more efficient. This committee has believed for a very long time, indeed, that large savings could be made at the Department of Defense. We, along with the Hoover Commission, and from time to time various subcommittees in the House, have made specific, detailed recommendations along these lines.

You will recall that, after you had been designated Secretary of Defense by President Kennedy, and before you took office, I wrote you a detailed letter dated December 30, 1960, outlining the general areas where I and certain other members of this committee thought great savings could be made. I urged that this be done so that the savings in procurement and supply could be translated into more missiles, tanks, and combat troops so that our country could be more adequately defended and our people protected.

In short, our aim was to transform what we believed was fat into muscle. To be specific, in that letter, which I will ask to have made a part of the record, I said that (see p. 3) :

First, far more contracts could and should be let by competitive rather than negotiated bidding.

Second, that the Defense Department should take very seriously and act upon the numerous detailed reports of the General Accounting Office which, I may say, has performed a great public service. I want to pay a tribute to Comptroller General Campbell for his extraordinarily efficient work. I regard him and Lindsay Warren as two of the great public servants of all time.

Third, that there is great overlapping in the supply systems both of the individual services and within the services, so there was duplication of personnel, inventories, warehousing, and so forth.

Fourth, savings could be made by drawing down on the stock funds.

Fifth, something should be done about the amount of surplus property that was being disposed of which at that time was said to be in the neighborhood of \$8 to \$10 billion a year, on which only about 2 or 3 cents per dollar of the original cost was being realized. I asked the question, "What kind of a supply system is it which generates such huge amounts of surplus property?"

Sixth, I mentioned we were concerned about concurrent buying and selling; that is, disposing of items as surplus which were new or in good condition at the same time that the same items were being purchased new by the Defense Department and, in fact, by many civilian agencies of the Government.

Seventh, that we were concerned about the size of the various inventory categories such as the economic and mobilization reserves.

And finally, we also pointed out to you personally that a considerable proportion of the purchasing and distribution of the most common items, such as chairs, tables, desks, typewriters, business machines, paints, handtools, and so forth, could more properly be purchased and stored by the General Services Administration than the Defense Department, so that you would be free to get on with your task of providing the greatest possible defense of this country rather than be burdened excessively by a lot of minute problems which were not fundamental to your basic mission.

In my letter to you, which was based largely on information developed by this committee, by some of us individually, by the Hoover Commission, and by the very splendid work done by some of the House committees, I said that I thought \$2 to \$3 billion a year could be saved by putting into effect some of these reforms, and I urged that your motto be, "Use it up, wear it out, and make it do."

I also pointed out to you that under the McCormack-Curtis and O'Mahoney-Douglas amendments, as well as various other legislation, you needed no new legislative authority to act on these matters and I wish to affirm that now. I hope you do not allow any Members of the House and Senate to trip you up on that point.

Mr. Secretary, since that time you have kindly met with a number of us from this committee, as well as with the heads of some of the agencies involved and a number of the Members of the House, to go into these specific questions. I must say that in these half dozen or so meetings, we have been extremely gratified, first for your willingness to admit that these were genuine problems. We were never able to get any previous Secretary of Defense to admit these were problems.

Second, you were willing to do something about them and act upon them.

Third, we are grateful for the information you have given us from time to time about the progress you have made.

Mr. Secretary, we are extremely gratified to know that you have now taken actions which have saved, in the fiscal 1964 budget alone, over \$1 billion, and that you have initiated actions in fiscal 1963 which will ultimately produce annual savings of almost \$2 billion.

We are further pleased to know that you intend to initiate further actions which will increase the rate of savings to over \$3.4 billion per year.

I read your preliminary statement and I should like to say I hope you will indicate when these savings will be realized and not when they will be initiated.

Mr. Secretary, this is a great record. We want to get from you today a progress report about what you have done. Furthermore, while we are extremely pleased with what you have done, it is also true that we probably will continue to press you to do more and to make certain that this committee functions in the way to make certain that the actions you have initiated are carried out and fulfilled, because there is a long gap between intention, program, and fulfillment.

Mr. Secretary, we on this committee have not concerned ourselves about weapons, strategy, or tactics. We are not competent to deal with these matters. This is not our job. But we are concerned about supply and procurement and the effect these have on our economy. I can say to you that I personally consider you to be a great Secretary of Defense, one fit to rank with Stimson, Newton Baker, and perhaps any one of them, a man who both understands the intricate problems in these areas which we have gone into, and who has also had the courage—and some of your actions have taken great courage—to act upon them.

In addition, we have had the finest cooperation from your staff, including Mr. Gilpatric, Mr. Morris and General McNamara. We salute you for the progress you have made. We are now interested in hearing a review of that progress as well as your plans for the future.

(The letter from Senator Douglas to Secretary McNamara, dated December 30, 1960, follows:)

DEAR MR. MCNAMARA: May I first congratulate you on your appointment as Secretary of Defense. I want to wish you well in this post which is of the highest responsibility and where the opportunity to serve the country is unsurpassed.

I am writing to draw your attention to my concern, and I think that of almost every Member of Congress, and of private persons who have gone into it, over what is "appalling" and even "scandalous" waste in the Defense Department's procurement and supply system. I am enclosing a number of reports and other documents concerning this. May I mention only a few points.

(1) Some 86 percent of all contracts—both in dollar and number—are now "negotiated" rather than let by competitive bidding. This is inexcusable and results in millions of dollars in excess prices (maybe billions). In fact, in the reports on the latest Defense Department appropriation bill, both the House and Senate urged radical reform in this area. We have been met, however, by little more than a series of justifications of the existing system, instead of action to carry out the congressional mandate.

(2) In the last 2 years alone, the General Accounting Office has submitted over 50 reports going into detail concerning waste in procurement and supply. The testimony of the Comptroller General before my committee indicates that these are representative samples of a much larger universe. Almost every time they go into this question, malpractices and bad practices are found.

(3) There is almost a complete lack of integration between and among the supply systems of the individual services and, equally important, within the

services. There is vast duplication of personnel, inventories, warehousing, etc., which can only be solved by centralizing the supply systems. This should be done immediately, at least with respect to those items which are common to all of the services.

(4) The stock fund system has resulted in the accumulation of excess stocks and cash. Each service seems to operate them in a different way. There is no common practice concerning them. They often involve a double appropriation. In addition, the reimbursable requirements have had the effect of preventing other services and agencies from using stock fund materials which have subsequently been disposed of as surplus.

(5) The amount and disposal of surplus property is also of scandalous proportions. We are now selling off some \$8 to \$10 billion of surplus supplies. The question arises, "What kind of a supply system do we have which could conceivably generate such amounts?" In addition, we are receiving only 2 to 3 cents on the dollar when they are disposed of.

Furthermore, there are literally hundreds of examples of concurrent buying and selling—where one agency of the Government buys new supplies which another agency is at the same time disposing of as surplus. A recent Budget Bureau study showed that this was true in two-thirds of the examples, and in their study the equipment was new, available in the same geographic area, etc.

(6) The Defense Department has at hand one agency which would radically help in solving some of these problems. That is the Armed Forces Supply Support Center. But it is not being properly used. Services have, in effect, a veto over its activities and its hands have been tied.

At the moment the Armed Forces Supply Support Center is attempting, under great difficulties, to match the excess or surplus supply inventory with requirements of the services. But much more is needed. There should be a complete inventory of all supplies so that new procurement or requirement can be matched against existing stocks. This is not now true and calls for a central agency where all procurement requests can go and be matched against existing supplies before new purchases are made.

In this connection also, many of us believe that the services have excessive quantities in their various inventory categories, i.e., mobilization reserve, etc.

I believe that great savings can be made in procurement and supply in the Defense Department. To summarize—there must be more competitive bidding, greater centralization of purchase and supply, much more efficient handling of the surplus supply and disposal system, and the reform of the stock fund and reimbursable requirements.

Fortunately, these reforms can take place under existing law. The Defense Department does not need legislation to effect these reforms.

I think the motto of the Department should be to "use it up, wear it out, make it do," wherever possible. As a minimum, I believe that \$2 to \$3 billion per year could be saved by merely beginning on these reforms. These savings should then be translated into more missiles, tanks, and combat troops so that our country can be more adequately defended and our people protected.

With best wishes.

Faithfully,

PAUL H. DOUGLAS.

Chairman DOUGLAS. Since it is now 10 o'clock, you may begin.

#### STATEMENT OF HON. ROBERT S. McNAMARA, SECRETARY OF DEFENSE

Secretary McNAMARA. Thank you, Mr. Chairman.

I have a very long statement I propose to present to your committee. I apologize for its length. It is as long as it is because the program we have underway to achieve cost reduction in the Defense Department is an extensive program.

I will comment on each of the eight items you referred to in your letter of December 30, 1960. That letter served as a platform, if you will, of cost reduction which we have followed since that time. I think you will find we have made progress on each of the eight items and we fully agree with your two major conclusions that there

is a potential saving of at least \$2 to \$3 billion a year in the Defense Department operations and this saving can be achieved without further legislative authority. With the authority I presently have, I am confident we can take the actions necessary to realize that saving.

Chairman DOUGLAS. If I may say, in the staff materials which we have prepared and published, the full text of the McCormack-Curtis and the other enabling legislation is given, so that the person who reads can understand that you already have this authority, have acted under the authority, and that you do not need additional authority either to assist or to hamper.<sup>1</sup>

Secretary McNAMARA. I fully support that conclusion, Mr. Chairman. Now, if I may, I will present my statement.

Chairman DOUGLAS. If you will.

Secretary McNAMARA. It is a very great pleasure to come before this committee for the first time to discuss the progress made by the Department of Defense in improving the economy and efficiency of its procurement and logistics operations. The Subcommittee on Defense Procurement of the Joint Economic Committee is among the pioneers in this effort. To the continuing interest and prodding of this and other committees of the Congress, we owe much of the progress achieved in this area over the last 10 years. The personal interest and warm support of the chairman and Mr. Curtis and the other members of the committee have been a source of strength to me in my efforts to bring about improvements in our logistics management, many of which stem directly from the committee's recommendations.

As the members of this committee well know, it is extremely difficult to change the traditional way of doing things in the Defense Establishment. Many of the actions we have taken during the last 2 years to improve the management of our procurement and logistics operations were recommended by this and other committees of the Congress and by various nongovernmental committees and commissions, 10 and even 15 years ago. For example, the reorganization of the Army technical services, which we put into effect last year, had been recommended to the President by Secretary of Defense Lovett in 1952 with the comment that:

A reorganization of the technical services would be no more painful than backing into a buzz saw, but I believe that it is long overdue.<sup>2</sup>

Chairman DOUGLAS. I hope you have not suffered.

Secretary McNAMARA. It has now been accomplished and some of the scars remain, but time is dimming the memory of them.

Resistance to change is not unique to the Defense Department. This same problem is also found in almost any large business organization. Change means that people have to relearn the way they are doing things and this is always a painful and time-consuming process, whether in Defense logistics or private business.

The term "logistics" in its broadest application encompasses the entire spectrum of activity beginning with research and development and extending through procurement, production, construction of facilities, deployment, supply, maintenance, transportation, et cetera, and ending with the disposal of surplus materiel and facilities.

<sup>1</sup> See "Hearings, 1960," p. 429; "Report, 1960," p. 72; staff report, 1960, pp. 1, 163.

<sup>2</sup> See "Report, 1960," p. 83.

In this sense, our logistics operations account for about three-quarters of the total Defense budget. Looked at in another way, our total payroll for active duty, reserve and retired military personnel, and all civilian personnel, accounts for roughly two-fifths of our total budget, with the balance—about \$30 billion out of a total of \$50 billion—accounted for by the purchase of goods and services of all kinds; that is, research and development, the procurement of weapons, equipment, spares and other consumables, military construction, maintenance, utilities, et cetera.

Truly important savings in defense expenditures can be achieved only by attacking this entire spectrum of logistics activities, and that is precisely what we are trying to do. Decisions in the development phase of a weapons system will affect not only the cost of development, but also the cost of production and operation of the system throughout its life.

As this subcommittee noted in one of its recent reports, "It is apparent that two identical items can be procured, stored, inventoried, issued, and maintained in a common way much more economically and efficiently than can two different items." Yet, each new weapon or piece of equipment that enters the inventory brings with it thousands of new and different items of spares and supporting equipment. That is why any serious attempt to reduce the number of different items in our logistics system and thereby reduce costs must begin in the research and development phase.

#### RESEARCH AND DEVELOPMENT

The research and development phase itself can be broken down into a number of significant sequential steps:

1. Research (basic and applied): The effort directed toward the expansion of knowledge in such fields as the physical and environmental sciences, that is, mathematics, physics, psychology, biology, and the medical sciences.

2. Exploratory developments: Work directed toward the solution of specific military problems, but stopping short of the actual development of experimental hardware for technical or operational testing.

3. Advanced developments: Projects which have advanced to a point where the development of experimental hardware for technical or operational testing is required, prior to the determination of whether the item should be designed or engineered for eventual service use.

4. Engineering developments: Developments which are being engineered for service use, but which have not as yet been approved for production and deployment.

5. Operational systems development: Continued development, test, evaluation, and design improvement of projects which have already entered the production-deployment stage.

It is from the first three categories, research, exploratory and advanced developments, that we acquire the "technical building blocks," that is, the new technologies and critical components, that we need for major systems development. We cannot do a proper job of engineering development, least of all operational systems development, unless these building blocks are available. Lack of attention to this principle in the past has been one of the major causes of waste and inefficiency in the research and development program.



All too often, large-scale weapons systems developments, and even production programs, have been undertaken before we had clearly defined what was wanted and before we had clearly determined that there existed a suitable technological base on which to draw in developing a system.

And all too often insufficient attention has been paid to how a proposed weapons system would be used, what it would cost, and, finally, whether the contribution the weapon could make to our military capability would be worth the cost.

Let me give you a few examples to illustrate this point:

#### NUCLEAR-POWERED AIRCRAFT

Here is a case where a major development program was undertaken before a suitable technological base had been created. (See p. 128.) Nearly 15 years and about \$1 billion had been devoted to the nuclear-powered aircraft project before it was terminated in 1961. Throughout its history the program was characterized by attempts to find shortcuts to early flight. Only a relatively small fraction of the money expended was applied to the really critical pacing item, namely, the development of an efficient reactor with a potentially high performance.

Most of the funds were consumed in aircraft and weapon system design, in trying to develop turbine machinery, aircraft components, radiation resistant tires and oils, and for the construction of various facilities, many of which would be needed only in support of a flight test program.

The powerplant development was oriented primarily to the goal of early flight, an approach which yielded little, if any, potential for further growth into a militarily useful system. Neither of the two powerplants under development at the time the project was canceled held any great promise as practical propulsion units. Both would have required very large aircraft with limited speed and altitude characteristics, and involving severe operational and ground handling problems and hazards.

Thus, due to the lack of the pacing item, the reactor itself, it is highly unlikely that we would ever have obtained anything useful from a military point of view, had we continued the project.

#### THE P6M JET-POWERED FLYING BOAT

Here is a case where a project was advanced into the production phase long before even the basic design problems were solved. The project was started in 1961 to meet an anticipated requirement for a fast, mine-laying, jet-powered seaplane capable of flying at transonic speeds at sea level and at high altitudes, with an ability to take off and land in 6- to 8-foot waves and carry a payload of 30,000 pounds over a range of 900 miles.

Even though various model tests conducted in 1953 and 1954 disclosed a number of serious design deficiencies, the development was continued. Further technical deficiencies were disclosed during flight tests in 1955 and 1956. Nevertheless, the first production contract for operational aircraft was placed in late 1956. By the time this project was terminated in August 1959, the Government had expended almost \$450 million, of which more than \$200 million was spent on the pro-

duction contract. Even then, most of the technical problems had still not been solved.

#### SM-73-GOOSE AERODYNAMIC DECOY MISSILE

Here is a case where the operational use of a weapon was not clearly foreseen prior to the commencement of full system development. The project was started in June 1955 and terminated in December 1958 at the cost to the Government of about \$80 million. The GOOSE was essentially a pilotless aircraft which was designed to fly at about the speed of a B-52 and appear on enemy radar as a manned bomber.

The operational concept called for launching GOOSE at the same time the manned bombers took off. However, the manned bombers could be recalled and returned to their bases, but the GOOSE could not be recovered once it was launched. Thus, the GOOSE was incompatible with the new concept of positive control (under which the bombers automatically return to base unless specifically directed to continue to target) and had to be abandoned.

Chairman DOUGLAS. In slang parlance, could we say that the GOOSE laid the egg, but was unable to produce its kind?

Secretary McNAMARA. It was not a golden egg in any case.

#### CONSTRUCTION OF A RADIO TELESCOPE AT SUGAR GROVE, W. VA.

The next case is the construction of a radio telescope at Sugar Grove, W. Va. Here is a case where the construction of an extremely complex research facility was started before all of the technical problems had been thoroughly studied. Construction of this radio telescope, known as the "Big Dish," was decided upon in the fiscal year 1959 budget at which time its total cost was estimated at \$80 million. Two years later the cost estimate had risen to \$135 million and to preclude a further increase, the House Appropriations Committee established this amount as a ceiling on the project.

By the spring of 1962 it was clear that the cost would amount to \$190 to \$200 million, at the least, without any assurance the facility would meet the originally stated requirements. In the light of this, and other factors, the project was terminated last July at a cost to the Government of about \$70 million.

#### PROGRAM DEFINITION

In order to minimize such problems in the future we are now following the practice of inaugurating large system development projects only after completion of what we call a program definition phase. This is the phase in which we, together with our contractors, do our thinking and planning—before we start we start "bending metal."

Very briefly, the program definition phase begins with the solicitation of proposals from industry and involves a number of early study contracts whose purpose is simply to define the program, prior to authorizing full-scale development. In the early stages of the program definition phase we do not attempt to establish rigorous specifications, preferring to encourage initiative and innovation on the part of our contractors or contractor teams. Indeed where competing approaches present an unusually difficult choice, we may support more than one approach throughout the whole program definition period.

Working together, a contractor team can explore in depth the many unknowns which are present in any new effort. They can accomplish the overall system design, define the subsystems and major components and begin the early stages of laboratory experimentation and design. Most important, they can identify the critical problems and make good estimates of how long and how much money it will take to solve them.

With this information at hand, we are in a much better position to decide whether or not to proceed with full-scale development. And if we decide on full-scale development, the basic scientific and management team will have already been established, with a visible history of successful collaboration during the program definition phase. Finally, it will be possible to make the decision for full-scale effort with far greater assurance that the cost estimates are sound, that the performance of the system will meet the promise, and that the military requirement will be filled at the time needed.

Prior planning, and even feasibility testing of "pacing" components, are a lot cheaper than having to reorient, stretch out, or terminate expensive projects after they have been started. There are, of course, exceptions to this general rule. Where a development can add a new and unique dimension to our military capability like the A- and H-bombs and the ICBM, great costs and risks are justified. But such cases are rare. The typical development promises, if successful, to achieve a capability that can also be achieved in other ways or represents an improvement of but modest proportions in our total military capability.

In these cases the urgency is not as great and the employment of a more measured and orderly approach to development and production is fully justified. In fact, I have observed that in most cases careful and comprehensive prior planning actually saves time as well as money and results in more effective and more dependable weapons.

#### PARALLEL DEVELOPMENT OF SIMILAR PROJECTS AND SYSTEMS

Another major source of waste, as I noted earlier, is the parallel development of projects and systems designed for the same general mission. The cost of developing new aircraft today is reckoned in the hundreds of millions of dollars. In the case of the B-70 the development of three prototype aircraft will probably cost us about \$1.5 billion and they will still not be designed as operational vehicles. The cost of developing a new major missile system is even higher. We have invested well over \$1 billion in the NIKE-ZEUS already and the ATLAS and TITAN developments ran well over \$2 billion each. Even the cost of developing a new aircraft engine to the point of production is about \$150 million.

But this is only the beginning of the increased cost. If two models are produced where one could do the job, the cost of production is also increased. Two production lines instead of one must be set up and tooling and economies of large-scale, repetitive production are lost, thus significantly increasing the cost per unit. Two separate pipelines of spares and unique support equipment instead of one must be established in the logistics system, with all the additional costs involved.

And, finally, two sets of obsolete spares and support equipment instead of one will eventually have to be disposed of when the end item is finally phased out of the inventory. We have on hand, at

this very moment, more than \$12 billion of "excess" and "long supply" items in our inventories, excluding the billions of dollars of surplus and obsolete major end items which have to be disposed of each year. Thus there are very great economic incentives for reducing the number of different weapon systems and major items of equipment in our inventories. Yet the record is replete with instances of duplicate developments.

I will mention several duplications which resulted in substantial waste, duplication which we hope to avoid in the future.

#### NIKE-TALOS CONTROVERSY

One of the most memorable cases of parallel weapon projects conducted under the auspices of different services was the NIKE-TALOS controversy. The land-based TALOS, an Air Force sponsored adaptation of the Navy shipborne TALOS, was directly competitive with the Army's NIKE-B (later the NIKE-HERCULES) development, the follow-on effort to the NIKE-AJAX. The history of this controversy was complicated by the roles and missions issue which need not concern us in this context. What is of interest here, however, is the fact that these parallel developments proceeded right up to the point where both were about to be produced and deployed.

At this point, however, Congress balked at the prospect of such an obvious duplication and refused to authorize the use of construction funds for TALOS until the Department of Defense completed an evaluation of the two systems and came forth with specific recommendations. As the report of the Senate Armed Services Committee stated:

The committee concluded that both the Army and Air Force are assigned overlapping roles and missions in the antiaircraft and continental air defense fields \* \* \* The committee believes that unless concise responsibilities are assigned, duplication of weapon systems costing in the multibillion-dollar ranges might result and that such duplication would obviously be too costly as well as inexcusable from a military standpoint.

Faced with this mandate, responsibility for land-based TALOS was transferred to the Army in the fall of 1957. Following an evaluation study, the Army canceled the project in July of 1958 at a cost to the Government of \$118 million.

I know that I need not burden this committee with a recitation of the THOR-JUPITER controversy which involved essentially the same kind of issue.

#### MULTIPLE AIRCRAFT ENGINE DEVELOPMENT

Another area in which unnecessary duplication has long existed is in jet aircraft engine development. While there may have been a justification in the early stages for a large number of different projects, jet engine technology has now reached a point where parallel development is no longer justified.

Indeed the time has come where we should make use, wherever possible, of engines already developed. This we have done in the case of the new C-141 cargo transport aircraft, contracts for which were let last year. Here we had a choice of developing an entirely new engine, which would probably have given this aircraft perhaps a 2- to 3-percent improvement in overall performance, or of using an already

developed engine, the TF-33, at a saving in development costs alone of well over \$100 million. Considering the additional saving which will accrue in production costs and later in supply and maintenance costs, it was clear that we should use the TF-33 engine.

#### MULTIPLE FIGHTER AIRCRAFT DEVELOPMENTS

One of the most costly areas of duplication has been that of fighter aircraft. For example, in the 1955-58 period there were no less than four aircraft under development to perform the fighter mission—two in the Navy and two in the Air Force. The Navy aircraft were the F-4H-1 and the F-8U-3. The Air Force aircraft were the F-105 and the F-107. One might argue that there were special requirements associated with Air Force and Navy missions which necessitated basically different aircraft. Even so, both the F-4H-1 and the F-8U-3 were, as the House Appropriations Committee noted in its report on the 1958 defense appropriation bill, "all-weather fighters with approximately the same mission and operational characteristics." Accordingly, the committee directed the Navy to "take prompt action" to decide which of these aircraft it will place in production.

"This should be accomplished at an earlier date and with fewer test and evaluation aircraft than is presently scheduled." The Navy eventually chose the F-4H-1 for production, but by the time the F-8U-3 development was terminated, it had cost the Government over \$136 million.

In the case of the Air Force, the F-107 was terminated at a cost of about \$85 million. Even so, two of the four aircraft, the F-4H and the F-105, were actually placed in production. A comprehensive analysis of these two production programs in 1961 convinced me that one aircraft, the F-4H, could meet the need of the Air Force as well as the Navy, and do it better than the F-105.

Accordingly, further procurement of the F-105 has been terminated and the F-4H, now designated the F-4, will be bought for both the Air Force and the Navy, and will be the basic fighter of each of the services during most of the remaining years of this decade. In addition, I have assigned supply management responsibilities for all spare parts and components peculiar to the F-4 aircraft to the Department of the Air Force and I have asked the Air Force and the Navy to develop and submit to me, for my approval, joint plans for the maintenance of this aircraft.

#### PARTS INVENTORY OF \$15 BILLION

Chairman DOUGLAS. Mr. McNamara, the staff has produced figures from the Government Operations Committee report on real and personal property inventories which indicate that the four military services, as of last June, had spare parts of one kind or another amounting to more than \$15 billion.

#### SAVINGS THROUGH STANDARDIZATION

Is not a large part of this caused by duplicate equipment, and if you are able to standardize this equipment and use the spare parts to the optimum on the standardized equipment, couldn't you effect substantial savings in these spare parts?

Secretary McNAMARA. There is absolutely no question in my mind that you are correct that we have \$12 billion worth of long-supply inventory in our possession at the present time. However \$4½ billion relates specifically to aircraft spare parts. An important factor contributing to that huge supply has been the tremendous variety of aircraft, both transport and combat types. It is to reduce that variety and achieve both a reduction in development and production costs as well as the reduction in maintenance costs and particularly the reduction in surplus inventories that we have taken the step I have just outlined. We are also taking another step which I will now discuss.

#### TFX

Perhaps the most important single action we have taken thus far to reduce the number of different weapon systems in our inventory is the TFX, which has been so prominent in the news of late and of which we have all heard much in the last few weeks. This aircraft development is designed to provide a replacement for the F-4. Instead of developing and producing two separate aircraft, one for the Navy and another for the Air Force, as was done in the case of the F-105 and the F-4H, we decided to develop and produce one aircraft which would meet the requirements of both services.

I might draw a distinction between the F-4H, which was developed as a Navy aircraft, put in production, and later, as I suggested a few minutes ago, adopted by the Air Force in preference to an aircraft originally developed solely for the Air Force requirements. In contrast to that situation, the TFX has been designed from the beginning of the project to serve the requirements of both the Air Force and the Navy.

Admittedly, this is not a simple undertaking. The development of a major weapon system to meet the requirements of more than one service is something of a precedent in the Department of Defense. It took more than a year and a half and tens of thousands of man-hours of intensive study by both the Defense Department and industry to perfect this plan.

Yet it should be clear to all who are interested in economy and efficiency in the Defense Establishment that we can no longer afford to undertake major development projects to meet unilateral service requirements where a single project can meet the requirements of more than one service. The additional costs involved are much too great. From here on out, we must seek to develop weapon systems to perform a military task, and if it so happens that more than one service has the same task, then they will be required, as a general rule, to use the same weapon system wherever this can be accomplished without compromising essential military requirements. Where operational conditions vary, as for example, in attack carrier operations, the minimum number of changes in the common system will be made to accommodate these differences.

This is the principle involved in the TFX and I think everyone will agree it is an entirely sound one. While one might argue as to precisely how much one system would save as compared with two, I believe everyone would agree that the saving in logistics costs, as I am using the term here today, cannot help but be very substantial. In the case of the TFX, we believe these savings will amount to at least a

billion dollars, probably in excess of a billion dollars, in development, production, and operating costs over the life cycle of this aircraft.

Senator JAVITS. Mr. Chairman, would the witness yield at this point?

Chairman DOUGLAS. The Senator from New York happens to be a member of the Government Operations Committee and this committee and therefore has been following this discussion with a great deal of interest. I know you will welcome questions from him.

Secretary McNAMARA. I will, indeed.

Senator JAVITS. I will make it brief because I understand the Secretary has to get away, as I do, for another committee meeting.

Mr. Secretary, this is the first opportunity you have had in testifying in public on the TFX?

Secretary McNAMARA. Yes; it is.

Senator JAVITS. Mr. Secretary, would you say this is a classic demonstration of the TFX decision of the principle which you have enunciated in this paper?

Secretary McNAMARA. I would, sir.

Senator JAVITS. Would you say, too, that the TFX represents those marginal differences in terms of quality which you are ready to forgo, in order to make the overall decision of, not economy—I don't like that word in defense, we will spend anything to defend ourselves—but in terms of a balancing of the economic resources of the country and their utilization for defense and for other national purposes?

Secretary McNAMARA. Yes, sir. I would. I would say that the marginal differences between performance that might have been achieved by unique aircraft versus performance achieved by the TFX are small indeed, and therefore, the operational penalties are very, very minor.

I fully accept the point you make, that in Defense our primary objective is not economy. Our primary objective is to protect our national security. In the course of working toward that objective, as you well know, we have substantially increased the Defense budget because we have felt that conditions in the world required additions to both our nuclear and our nonnuclear forces.

But having recognized that primary objective, it then becomes extremely important for us to pay attention to the second instruction given to me by the President, which was specifically, after having determined the military force requirements, without any regard to arbitrary or predetermined financial limits, to procure and operate those forces at the lowest possible cost.

It is in the pursuance of that second objective that we have adopted the TFX approach.

Senator JAVITS. Do you find—and I know that this will not be a question of individual use—do you find resistance on the part of the separate Services to this kind of change?

When I say individual use, Mr. Secretary, there are many things a Senator can say that you can't. I would like to say it. This is not disrespect to any service.

If anything, it is a credit to the service that men are so imbued with the sell and belief in their particular arm that they believe that it should have everything it wants and it can do the job for the Nation the best.

So we are not talking about criticizing an officer because he is a hot Air Force man, or a hot Navy man or hot Army man. We understand. We sympathize. We agree.

It is good for morale. Is it a fact that kind of sell does give you a big amount of opposition in the Department of doing the very things that you are trying to do?

Secretary McNAMARA. As I said earlier, I think one finds in any large organization resistance to change. The resistance to change is a function of lack of understanding of the benefits of change.

I have found with respect to any number of modifications we have made in the Defense Department, for example, the establishment of the Defense Supply Agency, which in large part, I believe, reflected the interest and views and suggestions of this and other committees of Congress, was strongly resisted by some in the Defense Department. They resisted it, not out of any desire, I think, to advance their personal position or the power of their particular department, but rather because of an honest belief that it would be contrary to the interests of the Department and would penalize the combat readiness of our establishment.

This, I believe, was a misapprehension. I think the record, since the Defense Supply Agency was established, proves it to be a misapprehension. The Agency turned in a truly remarkable performance during the Cuban crisis. So, in terms of combat readiness, if anything, it has increased our capability. While at the same time, as I will mention later and as the committee may wish to investigate further, it has yielded very substantial and measurable cost savings.

I think your point is well made. I simply want to share what I think is your own thought, that this is a function of misunderstanding rather than of desire to advance one's personal interests or the position of one person's organization.

Senator JAVITS. Is this the reason why you believe, as I believe and many other Senators believe, in the paramount situation of the decision of the civilian Secretary as the final deciding factor over whatever very well intentioned, honorable, zealous points the military arm might make in respect of procurement matters?

Secretary McNAMARA. Sir, I would say in my mind it is not primarily the primacy of the civilian versus a military authority, but rather the primacy of an individual, military or civilian, who bears the total responsibility and who can see the total problem in light of all its aspects. It is extremely difficult for individuals who are assigned to only one part of the organization to see the implications of acts that affect other parts of the organization.

Therefore, in certain of these cases one must move up the scale to the top of the organization, to, for example, the Joint Chiefs themselves or to the civilian Secretaries to obtain a point of view that encompasses the entire activity of the Department.

To that extent I fully agree with your point.

Senator JAVITS. You want your decision to be the final one, don't you, Mr. McNamara, in the absence of an abuse of discretion on your part?

Secretary McNAMARA. I am charged by law to make the final decisions. I have no hesitancy in doing so.

Senator JAVITS. Is the TFX development being held up?



Secretary McNAMARA. Senator Javits—

Senator JAVITS. You don't have to answer that.

Secretary McNAMARA. I would rather not.

Senator JAVITS. I think that is a very important point. May I point out, too, in fairness to what is going on around here, that you yourself demonstrated in your testimony on the NIKE-TALOS controversy and on the multiple-fighter controversy that often it is congressional committees that cut the Gordian knot, so often they can be very useful and indeed these present hearings may prove to be very useful in regard to the matter we are discussing.

Secretary McNAMARA. There is no question whatsoever that that is true.

Senator JAVITS. Mr. Chairman, I am very grateful to the Chair and to the witness for being willing to divert himself for the moment.

Secretary McNAMARA. Thank you, sir.

Mr. Chairman, I will now move to another section of our Department of Defense cost reduction program.

#### DEPARTMENT OF DEFENSE COST REDUCTION PROGRAM

Because of the great uncertainties inherent in research and development, we have not attempted to establish precise monetary savings targets for that part of the "logistics spectrum," as we have for procurement, production, construction, supply, maintenance, transportation, and so forth. For the latter, we have established specific time-phased Defense Department goals for some 24 areas of logistics management. Selected goals in turn have been established for the military departments and defense agencies; that is, DSA and DCA, so that our key logistics managers know exactly what is expected of them.

These goals are admittedly ambitious and will be achieved only if all management levels in the Defense Department give them continuing, high priority attention. Accordingly, the service Secretaries and agency heads have been directed to make a monthly or quarterly review of progress achieved and to report the results to my office. These reports are audited by the Comptroller, both with regard to the goals and the progress against them.

It is easy to overstate one's savings. We are attempting to avoid such overstatement. The current cost reduction goals are summarized in the attached table. The last two columns show the goals reported to the President last July.

As I mentioned to you earlier, the President has emphasized to me on numerous occasions the importance of achieving whatever military force is required at the lowest possible cost. On July 5 of last year, I reported to him upon the program we had developed to meet his instructions. The last two columns of that table show our estimates as of the day that I reported to him.

Management improvement actions instituted in 1962 and planned for fiscal year 1963 should ultimately produce annual savings of about \$1.9 billion. Our goal for end fiscal year 1965 is to initiate actions which will increase the rate of savings to about \$3.5 billion a year. These are higher goals than those reported to the President, but I believe they can be achieved with a real effort on the part of all concerned.

Mr. Morris will discuss these goals in detail later and give you an up-to-date progress report on their attainment.

Chairman DOUGLAS. Mr. Secretary, do you have an estimate as to the amount which you will have saved in the current budgetary year ending July 1963?

Secretary McNAMARA. I do, Mr. Chairman. I happen to have the figures for fiscal year 1964 with me rather than 1963. I can give you those. We, of course, have to distinguish between the savings that accrue from decisions and the timing of those estimates on the one hand versus the fiscal years in which the savings will be realized.

For example, as I will mention later, we have decided to close or dispose of about 330 installations. Those decisions have been made. But not all of those anticipated annual savings will be realized in the current fiscal year, because it takes, in some instances, up to 3 years to complete the action. The actions that we will take through fiscal year 1963 will result in savings of about \$1.9 billion when fully realized. This will be every year.

In fiscal year 1964 budget we have reduced the budget below what it otherwise would have been, by over \$1 billion.

Chairman DOUGLAS. So you really saved over \$1 billion in the budget for next year?

Secretary McNAMARA. That is right. Without further action, that will rise eventually to \$1.9 billion per year every year.

Chairman DOUGLAS. You may proceed.

Secretary McNAMARA. What I will do now is to discuss some of the basic concepts and principles upon which these objectives of our three and a half billion dollar cost reduction program have been developed.

#### BUYING ONLY WHAT WE NEED

First, I will discuss buying only what we need. Before we can intelligently decide what to buy, we must first determine precisely what is needed, and what is needed must be directly related to realistic and soundly conceived military plans and policies. All too often in the past, material requirements were determined on the basis of unrealistic military plans which themselves reflected the wide divergence of views among the services as to the probable nature of a future war. For example, the Air Force, planning essentially for a short nuclear war, was not buying enough combat consumables to support the Army in a conventional limited war. And the Army, envisioning a long, large-scale general war, was generating requirements so large as to be useless in planning its actual procurement programs. As a result, serious imbalances developed in the stocks of weapons, equipment, and combat consumables held by different services and even within the inventories of a single service.

Therefore, one of my first actions in the logistics management area was to insure that the requirements calculations for our major combat items were soundly based on unified contingency planning and realistic, attainable logistics objectives.

By redefining our logistics objectives to accord with approved Defense Department-wide contingency plans we were able to reduce our total stated materiel requirements by some \$24 billion.

I want to emphasize we didn't save \$24 billion. I am not claiming that. But the requirements were reduced by \$24 billion. They had

been so unrealistic that they did not serve as goals or guidelines for efficient procurement.

By setting out realistic goals that could be achieved within a reasonable period of time, we have been able to assure that the readiness levels of all related elements of the military forces are raised together and maintained in balance, one with another.

Chairman DOUGLAS. Mr. Secretary, if you had accepted the programs of the various services you would have been compelled to increase material purchases by \$24 billion?

Secretary MCNAMARA. Yes. I think that is a fair statement. I think we should define a requirement as something we need. If we accept the principle that this Nation can afford whatever military force is required to support its national security we ought to finance the requirements. To establish requirements which you have no intention of fulfilling simply introduces serious inefficiencies and imbalances into the system and is one of the major factors contributing to our current \$12 billion of long supplies held in inventory.

The first step was taken in 1961, in connection with the development of the fiscal year 1963 budget, with the establishment of a specific procurement objective for a large number of important items needed to insure that all of our forces could engage in sustained nonnuclear combat operations for a reasonable period of time. In the 1964 budget, now before the Congress, we propose to take another step to a still higher level of readiness, but again with an eye to the balance among all the related elements of the forces.

In moving toward this goal, we are giving priority to those items in which we are most seriously short, and to those new items which offer large improvements in combat effectiveness in relation to their cost. Modernization simply for its own sake is a luxury we cannot afford. Only by carefully husbanding our resources can we insure that all of our essential materiel requirements are met and that all of our forces are supplied and equipped, on a balanced basis, and are able to carry out the plans we have set for them.

We are also taking steps to get away from the use of often arbitrary and wasteful rule-of-thumb measures for determining pipeline requirements. Instead of simply adopting a standard factor for pipeline computations ( $x$  days, for example) we must, at least in the case of high-cost, major end items and components, determine quantitative requirements on an item-by-item basis. We must explore every opportunity to shorten leadtimes by using our transportation resources more effectively, by taking steps to increase the post-D-day production potential, and so forth. It is obvious that very great savings are possible if we are able to reduce the pipeline requirements without adversely affecting combat readiness. Let me give you a specific example: In the case of the M-88 tank recovery vehicle, we found that the substitution of a fully adequate transit pipeline factor of 55 days for the previously used arbitrary factor of 120 days enabled us to realize savings of \$12.5 million on just this one item.

These actions not only reduce procurement requirements, they also reduce storage and maintenance costs for the entire operational life of the item and, eventually, the amount of surplus which has to be disposed of.

The problem of setting sound requirement standards for major items of equipment is admittedly difficult; however, in the area of "supply

inventories," particularly spare parts, the logistics-management problem becomes far more complicated. This complexity is caused primarily by the great number and diversity of the items involved—nearly 4 million different items, having a value of \$40.6 billion, currently being carried in our supply system. Because these items are so numerous and diverse, we simply must decentralize their management. However, when we do so, we then encounter the tendency of each echelon in the supply system to introduce unilateral safety factors into its requirement calculations. The final result, of course, is that the computed requirement often grossly overstates true needs. To improve the soundness of our supply item requirement calculations, we are undertaking a series of management-improvement actions such as wider application of automatic data processing equipment, the increased use of fast logistics-communication links, and the continuous review and redefinition of safety factors in our requirements computations.

It is not enough to determine simply the quantitative requirements for equipment and supplies. We must also determine the qualitative requirements as well. There is no point in paying for performance or quality features that are not needed to accomplish the essential military task. In any meaningful sense, procurement of excessive quality, which we call gold plating, is just as wasteful as procurement of excessive quantities. While it is understandable that an item costing \$1,000 may perform more effectively than another costing half as much, we must always make a judgment as to whether the additional performance is worth the doubled cost. This will always be a most difficult area, since informed judgment is required in all such determinations. It is an area, however, in which we have only just scratched the surface of potential management improvement and in which we feel that substantial additional savings can be made in the future.

#### CONSOLIDATION OF COMMON SUPPLY AND SERVICE ACTIVITIES

In order to be sure that we are buying only what we need, we must know exactly what we already have on hand and on order; and this, in an organization as huge, diverse, and far flung as the Defense Department is far from a simple operation. This is particularly true with regard to long supply and excess items, one of the most galling and troublesome areas of logistics management. Instances of one service buying items that are being disposed of by another are, to the taxpayer, the most unexplainable and inexcusable kind of waste.

This is one of the points you specifically mentioned in your letter, Mr. Chairman. I think we have made much progress since you have brought it to our attention. Yet, this problem can never be entirely avoided as long as you have different parts of the organization buying and managing the same items. One solution, of course, is to have only one element of the organization purchase and manage all commonly used supplies and services, wherever centralized procurement is indicated, and this has been the solution favored by many Members of the Congress.

Chairman DOUGLAS. That does not mean weapons?

Secretary McNAMARA. It does not, sir. The major weapons systems generally are unique to one service, and in any case the responsi-

bility for their research, development, production, and maintenance remains with the services. The procurement of items used by more than one service has, however, to a considerable extent, been centralized.

The trend toward the consolidation of the logistics functions, including the procurement of common items of supply and services, has been underway in the Defense Establishment for a long time. Certainly, since the end of World War II, the sentiment, especially within the Congress for faster progress toward consolidation grew markedly stronger. Following the Unification Act, the problem of overlapping logistics functions in the Defense Department drew the repeated attention and criticism of the Congress. Beginning with the recommendations of the Bonner subcommittee in 1952, the efforts of members of this committee in effecting passage of the O'Mahoney amendment to the 1953 defense appropriation bill and later the McCormack-Curtis amendment to the Reorganization Act of 1958, Congress continually prodded the Department in the direction of truly unified logistics management.

The Defense Establishment, however, moved very cautiously toward that objective with various improvisations such as coordinated procurement, joint procurement agencies, and later the establishment of single managers for common supplies and services and the creation of certain Defense-wide coordinating agencies such as the Armed Forces Supply Support Center. These improvisations, however, did not get to the core of the problem—the need for a single agency charged with the responsibility for procuring and managing all commonly used and centrally procured supplies and services.

I remember a presentation made to me back in 1961 dealing with the lack of standardization in the clothing area. While this may seem to be an absurd example, it is typical of thousands of other more important situations. Each service, for example, was buying a different type of butcher smock, each in several sizes—a total of 18 different inventory items. Today we stock only two types in fewer sizes—a total of seven different inventory items. You all know the story of the belt buckles and the exercise bloomers.

While these are small they are typical of the tens of thousands of standardization actions we have taken which resulted in substantial savings.

Chairman DOUGLAS. Isn't this also true of blankets? Which one of the services felt disgraced if it had to sleep under blankets bearing the insignia of the Marine Corps?

Secretary McNAMARA. I don't think anyone should feel disgraced sleeping under a blanket bearing the insignia of the Marine Corps. It was interesting to note in the newspapers yesterday or the day before that the Marines or the Commandant has ordered that hereafter the standard uniform will include black shoes and black socks. This is entirely due to further standardization. General Shoup himself, as a matter of fact, has been a great proponent of standardization and has done much to introduce it into the Marine Corps.

Thus, one of the first and most pressing tasks I had to face when I assumed the Office of the Secretary of Defense was the solution of this longstanding problem of the management of common supplies and services. In reviewing the efforts that had been made since World

War II, I concluded that this problem must be attacked head on. It seemed clear to me, as it had to this committee for many years, that only through the establishment of a separate, single supply support agency could we ever hope to find a lasting solution. The result was the creation of the Defense Supply Agency, which now does the buying, the stocking, and where necessary, the surplus disposal of a wide range of commonly used supplies and services. Within its area of responsibility, it will greatly help to ensure that we "buy only what we need."

Already, the new Agency has made possible a personnel reduction of 3,700 and a savings of \$33 million in the fiscal year 1964 budget.

Chairman DOUGLAS. Mr. McNamara, this means that if you take all of the supply agencies together, including the Defense Supply Agency, there is an overall reduction?

Secretary McNAMARA. That is correct, sir.

Chairman DOUGLAS. That is, you have not merely reduced in the separate services and expanded in the Defense Supply Agency?

Secretary McNAMARA. Certainly not. We counted all of the people in the separate services performing the consolidated functions or the functions to be consolidated before we took action to consolidate them. We then removed that number of spaces from the total number of personnel authorized to the separate services. Then we asked General McNamara how many people he needed to perform the functions to be consolidated. He provided a very well considered budget. It provided for a lesser number of people than we had removed from the services. We assigned to General McNamara the authorization for the lesser number and we eliminated the authorization for the difference between the number previously required by the separate services and the number required by DSA. It was, therefore, a net saving to the Government of approximately 3,700 people.

Chairman DOUGLAS. And you revised the tables of organization?

Secretary McNAMARA. We have revised the tables of authorization for the services accordingly.

Chairman DOUGLAS. Organization as well as authorization?

Secretary McNAMARA. Yes. These are, to be very precise, not tables of organization but tables of authorization, because they are not primarily military personnel. They are primarily civilian personnel.

Furthermore, the inventory is expected to be reduced by \$232 million during the current fiscal year with a further reduction of \$112 million in fiscal year 1964. DSA now handles about 1 million supply items but the number of different storage points is being reduced from 77 to 11.

Chairman DOUGLAS. That is a great improvement.

Secretary McNAMARA. This will do much to reduce excess stocks in the future, because excess stocks in part are a function of the number of different storage points.

#### COMMON USE ITEMS FOR WHOLE GOVERNMENT USE OF GSA

The basic principle that there should be a single agency to procure and manage common items of supply or services for all users is, as this committee has repeatedly pointed out, as valid for the Government as a whole as it is for the Department of Defense. (See pp. 2-3, 43, 378.) Therefore, in our own efforts to obtain greater efficiency through the consolidation of common logistics support activities, we should not.

restrict ourselves to Defense agencies alone. Whenever we find that it is more economical to use the capabilities or facilities of other Government agencies, with no loss in military effectiveness, and at the same or less cost, we should not and have not hesitated to do so. The General Services Administration annually buys for us about \$770 million of common use items such as office supplies, furniture, and automatic data processing equipment.

This agency also helps us in the screening and disposal of surplus property, in the leasing and maintenance of real property, the storage of records, the purchase of utilities, and so forth.

#### BUYING AT THE LOWEST SOUND PRICE

Once we have determined what it is we need to buy, the next problem is to procure it at the lowest sound price considering, of course, quality and delivery dates. For over 100 years, formal advertising has been the preferred method of Government procurement. This method not only insures that the price discipline of the competitive system is harnessed to the advantage of the Government but it also minimizes the risk of bias and preferential treatment in the awarding of contracts. However, since the end of World War II only a small portion of Defense procurement has been awarded on a formally advertised basis. To a major extent this was unavoidable, as only conventional classes of equipment and supplies, purchased repetitively in volume, lend themselves fully to procurement by this method.

Formal advertising is inappropriate for virtually all research and development work and for the acquisition of many of today's sophisticated weapon systems, where it is impossible to draw up detailed specifications in advance and make firm fixed-price contracts, with selection based on price alone.

Senator PROXMIRE. Mr. Chairman, may I ask a question at this point?

Chairman DOUGLAS. Yes, indeed.

Senator PROXMIRE. Mr. Secretary, you say formal advertising is inappropriate for virtually all research and development work.

I notice in the exceptions listed in the report of our committee—on pages 35, 36, and 37, it shows that experimental development, test and research, that category of exception, in June 1961 to June 1962 for \$5.4 billion worth of procurement.

I am wondering in view of the enormous amount of research which the Government does not only through your Department, but through NASA if we are not coming to a time when we can use advertised competitive bidding to some extent in this area.

I am wondering if maybe Congress shouldn't take action to consider modifying that exception.

Secretary McNAMARA. I don't know at the present time how we could enter into research contracts based on competitive bidding. But, I do think we can do much more than we have to introduce incentives for efficient management of research into our contractual forms.

Senator PROXMIRE. For example, listed in the Armed Services Procurement Regulations, 321.2 applications, subparagraph 3, this is one of the exceptions, contract for such quantities and kinds of equipment, supplies, parts and accessories and apparent rights and drawings and designs as are necessary for experiment, development, research, or test.

It seems to me in many cases this kind of procurement could be competitive and advertised competitive. I have a feeling that this is one of the reasons why far too much Government procurement, \$7 out of \$8 worth, is not by formal advertisement.

We want formally advertised bidding. We get only about 15 or 17 percent. Certainly, in purchasing equipment, supplies, parts, accessories, in connection with the research project, we could make some progress there.

Secretary McNAMARA. I think it might be possible to work with our research contractors after a contract has been awarded to insure that they in turn introduce more competition into their own procurement practices. This I fully agree with you on. But to arrange for the research contract itself to be let on the basis of formal advertising, I think at least at the present time, would be well-nigh impossible.

I would agree with your suggestion or implication that we can introduce into the procurement procedures of not only our research contractors but other contractors as well either more reliance on formal advertised competitive bidding or more reliance on competitive procurement, as I will discuss in a moment.

There are a number of other situations where formal advertising is not applicable by law listed in the same document you were referring to. For example, small business set-asides, small purchases (under \$2,500), emergency purchases, the procurement of perishable subsistence, and items subject to military security classification. These, too, serve to reduce the portion of Defense procurement that can be accomplished through formal advertising.

Notwithstanding these limitations, we are making a vigorous effort to expand the use of formal advertising. In this connection, the so-called "two-step" procurement procedure recently approved by the GAO should prove extremely helpful where precise design is not as important as specific performance characteristics. Under this procedure bidders are first asked to submit proposals to meet specific performance criteria without providing a price quotation. These proposals are then examined by the Government engineers and buyers, and those which meet the desired performance characteristics are approved. In the second step, bidders whose products have been approved then submit sealed bids and the contract is awarded to the lowest responsible bidder under the formal advertising procedure. We think this is a major step forward.

#### INCREASING PRICE COMPETITION

But the fact that for much of our procurement we cannot rely on formal advertising does not mean that we should not demand and facilitate competition for Defense contracts. This, in fact, has been one of my principal objectives, not only in the procurement area but also in research and development. One way in which we can increase competition is to minimize sole-source procurement wherein, for example, we automatically buy spares and spare parts from the original producer of the end item. By "breaking out" these spares from the main contract we can procure them separately through competitive procedures. This, of course, entails the identification of the spares or spare parts, the preparation of procurement specifications and the seeking out of sources of supply in order to permit competitive bidding.



In this effort, we have concentrated first on the high-dollar-value items already in the defense supply systems. Now we are seeking to apply this technique to new items as they enter the supply system and to develop uniform procedures for screening and identifying such items in current and future procurements.

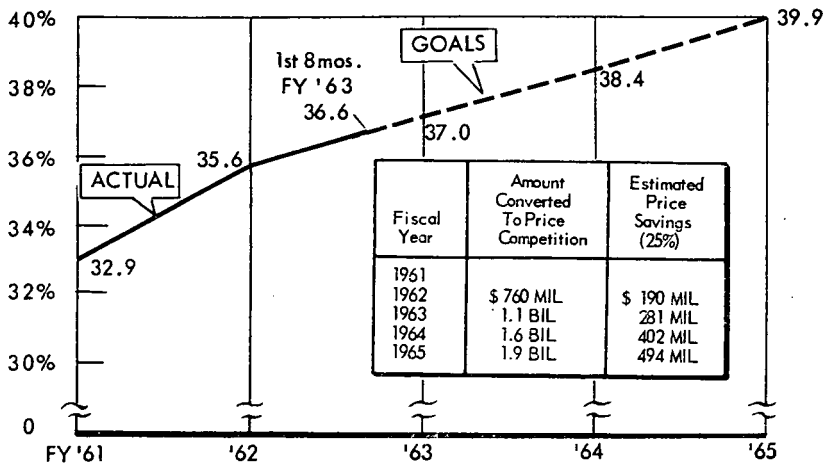
We are also trying to introduce competition at an earlier stage in our procurement process at the point where a new item is ready to be moved from development into production. If successful, this would enable us to avoid paying a price premium on the first large-scale production buy. But use of this method does open up a whole series of new and difficult problems. In order to introduce competition early in the procurement cycle, we must see to it that the necessary drawings and technical data are produced during the development phase so that they may be available at the time the first procurement is made. This is not always possible, especially where time is critical or where the design is still subject to major change. Also, where large engineering and tooling costs are involved, it is unlikely that any new source would be able to compete successfully against the development contractor who may have already completed a large part of the production engineering and tooling.

Experience has demonstrated that very large savings can be achieved by increasing competition. We estimate these savings at about 25 cents on each dollar shifted from noncompetitive to competitive procurement and this is the basis upon which we have computed the savings of nearly \$500 million per year to be achieved by fiscal year 1965, as shown on the following chart (as the result of shifting \$2 billion from noncompetitive to competitive procurement).

(The chart referred to follows:)

CHART 1

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



Secretary McNAMARA. We have shown on the chart of my prepared statement the past record and our future objectives.

## SAVINGS OF 25 PERCENT ON EACH DOLLAR SHIFTED FROM NONCOMPETITIVE BIDDING

Chairman DOUGLAS. Secretary McNamara, this is an extraordinary achievement. Can you give at a subsequent date or have one of your assistants prepare for the record the basis of your claim that you have saved 25 percent on each dollar shifted from noncompetitive to more competitive bidding?

Secretary McNAMARA. Yes, sir. I will be very happy to. This has been our experience to date. We will have to watch it carefully because maybe we are picking the easy items to deal with initially and perhaps as we dig deeper and deeper into this \$2 billion we propose to shift from noncompetitive to competitive procurement the rate of saving per dollar shifted will change. But I would be very happy to introduce to the record our savings to date.

Chairman DOUGLAS. Without necessarily identifying the companies or the units, if you can designate them by a code, it would be helpful.

Secretary McNAMARA. Yes, sir.

(The information requested is as follows:)

In September 1961, GAO reported to Congress on a review of price reductions resulting from competitive procurement of aeronautical spare parts, as follows:

"Our review included an examination of a number of instances where the Air Force and Navy obtained competition in procuring replacement spare parts which had previously been purchased from sole-source contractors. We found that new sources of supply received the competitive awards in more than 70 percent of the instances and that the total prices in these instances were more than 30 percent lower than the total of the prices offered by the previous sole-source suppliers. We also found, in the instances where previous sole-source suppliers received the competitive awards, that they often made substantial reductions in their prices."

As to specific competitive procurements in the Air Force, the report states that:

"Our review of 178 Air Force competitive procurements disclosed that, when new sources of supply competed against previous sole-source suppliers, the new sources received 130 (73 percent) of the awards. In these cases, the Air Force obtained spare parts at prices that averaged 33 percent less than those bid or proposed by previous sole sources. In the other 48 cases, we found instances in which the prior sole source substantially reduced their prices under the pressure of competition in order to get the awards. There were also instances of substantial increases over the last previous sole-source prices.

"In the 130 cases where new suppliers received competitive awards, the former sole-source suppliers proposed total prices of \$4,880,000, or \$1,621,000 more than the total prices of \$3,259,000 paid to the new suppliers. The price reductions on individual parts ranged from 1 to 95 percent.

"In the 43 cases where former sole-source suppliers received competitive awards, and we were able to establish their previous prices, the total prices of \$1,143,232 were \$242,131 (17 percent) lower than their last previous prices as sole-source suppliers. In the other five cases we did not find any record of the previous prices."

Regarding the Navy, the report states that:

"Our review in the Navy disclosed that, when new sources of supply competed against previous sole-source suppliers, new sources received the award in over 90 percent of the cases. As a result the Government obtained prices that averaged 33 percent less than those bid or proposed by the previous sole sources.

"We found that the Navy has a special program which is designed to increase the use of competitive procurement. In January 1958, as part of this program, the Bureau of Supplies and Accounts issued instructions requiring the submission of quarterly reports showing savings achieved through competition resulting from conversion from sole-source procurement. During the period March 31, 1958, to June 30, 1960, the Aviation Supply Office reported the conversion of 72 line items to competitive procurement with the following results:

"Prices based on former sole source.....	\$9,690,000
Competitive prices.....	\$6,500,000
Price reduction.....	\$3,190,000
Percent of reduction.....	33"

Additionally, in aeronautically spare parts, during the first half of calendar year 1962, we tested a procedure for breaking out spares for competitive procurement which has since been installed on a permanent basis in all activities purchasing replenishment spares of all kinds. Savings achieved through breaking out from sole sources averaged approximately 25 percent during the test period.

Some other examples are:

Tube formerly procured sole source at \$110 each; after advertising, unit price of \$79.50 was obtained. Reduction, 30 percent.

Aircraft hydraulic fluid previously supplied from a qualified sole source at a unit price of \$25 per gallon. The addition of a newly qualified bidder resulted in a unit price of \$15 per gallon. Reduction, 40 percent.

Electric motors previously procured at \$614.87 each from sole source. Advertised for 110 motors and award made to new source at \$280 each. Reduction, 54 percent.

Electron tube: Sole source price, \$11.80; competitive price, \$9.04. Reduction, 23 percent.

Eight-inch howitzer: Procured sole source at unit price of \$68,044. When purchased competitively, award made at unit price of \$41,415. Reduction, 39 percent.

Radio set AN/ARC-73: Procured sole source at unit price of \$4,024. Bought competitively at unit price of \$2,215. Reduction, 45 percent.

Talos fins: Sole source unit price was \$1,998.99. When purchased competitively they were bought at a unit price of \$1,360. Reduction, 32 percent.

Chairman DOUGLAS. This is what many of us have felt for a long time. We have never previously had any sound solid figures to back up our beliefs. If you can save 25 cents on each dollar, this means that you are going to save hundreds upon hundreds of millions of dollars and get greater combat efficiency at the same time.

Secretary McNAMARA. That is right. I am personally a great believer in the free enterprise system. All we are doing is applying the free enterprise system to the Defense procurement. I recall one case in particular where we were purchasing a particular item, a fairly expensive item from a manufacturer. We concluded that we could open that item to competition. We did so. I was literally shocked to see the price reductions ranged from a reduction of 25 percent to a reduction of 50 percent in the price.

The lowest bid came from the original manufacturer. It was for a reduction of 50 percent.

I want to emphasize that our objective here is not to cut the profits of Defense contractors. If anything, they are too low. They average about 3½ percent of selling price. This seems to me to be on the margin of being an inadequate incentive for individual business firms to participate in Defense work.

I am not at all concerned with cutting the profits of the average Defense contractors. Were we to cut them in half we would save only roughly 1½ percent of our procurement budget. I am not interested in just 1½ percentage points. I am interested in the savings that we can achieve by reducing the 97 percent of Defense procurement which represents costs. This, of course, can be done without any adverse effect on contractors by both the Defense Department and the contractors seeking more efficient ways to design, develop, and produce the item. This is our objective. This is what actually resulted in the instance I mentioned where there was a 50 percent reduction in the price. The contractor himself went back and redesigned his layouts and his method of producing the item. If anything, as I have suggested, I believe American business needs higher incentives to insure more efficient Defense production.

## OBJECTIVE TO REDUCE COSTS—NOT PROFITS

Our objective is to reduce the cost. I think we can reduce them by at least the amount that this committee at various points has indicated it believes possible.

Senator PROXMIRE. Mr. Chairman, may I ask a question?

You talk about contracts awarded on the basis of competition as a percentage of the total contract awards and back on page 24 you talk about competitive procedures. You are not confining this to formal advertising?

Secretary McNAMARA. No, sir. I am not.

Senator PROXMIRE. You are talking about competitive procedures including incentive fee method, for example?

Secretary McNAMARA. No; not in that case. These are basically fixed-price competitive awards.

In the case I mentioned of this particular part, we show the part to 5 or 10 manufacturers and they produce bids for it. We then take the lowest bid.

Senator PROXMIRE. How about on the TFX situation? Here you had a competition of a kind certainly between Boeing and General Dynamics and it was a competition that was decided, however, based on an analysis which certainly is not reducible to precise cost?

Secretary McNAMARA. No. I think it is very hard to call this a competitive procedure. It is in a sense. It is a design competition basically. But once we have chosen a design for the TFX, it is very, very difficult after that to introduce competition into the procurement process.

This is so because the company which has designed the aircraft, by that time, would have arranged for tooling. It would have so much invested and have such a lead in both technology and investment, that no other company could really equal its costs. From then on, we are forced at that point into what I would call a noncompetitive form of contract. Then the question becomes one of introducing sufficient incentives into this noncompetitive situation to insure that we have maximum pressure, if you will, on the contractor to minimize his cost through the application of incentives from which he benefits.

## TFX FIXED-PRICE INCENTIVE CONTRACT

Senator PROXMIRE. The TFX, as I understand it, was a cost-plus-fixed-fee procurement, is that correct?

Secretary McNAMARA. No, sir. The TFX will be a fixed-price incentive contract.

Senator PROXMIRE. Cost-plus-incentive fee?

Secretary McNAMARA. That is not right. During the design competition, it was a level-of-effort contract with a fixed ceiling for, let us say, something on the order of \$3 million per contractor. This was a level-of-effort contract with a fixed ceiling. But the huge development contract which will be for several hundreds of millions of dollars will be an incentive contract under the terms of which a target cost objective and an agreed upon profit rate will be established at that point with a recognition that the profit, both rate and dollar absolute profit, will drop if the costs exceed that target or if the performance fails to meet the agreed upon performance objectives, or if the time during which the development takes place is greater than originally agreed upon. This is what we call a fixed-price incentive contract.

Senator PROXMIRE. It is very hard for us as Members of Congress to evaluate these situations. One newspaper report was that the Boeing bid was \$400 million less over the life of the whole contract?

Secretary McNAMARA. Yes.

Senator PROXMIRE. Than the General Dynamics.

The performance, while as you say was only slightly better, in many respects it seemed somewhat a shade better. It is hard, if these are the facts, to understand the situation.

But as I understand it, because you have a cost-plus incentive fee this figure doesn't mean very much.

That is, if the cost is exceeded, it might have some effect in reducing the fee. But nevertheless the costs are always covered. There is always a profit guaranteed.

Hence, a firm that badly wants to get an enormous contract like this can make a bid that is substantially less than any competitor can honestly compete.

Secretary McNAMARA. Because of other committees investigating the TFX, perhaps I should avoid commenting specifically on it. I think I can simply say that the contractual form is a very complicated one.

Moreover, one must look at both the research and development and the production contract combined and when one does so, there are many ways in which potential differences in initial cost estimates subsequently disappear.

As the hearing will bring out, I think, there are many, many reasons to consider initial estimates unreliable.

Senator PROXMIRE. At any rate if you take company A and company B, and company A has a lower estimate of what its costs will be in a situation of that kind, a cost-plus incentive fee, and the lower estimate wins the contract but then in production the actual cost is far higher than either estimate, then the taxpayer has to pay for it and the cost to the Government is excessive. Therefore, you have responsibility to analyze what the costs actually will be.

Secretary McNAMARA. This is exactly the point, Senator Proxmire. Although there can be inserted into the contracts protections to the Government such as ceilings, nonetheless, even the ceilings are subject to erosion by engineering changes or by follow-on contracts or a hundred and one other ways. I think much of this will be discussed in the TFX hearing and I don't wish therefore to discuss it here. I think it would be inappropriate to get into it.

Senator PROXMIRE. I mean this as an example.

Secretary McNAMARA. I think you are absolutely right. It doesn't however, negate the point I am making here, that in a higher percentage of our cases we can introduce competition into the procurement process where we have not had it before and the result is a very, very substantial saving.

In response to the chairman's request, we will be very happy to document that with illustrations for the record.

I will now discuss cost-plus-fixed-fee contracts in contrast to contracts which are placed as the result of the application of some type of incentive.

#### REDUCTION IN CPFF CONTRACTS

It has long been recognized that cost-plus-fixed-fee contracts usually provide no incentive for economy, or superior performance. Never-

theless, in recent years, an increasing share of our procurement has been carried out under CPFF contracts, rising from about 13 percent in 1952 to nearly 38 percent during the first 9 months of 1961. To some extent, this shift to CPFF contracting was unavoidable because of the exploding technology of the 1950's which introduced unprecedented complexity and sophistication in our equipment.

However, even where firm, fixed-price contracting is not feasible, penalties and rewards can still be utilized. There are other techniques available through which we can provide incentives to the defense contractor to perform economically and efficiently. The most important method is the use of incentive contracts in which the contractor's fee is increased if he betters the target-price or target-performance goals, or conversely, is reduced or eliminated entirely if he fails to meet the contract targets. By fiscal year 1965, we hope to reduce cost-plus-fixed-fee contracts to about 12½ percent of our total contract awards, with an eventual annual savings of nearly \$700 million. Already in the first 8 months of the current fiscal year we have reduced the cost-plus-fixed-fee contracts to about 23.3 percent of the total as compared to 38 percent in the first 9 months of 1961, as shown on the following chart.

#### LACK OF INCENTIVE IN CPFF CONTRACTS

Chairman DOUGLAS. In other words, whereas, under the cost-plus-fixed-fee contract, there is no incentive whatsoever to be economical, you now say if you cut your costs you can have a portion of the savings.

Secretary McNAMARA. Yes, sir. Under many forms of the fixed-fee contracts there is an inverse incentive, an incentive to waste. I don't mean any contractor is so insensitive to the national interest as to waste deliberately. All of us are sensitive to incentives and if there is no positive incentive present, the maximum effort for economy and efficiency is not likely to be applied.

In a contract in which the formula provides for reimbursement of all costs plus  $x$  percent of cost as profit, it simply means that as cost rises the profit rises. This has been a traditional form of contract. As I say, in my mind, that gives an inverse incentive.

Chairman DOUGLAS. I tried to keep fairly apace of the reports by the Comptroller General and I have noticed that the major portion of the waste and abuses which he has reported on in the Defense Department have been under cost-plus-fixed-fee contracts.

Secretary McNAMARA. Yes. I think the waste under cost-plus-fixed-fee contracts is a function of two factors: First, such contracts are frequently let by the Department of Defense before the Department itself has fully defined the job to be performed either in terms of quality, quantity, or time. Obviously, if it has not made its requirements clear, the contractor can't be clear as to how he should perform that contract.

But secondly, even if the Department has precisely defined its requirements, if it is a cost-plus-fixed-fee contract, the contractor may accept the contract before he has undertaken the planning to insure that he will apply the most efficient process or method of producing the item. Either one or both of these factors will introduce serious inefficiencies into the contract's cost.

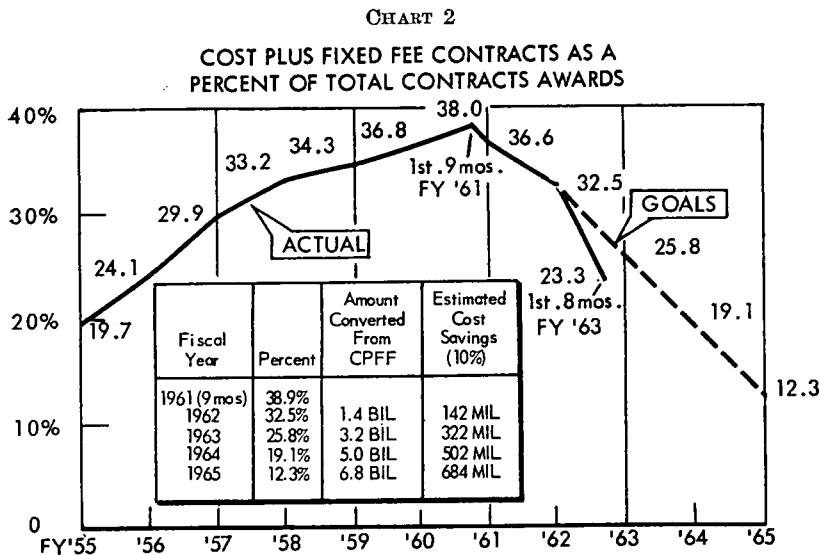
Chairman DOUGLAS. In the early stages of World War II, there was great need for haste, and many contracts were let both in the construction of military installations and the building of ships on a cost-plus-percentage basis. This, of course, led to the terrible abuses at Hog Island and other places because there was a direct financial incentive to waste.

Secretary McNAMARA. Yes.

Chairman DOUGLAS. What you are saying is that the cost plus fixed fee, which is not as bad as the cost plus percentage, gives no inducement to efficiency and frequently leads to a padding of costs which, in turn, serves as a basis for still further higher prices in the future.

Secretary McNAMARA. Exactly so. In my prepared statement I have traced the history of the cost-plus-fixed-fee contracts as a percent of total contract awards when measured in dollars from 1955 through to 1965, showing the actual experience from 1955 to 1961, in which the cost-plus contracts as a percentage of total contracts almost doubled, and the experience since that time, which we think has been quite favorable.

We have turned that around, as you can see, by the shape of the curve and we think we are going to be able to meet our objective. (The chart referred to follows:)



Secretary McNAMARA. I would be less than frank if I didn't tell you that in the course of doing this we are bound to make some mistakes. To shift this from a negative incentive to a positive incentive, we must negotiate targets as to cost, performance, time, and profits. It is entirely possible that in negotiating these targets we might overestimate the difficulty of the task; and, therefore, if you will, establish a cost target that was high. With a formula that provides for a contractor's profits to increase substantially as he more than meets his cost, performance, or time targets, if we fail to set proper targets in the first place, a contractor's profits might be substantially above what would perhaps be justified by the efficiency of his performance.

We will make a few errors of that kind. I think those are very small prices to pay for the tremendous effect that this is already having on us. We are receiving from our contractors their comments as to how much better the Defense Department's own planning is in approaching them on contracts. This is required because our contract officers must think through exactly what is required, exactly what specifications must be met, when they must be met, and what a reasonable cost is before they put their names to a contract.

As I say, this has had already tremendous and favorable effects on our own efficiency. Similarly, the contractor before he signs an incentive contract under the terms of which his entire profit can be wiped out, must think through very carefully how he will approach the job, what his production line will be, what tools he requires, what his cost estimates are, and whether he can match the performance specifications we require.

Senator PROXMIRE. You say his entire profit might be wiped out? Isn't there usually a provision that he gets 2 percent?

Secretary McNAMARA. No, sir. In many contracts, as a matter of fact in all of those that we will eventually put into effect, I hope there will be provision for zero profit and possibly even loss. I think all too often that we forget ours is a profit-and-loss economy. A profit is not guaranteed and should not be guaranteed. Profits are a function of efficiency. If there is no efficiency, there should be no profits. We have been rather hesitant to apply it.

Senator PROXMIRE. You don't have that in effect yet?

Secretary McNAMARA. Yes, sir; we have already put into effect contracts under which all profits are wiped out under certain circumstances. To the best of my knowledge, we have not put any contracts into effect yet in which there is a potential for loss, I mean, no potential for loss except in the sense that we don't always recognize all contractors' costs. So if we put into effect a formula under which a contractor's profits could fall to zero, it is possible that would be an actual loss to him because he might incur costs we don't recognize as proper and for which we do not reimburse him.

Senator PROXMIRE. You have a problem with procurements from firms which want to get into a field, are willing to take a loss or take no profit, and, therefore, will make a bid or representation that sometimes may be obviously very hard to justify. After all, they develop a lot of know-how at Government expense. They are able to train their people. They get the advantage of utilizing their plant and keeping the personnel employed.

Under these conditions, there would be an incentive to try to suggest to the Defense Department they can produce for a little less than somebody else so they can get their chance and get their costs covered even if they don't get a fee.

Secretary McNAMARA. A loss-leader approach.

Senator PROXMIRE. That is right.

Secretary McNAMARA. I think any good purchasing agent must constantly be on guard against the possibility that a contractor is seeking to obtain a contract by an unreasonably low price with the clear intention of establishing a firm relationship with the buyer and taking advantage of that relationship after the initial contract to raise the price and more than recover the initial loss. This happens. It happens in business. I am certain it happens in Government. This



is one of the problems that a purchasing agent must face and must recognize. Having recognized it, he must turn down such a contract proposal.

Senator PROXMIRE. Thank you.

REDUCING OPERATING COSTS

Secretary McNAMARA. Turning to another subject, an equally important part of our cost reduction program is our effort to reduce the day-to-day costs of operating the Defense Establishment. One important aspect of this effort has been our program for the closing of unneeded bases and installations. To date, we have announced plans to close or reduce in scope some 330 activities, of which 72 are located overseas and 258 within the United States. As Assistant Secretary Morris will report in detail later, good progress has been made in carrying out these announced closures and continuous studies are being made to identify additional installations and bases that can be reduced or closed in future years. We expect by the end of fiscal year 1965 to have initiated actions which will eventually save over \$440 million per year. Progress to date is shown in the table below:

TABLE 1

*Actions announced as of Dec. 31, 1962*

	<i>Total</i>
Number of locations.....	330
Acres to be excessed.....	274,000
Acquisition cost.....	\$1,922,000,000
Personnel to be released.....	44,923
Annual savings when action completed <sup>1</sup> .....	\$270,000,000

<sup>1</sup> Many actions require 2 or 3 years to complete.

Thus you see that there are 330 activities or locations which have been closed or reduced in scope. They cover 274,000 acres which we have declared to be excess to our needs. The installations which we have closed or declared excess to our needs had an original acquisition cost of just short of \$2 billion. By closing them or reducing the scope of their activity we have saved about 45,000 people. We have either taken them off the rolls entirely or transferred them to other areas for which we would have had to hire other people. The net result will be savings of \$270 million per year when these are fully completed.

Chairman DOUGLAS. Now, Mr. McNamara, this is a very admirable program. We have had an excessive number of bases and installations. Great savings can be effected in closing some of them. I hope in your choice of locations you will not be so anxious to propitiate your critics as to injure your friends.

Secretary McNAMARA. I don't think we have done so to date, Mr. Chairman. I hope we won't in the future.

Chairman DOUGLAS. We will be watching the number of installations closed in the State of Georgia very closely.

PUBLICIZING CONGRESSIONAL COMMUNICATIONS TO DOD

Senator PROXMIRE. If I could ask along exactly the same line, there have been representations by Members of Congress and Members of the Senate that they should be elected because they can get contracts or they can do something for locations that are in their district or

State. I am sure you must be aware of Senator Case's proposal that communications from Members of Congress to the Defense Department should be made public. I am cosponsoring that proposal.

It seems to me that makes sense. I am wondering if you think this is sufficiently serious so that something of this kind would be useful.

Secretary McNAMARA. I haven't seen a draft of the bill, Senator Proxmire. I would be very interested in reviewing it, when it is drafted. I have seen summaries of it, of course. I don't think from the Department of Defense point of view it is necessary. I think this is really a matter for Congress to decide itself. I don't feel, for example, that I will be influenced by letters, pleas, or other pressures that are based on other than achieving the most economical form of procurement for the Defense Department items.

Senator PROXMIRE. The difficulty is, as you may know, that you are an unusual Secretary of Defense. You won't always be Secretary of Defense. I think we have to prepare for people who, after all, are subject to pressure. Many people are. And the Defense Department is an enormous establishment. You have to delegate a great deal of judgment, of course, as any good executive does. It would seem to me under these circumstances that the knowledge by the public and by the Congress, to know who has communicated and in what connection and what project would be very helpful.

Secretary McNAMARA. I would be very interested in reading the bill. As a matter of fact, I should have initiated the request to you or Senator Case for a copy before this, because so far I have read only the summaries of it. There are certain features apart from this notice feature which cause me a little concern and question.

Senator PROXMIRE. I am not asking about the bill. I am asking about that particular publication of communication.

Secretary McNAMARA. I would certainly have no hesitancy in complying with that. Some of the other features I am a little either in doubt on or question. I would like to have a chance to examine them in detail.

#### DOUBLE STANDARD OF PUBLIC ON GOVERNMENT SPENDING

Chairman DOUGLAS. If I may make a comment, I think the actions of many Members of Congress really flow from ambivalence on the part of the public. The public demands economies in general, but when any economy is proposed to hit a specific locality, the very same business groups which will write to a Senator or Congressman demanding general economy will also protest to high heaven about the closing of this particular installation.

I think this reflects, really a dual standard on the part of the general public and it exposes Members of Congress as well as the Defense Department to great pressures. It is undoubtedly true that these issues should be decided on their merits, but as long as the public has this general attitude to bring tremendous pressures on Members of Congress and on Secretaries—they may not have the intestinal fortitude as Secretary McNamara—this is something that I hope that the members of the business community will take very closely to heart and members of unions as well.

Secretary McNAMARA. I fully agree with you. I think that is the source of much of the pressure on Congress, as a matter of fact.

I should add that the business community has given us excellent support in our efforts to move from noncompetitive to competitive contracts and our efforts to move from cost-plus contracts to incentive forms of contracts.

I think there may have been a little misunderstanding initially, a little hesitancy, a little concern about the potential effect on business, over the question as to whether our objective was to reduce business profits, which, as I stated, certainly was not the case. At the present time we are getting excellent cooperation from business to this end.

Chairman DOUGLAS. If I may add at this point, the U.S. Chamber of Commerce, with which I am not always in ideological agreement, has been very helpful in this whole matter and has given you and this committee a great deal of assistance. I think the way in which they have performed is really beyond praise. But nevertheless, when you get down to the local level, everybody is for economy in general, but let the other fellow take it.

Secretary McNAMARA. It depends on whose ox is being gored.

Chairman DOUGLAS. That is right. The newspapers are not above criticism on this point either, because the editors back home proceed to get angry if there is any decrease in employment in their particular locality. Then they will publish editorials condemning waste in the Defense Department. I wish the reporters in the room would send the transcript of this testimony back to them.

Go ahead, Mr. Secretary.

#### SIMPLIFICATION OF PROCEDURES

Secretary McNAMARA. Mr. Chairman, I will turn to another subject now, which perhaps is of less importance, but still a source of potential savings. In any organization as large as the Department of Defense, efforts to simplify procedures can yield surprisingly large savings. Therefore, we are examining our contractor reporting requirements, our requisitioning and transportation procedures, and other types of logistics paperwork with the aim of eliminating unneeded or overlapping procedures and achieving the greatest degree of standardization where elimination is not practicable. Substantial success has already been achieved, and we expect to make ever greater progress in the coming years.

#### EQUIPMENT MAINTENANCE

Another area where increased management efforts can yield significant monetary savings, as well as greater combat readiness, is equipment maintenance for which we spend about \$11 billion a year. Actions which we have already taken and plan to take through fiscal year 1965 should produce savings of about \$300 million a year. But this is an area in which we have barely scratched the surface. (See p. 129.)

Chairman DOUGLAS. Can you itemize that later for the record?

Secretary McNAMARA. Yes. Here we have progressed less far than in other areas and your itemization will be in less detail.

(The information requested is as follows:)

Actions which we have taken and plan to take are included in the following:  
1. A Defense Maintenance Equipment Council has been established to cross-fertilize the experiences of each military department for the benefit of all.

2. A uniform system is being developed to measure the physical readiness of military end items for operational service.

3. A uniform system of cost accounts is under development to reflect total and comparative costs of equipment maintenance.

4. Steps are being taken to determine and eliminate unnecessary inspection and preventive maintenance practices.

5. In connection with the latter, guidance has been furnished to the military departments in the form of a list of activities for exploration and action.

(a) The extension of intervals between inspections to maximum dictated by experience.

(b) The reduction in scope of inspections.

(c) The extension of intervals between overhaul.

(d) The reduction and scope of overhauls.

(e) The elimination of evacuating equipment susceptible to being repaired locally.

(f) The elimination of repair and/or overhaul when replacement is more economical.

(g) The improvement of effectiveness of direct labor force.

(h) The reduction of overhead to support the direct labor force.

(i) The consolidation of maintenance activities within installations for increased efficiency and reduction of overhead.

(j) The avoidance of new investment in tools and facilities by cross-servicing for maintenance support.

(k) The lessening of time for processing through maintenance.

(l) The reduction of workload generated by deterioration in storage.

(m) The reduction of maintenance engineering for obsolescent equipment.

(n) The elimination of nonessential types of technical assistance.

6. Actions taken by the Air Force to date in connection with items (b) and (e) above, have resulted in a reduction in fiscal years 1963 and 1964 budgets of \$56.5 million of depot maintenance cost.

7. In connection with item (d) above the Navy has saved \$4 million by extending the interval of overhauling a nuclear submarine.

8. In connection with (d) above the Army saved \$5.6 million in fiscal year 1963 by eliminating the overhaul of selected tactical wheeled vehicles.

Secretary McNAMARA. This is an area in which we have hardly scratched the surface and to which we will be giving intense attention.

To insure top-level attention to this function, and to coordinate the efforts of the entire Department, a full-time Deputy Assistant Secretary of Defense for Equipment Maintenance has recently been appointed.

#### CONSOLIDATION OF LIKE ACTIVITIES

One of the key ways in which we can make savings in the operations of the Department is through the consolidation of like activities. I have already mentioned the Defense Supply Agency, but I am sure you will agree that the underlying principle applies to other areas of Defense activity as well. The swiftly expanding requirements for modern military communications, for example, and their even more swiftly rising costs have made Department-wide management of certain portions of the communications system both militarily necessary and financially imperative. Accordingly, a new Defense Communications Agency has been established to guide the development of unified long-line communications systems for use by all elements of the Department. This Agency is also responsible for other important functions, such as the development and support of the National Military Command System and the supervision of the military communications satellite development program.

Still another area where consolidation appeared to be a necessity was in headquarters intelligence activities. For this reason, we created the Defense Intelligence Agency not so much in this case, to reduce costs but rather to utilize more effectively our resources in this vital area.

Real property management, including military family housing, provides another area for reducing operating costs. We have now brought family housing under centralized management in each department and established a new cost-accounting system to facilitate better management. And with the cooperation of the Congress, we hope to bring together in a single appropriation all funds for construction, operation, maintenance, improvement, and leasing of family housing.

#### COMPTROLLER'S REPORTS ON CAPEHART HOUSING

Chairman DOUGLAS. Mr. Secretary, the Comptroller submitted a number of reports on abuses under so-called Capehart housing. Do you know whether your staff has had a chance to go over those reports?

Secretary McNAMARA. Yes, we have finished our review of most of them, Mr. Chairman.

Chairman DOUGLAS. Are you ready to make a reply or take steps?

Secretary McNAMARA. Yes. I think it is the desire of Congress, and I believe the preferred program of the Department, to move away from Capehart housing to direct appropriation housing. I think that would do much to correct some of the deficiencies referred to in the report.

Chairman DOUGLAS. That was covered in the report of July 20, 1962, that was made to you.

Secretary McNAMARA. Yes. I am familiar with that. I think most of these instances referred to warranted the criticism that he made.

Our efforts to improve the management of the entire logistics spectrum have resulted in some important changes, not only Department of Defense-wide, but also within the military departments. The Air Force in 1961 substantially realigned its organizational structure to meet better the management requirements imposed by the radical change in the nature of modern weapon systems. The Army has virtually completed its reorganization started last year, and has significantly reduced the operational complexity and administrative overlapping of the former technical services. And now the Navy, too, is considering a substantial realignment of its organization to fit it better to the demands of modern warfare.

#### EXAMINATION OF GAO REPORTS

Mr. Chairman, the task of management in the Defense Department is never done. New problems arise as old ones are solved, as evidenced by the constant flow of GAO reports. I can assure you that these reports, as well as constructive criticism from any other source, receive top-level attention in the Defense Department. For example, I examine all GAO reports as they come into the Department and all of the written replies are reviewed and initialed by either Mr. Gilpatric or me, in terms of approving their substance, before they go back to the GAO. Many of the actions we have taken to improve our efficiency can be traced directly to the reports from that office which have come to my personal attention.<sup>3</sup>

I am sure that the logistics management improvement program, which I have outlined here this morning, will not prove to be the final word. But I am equally sure that this program will correct many deficiencies of long standing and result in savings of several billion dollars per year.

<sup>3</sup> See index and digest of GAO reports from Nov. 1, 1959, to Feb. 28, 1963, on defense activities. Staff report 1963 pp. 78, 107.

36 PROCUREMENT ACTIVITIES OF THE DEPARTMENT OF DEFENSE

Mr. Chairman, I am very grateful for the time you have allowed me to review this program with your committee.  
 (The chart entitled "Department of Defense Procurement and Logistics Cost Reduction Program" follows:)

CHART 3

Department of Defense procurement and logistics cost reduction program

[In millions]

	Recurring annual savings to be realized from actions in fiscal years 1962 through current year				
	As estimated Jan. 15, 1963			As reported to President	
	1963	1964	1965	Fiscal year 1963	Fiscal year 1967
<b>1. Buying only what we need:</b>					
(a) Refining requirements calculations:					
(1) Major items of equipment.....	(1) \$104	(1) \$157	(1) \$210	0	0
(2) Initial spares provisioning.....	\$420	\$502	\$550	\$150	\$300
(3) Secondary items.....	\$8	\$25	\$30	0	0
(4) Technical manuals.....					
Total from refinement of requirements.....	\$532	\$684	\$790	\$150	\$300
(b) Increased use of excess inventory in lieu of new procurement:					
(1) Equipment and supplies.....	\$189	\$284	\$394	\$225	\$450
(2) Idle production equipment.....	\$2	\$10	\$21	0	0
(3) Excess contractor inventory.....	\$20	\$20	\$20	0	0
Total from increased use of excess inventory.....	\$211	\$314	\$435	\$225	\$450
(c) Eliminating "goldplating".....	\$64	\$100	\$100	\$64	\$100
(d) Inventory item reduction.....	\$1	\$4	\$5	0	0
<b>2. Buying at the lowest sound price:</b>					
(a) Shift from noncompetitive to competitive procurement:					
Total percent competitive <sup>2</sup> .....	(37.0)	(38.4)	(39.9)		
Amount of saving.....	\$281	\$402	\$494	\$160	\$480
(b) Shift from cost plus fixed fee to fixed or incentive price:					
Total percent cost plus fixed fee <sup>3</sup> .....	(25.8)	(19.1)	(12.3)		
Amount of saving.....	\$322	\$502	\$684	\$100	\$600
<b>3. Reducing operating costs:</b>					
(a) Terminating unnecessary operations.....	\$292	\$357	\$442	\$257	\$600
(b) Standardizing and simplifying procedures:					
(1) Consolidation of 16 requirements systems into 1 on July 1, 1962.....	\$10	\$20	\$20	\$20	\$20
(2) Consolidation of 81 transportation documents into 1.....	0	\$22	\$32	\$30	\$30
(3) Reduction of contractor reports.....	\$1	\$4	\$25	\$30	\$30
(c) Consolidating and increasing efficiency of operations:					
(1) DSA operating expense savings.....	\$31	\$33	\$42	\$28	\$50
(2) DCA and communication system savings.....	\$16	\$20	\$25		\$30
(3) Improving transportation and traffic management.....	\$17	\$23	\$23	\$40	\$65
(4) Improving equipment maintenance management.....	\$108	\$199	\$297	\$48	\$300
(5) Administrative vehicles.....	\$3	\$9	\$11	0	0
(6) Improving military housing management.....	\$6	\$11	\$19	\$3	\$27
(7) Improving real property management.....	\$24	\$34	\$45	0	0
Total program.....	\$1,919	\$2,738	\$3,489	\$1,155	\$3,082

<sup>1</sup> Savings will be reported as identified. In fiscal year 1962 "requirements" for major items of equipment were reduced by \$24,000,000. In fiscal year 1963, the Army reduced 1964 pipeline requirements by \$500,000,000; and substituted an expanded production base for a mobilization reserve inventory, saving a net of \$36,000,000, a total saving of \$536,000,000.

<sup>2</sup> Fiscal year 1961 was 32.9 percent; total annual conversion from sole source of \$1,900,000,000—savings are 25 percent per dollar converted.

<sup>3</sup> For the first 9 months of fiscal year 1961, cost plus fixed fee was 38 percent; a reduction of \$6,000,000,000 is required to reduce that percentage to 12.3 percent; savings are 10 percent per dollar converted.

<sup>4</sup> Fiscal year 1963 goal reported in July 5, 1962, memo to President, on a conservative basis, as \$750,000,000.

Chairman DOUGLAS. I want to both congratulate and thank you for your efforts, devotion, and sense of public spirit and efficiency. Trying to do these things is like trying to duplicate the labors of Hercules. While I shall not describe the particular labor with which this is comparable, lest the reference seem invidious, I can say that it is an enormous job.

I think the country is very fortunate in your efforts. I want to praise you for work well done. I know you are under great pressure of time, so probably we shall reserve certain suggestions for still further improvement for General McNamara and Mr. Morris when they come up.

PROGRESS ON PRESIDENT'S REQUEST TO HELP SMALL BUSINESS

Senator PROXMIRE. I would like to ask a few brief questions.

The President in 1961 requested that the share of small business contracts be increased from 16 percent by 10 percent. How are you coming along with that?

Secretary McNAMARA. We did very well in fiscal 1962. Mr. Morris can report to you on that. It is difficult to say what progress we will make in 1963. At the moment it looks as though we have slipped back a bit. Our procurement is uneven during the year and we have to wait until the 12 months are completed. I am not quite as optimistic for 1963.

Senator PROXMIRE. How about on subcontracts? If you recall, we had a discussion a couple of years ago on the subcontracting program for small business that our Banking Committee was proposing.

Secretary McNAMARA. Yes. I think we made progress on subcontracts with respect to small business. I don't feel on subcontracts we have made nearly as much progress to introduce competitive procurement as we have in the prime contracts. This is not directly responsive to your question, but speaking of subcontracts made me think about it.

ADVERTISED COMPETITION HELPS SMALL BUSINESS

Senator PROXMIRE. Small business does better on advertised competition. As I understand it, they get a larger share. The figures I have seen indicate that with formally advertised bidding small business gets up to 50 percent, whereas, they get 10 percent of the negotiated. There are reasons for it.

Secretary McNAMARA. I think that is correct.

\$13 BILLION REDUCTION IN SERVICES' REQUESTS

Senator PROXMIRE. The other questions are related but not directly on this. One is, if this can be a public record, what was the amount of reduction in the requests of the Army, Navy, and Air Force which you made before this budget was recommended to the Congress?

Secretary McNAMARA. Yes.

Senator PROXMIRE. How many billion dollars?

Secretary McNAMARA. The service requests, the requests submitted by the Secretaries and the Chiefs of the services, supplemented by the budgets of the independent agencies such as the Defense Supply Agency and the Defense Communications Agency, totaled about \$67 billion.

Senator PROXMIRE. \$67 billion?

Secretary McNAMARA. \$67 billion. The budgets which the President has submitted to Congress total about \$54 billion in terms of new obligational authority. I think the amount is \$53.7 billion.

Senator PROXMIRE. About a \$13-billion reduction.

Secretary McNAMARA. Yes, sir.

Senator PROXMIRE. This is an astonishing achievement. I think it accounts for what could be predicted as a very vigorous criticism which you have had from some sources. I would like to just ask one other thing. I know it is an imposition, but it will just take a minute.

You talked in your paper about the evil of modernization for its own sake. Then on page 18 about gold plating by asking for quality which is not needed. I am wondering if the requests that we get for new aircraft carriers can't be put into both categories? No other country, as far as I know, is building aircraft carriers. Almost no other country uses aircraft carriers. Our aircraft carriers are very useful, but we have 15 or 16 attack carriers. When we build a new one we retire an old one, usually.

Under these circumstances, I can't understand why the Defense Department insists on coming up with a request. Each ship, as I understand it, fully equipped costs about \$1 billion.

Chairman DOUGLAS. May I say I don't want to shut off my good friend from Wisconsin, but we have tried to keep this committee, which is an economic committee, free from discussions of strategy, tactics, and weapons. I think this is a good question if the Secretary wishes to answer, but I don't think we should use the powers of the committee to compel an answer because there is no compulsion involved.

Senator PROXMIRE. I believe this has economic implications.

Chairman DOUGLAS. I will allow it to stand except we have tried to walk a very strict line.

Secretary McNAMARA. I think I can make perhaps three brief points, Senator Proxmire, in reply.

First, I believe it is true that no other country has embarked upon an aircraft carrier program in anyway comparable to ours, but I think, in part, no other country has the responsibilities or requirements for seapower worldwide that we do.

Second, I think that it is true also that when we add a new aircraft carrier to the fleet we retire one of the existing carriers. I am told it is more for reasons of true obsolescence and deterioration in physical qualities than for what might be called desire for gold plating or modernization.

But, third, I think, as is true of all our major weapons systems, our carrier program must be kept under constant review. I have noticed articles within the last 48 hours in the press implying that I seriously question the role of the carrier and am undertaking a major study of it. They are half correct.

I don't question the role of the carrier, but I am undertaking studies of all our major weapons systems in order that we may keep them constantly under review and assure that we adjust our forces to possible changes in technology and possible changes in military requirements.

Senator PROXMIRE. The prime point I have is that we don't have any competition in aircraft carriers as we do in other systems for obsolescence and so forth.



## DOD HAS REDUCED CIVILIAN PERSONNEL BY OVER 3,000

The final question I have, as I understand it, your Department is the only major department of Government which is not increasing its personnel; in other words, which has decreased its personnel. We have had hearings before the Joint Economic Committee on the budget and related to it and I wonder if the chairman would indulge me just to ask if you could tell this committee how you were able to achieve this, with a bigger budget and bigger responsibilities, how you were able to cut your personnel in contrast to the inability of other department heads to do the same.

Secretary McNAMARA. First, I must confess we have increased the military personnel, not, I think—

Senator PROXMIRE. Civilian personnel has been reduced.

Secretary McNAMARA. That is correct. We have increased the military personnel but not in any way proportionate to the increase in combat readiness or strength. In any case, they have been increased.

Senator PROXMIRE. Which would suggest that you have to have an increased civilian component to take care of them and you haven't got that.

Secretary McNAMARA. I think that is a reasonable conclusion and it is one that some have brought to my attention inside the Department. In any case, the President has emphasized that if we are—we civilians in Government—are to participate in what might be called productivity wage increases, as do other sectors of our society, that we, too, must expect to achieve productivity gains.

In the case of the Defense Department, we employ about a million civilians in addition to something on the order of  $2\frac{3}{4}$  million military personnel. In any part of our society in which a million individuals are employed, it seems reasonable to me to expect productivity gains. I must confess that our system doesn't permit us to measure them in the Defense Department. I think it should, but it doesn't. Since it doesn't, I assume they are there. Therefore, we have arbitrarily reduced the authorized civilian personnel by what I consider to be the minimum productivity gain we should accomplish, this in pursuance of the President's instruction.

Senator PROXMIRE. This is based on what your productivity gains were and then let them work it out.

Secretary McNAMARA. Yes. Anybody who has a substantial number of a million people working for him ought to be able to figure ways of doing the job more efficiently. I say you will do by  $x$  percent and you figure out a way to do it.

Senator PROXMIRE. That is very encouraging.

Chairman DOUGLAS. To give qualitative value to the statement of the Secretary, between June 30, 1959, and June 30, 1962, we increased the military personnel by 206,000, but the Secretary decreased the civilian personnel by over 3,000.

## 10,000-MAN PLANNED REDUCTION FOR FISCAL 1964

Secretary McNAMARA. Yes. We have a 10,000-man reduction in civilian personnel planned for fiscal 1964. I see no reason at all why we shouldn't accomplish it.

Senator PROXMIRE. You have a 10,000 man reduction planned for 1964?

Secretary McNAMARA. Yes, sir.

Chairman DOUGLAS. That is an extraordinary objective. Thank you very much.

Secretary McNAMARA. Thank you, sir.

Chairman DOUGLAS. Senator Javits has some questions which he would like to put in writing. We don't have them yet, but if you and your staff would review them and prepare answers for the record—

Secretary McNAMARA. I would be very happy to.

Chairman DOUGLAS. Thank you very much.

Secretary McNAMARA. It has been a great pleasure to appear before you. Thank you, sir.

(The questions and answers referred to appear in appendix 3, see p. 355.)

Chairman DOUGLAS. The next witness is Assistant Secretary Thomas D. Morris.

Mr. Morris, we kept the Secretary longer than we had intended. You have a lengthy statement, too. I wonder if it would be satisfactory to you if you were to put it in the record and then let us ask questions?

#### STATEMENT OF HON. THOMAS D. MORRIS, ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS)

Mr. MORRIS. I would be very pleased to do this.

(Mr. Morris' prepared statement follows:)

##### STATEMENT BY THOMAS D. MORRIS, ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS)

Mr. Chairman and members of the committee, in October 1960, this committee issued a report on the economic aspects of military procurement and supply. Shortly thereafter, Mr. Chairman, you wrote Secretary of Defense-designate McNamara outlining reforms which you estimated would produce minimum savings of \$2 to \$3 billion per year. These documents, plus a continuing flow of well-documented GAO reports, have served to pinpoint the most important opportunities for savings in the 5-year cost reduction program which has been promulgated by DOD directive 5010.6.

Secretary McNamara has just outlined the major steps which are being taken by Defense management to obtain balanced readiness at minimum costs. In respect to procurement and supply matters, we have initiated actions which will accomplish about 40 percent of the \$3.4 billion cost reduction goal. By the end of fiscal year 1965, we believe that most of the remaining actions can be initiated, and that the full impact of these actions should be reflected in the fiscal year 1967 budget. We certainly will strive to accelerate this progress, wherever possible, and to open up still other avenues of improvement.

There are three matters on which we would like to offer further comments in response to the expressed interest of this committee:

Improvements in procurement management.

Improvements in supply management.

Improvements in the utilization of facilities, with particular reference to commercial and industrial-type operations.

##### A. IMPROVEMENTS IN PROCUREMENT MANAGEMENT

Secretary McNamara has strongly reaffirmed our goal of converting a much larger percentage of defense procurement to price competition. In so doing, our first preference is to use the formal advertised method of price competition since this technique assures maximum competitive opportunity and eliminates any possibility of favoritism in awards. His statement has described our progress during fiscal year 1962 when \$760 million was shifted from noncompetitive to

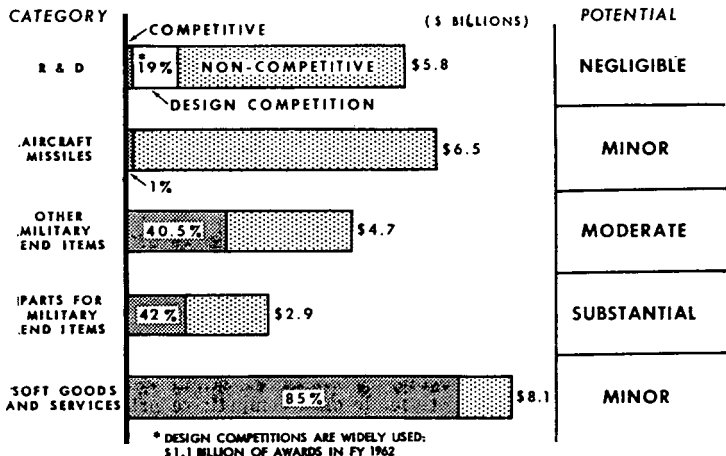
price competitive procurement, bringing an average price reduction of 25 percent for each dollar shifted. Attached at the end of my statement are several illustrations of the dramatic savings which have resulted from the more aggressive efforts of our procurement officials to develop specifications on which competitive bids can be obtained, and to seek out and obtain proposals from a number of qualified sources. You will note that these examples cover a broad spectrum ranging from high-unit-price ordnance vehicles, such as the 8-inch howitzer, to low-unit-price, high-usage items such as the fluorocarbon O-ring packing, pp. 48-51.

By the end of fiscal year 1965, we expect to be buying about \$2 billion more per year through such competitive methods compared to fiscal 1961. I would like to stress that this improvement is not easily obtained since it requires (1) extensive new effort on the part of hundreds of our engineers, legal and procurement personnel to develop procurement specifications in a form suitable for competitive bidding, and (2) longer leadtime to obtain competitive bids and qualify new sources.

It should also be stressed that even with this additional effort there are major segments of defense procurement which have only negligible or minor potential for price competition. The following summarizes the principal areas of potential for greater price competition, based upon our experience in fiscal year 1962.

CHART 4

**THE POTENTIAL FOR GREATER PRICE COMPETITION  
(ANALYSIS OF FY 1962 CONTRACT AWARDS)**

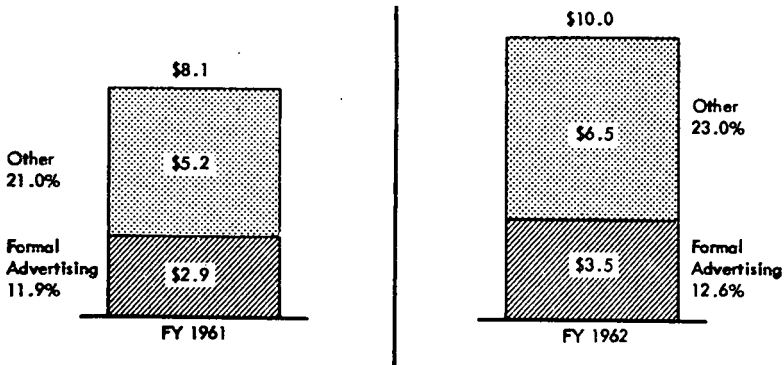


In *research and development* and in the *production of aircraft and missile systems*, we have very limited opportunities to make awards on the basis of price competition. These two segments accounted for \$12.3 billion, or 44 percent, of our procurement awards in fiscal year 1962. Research and development can rarely be placed under a firm fixed-price contract, which is a requisite to price competition. There are several reasons for this. First, the unknowns and the risks are far too great for most contractors to assume, and second, we are buying creative effort where rare technical competence and technical concepts of bidders are of greater importance than price alone, which is at best a matter of estimation in such work. In these situations an undue emphasis on cost reduction may deteriorate the quality of the development. Third, the production of new aircraft and missile systems cannot be economically procured on the basis of price competition due to the high startup costs, and the leadtime required to introduce a new production source after a long period of development. It is estimated that to establish a new production source on the POLARIS missile, for example, would require up to 3 years and an investment of over \$100 million in facilities and special tooling.

At the other end of the spectrum, our purchases of soft goods, construction and other services are now highly competitive, having reached a level of about 85 percent in fiscal year 1962. Hence, only small additional potential exists to increase price competition in this segment.

This leaves two principal categories in which definite improvement can be and is being obtained; namely, other military end items, and parts for all military end items. Here we are concerned with tanks, guns, electronics, communication devices, ships and equipment of all kinds. In many of these areas we have obtained far too little competition, but recently progress has been made. For example, in the purchase of aircraft spare parts we were buying only 15 percent competitively in fiscal year 1961. In fiscal year 1962 we doubled our performance to 30 percent. The more we can enlarge price competitive procurement, the greater use we can make of formal advertising with bidding open to any and all qualified bidders; where sealed bids are received, publicly opened, and awards are made to the lowest bidder. The highest percentage of formally advertised awards in the past 12 years was 16.3 percent, and the average has been 13.8 percent. Members of the public naturally cannot understand why all price competitive contracts cannot be made by formal advertising. While we fully expect to achieve increases here, the basic procurement laws require a very large volume of our procurement, which is highly competitive and awarded only to the low bidder, to be called negotiated rather than formal advertising. To illustrate this, I believe you will be interested in the following chart which is an analysis of our price competitive procurement in fiscal year 1962.

CHART 5  
PRICE COMPETITION  
(\$ Billions)



While \$10 billion of awards were made on a competitive price bases, \$6.5 billion of such competitive procurement was not formally advertised. The explanation for almost two-thirds of this difference—\$4.1 billion—is found in the following tabulation which shows the unavoidable restrictions placed on bidding for various valid reasons required or allowed by law:

TABLE 2  
Fiscal year 1962 awards

[In millions]

Restrictions:	
Set-asides—small business and labor surplus (Exs. 1, 17)	\$1,370
Purchases under \$2,500 (Ex. 3)	1,060
Purchases restricted to sources outside of United States (Ex. 6)	610
Perishable subsistence (Ex. 9)	480
Classified purchases (Ex. 12)	340
Emergency purchases (Ex. 2)	140
Medicines and purchases for resale (Exs. 7, 8)	110
<b>Total</b>	<b>4,110</b>

We believe that these restrictions are proper, but we also feel that it is misleading to the public to leave the impression that most of this procurement is not highly competitive, with large numbers of bidders frequently participating, and the award made to the lowest bidder. Perhaps this committee would like to con-

sider whether such procurements should not be separately classified as "price competition with restricted bidding," so as to recognize such procurements as very desirable, and not negotiated in the commonly accepted sense of the term. The two largest elements of this restricted competitive procurement are those concerned with the set-asides for small business and labor surplus areas (where our mandate is to increase rather than decrease)—and with small dollar purchases made by local installations, usually from local suppliers after taking three or more quotations. In the latter case, we made over 6 million procurements in fiscal year 1962. Were we to engage in nationwide formal advertising in such cases, it is estimated that our operating expense would be increased by as much as \$100 million.

B. IMPROVEMENTS IN SUPPLY MANAGEMENT

Perhaps the greatest progress during the past 2 years has been made in eliminating overlapping and duplication in the operation of purchasing offices and depots which procure and distribute items of common use among the military services. You will recall that this was an action which this committee recommended strongly in October 1960. A few vital statistics will, I believe, be of interest in supplementing Secretary McNamara's comments:

1. *Defense Supply Agency.*—The DSA became operational on January 1, 1962, and has produced results exceeding even our best predictions prior to its creation. A picture of the size and rate of progress of DSA is depicted in the following table:

TABLE 3  
*DSA assumption of responsibilities*

	January 1962, actual	January 1963, actual	End fiscal year 1963, projected	End fiscal year 1964, projected
Items managed.....	87,000	905,000	1,064,000	1,468,000
Inventory.....	\$1,588,000,000	\$2,003,000,000	\$2,223,000,000	\$2,149,000,000
Procurement.....	( <sup>1</sup> )	<sup>2</sup> \$2,824,000,000	\$2,971,000,000	\$3,372,000,000
Total personnel.....	9,523	24,459	28,482	29,437

<sup>1</sup> Not available.

<sup>2</sup> Total January–December 1962.

DSA was created to assure effective and timely support of the military services with respect to common supplies and services; and to furnish this support at a much lower cost than had previously been possible. DSA's own cost reduction program is shown in the following table which sets out its recurring annual savings goals for fiscal year 1963–65.

TABLE 4  
*DSA cost reduction goals*

[In millions]

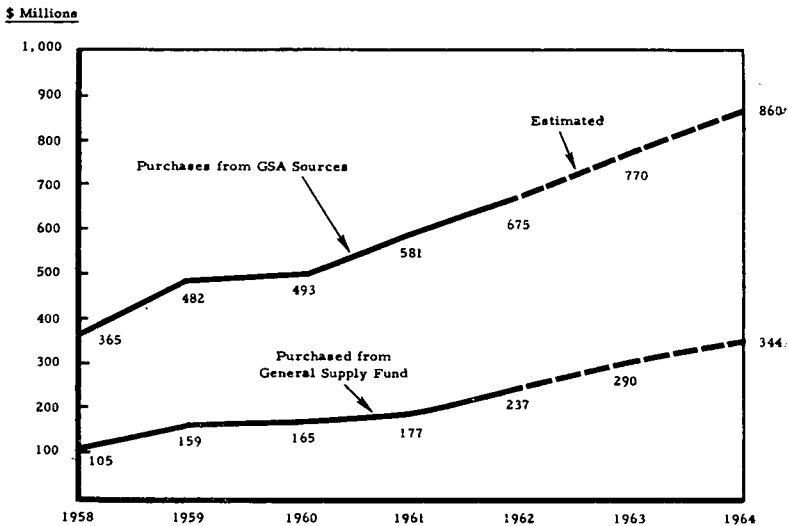
	Recurring annual savings		
	Fiscal year 1963	Fiscal year 1964	Fiscal year 1965
Operating expense savings.....	\$31	\$33	\$42
Initial spares provisioning.....	\$4	\$7	\$10
Secondary items.....	\$11	\$20	\$27
Value engineering.....	\$2	\$5	\$10
Item reduction.....	\$1	\$4	\$5
Shift from noncompetitive to competitive procurement:			
Percent competitive.....	(93.8)	(93.9)	(94.1)
Amount of savings.....	\$3	\$4	\$6
Shift from CPFF to fixed or incentive price:			
Percent CPFF.....	(0.2)	(0.1)	(0.1)
Amount of savings.....	\$1	\$2	\$2
Total.....	\$53	\$75	\$102

The operating expense savings for fiscal years 1963 and 1964 have already been removed from the Department of Defense budget, and are the result of actual

reductions in number of personnel performing these functions by 3,700 positions through fiscal year 1963. Plans are approved and in process to achieve the fiscal year 1965 operating savings of \$42 million by shrinking the number of depot locations in which DSA stocks are held from the former 77 to 11. All areas of savings which DSA has targeted—rising to a total of \$102 million per year by fiscal year 1965—are on schedule, and we confidently expect they will be met or exceeded.

2. *Utilization of General Services Administration.*—A companion objective to the formation of the Defense Supply Agency has been maximum economic utilization of GSA's procurement and supply services. We support this policy for those items which are used in common by the civilian agencies and the military departments, because we believe that single management of such items brings the full purchasing power of Government to bear as a single customer, as well as eliminating duplication in supply systems between the civilian agencies and military departments. The next chart, we think, speaks clearly to the progress which has been made and which is now projected in respect to the use of GSA services.

CHART 6

ACQUISITION OF MATERIEL BY DOD FROM GSA SOURCES

This progress involves much hard work by our respective staffs, and there are still many procedural problems to be solved. I would like, however, to affirm our positive desire to support GSA's program of achieving the benefits of integrated supply management for those items which are common between the military and civilian agencies, in all cases where military considerations do not necessitate the retention of management within Defense. (See pp. 2, 3, 20, and 380.)

3. *Standardization and simplification of inventories.*—Public Law 436, passed in 1952, has provided one of the most significant tools for improving logistics management. Without a uniform catalog and organized programs to eliminate unnecessary and duplicating items from our inventories, there is little doubt that our annual supply management costs would be at least \$250 million more per year; that we would be building additional warehouses throughout the world rather than declaring such facilities excess to our needs, and paying much higher unit prices for thousand of items for which standard specifications have been developed.

As of last December, the catalog contained over 3.9 million items, each of which is individually identified with a unique number. Without this identification system, we would find it virtually impossible to interchange items within and among the military departments. Furthermore, since a new item cannot be added to the supply system until it has been cataloged, we can prevent duplicate

items from entering the system at the outset. During the past 5 years, there has been an average in-flow of new items into the supply system at a rate of about 45,000 new items per month. With the controls provided by the cataloging and standardization programs, we have been able to eliminate items from the catalog to the extent of over 30,000 items per month. This alone is an accomplishment of major magnitude.

However, these figures also illustrate one of our most urgent continuing problems; namely, that sophisticated new weapon systems are adding parts and supply items at a much faster rate than we have been able to achieve eliminations. As a consequence, we have greatly expanded the effort applied to item-reduction activities, and during the past year have increased the rate of eliminations almost to the point of balancing the rate of additions. It is my hope that we will stabilize the size of the catalog through these efforts. Whether we do or not, the item elimination program is preventing new costs of nearly \$1 million per week in the operation of the supply system.

Interesting examples of the progress being made in item elimination are found in handtools.

TABLE 5  
*Reduction in handtool items*

Item	Items stocked	Items eliminated	Percent eliminated
Screwdrivers.....	526	235	45
Pliers.....	280	109	39
Hammers.....	197	85	43

4. *Utilization and disposal of excess and surplus personal property.*—There is no more dramatic evidence of the inevitable waste of maintaining a modern military establishment under rapid changes in technology than the enormous volume of excess and surplus material which is generated year after year. By fiscal year 1958 the problem had reached serious proportions. New excess was being generated much faster than disposal action was taking place, and an enormous backlog had developed. During fiscal year 1958 new excess and surplus personal property generated was \$8.4 billion, while disposals were \$6.3 billion. Reuse of excess within DOD was a negligible \$213 million despite repeated GAO findings of concurrent buying and selling.

GSA and DOD attacked the problem, and Congress assisted by permitting use of proceeds of sale to finance the preparation and conduct of sales. During the past 4 years, the adverse trend has been reversed, and steady progress has been made. While much remains to be done, I believe this committee will be heartened, as are we, at the improvements which are found in comparing the record in fiscal year 1962 versus that in fiscal year 1958.

First, the generation of excess and surplus has steadily declined :

TABLE 6  
*Generation of excess and surplus*

Fiscal year	Excess generated, in billions	Percent decrease
1958.....	\$8.4	-----
1959.....	8.2	-2
1960.....	7.8	-7
1961.....	6.6	-21
1962.....	4.1	-51

We believe this downtrend is a reflection of many factors, including improved inventory control and more realistic purchasing of parts and supporting supplies.

Second, much greater reutilization of the excess is now being achieved within Defense—and elsewhere in Government—thus preventing new procurement.

TABLE 7  
*Reutilization of excess*  
 [Dollar amounts in millions]

Fiscal year	DOD	Reutilization by other Government agency	Total	Percent increase
1958.....	\$213	\$168	\$381	-----
1960.....	666	141	807	112
1962.....	1,080	271	1,351	256

This increase is even more impressive when it is related to the fact that the amount of excess available for reuse has decreased 51 percent. These improvements are the direct result of the intensive interservicing programs carried on under the former Armed Forces Supply Support Center. Further improvements are now being made by the Defense Supply Agency which is establishing a central computerized record of all excess- and long-supply stocks in the DOD against which the military departments must screen their requirements before new procurements are made. This central clearinghouse, connected by high-speed communications links to every inventory control point, will result in estimated annual savings of \$1.3 billion by fiscal year 1965, and these savings will be reflected in reductions in new procurement or by increases in readiness at no added cost.

Third, better merchandizing is being accomplished on that material which is sold as surplus. The rate of return from surplus sales, other than scrap, has increased from 5 percent in fiscal year 1959 to 7 percent in fiscal year 1962. However, this return is still distressingly low, and we are just completing a major evaluation of our surplus-disposal operations worldwide at the direction of Secretary McNamara. As a result, further consolidation of sales offices will be effected during the next 9 months, and numerous improvements in disposal techniques made. GSA has joined us in this evaluation, and consideration is being given to the desirability of transferring responsibility for domestic surplus sales to GSA.

Mr. Chairman, our main objective is to minimize the generation of excess and surplus materials. Avoidance of unnecessary duplication in major weapon systems and end items, as Secretary McNamara has testified, is among the most essential steps to produce this much desired result.

5. *Use of stock funds.*—This committee has expressed concern that the use of stock funds to finance the replacement of supply inventories might lead to the generation of excess cash and excess stocks. We have carefully assessed this matter and find that, while there are some imperfections and lack of uniformity in procedures, stock funds have produced important economies and more businesslike inventory management. Inventories originally capitalized under stock funds had a net value of \$10.4 billion. Today the investment in these inventories is \$6.2 billion—a reduction of 40 percent. The cash generated by this inventory drawdown has been returned to the Treasury or transferred to DOD appropriations by affirmative action of the Congress. Today's operating inventories in stock funds are being turned over 2.5 times annually, while non-stock-fund inventories turn only 1.0 times annually—less than half as fast. We believe that stock funding forces closer and more imaginative inventory management, and that return to the old "free issue" system would result in an inflation of inventory, and more excess stocks, due to the lack of discipline which exists when the user can requisition whatever he wants from stock without having to pay for it.

We recognize that there are a number of improvements needed to assure that stock-funded items are not withheld from users when vital equipment is out of service awaiting parts, as GAO has reported in its recent studies. We believe the solution to these problems lies in better financial planning and management rather than in relaxing the discipline of stock-fund control.

#### C. UTILIZATION OF FACILITIES—USE OF PRIVATE ENTERPRISE

As you know, Mr. Chairman, we have been actively engaged in a DOD-wide program to reduce or terminate unnecessary operations during the past 2 years.



This has resulted in a continuous review and evaluation, on a worldwide basis, of our base and facilities holdings against long-range military requirements. Secretary McNamara has reported to you the results achieved to date.

Included in this program are periodic reviews of those commercial or industrial-type activities falling within the purview of BOB Bulletin 60-2.

Principal attention has been given during the past 2 years to releasing unused plant capacity for productive use in the civilian economy. The benefits derived from this program include reduced defense expenditures for maintenance, revenue to the Treasury from the sale of such plants, and increased employment for local communities. In calendar year 1962, GSA sold 26 defense industrial plants at their fair market value of \$49 million. These plants are now employing 27,000 workers, instead of lying idle or experiencing only partial utilization.

An interesting example of this program is the recently announced plan to dispose of the Naval Ordnance Plant, York, Pa. This plant is producing at approximately one-third of its capacity, and its backlog of work is steadily declining. The Navy estimates that by 1966, production requirements at this plant will be largely completed, and there will be no further need to continue the plant in operation. Rather than being faced with another situation similar to the Washington Gun Factory, where it became necessary to lay off the production work force, the Navy considers that the York Plant should be disposed of now, while it still had a backlog of work in progress. This will permit the organization which purchases the plant to take over the present plant employees as their own work force; complete the remaining Navy work which is now in progress; continue the plant in operation for any additional Government work on which they are the successful bidder; and begin utilizing the idle capacity for production of civilian-type goods.

We have just issued a new directive on commercial-industrial activities which reaffirms our policies under BOB Bulletin 60-2, and provides for cyclic reviews of all such activities not less than once every 3 years. It is our belief that we should continued ownership and operation of such facilities only when it is clearly essential to do so in the interest of military readiness, or when it is infeasible or uneconomic to contract for such goods or services from private industry. With your permission, I would like to submit our new policy directive on this subject for the record. (See appendix 5, p. 416.)

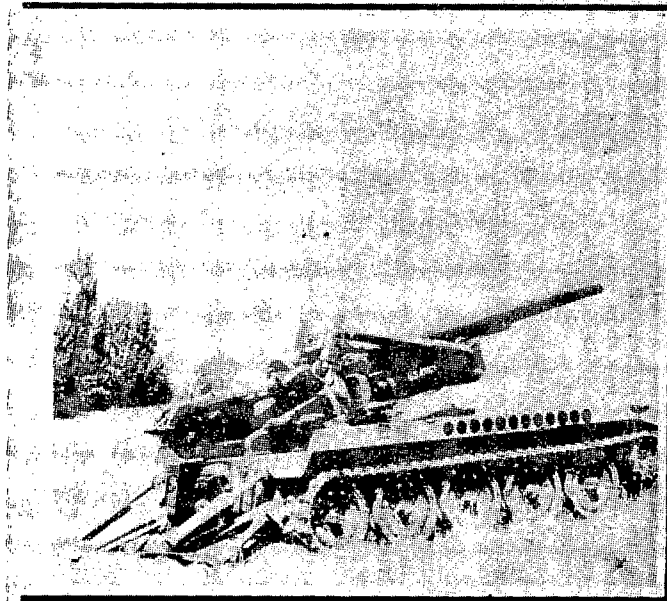
#### CONCLUSION

In conclusion, Mr. Chairman, we hope that this committee will find satisfaction in the progress which has been made in achieving objectives which you have advocated for many years. We solicit your support in the hard work that lies ahead to exploit these opportunities, and we desire your continued counsel on how we can proceed to better achieve these goals.

CHART 7

*Savings through competitive procurement*

## M110 SPECIAL 8" HOWITZER



### SOLE SOURCE

UNIT PRICE ... \$68,044

### COMPETITIVE PROCUREMENT

UNIT PRICE ... \$41,415

### SAVINGS

PER UNIT ... \$26,629

TOTAL,

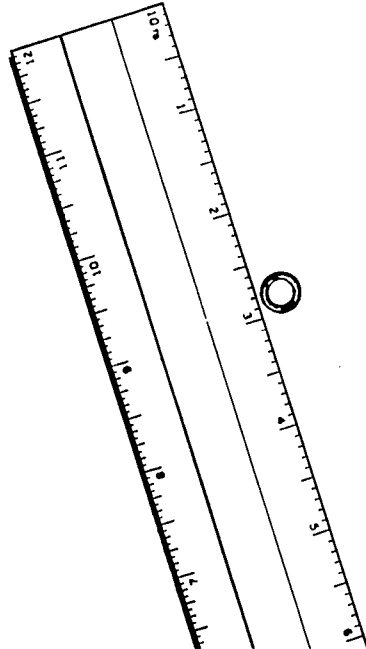
295 UNITS \$7,855,555

PRICE  
REDUCTION 39%

CHART 8

*Savings through competitive procurement*

# FLUOROCARBON "O" RING PACKING



**SOLE SOURCE**

**UNIT PRICE...\$ .54**

**COMPETITIVE  
PROCUREMENT**

**UNIT PRICE ... .055**

**SAVINGS**

**PER UNIT... .485**

**TOTAL,**

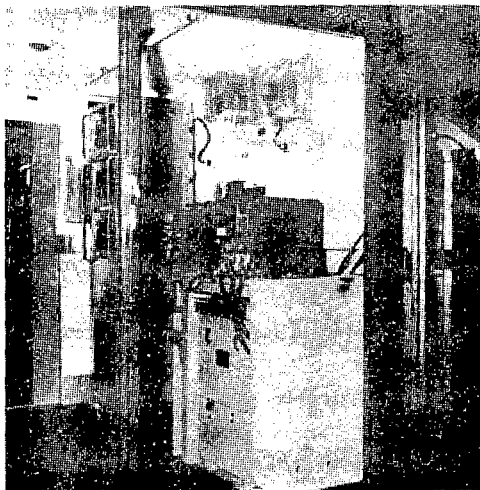
**16,320 UNITS \$7,915.20**

**PRICE REDUCTION 90%**

CHART 9

*Savings through competitive procurement*

# RADIO SET AN/ARC-73



## SOLE SOURCE

UNIT PRICE .. \$4,024

## COMPETITIVE PROCUREMENT

UNIT PRICE .. \$2,216

## SAVINGS

PER UNIT .. \$1,808

TOTAL,  
538 UNITS...\$972,704

PRICE REDUCTION 45%

CHART 10

*Savings through competitive procurement*

# TALOS FINS



## SOLE SOURCE

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## COMPETITIVE PRO-

CUREMENT ..... 1,360.00

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PRICE REDUCTION 32 %

Chairman DOUGLAS. I will ask Senator Proxmire to start the questioning.

#### SMALL BUSINESS PROCUREMENT PROGRAM

Senator PROXMIRE. Mr. Morris, I had asked the Secretary about the small business procurement program and he said that you would be able to give us a little more detail on that program. (See p. 37.)

Mr. MORRIS. Yes, sir.

Senator PROXMIRE. What progress are you making and the reason why you apparently have been slipping back in 1963 as compared with 1962?

Mr. MORRIS. As the Secretary said, sir; we don't feel that until we have a greater span of months behind us that we should draw a conclusion. Through the first 6 months of 1963 we slipped nine-tenths of 1 percentage point in our small business rate as compared to last year.

We have been attempting to isolate the reason for this and find ourselves a bit mystified because actually our set-asides are somewhat better than they were last year at this same time. We do find that about \$200 million of contracts to small business last year had been converted to firms that were small business but have passed that test and are now big business, so one of the successes of the program apparently is to raise small businesses to bigger businesses.

We are keeping the same tempo of effort and activity throughout the Department to achieve the maximum sound rate of awards to small businesses.

Senator PROXMIRE. How about in the subcontracting area which is so vital to small business? As you know, we have been very anxious to have a subcontracting program. We encountered a lot of opposition from the Defense Department.

Mr. MORRIS. We have given this much attention and I am happy to report that progress has been made this year compared to last.

As you may know, we have set specific goals for increasing the amount of subcontracted awards to small business by specific companies and each department monitors this performance. We are making more progress this year.

Senator PROXMIRE. Can you tell me about the cost of this kind of small business consideration? I have heard some advocates of small business say it actually saves money.

#### SUCCESS OF SET-ASIDE PROGRAM

I would like your opinion as an administrator in this field whether (a) the small business set-aside program has actually saved money for the taxpayer; and (b) whether the emphasis in trying to direct contracts and subcontracts to small business saved or cost money, and if you can give us any estimate of how much?

Mr. MORRIS. Sir, we are unable to give you any precise or factual figures, although we would very much like to have them ourselves. It is our firm belief that by virtue of greater competition, as the Secretary of Defense has outlined, the greater exposure of opportunities to small business, many of which they do succeed in securing, that we are cutting our costs in procurement by about 25 percent. Hence, the very fact that the small business program lends greater incentive to break out for competition, we think contributes to our cost reduction goal.

As to whether 100 percent set-asides involve any price premiums, we have no evidence they do or don't. Hence, we do not assume that they increase costs.

Senator PROXMIRE. It would seem logical that it probably would increase costs, the set-aside program, unless you can show that it does tend to build up new sources of supply which you can rely on for competition later.

Mr. MORRIS. This is correct, sir. But we should also stress that set-asides are used only where we have adequate competition to assure a reasonable price.

#### WASTE DUE TO INADEQUATE RESEARCH

Senator PROXMIRE. Secretary McNamara stressed the waste involved in engaging in production before research was adequate to justify it. I am wondering. I felt while it was a brilliant statement, that there was not any analysis here of the cost in terms of time for vital weapons.

I can recall debates back in 1959, 1960, and 1961 talking about our much slower leadtime, this country, as compared to Russia. If we follow the Secretary's advise and delay production until research is finally proven out are we paying a price in slower leadtime? Are we likely to lose something significant in the availability of the most modern weapons?

Mr. MORRIS. Sir, this is an area in which my staff and I are not experts. But I can tell you that it is the firm conclusion of the research and development experts and the Secretary that in some cases we have not only lost time but have generated failures and penalties of the type the Secretary described. Hence, we think the extra time spent at the outset in a program definition phase is time very well spent that may save time and get greater reliability at less cost in the long run.

Senator PROXMIRE. Thank you.

Thank you very much, Mr. Chairman.

#### R & D CONTRACTS AND PATENT RIGHTS

Chairman DOUGLAS. Mr. Morris, one of the important advantages of firms which get research and development contracts lies in the fact that they own the patents or take out the patents and have the drawings, so that once they get a research and development contract they have a virtual stranglehold on production.

Similarly, when a firm gets a research contract it has a stranglehold on development. Of necessity, the research contract carries with it the production of the prototype. Then when research and development is carried on with the private ownership of patents which, as I understand it, the Department of Defense permits or encourages, then others are foreclosed from coming into the field to bid on the production items. (See p. 175.)

My colleague, Senator Long, has proposed that the ownership of patents, and I would say also of drawings, should not be confined to the firm which does the research.

I want to raise two questions: First, could not the patents and the drawings be thrown open, since you have paid for them, to all firms after research and development has been carried out; and secondly,

whether the drawings and patents taken out after research, but prior to development, if those could not be made available and in this way you could get much greater competition and lower costs in the production of the end items?

Mr. MORRIS. Sir, I think this is a field that is greatly misunderstood. It is a very complex field involving a great deal of law and administrative practice.

The first and most important principle is that when we pay for the development, we do acquire the drawings and technical data and unrestricted right to their use.

Chairman DOUGLAS. Do you make them available to other bidders?

Mr. MORRIS. Yes, sir. If we go out on competitive procurement, this is one of the prime reasons for obtaining this data.

Chairman DOUGLAS. Have we been traveling under a complete misapprehension for some years in connection with atomic energy? After a severe fight on the floor, we were able to get into the act of 1954 a provision that inventions, patents, and development under Government funds should not be the property of the individual contractor, but should be the property of the Government and freely available to all.

I have understood, however, that the practice in the Defense Department differs from the practice in the atomic energy authority. Do I understand you to say that there is no difference?

Mr. MORRIS. There is a difference, sir. The first principle is that we do acquire unrestricted rights to the use of the data where we pay for the development. If we do not pay for the development, then we think we are entitled to use it only if we acquire it and pay a proper price for it.

The differences in our practices, as I understand it, sir, and I have an expert with me who would like to go into this, is that in the case of Defense, normally, we simply take a license for unrestricted use to the development and its drawings, leaving the patent title frequently with the developer. We do not automatically take title, in other words, although this is at our option and under certain circumstances in the national interest where new art is involved, where the public interest is involved, we can take title. As a practice, we do not do so automatically.

Chairman DOUGLAS. In practice, if the title to the patent remains with the original researcher or researcher and developer, this title carries with it the right to exclusive use and denial of the patent to others. How is it then that you can say you get competition from others?

Mr. MORRIS. Because, sir, in our basic contract we are given an unrestricted right to the use of the development and all data associated with it. We can license anyone whom we may select under competitive or other methods to use this material.

Chairman DOUGLAS. Do I understand, then, that the patent does not carry with it the right to exclusive use?

Mr. MORRIS. We have an exclusive right for our own purposes to make use of the development.

Chairman DOUGLAS. Does this carry with it the right to permit others to use it or simply for Government production itself?

Mr. MORRIS. Only for our purposes.

Chairman DOUGLAS. That is just the point. Doesn't this foreclose other competitors from coming in, and would it not be wiser, since



we pay for the expenses connected with the development of the invention or the process, to make it available to competitive business?

Mr. MORRIS. I think this is the point, sir. We have full control over the data and its use.

Chairman DOUGLAS. Do you exercise that control to make it available?

Mr. MORRIS. Yes, we do, sir. This is largely at the heart of the way in which we are achieving greater price competition on components, end items, and parts. At the end of my statement as an illustration, sir, is this large ordnance vehicle with a very high unit cost. This was developed for the Army by a single developer. Full rights to those data are in the Army. It was broken out for competition. As you see, a very substantial price reduction of 39 percent was achieved. This is but an illustration of the importance of our acquiring the data so as to use such information for competitive procurement. (See p. 48.)

Chairman DOUGLAS. Is Senator Long simply off on a wild goose chase?

Mr. MORRIS. Sir, I am not familiar with his present proposal.

Mr. BANNERMAN, if you would care to have him do so, can comment technically on this.

Mr. BANNERMAN. Senator, the Department, as Mr. Morris has said, in connection with its research or development contracts, always takes an unrestricted license in any patent that results from an invention during the performance of that contract. This license can be transferred to any other contractor for any governmental use. It can be used in other purchases we make or in other purchases other departments make.

However, if the patent has commercial utility, to be used in civilian or nongovernmental markets, the title remains in the inventor. This is the point where we differ from Senator Long. He would like to have us take title and devote it to the public domain. In other words, cancel any monopoly that might be involved in it.

We feel very strongly that this step should not be taken because we consider it essential in our weapons development programs to be able to tap the most advanced research work that has been done in commercial fields up until the time we have moved in. In short, no invention is ever the product of one contract. It is the product of an on-going technology, usually in some company. These companies, for the most part, are in business for commercial reasons, for making profits in the commercial markets. We want to tap their technology for governmental use.

If we were to demand that they give away their commercial rights, we feel quite confident they would be very reluctant to devote their best research talents to our work. We think it is vital that they should.

We are not in the commercial business, so we are not giving up anything we need. We don't think we are giving up anything the Government needs. We are using very advanced resources to get where we want to go.

Chairman DOUGLAS. What about nonweapon items?

Mr. BANNERMAN. Primarily our research-and-development contracts are in the weapons field. As Mr. Morris has also said, when we do happen to be in a development program that could have

civilian application, we do have the latitude under our regulations and, in fact, in many cases do take full title to any patents which may result.

For instance, one of Senator Long's subjects that he is very interested in is this question of weather research. He looks forward to the day when we might be able to have some control or influence over the weather. We have done some work in the field of weather research. In these contracts we have taken title. We put a clause in the contract that requires that title be transferred to the Government.

There are other fields such as in health or medical fields where we have done the same thing, but where the basis or the purpose of our research and development is essentially a weapon which has no civilian application, we have assumed that any civilian fallout should be the property of the inventor. In short, we think we have built on the patent system.

Chairman DOUGLAS. Thank you very much.

Mr. MORRIS, I think you have performed very valiant service inside the Defense Department and a large part of the progress which has been made is really due to your devoted efforts. I would like to ask you about some of the problems which remain, not in any critical sense, but as the Secretary said, this is a continuing struggle.

#### CONSOLIDATION OF COMMON SERVICES—HOSPITAL FACILITIES

Have you been able to effect any consolidation of hospital facilities?

Mr. MORRIS. Sir, this again is not a responsibility of our office. I know of no efforts that have been made in this direction during the past 2 years.

Chairman DOUGLAS. That is, we still have Army hospitals, Navy hospitals, Air Force hospitals; is that true?

Mr. MORRIS. I am sure there are joint services, sir, in specific locations, but in terms of a major integrated effort such as the Defense Supply Agency, there has been no such move.

Chairman DOUGLAS. Some years ago, and my information is not recent, I found that we would have two or three service hospitals very close together, each of them operating at only partial capacity, but with a full staff, and the suggestion naturally occurred, Why could you not close down one of the hospitals or have it used for civilian use and have members of the four services treated in one hospital?

Mr. MORRIS. That is, in fact, sir, the basis of requirement planning for new construction in given locations today.

Chairman DOUGLAS. For new construction?

Mr. MORRIS. Yes, sir.

Chairman DOUGLAS. What about existing surplus hospitals?

Mr. MORRIS. I don't feel competent to speak in depth on it, sir.

Chairman DOUGLAS. In other words, there is a limit to the number of struggles that you can take on at any one time.

Mr. MORRIS. Yes, sir.

Chairman DOUGLAS. I have never seen why there should not be a consolidated Medical Corps or, for that reason, a consolidated Chaplain Corps. I never thought there was Navy religion and Army religion and Air Force religion or that you had to have three different medical services. I guess three different dental services.

Mr. MORRIS. I believe so, sir.

Chairman DOUGLAS. I thought the teeth of soldiers, sailors, and aviators were not substantially dissimilar.

Mr. MORRIS. As you know, Mr. Chairman, there is a continuing<sup>4</sup> effort to study all feasible possibilities for integration and consolidation. (see p. 234.)

Chairman DOUGLAS. I think there is paydirt here and perhaps there is room for future effort.

#### INCREASE IN DOD PROPERTY HOLDINGS

Now, Mr. Morris, our report, or the report prepared by Mr. Ward, on page 3 shows the total property held by the Department of Defense increased from \$154,600 million in 1960 to \$164,800 million, in 1962. In other words, your property holdings went up by \$10 billion during this time.<sup>5</sup>

Is this simply an increase in weapons? I notice real property went up from \$32 billion to \$35.4 billion. We wanted to reduce the surplus. Now we find total property increasing. Is there a contradiction here?

Mr. MORRIS. I don't think so, sir. The increases since 1958 have been in two categories: real property of about \$8.5 billion, and almost \$12 billion in weapons and other end items of military equipment in the hands of our operating forces. This simply reflects the growing investment in ICBM bases which have been quite expensive.

Chairman DOUGLAS. That is counted as real property?

Mr. MORRIS. Yes, sir. And the missiles themselves. POLARIS ships and such new and greatly accelerated costs of military weaponry are included in the increase in the value of property with the operating forces. On the other hand, our supply system inventories in the same 5-year period have dropped by \$7 billion.

Chairman DOUGLAS. I am glad that is cleared up.

Are you satisfied with progress which you have made in the disposition of surplus?

Mr. MORRIS. Personal-property surplus, sir?

Chairman DOUGLAS. Yes.

Mr. MORRIS. We feel that during this last 5 years, with a reduction of 50 percent in the volume of surplus generated from about \$8 billion in 1958 to \$4 billion in 1962, that the trend is definitely in the right direction. We would only hope that by better requirements planning, more skillful inventory control, we can continue to reduce this.

Chairman DOUGLAS. In other words, you are using up a large portion of the equipment which was formerly scrap or surplus?

Mr. MORRIS. Yes, sir.

Chairman DOUGLAS. I think that is a very real achievement. How much money have you obtained from the sale of the surplus? How do you use it?

Mr. MORRIS. The rate of return, sir, on surplus disposal?

Chairman DOUGLAS. Yes.

Mr. MORRIS. This, as the committee knows, is not one of the brighter spots in our statistics. We have, however, during the past 2 years been able to increase the rate of return from 5 cents on the dollar to 7 cents on the dollar. This is still a distressingly low figure, but ac-

<sup>4</sup> See statement on Project 81, "Hearings, 1961," p. 59.

<sup>5</sup> Staff report, 1963, p. 3.

counted for by the very large amount of very costly military material which has no commercial sales value except for scrap.

#### USE OF PROCEEDS FROM SURPLUS SALES

Chairman DOUGLAS. The Comptroller General has made a statement in which he says that considerable amounts of the proceeds have been misused. I wondered if you would have someone here tomorrow when Mr. Campbell testifies so that we can get this matter cleared up. (Pp. 157, 438.)

Mr. MORRIS. We would be glad to, sir.

Chairman DOUGLAS. If you have not already seen his statement, this is on page 21 of the statement which he has filed. (See p. 136.)

Mr. MORRIS. I have not seen it, sir.

Chairman DOUGLAS. We will see that a copy is furnished. Those are the only questions I have. I want to congratulate you.

#### EXEMPTIONS FROM COMPETITIVE BIDDING

Senator PROXMIRE. I have a couple of more brief questions.

Mr. MORRIS, in your statement you list a series of restrictions on competitive bidding and total the amount involved. I notice purchases under \$2,500, this exempts over \$1 billion from competitive bidding.

Mr. MORRIS. That is right.

Senator PROXMIRE. It is very difficult for me to understand the justification for this in view of the fact that it amounts to such a whale of a lot of money and I would think in many cases these purchases could be submitted to competitive bidding with simple procedures that would be practical.

Mr. MORRIS. We do, in fact, do this, sir. These are purchases for the most part, 6 million of them in the last fiscal year, that are made by local installations under their local purchasing authority. They buy from the local stores for the most part.

Senator PROXMIRE. There is no reason why they couldn't be told to have some showing that they have shopped around some.

Mr. MORRIS. They do, sir. For every buy over \$250 they must obtain three or more quotations and make a record of this.

Senator PROXMIRE. That is very good. Then this exception is not a serious problem for you.

Mr. MORRIS. No, sir. The only reason for pointing it out is that we do not abstract these particular procurements or open them to national bidding because the cost would be prohibitive.

Senator PROXMIRE. How about the sources outside of the United States. Why is that not competitive bidding?

Mr. MORRIS. These are the few cases, in the case of perishable subsistence—potatoes, for example.

Senator PROXMIRE. That is a separate item. I am talking about the No. 3 item.

Mr. MORRIS. The oversea item does include perishable subsistence bought abroad because it would not be economical to buy it and ship it.

Senator PROXMIRE. Most of the purchases abroad are by competitive bidding or at least not restricted?

Mr. MORRIS. We attempt to get competition wherever we can abroad. The practice is in many countries that formal advertising

is not known or accepted. So we must abide by the custom of the local economy.

Senator PROXMIRE. It doesn't prevent you from getting quotations?

Mr. MORRIS. No, sir. The dollars shown here were actually placed under competitive quotations.

#### DOD CONCERN ON ECONOMIC IMPACT OF ITS POLICIES

Senator PROXMIRE. One other question. This is the Economic Committee, as you know. We have been quizzing the Secretary. I probably should have asked the Secretary this question. We have been quizzing him about making economies. We do have a serious problem of unemployment in some areas.

Does the Department have any economic specialists or does the Department make any effort by itself, independent of the President, to determine the economic impact on particular areas of their procurement policies and of their location policies?

Mr. MORRIS. Yes, sir. I have a full-time staff headed by an economist—whose title is "Economic Adjustment Adviser to the Secretary of Defense"—who devotes himself to two things: First, where a base must be closed or reduced in size, he immediately begins work with the local community to find other uses for that facility. He has had some very outstanding successes in this regard.

Secondly, when weapons systems change, such as a cancellation of the SKYBOLT, he is available to begin working with the communities, companies, and employees affected. He attempts to look ahead as far as our planning goes to identify emerging problems so as to begin planning at the earliest feasible time.

#### IMPACT OF CUT-BACKS ON EMPLOYMENT

Senator PROXMIRE. The Secretary gave a whole series of examples of production on defense weapons which had been stopped. We are familiar with the B-52 cutback, with the RS-70 cutback, and so forth. There are some contracts throughout the country on SKYBOLT and so forth that are going to be cut back, I suppose.

Have you had the experience to tell this committee whether the unemployment which must have resulted at least temporarily is of a serious nature or is it of a kind, because skilled people are involved, which has not resulted in a substantial or significant increase in national unemployment?

Mr. MORRIS. Sir, I think it is fair to say that our actions have not made a significant contribution to this national problem. We do follow our impacts in specific communities very closely. Often they are quite sharp.

Senator PROXMIRE. Not only specific, but our responsibility is national, as yours is. You look at it from the standpoint of a 6-percent unemployment rate and what this might do to increase it.

Mr. MORRIS. I am sure we have made very little contribution to the problem. I would be glad to submit for the record the studies we do have of this.

Senator PROXMIRE. I would like to see those studies, if the chairman will permit.

Chairman DOUGLAS. Yes.

(The studies referred to follow :)

The studies referred to show the following :

Department of Defense studies of employment impacts of its major procurement programs have covered 156 individual, company-operated plants or plant complexes, including all of the major suppliers of military hardware.

These suppliers accounted for about 80 percent of all military prime contracts for major hard goods in fiscal year 1962, including aircraft, missiles, ships, vehicles, weapons, ammunition, and separately procured electronics. These plants also perform a significant amount of subcontract work.

These studies include the principal prime and associate contractors for each military weapons system.

Accordingly, although the coverage of total employment on defense work is not complete, it can be safely assumed that the major impacts, upward or downward, are covered, and that trends in those plants are fairly representative of the total hard goods program.

The downward trend in several major weapons programs in 1961 and 1962 has created unemployment problems for many individual workers, and for several plants and communities during the past 2 years. Examples are the B-52, B-58, BOMARC, HOUND DOG, SKYBOLT, ATLAS, BMEWS, and other programs.

However, in spite of these major changes, the general trend of total defense procurement and employment has been upward in the past 2 years. In the plants covered by Department of Defense studies, estimated employment on defense work increased about 10 percent from June 1961 to December 1962, from 790,000 to about 880,000.

As shown in the summary below, the changes in total defense employment in the covered civilian-operated plants have been very small in relation to changes in national employment and unemployment, and have no consistent relationship to the direction of change in the national figures. If it is assumed that the reported figures represent between one-half and two-thirds of all employment on military weapons production, it is apparent that the total magnitude of the changes that have occurred in recent periods have not had a major effect on the national totals.

There, of course, is no assurance as to how long the upward trend in defense employment will continue.

TABLE 8

*Employment in 156 major defense plants compared with total civilian employment*

[In thousands]

	June 1961	December 1961	June 1962	December 1962
Employment in plants of 156 major defense suppliers: <sup>1</sup>				
Total.....	1,018	1,068	1,092	1,103
On defense work.....	792	842	871	879
Change.....		+50	+29	+8
Nationwide total employment:				
Civilian employment <sup>2</sup> .....	68,706	66,467	69,539	67,561
Change.....		-2,239	+3,072	-1,978
Unemployment <sup>2</sup> .....	5,580	4,091	4,463	3,817
Percent.....	7.5	5.8	6	5.3

<sup>1</sup> Source: Department of Defense Surveys.

<sup>2</sup> Source: Department of Labor.

Senator PROXMIRE. Thank you very much.

Chairman DOUGLAS. Thank you very much, Mr. Morris.

Mr. MORRIS. Thank you, Mr. Chairman.

RELATIONSHIPS BETWEEN DOD AND GSA

Chairman DOUGLAS. I am sorry; there is one final question.

I was very much interested in the very cooperative statements which the Secretary and you have both made about your relationships with

the General Services Administration. I would like to follow that up a bit if I may. (See pp. 2-3, 20, 44.)<sup>6</sup>

The General Services Administration Act of 1949 provided that the Administrator of that agency be given a good deal of authority in the area of general supplies and that his findings would be controlling unless the Secretary of Defense determined that national security would be endangered and then excepted the DOD and gave the work to the Department of Defense. In other words, the common supply items would then be thrown on the Department of Defense, rather than the General Services Administration as far as procurement is concerned.

I am glad you have made the progress that you have, but we are getting a series of complaints by manufacturers of handtools particularly that the Department of Defense is reserving these purchases for themselves and not allowing GSA to do it. Therefore, some of these producers feel that they are being foreclosed from bidding.

Do you have any light that you can shed on that problem?

Mr. MORRIS. Sir, I have received no complaints from such manufacturers.

Chairman DOUGLAS. We will put them in the record and send copies to you so that you may check them.

Mr. MORRIS. Very good, sir.

Chairman DOUGLAS. Thank you very much, Mr. Morris.

Mr. MORRIS. Thank you, sir.

(The material referred to appears in appendix 4, see p. 380.)

Chairman DOUGLAS. We will meet this afternoon at 2 o'clock.

(Whereupon, at 12:25 p.m. the subcommittee recessed, to reconvene at 2 p.m. the same day.)

#### AFTER RECESS

(The subcommittee reconvened at 2 p.m., Senator Paul H. Douglas, chairman of the subcommittee, presiding.)

Chairman DOUGLAS. The subcommittee will please be in order.

Twelve years ago I was interested in the subject of waste in Government and I was referred to the Bonner subcommittee of the House of Representatives, which was doing some notable work in the field of supply management in the military and civilian establishments.

I had some conferences with Chairman Bonner and members of his committee at that time. Then in the spring of 1952 Chairman Bonner introduced a bill which, if enacted, would have set up a consolidated supply agency in the Office of the Secretary of Defense. No action was taken on the bill, so with Congressman Bonner's blessing, I introduced the entire bill as an amendment to the then current military appropriations bill.

Eventually some compromise language emerged and much good resulted from it. It was not until January 1, 1962, that the Defense Supply Agency was set up in the Department of Defense by Secretary McNamara. I am, therefore, very pleased to introduce as our next witness the chairman who was a decade ahead of his time, Congressman Bonner. We realize you have been more than busy with your committee, but we would like your observations after 2 full

<sup>6</sup> See also staff report, 1963, pp. 182-216, "Legal Background and DOD/GSA agreements" and p. 411, "Report, 1960."

years of hearings and investigations and a decade of speculating on "what might have been."

Representative CURTIS. Mr. Chairman, could I say a word of welcome to my former chairman, being a member of the Bonner committee as a freshman Congressman? It was a great introduction to the work of the Congress under a splendid chairman.

**STATEMENT OF HON. HERBERT C. BONNER, A REPRESENTATIVE  
IN CONGRESS FROM THE STATE OF NORTH CAROLINA**

Representative BONNER. Mr. Chairman and gentlemen of the committee, I appreciate very much what you have said. The committee you made reference to did diligently work on this subject for a number of years. Although I have been separated from it some time, I am delighted and interested in the continuation of your personal effort and the effort of your committee to carry on this effort, if I may use the word, again, to see if we can't practice a little economy in an area where economy can mean a great deal to this country.

As I said, I am honored and pleased to present my views to this distinguished group on the general subject of the impact of military procurement and supply on the economy since I have some firm views on the subject as a result of the Bonner committee investigations and reports in 1951 and 1952.

I should add that Congressman Curtis, of Missouri, a member of this distinguished committee, was an important member of that committee and a diligent worker toward the effort of the committee.

I am pleased that there are now some important changes taking place in the supply management activities of the Department of Defense under Secretary McNamara that are in accord with the recommendations we made 11 or 12 years ago.

**ORIGIN OF O'MAHONEY-DOUGLAS AMENDMENT**

Mr. Chairman, I recall very vividly that members of our committee had several meetings—with you personally in 1951 and 1952 because of your interest in eliminating waste in Government operations, and when our committee failed to get action on a bill we had developed to correct some of the deficiencies we had found, you took up the burden in the Senate and on June 30, 1952, 11 years ago, offered the entire bill as an amendment to the Defense Appropriations Act of 1953.

Chairman O'Mahoney of the Appropriations Subcommittee was in agreement with the intent of your amendment, but feared it would be subject to a point of order and so offered a short compromise amendment which has become known as the O'Mahoney amendment. This is permanent law and in a sense calls upon the Secretary of Defense to develop an integrated supply system for the Department of Defense.

Mr. Chairman, in view of the fact that you were the one in the Senate who made this fight for the amendment, I have always thought it should have become known as the Douglas-O'Mahoney amendment.<sup>7</sup>

Chairman DOUGLAS. Or rather, as the Bonner amendment.

Representative BONNER. Thank you, sir. As a tribute, if I might say, to your effort, without in any manner reflecting upon that other great legislator, Senator O'Mahoney.

<sup>7</sup> See "Report, 1960," p. 64 for text and intent.



## IMPACT OF DOD LOGISTICS ACTIVITIES ON ECONOMY

As you know, I am not an economist, but one need not be to recognize the impact that defense expenditures of \$50 billion annually make on our economy. This amounts to almost 10 percent of the gross national product. Purchases of \$20 to \$27 billion per year affect large and small businesses throughout the Nation, and employment of 1 million civilians is big business.

Transportation costs of \$1 to \$2 billion annually affect all our shipping industries. The location of numerous depots and hundreds of other installations are of national, regional, and local concern.

Your hearings and reports have brought out how important is the matter of surplus disposal as, for example, the disposition of 60 million yards of canvas and many other items. Almost every Congressional Record carries the statement of Senators and Representatives on the fairness of the distribution of defense business. Current hearings in the Senate bear heavily on this, but so long as awards are made by negotiation, the approving officials will be on the defensive to explain their actions.

## NEED FOR ADVERTISED BIDS

So, where practicable, Government contracts should be made in conformity with advertised competitive bid procedures. That means that minimum requirements should be stated both as to the quantity and quality. There should be free and full competition. Sealed bids should be opened in the public at a specified time and the award made not tentatively, but finally to the lowest, responsible bidder.

This is the essence of Revised Statute 3709 which was developed over a period of more than 100 years during which time there were many transactions which, in principle, were similar to the large ones before us today.

About 11 years ago a boat manufacturer in my congressional district complained that he was unable to bid on small boats for the Navy, although he had done so successfully before. He was told his prices were out of line, but he couldn't find what current prices were. The bids were negotiated, renegotiated, escalated, deescalated, and most everything else.

He didn't know how to "sharpen his pencil," as the saying goes. He felt that there was some undercover work going on, which leads me to an old saying, and I quote: "Government contracts must not only be good, they must look good, and it is almost impossible to make a negotiated contract look good."

In 1952 I introduced a very simple bill to amend the Armed Services Procurement Act of 1947, and the Federal Property and Administrative Services Act of 1949. It provided that Government procurements be made by advertised, competitive means where practicable. If this could not be done, competition should be obtained by negotiation. If this could not be done, negotiation could then be used.

The Comptroller General would decide upon the practicality rather than a party at interest. The military didn't like the bill. It was not enacted.

## UNIFICATION MEANS TRIPPLICATION

Mr. Chairman, you may be interested in some of the committee findings in 1951 and 1952 as they bear upon today's problems and progress.

After 4 years of debate, the National Security Act of 1947 was signed. We then had three departments instead of two, and the complications or problems were multiplied rather than added. It took 600 internal committees, boards, and so forth, to tie 3 departments together where 100 had sufficed with only 2 departments.

An officer in Okinawa testified before us in November 1951, and I quote:

Since the Unification Act, the U.S. Air Force has progressively moved toward establishment of their own separate supply system. Many common items have already been transferred, such as lumber, vehicles, and class II and IV quartermaster supplies.

That was truly what we learned from our investigations around the world. We found that there was a dividing of quartermaster stocks in the United States and around the world into two piles; Army and Air Force. The Air Force was then building its own warehouses, for example. The Air Force moved 600 to 700 carloads, railcars, of quartermaster material from Army depots at San Antonio and Fort Worth and Topeka, Kans., Memphis, Tenn., and Shelby, Ohio.

#### WASTE IN AIR FORCE SUPPLY ACTIVITIES

What did that cost in manpower, transportation, buildings, facilities, and so forth? Millions and millions of dollars. Was it necessary? Absolutely not. Much of that material has been declared surplus, donated or sold, and your hearings of January 1960 show that those Air Force depots were to be deactivated in 1962.

We found that the Air Force was building a quartermaster depot at Fairbanks, Alaska, at a cost of \$900,000, to store stocks to be moved from Army stores nearby that were giving good service.

So it was the world around, Mr. Chairman. Despite the intent of the National Security Act and the promise of Air Force witnesses, it wanted its own supply, engineering, ordnance, and other corps, and was out to get them. They wanted to be just as separately administered as the Army and Navy, and the 1949 amendments to the Security Act gave them encouragement.

We found the services were doing many things of a commercial-type nature in competition with American business. We also found that the Navy was shipping medical supplies right by Army depots to their installations and vice versa. We found that the Army had a big medical depot on one side of the street and the Navy had one across that street in Oakland, Calif. The same purchasing office was buying the same items from the same suppliers and shipping them across the United States on different bills of lading to these adjacent depots to be used later in unified theaters.

I won't go on, Mr. Chairman, with the misuse of public funds, the disregard of the law and the lack of supervision and control that then existed, but there was duplication and triplication on every hand.

#### RECOMMENDATIONS OF BONNER COMMITTEE

I would like to mention some of the measures we recommended in reports of 1951 and 1952.

First, clarification by the Congress of the basic statute. To implement fully centralized supply direction and coordination and to avoid conflicting administrative interpretations.

Second, large-scale activities in the field of military procurement should be improved through a realistic, balanced program of schedules of purchases based on advanced planning and prior determination of requirements.

Third, every effort should be taken to assure that the completion deadline set for the Federal cataloging program is met, June 30, 1952. That was 10 years too optimistic.

Chairman DOUGLAS. After 10 years your recommendation has been largely carried out; not wholly, but largely.

Representative BONNER. It is refreshing to come over here and learn the results of your good work.

Chairman DOUGLAS. Yours, too, Mr. Bonner.

Representative BONNER. And fourth, the Munitions Board Standards Agency should be given a strong charter adding the necessary powers of decision. The number of variations and deviations in specifications should be reduced as much as possible in order to prevent duplication in purchasing, distribution, and utilization.

Fifth, there should be better utilization of property, including warehouse and office space.

Sixth, effective supply training programs for military and civilian personnel should be instituted for the Department of Defense.

Seventh, staffing standards should be established to produce economy and efficiency in utilizing supply personnel.

Eighth, except in isolated areas and under special circumstances, commercial-type operations in the military departments, such as coffee roasting, are of questionable value. Skilled military personnel, specialized equipment, and much needed administrative warehousing space are utilized by these activities which are not essentially military operations. The Secretary of Defense should ascertain whether, under proper cost-accounting standards and so forth, retention of commercial-type operations are justified.

Chairman DOUGLAS. Congressman Bonner, you have touched a very real point here. As you know, when efforts are made to eliminate these fringe occupations, very frequently the Senators and Congressmen from those areas make great objection. I won't go into specific examples, but there are a great many Senators and Congressmen who speak of their devotion to private enterprise but who are reluctant to have these operations taken out of their districts.

You know that don't you?

Representative BONNER. Sir, I have never been blessed with any of these luxuries that come from the armed services in my congressional district. Otherwise, instead of being blessed with something beneficial, I have been burdened with one of the largest bombing ranges that can be conceived of. It has caused a great disturbance not only to the population but threatens the movement of an industry from the area in which this bombing range is going to be established.

So I can understand the effect of certain things that I have spoken of on the local economy, but in dealing with this question, Mr. Chairman, we must deal as citizens who are interested in the overall broad cost of the national defense, and recognize that private industry does have a proper place to supply when it is proper.

#### COMMERCIAL ACTIVITIES—COMMISSARIES

Chairman DOUGLAS. Congressman, a few years ago I made some criticisms of the widespread use of the commissary system. Commis-

saries are supposed to be operative only where commercial facilities are lacking or where the commercial stores make excessively high charges.

I found that 5,000 military personnel were locked up being grocery clerks in the commissaries. I am not speaking of the PX's. I found the location of many of these commissaries, including one at Fort Myer, in large metropolitan areas. We found 269 of these commissaries scattered around. It would hardly seem that commercial facilities were lacking either in Washington or in Arlington, Va.

But I was subjected to one of the most severe bombardments from officer personnel in the armed services because they said this was a fringe benefit which they received and I was proposing to take away from them the opportunity to get meats and groceries at less than market price.

This was so hot an issue that I think even Secretary McNamara has not been able to make any headway against it. I am delighted that you bring this out. It seemed to me it was a great waste not only in terms of money, but armed services. We are not drafting men to be grocery clerks or butlers or housemen.

Representative BONNER. Mr. Chairman, I have the highest regard and respect for the men who wear the uniform of this Nation, and I am sure you do, in the past, present, and the future. I want them to have such fringe benefits as are necessary and essential, but I do not think that extraordinary concessions should be granted and given in conjunction with the civilian population. They have the same opportunity to trade and shop as those of us who were formerly in the service now have.

Chairman DOUGLAS. You know our Armed Forces were defenders to the death against militant communism, but the extension of these services under Government auspices where private services could do as well or better is really a type of—what shall I say—a form of military socialism in the sense that it is a Government operation of what is really a private endeavor.

Representative BONNER. Mr. Chairman, they are your words.

Mr. Chairman, the committee that my distinguished colleague in the House, whom you have serving with you now, served on, also urged the military to use the facilities of the newly created General Services Administration for civilian-type items used by many other agencies of Government.

#### UNIFIED OPERATION FOR MEDICAL SUPPLIES

Of great importance also was the recommendation that a test be made to see if one military department could buy, store, and issue medical supplies for all three. A test was begun in March 1952 at Alameda, near Oakland, Calif., after 9 months of wrangling. It was to run for 6 months. The test was successful despite many service roadblocks. We thought there would follow a consolidation of the other eight Army and Navy medical depots after this successful test, but it was not so. By the end of 1953 the test was abandoned. There were no further consolidations and the old military guard in the Pentagon were in charge and there followed a wave of decentralization of common-use activities until a public storm broke out following the Second Hoover Report on Subsistence and Clothing, and Congressman Dawson's hamburger hearings.

Soon there was an announcement that a bright idea had been developed—single managers. There would be a single manager for subsistence. Later, under proddings from Congress, other single managers were set up for several other common commodity classes.

I am sure all of us who had studied the matter knew that sooner or later it would be apparent that the many single managers would need to be combined. This has now been done under the Defense Supply Agency. I think your subcommittee members have been largely responsible for this action after 10 years of prodding.

#### M'CORMACK-CURTIS AMENDMENT

Great credit must be given to Speaker McCormack and Congressman Curtis for pushing their amendment which gives the Secretary of Defense the authority, and as the Comptroller General stated, "a mandate to set up the Defense Supply Agency." Secretary McNamara did not hesitate to do this.

Chairman DOUGLAS. Congressman Bonner, this is very significant testimony coming from you. What you are saying is that Secretary McNamara proceeded under the law and that he does not need any additional legislation to justify his acts, and that to repeal the law would be a mistake.

Representative BONNER. That is correct. I previously mentioned the bill H.R. 8130 which I introduced and which was first referred to our committee in 1952, and which Senator Douglas pushed in the Senate. It would have done five things: First, set up an Under Secretary of Defense for Supply; second, abolish the impotent Munitions Board; third, transfer to the Secretary of Defense control over supply matters then vested in many boards, individuals, and so forth; fourth, create an efficient and well trained Supply Corps to assist the Under Secretary to perform his duties; fifth, give the Under Secretary proper control over appropriations for supply.

#### NEED FOR SUPPLY CORPS

Several of these purposes have been met through the creation of the Defense Supply Agency and through other actions. I believe that point 4, about establishing a Supply Corps in DSA should be carefully considered. Men cannot serve two masters. Men in uniform from the four services who get their promotions from the services are in a bind when they work in a consolidated DOD agency.

We found that many competent officers got their careers blighted in the Munitions Board. It is unfair to them. Hiring, promoting, and firing should go together.

Chairman DOUGLAS. This is a very important suggestion that you are making.

Representative BONNER. Mr. Chairman, I met some of the finest men I will ever meet in my life in the studies we made during this period of time, and it was significant that on the record their testimony was one way and then in private conversation they complimented our effort.

There was one great man we visited who said to our committee, "All you need is a man in the right place and it will just accomplish what you gentlemen are trying to do." Some years later I met him and he had reached that place. I was at lunch with him. The conversation

lapsed and I kind of smiled, I don't know why. He said to me, "What are you smiling about?" I said, "I am thinking what you said to me in your headquarters. You said all that a man needed was to reach the spot." "Yes, but," he said, "it is a hell of a sight different after you get in the spot."

I have never forgotten that conversation.

Mr. Chairman, I said a moment ago that I was honored to appear before this group, but I am also deeply sad why it should take so long to accomplish these obvious things. Secretary McNamara claims, and I believe him, that his cost reduction program will save \$3 billion or more per year in a few years' time. Much of this saving is in the supply management and related fields. It saddens me to contemplate the savings which could have been made during the past 10 or 12 years when our military procurement actions have averaged \$20 billion annually.

I do hope that Secretary McNamara will have great success and cooperation from you and others of us in the Congress in his effort to accomplish what he desires in relation to this matter.

#### DEACTIVATION OF INSTALLATIONS THAT WERE NEVER NEEDED

Military installations are now being deactivated that should not have been activated in the first place. There are \$13 billion in excess and long stocks in inventory. Surplus disposals amount to billions annually. I am unhappy to note that 86 percent of the military procurement is done by the negotiated contracting despite the fact that the Congress intended that negotiation would be the exception and competitive bidding the rule. We get better prices through competition and avoid many evils thereby, such as favoritism, collusion, nepotism, and the charges, often unjust, that these have been indulged in.

I have great admiration, as I have stated, for the military personnel. They are sincere in their desire to protect our Nation, but military people, with their training and background, are often not good businessmen. They are trained, Mr. Chairman, for another purpose. They often do not appreciate where excessive and wasteful spending is taking us.

#### MILITARY SHOULD DO STRICTLY MILITARY THINGS

So in conclusion, I would add this thought: Even as the Government should only do those things that it must do, even more so the military should only do those things which are strictly military in nature. In the long run, this will protect them from unfair charges about the military-industrial complexes. It will reduce them in size and also permit civilian agencies to handle civilian matters.

#### NEED FOR CONTINUITY OF EFFORT TO OBTAIN SUCCESS

I think that Secretary McNamara has been doing a magnificent job, and I only wish he had been at the helm for the past 10 years. He has started an excellent cost-reduction program. The President supports him. But it will take continuity of effort by all concerned to make it effective. I know, Mr. Chairman, from experience.

Thank you, sir.

Chairman DOUGLAS. Congressman, this testimony coming from the man who really started this whole campaign is very eloquent and very

compelling. You can take consolation in the fact that the seed which you sowed back so many years ago is beginning to bear fruit.

We probably have a great deal of work to do in two directions: First, in protecting what has already been accomplished, because the separate services are anxious to recover their former powers; and second, in seeing that the programs of the Secretary are carried through to the point of ultimate purchase and handling in the local units. Your testimony is going to be of great help.

Congressman CURTIS?

Representative CURTIS. I want to join in that expression and point up a couple of things.

First, I want to say to the chairman how distressed I was that, after working some time to have these hearings set up, I was unable to be present this morning when Secretary McNamara and Assistant Secretary Morris testified.

I want to say simply for the record that the Ways and Means Committee met this morning on the Silver Act. Since we were actually voting the measure out, I had no choice. I just had to be there. But I have read both Secretary McNamara's and Assistant Secretary Morris' testimony.

It is gratifying to see the real progress that is being made along the lines that the gentleman, my former chairman, Mr. Bonner, has suggested, and we in the subcommittee were working on 12 years ago.

One of the weapons being used today to combat the efforts of Secretary McNamara is the charge that he is trying to build an empire in the armed services. I think it is highly significant that two of the goals that he is directing his attention to are the very goals that the gentleman has directed his attention to, which is just the reverse. One is moving over into GSA those common-use items that can be handled by a civilian agency. It gets out from under the Defense Department, out of uniform, as it were, over into the civilian sector.

The progress that has already been made under Secretary McNamara in this line is a clear refutation of any charge of empire building.

The second, and equally important, is getting the military out of business, as it were, in many areas. In World War II, as the result of necessity, the military did move into many kinds of civilian business. Secretary McNamara's program, in accordance with his testimony this morning which I have read, points out the progress that is being made toward returning these areas of endeavor to the tax base.

Representative BONNER. May I interrupt you?

Representative CURTIS. Yes, I wish you would.

Representative BONNER. War brings many evils, but we should be so constituted that we can correct these evils after the military has performed its duties and functions—

Representative CURTIS. And with proper respect and credit to our fine military leaders for that. But this is something that in the wake of war we must move into, and in many instances, I think we failed to do so. This is pertinent because it again refutes the charge of empire building.

A third item that the gentleman has emphasized, and was so dear to our hearts in those days many years ago, is the insistence upon the use of advertised bids. It was a long time before we could establish

the fact that the use of advertised bids was actually a more efficient way of getting the same goods and services at a cheaper price in the long run.

Secretary McNamara has given us the statistics to verify this. It is interesting to note the implications of the substitution of advertised bids for negotiated bids, as far as concentration of power in a group of men is concerned. Under advertised bids, where you say you open up the bids in a public room, there is not this power of concentration because it is a marketplace operation.

This business of concentrating in the area of negotiated bids could lead to this kind of empire building. I think Secretary McNamara deserves great credit for moving in these three areas and clearly refuses the rather unsustained charges of any kind of empire building.

It looks as if it is the same thing we experienced over a period of years while we were conducting our hearings under the Bonner subcommittee when we ran into constant difficulty with the three services. I honestly believe that in their own eyes they thought they were doing the best thing. Nonetheless, they were determined to resist losing any jurisdiction by returning things to the civilian sector, losing jurisdictions that they could control as individuals by having centralization, or sending it over to GSA.

It looks like it is just one more sortie on their part to try to stop this coordination and efficiency in the military procurement field.

I am so pleased that this subcommittee exists and I want to give credit to my chairman, Senator Douglas. We are concerned with economics of this country, and the impact of military procurement on our economy is so great that we have to view this in its broad scale and keep watch over it. That is the reason we are studying this subject.

I want to mention two things finally. I am almost being reminiscent here. We set out two tests, one of which was in the field of medical supplies, the Alameda test.

Incidentally, the Korean war was going on at the time, and the supplies for medical service were operated off the Alameda test. What a strange thing we found out: in the theater of war, there was unification, but when we got behind the lines, away from where actual military action was going on, we found a disturbing lack of coordination and unification.

We felt that if it were true that in the field of medical supplies there could be this kind of unification, then there were many other areas where comparable steps could be taken. Whether a person is in the Army, Navy, or Air Force uniform, as far as medical treatment is concerned, an aspirin is an aspirin, treatment for a broken leg is the same, surgery is the same, and so forth.

To me, it was a tragedy that after this proved to be successful, not only was it not extended to other areas, it was abandoned. Even with all the progress that Secretary McNamara reports, we are just beginning to get into this unification.

One of my favorite illustrations is the Chaplains' Corps. Here, we are almost worshiping God according to the Army, Navy, and Air Force, because we have a separate supply setup for all three of the Chaplains' Corps. The same illustration is true in the medical service field, as is many of these other areas.



## MOBILIZATION RESERVES OF COFFEE

The second major example, was coffee roasting. Assuming that 180 million people would drink about the same amount of coffee, whether you had 10 million in uniform and 170 million out, or 5 million in uniform and 175 million out of uniform, surely there was nothing that needed to be expanded in the event of mobilization. There could be coordination without the need for Army, Navy, and Air Force coffee roasting setups. In fact, the military, itself, should not even have been in the field.

We found, Mr. Chairman, that they were sending naval officers down to Brazil to look over the purchasing of green coffee beans. They had a 2-year supply of green coffee beans. I think they cut it down to a 6-month supply and the savings were supposed to be around \$50 million because of the warehousing that went with it.

This was only to illustrate a point. If it were true of coffee roasting, it was true of all sorts of areas. Here we are now at the point where real progress is being made, but very strong efforts are being conducted by those who disagree with this principle. They apparently are not willing to debate it on the floor of the House or the Senate, but under cover, they are in disagreement and are trying to move this backward.<sup>8</sup>

All I can say is that I welcome your testimony and your encouragement, because if there is going to be a fight on this thing, I am ready to conduct it.

Representative BONNER. Mr. Chairman, I know it is a very frustrating field to venture into, and there were many times that I was so blue and despondent about things that I saw that I almost wished that I had never ventured into it.

But nevertheless, after it was all over, and to see you carrying on here, and others, I hope there is a thorough understanding in the military that what has been said here by me and what I did in the past was only for the best interests of the country and the men themselves. I appreciate this opportunity.

Chairman DOUGLAS. Thank you very much, Congressman. You have made a great contribution to the Nation. We are very grateful.

Our next witness is Mr. Bernard L. Boutin, Administrator of the General Services Administration.

Will you come forward with you associates, Mr. Boutin?

We are very glad to have you testify. I think this is your first appearance before this particular group. I know you have an important role in the General Services Administration in carrying out the intent of the Federal Property and Administrative Services Act of 1949.

In 1960 your predecessor told of some of GSA's accomplishments, problems, and plans. I addressed a letter to you on March 12 indicating the subject matter of the subcommittee's interest and the information we sought from you, and I am very glad to have that letter made part of the record at this point.

We have your prepared statement and you may proceed as you desire.

<sup>8</sup> See "Study on Coffee," staff report 1963, p. 217; also GAO study on reserves of commercial vehicles, *ibid* p. 219.

(The letter referred to follows:)

MARCH 12, 1963.

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

DEAR MR. BOUTIN: The Subcommittee on Defense Procurement of the Joint Economic Committee held hearings in January 1960 on the impact of defense procurement and related activities on the economy. A considerable part of the hearings and subsequent report issued in October 1960 dealt with the authority and functions of GSA in its relationships with the Department of Defense.

With the creation of the Defense Supply Agency (DSA) which action the subcommittee strongly urged in Recommendation No. 1, it has become increasingly important that the role of GSA vis-a-vis DSA be clearly defined, understood, and implemented.

The President's recent statements on the need for an across-the-board cost reduction program to cut duplication and close nonessential installations as an aid to the economy, strongly support the views and recommendations of the subcommittee. A review and analysis of the current situation therefore seems to be appropriate.

Specifically, we should like for you to convey to the subcommittee information as to:

- (1) GSA's role and degree of accomplishments;
- (2) Agreements made with DOD subsequent to the subcommittee hearings in January 1960 and status thereof;
- (3) Bottlenecks to optimum progress;
- (4) Recommendations for improvement;
- (5) Functions, funds, facilities, personnel transferred to GSA by DOD since January 1960; and
- (6) Pending transfers of functions, if any.

The subcommittee will hold hearings on these and related subjects on March 28, 29, and April 1, 1963, in the Senate caucus room. You and your associates are scheduled to testify at 2 p.m., March 28. One hundred copies of prepared statements should be filed with the committee, room G-133, by March 27. You may contact Mr. Ray Ward, economic consultant to the subcommittee, Capitol 4-3121 (code 180), extension 5220, or room 502, George Washington Inn, respecting further details.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

**STATEMENT OF HON. BERNARD L. BOUTIN, ADMINISTRATOR,  
GENERAL SERVICES ADMINISTRATION**

Mr. BOUTIN. Thank you very much, and Congressman Curtis.

I am delighted to appear before you today to again discuss with you some of the economic aspects of military procurement and supply as they relate to GSA and, of course, to the Department of Defense.

I want to review with you the role of the General Services Administration in relation to the military procurement and supply operations, to discuss some of the actions which have been taken in coordination with DOD, as well as other actions in process or under consideration, and relate to you their results in terms of improved economy and efficiency in the conduct of Government affairs.

**GSA-DOD RELATIONSHIP**

The improvement in relationships between GSA and the Department of Defense, as well as with all of the civilian agencies of Government, in fulfillment of the purposes of enactment of the Federal Property and Administrative Services Act by the Congress in 1949, and as it has been amended from time to time since that date, has been my primary objective since I first become Deputy Administrator in January 1961. I have continued to vigorously pursue this objective

as Administrator of the agency, and intend to continue to do so for as long as I am associated with GSA. (See pp. 20, 44.)

INTENT OF GENERAL SERVICES ADMINISTRATION ACT, PUBLIC LAW 81-152

The intent of Congress in enacting the 1949 act, as clearly stated therein, was to provide for the Government an efficient and economical system for the procurement and supply of personal property and nonpersonal services and related functions, including contracting, storage, inspection, issue, transportation, traffic management, motor pools, management of public utility services, representation before Federal and State regulatory bodies, utilization of available excess property, disposal of surplus property, records, management, maintenance, operation, management and repair of public buildings, lease of privately owned space required for housing agencies of the Government, and related responsibilities.

Other statutes vest GSA with responsibility for design, construction, alteration, and improvement of public buildings and the acquisition, storage, rotation, upgrading, and disposal of strategic and critical materials.

In other words Congress has provided GSA with broad authority to act as the business management arm—using the term in its broadest sense—of the executive branch of the Federal Government.

PRESIDENT TRUMAN'S DIRECTIVE

Although there are some specific statutory exemptions from our authority, President Truman, upon enactment of the law, directed all executive agencies, including those specifically exempted, to cooperate with GSA and procure, utilize, and dispose of property in accordance with the provisions of the act and regulations issued thereunder consistent with the purposes of the legislation and in order that the greatest efficiency and economy might be effected.<sup>9</sup>

From modest beginnings, which have grown progressively through the years, much has been accomplished, both in the military and civilian agencies, toward carrying out the purposes of the legislation. Substantial economies and efficiencies have been achieved.

Much of our progress has been due to the establishment of sound and sensible cooperative relationships with the military and civilian agencies. With this ingredient we confidently predict continued progress in unified procurement policies and practices. Without it the purpose for which GSA was created will not be realized.

GROWTH OF GENERAL SERVICES ADMINISTRATION

As clearly illustrated by the attached table of selected financial and operating statistics covering GSA's operations for the 10-year period 1953 through 1962 our growth in some activities has been dramatic. For example the number of square feet of space for which we have repair and improvement responsibility increased by 29.2 million from 99.3 to 128.5 million square feet.

Our responsibility for managing Government-owned buildings covered 67 million square feet in 1953 and had increased by 37.7 million to 104.7 million in 1962. Our construction program in 1953 of

<sup>9</sup> See staff report, 1963, pp. 182-183. See also "Hearings, 1960," pp. 60-63; and "Report, 1960," pp. 55-59.

\$11.4 million had increased nearly twentyfold to \$215.4 million in 1962.

Stores depot sales of \$54.7 million in 1953 more than quadrupled to \$229.6 million in 1962. The 1953 Federal supply schedule purchases amounting to \$311.2 million, more than doubled to \$697.1 million in 1962.

The 1,881,000-cubic-foot inventory of records in our records centers at the end of 1953 had more than tripled to 6,950,000 cubic feet by the end of 1962.

At the end of 1962 there were pending before State and Federal regulatory bodies 49 proceedings involving transportation and other public utilities in which GSA, or the DOD acting under delegated authority, were representing the Government as a user. Nine of the cases were being handled by DOD.

Sixty-six motor pools were in operation at the end of 1962, having grown from 12 such pools activated in 1956, the first year of this program.

The surplus real property sales workload in 1953 was \$275 million at acquisition cost compared to \$1.4 billion in 1962. Sales return from surplus real property grew more than 25-fold from \$3 million in 1953 to nearly \$80 million in 1962.

Excess personal property costing \$38.6 million was transferred by GSA to other Federal agencies for utilization in 1953 as compared to \$362.7 million in 1962.

As stated previously, the foregoing statistics show major advances by GSA in discharging its many and varied responsibilities. Obviously, however, much remains to be done. There are areas where, through improvement and modernization in methods, systems, and procedures and improved cooperative relationships with military and civilian agencies, far greater economy and efficiency in the conduct of Government business affairs can be realized.

We are irrevocably committed to an aggressive course of action which will affirmatively implement the full responsibilities vested in GSA by the Property Act and related statutes and Presidential directives, thus bringing full realization, in terms of economy and efficiency, to the purposes and intent of Congress in creating GSA.

I will outline for you some of the steps which have been taken since the hearings held by your subcommittee in January 1960, set forth the economies achieved and anticipated, and mention other improvements under study.

#### AGREEMENTS WITH DOD

Since the January 1960 hearings, we have reached a series of understandings with DOD which clarify and expand GSA's procurement and supply support of the Department of Defense as recommended in your subcommittee's report of October 1960. DOD has issued policy statements and directives which provide:<sup>10</sup>

(A) There will be no withdrawal of items from GSA's supply system without the prior approval of the Assistant Secretary of Defense (I. & L.).

(B) GSA will be offered common use items which do not require military management under criteria established by the Department of Defense. Generally, DOD's criteria requires Defense management

<sup>10</sup> See staff report, 1963, pp. 182-216.

of items related to the operation of weapons, items used only by the military services, and items with valid mobilization reserve requirements.

As a result of this agreement, over the last 2 years DOD has offered to GSA, through February 28, 1963, 150,553 items. Of these, 21,853 were selected for GSA support, 80,325 were left for local purchase, and 48,375 are in process of review.

The largest portion of these offers are items which do not warrant the cost of central management by either DOD or GSA. Of the 21,853 items selected for support to DOD, about three-fourths were already available from GSA sources.

(C) GSA will determine which of the items offered can more economically be handled through GSA's supply programs, and which are best obtained through local purchase by the requiring military activity.

(D) GSA is shown as a primary source of supply in military catalogs for items to be supplied by GSA.

(E) DOD will transfer residual inventories to GSA on items for which GSA will assume supply support. Residual inventories transferred to GSA as of December 31, 1962, totaled \$8,464,388.

(F) GSA and DOD jointly coordinate item reduction studies designed to eliminate overlapping and duplicative items and to reduce the total number of different items in both systems. Through February 1963, over 90,000 items have been studied with the result that over 26,000 or 34 percent, are being deleted from both systems.

(G) The Department of Defense is discontinuing preparation of Federal specifications under which purchase support for the military departments is normally provided by GSA.

(H) GSA has joined with DOD in the adoption of common operating procedures so that military requisitioners can utilize GSA supply sources as conveniently as their own military depots. We installed the military standard requisition and issue procedures (MILSTRIP) along with the Department of Defense on July 1, 1962. The uniform issue priority system was incorporated in our conversion. Transceivers to receive requisitions transmitted by mechanized methods were also installed in four of our regions and are now being installed in the remaining regions so that a military or civilian requisitioner, state-side and overseas, can transceive MILSTRIP cards containing priority designations directly to GSA under the same procedures as are used within the Department of Defense.

(I) Military standard transportation and movement procedures (MILSTAMP), which cover the processing of shipments to military customers is scheduled for implementation by GSA/DOD on oversea transactions on July 1, 1963, and on July 1, 1964, for domestic.

(J) Since 1960, GSA has issued procedures which call for payment of general supply fund bills within 30 days of the billing date as a means for keeping our accounts receivable at minimum levels. DOD has cooperated fully in complying with these procedures and has issued its own internal instructions for payment of billings on a "constructive receipt" basis—without waiting for the usual receiving reports which had been previously required before payment. In addition, to ease the drain on the working capital of the general supply fund, we recently have worked out an agreement under which DOD makes cash

advances equivalent to 60 days' purchases from the fund. (See p. 380.)

The increases in military business experienced by GSA over the past few years are primarily due to stronger policies issued by DOD in February 1961, which required all military departments to utilize GSA's supply programs as a primary source of supply for items not under central military management. This has produced significant increases in our stores depot and Federal supply schedule programs.

#### VOLUME OF PROCUREMENT

This year our volume of procurement of common use items will reach \$1.325 billion, almost double the \$716.5 million volume of 1958. In 1968 it should be in excess of \$2 billion. These figures include procurement by GSA for its stores depot and direct delivery purchase programs, as well as orders placed by other Government agencies against our Federal supply schedule contracts.

In our stores depot program, we shipped 6.7 million line items in 1962, over twice as many as in 1958. Our inventory will reach some \$115 million this year. Despite the growth in stores volume, our level of service has actually improved, while costs have been appreciably reduced.

For example, stores operating costs per \$100 of sales dropped from \$5.09 in 1958 to \$4.53 in the first half of this year. Our back orders dropped from 10.8 percent of line items received to 5.9 percent, and the number of days of work-in-progress was reduced to 5.3 days from 8.8 days over the same period.

Our firm policy is to use Government-owned warehouse space wherever it is economically feasible. Of the 8.7 million square feet in use by the Federal Supply Service during 1962, 22 percent was leased and it is our intent to convert this to Government-owned space as rapidly as possible, much of which is expected to be available in phased out military installations, as is the case with respect to much of the Government-owned space presently occupied.

Chairman DOUGLAS. You have negotiations, do you, to take over some of the warehousing space that will be vacated by the military?

Mr. BOUTIN. We do this practically on a day-to-day basis. We review our requirements with Mr. Morris' office as we get their projections of when they are going to phase out entire military depots or bases or many have free space. I could cite a couple of examples.

In Fort Worth, Tex., we had a bad situation where we were paying high rentals. At the Fort Worth General Depot they had some space which was available. We converted that space to our requirements and moved in.

Albany, Ga., General Depot was exactly the same thing.

Chairman DOUGLAS. Very good.

#### CATALOGING CIVILIAN ITEMS

Mr. BOUTIN. A new approach to the cataloging of civilian agency items has been initiated whereby GSA will restrict its efforts to cataloging only new items being procured for stock and existing items which are being restocked. This approach will preclude the cataloging of items in civil agencies supply systems which become obsolete and are being deleted at the rate of about 30,000 per year.

To assist in the gold-flow problem, we are working closely with the military agencies in their efforts to channel procurement to U.S. sources. We have established a customer sales center at Sembach Air Force base in Germany to provide quick support on the many items in the GSA supply system produced in the United States.

We also arranged for supporting Army oversea installations with many common-use items and for restricting awards for household and quarters furniture for Far East Air Force bases to domestic sources. These actions will contribute substantially to the U.S. balance of payments.

Specific purchasing and contracting techniques have been developed to meet the basic objectives of GSA's supply programs which are (1) continuity of supply, (2) short leadtime, (3) flexibility to meet changing requirements, and (4) advantageous prices.

#### COOPERATION WITH BUSINESS

It is our practice to utilize a method of term contracting in stores item buying which provides a contract source against which orders may be placed as requirements arise.

This has been advantageous to both the Government and supplier, enables GSA to minimize its inventories, and still provide rapid service. The contractor is in a position to commit raw materials, organize production schedules, avoid overtime to meet delivery schedules for large quantities, reduce the cost of production, and permits the contractor to meet Government delivery requirements on a businesslike basis without jeopardizing commercial accounts.

This system has been effective with regard to most volume stock items and has produced advantageous prices as well as promoting industry confidence in doing business with the Government on a sound and realistic basis.

We have achieved a situation analogous to that which commercial firms normally establish with respect to continuing supply relationships.

In other words, we do business with industry on a basis to which they are accustomed and need not adjust in order to deal with the Government.

The same term contracting method has recently been applied successfully to items delivered directly to using agencies, such as appliances, furniture, heavy duty storage racks, wire rope, and so forth.

#### COMPETITIVE BID PROCEDURE

Chairman DOUGLAS. May I ask a question there? This is a fairly obvious one. Do you practice what we have been preaching of competitively bid prices or contracts rather than negotiated contracts?

Mr. BOUTIN. We certainly do, Mr. Chairman. Since I have been Administrator, I have placed a great deal of emphasis on this.

Our experience as of right now with respect to direct purchases is 78 percent by competitive bid, 22 percent by negotiation.

But that 22 percent should be qualified because this includes the set-asides for small business. So actually, in pure negotiations we are doing very, very little.

Chairman DOUGLAS. Very good.

Mr. BOUTIN. However, in buying vehicles, bulk paper products, and other items where close production scheduling is essential to attract-

ing advantageous prices, consistent with normal industry practices, definite quantity procurements are made.

Term contracts are also utilized in connection with the Federal supply schedules program where using agencies place orders directly against contracts made by GSA.

These contracts take full advantage of industry distribution systems in meeting Government supply needs and minimize the necessity for Government distribution of the items involved.

Here, again, the Government is doing business with industry on the same basis as industry does business with its other customers.

Adequate provisions is made for using agencies to make direct purchases for emergency needs.

#### 80 PERCENT DIRECT DELIVERY

Taken on a total basis, approximately 80 percent of GSA's buying programs provide for direct delivery from the supplier to use point. This has resulted from a policy of designing our programs to make items available at the point of use when needed at the lowest overall cost to the Government, utilizing industry distribution to the maximum extent feasible and not undertaking distribution through Government warehouse systems unless overall advantages will accrue.

Our Office of Procurement and Economic Policy plans, directs, and coordinates a Government-wide program, pursuant to section 201 of the act, for the establishment of uniform policies and procedures applicable to the procurement of personal property and nonpersonal services, including construction.

These policies and procedures are published as Federal procurement regulations in title 41 of the Code of Federal Regulations.

Such regulations (FPR), together with regulations of agencies implementing FPR, comprise the Federal procurement regulations system which is administered by GSA.

The regulations, encompassing all legal, economic, and social requirements of Government contracting law and policy, are developed in cooperation with all procurement executive agencies and SBA, BOB, and GAO, as well as, where appropriate, with private industry and industry associations.

Particular close coordination is achieved between GSA and DOD in the development and maintenance of FPR and the armed services procurement regulation (ASPR) in order that maximum uniformity may be had throughout all military and civilian agencies in procurement policies and procedures.

#### FEDERAL PROPERTY UTILIZATION PROGRAM

One of the primary objectives of GSA is to attain maximum utilization of Federal property within the Government. We have streamlined our procedures to improve the screening of excess property to determine its usability and to increase utilization by Federal agencies.

Further emphasis is being placed on the utilization of excess inventories held by Government contractors. The volume so transferred is expected to increase to \$575 million at acquisition cost in 1964 compared to \$389.1 million in 1961.

In disposing of surplus real property, GSA makes every effort to effect such disposals in a manner calculated to aid the economy of the communities where such properties are located.



Through coordination with the reporting agencies, particularly the Department of Defense, advance notices of large properties which will become excess to the needs of the particular agency are given to GSA.

Large high-cost industrial properties, most of which are reported by DOD, continue to be the dominant type of real property reported excess by executive agencies.

These properties, many of which have limited potential for further utilization, present special disposal problems both to GSA and to the communities in which the properties are located.

These problems are being resolved by close cooperation with the communities, and by coordination with DOD and other agencies determining such properties excess well in advance of deactivation, in order to lessen the economic impact of changed use and ownership to the greatest extent possible.

#### ECONOMIC IMPACT OF INDUSTRIAL PROPERTY SALES

For example, during calendar year 1962, 26 industrial-type properties were sold to user-buyers with an employment potential of 27,000 people, thereby doing much to offset the adverse economic impact of Government closure of the installations.

Representative CURTIS. Those properties are then returned to the tax base?

Mr. BOUTIN. That is right.

Representative CURTIS. The local tax base?

Mr. BOUTIN. That is correct.

Since 1956, GSA has recovered an average of 110-percent return on the appraised fair market value of real property sold.

Chairman DOUGLAS. How does that compare with original cost?

Mr. BOUTIN. It is about 15-percent overall average.

Chairman DOUGLAS. Of original cost?

Mr. BOUTIN. Yes.

Chairman DOUGLAS. So there has been a loss of 85 percent?

Mr. BOUTIN. I think it would be well to qualify that. This is the overall percentage. As long as the bulk of the properties coming to us are industrial in nature, this will continue.

But on a great many of the properties, airbases are very good examples, where you have great appreciation in land value, we are actually showing a profit including the total Government investment in improvements.

Chairman DOUGLAS. Very good.

Representative CURTIS. I have a question here.

Of course, some of this will go under your 50-percent disposition when it goes to a municipality or a charitable organization.

How do you calculate that? Maybe you would not be including those. Like a hospital?

Mr. BOUTIN. Those are not included. Any of the donation programs like park and recreation at 50-percent discount, wildlife conservation could at a hundred-percent donation, education, hospital requirements at whatever discount is set by the Department of Health, Education, and Welfare, up to a hundred percent, these disposals are not included in our calculation of sale return.

Representative CURTIS. They would not be calculated?

Mr. BOUTIN. They are not.

## JOINT GSA/DOD PROGRAM FOR SCREENING EXCESS PROPERTY

Subsequent to the hearings held by your subcommittee in January 1960, agreements were consummated with DOD (1) in regard to utilization screening of excess DOD personal-property line items of less than \$3,000 acquisition cost under which there is a simultaneous utilization screening among both military and civil activities with DOD having priority rights of selection, the objective of the program was to reduce materially the DOD costs of paper processing, catalog preparation, and circularization and increase utilization, and (2) on September 1, 1961, a new program was initiated which established a uniform and systematic procedure for the utilization screening among military and civil agencies of unneeded items of contractor inventory; both agencies regard the new program as successful; Federal utilization of excess contractor inventory has risen substantially, as a result of the agreement, from \$42 million in fiscal year 1962, to \$49.8 million in the first 8 months of fiscal year 1963.

A joint DOD-GSA team has just completed studying the feasibility of consolidating in GSA the function of selling DOD personal property, heretofore performed by DOD under a delegation of authority from GSA. The goals being sought are:

1. Overall cost reduction.
2. Uniformity in sales methods throughout Government.
3. One bidders list for all Government sales which would benefit the buying public and increase participation.
4. Single-point responsibility for sales and sales analysis.
5. Elimination from DOD of a nonmission function.
6. Reduction in the number of management levels in sales programs.

Agreement has been reached with DOD on this matter and the proposal is presently under evaluation by the Bureau of the Budget.

## TELECOMMUNICATIONS SYSTEM

We have established the Civil Agency Telecommunications System designed to connect over 8,000 Government offices in more than 1,700 cities and towns throughout the United States and its possessions.

Direct dialing through strategically located switching centers and increased capability to handle the rapidly rising communications volumes are being made possible through this system and are expected to produce substantial savings to the Government.

Chairman DOUGLAS. Do I understand that this is independent and outside of the interconnected system which is largely run by A.T. & T.?

Mr. BOUTIN. Yes. These are exclusive Government-use lines, Mr. Chairman. Under the Telpak we are able to reduce substantially our costs by bringing within Telpak the circuitry required for Federal utilization.

These are exclusive use. We have dramatically reduced the costs and we have absolute security on these lines, which is certainly in the public interest as well.

## ESTIMATED SAVING

Chairman DOUGLAS. Have you any estimate on the reduction in cost?

Mr. BOUTIN. We estimate that initially the reduction in cost is going to be about \$7 million a year.

However, the work that we are now doing with DOD to bring their system, and the system for which we have responsibility on the civil side of the Government, into compatibility. We are working together on joint procurement. We have a team at Scott Field right now working with the DOD people. The actual potential is closer to \$30 million a year in savings.

Chairman DOUGLAS. Thank you.

Mr. BOUTIN. On February 15, 1963, the first phase of the nationwide circuit-switching system was accomplished with the interconnection of 42 major metropolitan areas.

This will be extended to an additional 308 cities and towns by the end of fiscal year 1964. Centralized procurement of circuits for civil agencies is well underway and is expected to produce approximately \$7 million in annual savings.

Magnitude and growth of our communications functions is illustrated by transmission of 63 million words in 1963, as compared to 41 million 10 years earlier.

Chairman DOUGLAS. As a matter of curiosity, how do you measure your words over the telephone?

Mr. BOUTIN. We actually keep a record of the number of words going over our teletype system. This is teletype rather than voice. We are able to have an actual measurement.

Similarly, telephone stations served doubled from 65,000 to 112,000 in the same period.

#### PROCUREMENT OF UTILITY SERVICES

There is cooperative action between GSA and Federal agencies, including DOD, in the communications and utility procurement areas. In the utility field this is done through an interagency public utilities committee. In communications there are four groups of GSA/DOD personnel working on problems of interconnection and compatibility of systems.

Also, GSA/DOD have joint staffs at Scott Field engaged in procurement of communications Telpak circuits for all agencies of the Government as a single customer, expected to obtain additional savings which may amount to as much as \$4 million per year.

In transportation, Federal civilian agencies utilize the traffic management assistance program of GSA, which includes furnishing of tariff information, negotiation of freight rates and transportation contracts, assistance in shipping operations, and seminar training of personnel engaged in transportation operations. Such services by GSA resulted in transportation savings of \$16.9 million in 1962.

The 1954 exemption by the Secretary of Defense of DOD transportation operations from the Federal Property and Administrative Services Act discussed in the subcommittee's October 1960 report remains in effect.

#### MANAGEMENT OF STRATEGIC AND CRITICAL MATERIALS

GSA plays a key role in achievement of certain national defense goals by management of the strategic and critical materials stockpiling programs. The stockpile inventories of 98 materials bulking more than 50 million tons has an acquisition value of \$3.8 billion.

GSA's management of these inventories must be carefully planned so as to assure the orderly flow of materials in and out of these inventories without disrupting normal markets and prices.

Chairman DOUGLAS. You manage these strategic materials?

Mr. BOUTIN. These are all, Mr. Chairman, in the custody of GSA. We only dispose of them, however, upon receipt of directives from the Office of Emergency Planning and many of these require agreement to the disposal by the Congress.

Chairman DOUGLAS. Who authorizes the purchase?

Mr. BOUTIN. The purchase in each one of these has been authorized specifically by Congress either under omnibus legislation or specific legislation.

There is a difference with respect to strategic and critical materials acquired under the Defense Production Act and under other acts. The days of acquisition, might I say, are just about over.

#### COPPER AND ALUMINUM CONTRACTS STILL RUNNING

We have two active DPA contracts that still have some time to run. We have a few items—

Chairman DOUGLAS. Is it classified as to what materials these are for?

Mr. BOUTIN. No, not at all. One of the contracts is with Harvey Aluminum and the other is Hanna Nickel Co. Nickel and aluminum are the two materials.

Chairman DOUGLAS. You are not buying any copper?

Mr. BOUTIN. No.

Chairman DOUGLAS. No zinc?

Mr. BOUTIN. No.

Chairman DOUGLAS. No lead?

Mr. BOUTIN. No, we are not, although on lead and zinc, as the chairman knows, there is a subsidy program where we, under direction of the Department of the Interior, actually carry out the responsibilities.

But this is a straight subsidy. No inventory coming into us at all.

Chairman DOUGLAS. Fluorspar?

Mr. BOUTIN. Nothing at all. The only thing we are buying right now is jewel bearings where we have a shortage and this is in connection with the plant at Rolla, N. Dak.

Representative CURTIS. Congress may have voted, but it is on the recommendation of the executive, and which department of the executive makes the recommendations? Is it always the same?

Mr. BOUTIN. Office of Emergency Planning.

Representative CURTIS. In all instances?

Mr. BOUTIN. In all instances, yes.

#### IMPACT OF DISPOSAL PROGRAMS

The disposal of excess strategic and critical materials is important to the national economy and is administered so as to stimulate economic growth.

The magnitude of the economic impact of the disposal program is evidenced by the fact that present inventories of excess materials have a value of \$3.4 billion.

Through December 31, 1962, sales totaling \$470 million have been made since 1955 under approved disposal plans. With the establish-

ment of the long-range disposal policy by the President, and new legislation anticipated to result from the recent Senate committee hearings, it is reasonable to assume that future releases from the stockpile will be accelerated.

In the past 2 years, GSA has emphasized the use of excess materials by all Federal agencies to avoid expenditure of dollars for such materials and thereby reduce gold outflow.

As a major procurement agency using stockpile materials, DOD can be of vital assistance to GSA in disposal of excesses. On the basis of agreements already concluded, our Government-use program for 1963 envisages purchases of stockpile excesses by DOD of approximately \$8 million; \$6.5 million by the Bureau of the Mint; and \$20 million under the foreign-aid program.

It is anticipated that these utilization programs will be further increased in the coming years when the benefits of the long-range programs approved by the President are fully realized.

We also have had a continuing program to maintain our stockpile inventories at the least cost consistent with security considerations. In line with this principle, we store our materials in Government-owned space to the maximum extent possible.

During the past 2 calendar years we have gotten out of six commercial warehouses at a saving of \$106,000 annually. Where feasible, we jointly occupy existing military operated depots, and use facilities declared excess by the military or existing GSA facilities.

Closed storage space presently occupied totals 22.9 million square feet of which 7.2 million is at military depots, 13.4 million in GSA facilities, and 2.3 million, 10 percent, is commercially leased.

I might say to the committee it is my intention that over the next 2-year period we will be out of every single lease facility that we have right now in commercial warehouses.

#### NATIONAL INDUSTRIAL EQUIPMENT RESERVE

In addition to these programs, GSA provides support to DOD in operation of the national industrial equipment reserve (NIER) which provides the nucleus of machine tools for expansion of essential defense industries.

About 9,300 items, costing \$92.2 million are currently being stored in 3 depots maintained by GSA, and in various military depots under GSA/DOD cross-servicing arrangements.

#### SPACE MANAGEMENT

GSA is currently working with Federal agencies to achieve improvements in space management and utilization within the framework of Executive Order 11035, issued by President Kennedy on July 9, 1962, which strengthened our authority in this area.

In addition, we have developed, and are implementing, a system utilizing our computers to provide needed data to management on a timely basis with respect to the current assignment and use of space in Government-owned and leased buildings managed by GSA in some 10,000 locations.

By perfecting and utilizing these new management tools we expect to accomplish significant improvements in our space management program, including ultimate savings in the magnitude of \$3 to \$5 million annually from improved space utilization.

Since enactment of the Public Buildings Act of 1959, 157 public buildings projects estimated to cost \$1.35 billion have been authorized as well as 110 alteration projects costing \$221.1 million.

The completion and occupancy of new and altered Federal buildings made possible under the foregoing program enables us to progressively carry out a policy of meeting the requirements for new or badly needed replacement space in Government-owned rather than leased space.

Continuous efforts have been made to effect better manpower utilization in building operations. Since 1956, our total space workload has grown from 100.7 to 141.6 million net square feet in 1962, or a 41 percent increase during which period the related employment has increased only 2.5 percent.

As a result of improved manpower utilization and increased productivity, we estimate that by the end of 1964, there will be one building employee for each 7,221 square feet of space, compared with 5,201 square feet in 1956.

As early as 1952 a start was made to automate some of our operations on a small scale using punched-card (IBM) equipment for supply and accounting operations.

The automation process has improved through the years so that we now have uniform electronic computer equipment and procedures in our 10 regional offices.

The applications cover a wide variety of our operations such as supply management, buildings, and space management, transportation, accounting, personnel, and stockpile inventories.

In addition to making major contributions to efficient business management of GSA activities, our automation enabled us to cooperate with DOD in the installation of its uniform milstrip and milstamp systems discussed above.

#### AUTOMATION REDUCES UNIT COSTS

Automation has materially contributed to the previously discussed increased productivity and lower unit costs of operation.

Other examples include a 258-percent increase in store sales over the past 10 years while unit costs per \$100 of sales decreased almost 50 percent; accounting documents processed per man-year increased from 2,134 in 1957 to 6,057 in 1962 with a resultant decrease of 231 man-years in staffing; invoice payments processed per man-year increased from 2,350 in 1957 to 4,665 with the result that in 1962 we processed about twice the workload volume with about 11 percent less staff; the cost of payrolling an employee decreased from \$16.79 in 1957 to \$13.49 in 1962, a decrease of almost 20 percent.

In addition to our utilization of excess DOD facilities for storage of supplies, stockpile materials, and civil defense survival items, the transfer of certain functions to GSA resulted in related transfer of the following facilities, funds, and personnel since the January 1960 hearings:

A. Murphy General Hospital—49 buildings with 219,000 square feet. This facility is now occupied by DOD and civilian agencies.

Chairman DOUGLAS. Was this or is this located in Attleboro, Mass.?

Mr. BOUTIN. This is located in Waltham, Mass.

Chairman DOUGLAS. This rings a familiar bell in my memory because I tried to get this hospital closed for many years with a great lack of success. It has been closed now.

Mr. BOUTIN. We are using it entirely for housing Federal agencies. It has been converted to office use and is doing a great job for us. We have made very good use of this facility.

B. Kansas City Records Center—20 buildings with 1,155,600 square feet, 21.7 acres of land, and 145 employees.

C. St. Louis Area Support Center—2 buildings with 892,414 square feet, 3.5 acres of land, and 88 employees.

D. Military Personnel Records Center, St. Louis, Mo.—Buildings, grounds, equipment, and supplies valued at \$19,797,027 and 831 employees.

PROGRESS SINCE 1960

Thus, Mr. Chairman, we feel that since January 1960 substantial progress has been made with respect to GSA-DOD relationships in the areas of supply, procurement, communications, surplus property, records, and other areas of mutual interest.

Through our continued joint efforts and cooperation, further progress in these important areas will be made in the months ahead.

Indeed we are presently engaged in further negotiations with DOD with respect to these mutual areas of interest and we have every reason to believe that these negotiations will produce additional economies and benefits to the Federal Government.

As previously stated, much remains to be accomplished. This applies not only to our ability to materially contribute to the economy and efficiency of the military procurement and supply operations, but also to such functions as they involve civilian agency requirements.

The rapid expansion programs of a number of such civilian agencies afford real opportunity for GSA to provide logistics and other support to the overall advantage of the Government.

Such opportunities for improving economy and efficiency now under study or discussion include merger into the GSA supply distribution system of the supply and distribution functions and oversea supply depots of several other civilian agencies.

Mr. Chairman and members of the subcommittee, I wish to express my sincere appreciation for the opportunity you have afforded me to discuss with you our programs and accomplishments over the past few years and our plans for the future.

(The tables referred to follow :)

GENERAL SERVICES ADMINISTRATION, SELECTED STATISTICS, JULY 1, 1952-  
JUNE 30, 1962

SOURCE OF DATA

This publication contains selected financial and operating statistics covering GSA's operations and growth for the fiscal years 1953-62. These statistics are presented for each GSA "service" by major program activity.

Financial data and related operating statistics, where applicable, are based on actual year data contained in budget justifications submitted to the Bureau of the Budget. Data not contained in budget submissions are based on other official published financial and operating reports.

As indicated by appropriate footnotes, data for fiscal year 1962 and prior years have been adjusted to show comparative transfers to transportation and communications service and utilization and disposal service, both of which were established subsequent to June 30, 1961.

TABLE 9  
Public Buildings Service—Selected statistics, fiscal years 1953-62

[In millions]

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Operating expenses—Obligations:										
Operating expenses, PBS.....	\$94.1	\$91.8	\$106.4	\$106.6	\$114.4	\$130.5	\$139.9	\$150.1	\$164.6	\$179.5
Emergency operating expenses.....	\$27.2	\$19.6								
Repair and improvement:										
Obligations.....	\$17.9	\$18.3	\$18.2	\$33.1	\$45.8	\$76.0	\$75.9	\$53.1	\$61.2	\$62.6
Workload (square feet).....	99.3	102.3	105.0	108.5	111.2	114.4	114.4	115.6	121.4	128.5
Buildings management:										
Income by source:										
Operating expenses, PBS.....				\$108.3	\$116.3	\$129.0	\$135.2	\$142.2	\$156.9	\$168.6
Repair and improvement.....	(?)	(?)	(?)	6.9	10.2	29.0	24.1	14.0	14.2	16.2
Other GSA funds.....				7.6	9.5	8.0	9.8	9.4	9.1	10.6
Other agencies.....				47.8	51.7	55.6	70.3	81.7	84.6	90.9
Total.....	\$162.2	\$156.3	\$153.3	170.6	187.7	221.6	239.4	247.3	264.8	286.3
Expense by type:										
Government-owned space.....	46.3	59.3	60.2	66.4	62.6	81.5	89.7	94.5	111.7	118.6
Leased space.....	76.2	68.9	61.2	62.4	66.4	73.2	80.4	86.9	88.5	96.1
Communication.....	12.9	12.0	12.9	14.4	15.4	17.0	19.4	21.2	22.8	26.7
Other.....	26.6	16.2	19.5	27.2	43.1	49.5	49.8	44.5	42.6	44.3
Total.....	162.0	156.4	153.8	170.4	187.5	221.2	239.3	247.1	265.6	285.7
Buildings management workload (average net square feet):										
Government-owned space—Financed by:										
Operating expenses (see above).....	56.2	56.3	56.4	56.4	54.9	54.9	55.1	57.7	62.9	69.2
Other agencies and other GSA funds.....	10.8	9.1	9.7	10.9	14.6	19.3	22.9	26.0	29.9	35.5
Total.....	67.0	65.4	66.1	67.3	69.5	74.2	78.0	83.7	92.8	104.7
Leased space—Financed by:										
Operating expenses (see above).....	31.5	28.1	23.7	20.3	20.5	21.4	22.0	22.1	22.0	24.0
Other agencies and other GSA funds.....	7.2	10.7	12.1	13.1	13.5	14.4	14.5	14.0	13.9	13.0
Total.....	38.7	38.8	35.8	33.4	34.0	35.8	36.5	36.1	35.9	37.0
Total, all space.....	105.7	104.2	101.9	100.7	103.5	110.0	114.5	119.8	128.7	141.7



Construction:										
GSA direct:										
Construction:										
Appropriations.....	11.4	1.2	3.0	5.7	0.5	3.9	173.1	166.0	215.4	
Obligations.....	8.0	8.2	18.6	4.3	5.5	4.1	55.0	95.7	127.4	
Sites and expenses:										
Appropriations.....				15.0	5.0	20.3	39.9	25.0	21.0	
Obligations.....	.2	.1	.2	3.6	13.2	7.9	80.3	8.8	18.9	
Payments, purchase contracts:										
Appropriations.....					.2	1.3	.5	1.7	4.0	
Obligations.....						.1	.1	1.3	3.7	
Transfer to GSA—Construction:										
Appropriations.....	14.0	4.1	7.1	17.5	65.4	43.5	133.4	24.3	56.1	
Obligations.....	11.1	6.7	7.6	14.5	59.5	39.6	85.8	46.6	62.6	
Number of employees, end of year: <sup>1</sup>										
Central office.....	381	304	303	329	367	439	453	422	446	
Field.....	21,994	20,376	19,316	19,588	19,786	19,936	19,873	20,045	20,490	
Total.....	22,375	20,680	19,619	19,917	20,153	20,375	20,326	20,467	20,936	
									434	
									* 19,973	
									20,227	

<sup>1</sup> Adjusted to show comparative transfers to "Expenses—Utilization and Disposal Service," and "Operating expenses—Transportation and Communications Service."

<sup>2</sup> Not available.

\* Adjusted to show transfers to "Transportation and Communications Service."

TABLE 10

## Federal Supply Service.—Selected statistics, fiscal years 1953-62

[Dollar amounts in millions]

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Stores depot sales, including fuel.....	\$54.7	\$52.8	\$75.9	\$96.4	\$116.4	\$120.7	\$145.5	\$154.3	\$183.2	\$229.6
Direct delivery sales, including items paid direct by using agency.....	\$113.7	\$96.0	\$148.2	\$112.8	\$148.0	\$140.5	\$176.7	\$153.1	\$160.3	\$174.0
General supply fund inventories, end of year.....	\$27.2	\$21.4	\$26.3	\$29.8	\$37.1	\$41.1	\$53.1	\$55.5	\$66.3	\$94.8
Federal Supply schedule purchases.....	\$311.2	\$275.0	\$308.9	\$333.2	\$373.7	\$411.3	\$511.7	\$540.2	\$644.8	\$697.1
Operating expense obligations:										
Expenses, Supply Distribution.....	\$13.5	\$13.8	\$13.1	\$15.0	\$16.1	\$18.5	\$20.9	<sup>1</sup> \$22.1	<sup>1</sup> \$24.9	\$30.1
Operating expenses, FSS: <sup>2</sup> Definite—Appropriation.....	\$1.8	\$1.6	\$2.0	\$2.6	\$3.0	\$3.4	\$3.7	<sup>1</sup> \$2.9	<sup>1</sup> \$3.4	<sup>3</sup> \$4.0
Other—Advances and reimbursements.....	\$0.2	\$0.2	\$1.3	\$1.7	\$2.0	\$2.8	\$3.5	\$3.5	\$4.1	\$3.8
Number of employees, end of year: Expenses, Supply Distribution:										
Central office.....	145	138	142	268	300	319	297	343	375	433
Field.....	1,642	1,286	1,478	1,479	1,497	1,464	1,522	1,553	1,753	2,120
Total.....	1,787	1,424	1,620	1,747	1,797	1,783	1,819	1,896	2,128	2,553
All other: <sup>3</sup>										
Central office.....	88	96	106	202	247	246	254	209	249	308
Field.....	180	265	289	279	321	342	387	374	465	605
Total.....	268	361	395	481	568	588	641	583	714	<sup>4</sup> 913
Total, Federal Supply Service: <sup>3</sup>										
Central office.....	233	234	248	470	547	575	563	568	638	741
Field.....	2,131	1,825	1,930	1,959	2,102	2,144	2,284	2,370	2,703	2,725
Total.....	2,364	2,059	2,178	2,429	2,649	2,719	2,847	2,944	3,341	3,466

<sup>1</sup> Reflects transfers of costs of buying and inspection relating to Federal Supply schedules from "Operating expenses, FSS" to "Expenses, Supply Distribution."

<sup>2</sup> Adjusted to show comparative transfers to "Operating expenses, Utilization and Disposal Service."

<sup>3</sup> Adjusted to exclude costs for "Motor vehicle management" transferred to "TCS" and "Property rehabilitation" transferred to U. D. S.

<sup>4</sup> Includes 322 employees assigned to OCDM warehousing program. Transferred to DMS in August 1962.

TABLE 11

## Defense materials service—Selected statistics, fiscal years 1953-62

[Dollar amounts in millions]

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
<b>All programs:</b>										
Inventories, end of year:										
National stockpile.....	\$3,966.8	\$4,679.0	\$5,399.7	\$5,717.2	\$6,041.8	\$6,169.0	\$6,216.2	\$6,153.5	\$6,107.2	\$6,049.6
Supplemental stockpile.....					216.6	291.9	604.1	754.2	950.6	1,141.1
Defense production.....	102.8	374.3	441.7	567.2	679.6	1,140.1	1,368.2	1,448.7	1,482.9	1,495.8
Department of the Interior.....					17.9	23.0				
RFC/FFC.....					9.2	9.5	9.5	9.5	9.5	
Commodity Credit Corporation.....			49.3	162.6	143.5	226.5	98.5	119.1	108.8	99.9
<b>Total.....</b>	<b>4,069.6</b>	<b>5,053.3</b>	<b>5,890.7</b>	<b>6,447.0</b>	<b>7,108.6</b>	<b>7,860.0</b>	<b>8,296.5</b>	<b>8,485.0</b>	<b>8,659.0</b>	<b>8,786.4</b>
Number of storage locations, end of year (excludes NIER).....	318	313	273	242	224	216	217	215	213	208
<b>OCDM warehousing:</b>										
Warehouses in operation.....	9	10	15	18	21	24	23	22	22	25
Inventory, end of year.....	\$34.0	\$51.0	\$58.5	\$78.3	\$85.0	\$96.2	\$99.5	\$99.5	\$100.8	\$117.5
<b>Strategic and critical materials: Expenses—Obligations:</b>										
New materials purchases.....	\$280.1	\$211.3	\$580.8	\$229.4	\$191.2	\$80.8	\$4.3	\$1.6	\$0.6	\$1.0
Upgrading of materials.....						2.3	4.5	0.6	3.6	.4
Rotation purchases.....		54.5	58.2	90.1	70.2	40.2	48.1	14.4	8.5	13.4
Storage, industrial equipment, and operating expenses.....	22.1	26.9	21.0	17.2	18.2	20.3	25.1	19.0	17.6	17.1
<b>Total.....</b>	<b>302.2</b>	<b>292.7</b>	<b>660.0</b>	<b>336.7</b>	<b>279.6</b>	<b>143.6</b>	<b>82.0</b>	<b>35.6</b>	<b>30.3</b>	<b>31.9</b>
<b>Defense Production Act:</b>										
Cumulative gross transactions contracted, end of year.....	\$6,468.5	\$6,356.4	\$7,187.2	\$7,113.3	\$7,315.9	\$7,550.1	\$7,489.9	\$7,492.7	\$7,481.3	\$7,508.7
Deliveries of strategic materials.....	\$189.7	\$397.3	\$482.0	\$266.7	\$216.2	\$495.2	\$246.6	\$135.1	\$72.0	\$57.0
Gross expenditures for operations.....	\$299.8	\$484.2	\$544.6	\$349.6	\$281.7	\$552.0	\$310.1	\$224.1	\$163.8	\$129.9
<b>Number of employees, end of year:</b>										
Central office.....	287	297	251	248	233	214	176	152	143	127
Field.....	429	394	400	398	685	595	553	513	525	482
<b>Total.....</b>	<b>716</b>	<b>691</b>	<b>651</b>	<b>646</b>	<b>918</b>	<b>810</b>	<b>729</b>	<b>665</b>	<b>668</b>	<b>609</b>

TABLE 12  
*National Archives and Records Service—Selected statistics, fiscal years 1953-62*

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
All records centers (thousand cubic feet):										
Accessions.....	695	739	710	753	643	597	705	701	744	819
Disposals.....	88	175	251	293	331	351	410	416	587	550
Inventory, end of year.....	1,881	2,439	2,886	3,337	3,623	3,840	5,134	5,764	6,735	6,950
Reference services (thousands):										
Regional centers.....	384	698	899	1,226	1,663	1,944	2,621	2,946	2,972	3,110
National personnel records centers.....	518	582	601	642	685	559	630	483	1,842	1,764
Total operating expenses—Obligations (millions).....	\$4.9	\$6.2	\$6.3	\$6.6	\$7.0	\$7.9	\$9.1	\$9.4	\$14.2	\$13.9
All records centers.....	2.7	3.4	3.4	3.8	4.0	4.2	4.8	5.0	8.9	8.6
All other activities.....	2.2	2.8	2.9	2.8	3.0	3.7	4.3	4.4	5.3	5.3
Total number of employees, end of year.....	930	931	935	985	1,009	1,125	1,190	1,203	1,885	1,891
All records centers.....	522	534	534	584	590	680	658	655	1,308	1,306
All other activities.....	408	397	401	401	419	445	532	548	577	585
Central office.....	368	360	364	365	385	410	499	494	493	543
Field.....	562	571	571	620	624	715	691	709	1,392	1,348

TABLE 13

Transportation and Communications Service <sup>1</sup>—Selected statistics, fiscal years 1953-62

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Regulatory proceedings:										
Transportation cases:										
Entered.....		4	5	7	21	16	9	12	9	24
Concluded.....	2	3	3	6	7	18	7	11	14	4
Pending, end of year.....	4	5	7	8	22	20	22	23	18	16
Utility cases—GSA:										
Entered.....	4	3	1		6	7	2	5	4	5
Concluded.....	6	1	3	1	2	3	3	7	4	2
Pending, end of year.....	2	4	2	1	5	9	8	6	4	9
Utility cases—Delegated.....						2		10	11	9
Communications; including SAGE cases:										
Entered.....					2	1	3	7	9	2
Concluded.....								2	3	2
Pending, end of year.....					2	3	6	9	15	15
Estimated freight savings (in millions).....	\$4.6	\$6.6	\$8.1	\$9.3	\$9.7	\$12.1	\$16.9	\$15.6	\$24.1	\$16.9
Interagency motor vehicles pools: <sup>2</sup>										
Studies completed (cumulative).....			2	14	29	42	56	68	80	80
Pools activated (cumulative).....				12	22	33	44	56	60	66
Operating expense:										
Total obligations in thousands.....	\$1,284	\$1,399	\$1,579	\$1,694	\$1,959	\$2,515	\$2,995	\$2,977	\$3,305	\$4,046
Operating expenses.....	1,284	1,399	1,573	1,672	1,829	2,305	2,758	2,755	3,057	3,807
Other.....			6	22	130	210	237	222	248	239
Number of employees, end of year:										
Regular:										
Central office.....	137	147	178	163	193	214	193	165	165	190
Field.....	85	89	90	101	98	125	125	169	168	183
Total.....	222	236	268	264	291	339	318	334	333	373
General Supply Fund: <sup>3</sup>										
Central office.....						10	12	16	14	12
Field.....	309	274	163	201	284	338	375	449	485	502
Total.....	309	274	163	201	284	348	387	465	499	514
Buildings management fund, <sup>4</sup> field.....										1,274
Total, Transportation and Communications Service:										
Central office.....	137	147	178	163	193	224	205	181	179	202
Field.....	394	363	253	302	382	463	500	618	653	1,959
Total.....	531	510	431	465	575	687	705	799	832	2,161

<sup>1</sup> Established in fiscal year 1962.<sup>2</sup> Transferred from Federal Supply Service during fiscal year 1962.<sup>3</sup> Includes transfer from FSS and PBS for "Motor vehicle" and "Communications management," respectively.<sup>4</sup> Telecommunications function transferred from Public Buildings Service during fiscal year 1962.

**TABLE 14**  
*Utilization and Disposal Service—Selected statistics, fiscal years 1953-62*

[Dollar amounts in millions]

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
<b>Real property:</b>										
Excess property, acquired cost:										
Excess workload for year.....	(1)	\$212	\$191	\$333	\$184	\$449	\$671	\$1,131	\$998	\$1,162
Utilization transfers.....	\$5	13	87	11	6	32	16	10	79	87
Withdrawn by holding agency.....	(1)	4	9	8	7	11	13	24	8	10
Determined surplus.....	(1)	132	57	261	96	312	427	766	545	657
Inventory end of year.....	88	63	38	53	75	94	215	331	366	408
Surplus property, acquired cost:										
Surplus workload for year.....	275	322	278	417	358	460	704	1,293	1,376	1,398
Sold.....	19	30	31	87	27	80	81	320	413	442
Donations.....	41	54	26	19	26	26	31	67	116	91
Recalled from surplus.....	8	3	39	5	12	16	7	29	27	100
Inventory end of year.....	208	235	182	306	293	338	585	877	820	765
Sales:										
Appraised FM value.....			\$7.5	\$26.4	\$9.7	\$31.1	\$27.1	\$71.4	\$71.6	\$71.5
Sales price.....	\$3.0	\$9.9	\$7.4	\$26.0	\$11.6	\$40.1	\$31.0	\$78.0	\$71.6	\$78.9
Percent return.....			98.7	108.3	119.6	128.9	114.4	109.2	100.0	110.3
Personal property utilization—Acquisition cost:										
Excess property workload.....	\$335.8	\$764.7	\$809.4	\$620.3	\$642.4	\$1,093.4	\$1,258.0	\$1,500.0	\$1,680.7	\$1,473.8
Utilization transfers.....	\$38.6	\$57.5	\$71.1	\$94.9	\$63.2	\$188.0	\$141.4	\$218.0	\$310.1	\$362.7
Donations.....	\$58.5	\$99.4	\$130.1	\$194.1	\$212.8	\$289.0	\$361.0	\$413.0	\$387.7	\$350.7
Usable property sold.....			\$2.3	\$2.3	\$2.0	\$11.7	\$19.3	\$17.1	\$24.4	\$39.8
Sales price.....			0.7	0.8	0.6	\$1.7	\$1.7	\$2.7	\$3.6	\$5.8
Percent return.....			30.4	34.8	30.0	14.5	8.8	15.8	14.8	14.6
Operating expenses—Costs: <sup>2</sup>										
Real property activities.....	\$2.3	\$2.6	\$1.5	\$2.7	\$2.3	\$2.3	\$2.4	\$3.6	\$3.6	\$4.0
Personal property activities.....	.6	.5	.6	.8	1.1	1.6	1.9	2.2	3.0	4.0
Subtotal.....	2.9	3.1	2.1	3.5	3.4	3.9	4.3	5.8	6.6	8.0
Expenses, disposal of surplus real and related personal property.....			.2	.3	.4	.7	1.0	1.9	1.2	1.2
Total.....	2.9	3.1	2.3	3.8	3.8	4.6	5.3	7.7	7.8	9.2
Number of employees, end of year: <sup>2</sup>										
Central office.....	30	30	37	50	71	71	82	87	96	122
Field.....	132	121	129	166	225	278	281	350	401	499
Subtotal.....	162	151	166	216	296	349	363	417	497	621
Reimbursable.....										5
Total.....	162	151	166	216	296	349	363	417	497	626

<sup>1</sup> Not available.

<sup>2</sup> Adjusted to show comparative transfers from "Operating expenses, Public Buildings

Service (real property)," and "Operating expenses, Federal Supply Service (personal property)."

TABLE 15

*Relationship of A.O. fund employment to total GSA employment—Selected statistics, fiscal years 1953-62*

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Total GSA employment.....	28,956	26,765	25,729	26,426	27,410	27,891	27,946	28,213	29,944	31,519
Total A. O. fund employment:										
Number.....	2,016	1,878	1,772	1,826	1,951	2,009	2,005	<sup>1</sup> 1,960	<sup>1</sup> 1,982	2,157
Percent of total GSA.....	7.0	7.0	6.9	6.9	7.1	7.2	7.2	6.9	6.6	6.8
Financial services.....	1,333	1,223	1,175	1,204	1,266	1,287	1,273	1,303	1,299	1,484
Legal services.....	112	106	96	97	117	125	126	131	125	134
All other.....	571	549	501	525	568	597	606	526	558	539

<sup>1</sup> Gives effect to comparative transfer of employees to "Salaries and expenses, Office of Administrator."

## BIDS OPENED IN PUBLIC

Mr. BOUTIN. I would also like to say, Mr. Chairman, and Congressman, that in line with the statement made by Congressman Bonner, and I am sure of interest to the committee, about a year and a half ago I issued a directive requiring that all bid openings in GSA be public; that they be handled centrally by our business service centers so that anyone would know specifically where to go; would have an absolute time when the bids would be opened; so there would be no question of someone saying that this was private information or they did not have an equal opportunity.

This has worked extremely well. We have even gone so far, occasionally when there was great interest, particularly in a construction project or a disposal, to go to the local community and have the bid opening there, so that the local newspaper people and interested citizens could be right there and see how it is done and have a voice in it. We also would like to say that these business service centers have done a great job in stimulating competition. They involve very few people.

## SMALL BUSINESS AID

These people go out into the hinterlands and knock on the doors of the small businessman and tell him how to do business with the Government. Many of these firms don't have a large office staff. They may have a lawyer on a retainer. They look at these Government forms and they are flabbergasted.

We explain how to fill them out. We even go in and talk with them on their production schedules, give them an idea how to rearrange the schedules to better do business. The benefit is not only to the country as a whole and to small business but the Government has had a direct benefit in more competition and therefore lower prices.

## GSA-DOD RELATIONSHIPS

The final thing I would like to say is that my relationships personally and as Administrator with the Assistant Secretary of Defense who is the person I deal with mostly, referring to Tom Morris, couldn't be better.

It would be foolish and certainly not a candid statement for me to say that there have not been problems. The committee is aware of these problems. But Tom is always available, willing to sit down and talk about these things, and we can always resolve them. (See pp. 20, 44, 94, 101.)

It is always a very pleasant atmosphere and good attitude.

Chairman DOUGLAS. That is a very splendid record of achievement. I wonder if you ever totaled up the savings on an annual basis that you have made to date. You have a number of instances.

I wonder if you could total them?

Mr. BOUTIN. I never have, Mr. Chairman. I think this might be a good idea. I might say in that regard that perhaps we haven't done it because the Administrator has never been satisfied with the performance. Until we implement all of these things we are working on, work measurement systems and so forth, to get our absolute maximum.

Chairman DOUGLAS. Why can't you make two estimates. Economies realized actually to date, economies anticipated when the program is carried out.



Mr. BOUTIN. I would be happy to have that done.

Chairman DOUGLAS. Would that be too much trouble?

Mr. BOUTIN. No; it would not be.

Chairman DOUGLAS. Could you have it submitted in reply to this question before the hearings go to press?

Mr. BOUTIN. I would be very happy to.

(The material to be furnished follows:)

GENERAL SERVICES ADMINISTRATION,  
Washington, D.C., April 19, 1963.

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

DEAR MR. CHAIRMAN: The following information is submitted in response to a request made at the hearings of the Subcommittee on Defense Procurement of the Joint Economic Committee on March 28, 1963, concerning savings and economies accruing to the Government as a result of GSA operations.

In creating GSA, the Congress visualized that a central property and records management agency could provide a variety of business services to other agencies more efficiently and at less cost than they could provide such services for themselves. On June 30, 1962, GSA had completed its 13th year of operations. During this period, economies and savings to the Government stemming from the basic functions assigned to GSA under Public Law 152, as amended, totaled an estimated \$3.9 billion. The sources of these savings are set forth in the attachment to this letter, identifying the many GSA activities which contribute to economy and efficiency of Government operation.

In addition to savings and economies discussed in the attachment, certain GSA activities have produced substantial revenues to the Government and avoided expenditure of Federal funds thus contributing to a more favorable financial posture. Specifically:

1. The sale of surplus real and personal property produced revenues to the Treasury of \$417 million in the 13-year period ending June 30, 1962. In recent years, our return on sales of personal property averaged 15 percent of acquisition cost; similarly, return on real property sales has averaged 110 percent of the appraised fair market value of the properties sold during the past 5 years.

2. Sales of excess strategic and critical (stockpile) materials totaled \$445 million through December 31, 1962. If, as a result of the recent Senate investigation of the stockpile program, legislation is enacted by the Congress to provide a more flexible disposal policy, it is reasonable to expect substantial increases in sales of excess stockpile inventories.

3. A reduction of \$704 million in the Government's obligation to take delivery of strategic materials under Defense Production Act and Stockpile Act contracts was effected through negotiation with the contractors as soon as it became known that the wartime planning period had been reduced from 5 years to 3 years and that defense requirements would be substantially reduced.

Thus, these three programs produced a financial benefit to the Government of about \$1.6 billion.

Although the economic impact of GSA's property and records management activities on the costs and staffing in other agencies is difficult to assess in terms of specific dollar and manpower savings, utilization by such other agencies of GSA's central services has avoided a need on their part to maintain staffs for handling procurement, warehousing, communications, records, property management, transportation, and similar services.

Judging from the trend in recent years, it is reasonable to project that savings and economies from GSA operations in the next 5 years will at least equal the \$3.9 billion accomplished in the preceding 13 years. The wisdom of the Congress in adopting the recommendation of the first Hoover Commission through the creation of GSA and the soundness of the GSA concept has already been proven. Full implementation of the responsibilities assigned to GSA in the Federal Property and Administrative Services Act, toward which we are now working, will prove to be of even greater economic advantage to the United States.

Sincerely yours,

BERNARD L. BOUTIN, Administrator.

TABLE 16

*Savings and economies accruing to the Government as a result of GSA operations—Selected annual totals*

	1950	1953	1960	1964 estimated
<b>1. Savings from reduction of expenditures through improvement of operating procedures and techniques and increased productivity in supply, transportation, and communication operations:</b>				
(a) Large volume buying of supplies and materials for distribution through the GSA supply system and FSS schedule purchasing by using agencies (millions)-----	\$28. 0			
(b) Unit cost of stores buying (per \$100 purchases)-----	(?)	\$69. 5	\$157. 6	\$283. 0
(c) Reduction in unit costs of supply operations due to automation of warehousing activities and paperwork plus increased productivity of employees (cost per \$100 sales)-----	(?)	\$9. 65	\$4. 60	\$4. 56
(d) Reduction in freight costs of GSA and other Government agencies through consolidation of shipments, negotiation of rates with carriers, etc. (millions)-----	\$1. 7	\$4. 6	\$15. 6	\$19. 3
(e) Reduction in public utilities and communications costs through operation of the Federal Telecommunications System, consolidation of switchboards, execution of areawide contracts, negotiation and representation before regulatory bodies, etc. (millions)-----	(?)	\$3. 2	\$9. 5	\$33. 5
<b>2. Savings from more effective utilization of Government resources and improvement of consolidated services:</b>				
(a) Reduction in costs of storing strategic materials inventories through greater use of Government excess facilities (primarily DOD), permitting cancellation of commercial warehouse leases (millions)-----	(1)	\$1. 2	\$1. 3	\$1. 3
(b) Anticipated savings in replacement cost of materials through extension of cycle for rotation of perishable materials in the stockpile inventories (millions)-----	0	0	0	\$1. 5
(c) Avoiding rental of office space by increased emphasis on moving, dead or inactive records to GSA records centers to release of substantial quantities of office space for reuse. Also, filing equipment, steel shelves and transfer cases were put back into active use, thus avoiding new procurement of similar items (millions)-----	\$0. 1	\$4. 2	\$4. 3	\$4. 0
(d) Increased emphasis on better space utilization, the conversion of warehouse and other special use space to office space, and the conversion of excess military and post office installations to office space have avoided the leasing of space to house the Federal Establishment (millions)-----	\$0. 6	\$11. 7	\$22. 8	\$42. 2
(e) The expansion of the motor pool program (activated in 1956) continues to pay dividends to the Government:				
(1) Number of motor pools in operation-----			56	80
(2) Number of vehicles in the pools (in thousands)-----			18. 1	29. 3
(3) Miles traveled per vehicle year-----			11, 691	12, 000
(4) Unit operation cost per mile-----			\$ . 075	\$ . 075
(5) Annual savings compared with pre-pool operation by agencies (millions)-----			\$5. 4	\$9. 5
(f) The transfer of excess personal and real property among Federal agencies for reuse avoids expenditures for procurement of similar items. The recent establishment of the Utilization Disposal Service in GSA has brought together the know-how which was previously dispersed within the organization and has contributed to growth of the program as well as actually realizing a better return on sales:				
(1) Utilization transfers (acquisition cost in millions)-----	(1)	\$50. 1	\$220. 3	\$579. 3
(2) Proceeds from sales of:				
(a) Personal property (millions)-----	(1)	(1)	\$2. 7	\$10. 1
(b) Real property (millions)-----	(1)	\$3. 0	\$78. 0	\$105. 0
(3) Savings due to rehabilitation of personal property and distribution of such property through the GSA supply system (equivalent replacement in millions)-----	(1)	(1)	\$6. 3	\$39. 8

See footnotes at end of table.

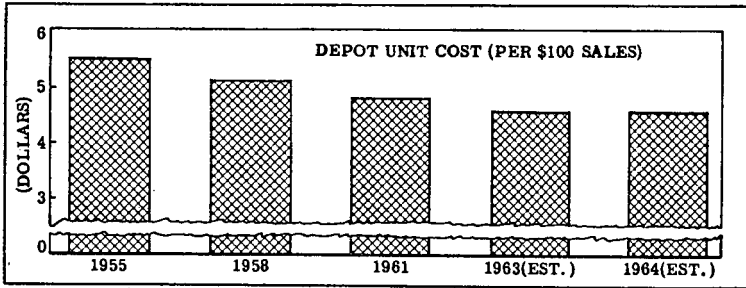
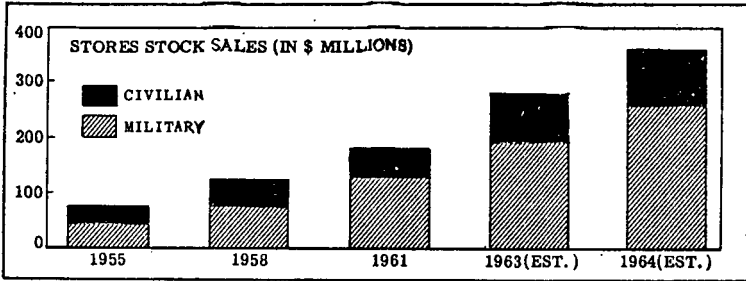
*Savings and economies accruing to the Government as a result of GSA operations—Selected annual totals—Continued*

	1950	1953	1960	1964 estimated	
3. Through constant attention to improving our organization, making maximum use of automatic data processing techniques, expansion of common services for use by other agencies, and improvement of our operating procedures, we have made savings which may be termed "Administrative Improvements":					
(a) Expansion of GSA printing plant operations for use by other agencies in the field (thousands).....	(1)	\$11.0	(1)	\$67.0	
(b) Automation of mass paperwork operations in accounting, payrolling, billings, and collections (millions).....	(1)	\$0.1	\$1.5	\$1.5	
(c) Economies resulting from audit of contractor operations and adoption of employee suggestions for improvement of procedures (millions).....	\$1.5	\$2.0	0.3	1.1	
			1957	1960	1964, estimated
(d) Increased production per employee and lower unit costs achieved are illustrated by the following:					
(1) Payrolling of employees:					
(a) Unit cost per employee payrolled.....		\$16.79	\$14.31	\$12.22	
(b) Number of employees payrolled per man-year.....		275	392	542	
(2) Invoice payments:					
(a) Unit cost per voucher.....		\$2.07	\$1.68	\$1.21	
(b) Number of vouchers processed per man-year.....		2,350	3,471	5,355	
(3) Accounting documents (billings, collections, etc.):					
(a) Unit cost per document processed.....		\$2.82	\$2.56	\$1.04	
(b) Number of documents processed per man-year.....		2,134	2,476	6,811	
(4) Personnel operations:					
(a) Ratio of personnel staffing to total number of GSA employees. (Note: Ratio in the Independent Offices Appropriation Act is 1:135.).....		1:158	1:173	1:206	

<sup>1</sup> Not available.  
<sup>2</sup> Not comparable.

CHART 11

STORES STOCK SALES AND UNIT COST



SALES IN \$ MILLIONS

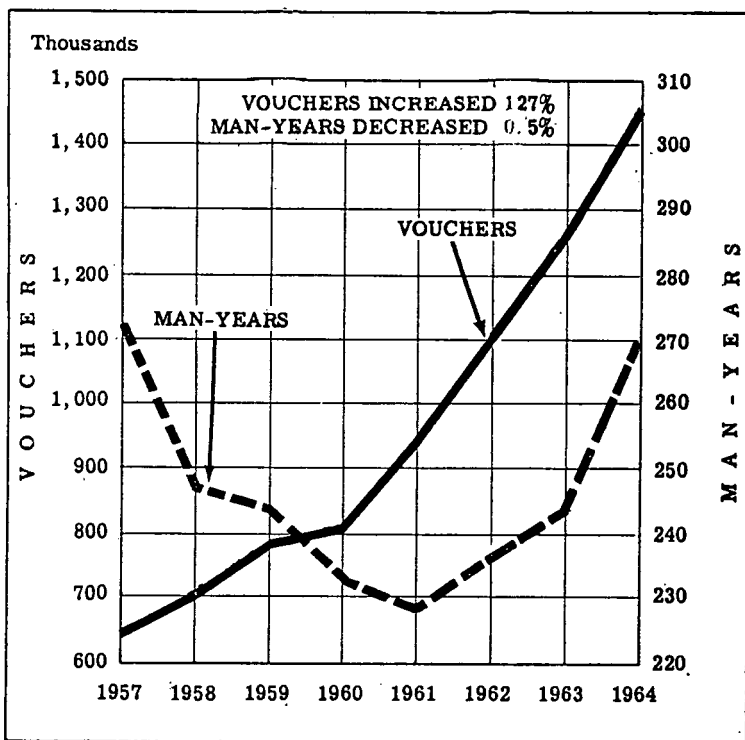
FISCAL YEAR	TOTAL SALES	CIVILIAN	MILITARY		DEPOT UNIT COST
			AMOUNT	PERCENT	
1953	54.7	31.6	23.1	42.2	9.65
1954	52.8	26.5	26.3	49.8	9.55
1955	75.9	31.9	44.0	58.0	5.50
1956	96.4	35.4	61.0	63.3	5.10
1957	116.4	44.1	72.3	62.1	4.82
1958	120.7	45.1	75.6	62.6	5.09
1959	145.5	48.2	97.3	66.9	4.97
1960	154.3	51.6	102.7	66.6	4.60
1961	183.2	60.0	123.2	67.2	4.80
*1962	238.8	76.1	162.7	68.1	4.64
*1963 (EST.)	278.0	82.7	195.3	70.3	4.56
*1964 (EST.)	364.0	100.1	263.9	72.5	4.56

\*ADJUSTED TO REFLECT DELIVERED PRICES.

CHART 12

# INVOICE PAYMENTS

(Vouchers Processed)

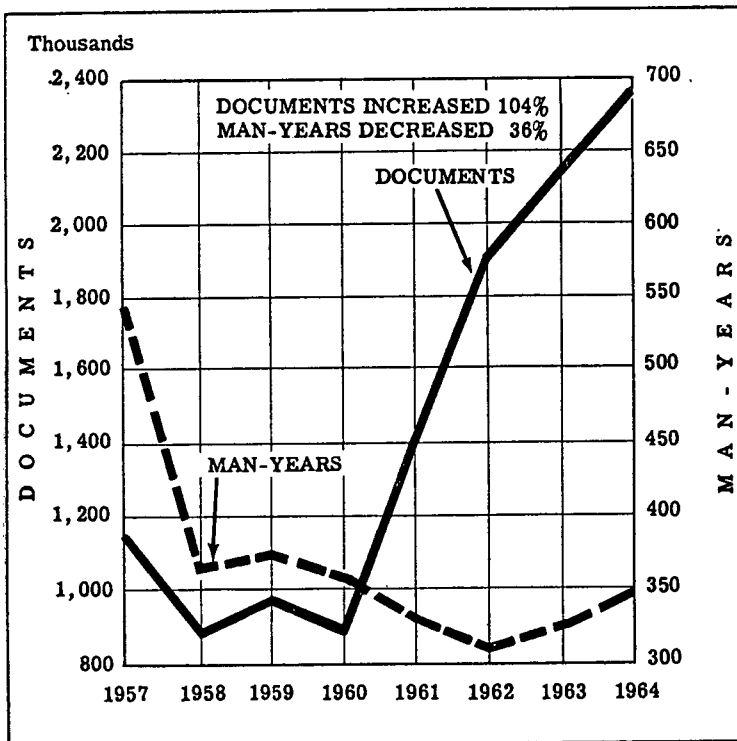


Year	Vouchers	Man-Years	Production per M. Y.		Unit Cost Per Voucher
			No.	% Increase From 1957	
1957	639,413	272.1	2350	-	\$2.07
1958	699,620	247.1	2831	20	1.92
1959	781,179	244.6	3194	36	1.80
1960	811,887	233.9	3471	48	1.68
1961	942,782	228.6	4124	75	1.50
1962	1,104,196	236.7	4665	99	1.34
1963	1,275,000 Est.	243.0	5247	123	1.21
1964	1,450,000 Est.	270.8	5355	128	1.21

CHART 13

## ACCOUNTING

(Billings and Miscellaneous Accounting Documents Processed)



Year	Documents	Man-Years	Production per M. Y.		Unit Cost Per Document
			No.	% Increase From 1957	
1957	1,162,632	544.9	2134	-	\$2.82
1958	883,045	363.7	2428	14	2.48
1959	975,507	375.3	2599	22	2.44
1960	890,996	359.8	2476	16	2.56
1961	1,405,122	335.0	4194	97	1.66
1962	1,900,800	313.8	6057	184	1.12
1963	2,160,000 Est.	321.0	6729	215	1.04
1964	2,375,000 Est.	348.7	6811	219	1.04

HANDTOOLS, PAINT, AND FURNITURE

Chairman DOUGLAS. Mr. Boutin, I am delighted you are getting on so well with the Department of Defense. As I remarked to Mr. Morris this morning, we have had complaints that the Department of Defense is still handling handtools and paint and, I believe, furniture. These would certainly seem to be common-use items for civilian departments as well as for the military.

Have you been negotiating with the Department of Defense on these and other items?

Mr. BOUTIN. Yes; I have been. I have had a goodly number of discussions with Assistant Secretary Morris, with members of his staff, with General McNamara, who heads up DSA. I think to be perfectly candid, Mr. Chairman, that some of this problem has been due to the fact that there has been a great changeover in the Department of Defense.

The testimony you have heard already on the creation of DSA and other single-manager concept implementation has tended to slow down to a certain extent the turnover of some of these items. I would be further less candid if I didn't say that we have been disappointed particularly in the handtool and the paint program, where we think that these items should be turned over to GSA.

A lot of the problem, however, is in the area of definition of military-management requirements, military-reserve requirements. This is something that we are getting to.

JOINT GSA-DOD LETTER TO BOB REQUESTING STUDY

I am sure the committee will be pleased to know that as recently as last week Tom Morris and I jointly signed a letter to the Director of the Bureau of the Budget asking that a study be initiated, effective immediately, headed by the Deputy Director and members of the staff over at the Bureau of the Budget, with the selection of participants in the study group to be made by the Deputy Director, to look at not only the relationship of GSA/DOD but the overall procurement and supply operations of the entire Federal Government. (See pp. 20, 408-409.)

NEED FOR FEDERAL SYSTEM

So initially we will get from the study, I hope, the concept that I think Congress had in mind when they passed the law of 1949, that we will have a Federal system. A system that is not in competition, that is completely compatible, where the facts speak for themselves.

If it is more economical and efficient for X agency to handle it, then it should be handled by that agency. It should not be handled somewhere else.

Chairman DOUGLAS. Do you anticipate an agreement in the field of handtools and paint?

Mr. BOUTIN. I am very hopeful that we are going to get an agreement and get it very soon. It is my personal opinion that handtools should be handled entirely by GSA. Right now we are buying slightly over 50 percent of the handtools. I think we have the capability of handling the entire requirement.

Paint procurement is going to require some negotiation between GSA and DOD and analysis of the requirements of the entire Federal Gov-

ernment. One of the problems, for instance, is in can sizes. The requirements in the civil side of Government are altogether different.

In the Department of Defense larger quantities are required. We find right now, for instance, that GSA may have a pint can and quart can and DOD may have a gallon can or vice versa, which is ridiculous for exactly the same paint. We are in harmony with Tom Morris that this matter and all other related matters must be straightened out.

#### IDENTICAL BIDS

Chairman DOUGLAS. Are you ever troubled by identical bids?

Mr. BOUTIN. We are practically never troubled by identical bids with the exceptions that very, very seldom we have identical bids on disposal of the items from our stockpile.

Chairman DOUGLAS. That is on sale, not on purchase?

Mr. BOUTIN. Not on purchase. I don't think, Mr. Chairman, that I could recall even one on purchase. Mr. Dunkle, who can correct me on this, is here. This has not been a problem to us.

Chairman DOUGLAS. Sometimes where bids are not identical you have an orderly rotation of bids. If you have five or six companies, A will be low man on the first contract, B on the second, C on the third, D on the fourth, and E on the fifth, and so forth.

But all these bids will tend to be substantially identical. That is, the low bid each time will be more or less identical with the low bid the previous time.

Mr. BOUTIN. We would treat that as a tie bid.

Chairman DOUGLAS. There is an orderly pattern of rotation indicating that some prior arrangement may possibly have been agreed upon to see that a given horse wins one race and another horse wins the next race.

Mr. BOUTIN. We watch that very, very carefully for any type of pattern developing that would give us an indication that there may be some collusion. In such cases we immediately report it to the Department of Justice. We treat it exactly the same as we would a tie bid.

#### IMPROVING BID TECHNIQUES

Representative CURTIS. I want to thank Mr. Boutin for a very fine statement. Now that we have established, or I hope we have, the efficacy of advertised bids, we get into the real interesting area of how we improve the techniques of advertised bids.

For a long time we could not cross that first barrier. Incidentally, we all recognize, and always have, that there are areas where negotiated bids must remain, particularly in the military. I dare say they are not so much in the areas in which you deal.

Of course, getting into the techniques of good advertised bids, we get into specifications and writing them fairly. Also, we get into the key question of who bids.

#### INDUSTRY CONFIDENCE

I was very pleased with your statement on page 77 where you referred to this important factor of business confidence. Promoting industry confidence in doing business with Government is an important factor of which I wish some of our procurement officers were more aware.



In many, many areas, whether it is fair or unfair, the Government has gotten the reputation of being a shyster and, as a result, many of our best companies won't do business with the Government. When you advertise bids and you only have the sort of fly-by-nights bidding on them, you are in bad shape.

The real test of whether you are going to have a successful bid is by the caliber of the people who bid. I know you agree with that.

Mr. BOUTIN. I agree completely.

Representative CURTIS. I was very pleased to see you stress this point of business confidence. That gets back to small business a little bit, too. I have used my definition of what is a small business as one who can't afford a Washington lobbyist.

This business of getting out there, making the techniques as simple as possible, and letting them know what is there, will encourage them to come on in. This is the very thing that is going to increase the caliber of the people who will bid on your advertising.

#### SMALL BUSINESS SET-ASIDE

I have always worried about this small business set-aside. I don't like it. I don't think small business needs a crutch. But it does need an opportunity of knowing the techniques and procedures to be followed.

Of this 22 percent listed as negotiated, you said a good part of that was set aside for small business. But actually, within that set-aside, you have techniques of advertised bidding there; do you not?

Mr. BOUTIN. Yes; but we considered it as a negotiated bid.

Representative CURTIS. I can understand why you do. I just want to stress that point because it is not what we generally think of as the negotiated bid which the military on many items has to use.

Mr. BOUTIN. Yes.

Representative CURTIS. This does follow some techniques which make it similar to advertised bidding; am I not correct?

Mr. BOUTIN. Yes.

#### SURPLUS DISPOSAL-SALES SPECIALISTS

Representative CURTIS. Here is the question: If the decision has been made to have surplus disposal conducted by GSA—I understand you are getting more and more into this and I am very pleased about that—what is the situation as far as the trained sales specialist to do this job is concerned? Are you going to have to recruit them or can you move that personnel over from where the job is being done now?

Mr. BOUTIN. We would take over the operations and the people as well as funding from the Department of Defense. Then we would consolidate with our own and have a complete new system. (See p. 409.)

Representative CURTIS. One way we can determine efficiency is by watching the number of personnel. I also worry about all the talk when we save money, and I think we do in many instances, but sometimes when we try to figure out where it has been saved it is difficult to follow.

One place you can really tell it is if there has been a cut in personnel. You can be fairly sure that you have saved. If you actually take the

personnel over and not recruit and train others, then the personnel formerly doing it will not be doing something else.

Mr. BOUTIN. There will be a takeover of personnel. That is part of the plan.

#### PROCUREMENT OF HANDTOOLS

Representative CURTIS. I have received a letter on this point that Senator Douglas has raised in regard to handtools. I think it might be well, if I may, Mr. Chairman, to put it in the record. Let me read it to you because I think it is not too long for your comments.

This is from people who are in the handtool business. Here is the statement:

It is our understanding at this time that a move has been made to tentatively assign only the purchasing functions of handtools to GSA and under this arrangement GSA would lose the responsibility for (1) quality control and source inspection; (2) the direct purchasing for using activities for the Army, Navy, and Air Force requirement.

Splitting the purchasing function from its present efficient system would mean (1) DSA would requisition the requirements for depot stock through GSA in Washington; (2) DSA in Richmond would be responsible for quality inspection at the manufacturing source; (3) GSA would only be a buying agency.

If this new procedure is followed we will continue to have two agencies of the Government doing a job that up to this point has not worked successfully. DSA in Richmond has been given every opportunity to cooperate with GSA, but we have facts that prove that Richmond has purchased duplicate items, refused to contact GSA on items that GSA has under contract, et cetera.

We have submitted facts that DSA in Richmond has not demonstrated ability to function efficiently in conjunction with GSA, although our facts only cover the period 1962 and 1963. This obvious attitude has existed since 1960.

I think that is enough. I will have the whole thing put in the record. Would you comment on this situation? Is it as bad as it sounds, or does it look like you are working something out?

(The letter referred to follows:)

KRAEUTER & Co., INC.,  
Newark, N.J., March 22, 1963.

Congressman THOMAS CURTIS,  
House Office Building,  
Washington, D.C.

DEAR CONGRESSMAN CURTIS: At the suggestion of Ray Ward, we are writing to you concerning the Joint Economic Committee hearings.

Enclosed are copies of letters to:

- (1) John H. Holmead, Jr.;
- (2) President John Kennedy;
- (3) Ray Ward; and
- (4) Letter from George Mullins.

that give you a complete picture as to our efforts to consolidate handtool purchasing under GSA in Washington.

It is our understanding, at this time, that a move has been made to tentatively assign only the purchasing function of handtools to GSA. Under this arrangement GSA would lose the responsibility for—

- (1) Quality control and source inspection; and
- (2) The direct purchasing for using activities—for the Army, Navy, and Air Force requirements.

Splitting the purchasing function from its present efficient system would mean—

- (1) DSA would requisition the requirements for depot stocks through GSA in Washington;
- (2) DSA in Richmond would be responsible for quality inspection at the manufacturing sources; and
- (3) GSA would only be a buying agency.

If this new procedure is followed, we will continue to have two agencies of the Government doing a job that up to this point has not worked successfully. DSA in Richmond has been given every opportunity to cooperate with GSA,

but we have facts to prove that Richmond has purchased duplicate items, refused to contact GSA on items that GSA has under contract, etc.

We have submitted facts to George Mullins that the DSA in Richmond has not demonstrated their ability to function efficiently in conjunction with GSA. Although our facts only cover a period in 1962 and 1963—this obvious attitude has existed since 1960.

Since DSA in Richmond has demonstrated their unwillingness to cooperate with GSA in Washington under the present arrangement, how could anyone expect this new plan to work with improved efficiency at less cost to the taxpayer?

Handtools are used to maintain Government equipment for defense, quality, and delivery, to the using activities are of prime importance, along with good inventory control procedures.

Therefore it does not make sense to have an item of this importance fall under the jurisdiction of two agencies.

This method and procedures that GSA have used to purchase handtools has proven their ability to:

- (1) Purchase items at a lower cost, through term contracts;
- (2) Maintain an excellent standard of quality with no additional cost;
- (3) Through experience has the knowledge of manufacturer's capabilities who will perform under alert conditions;
- (4) Providing contracting officers with a complete reservoir of information on the various types of handtools available—without duplicating Government inventories (DSA has repeatedly purchased items for using activities that are already stocked in all regional GSA warehouses); and
- (5) Provides contracting officers with information relative to specific types of tools for specific functions without duplicating Government inventories.

When you analyze this situation, objectively, the responsibility for all functions of the Government handtools program should be under the direction of GSA in Washington.

It's just good business, whether it be the Government or private enterprise, to give complete responsibility to one agency or one individual \* \* \* splitting functions and responsibility has seldom allowed successful objectives to be achieved.

Under the proposed new plan, there would only be additional cost, more confusion, additional inventory, lower standard of quality.

As a taxpayer and supplier to the U.S. Government, we are interested in more efficiency at less cost.

As a manufacturer and supplier to the Government, we have experienced the additional cost and confusion of having to deal with two agencies for procurement of the same item.

While we are only concerned with handtools, it is obvious that the total responsibility for any item the Government purchases, belongs with one agency—not two.

Cordially,

BRUCE BRIGGS,  
*Vice President and General Manager.*

Mr. BOUTIN. It has the potential of being as bad as it sounds but I think we can prevent that. I have had extensive talks with Tom Morris on this. The big thing that needs to be done here is to identify which of these handtool items are required for a mobilization reserve where they have kits and a division is called out tomorrow that equipment will be available to that division.

But it is our firm belief, and we concur and are pleased with the letter and the good feeling that does exist with the handtool industry and GSA, that we have the absolute capability of providing the quality control inspections, working out the scheduling and doing the procurement and having these items in our depot system, where required, or on our schedules and, those items that DOD needs to have in this mobilization reserve they could secure from us or through us.

I think this is going to be resolved to everyone's satisfaction. We have had an excellent relationship and this is a good example of

what I was talking about in our work with industry on the development of specifications.

We in GSA and it was common in the Government, not necessarily in the handtool industry but throughout, were using name brands or equivalent. We are just removing those as quickly as possible and having absolute specifications backed up by a tight quality controlling program so that the Government is getting its money's worth.

Industry in turn knows exactly what they are bidding on, knows what the procedures are. I think that we can get this whole thing squared away.

Representative CURTIS. Thank you very much.

Mr. BOUTIN. Thank you.

#### IDENTICAL BIDS ON GOVERNMENT SALES

Chairman DOUGLAS. Before I ask Mr. Ward to take over the questioning, I would like to pick up a matter that you touched upon. You said you had not found many examples of identical bidding so far as the sale of commodities to the Government is concerned.

Have you found many cases of identical bidding in the case of purchase of surplus from the Government?

Mr. BOUTIN. No, in those terms. On the stockpile items that we have offered for sale. Of course, these are based on market values so there is a higher chance for currency here than would otherwise be normal.

If you are offering copper, the market price is published in New York and the world price is published. We have had perhaps 8 or 10 in the past year. But many times these are not the high bidder. So there would not be an award made anyway.

These are down the line but they may bid exactly on market or they may bid 5 points or 10 points off from market or maybe a hundred points off the market hoping to get a real bargain. Mr. Dunkle here who is in charge of our procurement operations can testify as far as others that don't come to mind.

In your operation do you have a frequent occurrence of this?

Mr. DUNKLE. Mr. Chairman, we do have isolated cases where this occurs. But in most cases that come to our attention, it is a matter of distributors of the same manufacturer's product bidding the same price.

Chairman DOUGLAS. Are you speaking of purchases by GSA or sales?

Mr. DUNKLE. Purchases by GSA. In other words, it is the same manufacturer's product being bid by dealers. Frequently this is because of controls which are permitted within industry with regard to prices charged the public.

#### PRICES PAID BY GSA

Chairman DOUGLAS. Do you ever find yourself compelled to pay retail prices for purchases in wholesale quantities?

Mr. DUNKLE. We do not, sir.

Mr. BOUTIN. No, sir.

Chairman DOUGLAS. Are you able to break down the retail prices and get to the wholesale prices?

Mr. BOUTIN. We will do at a very minimum 15 percent below wholesale in most cases.

Chairman DOUGLAS. 15 percent below wholesale?

Mr. BOUTIN. Yes, sir. In many items a lot better than that.

Mr. DUNKLE. Mr. Chairman, this is because in the quantities we buy of our major program items we are dealing direct with the producing sources.

Chairman DOUGLAS. So you go to the manufacturer?

Mr. DUNKLE. Yes, sir.

Chairman DOUGLAS. This is so important a point that I wondered if you could devote a few paragraphs to that.

Mr. BOUTIN. We would be happy to do that.

(The material referred to follows:)

GENERAL SERVICES ADMINISTRATION PURCHASE PRICE COMPARISONS

In those instances where large volume requirements are purchased, it is usually possible to buy direct from production sources at prices substantially below wholesale list. This usually occurs when items which are normally bought and sold in the process of commercial distribution are purchased direct from production sources and delivered to GSA warehouses for distribution to Government users. Several examples follow:

TABLE 17

GSA purchase price comparisons

Item	Unit	GSA price	Wholesale price
Battery, flashlight, size D, Federal specification W-B-101f...	Each.....	\$0.05	\$0.095
Paint, synthetic latex base, Federal specification TT-P.....	Gallon.....	1.96	4.18
Soap, white, floating, Federal specification P-S-616d, 6-ounce cake, 100 per case.	Case.....	4.28	7.40
Wrench set, socket, Federal specification GGG-W-00641c, 1/4 inch square drive, 15-piece.	Set.....	3.97	8.14
Refrigerator, household, white, 13-cubic foot, top freezer, automatic defrost and reset, 2-door, Federal specification AA-R-211e. <sup>1</sup>	Each.....	142.00	170.00
Switch, toggle, brown, Federal specification W-S-896a, single pole, compact size.	.....do.....	.14	.22
Carpet, wool, loop pile, Federal specification DDD-C-61c. <sup>1</sup>	Square yard.....	4.81	7.47
Desk, typewriter, steel, gray, Federal specification AA-D-191a, 60 by 34 by 30 1/2 inches, linoleum top.	Each.....	76.00	138.15
Paper, carbon typewriter, Federal specification UU-P-00158c, medium weight and finish, 8 by 11 inches.	Box of 100 sheets..	.62	2.02

<sup>1</sup> Not warehoused. GSA price includes delivery to user.

Chairman DOUGLAS. When Congressman Porter Hardy made his investigation into the purchase of automotive equipment in Detroit he found that the automotive companies, in selling to the Government, would charge retail prices for parts sold from the factory.

MOTOR VEHICLE COSTS

Mr. BOUTIN. I have some information here on vehicle purchases that I think might be significant for the committee. This is a very good example. We have a statutory limit on sedans of \$1,500. We actually pay \$1,480 for standard four-door sedans.

The same vehicle costs a dealer, the wholesale price, \$1,776 and the listed retail is \$2,400. On vehicles it is, too, significant that we try to schedule our requirements by going to the agencies, determine

what they need in the course of a year, to schedule our procurement at the time the manufacturer's business might otherwise be slow.

Chairman DOUGLAS. Very good.

Representative CURTIS. Is that factory price? That is not the delivery of the unit. You take it at factory?

Mr. BOUTIN. That is right. That does not include transportation costs.

Chairman DOUGLAS. That is very intelligent. In other words, you purchase for delivery during the slack seasons?

Mr. BOUTIN. Yes, sir.

Chairman DOUGLAS. Thus enabling the company to utilize their overhead and force more fully?

Mr. BOUTIN. Yes, sir.

Representative CURTIS. In automobiles, you don't have to get variety of colors and other things like that?

Mr. BOUTIN. We do not normally. We have a few requirements. For instance, FBI comes to my mind where they prefer to have a black car with no markings of any kind. In our motor pools it is a gray-colored car. We don't have a great variety of colors.

#### CONCURRENT BUYING AND SELLING IDENTICAL ITEMS

Chairman DOUGLAS. Some years ago we had the Budget Bureau make an investigation of GSA and other agencies and they found that in many areas, and we confined the study to areas, in as many as two-thirds of the times agencies were buying new equipment and new items when this was already available in other agencies. Have you been able to improve on that?<sup>11</sup>

Mr. BOUTIN. I think, as I stated in the statement, Mr. Chairman, that we have that situation pretty well licked. We have increased our utilization last year up to \$365 million and we are looking in fiscal 1964 in the vicinity of \$500 million from a couple of years ago being at \$1.2 million of utilization.

Chairman DOUGLAS. From only about a million?

Mr. BOUTIN. I mean \$100 million, excuse me. The exact figures are in the statement. So there has been a dramatic change here. The screening procedures have been vastly improved.

#### GAO REPORT ON TIRE PURCHASES

Chairman DOUGLAS. You have done so well, it seems ungracious to break out items. Are you aware of the report of the General Accounting Office of February 20, 1963, entitled "Review of Uneconomical Procurement of Aircraft Tires by the Military Service Under Federal Supply Schedules Issued by the General Services Administration."<sup>12</sup>

Mr. BOUTIN. Very much so, Mr. Chairman. We have gone over that thing from A to Z. Might I say right at this point we do not agree with that. We have been talking with the Comptroller General's people. I don't say this in a disparaging way because they are our friends.

We are gathering the facts with the Air Force, working very closely with GAO and the Air Force.

<sup>11</sup> See "Hearings, 1960," p. 563, et seq.

<sup>12</sup> See staff report 1963, p. 149.

Chairman DOUGLAS. When you have your reply would you be kind enough to send a copy of your reply to this committee?

Mr. BOUTIN. I would be delighted to.

Chairman DOUGLAS. We will put it in the hearings.

Mr. BOUTIN. Yes.

(The information requested follows:)

The GSA/Air Force research on this has not yet been completed. The committee will be furnished a copy of our reply to the GAO as soon as it is forwarded to the Comptroller General.

Chairman DOUGLAS. I am going to ask Mr. Ward to continue the questioning.

#### MANAGEMENT OF AUTOMATIC DATA-PROCESSING EQUIPMENT

Mr. WARD. There is only one question, Mr. Boutin, that I want to raise. The General Accounting Office in several reports has been very critical of the Government's management of automatic data-processing equipment.

They point out that we are spending tremendous sums of money principally for lease of that equipment and some purchasing and there is no central control over it. There is no inventory control over it. I am sure Mr. Campbell and his staff will touch on that tomorrow.

I believe they think there should be some appropriation control if not some direct control. Have you done anything in that area?

Mr. BOUTIN. We have read the report very carefully, and we think that many of the conclusions in the report are completely valid. I think one of the things that has contributed Government-wide to this situation that we have today, with the vast majority of the equipment on a leased instead of an owned basis, has been the rapid change in technology.

A piece of equipment that you took over today, tomorrow was obsolete. The complete change in programing, the number of applications that a machine could carry. The technological changes in data transmission over the wires rather than having to have a piece of hardware at each of your locations.

GSA has 10 pieces of hardware and every one of them is leased. But we were only trying to reach a plateau. This was not the final answer. If we had purchased then I think it would have been a mistake. But when we finalize I think we should purchase.

They tell me, the best people I can get information from, that we have now reached a plateau in changes. The next 5 years we will see some refinements but you are not going to see rapid and dramatic changes that you have seen in the past.

So we attach a great deal of validity to the Comptroller General's report. We think there very likely should be and we have been talking to the Bureau of the Budget—in fact we have been talking to some people within the Congress who have called us up and asked us for our opinion on it—that there might very well be a focal point where the whole program is administered at least as far as regulations and directives are concerned. (See appendix 1, p. 269; see also p. 139.)

The Bureau of the Budget has done a vast amount of research on this matter and I am sure that when the Director comes in to testify he can give you the benefit of this. But this is a good report. It is

the type of constructive report that I think has the potential to save the Government perhaps as much as \$100 million a year.

Mr. WARD. Is it true that the bill for that kind of equipment is something like half a billion dollars a year?

Mr. BOUTIN. I know in GSA our rental bill is about \$2 million a year right now.

Mr. WARD. You don't know what it is in the DOD and all other agencies?

Mr. BOUTIN. I don't know what it is Government-wide. Mr. Dunkle knows.

Mr. DUNKLE. It is in the neighborhood of \$200 million a year.

Mr. WARD. Thank you.

Chairman DOUGLAS. Thank you very much, gentlemen. I want to congratulate you on the progress which you have made. I hope you will give us these figures of dollar savings already realized and that you expect to realize in the future.

Mr. BOUTIN. I think the secret there is that Congress gave GSA a tremendous mission in 1949. In my opinion, to be perfectly honest about it, I don't think we are scratching the surface as to the potential of this agency. I think the work of this committee will highlight the necessity to delineate very carefully all of the responsibilities that are peculiar to this agency and should be assigned to and exercised by this agency.

I think the Bureau of the Budget has this very much in mind and the work jointly between the Bureau and this committee can result in GSA getting a new lease on life. We have the capacity. We have to have a clear definition of responsibility.

Chairman DOUGLAS. We congratulate you, but I think you should know that we will try to keep our eye on you in the future, too.

Mr. BOUTIN. Thank you very much.

Chairman DOUGLAS. We meet tomorrow morning at 10 o'clock.

(Whereupon, at 4:15 p.m. the subcommittee recessed, to reconvene at 10 a.m., Friday, March 29, 1963, in room 457, Senate Office Building.)



# IMPACT OF MILITARY SUPPLY AND SERVICE ACTIVITIES ON THE ECONOMY

FRIDAY, MARCH 29, 1963

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON DEFENSE PROCUREMENT  
OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met at 10 a.m., pursuant to recess, in room 457, Senate Office Building, Senator William Proxmire presiding.

Present: Senators Proxmire, Sparkman and Miller, and Representatives Patman and Widnall.

Also present: James W. Knowles, executive director; Ray Ward, economic consultant; and Hamilton D. Gewehr, administrative clerk.

Senator Proxmire. The committee will be in order.

The chairman of the subcommittee and the chairman of the committee is the same man, Senator Paul Douglas, of Illinois, and Senator Douglas cannot be here this morning. I would like to read a statement from Senator Douglas. Senator Douglas says:

I have been called to see the President this morning and regret deeply I will not be here to introduce Comptroller General Campbell, whom I consider one of the great public servants of our time.

This subcommittee relies on the Comptroller General for many important services and has always found those services to be dependable, prompt, and efficient.

We asked the Comptroller to provide us with two sets of his reports which have been issued since our last general hearing in January 1960, and which deal with the subject matter of our current hearings. An index and digest included in the staff report entitled "Background Material on Economic Aspects of Military Procurement and Supply,"<sup>13</sup> two full copies of the reports, have been brought to the committee room for the use of the members and the press.

We specifically asked Mr. Campbell and his staff to cover a number of points which are included in my letter to him dated March 12, 1963. We have also specifically asked Mr. Campbell and his staff to comment on the use of stock funds in the Department of Defense and the use of proceeds from sales of surplus property and the full implications of his report on review of uneconomical procurement of certain aircraft-engine bearings by the Navy.

I ask unanimous consent that a letter from the chairman of the committee and subcommittee, Senator Douglas, to Hon. Joseph Campbell, Comptroller General of the United States, be put in the record at this point.

<sup>13</sup> See staff report, 1963, pp. 78-169.

(The letter referred to follows:)

MARCH 12, 1963.

HON. JOSEPH C. CAMPBELL,  
*Comptroller General of the United States,*  
*Washington, D.C.*

DEAR MR. CAMPBELL: The Subcommittee on Defense Procurement of the Joint Economic Committee held hearings on January 28, 29, and 30, 1960, on the impact of defense procurement and related activities on the economy and issued a report thereon in October 1960, which contained a number of recommendations. The testimony of you and your associates was most important in the conduct of those hearings.

Since a number of very important actions have been taken since that date, the subcommittee will hold hearings on March 28, 29, and April 1, 1963, to consider their impact on the economy and to evaluate the current situation.

The subcommittee will be honored to have the testimony of yourself and staff on the following and related matters:

- (a) Analysis of GAO reports since January 1960, which bear on military and related supply and service activities, showing accomplishments and deficiencies;
- (b) Information as to savings made from GAO reports in supply management, communications, transportation, etc.;
- (c) Progress made in cataloging, contract administration, utilization of inventory, standardization of items;
- (d) Use of existing legal authority and adequacy thereof;
- (e) A summary of GAO findings on the military assistance program;
- (f) Use of stock funds with particular emphasis on consumer funds;
- (g) Use of advertised competitive contracts versus negotiation and sole-source procurement;
- (h) An analysis of your Report B-146748, "Review of Uneconomical Procurement of Certain Aircraft Engine Bearings by the Department of the Navy and its implications respecting the gamut of supply management functions."

You are scheduled to testify at 10 a.m. March 29, room 457, Senate Office Building. One hundred copies of your prepared statement will be appreciated by March 27 at room G-133, New Senate Office Building. You may contact Mr. Ray Ward, economic consultant to the subcommittee, as to further details, at Capitol 4-3121 (code 180), extension 5220, or room 502, George Washington Inn.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

Senator PROXMIER. Mr. Campbell, we are pleased and honored to have you here and you may proceed in your own way.

#### STATEMENT OF HON. JOSEPH CAMPBELL, COMPTROLLER GENERAL OF THE UNITED STATES

MR. CAMPBELL. Thank you, Mr. Chairman.

At your request, we appear before you today to present a summary of more significant matters disclosed by the audits and examinations made by the General Accounting Office in the Department of Defense and the three military departments.

#### GAO ISSUED 200 REPORTS ON DOD ACTIVITIES

Since we appeared before your committee on January 28, 1960, we have issued to the full Congress over 200 reports on our examinations of Department of Defense activities. In our statement we will discuss supply management, stock funds and related consumer funds, and procurement.

Since most of the corrective actions already taken or planned to be taken by the military departments concerned relate to specific conditions dealt with in our individual reports, they do not lend themselves to generalizations in summary form in this presentation. On the whole, however, we believe that the Defense Establishment is mak-

ing substantial progress in most of the areas we have brought to its attention. Time has not permitted us to update our information on all of the significant matters disclosed by our reviews or on the effect of the corrective actions taken, but we intend to make followup examinations to the extent that time and staff are available.

First, as background, we would like to state that in planning and conducting our audits, we place primary emphasis on those aspects of agency operations and activities in which opportunities for improvement appear to exist. This policy gives recognition to the need to examine into areas of known or anticipated congressional interest, and at the same time provide for the most effective use of available manpower. Application of this policy results in placing particular emphasis on known or suspended weaknesses such as ineffectiveness, inefficiency, waste, and extravagance, improper expenditures, failure to comply with laws or congressional intent, and other problem areas.

#### SAVING BY GAO

The effectiveness of such an approach is illustrated by the fact that collections and measurable benefits alone resulting from our work in the Department of Defense amounted to \$93,500,000 during fiscal year 1961 and \$115,410,000 during fiscal year 1962. However, since our audits are highly selective, many of the areas in need of improvement, as disclosed by our audits, are symptomatic of conditions that may prevail in broader areas. Thus, we try to point out to the Defense Department matters which need further survey, investigation, or review to determine the extent to which deficiencies found by us exist throughout all the services, as a basis for broad corrective action.

#### SUPPLY MANAGEMENT

Supply management in the Department of Defense includes acquisition, positioning, storage, issuance, and repair of the numerous items of personal property required by the Armed Forces of the United States. According to a report published by the House Committee on Government Operations, the supply system inventories of the Department of Defense as of June 30, 1962, had an acquisition value of about \$40.3 billion.

Our reviews of the management of these extensive resources have disclosed—

(1) A lack of interservice coordination in utilizing material available in one service and needed in another.

(2) Procurement in excess of reasonable current needs and established levels of reserve stocks.

(3) Inadequate and inaccurate supply records.

(4) Failures to standardize items in common use by two or more services.

(5) Premature replacement of usable equipment.

(6) Needless and costly warehousing and distributing commercially available equipment and supplies.

A brief discussion of each of these areas follows:

#### INTERSERVICE COORDINATION LACKING

Interservice coordination in supply matters is a continuing problem in the Department of Defense. Such coordination is essential to as-

sure that individual services do not procure material from outside sources when one of the other services has quantities of the materials on hand in excess of its own needs and to assure that individual services do not dispose of material which should be transferred to other services to meet their current or future requirements. The Department of Defense has in the past created a number of supply agencies with responsibilities, among other things, for promoting coordination among the services in selected areas of supply management. Our examinations have shown that this approach to the problem has not achieved the desired degree of coordination. In 10 reports issued to the Congress since we appeared before your committee in January 1960, we identified millions of dollars of materials and supplies that were excess to the current needs of the owning military department, yet were needed by one or both of the other military departments to fill current requirements. As a result of our bringing these matters to the attention of the military departments concerned, interservice transfers were made in these 10 cases totaling approximately \$70 million. It is not possible to ascertain the extent to which new procurement was avoided as a result of these transfers; however, in six cases immediate cancellation of procurement plans amounted to a little more than \$15 million. These 10 reports resulted from our reviews of the management of such supplies as aeronautical engines and spare parts, electronics supplies and equipment and spare parts, and photographic supplies.

We believe, and so recommended in several of the reports mentioned above, that consideration should be given by the Secretary of Defense to establishing within the Department of Defense a centralized agency which would have the responsibility and appropriate authority to provide coordinated management of materiel common to two or more military services. We stated that responsibilities and authority assigned to the consolidated organization should include:

- (1) Authority to monitor the entry of new items into the supply system.
- (2) Responsibility for determining the initial spare parts requirements to support new equipment.
- (3) Authority and responsibility to control or achieve maximum practicable standardization of items used for the same general purpose by more than one military service.
- (4) Responsibility for computation, coordination, and consolidation of materiel requirements.
- (5) Responsibility for procurement.
- (6) Responsibility for storing, distributing, and redistributing supplies and equipment at the wholesale level, including mobilization and production reserve stocks.
- (7) Responsibility for control and management of maintenance and repair programs.
- (8) Responsibility for disposal of materiel excess to the needs of the Department of Defense.

The McCormack-Curtis amendment to the Department of Defense Reorganization Act of 1958 that permitted the Secretary of Defense to combine common supply activities of the military departments under a single agency organization provided the necessary authority for improving supply management within the Department of Defense.

It thereby enabled the Secretary of Defense to accomplish the purposes of the O'Mahoney-Douglas amendment to the fiscal year 1953 Department of Defense Appropriation Act. That amendment, in order to achieve the efficient, economical, and practical operation of an integrated supply system, prohibited the obligation of funds except in accordance with regulations issued by the Secretary. Several single-manager plans have been put into effect since its enactment. However, it is our observation that many of the single-manager plans did not achieve optimum advantages of centralized management because the single managers were not vested with the authority to completely manage the areas assigned them.

Under the authority granted and responsibilities assigned, single managers had little to do with the determination of requirements for a service or with control over inventories in the hands of the using services. If a military service desired to introduce new items into the supply system, it could do so notwithstanding the possible existence of a large inventory of suitable items which the new item was to replace and the single manager was without authority to intervene. The single managers could suggest items for standardization as a common use item, but could not direct the services to standardize where differences of opinion existed.

Thus, the single-manager function appeared to be one of coordination on supply matters rather than full management of such supplies. It was for these reasons that we recommended that managers of any central supply management activity be given broader authority consistent with the requirements of the individual services, over the entry of items into the system, over standardization decisions, over surplus disposals, et cetera.

Following the submission of a number of our reports, the Secretary of Defense had a study made of the problems inherent in the management of supplies common to two or more services and established on October 1, 1961, a Defense Supply Agency under his direct control for the purpose of providing centralized supply management of those commodities which are common to the military departments and are determined to be susceptible of integrated management by a single agency. Commodities which have been assigned to the Defense Supply Agency include food, clothing, medical, petroleum, industrial, construction, automotive, photographic, electronic, and general supplies. The Agency has also been assigned transportation management and the management of idle production equipment.

In May 1962 the Military Operations Subcommittee, Committee on Government Operations, House of Representatives, held hearings to examine in detail the mission, concept, organization, and operations of the Defense Supply Agency.

During these hearings we made a statement summarizing some of the more significant matters disclosed in our reviews and stated our conclusion that really effective interservice utilization of common use items will best be attained by consolidating, rather than attempting to coordinate, all involved functions and organizations.

We wish to reiterate this position here today. We believe there is a potential for considerable savings to be achieved through centralized management of the supply operations common to the three military departments.

Included in our recommendations for commodities and services to be placed under centralized management were (1) aeronautical equipment and supplies; (2) electronic supplies and equipment; (3) photographic supplies; (4) aircraft engines; (5) clothing and textiles; (6) food supplies; (7) idle production equipment; (8) communications and (9) automatic data processing. Items which have not been assigned to centralized management as of March 20, 1963, are aeronautical equipment and supplies, aircraft engines, and automatic data processing.

Senator PROXMIRE. Mr. Campbell, I hesitate to interrupt but I want to ask a factual question relating to what you just said.

What proportion of procurements are included in these categories that would be under centralized management and what proportion would not be so included? Does this mean 10, 15, 25 or just roughly give us a notion of how significant this is.

Mr. CAMPBELL. I haven't any figures available, Mr. Chairman, on that. We will try to provide the figures for you.

Senator PROXMIRE. Will you provide the figures?

Mr. CAMPBELL. If we can obtain them; yes, sir.

(The information to be furnished follows.)

We attempted to obtain the requested procurement information applicable to the nine categories of supplies and equipment from the Department of Defense. We were informed that such information was not readily available and could only be obtained by request upon the numerous field organizations engaged in directing the supply operations.

Senator MILLER. Mr. Chairman, would you yield at that point?

Senator PROXMIRE. Senator Miller.

Senator MILLER. I was wondering how this information should be broken down. Is it dollar value?

Senator PROXMIRE. Yes, I am talking about dollar value.

Mr. CAMPBELL. We believe greater utilization of surplus and excess property could be achieved by stricter discipline of the screening processes for determining availability of surplus and excess property to fill current requirements. Such need is demonstrated in our report to the Congress on our review of excess and surplus personal property in which we pointed out that, as a result of examination of 4,409 items of excess property, we found 405 instances where available excess and surplus property valued at \$3.1 million was not claimed and used by the military services although needed by them. In view of the results of our examination, we concluded that as much as \$65 million worth of excess and surplus property, over and above the amount recovered in fiscal year 1961 through Department of Defense efforts, could have been and should have been claimed and utilized by the military services.

We are aware that the Department of Defense is seriously concerned about interservice supply problems and that reforms in this area cannot be achieved overnight. It will take some time to fully implement the actions already directed. Other plans to improve the system are under consideration.

Our studies indicate that, in the past, coordination between the services in procurement and supply management has not been as effective as it should have been. In addition to the desire to maintain a complete and separate identification, there is a tendency to want something brand new instead of something not quite as good or up to date.

The success of the Defense Supply Agency in achieving maximum benefits under the McCormack-Curtis amendment will, we believe, depend largely upon whether or not its Director will exercise all of the authority granted to him to manage the supply system rather than merely coordinate on supply matters.

In addition, while as stated in our letter of May 25, 1962, to the chairman, Military Operations Subcommittee, Committee on Government Operations, House of Representatives, it would appear that the Secretary of Defense having delegated his authority to control the introduction of new clothing items into the supply system to the Director of the Defense Supply Agency, the manner in which this delegation is being exercised raises a question as to its efficiency. We believe, therefore, that the Director of the Defense Supply Agency should be given clear authority to control the entry of new items into the supply system in a manner consistent with the needs of the military departments.

On November 17, 1961, the Deputy Secretary of Defense directed the Director of the Defense Supply Agency to make standardization decisions on all items under his management and the military departments were advised that any appeals from decisions of the Director were to be presented to the Deputy Secretary of Defense for resolution. Thus, the authority of the Director, Defense Supply Agency, for a substantial number of commodities has been considerably strengthened. What remains to achieve optimum results is the proper exercise of this authority and the strengthening of authority to control the entry of new items into the supply system. This is not only true of the Defense Supply Agency, but also of any other centrally managed supply activity within the Department of Defense. (See p. 161.)

#### OVERPROCUREMENT

Another troublesome area of supply management is that of procuring sufficient quantities of materials and supplies necessary for efficient operation and maintaining the proper state of military readiness and, at the same time, avoiding procurement in excess of reasonable current and future needs. Except for planned and approved reserves for specific purposes, we believe procurement should be confined to current needs, because advances in the state of the art soon make today's items obsolete.

Since appearing before this committee in January 1960, we have submitted to the Congress 31 reports citing instances of procurement and plans to procure in excess of current needs. Causes of this overbuying included (1) overstatement of requirements, including failure to change requirements computations to reflect changes in programs, (2) failure to use satisfactory substitute items, (3) buying in excess of stated requirements, (4) failure to reclaim usable spare parts, and (5) premature replacement of equipment.

In summary the 31 reviews just mentioned disclosed that actual procurement in excess of current needs of the military departments concerned totaled about \$76 million. After bringing these matters to the attention of the military departments concerned, procurement plans were revised, requisitions on supply depots were canceled and purchase orders and contracts were terminated. As a result, \$49.7 million worth of procurement was either avoided or deferred. In-

cluded in this amount was the termination of \$5 million in firm orders and contracts.

Much of this overbuying can be avoided by engendering a personal awareness of responsibility, stricter supply discipline, and more thorough supervisory surveillance of supply activities. It must be recognized that changing conditions require frequent adjustments in routine procedures based on mature judgment by qualified individuals.

#### INADEQUATE SUPPLY RECORDS

We would like to mention one condition which appears to cause a significant amount of overprocurement and should, therefore, be of considerable concern to the Department of Defense. This is a condition which can and does prevail whether the supply activity is centralized or is maintained in separate military departments. It concerns the matter of adequate supply records. The records used as a basis for determining needs are frequently unreliable. We have found this to be true at almost all locations where we have made reviews of this nature. We have cited many instances in our reports when the services did not know what they had and even where the records showed that needed material was on hand, it could not be located. The unreliability of records is most serious because of their importance in determining what is needed, what is in the supply system, and what is to be bought. We have found many examples where millions of dollars of assets were "lost" for all intents and purposes.

It is essential to the proper functioning of the supply system that the Department of Defense exert unrelenting efforts to improve its recordkeeping and physical control of usable assets.

#### NEED FOR STANDARDIZATION

Our studies indicate that the coordination between the services in procurement and supply management has been hampered by reluctance, in some cases tantamount to refusal, to participate in standardization programs.

We conducted a review of selected activities of the Military Clothing and Textile Supply Agency, the operating Agency established to manage the clothing, footwear, and related equipment within the Department of Defense. On January 1, 1962, this Agency was redesignated the Defense Clothing and Textile Supply Center and authority and responsibility for activities were transferred from the Department of the Army to the Defense Supply Agency, which is under the direct control of the Secretary of Defense. Under Army management, we found that the Government was annually incurring significant unnecessary costs because the military services would not agree to maximum practicable standardization of the size ranges, design, fabric, and shades of color of the items used by them for the same general purpose, and that the Military Clothing and Textile Supply Agency lacked the authority to resolve such disagreements.

To illustrate, for the 57 items of clothing and textiles included in our review, we estimated that the Government was incurring unnecessary costs of about \$2.8 million annually because the military services had not resolved minor differences as to size ranges, design, fabric, and shades of color.



The principal deterrent to standardization was the authority vested in each individual service to make final determinations as to those items to be designated as peculiar or distinctive to its needs. We did not comment on the need for retention by each service of distinctiveness in its uniforms. However, for those items on which the distinctions seemed inconsequential, we expressed the belief that greater standardization should be effected.

Preliminary results of a followup review of the progress toward standardization of these clothing items showed only partial adoption of our recommendations. As of March 8, 1963, our recommendations for standardization were fully adopted for women's exercise suits and men's four-in-hand neckties. Standardization of the men's cotton dress shirts and men's woolen trousers identified in our review was limited to adoption of a common design. Standardization on men's utility uniforms was limited to the uniform proper and not the utility cap. Standardization was not achieved on women's handbags, men's raincoats, and nurses' working uniforms. In fact, the Navy withdrew its nurses' working uniforms from the centralized management of the Defense Supply Agency. This should not be permitted.

Standardization in areas that do not involve the combat requirements of clothing, material, and other commodities or major distinctions in uniforms would result in substantial savings. However, such standardization will not be achieved if the services continue to insist on variations and the Director, Defense Supply Agency, who could resolve such differences, fails to act.

#### PREMATURE REPLACEMENT OF USABLE EQUIPMENT

The military departments have issued regulations and directives containing repair and overhaul criteria for various types of equipment in use. These regulations and directives also set forth criteria for determining when replacement of equipment is economically preferable to repair of equipment.

Our reviews have disclosed improvident disposals or unnecessary procurement within the Army Corps of Engineers of such items as crane shovels, generators, gas cylinders, and outboard motors. For example, the Corps of Engineers disposed of 25 10-ton crane shovels costing \$541,200, which were in an unused or economically repairable condition, while planning to spend about \$12 million to replace them and other crane shovels of similar capacity during the period from 1965 through 1967. Similarly, the corps had spent \$575,000 to replace usable outboard motors and had planned to spend an additional \$321,000 to replace other motors in the system. The corps also planned to buy about \$6.3 million worth of 45-kilowatt and 10-kilowatt generators as a result of failure (1) to provide for the use of acceptable substitute 30-kilowatt generators already on hand, (2) to consider a reduction in need for generators because of the conversion to commercial power, (3) to use actual rather than estimated wearout rates, and (4) to use 10-kilowatt generators available in the Navy. The corps had disposed of 316 acceptable 30-kilowatt generators.

Many of the items which were planned to be replaced were in depot stocks in new condition and the corps determined that there were no

major improvements in current models of the items justifying replacement of the items on hand.

We proposed that, in all cases where a significant quantity of usable equipment is to be replaced due to age or improved design, the Secretary of the Army require that a determination be made as to whether technological improvements in items then available for procurement warrant prompt replacement of the items on hand as being obsolete regardless of age or condition and that, when it is determined that improvements are not sufficient to warrant prompt replacement, a determination including appropriate physical tests be made to establish usage and repair criteria to obtain maximum economical use of the equipment and repair parts remaining in the system.

#### NEEDLESS AND COSTLY WAREHOUSING AND DISTRIBUTING OF COMMERCIALLY AVAILABLE EQUIPMENT AND SUPPLIES

In recent reviews we have found instances where inventory managers within the Department of Defense have not given appropriate consideration to commercial availability of certain supply items and equipment. As a consequence, excessive costs of maintaining, warehousing, and distributing these supplies and equipment were incurred.

We found that the military departments are centrally managing over 1,000 supply items of electric lamps that are readily available to using activities at local commercial outlets. Generally there was little or no price advantage in buying for central supply management. This was because about 86 percent of the electric-lamp supply items were covered by the General Services Administration Federal supply schedules with major lamp manufacturers who would deliver direct to any Government activity in the United States. We estimated that supply-management costs can be reduced by about \$1.2 million annually and supply inventories can be reduced approximately \$5.5 million by decentralized procurement of commercial lamps.

#### RESERVE OF COMMERCIAL-TYPE VEHICLES

We also found that the Navy had purchased and was maintaining a reserve stock of commercial-type vehicles for use in the event of mobilization without determining whether the automotive industry could provide the Navy with the required vehicles in time to meet its mobilization needs if such an emergency occurred. We estimated that the cost of maintenance and interest on the Navy's investment in its reserve fleet of commercial-type vehicles of \$6.8 million was about \$550,000 annually. (See p. 150.)

Information provided to us by vehicle manufacturers indicated that for the most part this reserve was unnecessary since, in the event of mobilization, these manufacturers had the productive capacity to provide the Navy with all but a negligible quantity of the needed vehicles within the time requirements prescribed by the Navy.

#### SUMMARY

Supply management within the Department of Defense is, at best, a monumental task. Although many improvements in supply management have been achieved in recent years, we believe there is considerable room for additional improvements.

As outlined more specifically above, we believe the following are the most urgent areas for needed improvements:

- (a) More centralized control of common-use items for cross-service utilization and standardization.
- (b) Stricter enforcement of a sense of personal responsibility and supply discipline.
- (c) Improved financial and physical control records for supply activities.
- (d) Reevaluation of standardized replacement criteria to provide for effective utilization of acceptable equipment on hand.
- (e) Reliance, where economical and practical, on commercial-supply channels and stocks.

#### STOCK FUNDS AND RELATED CONSUMER FUNDS

The supply-system inventories of the Department of Defense include stock-fund inventories amounting to over \$6.1 billion as of June 30, 1962. Stock funds do not constitute separate supply systems. Stock funds are used by the three services, and by the Defense Supply Agency, as operational and financial systems for the primary purpose of facilitating financial control over consumption-type supply items.

Under the stock-fund method of operating, military units consuming or using the supplies must purchase needed items from the stock-fund inventories maintained at various supply depots and must have sufficient funds available to make such purchases. The funds utilized for these purchases are known as "consumer funds" and are used to replenish depot-stock-fund inventories when necessary. Units are also permitted to turn in currently unneeded materiel of certain types of the stock fund and to obtain credit against future purchases. The requirement that the using units must have sufficient funds to pay for the needed items is designed to provide an incentive against wasteful and uneconomical practices. The stock-fund system and intended control is implemented at the command level by providing the military units with allotments of consumer funds on a quarterly basis from the annual operations and maintenance appropriations.

In response to a request in March 1961, from Congressman John W. McCormack, on behalf of himself, Senator Paul H. Douglas, and Congressmen Thomas B. Curtis and F. Edward Hébert, we made a review of stock-fund operations in the Department of Defense.<sup>14</sup> Our inquiry was directed primarily to those aspects of the stock-fund system that require the using combat and combat-support units to have funds available before they are furnished repair parts and other combat materiel and the effect this system has on the combat readiness of the units. The stock-fund requirement that users must have funds available to buy needed parts is the main difference between this method of operating and regular supply systems in the Department of Defense.

As a result of our review, we issued two reports to the Congress—one on June 13, 1962, and one on December 28, 1962.<sup>15</sup> In these reports we disclosed that the preparedness of combat units was being seriously affected by the inability of the units to train and to obtain repair parts and other materiel required for combat readiness, although such materiel was available in the stock fund inventories at nearby supply sources. The lack of consumer funds was the immediate cause of inability of the units to obtain the needed parts and materiel.

<sup>14</sup> See "Hearings, 1961," p. 155.

<sup>15</sup> See also staff report, 1963, pp. 123-124.

The seriousness of this problem is illustrated by the conditions noted at Fort Bragg where one-fourth to one-third of the M-48 tanks were deadlined because of a lack of parts and on the aircraft carrier U.S.S. *Forrestal* which was operating without such essential materiel as repair parts for the oxygen-producing plant for jet aircraft, fire-fighting equipment, and main engines. Other examples are contained in our reports. Although these conditions existed at the user level, most of the needed materiel or parts were available at nearby stock fund supply sources.

In our review we found other deficiencies such as the failure to cancel excess items on order, ordering parts and materiel that were not currently needed or were needed less than other items, establishing costly duplicate supply activities that also led to accumulation of excess stock, unnecessarily shipping equipment, returning needed items for credit, and unnecessarily removing parts from equipment. We also found some instances of illegal practices such as obligating consumer funds after the authority to obligate had expired, improperly obtaining stock fund credits, and improperly obligating subsequent year's consumer funds.

While it is true that many of these malpractices existed before the adoption of the stock-fund consumer-fund system and probably exist under regular supply systems, the funding requirement of the stock-fund system aggravates and encourages such practices.

The prevalence of these practices in the activities we visited leads us to believe that they are common throughout the Departments of the Army and the Navy. We did not make reviews at Air Force units since they do not use the stock-fund and consumer-fund system for major combat repair parts. In general, the uneconomical or illegal actions were designed to fully utilize the fund resources made available to the using units or to augment these funds, without adequate regard to overall economy to the Government. Fund limitations are conducive to such practices, and proper administration is necessary to minimize them. Since, under the stock-fund consumer-fund system as presently administered in the Department of Defense, these limitations are applied at the consumer level, the practices tend to be more widespread and consequently more difficult to control than they are under systems where fund controls are not extended to these lower levels.

The uneconomical and questionable practices should be matters of considerable concern to those charged with the administration of the system as should the fact that the system, as it is being administered, does not assure that military units will not resort to uneconomical practices. Of greater concern, is the fact that preparedness of combat troop units in the United States and oversea areas and of individual Navy combat and service ships of the Atlantic and Pacific Fleets was being seriously affected by their inability to obtain repair parts and other material required for combat readiness. These conditions, existing solely because the using units did not have the funds to pay for the supplies, should not be tolerated under any type of supply system.

We proposed that the Secretary of Defense either (1) permit combat and combat support units to obtain needed repair parts and other combat materiel without charge and place the fund controls at departmental levels rather than allotting consumer funds to using units

through the various commands or (2) eliminate completely the use of the stock-fund consumer-fund system for repair parts and other combat materiel and have this materiel financed by annual appropriations.

The Department of Defense has acknowledged that the matters identified in our examination indicated areas for improvement and advised us the following actions were taken: (1) The Army, effective July 1, 1962, eliminated certain high-dollar-value items from the stock fund because of the difficulties that these items presented in budgeting and funding for materiel requirements for combat units; and (2) the Secretary of Defense has established a project to study and recommend appropriate action on problems associated with the operation of stock funds.

Until the Department of Defense completes this study and institutes appropriate action, we will not be in position to determine the extent that the problems identified in our review will be alleviated. However, we are of the firm opinion that combat-essential items already paid for and in the supply system should be denied to using units simply because they do not have sufficient money to buy them. It is inconceivable that combat items should be placed in competition with such requirements as maintenance of grounds, dependents' housing, maintenance and repair of administrative vehicles, and other noncombat activities that are now funded from operation and maintenance appropriations.

We hope that the Department of Defense studies will give full recognition to this problem.

#### PROCUREMENT

Contracts awarded for the procurement of supplies, equipment, and services to meet the needs of the Department of Defense totaled \$22.9 billion in fiscal year 1960, \$24.7 billion in fiscal year 1961, and \$28 billion in fiscal year 1962.

Where contracts cannot be awarded on the basis of full and free competition under advertised bid and award procedures, the generally preferred method of Government procurement, the Congress has authorized military departments to place contracts by negotiation under circumstances specified in the Armed Services Procurement Act of 1947. Dollarwise, contracts awarded by negotiation represented 86.2 percent of the total awards in fiscal year 1960, 88.1 percent in fiscal year 1961, and 87.4 percent in fiscal year 1962.

While negotiated procurement may be made competitively in many instances, such competition does not necessarily result in fair and reasonable prices because it is often weighted with considerations other than price. In any event, negotiation represents something less than the protection normally afforded by the forces of full and free competition.

As we pointed out to your committee in January 1960, in the absence of such forces, estimates of costs to produce the required articles must be sound and realistic in order to arrive at fair and reasonable prices, since such estimates are the principal basis on which contract prices are established. Also essential is the effective administration of the contracts, particularly cost-type contracts.

## NEED FOR SOUND PRICING OF NEGOTIATED CONTRACTS

In the negotiation of a contract, the preparation of accurate cost estimates upon which to base reasonable and equitable contract prices requires sound and earnest cooperative efforts of the contracting officials of both the Government and the contractor. Realistic cost estimates represent not only a basis for establishing an equitable price for a given item or service, but also can provide a contractor with an incentive for attaining efficient and economical operations. If cost estimates or targets are not realistically prepared, that is, if they are intentionally or inadvertently stated higher than current production cost experience or other available pertinent information would indicate to be reasonable to anticipate for future production, they result in unwarranted costs to the Government and unjustified benefits to the contractor.

Our audits of only a very small percentage of defense contracts have disclosed excessive prices totaling nearly \$67 million as a result of negotiations of prices that lacked the diligent efforts and cooperation on the part of Government contracting officials, prime contractors, and subcontractors that is necessary to avoid excessive cost to the Government. The procurement agencies have been able to recover a little over \$48 million of this amount, although in many cases there was no legal basis for recovery.

As a result of the substantial number and amount of excessive prices disclosed by our reports, and the interest of the Committee on Armed Services of the House of Representatives in this problem, Public Law 87-653 was enacted on September 10, 1962. This law amends the Armed Services Procurement Act by:

(1) Requiring submission and certification of cost data by prime contractors and subcontractors, where effective price competition is lacking.

(2) Providing for refunds of significant increases in prices resulting from the submission of inaccurate, incomplete or noncurrent cost or pricing data.

(3) Encouraging a greater use of formal advertising and of competition in negotiated procurements.

(4) Imposing more stringent requirements for meaningful statements of facts and circumstances requiring use of the authority to negotiate contracts.

(5) Extending the provisions requiring certifications and price adjustments to all negotiated contracts including cost-type contracts and modifications of formally advertised contracts.

## NEED FOR IMPROVED CONTRACT ADMINISTRATION

Administrative deficiencies have proved costly to the Government under many negotiated contracts. Such deficiencies take the form of acts of both commission and omission. They indicate the need for substantial improvement in the degree of comprehension, by personnel charged with the responsibilities of contract administration, of the nature of the contractual undertakings and the importance and consequences of their actions or failures to act.

Examples of such costly actions involving negotiated fixed-price-type contracts that we have found include: waiver of repricing rights

and negotiation of firm-fixed prices at a time when fair and reasonable prices could not be established; inclusion of excessive royalty allowances in the negotiated price; failure to recoup unpaid royalties included in contract prices although the contracts permitted such recovery; failure to fully recover tax refunds and accrued interest resulting from illegally imposed taxes borne by the Government; failure to adjust prices for items shipped in Government-owned containers; failure to collect rent for commercial use of Government-owned facilities or acceptance of rent at a lesser rate than due for such use; and allowance of interest free use by contractors of excessive provisional payments.

Cost-type contractors have little or no incentive to reduce or hold down costs, since they will be reimbursed for practically all costs incurring in performing. Protection of the Government's interest, therefore, requires effective utilization of the several means that are administratively available to assure, to the maximum possible extent, that unnecessary costs are not incurred. Nevertheless, in our review of selected cost-type contracts, we have found instances of significant excessive cost due to failure of the prime contractor to negotiate reasonable prices with its suppliers, improper reimbursement of costs chargeable to fixed-price work, failure to make adequate reductions for cash discounts when billing costs of materials, and charging Government cost-type contracts and subcontracts with overhead costs applicable to the contractor's commercial work and fixed-price contracts. In all of these cases the administrative audits conducted by the military departments failed to disclose or to question the overcharges.

Contracting officials and administrative personnel also must be as constantly alert for improvident or overliberal policies of cost-type contractors as for improper charges, as shown by the following examples. In our review of air travel policies of selected defense contractors we found that most of the contractors' employees used first-class accommodations when traveling by air, at a considerable increase in cost above aircoach or economy-class accommodations. Although use of the lower cost accommodations is urged by the Government's policy for travel by its employees the Department of Defense has not notified defense contractors to adopt a similar policy.

In a review conducted at 28 plants of 21 major aerospace contractors, we found that during a recent 12-month period over 1,400 newly hired individuals, who had been paid relocation allowances, voluntarily terminated employment or were discharged for improper conduct before they had completed a year's service. Because of the nature of work performed by these contractors practically all of these costs, together with related profits, are ultimately borne by the Government. We noted that some contractors had adopted policies that tend to curb the undesirable shifting of personnel. However, the majority of the contractors included in our review did not have such policies nor did they attempt to recover relocation allowances in case of voluntary termination of employment within a short time after an employee was hired.

#### NONCOMPETITIVE PROCUREMENT

In January 1960 we advised your committee that the Government is frequently denied the benefits of competition through failure of procurement officials to obtain, or reserve the right to obtain for

procurement purposes, manufacturing drawings and data prepared by contractors at Government expense. Failure to obtain manufacturing drawings and data in many cases makes competitive procurement impossible.

In September 1961 we submitted to the Congress a report on our review of noncompetitive procurement of aeronautical replacement spare parts within the military departments. In that review we found that contracting officers were generally procuring the replacement parts on open contract with the original manufacturer of the military equipment and had made little effort to find or develop competitive sources of supply. Many of the items bought could have been made by several manufacturers or were items that were completely fabricated by a subcontractor to the end-item manufacturer using drawings and technical data that were or should have been in possession of the Government.

We pointed out that noncompetitive procurement, under circumstances where competition could be obtained, generally results in higher prices, fosters or subsidizes inefficient and uneconomical practices in industry, and ignores or circumvents a basic policy of the Congress that all qualified suppliers have an equal opportunity to compete for the Government's business. We proposed to the Secretary of Defense that immediate steps be taken (1) to avoid the practice of routinely awarding contracts on a noncompetitive basis; (2) to correct the unsatisfactory conditions which exist in the military departments' control over and use of the technical data essential to the solicitation of competitive bids; (3) to assure that contract terms relating to the Government's rights to technical data are vigorously enforced; (4) to provide specified penalties against contractors who fail to furnish on a timely basis the technical data required by the contracts; and (5) to amend Department of Defense regulations to prohibit use of open contracts for other than emergency procurement.

More recently, we have substantially completed a follow-up review of the procurement of aeronautical replacement spare parts within the military departments. In the Air Force, we found that considerable progress has been made since our last review in increasing competition in the procurement of aeronautical replacement spare parts largely without the use of engineering data to describe the items required. In most of the items examined in which some measure of competition was attempted or attained, it was through the use of various means of describing the items short of providing detailed engineering data. For example, bids were solicited through the use of manufacturers' part numbers, catalog identification, brand names, and fragmentary data. Certain operating problems are still being experienced but those problems were known or have been brought to the attention of the Air Force as a result of our work and continuing efforts are being made to solve them.

While the Air Force also had made considerable progress in improving the conditions in respect to control of and ability to use engineering data, the extent to which it can still further progress in obtaining maximum competition is, in our opinion, dependent upon its ability to make greater use of engineering data in soliciting proposals.

In the Army, we found considerable progress was made toward increasing competitive procurement of aeronautical replacement spare



parts during the fiscal year 1962. We also found that the Army had strengthened its contracting procedures by including provisions in its contracts regarding specific data to be provided and the Government's rights pertaining to such data. Notwithstanding these improvements, little or no progress had been made by the Army toward obtaining an adequate technical data file. Controls over existing technical data were inadequate and there was a lack of procedures for the review of the adequacy of incoming new data for ultimate use for competitive procurement purposes.

In the Department of the Navy we found that little progress has been made in increasing competitive and direct procurement of aeronautical spare parts, in the receipt, control, and use of technical data, and in contracting for technical data. Within these areas, there are still many problems to be resolved if the Navy is to significantly increase the amount of competitive purchases of spare parts. Even though the Navy made improvements in the acquisition, control, and availability of use of technical data since our last review, the Navy continued to receive a large quantity of contractor-furnished technical data inscribed with legends which stated restrictions on the rights of the Government to use the data. Although, in many instances, these restrictions were inconsistent with the provisions of the contracts under which the data were furnished, the Navy did not question their validity and they became the basis for justifying non-competitive procurement of so-called proprietary items.

One particularly flagrant example of unnecessary noncompetitive buying may be found in a report we submitted to the Congress in January of this year. The Navy incurred additional costs of about \$408,000 during fiscal year 1962 because it purchased certain aircraft engine bearings from the aircraft engine manufacturer on a noncompetitive basis rather than competitively from the producers of the bearings. Although the Air Force actually procured the bearings, and advised the Navy that the bearings could be bought for about one-third less if purchased competitively, the Navy insisted the purchase be made from the engine manufacturer. In addition, the procurement of some of these bearings was unnecessary since identical bearings were being disposed of by the Navy as excess to its needs. The unnecessary purchase resulted in further additional cost to the Government of about \$48,000.

In commenting on our findings, the Navy expressed doubt that the Government had the rights to the technical data needed to buy the bearings competitively and stated that the Navy considered it necessary to have the quality assurance services of the engine manufacturer. Therefore, the Navy concluded that the purchase of these bearings from the engine manufacturer on a noncompetitive basis was neither wrong nor wasteful of Government funds.

We found, on the other hand, that the Air Force, which is responsible for the procurement of these aircraft engine bearings for the military departments, had determined that competitive procurement of these items was not barred by lack of rights and had purchased identical bearings directly from the producers. In addition, the Air Force had found that its own inspections of the bearings at the bearing producers' plants were more extensive and thorough than those performed under the engine manufacturer's quality assurance

program. Accordingly, there seemed to be no reason to believe that satisfactory bearings could not have been obtained at a lower price through competitive procurement methods. Therefore, we disagree with the Navy's position that the procurement of these bearings was neither wrong nor wasteful of Government funds.

Since the Air Force and Navy frequently use identical aircraft engine parts and frequently exchange such parts, we recommended that the Secretary of Defense establish uniform standards for use in determining when not only bearings but also other replacement spare parts for aircraft engines can be purchased competitively. We further recommended that these standards provide that disagreements between the services on the method of purchase to be followed for specific parts be referred to the Department of Defense for resolution, and that the Department of Defense maintain close surveillance over Navy purchasing practices to assure the fullest use of competition in the procurement of aeronautical repair parts.

#### ANALYSIS AND CONCLUSION

The number and types of situations that we have identified involving excessive costs to the Government indicate that these and similar deficiencies are widespread. The volume of defense procurement is so significant a factor in the economic pattern of our Nation that, in our opinion, toleration of expensive practices, if not of pure waste and extravagance, could drain away a substantial part of our resources.

It is true that considerable progress has been made lately both in the basic law and in recognition within the Defense Establishment of the need for tightening up its contract negotiation and administration. Realization of the benefits of these advances and solution of the still existing problems, however, will require a considerable period of time, together with increased and unremitting vigor by both top-level officials and personnel engaged in contracting and contract administration.

In the area of noncompetitive procurement, the Secretary of Defense has stated that on the basis of their own experience to date and the studies of the General Accounting Office, the Department of Defense anticipates initial price reductions on the order of 25 percent upon transferring items to competitive procurement. It is estimated that this progress to date in shifting to competitive procurement has saved \$190 million per year. By the end of fiscal year 1963, the Secretary estimates that the annual rate of savings should reach \$289 million and if the Department of Defense can achieve the increase in competition targeted through the end of fiscal year 1965, there should be an annual savings of \$494 million.

In our opinion, a good start has been made and the progress is encouraging. However, our follow-up review of noncompetitive procurement, and the Navy aircraft engine bearings case, demonstrate that the issuance of directives and policy statements cannot alone be relied upon to assure that necessary steps are taken.

The bearings case especially, in our opinion, emphasizes the need for a greater sense of individual responsibility for economy in Government operations and for considering the manner in which this responsibility is met in evaluating personnel performance and making management assignments.

It seems plain to us that the only way to curb Government spending and to get more goods and services for each dollar spent is to make concerted effort to eliminate the costly practices that exist. In the final analysis, it makes little difference whether the deficiencies are due to ignorance, carelessness, or indifference. Clearly, increased training of personnel and improved instructions are needed. They will not, however, substantially achieve reasonably effective correction of the deficiencies, unless coupled with increased awareness by personnel at all echelons of the nature and consequences of their acts and their personal responsibility to protect the interest of the Government.

Even though the Government will be in a better position to negotiate fair and reasonable prices under the new statutory requirements for submission and certification of cost data by prime contractors and subcontractors, it must be recognized that cost data certifications and defective pricing clauses will not cure all past deficiencies. There still can be no substitute for informed and astute negotiation by Government representatives, based on review, audit, and price analysis of the cost and pricing data submitted by the contractor or subcontractor.

Similarly, in respect to the deficiencies in contract administration, it seems evident that these costly deficiencies could have been largely obviated. This could have been accomplished, we believe, by greater knowledge on the part of the personnel involved of the pricing and cost implication of their acts and omissions, coupled with increased awareness of their responsibilities for protecting the Government's interest and for using the tools available to enable them to more effectively discharge these responsibilities. The most effective deterrent to the incurrence of unnecessary costs under cost-type contracts is proper administrative control by the contracting officer and other administrative personnel of the Agency. This control can be maintained in a number of ways, including effective administrative audits, effective surveillance by technical inspectors and advisory teams, and careful and informed review of the contractors' procurement procedures including the negotiation and administration of subcontracts.

We suggest that such an awareness and sense of responsibility can be fostered by improved supervisory surveillance and appropriate consideration of the manner in which the individual has discharged his responsibility, in evaluating personnel performance for promotion, demotion, and reassignment.

Mr. Chairman, this concludes our discussion of the three areas we mentioned in our opening remarks. However, we feel our work in other important areas would also be of interest to this committee.

Therefore, with your permission we will submit, for inclusion in the record, a résumé of some significant results of our reviews in the following additional areas:

1. Development and procurement of new types of equipment and systems.
2. Maintenance, repair, and overhaul of equipment.
3. Military assistance program.
4. Military construction.
5. Communications.
6. Automatic data processing.
7. Manpower utilization.

Representative PATMAN (presiding). Thank you, Mr. Campbell. I know the committee will be greatly helped by your testimony.

Without objection, the additional material will be inserted in the record at this point.

(The material referred to follows:)

ADDITIONAL MATERIAL SUPPLEMENTING THE STATEMENT OF THE COMPTROLLER GENERAL OF THE UNITED STATES, MARCH 29, 1963

DEVELOPMENT AND PROCUREMENT OF NEW TYPES OF EQUIPMENT AND SYSTEMS

In recent years, from 22 to 25 percent of the dollar volume of all military contract awards has been for experimental, developmental, test and research work. In fiscal years 1961 and 1962 the awards amounted to over \$6 billion each year. There is no question that research and development work is necessary to promote and engender new scientific discoveries and that they are vital to a nation's survival in today's state of world affairs. The use of research and development funds is, therefore, of significant importance.

There are many types of competition for the resources available. We recognize that conflicts in demands for resources can only be resolved on a judgment basis. The pressure of time is often a decisive factor in decisions to devote resources to multiple approaches to unsolved problems. Conflicting pressures between the desire to get hardware in hand now, and the desire to develop more advanced and more powerful hardware for the future, must always be resolved.

Despite the importance of research and development work and the many intangible factors that must be considered in programs of this nature, we feel that our audits during the past 3 years have uncovered certain areas where economies could be effected without detriment to basic objectives. These areas are (1) the tendency to start quantity production of items without adequate development and (2) the duplication of effort by the three military departments in developing similar items.

*Volume production before adequate development or testing of prototypes (see p. 7)*

We have found that decisions were made to proceed with production of aircraft, accessories, and equipment on a volume basis notwithstanding unfavorable prospects for producing an acceptable product or identified defects requiring correction either during production or by later modification. However, production was continued despite the absence of a realistic expectation of overcoming the difficulties, the lack of assurance of the effectiveness of proposed modifications or consideration of costs. In one report we point out instances where more than \$600 million was spent for aircraft and equipment that was incapable of performing its military mission.

In a review of the development and procurement of nine series of new combat and tactical vehicles costing more than \$1.6 billion, operational performance was found to be seriously deficient in the same areas in which deficiencies were known to exist when production was ordered. These deficiencies continued to exist despite extensive and extremely costly programs of modification. Incomplete records showed these costs amounted to over \$100 million. Our report was the subject of lengthy and thorough hearings by a Special Subcommittee of the Committee on Armed Services, House of Representatives, which stated that "Of real and immediate concern to us is the extent to which reliance on sincerity, integrity, and dedication to purpose is substituted for the exercise of good judgment, caution, and control within the Department of the Army," and concluded by strongly urging the Army "to look within itself and closely examine its procedures."

In another review we pointed out that the Army had procured 135 firetrucks at a cost of \$9.4 million without adequate tests of the prototype that could have disclosed the impracticability of accomplishing the purposes intended. After substantial production costs had been incurred, it was determined to be impossible to control missile eruption fires in their initial stages. The failure to fully test the trucks in advance of volume production resulted in the procurement of vehicles that were not needed.

To provide better assurance that material produced in volume will be able to perform in the manner intended, we have recommended that (1) responsibilities for surveillance of programs be more clearly fixed, (2) appropriate controls be established for each program for accumulating, consolidating, and evaluating all pertinent information bearing on management and progress of the program, and (3) adequate tests and evaluations be made of newly developed items prior to award of contracts for their production. We also believe that where emergency

conditions require early production, adequate tests and reevaluation of design should be completed as soon as possible in order to minimize procurement prior to determination of the adequacy of design and performance.

#### *Duplication of development effort*

In our review of the development and management of selected firetrucks in the Department of Defense, we found that the three military departments had spent about \$1.6 million in developing aircraft crash firetrucks for use with medium and small aircraft or for missile support, with considerable duplication of development effort and cost.

Similarly, we found that the failure of the Department of Defense to prevent the Air Force from developing and procuring a new type helicopter caused the Government to incur additional costs of at least \$9.5 million. At the time the Air Force undertook the development and procurement program for this helicopter, the H-43B, the Army had a helicopter, the HU-1A, that could have met the needs of the Air Force. The capacity and performance characteristics of the Army's helicopter, which was already in advanced stages of development and had been flight tested, were substantially the same as the specification requirements of the Air Force.

In view of the failure of the military departments to coordinate effectively in preventing duplicate development effort and cost, we recommended that the Secretary of Defense take positive measures to assure close surveillance and control by his office of the research and development programs of the three military departments.

#### MAINTENANCE, REPAIR, AND OVERHAUL OF EQUIPMENT (SEE P. 33)

Maintenance, including repair and overhaul, of equipment represents a major factor in the operating costs of each of the military departments. In fiscal year 1962, the Army's obligations for major overhaul and maintenance of materiel exceeded \$450 million. While Navy and Air Force budgets do not separately identify this item, their total appropriations for operation and maintenance are comparable in size with that of the Army.

We made reviews of the maintenance practices of the military departments in selected areas and found that such practices often were unnecessarily costly and extensive and, in other cases, had been inadequate to properly maintain equipment. Correction of these deficient practices should result in very substantial savings and in improvement in mission performance capability.

#### *Unnecessarily costly and extensive maintenance*

We found that fiscal year 1960 labor costs for maintenance of aircraft by the Military Air Transport Service were about \$13 million higher than they would have been under maintenance standards followed by commercial airlines, that the Air Force and Navy had duplicate facilities at McGuire Air Force Base to maintain the same type aircraft, and that the Navy unnecessarily spent more than \$5 million to overhaul aircraft engines instead of using 936 operable engines that could have been removed from aircraft in storage. We also found that repair and maintenance of Army and Air Force noncombat vehicles cost substantially more than it should and that the Air Force incurred an additional \$5 million in repair costs and depreciation due to failure to replace uneconomically repairable vehicles.

The excess aircraft maintenance costs were due principally to unnecessarily frequent inspections, testing, and replacement of accessories. High-cost non-combat vehicle maintenance in the Army and Air Force was caused by too many costly major overhauls, inordinately frequent inspections and minor repairs, poor productivity of personnel, and lack of adequate management controls and standards. In the Air Force, this was aggravated by the policy of retaining in use uneconomically repairable vehicles, which was attributed to budgetary limitations. If such operations were conducted as efficiently as those of the Navy, whose costs are comparable with those of private vehicle fleets, very substantial savings could be realized by both the Army and the Air Force.

Pursuant to our recommendations we were advised by the Assistant Secretary of Defense (Installations and Logistics) that action has been taken resulting in substantial reductions in the Air Force's aircraft maintenance costs, that studies of means of further reducing such costs were still under way, and that the duplicate maintenance facilities were being consolidated at an annual saving of \$1.1 million. Our followup review on aircraft engines disclosed that the Navy had studied the low-time engines in storage as we suggested and had reduced

its fiscal year 1962 program for overhaul by about \$1.3 million because of the availability of low-time engines on stored aircraft.

As stated earlier, the Assistant Secretary of Defense (Installations and Logistics) also told us that actions had been taken to attain economical and effective maintenance of noncombat vehicles resulting in savings of about \$4 million a year, and that the steps taken should produce an ultimate reduction in annual maintenance costs of about \$22 million, with additional cost reductions in other categories. He also said that more timely replacement of vehicles will result in reduced downtime for maintenance and permit a reduction in vehicle inventory with an eventual one-time capital saving of an estimated \$10 million. This contrasts with the Air Force's earlier position at the time of our reviews that it was not worthwhile to make a study as we recommended to determine the most economical and effective repair operation and replacement rate, as they had a program to replace wornout vehicles. We had found at that time that this program had not appreciably improved conditions.

*Maintenance deficiencies in combat, combat support vehicles, and other equipment*

We found serious and extensive deficiencies in the maintenance of combat and combat support vehicles at all three of the installations at which we reviewed maintenance and pointed out that these deficiencies assumed added importance in the light of the mission requirements of the combat troops to which the vehicles were assigned.

Our findings in the first of these reviews (maintenance of M48 and M48A1 medium tanks at Fort Bragg), which in general were representative of the types of deficiencies we found in each of the reviews, were discussed during the hearings on the Department of Defense appropriations for 1963 held before the Subcommittee on the Department of Defense, House Committee on Appropriations. The subcommittee questioned witnesses from the Department of the Army on the issues raised in our report and secured admissions that the Army recognized that the conditions we reported could exist extensively throughout the Army.

Our reviews indicated that the maintenance deficiencies were attributable principally to lack of attention to or knowledge of the situation on the part of responsible commands, as evidenced by failure to perform required repairs, inadequate management of maintenance practices at using troop levels, and inadequate control over the operation of the vehicles. The Assistant Secretary of the Army (Installations and Logistics) agreed that there was need for improvement and enumerated corrective actions that had been taken or were being taken in the areas of practices, procedures, training programs, and command management.

The aircraft maintenance practices of the Military Air Transport Service previously mentioned, in addition to their costliness, also resulted in aircraft being out of operation for excessive periods of 36 to 44 percent of the time as compared to 11 to 18 percent experienced by commercial airlines engaged in similar operations. In our opinion, there were similar, although unmeasured, reductions in availability of commercial-type vehicles in the Air Force due to their lack of an adequate replacement plan.

*Analysis and conclusion*

Our reviews of maintenance, repair, and overhaul activities have been made only in a limited number of areas. However, in our opinion, the extent to which they have disclosed uneconomical, inefficient, and ineffective practices, the indications that these are prevalent, and the importance of prompt correction, from the standpoint of both the potential monetary savings and improvement in operations, dictate the need for prompt and aggressive corrective action.

We believe it is highly significant that the top officials in the Defense Establishment have recognized the fact that the problems we reported exist, that they are important, and they have initiated corrective action on the matters reported. We have recently begun followup reviews in some of these areas to ascertain the extent of progress and plan to further extend such followups at appropriate times.

While the actions taken by the departments appear to be well directed for this purpose it is not to be expected that the management improvements we recommended could be attained or the full potential in savings achieved in a short time. The results of the departments' actions must depend on the vigor and persistence with which they are carried out and extended to assure that maximum improvements are made throughout the services. We believe therefore

that the Department of Defense should undertake a more comprehensive review than ours of the maintenance, repair, and overhaul practices in the military services, establish appropriate standards and controls, and provide continued surveillance to insure their observance.

#### MILITARY ASSISTANCE PROGRAM

The General Accounting Office has been and is engaged in a continuing review of the military assistance program, authorized by the Mutual Security Act of 1954, as amended, and continued under the Foreign Assistance Act of 1961, as amended. Our reviews during the past 3 years for the most part have been directed to the programing, delivery, maintenance, and utilization of equipment furnished to foreign countries, and to the local currency military budget support program. These reviews have disclosed frequent failure to adjust programs and deliveries for the recipient countries' inability to maintain and utilize equipment and materiel furnished, and the failure to exercise adequate controls to insure that funds contributed by the United States in support of military budgets are used in such a manner as to attain and promote the most desirable mutual security objectives.

#### *Ineffective maintenance and utilization of equipment furnished to foreign countries*

Our reviews have disclosed numerous instances where substantial amounts of military equipment provided to foreign countries have not been effectively maintained and utilized. The major deficiencies which have contributed to this condition are (1) programing and delivery of equipment by the United States without adequate coordination with the plans and programs of international organizations and recipient countries, (2) delivery of equipment to recipient countries which lacked the necessary capability to maintain and utilize the equipment provided, (2) imbalanced delivery of equipment and related components, and (4) delivery of equipment in excess of valid requirements. Following are illustrations of these deficiencies:

Our recent report on missile system equipment delivered to European countries disclosed that equipment valued at about \$25 million was either not in use or was in use but had a limited readiness as of March 1961. The equipment had been on hand as much as 13 months more than the period of time normally required for emplacement and checkout after delivery. The ineffective utilization of this equipment resulted because, at the time the United States delivered the equipment, permanent launching sites were not available, related equipment at NATO installations required to attain full operational capability of the equipment delivered by the United States was lacking, and a sufficient number of support personnel had not been provided by the recipient country.

A significant amount of military equipment furnished under the military assistance program to foreign countries has not been effectively utilized and maintained. For example our reviews of the maintenance and supply support of Army equipment disclosed that in one country almost one-fifth of the tanks delivered under MAP were unserviceable or deadlined, one-third of the 1,100 vehicles in 2 divisions were considered to be unserviceable and in no condition for a planned field maneuver, and about 38 percent of the radio communication equipment in another country had an effective range of only one-third to two-thirds of that for which it was designed.

In a third country we found that at the time of our review more than 2,000 of about 6,900 combat and combat-support vehicles were inoperable, about 50 percent of the jet aircraft in one of the 2 Air Force fighter wings were out of commission for lack of parts and had been grounded over an 8-month period, and shortages of gasoline had precluded full utilization of equipment. We identified the following as the major contributing factors to the poor maintenance and utilization of equipment in this country.

- (a) Persistent and critical shortages of trained personnel, tools, and maintenance publications.
- (b) Limited field and depot maintenance capabilities.
- (c) Inadequate supply procedures.

Still another recent review disclosed that aircraft, aircraft missiles, and related equipment valued at over \$8 million had been programed and substantially delivered to a recipient country although the necessary capability to maintain and utilize the equipment did not exist. At the time of our review two-thirds of the F-86F aircraft delivered were inoperable due to the absence of

proper maintenance, and trained pilots were available for only half of the aircraft delivered. In this case the Department of Defense told us that political conditions involving base rights became the overriding consideration leading to the programing and delivery actions.

We are of the opinion that equipment should not be furnished to recipient countries under the military assistance program until assurance exists that the countries have the necessary maintenance and operational capability. The premature delivery of equipment before such a capability exists precludes use of the equipment in other areas where there may be both a need for the items and an ability to maintain and operate them. Premature delivery of equipment also ties up in nonoperational equipment a portion of the limited U.S. funds available for the military assistance program which might be more effectively used to fill other priority requirements. In the event political considerations require a particular level of assistance every effort should be made to obtain the recipient country's agreement to accept equipment it can properly maintain and utilize.

Also a substantial amount of equipment has been delivered to foreign countries under the military assistance program which could not be promptly and effectively used by the recipient countries because related equipment and components were not available.

In one country our review disclosed that Air Force radio sets valued at about \$3.3 million had been programed and that a large portion of the equipment delivered was not being used because the necessary installation and ancillary equipment had not been delivered. In this same country we found that \$2.2 million worth of ammunition had been on hand for 18 months although the related weapon had been deleted from the program.

In four countries we found that about \$4.4 million worth of missile system mobility equipment had been delivered which could not be used because related equipment required to achieve a mobile capability for the missile systems had not been furnished. In these same countries we identified about \$900,000 worth of airborne electronic equipment on hand which could not be installed because related modification kits and other equipment were not available. Our review of delivery and utilization of tactical air navigation equipment disclosed that \$12 million worth of this equipment had been delivered to foreign countries although the equipment could not be used by the recipient countries because the related installation kits were not provided.

Millions of dollars worth of equipment and spare parts have been unnecessarily delivered to foreign countries under the military assistance program. The major causes of this inefficient and uneconomical use of funds available for the military assistance program are the failure of the Department of Defense to (1) establish the validity of requirement, and (2) take timely action to cancel or suspend delivery of equipment or spare parts which become excess due to changes in requirements.

#### *Military budget support programs*

The United States makes substantial contributions to the military budget of about a dozen foreign governments in addition to furnishing, as grant aid, military end items, spare parts, facilities, and services. These contributions are made in the currency of the recipient government derived (1) from funds generated under the supporting assistance portion of the economic assistance program and (2) from the sales of surplus agriculture commodities under title I of the Agricultural Trade Development and Assistance Act of 1954, as amended.

Our reviews of the military budget support program disclosed that the U.S. agencies charged with the responsibility for the administration of this program have failed to exercise adequate controls to insure that the funds contributed by the United States are used in an efficient and economical manner to attain mutual-security objectives. We found that hundreds of millions of dollars in U.S. owned or controlled foreign currencies have been released to foreign countries in support of their military budgets without a firm determination of the validity of the recipient country's military budget requirements and the extent of support required by the United States, without obtaining necessary assurances that contributed funds would be expended in furtherance of mutual-security objectives, without establishing effective control over the expenditure of funds by the recipient countries, and without making adequate reviews, audits, or inspections of the disposition of the contributed funds.

The ineffective administration of this program by U.S. agencies has permitted recipient countries to use contributed funds for purposes other than



those approved by the U.S. agencies, and for purposes not considered to be essential to mutual security objectives. In addition, attainment of mutual security objectives has been adversely affected because the recipient countries were not providing and expending sufficient amounts of their own funds to adequately maintain and utilize costly military equipment and military facilities furnished by the United States as grant military aid.

#### *General*

The military assistance program has been in effect for over 13 years, and while we recognize that marked improvements in administration have been made during this period, our examinations show that more effective military assistance could, through improved economy and efficiency, be obtained for considerably less money than is now required. We believe that the deficiencies disclosed by our examinations are symptomatic of a need for the Department of Defense to take aggressive action to insure that the military assistance program is administered in a more economical and efficient manner. In this respect the various actions taken by the Department of Defense in response to our recommendations, if properly implemented and vigorously pursued, will be a major stride in this direction.

#### MILITARY CONSTRUCTION

We have made reviews of the programing and financing of selected facilities constructed at Army, Navy, and Air Force installations. We found, in these reviews, that substantial amounts of construction have been performed with other than military construction funds and that the Congress has not been informed of nor permitted to exercise its right to review and approve or disapprove such projects. We further found instances of construction costs far exceeding estimated costs, of incurrence of unnecessary costs, and of improper use of proceeds of sales of scrap and salvage material to construct, improve, and modify facilities. In one case, we found that costs incurred in the acquisition of facilities by lease were substantially greater than those that would have been incurred to build the facilities.

#### *Operation and maintenance appropriations used for construction*

We reported to the Congress in January 1961 that we had found more than \$50 million of construction and construction-type work done by the military departments in the fiscal years 1957, 1958, and 1959 outside of the military construction program, that had not been justified to the Congress, and that this work was financed with other than military construction funds. As a result, the Congress was not informed of and did not have an opportunity to review and specifically approve or disapprove all the construction, as contemplated in the authorization processes established by the Congress to control and limit the extent of military construction.

For example, at Fort Lee, Va., we found an airfield being built with engineer-troop labor. At the time of our examination, the cost of the airfield and hangar had reached \$536,373 (including troop labor) with additional construction planned. Following the submission of our report, the House Committee on Government Operations held hearings on the construction of the airfield at Fort Lee, Va., and also investigated the construction of airfields at Fort Carson, Colo., and Sharpe General Depot, Lathrop, Calif. They found that the monetary limitation placed on the construction of facilities also had been exceeded without legislative authorization at each of these locations. As a result, the committee made certain proposals for amending laws and regulations pertaining to military construction.

Among other questionable applications of operation and maintenance appropriations for funding military construction, we found (1) conversions of existing facilities from one end-use to another, (2) additions or extensions to existing facilities and, in some instances, new construction, (3) use of operation and maintenance funds to complete construction projects when construction funds available for the projects were exhausted, and (4) classification of essentially similar work in some instances as repair, rehabilitation, or modification projects and, in other instances, as construction projects. We noted also instances of failure to furnish to the Congress, for its consideration at the time authorizations for construction were sought, information regarding the procurement and installation costs of certain types of equipment constituting an integral part of the construction project and without which the constructed facility would not be usable.

In a number of instances construction costs of individual facilities far exceeded the estimated costs submitted to the Congress at the time construction authorization was being sought. For example, at Fort Dix, N.J., with construction more than 90-percent completed, the cost of constructing a hospital would be \$12.4 million as compared with the \$8.3 million estimate presented to the Congress. Further, the presentation to the Congress specified a 750-bed facility whereas the hospital was actually being constructed with only a 500-bed capacity.

On two construction projects, the Department of the Navy had incurred unnecessary costs of about \$1.7 million. Unneeded Marine Corps warehousing was built at Beaufort, S.C., at an estimated cost of about \$1 million because of failure to consider significant reductions in requirements for warehouse space which occurred between the time of congressional authorization of the construction and the award of contracts. The cost of a Navy hospital at Great Lakes, Ill., was increased an estimated \$730,000 because certain essential work was omitted from the original construction contract in order to stay within the amount originally requested by the Navy and authorized by the Congress. The omitted work was later added to the contract at a higher cost than the original bid for this work, when a supplemental authorization became available.

At the Army's Edgewood Arsenal, we found that the installation renovated three old houses, using operation and maintenance funds, at a cost in excess of, and contrary to the spirit of, the maximum cost limitations established by the Congress for new housing for officers. For example, the cost of renovating the house occupied by the commanding general was over \$61,000 as compared to the statutory limitation of \$22,000 for the construction of a new house for an officer of that rank. Also, the cost of renovating five other old houses ranged between 88 and 93 percent of the statutory limitations.

On January 18, 1961, the Department of Defense issued Directive No. 7040.2 which established basic policies for improving financial management in the area of appropriations for military construction. The directive provided, among other things, definitions of such terms as construction, maintenance, repair, alteration, and replacement for the guidance of the military departments in distinguishing between the projects which require military construction funds and the projects which require operation and maintenance funds.

The Congress, in enacting the Department of Defense Appropriation Act, 1962, approved August 17, 1961, provided, in section 637, that funds appropriated in the act for maintenance and repair of facilities and installations shall not be available for acquisition of new facilities or alteration, expansion, extension, or addition of existing facilities, as defined in Department of Defense Directive No. 7040.2, dated January 18, 1961, in excess of \$25,000. Like provisions were contained in section 536, Department of Defense Appropriation Act, 1963, approved August 9, 1962.

*Scrap and salvage proceeds used for construction purposes. (See pp. 58, 157, and 438.)*

In another case, we found that the Air Force improperly used about \$4 million of proceeds from the sale of scrap, salvage, and surplus property during fiscal years 1957 through 1961 to finance projects for the construction, improvement, and modification of redistribution and marketing facilities at 12 Air Force Logistics Command installations. The construction and improvement projects financed in this manner constitute public improvements within the meaning of section 3733, Revised Statutes (41 U.S.C. 12), which, in effect, provides that funds for such projects must be specifically authorized by the Congress. Since these projects were financed out of scrap sales proceeds, this specific congressional review was improperly avoided.

Although the Air Force expressed the opinion that the use of the sales proceeds was within the authority granted by the appropriation acts, they agreed that projects costing \$1,146,519 should have been financed as military construction, rather than out of such proceeds.

The provisions of the appropriation acts concerning the use of proceeds from the sale of scrap, salvage, and surplus material, in our opinion, were not intended by the Congress to authorize military construction-type projects on which it consistently imposes strict specific controls as a matter of policy. We, therefore, notified the Secretary of Defense that the acquisition, outside the military construction program, of facilities such as those described in our report is legally improper and that, unless specific authority is obtained from the Congress to use proceeds from the sale of military scrap, salvage, and surplus property to finance such construction projects, funds for their construction, improve-

ment or modification should be obtained in the manner prescribed by law for all military construction programs.

*Additional cost of \$10.3 million for leasing instead of building fuel storage tanks*

Recently we reported to the Congress that, to satisfy Department of the Air Force requirements, the Defense Petroleum Supply Center negotiated eight contracts for petroleum storage in new dispersed and protected commercial (contractor owned and operated) facilities at a cost of about \$10.3 million higher than if the Government had built its own facilities.

The increased costs result chiefly from the fact that the lease contract prices, for use of the facilities for 5 years, including substantially all of the contractors' costs for acquisition of land and construction of the facilities even though the facilities have an estimated useful life of 20 years. Further, at the end of the initial 5 years of use, the Government will not have title to the facilities unless an additional \$9 million is paid. Should the Government exercise its renewal options under the contracts and continue to lease the facilities for an additional 15 years, the total cost for the full lease contract periods for storage in commercial facilities could aggregate about \$12.8 million higher than similar storage in Government facilities.

We found no evidence that officials of the Air Force, the agency responsible for determining the basis on which the facilities should be acquired, had compared the costs of commercial facilities with the cost of Government facilities before the decision was made to contract for the commercial facilities. Had such comparisons been made, they should have disclosed that disproportionately higher costs would be incurred for storage in commercial facilities and that contracting for storage in Government facilities would result in substantial savings to the Government.

*Analysis and conclusion*

There would seem to be no doubt, as shown by our reports and the inquiries by the Committee on Government Operations, House of Representatives, that the military departments are extensively circumventing the intended congressional control of military construction. The diversity of situations, prevalence of the practices, and variety of means used, in our opinion, strongly indicate the need to provide means of closer control to assure compliance with the riders in the fiscal year 1962 and 1963 appropriation acts regarding use of operation and maintenance funds.

The clearer definition in the revised Department of Defense directive of construction, maintenance and repair that properly may be accomplished with operations and maintenance funds should enable prevention of substantial amounts of unauthorized and unneeded construction. To assure these results, however, the Department of Defense must continuously review construction, maintenance, and repair projects planned and in progress by the military departments.

We also suggest that it would be desirable to enact positive legislation, similar to that included in the fiscal year 1962 and 1963 appropriation act riders, to prohibit the use for construction of proceeds from the sale of scrap and salvage material and to require justification to and specific approval by the Congress before entering into lease arrangements for new facilities that would, if constructed by the Department, require such justification and approval. Continuous vigorous review and surveillance by the Department of Defense also would be necessary in these areas and should include a determination of the comparative costs of leasing and building and a requirement that specific authority be obtained to proceed with those arrangements that are least costly to the Government.

COMMUNICATIONS

During the hearings before your committee in 1960<sup>16</sup> we discussed a report on our review of the management of leased private line telephone facilities in the Department of Defense and selected agencies, wherein we stated that the Department of Defense and selected service agencies had been incurring excessive costs amounting to possibly more than \$1 million annually in the leasing of private line facilities. These excesses were the result of (1) the erroneous application of certain rates, and (2) inefficient administrative practices on the part of Government departments and agencies. Question was raised during the hearing as to why there should not be a single management for all communications in the Department of Defense.

<sup>16</sup> See "Hearings, 1960," pp. 22-23.

## 138 PROCUREMENT ACTIVITIES OF THE DEPARTMENT OF DEFENSE

Following the submission of our report to the Congress, the Department of Defense established ad hoc working groups to investigate our recommendations and the American Telephone & Telegraph Co. filed a new tariff offering wide band service to users of leased circuits at substantially reduced rates. This tariff afforded possible savings of several million dollars annually to the Department of Defense and greater potential savings through combining the management of telephone services.

In May 1960, the Secretary of Defense established a Defense Communications Agency under his direction, authority, and control. Its mission is to insure that a defense communications system will be so established, improved, and operated as to meet the long-haul, point-to-point, telecommunications requirements of the Department of Defense and other governmental agencies as directed.

The Defense Communications Agency has recently advised us that its Office of Commercial Communications Management, with the assistance of I.T. & T. Communications Systems, Inc., has effected, or will effect, estimated savings of \$42.5 million through fiscal year 1964. The savings are attributed to the reconfiguration of Department of Defense circuits so as to take maximum advantage of reduced rates under the new American Telephone & Telegraph Co. tariff.

Also, in a report dated August 31, 1962, I.T. & T. Communications Systems, Inc., mentioned that a continuing long-range study of reconfiguration is necessary; that the Office of Commercial Communications Management was not properly staffed to continue most effectively the work mentioned in the report; and that integration of Federal Aviation Agency circuits with those of the Department of Defense would save about \$5 million annually. The Defense Communications Agency is considering the recommendations in the report. Accordingly, it appears that the Department of Defense is actively engaged in efforts to economize in the communications field and that there are many problems yet to be overcome.

We recently completed a review of the methods of transmitting and routing long-distance, printed-message communications within the Department of Defense. In this review we found that over \$1.1 million is being expended unnecessarily each year by the military services because messages are being transmitted long distances by commercial means without fully utilizing existing military networks. Furthermore, the most economical type of commercial message was not being used. The principal reasons for the unnecessary costs are that (1) applicable regulations of the military services do not designate a specific center or refite point to handle messages of all military services for delivery within a limited geographical area, and (2) adequate guidance is not furnished on the use of less costly TWX messages in lieu of telegrams. We are recommending that the Department of Defense issue appropriate instructions in these areas.

### AUTOMATIC DATA PROCESSING (SEE PP. 109, 155, AND 271.)

Our reviews of automatic data processing developments in the Federal Government have indicated a need for more effective and economical use of automatic data processing equipment in Government operations, a need for more positive long-range planning, a desirability of purchasing rather than leasing equipment, and a need for central management to direct and coordinate a Government-wide program of procurement and utilization.

In recent years there has been a very sizable expansion in the use of automatic data processing equipment in operations of the Department of Defense. Costs related to these programs have increased substantially in the past 3 or 4 years. For example, at the end of fiscal year 1959, 283 computer systems were installed in defense activities at an annual cost of \$168 million. By June 30, 1963, 750 computer systems will be installed. Total Department of Defense automatic data processing costs for fiscal year 1963, including costs for punched-card equipment, will amount to \$456 million. These costs are exclusive of amounts for equipment installed for military tactical operations, intelligence, surveillance systems, and certain other classified activities in the Department of Defense.

#### *Need for more effective use of automatic data processing*

The Aviation Supply Office, Department of the Navy, was one of the first military agencies to use high-speed electronic computer equipment in its supply operations. The first computer was installed at the Aviation Supply Office in March 1954. Our report submitted to the Congress on May 31, 1962, disclosed that because of deficiencies in the manner in which the data processing system was being used in determining need for materials, in some cases overbuying:

of materials resulted, and in other cases shortages of parts developed which subsequently resulted in aircraft being grounded. The shortcoming of the automatic data processing system at the Aviation Supply Office were attributable primarily to lack of effective planning and preparation for the use of automatic data processing equipment, failure to assure that correct and complete data were used in the system and failure to take remedial action necessary to correct systems deficiencies brought to the attention of the management.

The conditions found at the Aviation Supply Office showed a need for responsible centralized supervision over the preparation and entry of information into the master data file and suitable controls to provide prompt entry of changes in and correction of such data. Furthermore, the equipment was not being operated at full effectiveness because the machine programs in use were originally designed for equipment of lesser capability and had not been revised to obtain all the advantages of the newer equipment.

#### *Need for positive long-range planning*

One of the difficulties encountered by the military departments in the selection of appropriate automatic data processing systems is the failure to make adequate feasibility studies. At the Transportation Materiel Command, Department of the Army, St. Louis, Mo., we found that the command, with the approval of the Department of Defense, had installed electronic automatic data processing equipment at a cost of about \$300,000 for site preparation plus rental of about \$360,000 annually. However, after 2 years of use, the supply operations had not substantially improved. The equipment was inadequate for the volume of requisitions, the backlog of unfilled requisitions having doubled in the 2 years. Also, the Army had installed a large-scale computer at a rental cost of approximately \$275,000 more per year than available rental prices of equipment of comparable capacity.

Within a short period after installation of the automatic data processing equipment, the Transportation Materiel Command requested and obtained approval for numerous changes in equipment. As a result of these changes, additional costs were incurred for installation, training, and lost productive time. Substantial portions, if not all, of these added costs could have been avoided had the proper basic equipment been selected in the first instance. Expert feasibility studies, and proper advance planning and training of personnel are essential to the selection, installation, and operation of an effective automatic data processing system.

#### *Desirability of purchasing rather than leasing automatic data processing equipment*

Because of the increase in costs associated with the use of automatic data processing equipment in Federal Government operations, we conducted a Government-wide study on the subject of purchasing versus leasing of this type of equipment. We have recently completed this study and have issued a report to the Congress entitled "Financial Advantages of Purchasing Over Leasing of Electronic Data Processing Equipment in the Federal Government," dated March 6, 1963. A copy of this report was sent at that time to the Chairman of the Joint Economic Committee.

Our study showed that very substantial amounts of money could be saved if the Federal Government purchased more of its data processing equipment needs. A detailed cost comparison of 16 different electronic machine models, representing only 523 of the approximately 1,000 systems installed or planned for installation throughout the Government on a lease basis by June 30, 1963, indicated possible savings of \$148 million over a 5-year period if this equipment were purchased rather than leased. For additional use of these 523 machines after 5 years, there would be further savings at the rate of over \$100 million annually.

#### *Need for a central management office for automatic data processing*

We also pointed out in our report that, to fully realize savings of such magnitude, basic changes in the Government's overall management system will be necessary. Decisions as to the financial advantages of purchasing will have to be made from the standpoint of the interest of the Government as a whole, and not primarily from the standpoint of the interest of the individual using agencies as has been the practice in the past.

Because of the very substantial financial savings that can be realized through more extensive purchasing of electronic data processing equipment, and the related need for directing and coordinating its utilization throughout the Government, we recommended to the President of the United States that a central

management office suitably empowered to perform these functions be established in his organization. We are convinced that the establishment of such an office is the only practicable way to provide the kind of management that will make possible the realization of savings of hundreds of millions of dollars in the years to come.

The report also contains a general recommendation to the heads of all using departments and agencies that they arrange for a prompt and complete reappraisal of their current plans to lease data processing equipment and take such action as is possible to realize the financial savings that may be available from purchasing such equipment and fully utilizing it.

Since the Department of Defense is the largest user of data processing equipment in the Federal Government, this latter recommendation is particularly appropriate in its case.

#### *Summary*

We believe there is great potential for improving Government management of automatic data processing equipment. To realize the full potential requires expert management planning and coordination of both procurement and utilization of such equipment. We believe this function could best be performed by a central management office established in the executive branch of the Government. A central management office is needed to exploit the possibilities of Government-wide integration of systems and to plan for their development. And, finally, a central management office is needed for effective exchange of information among agencies and between the Government and industry.

Within each agency adequate feasibility studies, advance preparation for conversion to automatic equipment, and personnel training are highly important to promote the maximum degree of efficiency, economy, and effectiveness in the administration and management of costly facilities. Effective leadership by a centralized authority within the Department of Defense could minimize wasteful duplication of effort among the services by preventing repetitive explorations by different installations into the same or similar applications, some of which may have been already developed.

#### MANPOWER UTILIZATION

In our reviews of the utilization of manpower at selected locations we noted a lack of complete and valid manning guides or labor standards for the maintenance of facilities, for the operation of utilities, and for the operation, overhaul, and repair of vehicles. Also, our examination of the assignment and utilization of Ready Reserve personnel in Army Reserve units disclosed substantial misassignment of individuals on the basis of previous military training, civilian occupation, or education.

#### *Manpower utilization at military installations*

Our review of manpower utilization in selected areas of the Public Works Department, Fleet Activities, Yokosuka, Japan, Department of the Navy disclosed inefficient use of manpower in overhauling and repairing vehicles, in performing base maintenance work, and in dispatching and driving Government vehicles. We found this was due to the failure to develop and use labor standards in maintenance work.

We were subsequently informed by the Navy in response to our report that the number of personnel had been reduced by 262 at an annual savings of over \$400,000.

In another review of the utilization of manpower in maintenance of facilities and operation of utilities at selected military installations in Japan we found that the Army, Navy, and Air Force had not developed complete and valid manning guides as to the number of personnel required to maintain facilities and operate utilities in Japan.

Inefficient use of personnel was due to a lack of adequate work standards and estimates, inaccurate accumulation of work performance data, and failure of management personnel to systematically review and analyze significant variances between estimated and actual hours used to perform maintenance work.

In a report issued to the Congress, dated November 30, 1962, we disclosed that the repair and maintenance of noncombat vehicles in the Department of Defense is costing about \$66 million a year more than it should. This is happening primarily because the Air Force and the Army have not established and administered adequate controls over maintenance activities. The Air Force and Army practices are wasteful and inefficient when compared with those of the

Navy. The Navy's effective surveillance of vehicle maintenance results in costs that compare favorably with those experienced by private operators of motor vehicle fleets. If Air Force and Army vehicle maintenance operations were conducted as efficiently as those of the Navy we estimated that the Air Force and the Army could make substantial reductions in their vehicle maintenance staffs.

We proposed that the Secretary of Defense consider prescribing for the three military departments uniform maintenance standards and reporting systems in order to provide effective control over the efficiency and economy of vehicle maintenance. We were informed by the Department of Defense in a letter dated February 5, 1963, that they are moving in consonance with the objectives of our recommendation and that reductions in vehicle maintenance costs have been achieved or anticipated through fiscal year 1965 amounting to over \$22 million a year. The Army and Air Force are planning a reduction of about 2,800 personnel by the end of fiscal year 1964, an estimated saving of about \$12.4 million. Further cost reductions in other categories of vehicle maintenance are anticipated as management improvements now being planned are implemented.

*Ineffective utilization of members of Army Reserve units*

In April 1962 we reported to the Congress the results of our review of the assignment and utilization of Ready Reserve personnel in U.S. Army Reserve units. The review was made primarily in the XV Army Corps, 6th U.S. Army. We found a significant number of reservists who receive pay for attending weekly drills and for annual active duty training periods and were occupying positions unrelated to their previous military active duty training, civilian occupation, or educational background.

Failure to use reservists in positions for which they are best qualified results in waste of valuable skills and unnecessary expenditure of funds and manpower for retraining purposes. The seriousness of this deficiency was illustrated by the condition of units called to active duty during the partial mobilization in the autumn of 1961. Many of the reservists who had been in a paid drill status for lengthy periods and were included in the units mobilized were reported by the Army as not qualified in their military specialties. In response to our findings, the Deputy Under Secretary of the Army (Manpower) advised us that corrective actions had been taken in consonance with our recommendations.

On the basis of our selected reviews of manpower utilization in the Department of Defense, it can be seen that the inefficient use of manpower results in a substantial unnecessary expenditure of funds. The Department of Defense, being the largest user of manpower, including both military and civilian, in the Government, should be constantly aware of the need for the establishment of appropriate work standards, manning guides, and other criteria against which performance can be judged and appropriate organizational strengths can be established. The Department also should be constantly alert to make the best possible use of the skills available.

Representative PATMAN. Senator Proxmire.

REAL ECONOMY MUST COME FROM DEFENSE AREA

Senator PROXMIRE. I want to join the chairman in thanking Mr. Campbell for your excellent testimony and tell you how very grateful I am for the marvelous job you have been doing and how enormously important your testimony is this morning.

As I understand, more than half of our expenses in the defense area and more than half of the defense spending is in procurement and if we are going to have any economy in the Federal Government, we obviously have to have it in this area.

In your statement this morning you covered a great deal of material most persuasively but I am somewhat concerned about your omission of the recommendation that you made back in 1960. I presume you still feel the same way, as you did when you discussed competitive bidding and talked about how unfortunate it was that we did not have more competitive bidding and such a large proportion of our procurement is by a cost method.

## NEGOTIATED CONTRACTS DETERMINATIONS

You said:

We recognize the Department of Defense is now required to contract negotiations under exceptions 11 to 16 to support the decision of negotiation by a finding of determination.

In our review of these findings we have noted they are generally quite brief and do not provide enough information concerning the circumstances relating to the procurement and clearly show the factors requiring the use of employee negotiation. And many findings are somewhat stereotyped and give the reasons in negotiating in terms that are broad and generally rather specific.

Is this still the case?

Mr. CAMPBELL. May Mr. Keller answer that?

Senator PROXMIRE. Yes.

Mr. KELLER. Senator, by the enactment of Public Law 87-653 which was approved on September 10, 1962, the Congress required more specific and detailed findings for determinations to negotiate. We were very much in favor of this legislation, and worked with the committees in developing the language.

Senator PROXMIRE. I am wondering how this has worked out. You have had 6 months since the bill was enacted.

Mr. KELLER. I couldn't say how it has worked out right at this point. The law was not effective until December and we have not made any specific studies since that time.

Senator PROXMIRE. You have not had sufficient time to review the justifications to find out whether or not this is working out?

Mr. KELLER. No, sir.

## NO INCREASE IN COMPETITIVE BIDDING SIGNIFICANT

Senator PROXMIRE. The fact is that there has not been a significant increase in the proportion of procurement that is competitive.

Mr. KELLER. I don't believe so.

Mr. CAMPBELL. I believe that Public Law 87-653 was effective December 1, 1962. We have had very little experience with it.

Senator PROXMIRE. Let me ask you along the same line: The Defense Department testifying yesterday indicated that research and development category of exceptions are at an exceptional level. The potentially important competitive bidding was negligible.

Do you agree with that or do you feel even here we could have more competitive bidding than we have?

Mr. CAMPBELL. We are inclined to agree with the Secretary.

Senator PROXMIRE. In the area of aircraft missiles, they called the potential minor. This is another big area involving \$6.5 billion. Do you feel here the potential is minor or significant?

Mr. CAMPBELL. I don't know the answer to that, Mr. Chairman.

Senator PROXMIRE. And soft goods and services were considered minor. This is \$8.1 billion, in which 85 percent has been competitive to indicate, and only 15 percent has been noncompetitive.

Mr. CAMPBELL. May I have that question again?

## OPPORTUNITIES FOR COMPETITIVE BIDDING

Senator PROXMIRE. Yes. Another category is soft goods and services. Eighty-five percent of the \$8.1 billion has been competitive formal advertising bidding. Fifteen percent has not been. This is still



a large amount and it is in soft goods and services. I wonder if they could not make progress?

Mr. CAMPBELL. We are hopeful they will.

Senator PROXMIRE. I presume you will agree that in military end items which is \$2.9 billion there is a substantial opportunity for more competitive bidding.

Mr. CAMPBELL. Yes, sir.

#### USE OF STOCK FUNDS

Senator PROXMIRE. I would like to ask another part of your testimony that really, frankly, troubled me in your discussion of the use of stock funds.

You are quite critical of the present arrangements. I thought your testimony was compelling. But yesterday the testimony of Mr. Morris was quite persuasive the other way.

I would like to read a short part of his statement and ask your comment. He said that the Joint Economic Committee "has stressed concern that the use of stock funds might lead to the generation of excess cash and excess stocks. We have carefully assessed this matter and find despite some imperfections, stock funds have produced important economies and more businesslike inventory management. Inventories were originally capitalized at a net value of \$10.4 billion. Today the investment is \$6.2 billion or a reduction of 40 percent. The cash generated by this inventory drawdown has been returned to the Treasury by affirmative action of the Congress. Today operating inventory stock funds are being turned over 2.5 times annually while nonstock fund inventories turn only one time." That turnover is very important.

"We believe that stock funding forces closer and more imaginative inventory management and return to the old system would result in inflation of inventory and excess stocks, through lack of discipline."

I think this is a pretty persuasive argument. I take it you don't favor in your testimony abolition of the stock-fund practice. You would modify it.

Mr. CAMPBELL. No; we don't.

Senator PROXMIRE. So combat units and so forth would not have to compete under other circumstances?

#### CONCERN WITH ADMINISTRATION OF STOCK FUNDS

Mr. CAMPBELL. Our concern is with the administration of the stock funds.

Senator PROXMIRE. You would agree with the Defense Department that to date this has been helpful?

Mr. CAMPBELL. I think there has been an improvement in supply operations and procedures but we are not prepared to say they are attributable to operation of the stock fund.

#### IMPROVING SUBCONTRACTING

Senator PROXMIRE. I would like to ask you also about the possibilities of getting greater economy in procurement in subcontracting. It seems that here, as your testimony indicates, that we have a great deal of excessive payments. What action could we take in this area to provide greater protection?

Mr. CAMPBELL. As I pointed out, I think this is a matter of educating the contracting personnel to understand that their responsibility does not stop with the discussion with the prime contractor. In our present economy, that is, the way we are doing business, the subcontractor is a very important factor.

Senator PROXMIRE. Is there any kind of highlighting, any kind of publicity which we could give these subcontractors?

Mr. CAMPBELL. We have been pointing it up in our reports. I don't quite know what more we can do. As far as we are concerned, we simply have to keep after the military departments and the Defense Department to be sure that they are carefully watching subcontractor prices and operations.

Beyond that, I don't know what to suggest.

Senator PROXMIRE. How about the involvement of competitive bidding procedures here?

Mr. CAMPBELL. Do you have in mind further legislation? We think legislation now effective will eventually help. We hope it will. Public Law 87-653 requires price certifications by subcontractors in certain instances.

#### LOSS THROUGH UNRELIABLE RECORDS

Senator PROXMIRE. I wanted to ask you about another area.

In your statement you say you have found many examples where millions of dollars of assets were lost for all intents and purposes, referring to the unreliability of records. You cite many examples where millions of dollars were lost.

What does this really mean? Does this mean that the lost items constitute a complete waste or does this mean they simply could not account for this?

#### INVENTORIES AND RECORDS

Mr. NEWMAN. Senator Proxmire, we have found in the services that there are assets that exist at installation levels, that complete inventories have not been taken, adequate records have not been kept of those assets; and as a result when the procurement people, the buyers, get requests to buy, they don't know what really is in the system, what resources they have.

These unrecorded assets amount to hundreds of millions of dollars. In the Air Force I think there was around \$140 million or \$150 million of generators and that type of equipment where the procurement officials were buying additional equipment of this kind. Some items cost as much as \$10,000 apiece.

Senator PROXMIRE. They didn't know they had them?

#### \$147 MILLION STOCK NOT IN INVENTORY

Mr. NEWMAN. In the Navy we had the same thing. At ASO recently there were more than \$147 million in assets which should have been recorded as part of its inventory. There seems to be a tendency to not get this information on the electronic machines, the data-processing equipment. They do not go out and take an inventory to see what they already have. This is well illustrated by the fact that from 1958 to date we have issued nine reports to the Air Force dealing with this problem.

The same thing happened at St. Louis at the Transportation Command.

Senator PROXMIRE. This is simply indicative of what undoubtedly can be magnified severalfold.

Mr. BAILEY. Senator, we have a specific example that we can give you of this type of situation if you would care to hear it. I would like to ask Mr. Bell to give the details of a specific case as an example of what has happened in this area.

\$164 MILLION OMITTED FROM INVENTORY

Mr. BELL. Senator Proxmire, some time back we made an examination of the control the Air Force had over unit allowance equipment. That term covers equipment used by various Air Force combat or tactical units to carry on day-to-day maintenance. It involves oscilloscopes, generators, and this type of thing. We found that over a period of some years the Air Force had bought approximately \$600 million worth of this type of equipment.

This type of material doesn't wear out. Each year the units having custody of the equipment are required to report to the central inventory manager the items they hold and correlate these data with their needs. However, the inventory reports that came into the inventory manager for this type of equipment indicated \$164 million worth of this equipment had been lost in the system.

Senator PROXMIRE. Had been lost?

Mr. BELL. For all practical purposes.

Senator PROXMIRE. \$164 million had been lost?

Mr. BELL. \$164 million of equipment was presumably someplace but no one knew where. The principal factors that inventory managers must have in order to operate are knowledge as to what is needed, how much is already on hand to satisfy the needs, and how much must be bought. If, however, they do not know where the material is they cannot use it and must buy new material to satisfy immediate demands.

To illustrate that specifically, in the period covered by our study the Air Force had bought some 10,000 oscilloscopes. The requirements that came up from the using commands showed they only needed 5,700, indicating an excess of approximately 4,300 oscilloscopes somewhere in the system. At the same time, however, there were 1,700 unfilled requisitions for new oscilloscopes that the buyer was proceeding to place orders for, which, of course, would only add to the excess already owned.

We had our men go out to various bases in the Air Force and take a physical inventory and we found a large number of these so-called lost assets. This information was passed back to the buyer, the equipment was redistributed and planned procurement of some \$27 million was deferred.

Senator PROXMIRE. You would assume on the basis of this example that there undoubtedly are hundreds of millions and maybe billions of dollars of items which are not inventoried that the Army, Navy, and Air Force don't know what they do have, and therefore they can't use it. It is lost and wasted.

Mr. BELL. I could not give you a real projection.

Senator PROXMIRE. I am making a conclusion. Would this be a reasonable conclusion based on your experience?

Mr. BELL. No, sir.

Senator PROXMIRE. It would be reasonable?

Mr. BELL. I think our tests covered about 12 percent of the items in this particular category of materiel when you project from these tests the indicated lost assets is enormous.

Senator PROXMIRE. Then you say that conclusion might be a reasonable conclusion?

Mr. BELL. Yes, sir.

Senator MILLER. Would the Senator yield?

Senator PROXMIRE. Yes.

Senator MILLER. Just to try to develop this point a little further, how long ago was this investigation made?

Mr. BELL. That particular report was delivered to the Congress in 1961.

Senator MILLER. I am wondering if the development of the electronic data-processing equipment, inventorying by the Air Force in this subsequent period of time might not have relieved this problem somewhat?

Senator PROXMIRE. My understanding is that it did not from your initial response.

Mr. NEWMAN. In talking about it from an overall standpoint it is probably true that maybe the Air Force has corrected this one. However, we have seven more Air Force examples showing lost inventories of almost \$100 million.

To illustrate, we reported that Air Force records showed that the Air Force had procured, and should have in its possession, large quantities of a particular type of radio set which was excess to its needs. We found also that the Army had a definite need for this radio set and was planning to buy a substantial quantity. When we pointed out to the Air Force that their records showed these radio sets were excess to their needs and could be transferred to the Army, an attempt was made to do so. However, at that time the radio sets could not be found. Subsequent to our calling this to the attention of the Air Force, it took prompt and vigorous steps to take a physical inventory worldwide and located approximately \$20 million worth of these radio sets. The Air Force has now transferred some \$16 million worth of these sets to satisfy Army requirements. This is another example of inadequate, incorrect, and incomplete stock records that the Comptroller General mentioned earlier.

We find generally, gentlemen, that data processing equipment does not cure all the ills.

#### INVENTORIES AND RECORDS MUST BE CHECKED

The basic principle of taking inventories and continually taking inventories to know the equipment you have, generators as well as aircraft bearings, electric lamps or sparkplugs, whatever it may be, is important. It has to be constant, the electronic brain unit must have the correct quantities on hand because it is throwing out information of where to go to get the delivery of the item.

In the case of the Army at TMC, on which we have issued a report, they went ahead and just took the information off the books, put it in the electronic brain, and then went ahead and funneled through the requests and gave out shipping orders.

When the shipping orders came out to deliver from a certain depot, the depot replied, "We have not had this item in stock for 2 years." The Army had not taken a physical inventory. We found that, after

2 years of operation with ADP equipment, supply operations at TMC had not substantially improved.

There seems to be a general tendency within the services that we don't need to take inventories. This is one basic function that we feel is imperative for the efficient operation of supply and procurement activities. You have to know what you have on hand.

Senator PROXMIRE. You say there is no substitute for the regular physical inventory at frequent intervals and the Armed Forces have not done this adequately?

Mr. NEWMAN. That is right.

#### SET-ASIDE PROGRAMS

Senator PROXMIRE. One more question with the indulgence of the chairman.

Both Senator Sparkman and I are deeply interested in the set-aside programs. I notice the Defense Department called attention to that as one of the restrictions for competitive bidding. I wonder if you can tell me whether the set-aside programs have been costly to the taxpayers. We realize they have other values. It encourages small business.

I would like to know if we are paying too high a price. Does the set-aside program increase the cost of procurement?

Mr. CAMPBELL. We have had many cases come to us, Senator, through our General Counsel's office having to do with protests of one kind or another; you may be familiar with such problems. We don't know of any case wherein the set-aside program actually increased procurement costs.

Senator PROXMIRE. Your answer is not on the basis of a single investigation. You have investigated a number of cases.

Mr. CAMPBELL. We have had a number of cases presented to us for decision. We have not actually made a specific study in the field.

Senator PROXMIRE. You feel this elimination restriction of big business bidding on contracts has not been important?

Mr. CAMPBELL. We have not seen any signs of it, but we have not made a detailed study.

Senator PROXMIRE. Thank you very much. Thank you, Mr. Chairman.

Representative PATMAN. Mr. Widnall.

#### STOCKPILING OF ENGINEERS

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Campbell, I would like to compliment you and your staff on the work you have been doing. I think we are all grateful, all our American citizens, for the contribution you have made. I would like to ask two questions: One, whether or not you have had any complaint about the stockpiling of engineers by large companies that has caused an upping of costs on many items—large procurement items for the armed services.

I have heard that many of the big companies bid against each other for these engineers, to stockpile them, and actually do not get anywhere near maximum utilization of the engineering pool. Smaller companies are not able to obtain engineers because of the salaries paid for the stockpile of engineers by the larger companies.

Have you heard any complaints?

Mr. CAMPBELL. This is a common practice. I am well aware of it. I have had several complaints. It is a difficult thing for us to run down. We know it is a fact but from where we sit it would be quite a difficult matter for us to cover in report form.

Representative WIDNALL. I have heard from a number of sources that some complain that there is not really a shortage of engineers in the United States. Many skilled engineers are concentrated in the hands of just a few large corporations. Others who could get maximum utilization out of them and to the betterment of our own defense effort cannot procure their services.

#### CHECK ON USE OF R & D GRANTS

The second thing I wanted to ask about: How much of a checkup do you have on the universities and colleges as to the utilization of their research and development grants? Along that line I have had some people tell me that this has been a great field for giving masters degrees or doctorates to students but actually not as much research and development as you should have for the armed services.

Mr. CAMPBELL. Educational research and development contract activities we, of course, watch rather carefully. With respect to the type of grant you speak of, we have not gone into it very deeply. Such grants are not subject to the same kind of surveillance as a contract operation, particularly where a university or other educational institutions are involved.

Representative WIDNALL. There is not any surveillance of the competency of the ones employed and the duplication of effort?

Mr. CAMPBELL. No, I don't think there is any basis for us to question the judgment of the academic authorities as to the competence of a person using grant money.

Representative WIDNALL. Thank you.

Representative PATMAN. Senator Sparkman?

Senator SPARKMAN. Mr. Chairman, I do not believe I have any questions. I want to say that I think this is a tremendous presentation which you have given us, Mr. Campbell, you and your associates.

I would ask this question: You feel that progress has been made along these various lines that you present?

Mr. CAMPBELL. Yes, Senator Sparkman. That is our objective. We are very serious about helping the military departments and the Defense Department, and we think we have assisted them a great deal. I think the Secretary has so stated publicly and to me personally.

Senator SPARKMAN. Reading your report, I think one is likely to become discouraged when one reads about some of these defects and deficiencies that still exist. That is why I bring out the point. You are cutting in on them even though you recognize they have a lot to do yet.

Mr. CAMPBELL. We think we are cutting in on them, but we also think that the system is so complex and vast that new problems are constantly arising. This is a constant job of surveillance and a constant job of helping people to operate properly.

Senator SPARKMAN. And pointing out the needs for revision?

Mr. CAMPBELL. Yes, sir.

Senator SPARKMAN. I want to commend all of you for the presentation you made. I think it is most helpful.

Mr. CAMPBELL. Thank you, sir.

Senator SPARKMAN. Thank you, Mr. Chairman.

Representative PATMAN. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

#### PYRAMIDING OF PROFITS IN COST-PLUS CONTRACTS

Mr. Campbell, I want to join my colleagues in commending you for this fine presentation and also to tell you with what esteem I hold your operations.

I would like to ask a few questions. The first one is this: Noticeably absent from your statement was a comment about the problem that received considerable attention not too long ago, regarding the pyramiding of profits in cost-plus contracts where the subcontractor's fixed fee was passed on as a base to the prime contractor, resulting in what was called a pyramiding of profits.

Does your Office have any views on this subject?

Mr. CAMPBELL. Senator, we do have some views on it. However, Senator McClellan's committee has decided to look into the area. As is our custom, we did lend our people to his committee. He utilized some of our reports in his study. When a congressional committee moves into an area, we, of course, do not attempt to duplicate its efforts.

Senator MILLER. I appreciate that. I was wondering if for the record it might not be a good idea for you to express the policy that you perhaps recommended before that subcommittee. I think it might fit in with our committee.

#### POLICY RECOMMENDED BY GAO

Mr. CAMPBELL. I would like to furnish that for the record, Mr. Chairman. We will put a statement in the record for it.

Representative PATMAN. Without objection, it is so ordered.

(The material furnished follows:)

It is clear that a prime contractor or subcontractor, to the extent justified by the level of his effort, risk, responsibility, and investment, is entitled to earn a reasonable profit on his costs for work subcontracted to a lower tier manufacturer. Because effort, risk, and responsibility vary so greatly among jobs, there are no fixed criteria or standards with which to measure the reasonableness of profits on subcontracts generally.

It seems equally clear, however, that where the prime contractor's or subcontractor's contribution to the work of a lower tier subcontractor is limited, or diminishes as production experience is gained, profits on such work should likewise be limited. While it may not be true in all cases, the administrative effort and risk assumed for work in-house is generally greater than that for work subcontracted out. If the item subcontracted is a major component or assembly of established reliability that does not require further processing but is merely affixed to the item or another assembly, the profit allowance to the higher tier subcontractor or the prime contractor should be relatively lower in recognition of lesser responsibility for engineering, testing, and other assistance to the subcontractor than might otherwise be required.

We believe also that the Government should be constantly alert to opportunities to avoid the unjustified pyramiding of profits. This can be done in several ways, among which are: (1) Careful evaluation of negotiated contract proposals to assure that profits on subcontracted work are not unreasonable in relation to the higher tier subcontractor's and the prime contractor's contribution to the performance of the subcontracted work, (2) continued review and analysis of major components and assemblies with the objective of direct Government procurement from the subcontractor who manufactured such components and assemblies as soon as the design is stabilized and reliability has been established,

and (3) development of in-house capability to exercise technical and administrative supervision over the manufacture of major components and subassemblies, a function which is frequently being assigned to prime contractors.

#### COST-PLUS INCENTIVE-FEE CONTRACTS

Senator MILLER. As I understand it, the Air Force has had considerable success in using a cost-plus, incentive-fee contract system they have put into effect in the last 2 years in negotiated procurement.

Mr. CAMPBELL. This is a new technique, Senator, with which we are familiar and which was discussed with us in the initial stages. Our own Office has no experience thus far with the results of the Air Force's new incentive contracting program.

Senator MILLER. I have seen some reports indicating a considerable degree of success and I was wondering if it might not be helpful for your Office to review this with the view to making recommendations for possible application of this technique to the other services?

Mr. CAMPBELL. We are very much interested in it and we are watching it very carefully. We will certainly comment on it as soon as we have some basis for judgment.

Senator MILLER. Thank you.

#### RESERVES OF COMMERCIAL-TYPE VEHICLES

In your statement you called attention to an example in which the Navy had maintained a reserve stock of commercial-type vehicles whereas information provided you by the vehicle manufacturers indicated that for the most part the reserve was unnecessary and that in event of a mobilization or emergency, a suitable quantity could be provided.

There are two thoughts that occur to me there. First. What is an emergency? We can all visualize an emergency, I suppose, in which there might not be time available to obtain a reserve stock of commercial-type vehicles. But assuming that there is time, what is the policy of GAO in connection with the maintenance of a mobilization reserve of commercial-type items?

I don't believe that you made any conclusions (see p. 120). You merely pointed out the problem and stated that information had been provided you that the vehicle manufacturers could fill the requirements. But I don't believe you stated a conclusion.<sup>17</sup>

Mr. CAMPBELL. That is right. We have stated the facts as we found them and our conclusions and recommendations are in our report. I realize that many things might happen in different kinds of emergencies. But this is the considered statement of the suppliers as to what they could do to meet such emergencies. This reserve stock is not necessary if the suppliers are right.

Senator MILLER. Then it would be your position that this is not the type of an area for GAO to make a recommendation. All you should do is to limit your observations to a statement of what could be done and then leave it to DOD to make the decision?

Mr. CAMPBELL. Yes, sir.

Mr. BAILEY. Senator, in this particular case we used the criteria that the Navy used as to when these vehicles would be required. Based

<sup>17</sup> See staff report, 1963, app. 6, pp. 217-219.



on those criteria; that is, their own statement of when they would need the vehicles in the event of mobilization or emergency, we went to the vehicle manufacturers and they informed us and the Navy subsequently verified that these vehicles would be available to the Navy within their own time criteria.

When we presented our findings to the Navy we proposed that, before stocks are set aside for mobilization purposes, consideration be given to the availability of industry to meet mobilization needs. The Navy concurred with our proposal and further advised us that its inventory of commercial-type vehicles would be transferred to operational use to meet current needs. Also, in our final report, we recommended that the Department of Defense inquire into mobilization reserves of other commercial-type items to determine whether adequate consideration has been given to industry's ability to meet the mobilization requirements for the items.

Senator MILLER. Thank you very much.

#### VARIANCE IN USE OF STOCK FUNDS

Why is it that there is a difference between the Air Force on the one hand and the Army and the Navy on the other in the use of a stock fund method? Shouldn't they be uniform among the services?

Mr. CAMPBELL. No, I think it is just a matter of preference as to a method of operation. The Air Force has resisted the use of stock funds to control the issue of supplies to combat or combat support units. The Air Force has traditionally followed its present system and it apparently has worked out very well, relatively speaking.

#### STOCK FUNDS AND SUPPLY MANAGEMENT

Senator MILLER. Then you would conclude that the use of a stock fund method is not necessary to proper supply management?

Mr. NEWMAN. That is right.

Mr. CAMPBELL. I think that is a fair statement; yes, sir.

Mr. NEWMAN. May I add something there? In the stock fund area, for example, we just issued a report on electric lamps. In this case we had the same problem in buying electric lamps in the three services. Each service had its own centralized inventory. I would like Mr. Bell to tell you the problems there with the stock fund.

In the Army and Navy they are in the stock fund but in the Air Force they are not. But we still have the basic management problem.

Mr. BELL. We have recently completed an extensive study of electric lamps being managed by central managers in the Army, Navy, and Air Force. The managers have been buying electric lamps and stocking them in their warehouses from which to fill requisitions of the various issuing units in the armed services.

Our review was made to determine the extent to which these items might be commercially available to the military services on a reasonable time basis, for example 30 days, and what, if any, price differential there would be between the amounts paid by the managers of central depots and those that would be paid if the individual installations bought these lamps locally as they needed them. We found from the commercial manufacturers of these electric lamps that substantial quantities of most of them were carried in stocks in com-

mercial distribution centers around the country. We learned that these lamps could be furnished to the military services on relatively short notice. The cost would not increase appreciably because these lamps were being purchased under prices negotiated by the General Services Administration and placed on the Federal supply schedule.

#### SUPPLY MANAGEMENT PROBLEMS EXIST WITH OR WITHOUT STOCK FUNDS

We found also that the Army and the Navy manage electric lamps under their stock funds, while the Air Force does not. This fact had no effect whatsoever upon the supply management problems that were common in all three services.

As a result of the recommendation we made and studies by the three services that followed, a very substantial portion of these electric lamps will be taken out of the central management and the individual installations will be permitted to buy them as they need them.

We estimate that this will save a little over a million dollars a year and will enable the military services to reduce their inventories about \$5½ million.

In addition to the electric lamps we have just about completed our review of a large number of other commercially available items managed on a central basis by all three services. If our recommendation, to permit the individual installation to buy these items locally as needed rather than storing them centrally, is adopted, we anticipate that a very substantial amount of money can be saved annually, and investment in inventories of these type items can be reduced significantly.

As we mentioned earlier the Air Force has long resisted the use of stock funds to control the issue of supplies to combat or combat-support units.

#### AF SYSTEM IN SHARP CONTRAST WITH ARMY AND NAVY

The Air Force system of managing such items as electric lamps contrasts sharply with procedures followed by both the Navy and the Army. For example when an Air Force mechanic at base "A" needs light bulbs he merely submits a requisition to an appropriate stock control point at the base specifying the number and size lamps he needs. He, the mechanic, does not have to be concerned with fund availability or control. His requisition is filled from stocks already paid for and on hand either in the base supply department or from central stores at a major depot.

On the other hand before a Navy or Army mechanic can be furnished electric lamps that he needs he must first determine, or have someone determine for him, whether or not his unit has the money—consumer funds—to buy these electric lamps from the stock fund. If his unit does not have the money he doesn't get the lamps notwithstanding the fact that the lamps may be in the base supply department already paid for from appropriated funds. In addition to the possibility that he may be denied the lamps he needs in his work, an extra requirement for bookkeeping and fund control is imposed upon his unit—a practice neither the Air Force nor we support.

Senator MILLER. Thank you very much.

I have two additional questions, Mr. Chairman, if I may.

We received testimony in this subcommittee yesterday that DOD

stock fund inventories are now down to about \$6 billion, representing about a 40-percent decrease.

I am wondering if we can safely conclude necessarily that this is a genuine reduction in cost to our Government. What I have in mind is the possibility that this reduction could have been effected by donations of some of these items, by the sale of surplus at considerably less than cost. Also, by transfers to other Government agencies.

#### REDUCTION IN STOCK FUNDS NOT A MEASUREMENT OF EFFICIENCY OR SAVINGS

Mr. CAMPBELL. These figures have been mentioned to us, Senator. You are correct. The factors that you mentioned contributed to a great extent to this decrease in inventories.

Initially, to establish stock funds for common items, inventories of each service including excesses, which were procured with appropriated funds, were transferred at no cost to the fund. Consequently appropriated funds received no credit for the inventory transfer. This method was used to create the original working capital for the fund.

During fiscal years 1950 through 1961 inventory and cash in the stock funds have been reduced \$9.6 billion. Of this amount \$3 billion was returned to the Treasury, \$2.2 billion transferred to other appropriations and the balance of the reduction or \$4.4 billion, resulted from sale or donation of excess materiel. We do not believe these reductions should be considered as a measurement of the effectiveness or efficiency of the stock fund system or of savings to the Government. The disposal of excess properties and reduction of inventories should be accomplished under any supply management system.

#### EFFECTIVENESS OF CATALOG SYSTEM

Senator MILLER. The final question: Nothing much was said in your statement about cataloging programs. I remember when the Federal cataloging program was first started back in the late forties or early fifties, there was considerable enthusiasm about the potential savings by avoiding duplications and by consolidating common items.

I understand that there is considerable effort being expended on this program. When you ask how much of a result has been achieved from one year to the next you receive information to the effect that a great number of items had been deleted from the catalog through the consolidation process, but then if you happen to think to ask how many other items have been added to the catalog you find that far more items have been added to the catalog than had been reduced.

I am wondering if your office has made any review of this cataloging program with the view to determining whether it would be possible to cut down on the number of additions so that we are not taking one step forward and two steps backward in this cataloging program?

Mr. CAMPBELL. We have made a review in that area. I think it was an omission on my part in not including some reference to it. The question that you pose, however, would indicate to me that perhaps we ought to offer for the record a preliminary story of what we have done. That will answer many of your questions.

Senator MILLER. I think that would be helpful, Mr. Chairman, if

they could furnish a supplementary statement for the record on that point.

#### GAO REVIEW OF CATALOG PROGRAM

Representative PATMAN. Without objection, it may be inserted at this point in the record.

(The material follows:)

In view of the continued interest over a period of years by the Congress in the Federal cataloging system, we made a selective review of cataloging practices primarily in the areas of aeronautical and electronic materiel within the Department of Defense.

#### DOD COST \$375 MILLION

The Federal catalog system, which has cost the Department of Defense about \$375 million through fiscal year 1962, is now the responsibility of the Defense Supply Agency.

In our recently completed review we noted that one of the basic objectives of the cataloging program has been achieved; that is, each of about 3.4 million supply items in the system that is repetitively procured, stocked, or issued, has been assigned a distinctive stock number and new items entering the supply system are being similarly identified.

#### DEFICIENCIES IN SYSTEM DUPLICATE LISTINGS

However, our review disclosed that deficiencies in the cataloging process have permitted the frequent assignment of two or more identifying stock numbers to identical supply items, causing these items to appear in the inventory as though they were different. This condition results in failures in supply support and in unnecessary procurements when supply items already existing in the system are not recognized as being the same as needed items. For example, we found that the Navy had sold as surplus some mooring kits valued at \$11,520 that were identical to those needed by the Army. The Army did not recognize the Navy kits as the ones it needed because they were identified by a different stock number. In another case, we noted that the Air Force had 8 voltage regulators excess to its requirements valued at \$8,160 while, at the same time, the Army needed 30 such units.

Because of the use of different stock numbers for identical voltage regulators, these common use items were not recognized by either service. After we brought this to the attention of the Air Force, the excess units were transferred to the Army, thus precluding future procurement in this amount. We are not in a position to project the extent of unnecessary procurement resulting from this deficiency. However, we believe that the excess cost to the Government is significant when the administrative cost of establishing and maintaining extra stock numbers in the Federal catalog system is added to the probable cost of unnecessary procurement.

The practices which have led to the assignment of two or more numbers to identical supply items are as follows:

1. Obtaining different stock numbers for identical parts based on variations in the intended use of end items.
2. Citing various numerical references, such as manufacturer's part numbers, drawing numbers, etc., rather than describing the characteristics of an item when requesting the assignment of a stock number. This precludes the recognition that a stock number has been previously assigned to an identical item of supply.

#### LACK OF INTERCHANGEABILITY OR SUBSTITUTABILITY DATA

We also found that there was a need for information in the Federal catalog system as to the interchangeability and substitutability of catalog items and that such information would have identified assets valued at approximately \$530,000 which were available to reduce the procurement of similar supply items. In addition, we found that the catalog system included hundreds of thousands of inactive or "dead" items and items of nonrecurring use nature. We plan to make recommendations to the Defense Department designed to minimize these

conditions as well as to curtail the use of two or more Federal stock numbers for identical supply items.

Senator MILLER. Thank you. I have no further questions.

Representative PATMAN. I want to take advantage of this opportunity, Mr. Campbell, to commend you for a very fine public service. You are doing a great service for the Government of the United States and the people of this Nation. I personally appreciate that. I have observed your work over a long period of time and it has been very fine.

NEED FOR CONTROLS ON AUTOMATIC PROCESSING EQUIPMENT  
(SEE PP. 109, 271)

I would like to ask you about something in your supplemental statement about automatic data processing. You state that:

Our reviews of automatic data processing developments in the Federal Government have indicated a need for more effective and economical use of automatic data processing equipment in Government operations, a need for more positive long-range planning, the desirability of purchasing rather than leasing equipment, and a need for central management to direct and coordinate a Government-wide program of procurement and utilization.

PURCHASING VERSUS LEASING

I want to emphasize your statement about the desirability of purchasing rather than leasing equipment. I wonder if you would elaborate on that, Mr. Campbell, and tell us what should be done in that direction?

Mr. CAMPBELL. Mr. Chairman, we have issued a report quite recently setting forth our ideas on this whole problem; we have given it considerable time.

OVER 1,000 ADP MACHINES IN GOVERNMENT USE

As you probably realize, in our Government the use of these machines has grown like Topsy. In 1954 I am told there were 16 machines in use. At the present time, there are over a thousand in use and by 1966 it is estimated there will be 1,500 in use. We have made a rather thorough report suggesting the advisability of purchasing rather than leasing these machines.

RECOMMENDATION TO PRESIDENT TO CONTROL USE

We feel so seriously about it that we have recommended that the President himself set up within his own organization a separate group to control the purchase and the use of these machines.

Representative PATMAN. Is your report framed in a way that we can put it in this record?

Mr. CAMPBELL. I think it is.

Representative PATMAN. Would you mind filing copies for the committee?

Mr. CAMPBELL. Yes, sir.

Representative PATMAN. And then if Senator Douglas wants to get it later, he can.

Mr. CAMPBELL. This report was just issued during the current month.

Representative PATMAN. I think it is very important and I think you do, too.

Mr. CAMPBELL. I think it is very important.

(The report referred to appears in app. 1, see p. 271.)

Representative PATMAN. I notice that some of the equipment companies who formerly only leased are now selling; is that right?

Mr. CAMPBELL. Yes, sir.

Representative PATMAN. One of the major companies in particular?

Mr. CAMPBELL. Yes, sir.

Representative PATMAN. Still some of the larger companies are insisting on leasing, are they not?

Mr. CAMPBELL. Government agencies are still extensively leasing this type of equipment. Also we are now reviewing individual Government contractors to determine the extent to which they lease or buy and what costs are paid by the Government.

Representative PATMAN. And you think that is greatly to the disadvantage of the Government?

Mr. CAMPBELL. I am sure it is. We are convinced of it.

Representative PATMAN. We will examine that report carefully. I am sure Senator Douglas will want to incorporate it in the record but I would rather he would do it after he sees the record.

You mentioned here awhile ago about the electric lamps. You have decentralized that, I believe, to the extent that you permit the local dealers to sell a large part of these electric bulbs to installations?

Mr. CAMPBELL. Yes, sir.

Representative PATMAN. That is a rather interesting statement.

#### GAO REPORT ON MANAGEMENT OF ELECTRIC LAMPS IN DOD

Without objection, we will place in the record at this point a letter written by Mr. Campbell to the chairman of this committee, Senator Paul Douglas, on March 21, 1963, which is very enlightening along that line.

(The letter referred to follows:)

COMPTROLLER GENERAL OF THE UNITED STATES,  
Washington, D.C., March 21, 1963.

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

DEAR MR. CHAIRMAN: Enclosed for the use of your committee is a copy of our report to the Congress on review of the supply management of electric lamps within the Department of Defense.

This report discloses that inventory managers within the Department of Defense have not given appropriate consideration to commercial availability and distribution costs in determining whether lamps should be supplied by local purchase or through service supply channels. As a result, the military departments are centrally managing over 1,000 supply items of electric lamps that are readily available to using activities at local commercial outlets, generally at the same prices. The cost to centrally manage an electric lamp item in the supply system averaged over \$1,000 per year. The average annual inventory for each item amounted to about \$5,000. Therefore, we estimate that supply management costs can be reduced at least \$1.2 million annually and supply inventories can be reduced at least \$5.5 million by decentralized procurement of commercial lamps.

In addition, we found an accumulation of inventories that included approximately 670,000 electric lamps, valued at about \$253,000, which were in excess of current operating and mobilization reserve requirements. All of these lamps were readily available from local commercial sources. One depot had on hand 21,400 units of a certain electric lamp worth \$3.15 each, or a total of \$67,410,

which exceeded established requirements. On the basis of issues for the year we examined, this quantity represented 41 years' supply. The donation of these lamps to various State activities was subsequently authorized.

We brought our findings to the attention of the Secretary of Defense. In a letter from the Assistant Secretary of Defense (Installations and Logistics), dated November 20, 1962, we were informed that during and subsequent to the period of our review the military departments had implemented improved supply management techniques. He advised us that each of the departments had conducted a review and that all departments plan to conduct further reviews, with the objective of buying electric lamps locally where possible. For example, the Navy expects to authorize for local procurement 503 supply items of electric lamps by April 1963, leaving only 155 items in the supply system.

The measures referred to by the Assistant Secretary of Defense, if properly implemented and applied to all military supply activities including those which we did not review, should effectively reduce supply management costs and excessive inventories. We will consider the effect of decentralized management with respect to other commercial-type items in our continuing reviews.

Sincerely yours,

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

#### DECENTRALIZED PURCHASING OF LAMPS HELPS SMALL BUSINESS

Representative PATMAN. Would you like to elaborate on that further, Mr. Campbell?

Mr. CAMPBELL. This was an unusual situation which we looked into and concluded that it was more practical and less expensive to have the distribution of this particular item decentralized to the thousands of points of use around the country as against a relatively few depots which could result in the shipment of electric light bulbs from, for example, Boston to Chicago and perhaps back again just to satisfy the system—sort of efficiency at any price.

Representative PATMAN. It helped small business around the country, I assume?

Mr. CAMPBELL. Yes.

Representative PATMAN. A large number?

Mr. CAMPBELL. A large number.

Representative PATMAN. I think that is a good step, particularly in view of the fact that it is a saving to the Government. I hope that more in that direction is done in other lines of endeavor.

Are there any other questions from members of the committee?

#### SALE OF SCRAP AND USE OF PROCEEDS

Senator SPARKMAN. Mr. Chairman, may I ask one question? I want to refer back to one small section in your statement. That was the one in which you discussed the sale of scrap and the use of those funds, in one instance at least, for considerable construction work. It is found in your statement.

Mr. CAMPBELL. That is in the supplemental statement which I did not read into the record. (See pp. 58, 136, and 138.)

#### AIR FORCE USED \$4 MILLION SALES RECEIPTS FOR CONSTRUCTION

Senator SPARKMAN. But you did make some reference to it in your direct statement. Is that right; in the supplemental statement you have a short discussion of scrap salvage proceeds. You bring out the point that the Air Force last year used about \$4 million for construc-

ton out of these funds without having to be subject to Congress with regard to construction; is that right?

Mr. CAMPBELL. That is correct.

Senator SPARKMAN. You think this a bad practice. I believe you called this to the attention of the Secretary of Defense to the effect that it ought to be corrected?

Mr. CAMPBELL. We did.

Senator SPARKMAN. Would you think that Congress ought to take some action regarding it, or can it be done administratively?

#### GAO AND DOD DISAGREE ON PRACTICE

Mr. CAMPBELL. At this point the Secretary does not agree with me.

Senator SPARKMAN. He does not agree?

Mr. CAMPBELL. No. The Department feels that it has done the proper thing. We don't agree with them.

Senator SPARKMAN. It would be a matter for legislative correction?

Mr. CAMPBELL. Yes, sir.

Mr. BAILEY. Senator Sparkman, we suggest that the Congress might want to consider legislation restricting use of scrap and salvage proceeds similar to that put in the 1962 and 1963 Appropriation Act with respect to use of operation and maintenance funds.

Senator SPARKMAN. Yes, I had overlooked that in the supplemental statement.

#### SIDE-DOOR SPENDING

We hear a great deal in Congress these days about protests of back-door spending. Is this back-door spending in reverse?

Mr. CAMPBELL. It is not back-door spending, it is a different kind—perhaps side door.

Senator SPARKMAN. Spending without specific authorization?

Mr. CAMPBELL. That is correct.

Senator SPARKMAN. Just as a matter of curiosity, what kind of construction was done with these funds?

Mr. CAMPBELL. I think Mr. Bell, who is our expert in the Air Force area, can provide the details.

Mr. BELL. One of the items that was built was a redistribution and marketing center at Dayton Air Force Depot. It is quite an elaborate thing. I have here a picture of this center, facing page 3 in our report on this subject to the Congress in July 1962. Another item built at Davis-Monthan Air Force Base, was an aircraft reclamation center. Another item built at McClellan Air Force Base, was a redistribution and marketing facility, and an L-shaped structure, 100 by 500 feet and 100 by 800 feet.

Senator SPARKMAN. We have that report as a part of the committee file. That gives us the information.

Thank you very much, Mr. Chairman.

Representative PATMAN. I want to make one observation and ask a question, Mr. Campbell. As chairman of a House committee one time I had an investigation of the scrap industry, and I say this: I never dug up as many bad snakes to kill in my life when I started that investigation. But we were convinced before we were through that the scrap business was very much in the hands of probably one concern and very much of a monopoly.



Does that situation still exist now, or has it been decentralized in some way?

Mr. CAMPBELL. We don't know, Mr. Chairman. I think I recall the study and I recall the name. But we really don't know.

Representative PATMAN. That is all right. Senator Miller?

RECEIPTS FROM SCRAP SALES

Senator MILLER. Following on Senator Sparkman's last question, how much are we talking about in the case of the disposal of surplus properties and scrap? How much a year is derived from this?

Mr. NEWMAN. I think surplus property was around \$13 billion. You mean the return, Senator, on the sale of scrap?

Senator MILLER. Yes.

Mr. NEWMAN. About 2 percent on scrap and about 7 percent on other surplus items.

Senator MILLER. Would it be possible for you to furnish the information and the dollar amounts for the last 4 or 5 years so we get an idea of how much we are talking about?

Mr. NEWMAN. Yes, sir.

Mr. CAMPBELL. The acquisition cost is one figure and the actual return is about 3 or 4 percent of that figure.

Senator MILLER. I was really referring to receipts but if you can provide the acquisition cost and the receipts both, that would be fine. I would not want you to go to an undue amount of trouble to get the acquisition cost.

Mr. CAMPBELL. Those figures are available.

Representative PATMAN. Without objection, they will be placed in the record at this point.

(The information follows. See also, appendix 6, p. 438.)

TABLE 18

*Surplus personal property—DOD acquisition value and proceeds from disposals, fiscal years 1958-62*

[In millions of dollars]

	1958	1959	1960	1961	1962
<b>Proceeds:</b>					
Sales other than scrap.....	127.9	140.4	123.9	106.1	86.7
Sales of scrap <sup>1</sup> .....	55.8	71.9	70.1	60.4	48.2
Total, proceeds.....	183.7	212.3	194.0	166.5	134.9
<b>Acquisition value:</b>					
Property other than scrap.....	2,465.8	2,789.2	2,356.4	1,771.2	1,236.1
Scrap <sup>2</sup> .....	2,993.7	4,576.8	3,626.9	4,331.8	2,233.1
Subtotal, value of property sold.....	5,459.5	7,366.0	5,983.3	6,103.0	3,469.2
Acquisition value, donated property.....	221.2	313.7	347.1	275.7	258.3
Total, value of property sold and donated.....	5,680.7	7,679.7	6,330.4	6,378.7	3,727.5

<sup>1</sup> These figures include proceeds from the sales of ferrous metal, nonferrous, and other scrap and waste.

<sup>2</sup> This figure does not include the acquisition value of "other scrap and waste" (boxes, garbage, paper) which were never carried in the supply system at a stated value. Further, the scrap acquisition value figures used are the values of the input for each year and, therefore, may not be the actual values of the scrap disposed in any given year.

Source: The above data were obtained from the Department of Defense

## DOD STOCK FUND STUDY

Senator MILLER. You referred to a study by the Department of Defense with respect to the operation of stock funds.

Do you have any indication as to when that study will be completed?

Mr. NEWMAN. No, we do not, sir. As a matter of fact, the question of stock funds was brought up before and I would like to elaborate a little more. We have not completed a thorough study of stock funds. We have gone into various segments and have issued two reports already. (See p. 121.) They deal primarily in the combat supplies area. But more and more as we get into it, like the electric-lamp report, we find we have the same supply management problems in the stock fund that we have in other supply and procurement areas.

That is why, as we previously mentioned, not all the reduction in stock funds represented money returned to the Treasury.

## MANAGEMENT PROBLEMS THE SAME FOR STOCK FUND AND OTHER INVENTORIES

We think it was the result of better management in the supply area and determining requirements and reviewing inventories, et cetera, which is not necessarily due to the financial control imposed by the stock fund-consumer fund system.

We still have the same problems, we feel, with the stock fund inventories as with those inventories not in the stock fund.

Senator MILLER. You do not know whether the Secretary of Defense is coming up with a preliminary report?

Mr. NEWMAN. We have not heard of anything as yet, Senator.

## MOVING EXPENSES OF CONTRACTORS' EMPLOYEES

Senator MILLER. One last question, Mr. Chairman.

You brought out a very interesting thing, Mr. Campbell, regarding the loss to the Government as a result of the failure of contractors to police, we might say, their employees who have stayed with them only a short while after being reimbursed for moving expenses.

Do you have any specific recommendation as to how this should be handled?

Mr. NEWMAN. As a matter of fact, we recommend that the Department of Defense should consider this in the ASPR procurement regulations. There has been a policy established in the Government, that an employee has to stay in the employ of the Government a year if you pay his household goods and moving expenses and other transportation. A similar policy is needed in ASPR for Government contractors.

Mr. BAILEY. We suggested in our report<sup>18</sup> that Defense consider prohibiting reimbursement to contractors of the costs of subsequent moves, if the employee does not finish a given period of service, or doesn't reimburse the contractor for the moving expenses.

Mr. CAMPBELL. This ties into Mr. Widnall's remark on stockpiling of technical personnel. By such stockpiling these people are kept in reserve; when they find they are not needed they are let go; we have to bear the cost of their relocation and related operation expenses.

<sup>18</sup> Staff report, 1963, p. 149.

Senator MILLER. The proper way you think to handle this would be through a change or addition to the ASPR?

Mr. CAMPBELL. Yes, sir.

Mr. BAILEY. One further point on your question, Senator: We understand that the Department of Defense is working on an amendment to the armed services procurement regulations to provide something along the lines we recommended.

Senator MILLER. Thank you.

Representative PATMAN. Mr. Ward would like to ask a question.

NEED TO STANDARDIZE DOD ITEMS

Mr. WARD. In your statement, Mr. Campbell, you mentioned the importance of giving clear authority to DSA to manage certain items. (See p. 117.) The Department of Defense has about 4 million items in their inventory altogether, it is my understanding, and DSA has something like a million.

It is your point that if DSA is going to make real progress they will have to be able to dig into the mass of the 3 million items, to standardize where possible and move them over into centralized control?

Mr. CAMPBELL. You are absolutely correct, Mr. Ward. I think it is helpful now but it will not accomplish anything near what we hope for unless the base is considerably broadened.

Representative PATMAN. Thank you, Mr. Campbell, and your associates. If you gentlemen would like to enlarge on any of your testimony when you get the transcript and look it over, you may do so.

Mr. CAMPBELL. Yes, sir. I think there were some things today that we have omitted and it would be very helpful to have them in the record.

Representative PATMAN. We have another meeting this afternoon at 2 here in this room. Without objection, the committee will stand in recess until 2 o'clock this afternoon.

(Whereupon, at 12:05 p.m., the subcommittee recessed, to reconvene at 2 p.m., of the same day.)

AFTER RECESS

(The subcommittee reconvened at 2 p.m., Senator Paul H. Douglas, chairman of the subcommittee, presiding.)

(Present: Senator Douglas and Senator Miller.)

Chairman DOUGLAS. The committee will please be in order.

We are very happy to welcome Mr. Holst, corporate counsel of the Arthur D. Little Co., representing the U.S. Chamber of Commerce whom we invited to this hearing.

(The letter referred to in Mr. Holst's statement follows:)

MARCH 14, 1963.

Mr. H. LADD PLUMLEY,  
President, U.S. Chamber of Commerce,  
Washington, D.C.

DEAR MR. PLUMLEY: The Subcommittee on Defense Procurement of the Joint Economic Committee will hold hearings on March 28, 29, and April 1, 1963, as a followup to those held in January 1960, and to review the progress that has been made since that date in reducing the impact of defense and related procurement on the economy.

Inasmuch as the U.S. Chamber of Commerce has long had an interest in this subject and contributed an excellent statement for the consideration of the subcommittee in its hearings in January 1960, I am again extending an

invitation for you and/or your assistants to testify at 3 p.m., March 29, 1963, room 457, Senate Office Building.

Your views as to the current status of defense procurement with relation to the Nation's economy and any recommendations you may have for improvement will be appreciated.

If you desire additional information regarding the hearings you may contact Mr. Ray Ward, economic consultant to the subcommittee, Capitol 4-3121, extension 5220, or room 502 George Washington Inn. Please submit 100 copies of any prepared material to room G-133 New Senate Office Building, by March 28, 1963.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

Senator DOUGLAS. Will you proceed in your own way, Mr. Holst.

**STATEMENT OF HELGE HOLST, CORPORATE COUNSEL, ARTHUR D. LITTLE, INC., CAMBRIDGE, MASS.**

Mr. HOLST. As requested we have prepared and filed a written statement which you have before you. With your permission, Mr. Chairman, I think it will be more valuable to the committee if instead of reading the statement I gave you the maximum opportunity for asking questions. For this purpose I would prefer, if you are willing, to simply bring out and emphasize what seems to me some of the more important points. May I have your permission to do that?

(The statement referred to follows:)

**TESTIMONY OF HELGE HOLST, FOR THE CHAMBER OF COMMERCE OF THE UNITED STATES, ON IMPACT OF DEFENSE PROCUREMENT ON THE ECONOMY**

My name is Helge Holst. I am corporate counsel of Arthur D. Little, Inc., an industrial research firm, located in Cambridge, Mass.

I appear today on behalf of the Chamber of Commerce of the United States which was invited by the chairman to express its views on the impact of defense and related procurement on the economy.

In addition to my work with Arthur D. Little, where I have had considerable experience with the conduct and management of research for both private industry and the Government, I have served for the past 6 years as a member of the chamber's national defense committee. I am presently serving as chairman of the subcommittee on research and development.

Today I will be discussing vitally important aspects of defense procurement, which are having a significant impact on the economy of the United States and on future economic growth and development. These are the impact of Government research and development, and the policies of the Government with respect to ownership of inventions resulting therefrom.

It is important to the work of this subcommittee to discuss the impact of our growing Federal research effort—programed at almost \$15 billion for fiscal year 1964 with \$7.6 billion requested for defense R. & D. and \$4.2 billion for the National Aeronautics and Space Administration.

In addition, this subcommittee should concern itself with the long-range beneficial effect on the economy of leaving ownership of inventions in the private sector where they may be transformed into the new products and job opportunities so vital to continued economic growth and prosperity.

Both the Government and the private sector benefit from full employment, from the continuing introduction of new products and processes, from the rising standard of living generated by improved productivity and from the widest possible participation in the fruits of technology. Yet, despite this identity of interests, some Government programs, especially in their implementing regulations, take positions and follow practices incompatible with private enterprise and private initiative. They consequently may be impeding the operation of the private sector.

Because of this apparent conflict or contradiction, it is well to review with care the interdependence of all interests of the economy, and to try to see to it that the policies and practices of all sectors recognize, are consistent with, and actually support the common basic goals to the greatest extent possible.

In view of the challenges facing the Nation, at home and abroad, and the extent to which the peoples of the world look to the United States for leadership, it is timely that such an examination be made now.

*The impact of Government research and development*

It is generally recognized that research and development contribute substantially toward the goals of full employment and a rising standard of living. This is the primary source of new products, new industries, and new processes which increase productivity. Thus employment is provided for our expanding labor force, and costs are kept within limits which make the resulting outflow of goods and services widely available. Unfortunately, the evidence is overwhelming that the Nation's limited R. & D. resources have been increasingly diverted from civilian industrial purposes to Government programs, primarily military and space developments.

Without denying the necessity for strong military defense, and admitting the prestige value of space accomplishments, it is nevertheless desirable to recognize the extent of the diversion of R. & D. from efforts contributory to the goals of full employment and a rising standard of living. With such recognition, it is possible that steps can be taken to better achieve both objectives.

The statistics on this subject are now clear: In fiscal year 1963, Federal funds comprise \$12.3 billion out of a total national R. & D. expenditure of \$16.5 billion, as a result of which only one-fourth of the funds are provided by the private sector. Essentially the same relationship holds for manpower. According to the Department of Commerce, of an estimated total of 400,000 scientists and engineers engaged in R. & D. only 120,000, or less than one-third are devoted to civilian activities. Even more serious, U.S. effort is well below that of other major industrial countries (such as Japan, West Germany, Netherlands, and Sweden) in annual effort for civilian purposes. In terms of the proportion of its available R. & D. talent devoted to industry and commerce, the U.S. effort is only half of that of West Germany. This is a potential cause of lagging employment and deterrent to increased productivity.

These facts and figures prompt the question: How long can the United States continue in this unbalanced effort and still stand as an example of progress for the world, and remain competitive in an era of freer and wider competition?

Should not national policies recognize the relative importance of a sound and prosperous national economy as weighted against the prestige value of a space exploration, or overkill in military defense? Can different methods of operation in some Government programs preserve a greater proportion of the R. & D. staff and facilities for civilian effort and transfer more of the results of R. & D. to the civilian economy? Should not Government policies have this as a conscious objective?

If Government needs must absorb a substantial portion of the Nation's research and development resources, in what ways can this be handled so as to produce minimum diversions from the private sector? What unnecessary practices have contributed to the present situation and how might they be changed?

*Duplication of staffs and facilities*

Although a large proportion of Government R. & D. is currently performed by private organizations, the Government's fiscal and contractual policies tend increasingly to isolate this work from the civilian industrial effort of such organizations. Moreover, even a casual examination reveals many large Government laboratories and organizations directly engaged in research, development, test, and evaluation. These can be found in virtually all agencies. Unfortunately it is evident that there is a substantial degree of duplication in these staffs and facilities.

In the Department of Defense, for example, even where the objectives of the research are closely related, if not identical, it is not uncommon to find separate organizations in each of the services rather than to observe the joint use of a single staff and facility. This is also true of nondefense agencies and in their interrelationship with the Department of Defense. This tendency is extensive. It can be seen in the fields of electronics, communications, engine development, satellite and booster development, weather science, and a number of other fields. Present budget requests suggest that the National Aeronautics and Space Administration is following the usual pattern of having its own facilities of nearly all kinds, resulting in duplication.

The contrary policy of joint or shared use involves the hard choice of not having personnel and facilities totally subject to an agency's own control. Granted that there might be advantages to some programs in having staffs and

facilities just for that purpose, in R. & D. this has become a luxury which the limited resources of the Nation cannot afford. Moreover, it is believed that "single service" or shared operation of a single facility would promote efficiency and achieve a greater degree of transfer of technology and experience from one project to another. It would reduce the numbers of R. & D. personnel and facilities required for Government programs and thereby leave more for civilian effort.

#### *Greater use of private sector*

If the effort to avoid duplication of staffs and facilities is taken seriously it should include an effort to avoid duplicating in Government agencies the staffs and facilities which already exist in the private sector. This is not to say that there should not be Government organizations and personnel concerned with and competent in fields undertaken by private organizations for the Government. Clearly there must be capable and responsible management of its projects by the Government. But this would not require staffs as large as those needed to actually perform the work.

The subject of Government competence to deal with R. & D., and the obtainment of superior R. & D. for the Government, was extensively studied in 1962. The results of these deliberations are summarized in two reports, one by Government personnel and called the Bell report<sup>1</sup> after its chairman, the then Budget Director David Bell and another by a group of experienced contractors and sometimes referred to as "the Contractor's Bell Report."<sup>2</sup> Both of these studies deal with methods of obtaining the best R. & D. for the Government. Each recognizes the role of in-house work in the Government as well as the place and importance of the contractor. It is believed, however, that the new emphasis on minimizing diversion of R. & D. from the civilian sector, as well as the importance of securing a maximum transfer of technology from Government sponsored work to the private sector, may give renewed importance to reliance on contractors where their competence to serve is at least equal to what could be created within Government. It is suggested that a serious effort be made to avoid duplication of research and development staffs and facilities devoted to Government work, whether this duplication be in-house or in the private sector.

#### *Transfer of technology from Government research to the private sector*

Recognizing the potential adverse impact upon the economy of heavy investment in Government research and development with the resultant diversion of scientific talent to Government work, there is a growing effort to achieve the greatest possible transfer of findings and technology from Government R. & D. to the private sector. This effort is evidenced by the creation by the Atomic Energy Commission of the Office of Civilian Applications, and the establishment by NASA of a similar program.

These programs are aimed at obtaining maximum secondary benefits from work initiated because of military, space, or other Government objectives. While such aims are laudable, the search for such secondary purposes or applications is a diversion from the primary purposes of the Government agencies. The Department of Defense and the Space Agency, the two largest sponsors of R. & D., each has large and urgent primary missions. Surely, it is a distraction, if not actually a deviation from their purposes for such agencies to be concerned with civilian application. Moreover, the wide scope of possible civilian applications make the effectiveness of these efforts problematical. Both in the interest of conserving manpower and budget, it would seem preferable to leave the task of finding private applications to private industry.

#### *The effect of in-house versus contractor performance on transfer*

Any discussion of the desirability of transferring experience and technology from Government-sponsored work to civilian application must observe the impacts of in-house versus contractor performance of the work, and of efforts to prevent the obtainment or exploitation of advantages by contractors. If work is performed by a contractor in fields related to its regular commercial interests the likelihood of transfer of technology is substantial. On the other hand if Government research is conducted in-house or in a specially created institute or other quasi-public organization, direct transfer to the private sector is impossible, and any effort to obtain transfer will involve intermediate steps. Moreover the

<sup>1</sup> Report to the President on Government contracting for research and development dated Apr. 30, 1962.

<sup>2</sup> Operation and management of research and development facilities and programs, analytical and advisory services and technical supervision of weapons systems and other programs for the Government in-house and by contract dated Apr. 17.

driving incentive of opportunity for gain is absent, as are the means for utilization through manufacture, distribution, and sale. It would seem therefore that if transfer of benefits to the private sector is an objective, the choice of agency for performance of an assignment should be influenced by these considerations.

Similarly, because it is desirable to transfer know-how or data from Government-sponsored work to the private economy, restrictions should be held at a minimum on the use of such knowledge. Contractors should also be free to rotate personnel from Government to private work.

The Government's concern should be to see that the primary work for the Government is well performed; other considerations regarding any advantage to an original contractor because of its early involvement in the work of the Government should be quite incidental. Indeed the opportunity to obtain such advantage might well be held out as incentive for desirable contractors to undertake the work for the Government in the first instance. Provided this opportunity is fairly open to competitors at the outset the equity of transfer of know-how should not be in question but rather should be encouraged in the public interest.

#### *Government patent policy and the public interest*

Another Government policy which deserves examination because of its effect on the economy (and on the best interests of the Government agencies themselves) is the currently advocated policy that the Government should take title to any inventions resulting from Government-sponsored R. & D. Many strong statements have been made on this subject by representatives of both the Government and the private sector. Perhaps the most careful presentation of both sides to date was made by Congressman Emilio Q. Daddario's Subcommittee on Patents and Scientific Inventions of the House Committee on Science and Astronautics. The report (H. Rept. 2185, 87th Cong., 2d sess.), which accompanied H.R. 12812, is so penetrating and so impartial that we recommend it to anyone seriously interested in this subject.

As agreed at the outset, both Government and the private sector seek full employment and a continuing stream of new and better products, services, and production tools and methods. For years private ownership and use of patents has been felt to contribute to this end.

A few recent illustrations are synthetic fibers, color and self-developing film, special metals, and magnetic tape. In each of these instances the producer has relied on patents to justify the financing necessary to develop, produce, and distribute a new commodity or service for the ultimate benefit of the public. These and many other products could not have been launched without the benefits of the American patent system. Despite the lessons of these and numerous other examples, increasingly in recent years, many Government agencies have rejected private ownership of patents. Thus the Atomic Energy Act and the National Aeronautics and Space Act embody policies under which the Government either takes title to all inventions resulting from work sponsored to any significant degree by the Government, or alternatively retains the right to determine whether to waive ownership and accept only a royalty-free license. Efforts are currently in progress to extend this policy by attaching it as a rider to the Department of Defense appropriations authorization bill for fiscal 1964.

The taking of title by the Government can be made to seem self-justifying under the slogan, "What the Government pays for it should own." Otherwise expressed, this statement asserts that because public funds have been used for the support of the work which gave rise to the invention any resulting inventions should be the property of the public. Despite their appearance of self-evident truth, these statements can be challenged in many respects.

For example, in the contract under which the invention was made, what was it that the Government really sought and paid for? Was it a weapon or system rather than a patent? Did the Government get what it contracted for? Did the Government pay true full costs so that it is in equity entitled to ask for secondary or derivative benefits. Even more relevant, will a policy of taking title best promote the public interest?

As stated before private ownership of patents has led to their widespread use and resulting benefits. To date the opposite philosophy of Government ownership has been strikingly unproductive in terms of patents licensed or products produced for public consumption. Before such a departure from successful past practice is adopted it should be subject to careful examination. It would seem that the burden should be on the advocates to prove the desirability and effectiveness of the changed policy. Moreover it needs to be appreciated that in our free economy there can be no private gain without public benefit because success follows from wide acceptance of goods or services.

A positive policy of allowing title to inventions developed in the course of Government-sponsored work to remain in the private sector would have both the benefit of (1) attracting still more competent and knowledgeable contractors to work for the Government, and (2) result in more extensive and rapid transfer of resulting technology and experience to the private sector, with consequent benefits.

*Can the Government successfully exploit patents?*

A subordinate but necessary consideration in this issue of Government ownership of inventions—and one which should not be overlooked in any review of the subject—is the question whether the Government is capable of successfully promoting patents. If the Government continues to acquire inventions it will be under pressure to set up some form of patent administration. The experience of organizations which do promote patents indicates that only a very small proportion of patents issued ever become truly successful. Surely it is better that the risk taking involved in promotion of unproven concepts be undertaken by private interests with private funds so that costs and losses will occur in the private sector and not needlessly add to public expenditures. Likewise the gain, if any, will affect the private sector and provide employment and taxable revenue. Certainly at a time of high Government expenditures like the present speculation by the Government in patent ownership and promotion should be avoided.

*Conclusion*

As a nation we are constantly striving to keep the economy dynamic and expanding, to create new job opportunities, and to provide a high and rising scale of living for the American people.

A number of Government policies dealing with research and property rights in inventions are hindering rather than aiding this effort. A review of these factors suggests changes in the ways the Government deals with the private sector which would both improve performance in the interest of the Government and stimulate the economy.

COMMON INTEREST OF GOVERNMENT AND PRIVATE SECTOR

Mr. HOLST. We have been asked to discuss for the committee the impact of Government policies that may be having an effect in contributing to unemployment or possibly slowing down the rate of growth of the national economy. Because of my background, coming from a research company, and because I have been serving as chairman of committees concerned with research and development, I am going to limit my testimony to the impact of Federal Government policies related to research and development. This need not restrict your questions on other aspects, but at least my primary remarks will be aimed at R. & D. policies and their impact. Before making any specific comments I would like to emphasize that there is really a great deal of common ground between the objectives of the Government and of the private sector. Sometimes it appears from public discussions, and also from some Government regulations, as if there was an antagonism of interest. Really there is not. The Government, in the interest of the people, desires full employment and a growing national economy. And the private sector likewise. The manufacturers, the distributors, the retail trades, and the labor unions, all want increasing numbers of jobs and increasing participation in a rising standard of living. So there is a great deal of common interest, and it is unfortunate if this agreement of interest gets lost sight of under regulations or implementing practices.

IMPACT OF GOVERNMENT RESEARCH AND DEVELOPMENT ON  
GENERAL ECONOMY

You have my statement which has been carefully prepared, but I am not reading it to you, I am simply directing your attention to



some parts which I think are worthy of emphasis. The first point which should be recognized by everyone is what is happening to the Nation's research and development effort, and how this limited resource of the country is being employed. I am sure that it is not news to the committee that in fiscal 1963, of a total research and development expenditure of something over \$16 billion, \$12 billion was devoted to Government research and development. This means that of the research and development expenditures, 75 percent was devoted to Government purposes and only 25 percent to purposes primarily for the civilian economy.

In terms of manpower very much the same data are found. It has been indicated by the National Science Foundation that the scientists and engineers devoted to research and development for the Nation as a whole number approximately 400,000. If you add non-professionals the number is larger. But of the scientists and engineers, numbering approximately 400,000, as many as 280,000, or 70 percent of the total available pool, are devoted to Government assignments and only 120,000 or 30 percent is being devoted primarily to the civilian economy. Saying this again; in terms of expenditures, about 75 percent of the effort is aimed at governmental objectives, and in terms of manpower 70 percent, very nearly the same proportions.

Senator MILLER. Could I ask you a question at that point?

Mr. HOLST. Surely.

Senator MILLER. When you referred to the 70 percent or 280,000 of these scientists being involved in Government research, you are not talking just about Government employees.

Mr. HOLST. No, I am not.

Senator MILLER. You are talking about doing contract research for the Government?

Mr. HOLST. That is correct.

Senator MILLER. Are you talking about those scientists who are members of college faculties?

Mr. HOLST. Yes. The contrast here is between the objectives of the research, not the place of employment. The point I have been making so far is that approximately three-quarters of the research effort of the Nation—coming from all sources, educational, nonprofit, private organizations, and Government agencies—are aiming their efforts not at contributing to a rising standard of living or to an increase in national productivity, but to other objectives, primarily of course, defense, space, and atomic energy. This observation, that only about a third of the scientific resources are specifically directed at contributing to the national economy needs to be viewed in the light of an apparent slowdown in the growth of the economy and our current continuing unemployment situation. But it will also help to put it into perspective if we compare this proportion of the U.S. scientific effort with what is taking place in other countries.

It is a fact, if you look at the statistics closely, that the other industrial countries of the world, like West Germany, Japan, and Holland, are engaged in as heavy a military effort. Their scientific talent is much more devoted to developing their economy and to increasing their productivity. As a matter of fact, the data would indicate that in West Germany, for example, twice as much effort in terms of percentage, not necessarily in terms of overall manpower or

dollars, is being devoted to the national economy as is true as a percentage in the United States.

Chairman DOUGLAS. Your conclusion from this is that West Germany is doing a better job than the United States?

Mr. HOLST. No, I am not saying that. But I am about to say that in the United States we have been an outstanding example, of applied research making a vast contribution to the economy. We have stood before the world as a demonstration of this kind of system. But how long will we remain in that position and how long will we remain competitive in an era of increased free trade and increased competition if this kind of unbalance is continued.

Chairman DOUGLAS. Are not some of the burdens which we bear because of the fact the other countries are permitting us to assume the major responsibility for defending the free world? The development of nuclear energy is almost entirely in our hands. I imagine the development of new weapons is primarily conducted by us. We are conducting the major research in space. This takes from the countries of Western Europe burdens which they would have to assume if they bore their share of the defense of the West. Then if they make greater progress, they can say to us we are more efficient than you are because they have burdened us with the heavy military load. I personally have come to the feeling that probably we should not move ahead in the field of space at the same rate we have been going. It may not be necessary to get a man on the moon by 1970. That can be stretched out a number of years and possibly we could save a billion or more dollars a year as a result of it.

I think you are on sound ground when you point out the extra burdens which we have taken on. I hope your testimony will not be interpreted to mean that this is an indication of American inferiority as compared to that of Western Europe.

Mr. HOLST. It is not.

Chairman DOUGLAS. It is an indication of greater American sacrifice in the defense of the free world. I only wish the Western European nations would take some of the load.

Mr. HOLST. The point I am making, Mr. Chairman, is that we are going to have to choose between unpleasant alternatives because we cannot have everything that we would like. One of the ways in which we can meet the situation is perhaps to require our allies, or at least, certain of them to impose on themselves a greater share of the effort.

#### FEDERAL AID TO EDUCATION TO PROVIDE MORE SCIENTISTS AND ENGINEERS

Chairman DOUGLAS. What is the attitude of the chamber of commerce in expanding educational facilities to produce more scientific talent?

Mr. HOLST. I am not on the Education Committee, but I am sure the chamber strongly supports the expansion and improvement of education.

Chairman DOUGLAS. This would be news to me.

Mr. HOLST. I do not believe the chamber favors large Federal subsidies and direction.

Senator MILLER. On that 70-to-30 ratio that you mentioned do you have any figures regarding the ratio in the Soviet Union?

Mr. HOLST. No, I do not. It is my understanding that the Soviet Union may be spending as much as we are.

Chairman DOUGLAS. On a smaller gross national product?

Mr. HOLST. Yes. It is my understanding that they may be spending 25 percent of their gross national product as compared to our approximately 10 percent on defense. But I do not know the impact on their scientific manpower of their defense research effort.

Senator MILLER. I was referring not so much to the gross national product as I was to the scientific community.

Mr. HOLST. I do not have any data.

Senator MILLER. Do you think you could get those?

Mr. HOLST. I have friends from whom I might, and if I can I will send them to you.

Senator MILLER. If we could I think it might be interesting to have that in the record, Mr. Chairman.

Chairman DOUGLAS. Yes.

Mr. HOLST. I will.

(The information to be furnished follows:)

The only sources of information regarding Russian scientists and engineers available to us proved to be the National Science Foundation and the National Industrial Conference Board, New York City. They give information regarding professionals in various types of industry, for example, mining, but the statistics do not indicate the number engaged in research and development. We suggest that Senator Miller make direct inquiry of the National Science Foundation who may be able to analyze their data in ways different from that in their publication.

Mr. HOLST. The point I have been making is that it is quite generally agreed that the introduction of new products, and hopefully, occasionally new industries, and improvement in production efforts makes a substantial contribution to the national welfare, to the creation of jobs, and to a rising standard of living. This is not to say, and I want to emphasize it since I come from a research background, that it is not research alone which does this. Without production, finance, advertising, and distribution there would not be the widespread distribution of our products. Without a large demand there would not be volume production, and without that probably there would not be low costs. But the introduction of novelty into the economy on a continuing and consistent basis is the job of research and development.

In line with what I have been saying before, we are now finding an increasing proportion of the Nation's research and development talent, which is relatively limited, being devoted to military, space, atomic energy, and other governmental purposes, and not being devoted to the civilian economy.

Chairman DOUGLAS. I must come back to the question I raised before. Do you favor an increased program in the training of scientists?

Mr. HOLST. Yes, I do.

Chairman DOUGLAS. How would you finance it?

Mr. HOLST. I have never struggled with that one. In my hometown we consider education to be an obligation of the town.

Chairman DOUGLAS. What town do you live in?

Mr. HOLST. Concord, Mass.

Chairman DOUGLAS. That is a very well-to-do town. How would you finance it down in Arkansas or Mississippi or eastern Tennessee or the Dust Bowl of Kansas or the hill towns of Vermont or the woods of Maine?

Mr. HOLST. I do not know the answer to that question, Mr. Chairman. But I do not know either that the number of citizens to be edu-

cated is proportionately very different in those areas from in New England. If the proportion of students to be educated is not very different, then I would assume that the burden of supporting the education on a State or municipal basis would not be very different either. I do not know the facts.

Chairman DOUGLAS. You know that the per capita income differs in different sections of the country. As a matter of fact, it is only about one-third or 40 percent in Mississippi of what it is in Connecticut. I would imagine Mississippi would only be a quarter of what it is in Concord and Lexington. So they may have the same number of kids, but they do not have the same amount of property or income with which to educate them. You as a scientist, and presumably, therefore, as a mathematician know it is something more than children and young people who constitute ability to educate.

Mr. HOLST. I am not an expert in that field.

Chairman DOUGLAS. You obviously have a very high intelligence.

Mr. HOLST. It happens that scholarships for scientific education are exceedingly available. If you were asking me about educating philosophers and dramatists and religious leaders, which I think we need also, that is much more of a problem.

Chairman DOUGLAS. I am not going into that question at the moment.

Mr. HOLST. I am glad you are not.

Chairman DOUGLAS. In order to educate youngsters, they must be prepared in competent high schools and many have the burden of supporting a father or mother or grandmother or grandfather as they go and, therefore, are diverted into other occupations. I think we need something more than willingness to educate a scientist. We have to have facilities which cost money and income to support teachers, and income to support students.

Senator MILLER. May I say I am sure that the chairman would not want to overlook the need to educate more economists.

Mr. HOLST. No, he should not.

Senator MILLER. May I say on behalf of my profession, more lawyers.

Chairman DOUGLAS. I think the latter is more dubious.

Mr. HOLST. At any rate, Mr. Chairman, the point I am making is that for the moment until we have an abundant source of scientists and engineers—and bear in mind they are not the saviors of the world—until we have more, we are dealing with a relatively limited resource and how it is used is important.

Chairman DOUGLAS. I am greatly in sympathy with you as far as the space program is concerned. I have seen some of the figures and it looks as though the space program is going to absorb an undue amount of scientific talent.

Mr. HOLST. The point I am making applies pretty much across the board. I am not especially picking out one agency that is worse than another, although certainly NASA has been growing at a prodigious rate.

Chairman DOUGLAS. Would you say the same thing applied to the field of medicine? Each year we appropriate enormous amounts of money for medical research.

Mr. HOLST. Yes, I do.

Chairman DOUGLAS. You think it does?

Mr. HOLST. Yes, I do.

Chairman DOUGLAS. Do you think it applies to the field of atomic energy?

Mr. HOLST. I am not as familiar with that. I believe that we could get as much out of our medical effort with fewer dollars as we are now doing.

Chairman DOUGLAS. Medical?

NEED TO BALANCE USE OF R. & D. IN INTEREST OF ECONOMY

Mr. HOLST. Yes. What I am going to say now on the effect of the way in which the scientists and engineers are used is not to deny that we need a strong defense posture and it does not deny that there is prestige value in space accomplishment. First, we must recognize that the way in which we use our resources of R. & D. will have an impact on governmental programs or on the civilian economy. Since they are a relatively limited resource we face the unpleasant task of deciding how we use them to achieve a balanced effort. How we use a sufficient fraction of our research and development to contribute to a growing economy and to creating jobs and a rising standard of living, and how this matches up with the needs of defense and space and other Government programs. How to achieve this balance is not an easy question, and its answer is not black and white. But I do believe that something can be done about it.

Now if we assumed, which I do not assume, that the space and defense programs per se could not be reduced, is there any way in which they might be accomplished that would make less of a demand on the Nation's research and development talent? That is an interesting question. It seems to me that in trying to answer that question we should take into account another factor as well. If we are going to have large Government programs—military, space, atomic energy and others—can we handle those programs in such a way that there will be a maximum contribution of secondary benefits from the Government programs to the civilian economy?

AVOID DUPLICATION OF R. & D. STAFFS AND FACILITIES

So, we are now trying to address ourselves to two questions. Can we handle our programs, unreduced if necessary, in a way that is more helpful, and at the same time do so in such a way that there is a maximum opportunity of transfer of secondary benefits? It seems to me that the first effort along these lines would be to ask whether in any way the scientists and engineers that are being used in Government establishments, or in the civilian private sector as well, are being unnecessarily duplicated or wasted. Beginning on the Government side, the question would first be, are there more or larger Government establishments using scientists and engineers than is necessary? Certainly when you look at the services, and also the nonmilitary services, it appears as though—and I believe it actually is a fact—each of the services, the Army, Navy, Air Force, and NASA in some cases, is concerned with essentially the same subject matter, for example, communications at a distance, communications with satellites, rocket propulsion systems, or aerospace medicine, or aerospace surgery. Relatively seldom do you see joint use of the same laboratory staffs and facilities.

It is beginning to appear but it is an exception rather than the rule. It would seem much more likely to result in a transfer of data and knowledge and skill from one project to another project if the several services shared a single facility or a few facilities with each other rather than each insisting on having its own. Yet I am not aware of the same kind of effort having been made to produce a single service facility for research that has been developed in the form of the Defense Supply Agency.

I do believe that an effort along these lines could increase efficiency, increase transfer of information, and at the same time produce reduced demand for manpower and associated costs.

Chairman DOUGLAS. You have a very constructive suggestion there. We have tried to follow it out. We have had a great deal of trouble in getting the Defense Supply Agency underway over the opposition of the separate supply agencies. Military officers, and their civil service opposite numbers, are very hard to deal with. I rather imagine that scientists are even harder to deal with.

Mr. HOLST. Harder but not impossible. They are human, they are not impossible. They are like economists— independent minded but of good intention. If you are pursuing the subject, Mr. Chairman, a careful analysis of exhibit G to the fiscal 1964 Budget, which is concerned with research expenditures, may reveal how much common subject matter there is in the programs of each of the services. But seldom will you see any of the services proposing to do its work or have its projects taken care of in a joint facility. I think it is more common to see the opposite.

Chairman DOUGLAS. I think that is a very constructive idea.

Mr. HOLST. Let me go one step further. If we are seriously concerned about reducing duplication then we must not encourage duplication in the Government of facilities which exist outside of the Government or help to create additional duplicated facilities within the private sector which do not need to be duplicated. I think this follows. If we are against duplication it should be equally objectionable wherever it occurs. Now this leads me to this observation: As you are undoubtedly very well aware, last year a considerable study was made at the request of the President under the chairmanship of Budget Director Bell in comparing the accomplishment of Government research and development in-house versus by contract. This led to a report called the Bell report with which I am fairly sure you are familiar. Because that study was requested of an entirely in-house group, a number of contractors under my chairmanship made a corresponding study of how to respond to President Kennedy's questions. We turned the results of our studies over to Mr. Bell for his joint use. That report also is available, and I am sure you have it. If not I can give you a copy.

This represents an attempt to evaluate the accomplishment of Government work in-house in Government organizations, or by contract in contractor organizations. Let me hasten to add that both reports recognize that there is a role for each type of organization, the in-house organization and the contractor organization.

Currently, there is a great deal more interest in the transfer of technology and in benefiting the private sector than there was at the time of the Bell report. It seems to me that this may put a new perspective on the relative merits of accomplishing work in the private

sector when competence to do this exists as compared to creating a new or enlarging an existing in-house organization.

Chairman DOUGLAS. You are located right next to MIT?

Mr. HOLST. Yes, we are, and I am a graduate of it.

Chairman DOUGLAS. In the report which Mr. Ward has just issued we find that Massachusetts Institute of Technology is the 52d largest contractor for research or research and development—\$82 million last year. Johns Hopkins is the 70th largest contractor—\$44 million last year. I know that Stanford University has a great deal of work and it is true that American Tel & Tel is doing a great deal of research and development work in the field of space.

Mr. HOLST. If you are asking me whether a large proportion of Government research is not being accomplished by contractors, the answer is "Yes."

Chairman DOUGLAS. Is being accomplished?

Mr. HOLST. A large proportion, variously indicated at between 60 and 80 percent, is being accomplished outside of the Government.

Chairman DOUGLAS. By contract?

Mr. HOLST. Yes. You did not ask me and I perhaps can gratuitously throw in a question to you. You are interested in the education of scientists and economists and others. I think a number of the large educational institutions are concerned, including the ones you have mentioned, whether taking responsibility for so much research and development is not in fact diverting them to a significant degree from their educational mission. This is very serious. It is to the educational institutions alone to which the Nation looks for education. Research can be accomplished in other places.

Chairman DOUGLAS. If they are concerned with this, there is a very easy remedy for them, namely, not to ask for the money.

Mr. HOLST. That is on one side. On the other side there might be a remedy, too.

Chairman DOUGLAS. If this is a frustration it can be frustrated by the simple expedient of not yielding to temptation.

Mr. HOLST. That is correct. However, it must be recognized that there are kinds of research which are particularly helpful to educational purposes but there are many kinds which are not, and which actually interfere because they require faculty and administrative time diverted away from educational purposes. If you speak to the authorities who are responsible for the major schools having those large contracts, they are concerned about it.

Chairman DOUGLAS. You just suggest that to MIT, which has been one of the greatest gobblers of research and developments contracts in human history. It would be very interesting to have them change their policy.

Mr. HOLST. I know President Stratton is concerned about it. I know President Stratton, and I know he is concerned about it.

Chairman DOUGLAS. The great Vannevar Bush had previously been vice president of MIT and MIT got a very large amount of contracts. They had a head start for a long time, plus the ability of the staff.

Mr. HOLST. Yes, and the patriotism of the staff, too. In the early days, the days of Vannevar Bush, I am not sure who was beating on whose door. In more recent days it may be the different way around. I think in those days it was the Government asking MIT to undertake

the assignments and we were fortunate they had the ability and willingness.

Chairman DOUGLAS. Did not your concern really get its start on R. & D. contracts?

Mr. HOLST. No, we are 75 or 76 years old. We are older than that. I did work at the Radiation Lab during part of the war when I came back from overseas and I know what was going on. It was not that the institute really wanted to do a great quantity of Government work. It felt called upon just as many of us feel called upon, but perhaps all of us need to be reminded now and then what is our primary mission and what is the secondary.

So far the argument has been that we are dealing with a relatively limited resource and how we use it makes a great deal of difference.

One way to try to use it more efficiently is to avoid duplication where possible and to ask the agencies that are using this kind of talent to share a common pool of talent and joint facilities where possible, believing that if we did this, the work will probably be better done because there will be a greater cross-fertilization of ideas, and at the same time there will be a smaller demand on the manpower and facilities, and, therefore, the resources of the Nation. The objection to duplication should extend as well into the private sector. There is not much point having duplicate laboratories or duplicate programs or projects whether they be for the Army, Navy, or Air Force in several different private sector locations rather than trying to pool them.

#### IMPORTANCE OF SECURING MAXIMUM TRANSFER OF RESEARCH AND DEVELOPMENT BENEFITS TO THE ECONOMY

Now, are there any other factors which could help to make the use of research and development more efficient? It seems to me that there are. Even if you achieve a minimum of duplication, you have just mentioned, and correctly, so that a substantial part of the research and development for the Government is, in fact, accomplished in private organizations. Could the way in which this is being done be improved in efficiency and in the likelihood of achieving civilian fallout or civilian diffusion? I think the answer is that it could. By what means? You are only listening to one person speaking, but I am sure that from your connections with contractors in your own districts you certainly can get hold of other witnesses as well. I believe you will hear a fairly general story that the way in which the Government requires contractors to work does not contribute to maximum efficiency or to reduction in cost. There are various reasons but I think the end result would be agreed upon.

If we are concerned with economizing in our use of manpower and facilities, and at the same time achieving a maximum transfer of benefits to the economy, then I believe there are Government policies which could be altered to achieve that result.

Chairman DOUGLAS. Would you be specific?

Mr. HOLST. Yes, I will. The contractual and financial approaches that are made by the Government in connection with Government work, isolating overhead and trying to reject various forms of cost of the contractor tend to result in isolation of the performance of Government work by contractors to a greater and greater degree. Instead



of such effort being commingled with the rest of the organization, and the research and development staff being used in its usual location and usual laboratories, and with its normal degree of overhead and support, you are finding a segregation of the work, not in a racial sense but as separation of the work. The result is duplication of laboratories and duplicate staffs and facilities for one reason or the other. This is wasteful of manpower and increases cost. Perhaps most pertinent to the present inquiry, it greatly decreases the transmission of secondary benefits from the Government research and development to civilian products and processes, and thus into the economy at large.

#### IMPACT OF GOVERNMENT PATENT POLICY

There is another policy change, and I suspect we will now approach a controversial subject, but nevertheless a policy change which it seems to me could be made which lies in the field of the Federal patent policy. This is a subject on which there has been a great deal of debate and there is likely to be a great deal more. It is a subject which was looked into quite carefully last year by a committee of Congress under Congressman Daddario. He produced a report which I believe to be the most balanced statement on this subject from either side. I would recommend its careful study to anyone that is seriously concerned, whether he be in the private sector or in Government. (See pp. 53-56.)

There is a strong trend in recent Federal legislation, and there is a suggested amendment to the present military appropriations bill which proposes that any results of research which is in any way sponsored by Federal funds should become the property of the Government. For the moment I would prefer to pass the question of whether or not this is equitable although I would be glad to debate that.

If we are concerned as a primary interest of this committee with how to provide incentive to get transfer of new technology, and new data, into the civilian economy, I think there can be no question that a policy of taking title to inventions, of preempting for the Government any results of the research, makes the transfer of such technology and data to the civilian economy much more difficult.

This is so, first of all, because you are taking away the data or invention from the organization which created it and which presumably is in the natural position to use it.

Chairman DOUGLAS. Did the organization create it, or did scientists and technicians paid by the Government create it?

Mr. HOLST. A very interesting question, Mr. Chairman, and apparently we had better stop and debate that one for a while. I welcome the opportunity. I believe if you look at the contracts under which patents sometimes result, almost never will you find that the creation of a patent or the creation of a novelty was the objective of the contract. Usually it is the production of a new weapon or a weapons system or a space vehicle. Presumably what the Government, or at least that agency of the Government, sought from the contract, was a weapon or a system or a space vehicle. Any incidental results are quite secondary.

Chairman DOUGLAS. May I raise a question.

Mr. HOLST. You certainly may.

Chairman DOUGLAS. Would this be true of space communications? When that bill was up last year we were told that NASA and related

agencies had spent approximately \$400 million in this field, and said that the contribution of A.T. & T. was relatively much less than that. And yet the results of the Government-financed research were turned over to this communications corporation which will be privately owned.

Mr. HOLST. You are asking me if that is a desirable result?

Chairman DOUGLAS. Yes.

Mr. HOLST. It seems to me that we are very easily led to accept some truisms and to lose sight of the primary target. If in fact what is wanted is a military system or a communications system, and not just patents or data, and that is what the Government is seeking and what it negotiated its price for, the Government has received the fruits of its contract when it has gotten the system. But at the moment I thought that we were more concerned with how do you transmit the benefits of Government sponsored research to the economy? But let us carry on. If the primary mission of Defense is defense, and of NASA is space exploration or space communication—rather the bringing into being of functional systems but not the acquisition of patents, it seems to me that patent acquisition is a diversion of the manpower and the budgets and the attention of those agencies. It leads them to take their eyes off first things first and no longer center their attention on the weapon or communications system.

Chairman DOUGLAS. This is what you sometimes refer to as a scientific fallout which radiates into civilian industry.

Mr. HOLST. That is right. At least that we would like to have radiated into civilian industry. But it apparently has not been at a fast enough pace to keep employment up and an expanding economy.

Chairman DOUGLAS. If the discovery is made by Government money, or aided by Government money, and were to radiate out to private industry, this would be fine. But if the patents are held by the company in which the research and development work takes place, the company has the exclusive right of use or disuse, and either can withhold the invention from the market or can impose very high charges, or indeed really claim exclusive use for itself. So the benefits do not get fully distributed. If you had a vision of the patent system under which it would be freely available for use under the payment of a royalty, with the proceeds shared between the company and the Government, then this would certainly lead to a much more universal development of scientific knowledge.

Mr. HOLST. Mr. Chairman, you have raised a host of questions and I would love to deal with most of them but let me tackle only a few first and then you may wish to call several other witnesses. First of all, I believe that there is very little, if any evidence whatever, that any private owners of patents have really sat on them. I think there are very few if any instances of inventions being suppressed.

#### PATENTS AND SUPPRESSION OF INNOVATION

Chairman DOUGLAS. Are you acquainted with the United Shoe Machinery Corp.?

Mr. HOLST. Yes, I am.

Chairman DOUGLAS. They have their plant at Lynn, do they not?

Mr. HOLST. Yes, and in Beverly, Mass.

Chairman DOUGLAS. Haven't they suppressed patents?

Mr. HOLST. Do you know of any company which has disseminated useful machines for shoemaking?

Chairman DOUGLAS. Provided they are owned by the United Shoe Machinery Corp.

Mr. HOLST. At the moment we are not concerned with the enrichment of the owner of the patent. We are not at the moment concerned with the private owner, whether he be the inventor or employer. We are not concerned with that. At the moment we are concerned with how do you widely disseminate the results of invention and thereby benefit the public? The idea that you can create great personal wealth at the expense of the public or create a great advantage for one and hold back benefit from the public is a totally false idea.

Chairman DOUGLAS. I am not totally ignorant on this subject because while I am not a scientist myself my brother was a physicist and electrical engineer and at one time was one of Steinmetz' chief assistants. So I am not unacquainted with some of the practices of the General Electric Co. What you have in these situations is that a company will very directly have a big investment in existing machinery and existing processes, and a new invention will come along which they develop, but which if they put into effect will make existing machinery obsolete and will require new investment.

So they will frequently hold these inventions off the market until the existing machinery wears out and they can let the processes run their course. Then they can introduce the new system. In the interest of society it might be well desirable to have this come on at an earlier stage which it would if you have free use with the payment of royalty.

Mr. HOLST. I am not sure I agree with you. In fact, I am quite sure I do not agree with you.

Chairman DOUGLAS. I am sure you do not.

Mr. HOLST. It seems to me that the private patent system gives only, if you wish to say so, a limited monopoly. That is a monopoly for a limited period.

Chairman DOUGLAS. For quite a long period?

Mr. HOLST. Not very long.

Chairman DOUGLAS. How long?

Mr. HOLST. Seventeen years.

Chairman DOUGLAS. What about renewal?

Mr. HOLST. There is no such thing as renewal.

Chairman DOUGLAS. What about slight changes?

Mr. HOLST. There are such things as improvement patents that extend it. Let me make my point. What you are saying is frequently said that the patent system gives rise to monopoly and concentrations of power at the expense and disadvantage of the public. But first of all the experience of the country denies this because under the private system we have really been surprisingly successful and are the envy of the rest of the world. Second and not to be overlooked, if the patent system were destroyed or seriously altered away from its present provisions, then manufacturers might depend on trade secrets and the suppression of information for their protection.

As it is now, a patent is only valid if it correctly and adequately discloses the invention, which disclosure becomes apparent to competitors immediately on the publication of the patent, not 17 years later. So they can design around it, if they will. Certainly at the end of the patent life it is generally available.

Chairman DOUGLAS. If I may say so, I was referring not merely to private industry patenting developments and inventions made by their employees when paid by the Government, but also they can use for themselves trade secrets developed which are not patented.

Mr. HOLST. Yes, but in this country industry does not rely extensively on trade secrets because of the turnover of employees. There are some processes which are deliberately divided up or separated, but the reliance on trade secrets is quite small.

Chairman DOUGLAS. You are a very able and public-spirited man. I do not want to get into a debate with you. But first, you say patent control could not be effective, because then there would be resort to trade secrets. Now you say trade secrets are not important.

#### PATENTS PROVIDE EARLY DISCLOSURE OF INVENTIONS

Mr. HOLST. No, let me restate what I was trying to say. Under the patent system as it has existed to date, and with patents belonging either to the private inventor or to his employer—and I want to talk about that for a moment—we have had a flowering industry and a great introduction of new products and processes. Because the patent system requires an adequate disclosure of the patented process, a knowledge of that process is available immediately upon the issue of the patent.

Therefore a competitor can see the patented process, can understand what it is, and if able to do so, can undertake to design around the patent and perhaps come up with an improved product or process. If they are not able to design around the patent, and not able to obtain a royalty license under it, they can see what it is, and as soon as the patent expires they can duplicate it.

In the meantime, the fact that competitors were not able to copy the results of the original inventor or exploiter immediately has meant that the inventor or exploiter has been able to attract entrepreneurial capital and get the development into production. This may have been at very considerable cost. The cost of invention is perhaps only somewhere between a tenth and one-hundredth of the cost of getting items bugproofed, fully developed, distributed, and sold. The need for additional capital beyond the point of invention is a very real factor. The ability to attract this capital in the absence of patents is a quite different story from in the presence of a patent. The Polaroid Co., for example, and I know the officials there, has told me that they tried to raise equity and loan funds before they had patents and were refused. It was only after they had patents that they were able to raise their funds. It was only because they had patents that they were able to invade a field where strong organizations like Eastman and others were well established. Here you have a patent bringing into being a small business, enabling it to be financed and introducing another product, if not an improved one, into an already established situation.

This is quite contrary to the general belief of what patents do. Let me say again, and I do not want to linger on it, in addition to the inventor, in order to get a new development into widespread use and, therefore, benefit the public—because merely creating a scientific invention and writing it down in a patent, or not publishing it at all, does not do the public any good—in order to get from the invention stage into widespread distribution and use requires substantial additional cost and involves the entrepreneur and producer and distributor

all of whom incur very major investments merely hoping that the product will be a success. Hoping that if it is a success they will have an opportunity to recoup their costs before others come out with something which takes its place either by infringement or by finding other means of achieving the same result. The fact is that this kind of system has been in effect in this country for some time. I think we recently had the 125th anniversary of the patent system. It does appear to have promoted the useful arts. The opposite policy of having the Government own the invention has not as yet demonstrated that it will produce like results. It seems to me that the burden of proving that it will should fall on the proponents of the Government title policy.

Chairman DOUGLAS. What about the number of patents per year? I have not had the chance to look at the figures recently, but it is my impression that the number has remained relatively constant in recent years in the growth in the number of inventions.

Mr. HOLST. I believe that is right. I believe the number of patents issued each year has not been growing spectacularly in recent years.

Chairman DOUGLAS. Do you regard this as a decrease in inventions?

Mr. HOLST. No. I think it is in part because some of our industries have become more complex and the number of wholly new concepts is relatively fewer. I do not know the answer to the question. My observation is the same as yours. There has not been a continually increasing number of patents coming out of the patent office.

PATENTS RESULTING FROM GOVERNMENT SPONSORED R. & D. MIGHT BE SHARED BY CONTRACTOR

Senator MILLER. May I ask a question on this point? Granted that the Government, when it has had this contract for research and development completed, has attained the objective for which the contract was let, I think by the same token we can say that the contractor by receiving pay for this has also achieved the objective for which the contract was made, too. What we are talking about, as I see it, is a windfall or a byproduct which happens to have arisen out of this contract. If it is a windfall for the Government, if the Government is going to keep the patent, it seems to me it could equally be called a windfall to the private contractor if the contractor keeps the patent. That being so, I am just wondering whether the answer is to be found in either one of these proposed solutions giving the patent to the Government or to the private contractor. Would you think that a middle ground might be developed where perhaps the Government might share to some extent in the windfall, letting the private sector be the one to develop the market for the patented item, but inasmuch as it is a windfall, recognize that fact by letting the Government participate.

Mr. HOLST. I agree with what you are saying, that it may be regarded as a windfall to one side or the other. At the moment I do not want to prove to you that the Government has not paid the full cost. It does not matter. As I take it, this committee is not primarily concerned with patents. There is another committee concerned with that, but rather of the effect on the economy.

Chairman DOUGLAS. You introduced the subject.

Mr. HOLST. I did, with your egging me on.

Chairman DOUGLAS. It was in the text of your statement before I uttered a word.

Mr. HOLST. I do not mind introducing the subject. But I do think we might want to linger more on the end result—the impact on the economy.

Chairman DOUGLAS. I may say this was not mentioned in the letter which I addressed to your organization, this question of patents. You brought it in your statement. It is very interesting, and I thought we were at liberty to follow on it.

Mr. HOLST. You certainly are.

Senator MILLER. May I say I think it is entirely relevant because we are seeking to achieve the greatest economic benefit.

Mr. HOLST. That is correct. That is what I would like to concentrate on. I agree with you and I would be delighted to carry on the discussion much more.

Chairman DOUGLAS. I think Senator Miller has opened up a very interesting line and your support of it is very interesting. To work out a 50-50 arrangement that the benefits of the fallout would be divided both between the Government and the firm which had the contract.

Senator MILLER. Mr. Chairman, may I say I was not necessarily suggesting a 50-50 partnership. I can see where the proportion might vary considerably depending upon the facility that was used, the amount of the contract, the number of people involved. The point I was trying to make is that it seems to me where a windfall arises on both sides that some sharing might be a suitable or desirable approach without depriving the economy of the benefit, which you suggest, which I agree, would be the result if the Government got the whole thing.

Chairman DOUGLAS. Or if private industry got the whole thing.

#### THE OBJECTIVE IS TO GET PATENTS USED

Mr. HOLST. Let me, if I can, get us out of stalling on this point alone, really and truly not because I would not like to discuss it at length. But because, it is Friday afternoon and getting late. We were concerned, and I understand the committee is concerned, primarily with what policy on the part of the Government with respect to patents would be most likely to have a beneficial effect on the economy as a whole. That, it seems to me, is the primary objective. I would say in summary that the operations of the patent system to date have suggested that the private ownership and the private exploitation of patents has been successful.

We do not have any significant history indicating that the ownership of patents by the Government would be successful in transmitting the benefits of those patents to the economy on any significant degree. Let me cite, if I may, some brief indications of this. I am not sure how familiar the members of this committee are with these statistics but perhaps, Mr. Chairman, because you are an economist you may be aware of it.

Surprisingly few patents produce much income or prove to be economically successful. This means that a great proportion of patents are unsuccessful and do not support their costs. Those few which are

may be very rewarding. Can you conceive of a public agency owning a vast number of patents, having the courage to discard perhaps as many as 95 percent of the patents. Yet this is consistent with industrial experience.

Chairman DOUGLAS. No one is proposing that the Government use the patents.

Mr. HOLST. I know that.

Chairman DOUGLAS. It is simply a question of making patents available to private industry. I am not even going as far as to suggest that. It may be that the private industry should have the patent but making it available to others freely on the basis of a royalty payment rather than taking exclusive ownership.

Mr. HOLST. Provided that the sharing formula is such that it does not remove the incentive to put the patent into use.

Chairman DOUGLAS. Of course.

Mr. HOLST. So far, the experience of those organizations, and there are a few, which have sought to secure the use of patents find very few willing takers of nonexclusive licenses. Almost always the organization which wishes to license a patent, at least for some initial period, wishes to do so on an exclusive basis in order to recoup their costs. The issuance of exclusive license by the Government will be a very difficult policy to put into practice. It seems like a denial to the public of benefits under inventions created at public expense. I believe a Government agency would find it fairly difficult to adopt a general practice of licenses which are exclusive for some period and only after that period become available.

Chairman DOUGLAS. Why not throw them all open on the basis of free use and payment of royalty subject to individual choice?

Mr. HOLST. Because that method has been notoriously unsuccessful.

Chairman DOUGLAS. Where?

Mr. HOLST. In American experience.

Chairman DOUGLAS. When did we try it out?

#### GOVERNMENT OWNS 12,000 PATENTS

Mr. HOLST. We have been trying it out. The Government now owns something like 12,000 patents. They have been in general, either dedicated so you did not need a license or freely available for license. The number of licenses are fairly few, although there are a few. The number of products that have been made from these patents which have been available for license are almost nonexistent. That method has not worked. That is why it seems to me that this burden should be on the proponents of the Government title method to show that it will work as well as or better than the private ownership method. I think that is the fact. The Government has owned a very large number of patents. It has been willing to license them.

Chairman DOUGLAS. In what fields does the Government own the patents?

Mr. HOLST. Either by taking of inventions created by Government employees within the Government, which the Government obviously had the right to take. The fact is it has not been successful. I think it exists in all fields.

Chairman DOUGLAS. Are there articles published on this subject?

(The following was later received for the record :)

USE OF GOVERNMENT-OWNED PATENTS

ARTHUR D. LITTLE, INC.,  
Cambridge, Mass., April 3, 1963.

Subject: Use of Government-owned patents.

Hon. PAUL H. DOUGLAS,  
U.S. Senate, Washington, D.C.

MY DEAR SENATOR DOUGLAS: In reading the transcript of my testimony before your committee on March 29, I notice your question whether any articles have been published on the use of Government-owned patents and inventions. Because the subject is so important, it is worthy of as well-informed treatment as possible. Although there may be other references, I think that you will find a report prepared by Mr. Archie Palmer for the National Aeronautics and Space Agency dated December 23, 1960, and entitled "Administration and Utilization of Government-Owned Patent Property," to be quite relevant.

Likewise, on October 19, 1961, as part of the celebration of the 125th anniversary of the U.S. Patent of 1836, in a publication of the Department of Commerce just released captioned "Celebration of the American Patent System," there was a panel discussion on use of Government-owned patents which begins on page 32.

These are the only references which I can cite without further research. I believe you would find them useful.

Sincerely,

HELGE HOLST,  
Corporate Counsel.

TABLE 19

*Patents issuing in United States*

1950-----	43, 072	1957-----	42, 805
1951-----	44, 363	1958-----	48, 406
1952-----	43, 667	1959-----	52, 470
1953-----	40, 516	1960-----	47, 238
1954-----	33, 772	1961-----	47, 422
1955-----	30, 479	1962-----	55, 697
1956-----	46, 849	1963-----	<sup>1</sup> 50, 264

<sup>1</sup> Projected from 1st 3 months.

Mr. HOLST. My information comes mostly from members of the Government. Mr. Roland Anderson of the Atomic Energy Commission and I appeared on a program together and he cited figures like this. He gave the number of patents owned by the Government and the number licensed. He did not emphasize the failure of the licensing effort. I am drawing that conclusion. The fact is that the number of licensees—even from the hands of the Alien Property Custodian because they were alien property—the number of licensees have been very small.

Chairman DOUGLAS. Of course in the field of atomic energy the comparable civilian uses are thus far relatively few because of the high cost of developing energy from nuclear power as to the cost of developing energy from coal. So that it is not commercially attractive at the moment and I do not think it will be for many years.

Mr. HOLST. You are correct. In the case of using atomic energy for producing commercial energy thus far it suffers economically. But there are medical applications.

Chairman DOUGLAS. What about the research conducted by people in the Department of Agriculture?

Mr. HOLST. That appears to be the one area in which Government-owned inventions have been utilized for making fertilizers and so on. This is true because in those cases it has been possible for a manufac-



turer to produce the fertilizer or insecticide with no significant additional investment. The chemicals are such relatively common chemicals that they can be made in existing plants with no significant new investment. That is the area in which there has been some utilization of Government inventions.

Chairman DOUGLAS. I once read the history on the development of hybrid corn on which the prosperity of Senator Miller and my own State, in part, depends. The research was conducted at the University of Illinois and the Connecticut Agricultural College and the theoretical work was done by Prof. F. Shull at my University of Chicago, and then at Princeton. This is a case where a great invention in genetics revolutionized the industry. It was started in public institutions. It was taken up by commercial developers. Henry Wallace, the great geneticist and distinguished citizen of Senator Miller's State, and two or three people from Illinois, they developed it. But the research was done in Government institutions and the Bureau of Farm Industry helped to revolutionize crops in the country and this is distributed free.

Mr. HOLST. We have not said, and are not going to say, that the results of improvements made freely available will not be used. The question is, Will they be as rapidly used and as widely disseminated? The experience of the country outside the agricultural field indicates not, and I would suspect also in that field, although I do not know, because I think agricultural research is almost an exclusive domain of the Federal Government.

The number of people that are working to produce new types of plants is relatively few outside of the Government.

At any rate, experience would indicate that private ownership of patents and the opportunity to protect your invested capital under patent coverage has been a significant contributor to the creation of new products and new industries and resulting new jobs and new tax revenue. The opposite policy has not demonstrated anything like the same spectacular achievement.

I think this ought to be taken into account in formulating Federal patent policy.

Chairman DOUGLAS. One time Senator Miller led you right up to the point of saying that you thought where research was jointly conducted and jointly financed, the benefits should be jointly shared. Now, you are shying away from this. He has indeed struck a very interesting note.

Mr. HOLST. I don't want to shy or back away from it because there is merit to what Mr. Miller has said. There is no question about it. There are various suggestions being made along these lines. As a matter of fact, a number of us, including representatives of the chamber of commerce, are helping to develop such a policy for another committee of the Congress.

Chairman DOUGLAS. I wish you had stated that in your memorandum instead of coming out whole hog for complete private appropriation of inventions and benefits derived from Government-financed research.

Senator MILLER. May I say this.

I think Mr. Holst's principal point is that the burden should be on those who claim that it all ought to be the Government, and I agree, Mr. Holst. I think the burden is on that side. The only point I was

trying to make is that, assuming the burden is placed there, it seems to me that the ultimate solution of this ought to be somewhere in a middle area.

If it is determined that there is to be a middle area solution, you could go either way. You could let the Government take ownership and license it and let the private contractor participate in the profits, or you can let the private contractor take control of it and let the Government participate in the profits.

In that respect I would voice my opinion that it would be better to let the private sector go ahead for the very reason you have been pointing out at the same time not to the exclusion of letting the Federal Government participate to some extent. The degree of participation I can see could vary from one type of item or situation to another.

I do not know that it would be 50-50 all the time or 80-20. I am just striving for a principle here and I appreciate your recognizing that there are equities both ways.

Mr. HOLST. Yes. There are equities. I don't want to extend the points on this. As to the ability to go both ways, certainly it might go both ways. I think there is considerably less to be said in favor of the Government ownership and control because it puts the Government in a difficult position. I believe the various agencies would then have to devote themselves to trying to utilize patents. In the alternative it might be suggested that there is a necessity to create a special Government patent administration. There would be many problems associated with that.

Let us not forget that all extended attention to patents are diversions from the primary functions of those agencies. Furthermore, I think that Government ownership of patents would stand in the way of the rapid and successful transfer of benefits to the private economy.

Let me say again, in any discussion or decision of this kind, it is wrong to start on a premise that someone by means of a patent will suddenly be greatly enriched at the expense of the public. That is really not so.

Senator Douglas raised some very interesting questions about a corporation slowing down the introduction of new processes or products until they had recovered their investment in their existing equipment on the old products. This is after all the law of economics.

If you introduce new products at a very rapid rate and have not had an opportunity to spread the cost of your productive equipment and distribution and development costs over a reasonable period then either your organization will suffer losses, the Government loses taxes, or the prices that it must charge for its products as it goes along will have to be that much higher.

So, we are dealing in a realm of economics where you are trying to strike a balance between the competitive advantage of introducing new products and new processes and new productive equipment and continuing to sell your old product at a reasonable price and amortizing the cost of development and equipment over a reasonable period.

This is a field of economics and is one of the reasons why occasionally wholly new concepts are not introduced at once.

Another of the reasons—a very real reason why the fruits of research do not immediately appear in new products—is the high cost of

carrying the concept into a developed commodity and then equipping the productive facilities to produce and distribute that commodity. This cannot happen overnight.

In rough numbers it is sometimes said that for each dollar of inventive cost there will be about \$10 of developmental cost and something like \$100 of production and distribution costs.

Many an organization that can afford the \$1 of development cost has to swallow hard and spread over a period the incurring of additional developmental and promotional cost. I believe there are very few examples in a competitive economy, where new products are constantly threatening old products, of anyone consciously sitting on and suppressing new inventions. I think there are no well-known cases of that kind of thing.

Chairman DOUGLAS. That is just the point. I do not want to get into an economic discussion but in an industry which is characterized by free competitive enterprise and where knowledge is available to all firms then the advantage is for the individual firm to push ahead with the new process even though it makes obsolete the equipment of an existing company.

This is really the essence of really free competitive enterprise. Because of the hardship that causes we get added arguments for monopoly. The patent system is one form of monopoly, with the 17-year exclusive use surrounded with extension through modification, as you say.

But, this is a departure from the competitive system. If you want to depart from the competitive system it seems to me you must also take into account the social cost to the Nation and not merely the money cost to the Nation.

If you say it is to the social advantage to hold back invention in order to use up existing equipment, you must certainly argue it is a social advantage to hold back inventions if it makes skills obsolete and throws people on the sidewalk.

We must hold them back until a new group has been trained. The working force has a money price attached to it. This could be argued.

If labor is free, it is not capitalized and is therefore outside the accounting books. If you really want to stick for a free competitive enterprise then you must be willing to admit the ruthless application of new processes even though this hurts people already in the field. If you mitigate in the field of machinery and processes, equity demands that you mitigate as far as the skills of labor are concerned.

Mr. HOLST. I believe that the strong companies do introduce new products and processes just as rapidly as they can because they fear that their competitors will be there first with an innovation if they are not.

Therefore, there is a pressure on them to obsolete their existing processes. There is one additional point which I did not make in passing, and which is relevant to this question which patent policy do you favor, granted that it is not a black and white case.

One very material consideration in contrasting the Department of Defense policy with some of the other policies is this one. If the objective of the Government agency is to solve a problem, to get a weapons system or some other item, as soon as reasonably possible and at a reasonable cost, then it seems to me that one very important

question is, "How do you attract the most competent organization with the most nearly pertinent background to work on that problem?"

Will a patent policy which for any reason jeopardize the background rights of the contractor be most attractive? Or will a patent policy which does not?

Chairman DOUGLAS. In other words, the patent policy which gives to private industry the right to develop these inventions partially developed at Government funds constitutes the green trading stamps which attracts the company to Government work.

Mr. HOLST. Yes.

Chairman DOUGLAS. If you do not have the green trading stamps they won't like to do it.

Mr. HOLST. That is correct.

There is also a golden side to the stamp or a plaid side. That is that the organization with the know-how is the one most likely to be able to apply the new technology in its regular line and it will therefore reach the public most rapidly with any "fallout" benefits.

Now, to summarize. You ask that we discuss with you some Government policies—and I volunteered to discuss primarily those in the field of research and development—which we thought were having an impact on employment and the rising standard of living, or might be contributing to a slowdown in national economic growth.

I have tried to do this in a few areas relating to Government research and development and patent policies. I have tried to suggest some ways in which changes in Government policy would both serve the Government interest and also the private interest.

Senator MILLER. There is one point you did not touch on in your paper, Mr. Holst.

I was wondering if you would have any comment on the subject. We hear a lot of talk about the difficulty of the salary problem as far as being able to retain scientists for inhouse research and development activities. We hear some talk about abuses, or so-called abuses, that have been invented to circumvent this problem by establishing a so-called private corporation under Government auspices which can satisfy the salary problem. Do you have any observations on this point that you care to make?

Mr. HOLST. I will limit my observation to this:

If we are concerned with transfer of the benefits of Government-sponsored research and development to the general economy, then it seems to me that a specially created agency, whether it be inhouse or a special nonprofit—but which is not a producing organization—introduces an intermediate step between translating any technology which it may develop into the private economy. It will therefore slow down the process.

With respect to compensation, although you didn't ask this question, it is also said, and I believe with some justification, that the pressure to get employees to work on Federal projects—whether inhouse or private contractors, and perhaps more in private contractors—has been such that the salary levels have been driven upward. As a result the employer has to pay scientists and engineers working on purely civilian work salaries comparable to those that he is paying the others.

This is constantly raising the cost of research and development even when the objective is a purely civilian application.

I believe you could get evidence to that effect.

Senator MILLER. Thank you very much.

Chairman DOUGLAS. Thank you, Mr. Holst.

(Mr. Holst subsequently submitted the following for the record:)

CHAMBER OF COMMERCE POSITION ON AID TO EDUCATION

ARTHUR D. LITTLE, INC.,  
Cambridge, Mass., April 1, 1963.

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

MY DEAR SENATOR DOUGLAS: During the course of my testimony before you on Friday afternoon, March 29, you asked several questions regarding whether the chamber of commerce favored Federal assistance to education that could help to increase the number of scientists and engineers in the country. I mentioned to you that students desiring to major in these fields were already well able to obtain scholarship or similar aid.

Enclosed is a reprint from the March 1963 issue of Nation's Business. Under the title "Federal Influence Distorts Education" is summarized a study made by John F. Morse, a former official at Rensselaer Polytechnic Institute. I take it that his testimony was presented recently to the Education and Labor Committee which is concerned with Federal assistance to higher education. Accordingly, you can see the original data. However, the article in Nation's Business certainly confirms the availability of abundant fellowships or other types of financial assistance to any students seeking to major in science and engineering.

As briefly intimated during our session on Friday, I believe there is cause to question whether because of the kind of financial aid referred to in the enclosed article the Nation will not suffer from having too little of its able talent remaining in fields other than science and engineering. We need economists too, and likewise doctors, lawyers, dramatists, sociologists, and the like; in other words, a balanced nation.

Many thanks for the opportunity to appear before you and for the very helpful questioning which took place during Friday's session. Very best wishes for meaningful results from the work of your committee.

Sincerely,

HELGE HOLST, *Corporate Counsel.*

[From the Nation's Business, March 1963]

FEDERAL INFLUENCE DISTORTS EDUCATION

U.S. PROGRAMS CREATE IMBALANCE IN COLLEGES

New proof of the mess Federal intervention creates in education has just come to light in an investigation sponsored by Government itself.

Many university presidents and other educators have warned for years that Government research and student-support programs are distorting the educational system.

Widespread conviction that Federal subsidies would cause similar damage to grade and high schools has been an important reason Congress has rejected them.

Now President Kennedy is recommending a vast expansion of Government educational activities. And many colleges are clamoring for more Federal money.

New criticism arises from a 9-month investigation of Federal educational programs completed recently for Democratic Representative Edith Green, of Oregon, a strong supporter of expanded Federal programs and chairman of a House higher education subcommittee.

The study was made by John F. Morse, a former official at Rensselaer Polytechnic Institute.

Some of his major observations, as presented in testimony before the subcommittee and an interview with Nation's Business:

The Government is, in effect, committed to the postgraduate support of virtually the entire source of new scientific manpower, under programs that are already near the saturation point.

Sharply expanding fellowship programs are skimming off top graduate talent, leaving even some major universities hard put to meet research com-

mitments and dependent on the lowest caliber graduate students to perform their vital role of instructing undergraduates.

Chaotic accounting and piecemeal sponsorship of often overlapping programs by several agencies make it impossible for any agency—let alone one individual—to keep track of what Government is doing.

Attempts to restore balance to the Government's activities lose out in competition with costly, selfperpetuating Federal activities in education and other fields—"nineteenth century programs in 1963."

Mr. Morse says his assignment was to answer the question:

"How much overlap and duplication is there in the whole governmental process" involving higher education?

What he found was a picture of confusion.

By Mr. Morse's estimate, Government programs now entirely support the full-time study of some 35,000 graduate students at the predoctoral level in the physical and life sciences—including mathematics—and engineering, plus another 20,000 whose major support is derived from federally sponsored research.

The Nation's undergraduate institutions produce only some 98,000 students in these fields, he points out, and this figure includes many who are, in effect, education majors and others who, although pure science majors on paper, lack the competence to go on to successful graduate work.

This is what leads Mr. Morse to observe, as he did before the subcommittee:

"One wonders how much larger these programs of support can be and [still] profitably award fellowships that are going to pay off in terms of really producing more high-level manpower."

The National Aeronautics and Space Administration disputes his point that the saturation mark is being neared, Mr. Morse concedes, and has set a goal of producing 1,000 Ph. D.'s a year, which he estimates will cost \$25 million annually.

Theoretically, he adds, there should be no increase in the educational imbalance as overall college enrollments rise.

But, in practice, the number of students in physics has failed to keep pace and the number in engineering has actually declined.

As Harold Orlans says in a study of 36 institutions published by the Brookings Institution:

"Surprisingly, the vast sums invested in science have not yet significantly raised the proportion of either undergraduate or graduate enrollment in the sciences within the liberal arts curriculum. It is the social sciences which have gained most from the relative decline of enrollment in the humanities."

Mr. Morse testified: "There is widespread evidence that the great amounts of support available through fellowships and through the training grants and through sponsored research are making it almost impossible to find teaching assistants which have traditionally been one of our major methods of teaching undergraduate students."

"I know of no serious study of what has happened to undergraduate science studies in major universities," he adds.

But Mr. Morse personally suspects that such a study would show that a large percentage of instructors is drawn from foreign students lacking in language and technical competence, and others without full competence.

He was not too surprised, he tells Nation's Business, when a department head at one respected institution complained privately about the caliber of graduate students on whom he was forced to rely.

Far more disturbing, he says, was a similar report from a well endowed major university that one would think immune from such problems, which he traces directly to the Federal programs.

"In many universities," he told the Green subcommittee, "the amount of research that is contracted for by the universities with the Federal Government is limited by the availability of graduate student assistance. In most of these institutions there is a very severe problem of getting enough graduate students to carry on the research they are already committed to."

The Orlans study adds these points:

The concentration of Federal funds (in some 100 universities), by raising salaries and offering superior working conditions for scientists, complicates the staffing problems of lesser institutions.

The "research outlook" of Federal science agencies, fostered by their programs, is changing the academic scientist's job by deemphasizing teaching.

This emphasis on research, furthermore, tends to increase class sizes and thereby reduce student-teacher contacts, and helps increase faculty needs by reducing each faculty member's availability for class work.

Complicating the entire picture, observes Mr. Morse, is this fact of life: Once launched, Federal programs are sustained by "a growth factor and a staying factor."

Thus, for example, he finds that Federal funds for agricultural extension work were rising at the rate of \$3 million a year to \$60 million last year, regardless of the population shift from a rural to an urban majority.

And last year's Federal outlay was \$65.6 million for the hardy perennials of vocational education, including vocational agriculture.

The lack of unified policy, he contends, is complicated as such individual agencies as the National Science Foundation, Atomic Energy Commission, National Institutes of Health, and National Aeronautics and Space Administration—each with its own mission—launch programs piecemeal.

The lack of coordination, he adds, leads also to several apparently senseless inconsistencies, such as provisions in the Housing and Home Finance Agency legislation and National Defense Education Act that specifically bar use of funds to produce technicians, despite claims being made that they are in critically short supply.

Or denial to the Office of Education of the same flexibility allowed the National Science Foundation under programs to upgrade instruction. "It's this lack of consistency that I find most puzzling," says Mr. Morse.

Or similar programs for which NSF and NIH require matching grants where NASA requires none. Or grants for which AEC requires no matching contributions for equipment to aid teaching of nuclear physics but NSF requires 50 percent for similar work.

Or National Defense Education Act matching grants to States to improve science and language instruction, which often are used by only the wealthier districts in wealthier States because of the matching requirements.

One attempt to bring in some order resulted in agreement by NSF, NIH, and AEC—after years of experimenting with varying approaches—to pay institutions a flat fee of \$2,500 for each holder of a Federal fellowship they enrolled.

Then along came NASA to disrupt the situation by adopting a policy of negotiating with individual universities payments ranging from \$1,000 to \$4,000 per fellow and averaging \$2,850.

Mr. Morse posed one key policy question before the subcommittee:

"The thing that is of greatest concern to the university world is that in most of these large research programs governmental policy is to pay less than the actual cost of conducting this research \* \* \*.

"The concept seems to be that if the universities submit proposals, then they ought to be willing to support part of the cost. This may well be. This is a basic decision but one which I think must be faced.

"You will note that in everything I have [said] there has been almost exclusive concern with the sciences and engineering. To the extent that the universities are doing this in the public interest and to the extent that they are having to put their own free, uncommitted funds into this research, to that very extent these large governmental programs are self-feeding this imbalance in the academic disciplines in the university world.

"If, on the other hand, the Government's policy were to pay the full cost for what it wants the universities to do—and which, granted, the universities themselves want to do—then it would leave the universities free funds to support \* \* \* academic disciplines and those areas which quite obviously are not now and perhaps never are going to be supported by Government programs.

"But if half of a university's free funds have to be siphoned off from its central treasury to help support Federal programs of research, then the imbalance gets worse each year."

Mr. Morse, who supports much of the administration's program, has recently joined the American Council on Education, which represents 1,000 institutions of higher education and 175 national, regional, and State education organizations.

In the Brookings study, the author calls for more general programs of broad support to colleges and universities to counter the imbalance.

"It is \* \* \* easier [for institutions] to oppose Federal programs in the abstract or on general principles than to refuse to participate in a specific program which—despite certain drawbacks, deficiencies, and controls—offers immediate advantages to an institution."

He adds: "As these remarks may suggest, we are not inclined to dismiss the danger of Federal control as a myth designed simply to serve the interests of local and sectional forces. It is and will remain a continuing danger to the independence of academic institutions, and must be guarded against more vigilantly as the role of the Federal Government in higher education grows."

"A more evident danger," he says at another point, "which is the more difficult to withstand as the expansion of educational institutions and of our society normally takes the same course, is the growth of bureaucracy and its tendency to change universities from academic to impersonal or even business institutions."

"Often, as new Government programs age, they are run less by men and more by rules, less by personal and more by formal communications, less by the individual examination of individual situations and more by general regulations. This is control not by dictation but by redtape, which can frustrate and devitalize such intellectual effort."

Mobilization of the Nation's academic community in the national interest, he says, could lead to essential nationalization of the campus. Thus arises the need to balance two questions:

1. "Does not a noble conception of the national interest embrace the interest of man?"

2. "But do scholars best serve the Nation by forsaking their laboratory and their study for mechanical and political arts? Does not a bricklayer serve his Nation by laying bricks well, and a scholar by good scholarship?"

Chairman DOUGLAS. We meet Monday morning in the caucus room in the Old Senate Office Building at 10 o'clock.

(Whereupon, at 3:25 p.m., the committee recessed to reconvene at 10 a.m. in the caucus room, Old Senate Office Building on Monday, April 1, 1963.)



# IMPACT OF MILITARY SUPPLY AND SERVICE ACTIVITIES ON THE ECONOMY

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MONDAY, APRIL 1, 1963

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON DEFENSE PROCUREMENT  
OF THE JOINT ECONOMIC COMMITTEE,  
*Washington, D.C.*

The subcommittee met at 10 a.m., pursuant to recess, in room 457, Senate Office Building, Senator Paul H. Douglas (chairman of the subcommittee) presiding.

Present: Senators Douglas, Proxmire, and Miller, and Representative Curtis.

Also present: James W. Knowles, executive director; Ray Ward, economic consultant; and Hamilton D. Gewehr, administrative clerk.

Chairman DOUGLAS. The committee will please be in order.

Before we begin the hearing this morning, I would like to make a statement for the record.

Last week we passed compliments around as to Members of Congress and of the Senate who urged the Defense Department to adopt economies, which urgings at the time were disregarded. But we did not mention for the record the name of the man who has probably done more than anyone else, and that is the staff consultant to this committee, Mr. Ray Ward.

The civil servants who do the work for Members of Congress are frequently ignored and commonly lead anonymous lives, but it should be a matter of record that the staff expert behind the McCormack-Curtis amendment was Mr. Ward. The staff expert who advised me when I was making my fight on the floor for economies was Mr. Ray Ward.

He has been the expert for this committee now for a number of years. In fact, I sometimes think he has been the real person behind the various false faces which have been presented to the public. I regard him as one of the most constructive, most useful, less appreciated men on Capitol Hill, so I want to have this made a part of the record.

He has received very little money from this. He has received a great deal of pressure against him. But I would like to record the thanks of a grateful Republic to him.

Mr. WARD. Thank you, Mr. Chairman.

Chairman DOUGLAS. We are very happy to have with us this morning Mr. Elmer B. Staats, Deputy Director of the Bureau of the Budget, who will testify on some of the changes in the Department

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of Defense as seen from the Bureau of the Budget, per my letter of March 12, 1963, which follows.

MARCH 12, 1963.

Mr. KERMIT GORDON,  
*Budget Director, Executive Office of the President,  
Washington, D.C.*

DEAR Mr. GORDON: The Subcommittee on Defense Procurement of the Joint Economic Committee held hearings in January 1960 on the impact of defense procurement and related activities on the economy and reported thereon in October 1960. Members of your staff testified at that time and provided much valuable information. Several of the recommendations in the report concern the broad budgetary and management responsibilities of the Budget Bureau.

Of particular interest to the subcommittee is the extent to which recommendations have been accepted and implemented concerning a consolidated common supply agency (DSA) in the Department of Defense and its relationships with GSA which has a number of closely related functions.

The subcommittee also desires to be brought up to date on the progress being made in determining the proper use of stock funds and with regard to the Bureau's program on commercial-industrial activities under Bulletin 60-2.

The President's recent approval of the cost reduction program in the DOD "in cutting down on duplication, and closing down nonessential installations" while emphasizing that "other agencies must do the same" lends strong support to the views and recommendations of the subcommittee.

The subcommittee will hold hearings in the Senate caucus room on these and related subjects on March 28, 29, and April 1, 1963, and would appreciate your views. You are scheduled to testify at 10 a.m., April 1. One hundred copies of prepared statements should be filed by March 29 in room G-133, New Senate Office Building. Mr. Ray Ward, economic consultant to the subcommittee, may be contacted on Capitol 4-3121, extension 5220, room 502, George Washington Inn, if additional information is needed.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

Chairman DOUGLAS. You are very welcome, Mr. Staats, and will you proceed in your own way?

Before you do, may I insert in the record at this point a report which Secretary of Commerce Hodges has made on the surplus property activities of the Business and Defense Services Administration. It was presented in response to an inquiry which I made to them on the 12th of March.

(The report referred to appears in app. 2, see p. 347.)

**STATEMENT OF ELMER B. STAATS, DEPUTY DIRECTOR, BUREAU OF THE BUDGET; ACCOMPANIED BY GEORGE MULLINS, ASSISTANT CHIEF, MANAGEMENT AND ORGANIZATION; CLIFFORD J. MILLER, BUDGET EXAMINER, MILITARY DIVISION; AND GORDON OSBORN**

Mr. STAATS. Mr. Chairman, I am delighted to be here this morning. In light of your remarks about Ray Ward, we would like to add our own commendation for the work which he has done and for the work which this committee has done.

You neglected to mention that Mr. Ward was sometime ago on the staff of the Bureau of the Budget and much of our work in this area is the result of some of the pioneering efforts which he made at that time.

I appreciate this opportunity to review, from the point of view of the Bureau of the Budget, significant developments in improving

management of Federal procurement and supply activities with particular reference to the Department of Defense and the General Services Administration. These include the establishment of the Defense Supply Agency, increased reliance upon GSA for procurement and supply services, the Government's program for commercial-industrial activities, and intensive efforts to reduce costs.

In view of the committee's interest in the impact of defense procurement and supply activities upon the economy, I believe it is pertinent to compare current trends with military expenditures in 1960 when the committee held its first hearings. In fiscal year 1959, military expenditures were \$41 billion and in January 1960 when the committee held hearings we estimated that expenditures would be about \$41 billion in 1960 and 1961. Approximately one-third of all these expenditures were for procurement and half of all procurement expenditures were for aircraft. Expenditures for research, development, test, and evaluation of new military equipment were less than 10 percent of total military expenditures.

Three years later, in 1963, we estimate that expenditures for military programs will be \$48.3 billion, \$7 billion more than in 1960. Expenditures for every major category of military procurement except aircraft are higher than they were 3 years ago, the principal increase being for conventional types of military equipment. Research and development expenditures have nearly doubled; \$3.7 billion in 1960, \$6.6 billion in 1963.

We know that development and production of new weapons systems will continue to be expensive and that military expenditures are affected by developments throughout the world which cannot be predicted, such as those which are taking place in Cuba and southeast Asia. Such factors as these emphasize the need and the duty to reduce expenditures wherever it is possible to do so without harm to national security or to our other basic responsibilities.

Primary responsibility for achieving economies in Government must rest upon the agencies directly responsible for Government programs and operations. We believe the improvement of procurement and supply activities presents one of the best opportunities for reducing expenditures without harm to basic objectives.

You will recall, Mr. Chairman, that we went into this matter in some detail in our hearings before the Joint Economic Committee in connection with the hearings on the tax legislation. I should like to say that I have had an opportunity to read the statements presented to this committee by Secretary McNamara, by Assistant Secretary Morris, by Mr. Boutin, and by the Comptroller General, and in my personal opinion they represent some of the best and most careful presentations on this subject that I have seen.

I am sure that the development of this material in the form in which it has been developed should be extremely helpful not only to the Congress but in the executive branch as well. I should like to turn now to the subject to which I referred at the beginning of this statement.

#### DEFENSE SUPPLY AGENCY

We consider the establishment of the Defense Supply Agency to be one of the most important steps toward a more effective supply management system in the DOD. It is a milestone in the long evolution-

ary development of an integrated procurement and supply system for common use supplies.

It provides an essential mechanism for accomplishing the improvements which we all know are needed—the elimination of unnecessary and overlapping inventories, the standardization of procedures and operating systems, the elimination of duplicate, phantom, and unnecessary items, and the realization of savings through consolidated purchasing.

DSA's organization, current accomplishments, and future plans are matters which have been covered by other witnesses, but I believe it is appropriate that we comment on several aspects of DSA's creation and program. First, the Bureau of the Budget strongly supports the basic concept of a Defense Supply Agency. Second, we believe the Secretary of Defense should continue to have authority to organize common supply and service functions. This is in keeping with the McCormack-Curtis amendment to the Defense Reorganization Act. It is essential for him to have flexibility to organize these functions if he is to be held responsible for results. Third, we believe that establishment of DSA will accelerate progress toward further improvements in procurement, storage, and distribution functions, in the simplification and standardization of items, in development of better item specifications, and in standardization of operating systems for handling supplies.

## GSA-DOD RELATIONSHIPS

The volume of sales from GSA's supply centers to military services in 1962 was six times greater than in 1954 as indicated in the following table:

TABLE 20  
*Volume of supplies shipped from GSA stores depots*

[In millions of dollars]

	1954 <sup>1</sup>	1955 <sup>1</sup>	1959 <sup>1</sup>	1960 <sup>1</sup>	1961 <sup>1</sup>	1962 <sup>1</sup>	1963 estimate <sup>1</sup>
To civilian agencies.....	26.5	45.1	48.2	51.6	60.0	73.2	79.8
To military services.....	26.3	75.6	97.3	102.7	123.2	156.4	187.5
Total sales.....	52.8	120.7	145.5	154.3	183.2	229.6	267.3
Percent military sales to total.....	49.8	62.6	66.9	66.6	67.2	68.1	70.1

<sup>1</sup> Fiscal year.

NOTE.—In addition to the above sales from stores depots, GSA purchases property for direct shipment from factory to user. These sales totaled \$174 million in 1962 and it is estimated they will be \$199 million this year. In 1962 the military services were responsible for 73 percent of the total. GSA also arranges Federal supply schedule contracts from which agencies may order directly from source. The volume of such sales has increased from \$275 million in 1954 to \$697 million in 1962 and is expected to reach \$780 million this year.

I should like to spend just a second on the table. In the first line it indicates that shipments of supplies from GSA's stores depots to civilian agencies were \$26½ million in 1954. In 1958 the volume had increased to \$45.1 million. Then there is a slow but steady increase to 1963 when it is estimated that the volume will reach \$79.8 million.

Similarly, with respect to the military services, in line 2, the [volume] in 1954 was \$26.3 million, and this increased to \$75.6 in 1958. Then there have been, we think, quite significant increases in 1963

[when] the figure is expected to reach \$187.5 million. So the total stores sales in 1963 will be \$267.3 million, and the percentage of military sales to the total has increased from 49.8 percent in 1954 to 70.1 percent in 1963.

In addition to the above sales from stores depots, GSA purchases property for direct shipment from factory to user. These sales totaled \$174 million in 1962 and it is estimated they will be \$199 million this year. In 1962 the military services were responsible for 73 percent of the total.

GSA also arranges Federal supply schedule contracts from which agencies may order directly from source. The volume of such sales has increased from \$275 million in 1954 to \$697 million in 1962 and is expected to reach \$780 million this year.

The Bureau of the Budget supports an orderly program for transferring supply-management responsibility from the DOD to the GSA whenever there is a sound basis for doing so from the standpoint of overall economy and effectiveness. During the past year, staff of the Bureau of the Budget have visited many of GSA's supply centers. We are convinced that the GSA is rendering efficient service and has adequate capability to assume additional responsibility. An orderly procedure has been developed, based upon an agreement by the Department of Defense and the GSA in which our staff has participated. In his statement the Administrator of General Services presented to the committee detailed figures reflecting the progress under this agreement.

As other witnesses have stated, some problems and policy issues have developed. They are concerned largely with operating and procedural difficulties which could not have been completely anticipated when the joint agreement became effective. (See pp. 20, 43, and 94.) These problems are receiving the close attention of the responsible officials of both agencies and it is our judgment that they will be satisfactorily resolved. Our staff will continue to work with both agencies.

GSA relationships with other agencies: Although most of the civilian agencies obtain their supplies from GSA's supply centers or through GSA's sources, there are a few larger agencies with specialized programs which have continued to maintain their own supply systems.

However, these agencies also use common and commercial types of supplies which might be obtained from the GSA at less cost and with a savings in manpower, storage facilities, and inventories. We have done some fieldwork to explore these possibilities. We believe some of them offer worthwhile opportunities and we are exploring them further. We are proceeding cautiously in this area, however, because complete centralization is not always the most economical way to manage supplies. We want to be certain that any additional funds which GSA may require to handle more workload is at least matched by economies in the agencies from which the functions have been transferred.

In this connection, the difficulty of settling supply management problems has been increased by the delay in completing the Federal catalog system for the civilian agencies. The Department of Defense portion of the Federal catalog was completed more than 5 years ago. (See pp. 153 and 227.) Items which are stocked or procured by GSA also have been cataloged; however, it is estimated that other civilian agencies are using about 441,000 items which have not been cataloged.

The GSA has strengthened its staff and organization for completing the catalog but it is estimated that the task will not be completed until June 30, 1966. We intend to give support to this effort in order that it may be completed as soon as possible.

Stock funds: The chairman also has requested our views concerning the use of stock funds. I think the Comptroller General and the Secretary of Defense also testified on this subject. We have considered the use of such funds particularly in the DOD in the light of the Comptroller General's reports.

These reports indicate clearly that stock funds are not a substitute for good management. However, we believe the stock-fund concept is sound and an effective means for control of inventories.

(The following was later received for the record:)

BASIC CONCEPT OF STOCK FUNDS

APRIL 3, 1963.

MR. ELMER STAATS,  
*Deputy Director, Bureau of the Budget,  
Executive Office of the President,  
Washington, D.C.*

DEAR MR. STAATS: We were pleased to have your testimony on April 1, at the hearings of the Subcommittee on Defense Procurement of the Joint Economic Committee.

Time did not permit us to ask some questions on subjects we wanted further to explore. For the record, will you kindly advise at your earliest convenience what you consider to be the "basic concept" of stock funds which you indicated is sound.

As you know, our subcommittee has been endeavoring to get an authoritative answer to the question as to when stock funds should be used. In fact, our subcommittee report of October 1960 recommended that "BOB, DOD, and GAO should come to a decision as to the proper use of stock funds \* \* \*." I am sure you know also that Majority Leader McCormack on behalf of himself, Congressmen Hébert and Curtis, and myself, requested the Comptroller General on March 9, 1961, to make a comprehensive review of military stock-fund operations. This correspondence appears on page 155 of hearings of this subcommittee on June 12, 1961.

Since that time, reports from the Comptroller General show some very glaring deficiencies in the use of stock funds in the military.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

EXECUTIVE OFFICE OF THE PRESIDENT,  
BUREAU OF THE BUDGET,  
*Washington, D.C., April 20, 1963.*

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

DEAR MR. CHAIRMAN: This is in response to your letter of April 3 in which you requested a more complete explanation of what was intended in referring to the "basic concept" of stock funds in my statement to the Subcommittee on Defense Procurement of the Joint Economic Committee.

In using the term "basic concept," I meant the features of a stock fund system which distinguish it from other systems of financing and managing materiel. The principal features which we have regarded as characteristic of the stock funds in the Department of Defense are (1) a financial arrangement under which inventories and other assets are formally capitalized with the capital being maintained by reimbursements from organizations ordering and using supplies from the stock fund inventories; (2) management arrangements under which responsibility for maintaining the corpus of the fund, giving service to customers, collecting reimbursements, determining quantities to be purchased, replenishing stocks, and identifying excesses is clearly assigned to one manager; (3) reporting and control arrangements under which Congress

may review the status of the fund, the inventories carried in it, and the quality of management of the fund; and (4) supply and financial discipline placed upon the organizations and persons ordering and using supplies from the fund, with maximum authority and responsibility being vested in the users for deciding how the resources available to them are to be used.

The use of stock funds having these general characteristics is not a recent development. Such revolving fund arrangements have been used for many years in the General Services Administration and its predecessors in the Treasury Department, in the Department of Agriculture, in various Government corporations, and more recently, in the Veterans' Administration. Similar techniques have been accepted and used for many years in private industrial and merchandising concerns. For these reasons we have not regarded stock funds as untried innovations or experiments although their use on a large scale and in technical materiel areas in the Department of Defense is a relatively recent development.

Increased use of stock funds by the military services was proposed by the Department of Defense and authorized by the Congress in the belief that management of supplies would be strengthened and improved. We believe that decision was correct in light of the results that have been achieved. Some of the more significant of these results are—

From 1949 to 1962, a total of over \$15.7 billion in the inventory was incorporated in DOD stock funds; as of June 30, 1962, stock fund inventories were less than \$6.2 billion, a reduction of \$9.6 billion or 61 percent.

From 1955 to 1962, total DOD supply system inventories declined by \$10.1 billion. On a comparable basis, the stock funds accounted for \$7.9 billion or 78 percent of this reduction, while appropriated fund inventories accounted for \$2.3 billion of the decline, or 22 percent. Stock fund inventories were reduced 56 percent, appropriated fund inventories by 6 percent.

From 1949 through fiscal year 1962, a net of \$3.5 billion has been transferred to appropriations or rescinded from the funds; this will reach nearly \$4.1 billion through 1964, as proposed in the 1964 budget, even though the overall scope of our military programs and the demands placed upon the stock funds have continued to grow.

We have not made an independent study to determine how the quality of service from stock funds to users of supplies compares with service rendered under other systems. We know of only one such comparative study which was made by a DOD study group and issued in 1962. It indicated that 87.6 percent of requisitions submitted to stock fund systems were filled on time as compared to 83 percent filled on time under appropriated fund systems. This study also indicated that stocks available in stock funds were sufficient to meet 90 percent of total estimated requirements, including war reserve requirements, whereas stocks carried under appropriated fund systems were sufficient to meet 75 percent of anticipated requirements.

It is true that instances of serious deficiencies in the management of consumer funds as they relate to stock funds have been described in the Comptroller General's reports. Deficiencies in stock fund management also have been identified in studies by our staff. As I stated during the hearings, a stock fund is not a substitute for good management and these deficiencies will require aggressive and sustained management attention. Actions and plans for overcoming these deficiencies have been developed in the Department of Defense with participation by staff of the Bureau of the Budget. We believe progress is being made and we shall continue to work with the Department to assure that stock funds receive adequate management attention.

We believe it would be inadvisable to conclude from the Comptroller General's findings that the use of stock funds by the Department of Defense should be discontinued or substantially curtailed. Unsatisfactory conditions also have been found in supply programs where stock funds were not used and we agree with the Comptroller General's statements before the subcommittee to the effect that serious deficiencies in supply management are not confined to stock fund areas. On the contrary, we believe the studies by the Comptroller General, the House Appropriations Committee, the Bureau of the Budget, and the Department of Defense have revealed conditions in the management of aircraft and other spare parts that are more serious than those existing under the stock funds.

We agree with comments which you and Congressman Curtis have made that there is need for a more clearcut policy for determining which items should be carried in stock funds. Stock funds are not needed for all types of supplies and

we have anticipated with staff of the Department of Defense in developing guidelines and criteria for deciding which items should be included in stock funds. Information concerning these criteria is being furnished for the record as requested during the hearings. Some kinds of supplies are to be taken out of stock funds and other categories of supplies which have been carried in appropriated fund inventories are to be brought into stock funds. In general, these criteria reflect a conclusion in the Department of Defense that stock funds provide a much needed means for effective management of supplies when it is not feasible to exercise the type of line item control appropriate for major end items. We believe that conclusion is correct.

Sincerely,

ELMER B. STAATS, *Deputy Director.*

Mr. STAATS. We have found it is impractical from an overall management standpoint to maintain individual line item controls over 4 million items, and we find that operations can be reviewed and controlled more effectively under stock funds.

For example, the total inventory in stock funds as of June 30, 1962, was slightly more than \$6 billion. This represents a substantial reduction since a total of nearly \$16 billion was incorporated in these funds from fiscal year 1950 through 1962. Net cash withdrawals between 1950 and 1964 will total more than \$4 billion, thereby making it possible to rescind or reduce obligational authority in that amount. A substantial portion of these excessive inventories were brought into stock fund accounts after having been procured and managed by other methods.

The fact that they were larger than needed was not detected until after they had been brought into stock funds where they could be subjected to proper analysis.

We share the concern of the committee and of the Comptroller General with the problems which have been revealed in managing stock funds, but we believe our efforts should be directed toward correction of weaknesses in management of the funds and not to their curtailment or abolition. To this end we have participated with the DOD in developing new criteria for selection of items to be carried in stock funds. We believe that our position is supported by experience in managing similar working capital funds in other agencies such as GSA and the Veterans' Administration. (See GAO views, 121, 151, 160.)

#### COMMERCIAL-INDUSTRIAL ACTIVITIES

You have expressed interest in the Government's program on commercial-industrial activities under our Bulletin 60-2. That bulletin establishes a general policy that the Government will not engage in commercial or industrial activities unless it is found to be necessary or advisable to do so in the public interest after considering all pertinent factors, including interest on money and taxes.

The bulletin also provides for analysis of activities by responsible agencies and reporting of results to the Bureau of the Budget. Initially, in 1956, an inventory was made which identified over 19,000 commercial and industrial installations in civilian agencies and about 5,000 such installations in the DOD.

The inventory was subsequently brought up to date and activities were analyzed under the criteria established in the bulletin. It was determined that about 17,500 of the installations in civilian agencies did not represent substantial or significant competition with free enterprise and that compelling reasons existed for not procuring the goods or services involved through ordinary business channels.



For example, about 8,000 of these installations were custodial or janitorial activities carried on in post offices, and 3,900 installations were grain storage bins owned by the Commodity Credit Corporation. The program resulted in discontinuance of about 2,000 installations and curtailment of about 500 more.

We continue to support the basic policy of using available commercial and industrial resources to the extent feasible. For example, in 1961, the President requested the Panama Line, which has handled commercial shipping for many years, to discontinue all commercial shipping. That action has now been accomplished.

However, experience indicated that some of the procedures and reporting provisions which were included in Bulletin 60-2 have not been required. We are not requiring agencies to continue to submit detailed reports to the Bureau of the Budget concerning individual installations.

We have found that an overall figure composed of many different kinds and sizes of activities and dominated by such activities as janitorial services and grain storage has been somewhat misleading and of little value. We have placed maximum reliance and responsibility on agencies, and we intend to confine our activities to staff work in the agencies and to supplement such work by inquiries into specific situations which seem to warrant attention.

Instead of routine surveys of all types of activities, we have urged agencies to be selective so that their efforts may be concentrated in areas which offer the best possibilities for results. The DOD has incorporated this principle into its new directive for implementation of the basic policy expressed in Bulletin 60-2.

I believe Mr. Morris introduced this into the record, Mr. Chairman, when he was here in his testimony. We have reviewed that bulletin and we feel that it reflects very adequately and accurately the intent of the policy. (See app. 5, p. 410.)

Chairman DOUGLAS. He didn't submit it at the time but he will submit it and we will make it a part of the record.

Mr. STAATS. Finally we have placed increased emphasis on using Government installations and staffs rather than commercial or contractual arrangements when commercial operations are clearly more costly.

Most of the goods and services needed by the Government will continue to be obtained from commercial or other private sources, but when it is clear that a direct operation by the Government will save money when all pertinent factors are considered, we believe an operation by the Government is warranted.

The Comptroller General has recently endorsed this principle in the report which he submitted to the Congress on February 28, 1963, concerning costs of petroleum storage in commercial facilities.<sup>19</sup>

This is a matter on which the Comptroller General has written to us, Mr. Chairman, which we have under study. It reflects the other side of this issue of being sure that the analysis of costs indicates the economy of doing it within the Government or outside of Government.

In closing, Mr. Chairman, may I say that the same kind of cost reductions and improved management practices which have been discussed in these hearings are being sought continually in the other agencies. Finding opportunities for increased productivity of em-

<sup>19</sup> Staff report, 1963, p. 161.

ployees, for program economies, and for greater efficiency in carrying on Federal activities are always essential responsibilities of Government.

They take on added importance in a period of heavy pressures on the national budget. We, in the executive branch, assure you of our continuing cooperation and collaboration in this common cause.

This concludes my statement, Mr. Chairman. I would be happy to answer any questions. I have with me here this morning Mr. George Mullins on my left who has had long experience in this field, and Mr. Gordon Osborn, who is head of our Management Improvements and Research Branch which has been concerned particularly with the field of automatic data processing.

Mr. Cliff Miller of our Military Division who has had a particular background in the field of procurement and the stock fund matter.

#### DOD COST REDUCTION PROGRAM

Chairman DOUGLAS. Thank you very much. You will remember that the Secretary of Defense stated that the economies already made would result in savings below what the costs otherwise would have been of approximately a billion dollars in the fiscal 1964 budget.

It is expected that the savings which are being introduced before the end of this fiscal year would finally result in savings of \$2 billion and then that by 1965 the economies introduced would ultimately result in savings of \$3.5 billion. Do you in general agree with those claims?

Mr. STAATS. I am familiar with these figures. Some of these are obviously in the nature of objectives and of targets. We do not feel they are unreasonable objectives and targets. I do not want to say that we have made a detailed recalculation in the same manner that we would a budget estimate, Mr. Chairman, but we feel they are reasonable and achievable.

#### AGREEMENT ON ECONOMIES

Chairman DOUGLAS. The claim of a billion dollars in the fiscal 1964 budget is not merely on economies which will ultimately be realized but the economies which it is said have already been realized during the current fiscal year. Are you in general agreement with that claim?

Mr. STAATS. Yes, we are. I think another way of stating what he has said and what you have stated here is that the budget request would have been that much greater to achieve the same forces and the same degree of readiness in our Military Establishment had these economies not been achieved.

#### M'CORMACK-CURTIS AMENDMENT

Chairman DOUGLAS. The claim is being made by certain groups that the McCormack-Curtis amendment is not mandatory upon the Secretary of Defense, and that he is acting beyond the powers granted to him in setting up the Defense Supply Agency.

I have the text of that amendment before me, page 72 of our October 1960 report, I think perhaps it should be read into the record.

Whenever the Secretary of Defense determines it will be advantageous to the Government in terms of effectiveness, economy, or efficiency, he shall provide for the carrying out of any supply service activity common to more than one mili-

tary department by a single agency or such other organizational entities as he deems appropriate. For the purpose of this paragraph any supply or service activity common to more than one military department shall not be considered a "major combatant function" within the meaning of paragraph (1) hereof.

MANDATORY NATURE OF AMENDMENT

The Comptroller General has interpreted that, as I understand it, as being mandatory upon the Secretary of Defense to consolidate supply activities when he decides it will be advantageous so to do. Is that correct?

Mr. STAATS. That has been our construction of the language as well as the legislative intent of that amendment, Mr. Chairman.

Chairman DOUGLAS. In other words, the use of the word "shall" as distinguished from the word "may" implies a greater degree of intent of Congress, is that right?

Mr. STAATS. That would be my understanding. It is true that the language did not put a time limit on this, nor did it set up any time schedule. It obviously had to be written in the framework of a determination or a judgment to be reached by the Secretary of Defense.

But upon the reaching of such a judgment, it seems to us that the intent of Congress was very clear that he should proceed in this manner.

INTENT OF AMENDMENT

Chairman DOUGLAS. In the statement of Congressman McCormack, it was made clear that the Secretary had such powers, isn't that true?

Mr. STAATS. That is correct. We are not the principal legal officer of the Government, Mr. Chairman, but we had assumed that the intent here had been that this would allow the Secretary of Defense to make a judgment as to timing and as among items. But upon such a determination or judgment on his part we had assumed that this was clearly the thought behind this amendment.

Chairman DOUGLAS. So in your judgment, it is not necessary to have additional legislation for the Secretary of Defense to proceed with consolidation of noncombat activities.

Mr. STAATS. I would not see that additional legislation would add substantially to what has been written here, unless the Congress wanted to set up a mandatory schedule and go beyond the existing statute or not leave it to the discretion of the Secretary. (See pp. 2, 5.)

BOB SUPPORTS M'CORMACK-CURTIS AMENDMENT

Chairman DOUGLAS. Do you think the McCormack-Curtis amendment should be repealed?

Mr. STAATS. No, sir; we do not. We support that amendment. I think my statement has covered this point, and we would certainly hope that the McCormack-Curtis amendment would be continued.

Chairman DOUGLAS. I am very glad you say that.

Representative CURTIS. So am I.

DOD/GSA RELATIONSHIP

Chairman DOUGLAS. You mention in your statement the relationship between the Department of Defense and the General Services Administration. You have some optimistic statements at the con-

clusion of your statement. What is the situation so far as handtools and paint are concerned?

Mr. STAATS. This program has now been undertaken in terms of the agreement between Defense and GSA.<sup>20</sup> I suppose it would be fair and accurate to say that it has had more troublesome problems with respect to it than some of the other programs, but our present judgment is that they are largely of a procedural character rather than of any difference of intent on the part of the principal officers in both agencies. (See pp. 60, 103, 380 et seq.)

Chairman DOUGLAS. Who is now buying paint and who is now buying handtools for the Department of Defense?

Mr. STAATS. If I may, I would like to ask Mr. Mullins if he would respond to that question in more detail than I can.

Mr. MULLINS. Mr. Chairman, the same handtool or a particular unit of paint is bought either by the Department of Defense; that is DSA, or by GSA. There is not a duplication in buying the same item of paint or handtool. But there are many different kinds of handtools and many sizes and colors and so forth of paint.

The entire line of handtools and paint has not been assigned either entirely to GSA or entirely to DSA. So both agencies buy and stock and distribute in the general field of handtools and paint.

Chairman DOUGLAS. Don't you think consolidation would be desirable?

Mr. MULLINS. We believe that question has to be answered separately with respect to procurement. That is, the procurement or buying function, as distinguished from storage and distribution.

Chairman DOUGLAS. Let us take procurement.

Mr. MULLINS. Yes, sir. We believe that from the standpoint of pricing and simplification of the buying process, it would be desirable to have an item of that kind bought by one organization. However, there are some factors which have to be given a good deal of consideration before any such flat decision is made.

It is a rather complicated problem. For example, some kinds of handtools fit only a military item. They are very closely related to a weapon or to an airplane engine, and no one in the civilian Government or, for that matter, no one in the commercial field uses that tool.

It may be very closely related to an item that is still under development.

#### DUPLICATE BUYING OF HANDTOOLS

Chairman DOUGLAS. I am informed by Mr. Ward that he has copies of invitations to bid for handtools by the Defense Supply Agency which are identical to items carried by the General Services Administration. In other words, that there is duplicate purchase of identical handtools by the Department of Defense as compared with the General Services Administration. Is that true?

Mr. MULLINS. Examples of that kind have come to my attention. I have had an opportunity to run down some of those cases. So far as I can tell, they are simply mistakes.

Chairman DOUGLAS. What?

Mr. MULLINS. Administrative errors.

Chairman DOUGLAS. Whose errors? That the handtools are not identical or that just by accident the Department of Defense made the purchase?

<sup>20</sup> Staff report, 1963, app. 5, p. 182, et seq.

Mr. MULLINS. The latter. I might say I would classify this problem as being one largely of bad communications. Some procedural details are not worked out yet, and the result is that one hand doesn't always know what the other one is doing.

Chairman DOUGLAS. Have you made recommendations or has the Bureau of the Budget made recommendations to the Department of Defense in this matter?

#### DOD TO STUDY PAINT AREA

Mr. MULLINS. We have discussed this with the Department of Defense people, and they have agreed to make a study, for example, in the paint area. We feel that it would be desirable to have paint bought on a more integrated basis.

We don't want to be arbitrary about some of the other reasons that the DOD offered because they do have some validity and we don't want to take them too lightly. But we think there is enough involved in consolidating the buying of paint to make it worth while to make a very great effort to try to get the procurement of a class as common as that brought together.

Chairman DOUGLAS. The larger the volume of purchase, the lower the price which the Government will have to pay, isn't that true?

Mr. MULLINS. That is generally true. There are some exceptions, I am afraid. It depends upon the nature of the item.

Chairman DOUGLAS. Isn't this true of paint?

Mr. MULLINS. No, it is not true of paint. That is, it is not always true of paint. Paint is an item which is made in large batches. Integrated procurement is most economical, at least up to the total of one of these batches.

But if there is over a batch, say a batch and a half, or a very large quantity, as is the case with the Department of Defense, the result can be the reverse. A manufacturer can be forced into overtime, for example, or into other extra costs.

One of the most difficult problems in deciding this whole question is to determine which is the most economical way to buy an item.

Mr. STAATS. Mr. Chairman, if I might make a more general response to your inquiry as to our role and interest in this matter, as the result of some of the criticisms and instances, of the type that you cite here, having come to our attention, we have had discussions with both Defense and with GSA, and we are in agreement now that a further effort will be made to spell out the arrangements and the procedures by which we arrive at the individual determination on individual cases.

#### BOB TO SUPERVISE STUDY

There is always the problem of communications and misunderstandings which Mr. Mullins has referred to. They have requested us to take the lead in trying to spell out these arrangements in greater detail and greater precision. (See pp. 101 and 408.)

We have indicated that we would be happy to do that and we are now in the process of setting up a task group which will not only look at these arrangements for the Department of Defense but as soon as that is completed we will then move to some of the other supply agencies, such as the FAA, the Post Office, and other agencies.

Chairman DOUGLAS. I had not thought there was an difference between Army paint and civilian paint, and similarly I thought ham-

mers were the same whether used to drive nails in military installations or elsewhere.

Mr. MULLINS. If it is the same hammer and if it is being bought by both agencies, it is a mistake.

Chairman DOUGLAS. Why do you have to have a different hammer to drive nails in military barracks than to drive nails in a post office?

Mr. MULLINS. If it is to drive nails I can't conceive of any good reason for having a very different one. Along that line, I have asked some of the same questions on wrenches. Why is an open-end wrench different if it is twisting a nut in a defense establishment as compared to the Atomic Energy Commission?

Chairman DOUGLAS. What answer do you get.

Mr. MULLINS. The Department of Defense has wrenches that are about 6 feet long that weigh over 100 pounds. They need different kinds of items.

Chairman DOUGLAS. Does the Department of Defense claim that it needs left-hand monkey wrenches?

Mr. MULLINS. I haven't heard it make that claim.

Chairman DOUGLAS. Senator Miller.

#### AWARDS TO SMALL BUSINESS

Senator MILLER. Thank you, Mr. Chairman. Mr. Staats, a perennial problem with us is the degree to which small businesses are being given consideration in some of these contracts. As you know, we have written into the law various provisions designed to, you might say, give preferential consideration to small businesses.

Do you have any comments on how this is working? Whether it is going counter to the cost reduction program of the Defense Department, particularly.

Mr. STAATS. I think in general the answer is "Yes." How you would weight this against the benefits that it provides to small businesses is a difficult judgment to make. But to the extent that items are set aside for this purpose or for any other purpose that does interfere to some degree with what we are trying to achieve in cost reduction. You have two conflicting objectives here that somehow have to be balanced against each other.

#### COSTS OF SET-ASIDE PROGRAM

Senator MILLER. Have you made any review of the additional costs, perhaps, that this set-aside program has entailed?

Mr. STAATS. I am not aware of any specific calculations of dollars-and-cents cost. I am not sure quite how you could make that judgment unless you make some arbitrary assumptions as to what you might be able to do otherwise. Perhaps Mr. Mullins would be able to add to what I have said.

#### TOTAL AND PARTIAL SET-ASIDE PROGRAMS

Mr. MULLINS. I would first make a distinction between the so-called total set-aside and the so-called partial set-aside. A total set-aside is one in which big business is not permitted to submit a bid. In that kind of a situation, we have not been able to contrive any objective means of determining what it does cost. There is no way of knowing for certain what big business might have bid. Maybe small busi-

ness would have received the award anyway. On the other hand, maybe big business would have bid lower. It is just guesswork unless you do have a case of duplicate buying.

It would be possible to make duplicate procurements of the same item at the same time and in the same quantity, one under a set-aside situation, and the other under a complete open competitive situation. But this has not been done.

On the partial set-aside, quite a different set of circumstances arises, because big business is submitting bids, if it wants to. If a big business is the lowest bidder, the part that is set aside to small business also must be sold at that lowest price.

So there is no loss due to higher prices on partial set-asides, unless there is a loss caused by dividing the quantities into two parts—in other words, two production runs. It can be argued, at least in theory, that if 10,000 of an item are needed and you divide that into 2 parts of 5,000 each, perhaps the unit price simply as a result of dividing the quantity, is higher than it would have been if you left it together.

But here again it is rather conjectural. You can't tell for sure. The defense regulations provide that partial set-asides will not be used unless the quantity wanted is big enough for two production runs. That is the only safeguard.

#### EXEMPTIONS FROM SET-ASIDE PROGRAMS

Senator MILLER. I very much appreciate your bringing out the distinction between those two types of programs. Of course the Congress has decided that even assuming, for the sake of argument, that there are some additional costs entailed, and granted that these would be conjectural at best, according to your testimony, nevertheless it is our policy to give preferential treatment to small business in certain situations.

But there has more recently arisen a considerable question about whether or not the set-aside program should extend to construction as distinguished from maintenance and manufacturing activities. Have you any experience in this area which would prove helpful in considering whether or not small business set-asides should extend to the construction area, as they do now.

Would you have any recommendations as to whether they should be withdrawn from the construction area?

Mr. STAATS. I don't believe that you have in mind the accelerated public works program which was specifically designed to take care of the unemployment problem and the labor surplus area. You are talking about the regulation construction programs carried on in Government.

Senator MILLER. That is correct.

Mr. STAATS. I would like to make just one general comment on that. To the extent that we can through the normal budget process with respect to new construction programs in the 1964 budget, we have had in mind as one of our criteria—not our principal or governing criterion—one favoring projects which have gone into the labor surplus areas.

This doesn't deal directly with small business except as small business would be benefited along with all the business activities of that labor surplus area. With respect to extending the set-aside principle on procurement on the construction area generally—

Senator MILLER. May I say it is already extended to it. I am not questioning that. My question is, would you not have a recommendation with respect to whether it ought to continue to be extended.

Mr. MULLINS. I am familiar with the proposed legislation that you have in mind. I believe it has been introduced at least during the 87th Congress, perhaps during both sessions, and again this session. We have reviewed the agency reports as they have been sent to the committees on those bills.

The argument seems to be that the construction industry is so constituted that probably small business would get the bulk of it anyway, even under competitive conditions. I do not have any personal experience that enables me to make a judgment on whether that is the case. I have no facts one way or the other to support that legislation.

Senator MILLER. I am sure that you will be called upon for your comments, if you have not already been called upon, because it seems to me that this proposal to withdraw construction activities from the small business set-aside program has a bearing on your cost reduction efforts.

If you might locate some study that has been made in this respect, I would hope you would submit it to the committee.

Mr. STAATS. We would like to submit for the record any material which might be relevant to this. This particular matter has not come to our personal attention—at least to my personal attention—for any policy review. Obviously it is a matter which is of concern to you and this committee.

We would be happy to add to what we have indicated here.

Chairman DOUGLAS. That will be done.

(The information to be furnished follows:)

Proposed legislation to exempt contracts for maintenance, repair, and construction from small business set-aside procedures was introduced during the 87th Congress 1st session (S. 1363, H.R. 3690, and H.R. 5092), 2d session (S. 3096, H.R. 10518) and in the 1st session of the 88th Congress (S. 757). All of these bills have been referred to the Committee on Banking and Currency. The Small Business Administration and principal Government agencies concerned with contracting for construction, maintenance and repair work were requested to transmit reports on the proposed legislation and these reports have been reviewed in the Bureau of the Budget. All of these reports expressed opposition to the bills. In each instance we advised the agency that there was no objection from the standpoint of the administration's program to the presentation of its report to the committee. We have no facts or evidence which would indicate that construction contracts should be singled out for special treatment by exempting them from small business set-aside procedures that are applicable generally to contracts for other services and property required by the Government.

#### USE OF COMMERCIAL AND INDUSTRIAL RESOURCES

Senator MILLER. Mr. Staats, in your statement, you say:

We continue to support the basic policy of using available commercial and industrial resources to the extent feasible. (See p. 199.)

Of course, the problem is, what is "to the extent feasible?" Do you have any guidelines indicating on what basis the feasibility is determined?

BOB BULLETIN 60-2

Mr. STAATS. The basic policy statement or guidelines which has been developed was developed in 1959 under the Bureau of the Budget



Bulletin 60-2. A fairly comprehensive report was released on this toward the end of the last administration. This matter has been reviewed within this administration.

By and large, I think it is fair to say, there has been the view that these guidelines are adequate. We have in process now, and have had for sometime, a more detailed analysis of this bulletin looking forward to the possibility of more precise definitions which could be useful to the agencies in drawing a judgment as to whether the matter should be performed in-house, within the Government itself, or by contract. (See app. 5, p. 410.)

#### DEFINITION OF "COST"

One of the most troublesome things here is the definition of cost. The cost analysis is extremely difficult to make, as you are well aware, particularly when you have to make certain assumptions with respect to taxes and with respect to interest on money, and as to whether you allow some measure of profit or return on capital as a part of this analysis.

Just to mention one of the difficulties in the tax field do you include an element for income tax, or do you include only property taxes?

Senator MILLER. May I ask whether you do so in determining whether it is feasible?

#### INCLUSION OF TAXES

Mr. STAATS. One of the things that we feel have to be made more precise in this circular is to come to some agreement as to what elements of taxes we would include. Bulletin 60-2 simply refers to taxes. It doesn't attempt to draw this kind of sharper distinction.

Bulletin 60-2 also says that the cost should be predominantly or much greater outside of Government before you perform it within Government. The question is, What is predominantly greater? Do you draw a percentage distinction here or do you simply allow that as a matter of judgment for reasonable people?

These are the kind of things that we feel have to be looked at and reviewed. Secondly, we are inclined to the view that a distinction for practical purposes should be made here with respect to a function which is now being carried on in the Government as against a new activity which the Government is proposing to undertake.

We feel it is easier to make this judgment with respect to the latter. Because where you can make a distinction based upon perhaps a competitive bid on the basis of the cost of building up a laboratory or an installation within the Government as against going to an installation outside of the Government.

In the case I cited in my testimony which has been referred to us by the Comptroller General, his concern was that we had contracted out when we could have done it much cheaper within the Government itself. This has to do with petroleum storage facilities for the Department of Defense.

But we certainly feel that the cost analysis approach is the right approach to take here, assuming that there are no overriding considerations such as national security or confidentiality or matters of that kind.

Senator MILLER. In that particular item, can you tell me whether income tax was a factor that you took into account.

Mr. STAATS. We have this one under review at the present time and we have not really completed our analysis of it. I am not clear what the Comptroller General has included in his cost analysis at this point.

Senator MILLER. What would be your view as to whether or not income tax considerations should be taken into account?

Mr. STAATS. Certainly all direct taxes should be taken into account. As to whether a factor reflecting income taxes should be taken into account is a matter that we have not yet reached a judgment on. But all direct taxes in the nature of property taxes, direct excise taxes which enter into the cost of the end item certainly should be taken into account.

Senator MILLER. You see, Mr. Staats, what some of us run into quite frequently is criticism that the Federal Government is carrying on business activities which, if they had been carried on by private industry, would have netted 52 percent of the profit through income tax to the Federal Government.

It is pretty difficult to argue with that unless we have some specific examples which perhaps you could furnish us, indicating that this should not be taken into account. Speaking only for myself, I would hope that the income tax angle would be one of the factors and perhaps a very strong factor that would be taken into account, as long as we are seeking to try to provide employment opportunities in private industry.

But what I would like to ask, with the Chair's approval, is that you furnish the subcommittee with a listing of the factors or of the guidelines that are used as of now, and you could attach an additional list of those that are being considered, in arriving at the determination of the feasibility which you referred to at the bottom of page 7 of your statement. (See p. 199.)

Could you work up such a listing? I am not referring to a big report, but just a listing.

Mr. STAATS. Mr. Chairman, I would be happy to include the criteria insofar as they can be identified from presently existing instructions or guidelines in this area, together with a statement of the questions or issues which we feel are present in this picture. I would not want to imply that we have reached any conclusions at this point with respect to revisions because they are extremely complicated.

And I doubt if we will ever reach guidelines to which everyone will agree.

Senator MILLER. Would that be all right, Mr. Chairman?

Chairman DOUGLAS. Yes, indeed.

(The information to be furnished follows:)

#### CRITERIA GOVERNING COMMERCIAL-INDUSTRIAL ACTIVITIES OF GOVERNMENT

The criteria under which decisions are made with respect to commercial-industrial activities of the Government are included in Bureau of the Budget Bulletin 60-2. The pertinent parts of that bulletin are as follows:

*Policy.*—It is the general policy of the administration that the Federal Government will not start or carry on any commercial-industrial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels.

*Exceptions.*—Because the private enterprise system is basic to the American economy, the general policy establishes a presumption in favor of Government procurement from commercial sources. This has the twofold benefit of furthering

the free enterprise system and permitting agencies to concentrate their efforts on their primary objectives. However, in specific situations certain factors may make it necessary or advisable for a Government agency to produce goods or services for its own use. In these situations the burden of proof lies on the agency which determines that an exception to the general policy is required. A finding must be made that there are compelling reasons for Government provision of a product or service before an exception is authorized. All relevant factors must be taken into account, including pertinent economic and social aspects of public policy, even though they may not be the immediate concern of the agency or official directly responsible for the particular activity.

Compelling reasons for exceptions to the general policy include national security; relatively large and disproportionately higher costs; and clear unfeasibility. Each of these is discussed below.

A. *National security.*—"National security" as a compelling reason for continued Government ownership and operation of an activity is not meant to be all inclusive of all products or services with restricted classifications. Commercial contractors operating under proper security clearances and safeguards have been, and should continue to be, essential to the national defense effort. There are instances, however, when for reasons of national security, an activity cannot be turned over to private industry. These activities may include, but are not necessarily limited to, functions which must be performed by Government personnel in order to provide them with vital training and experience for maintaining combat units in readiness.

B. *Costs.*—Continuation of Government operation on the ground that procurement through commercial sources would involve higher costs may be justified only if the costs are analyzed on a comparable basis and the differences are found to be substantial and disproportionately large. In such cases, the costs of both Government operation and private procurement must be fairly computed and complete. The costs assigned to Government operation must cover all direct and indirect outlays, such as pay and other allowances for personal services and leave; contributions for retirement and disability; supplies; materials; transportation; warehousing; utilities; maintenance; repairs, and similar factors. Appraisal of elements not usually chargeable to current appropriations, such as depreciation, interest on the Government's investment, the cost of self-insurance (even though it is unfunded), and exemption from Federal, State, and local taxes<sup>1</sup> must also be made to the extent necessary to put the costs on a comparable basis. On the other hand, costs attributed to procurement from private sources must be computed on an equally fair and complete basis. They should be truly representative of the lowest price the Government would pay for the quantity and quality needed, taking into account all applicable costs of the Government for such procurement, and costs of handling and delivery.

The admissibility of relatively large and disproportionately higher costs as a possible compelling reason for continued Government operation does not alter the general policy which establishes a presumption in favor of Government procurement from commercial sources and does not prohibit procurement from more costly commercial sources. For instance, it may be found to be in the public interest to purchase the product or service, regardless of cost factors, in order to foster or maintain the development or growth of commercial production capabilities to meet ultimate governmental and nongovernmental needs at potentially lower costs.

The existence of Government-owned capital assets is not in itself an adequate justification for the Government to provide its own goods or services. The need for continued Government ownership or operation must be fully substantiated. In many instances, evaluation may show that excessive operating costs, obsolescence, replacement costs, or low rates of utilization make continued Government operation unwarranted and liquidation of the asset preferable. Similar examination should be made of any reasons that tend to substantiate a compelling need for continued Government ownership and operation. Even the operation of a Government-owned facility by a private organization through contractual arrangement does not automatically assure that the Government is not competing with private enterprise. This type of arrangement could act as a barrier to the development and growth of competitive commercial sources and procurement through ordinary business channels.

<sup>1</sup> Benchmarks for estimating taxes may be obtained from tables 1 and 3, "Statistics of Income, 1956-57, Corporation Income Tax Returns," publication No. 16, U.S. Treasury Department, Internal Revenue Service.

C. *Clear unfeasibility.*—Certain products or services may be found to be clearly unfeasible to procure from private enterprise through ordinary business channels due to the fact that the product or service is:

- (1) An integral function of the basic mission of the agency, or
- (2) Not available in the particular instance, nor likely to become available commercially in the foreseeable future because of the Government's unique or highly specialized requirements or geographic isolation of the installation, or
- (3) Administratively impractical to contract for commercially.

The above guidelines and criteria currently are being reviewed within the Bureau of the Budget to determine whether they may be clarified or otherwise improved. We are not prepared at this time to describe such changes.

#### BOB CRITERIA ON USE OF STOCK FUNDS

Senator MILLER. Mr. Staats, we have a similar problem. You referred to participating with DOD in developing new criteria for the selection of items to be carried in the stock funds.

Do you have a listing of those criteria which you might furnish the committee to be included in the record?

Mr. STAATS. Yes.

Senator MILLER. Would you do so?

Mr. STAATS. Yes.

Senator MILLER. Mr. Chairman, I would like to ask that supplemental information be furnished.

Chairman DOUGLAS. That will be done.

(The information to be furnished follows:) (See also p. 229.)

#### CRITERIA FOR DETERMINING WHETHER ITEMS SHALL BE FINANCED THROUGH STOCK FUNDS

I. The following categories of property are not to be carried in stock funds:

A. Principal items: These include such end items as aircraft, tanks, and ships and such replacement assemblies as aircraft engines. They are items which must be subjected to a high degree of line-item control because they are of critical importance and high unit cost. The number of such items is relatively small and it is feasible and appropriate to manage them on an individual item basis worldwide and stock fund financial controls are unnecessary. Such items generally have not been carried in stock funds and no change will occur under the new criteria.

B. The following categories of items which do not qualify as principal items also are to be excluded from stock funds:

1. Insurance items: These are items which (a) have no predictable failure rate in normal usage and (b) the failure of which would seriously impair the operational capability of a weapon system. Examples are ships propellers, aircraft wings, vehicles frames, and tank hulls.

2. Items directly related to safety of personnel: These include such items as parachutes and life preservers.

3. Items coded for repair at depots. These are items generally of high unit value although relatively small in number, which can be recovered and repaired after use. (Some of these items, such as aircraft engines, would be excluded from stock fund controls anyway because they are managed as principal items.)

4. Items in research and development stage: Items still undergoing research or not yet fully developed have not been carried in the stock funds and would continue to be excluded under the new criteria.

5. Items controlled locally at base level (in instances where stock funds extend only to supply depots.)

II. Items will be financed through stock funds if they do not fall within one or more of the categories described under I-A and I-B.

#### REDUCTION IN CATALOG ITEMS

Senator MILLER. You referred to the cataloging program. (See p. 195.) I wonder if your office would be able to furnish us with sta-

tistics over the last 3 or 4 years showing how much reduction in numbers of items has been effected through the cataloging program? It is my understanding that considerable reduction and duplications of items has resulted from this cataloging program.

I think it would be helpful if you could give us an idea of the number of items that have been reduced. It is my understanding that for every line item in the cataloging this entails considerable expense. Would you be able to do that for us?

Mr. STAATS. Yes, we would be happy to include that. We agree with your general remark of the value of the cataloging system.

(The information to be furnished follows:)

During the 4-year period ending December 31, 1962, a total of 1,549,876 items were deleted from the catalog system.

#### ITEMS ADDED TO CATALOG

Senator MILLER. Along with that, I wonder if you would also furnish us the number of new items that have been added to the catalog? Because if my information is correct, we have taken one step forward in reducing items but we have taken a couple of steps backward because we have added more items than we have been able to cut out. I wonder if you could get us that information?

Mr. STAATS. We can give you a figure on this. I would like to emphasize with the growing complexity of modern weapons we may be faced with this problem that you have mentioned. In other words, we cannot necessarily assume that the totals are going to decline simply because we have completed a cataloging system. It would certainly be less than otherwise. There is no doubt about that.

Senator MILLER. I realize that. Of course, in opposition to that is the program or policy we have, of reducing the numbers of weapons systems, too. While granted new weapons systems may be more complex and may entail more items if we reduce the total number of weapons systems, which is a definite policy we have been following for some time, it would be hoped that perhaps we would not be adding as much as I understand we are adding.

In any event, if you would furnish that information I would appreciate it.

(The information requested follows:)

During the 4-year period ending December 31, 1962, a total of 2,316,450 items were added to the catalog system. There was a net increase in the number of items in the catalog of 766,574 items during this period. The number of items added to the system has exceeded the number deleted each year for several years. An important factor has been the large numbers of spare parts coming into the catalog as each new major weapons system or other technical equipment becomes operational. When older equipment becomes obsolete it is possible to delete related parts and components from the catalog but many types of older conventional equipment have been retained for use and parts and related components continue to be carried in the catalog.

#### AVERAGE COST PER ADDITIONAL LINE ITEM

Senator MILLER. If you could come up with a figure which your Office believes to be the best average cost per line item added to the catalog, I think this would be very helpful to us.

I have had occasion to see four or five different figures, and there is substantial difference in cost between these various items. I think

it would be helpful if your Office could give us your evaluation of how much cost per line items, just in the mechanics. Would you be able to do that for us?

Mr. STAATS. We would be able to do it as long as you are willing to accept that these do not carry any weighting as to their importance. We would have to average in the very expensive ones with those which are less expensive. We could give you an average and that would reflect that situation.

Senator MILLER. May I suggest that you use as a starting point the figures that have been compiled by the various defense agencies, Army, Navy, and Air Force. I believe the DOD has its own. Possibly GSA has its own. I don't believe any of these are in agreement. If you could use those as a starting point I think it would be helpful to have your evaluation of how much the cost is.

Mr. STAATS. Suppose we give you a summary of these differing estimates and give you our comment with respect to them so far as we can give you that.

Senator MILLER. I think that would be helpful, if you would couple with it your best estimate of what figure you would use.

Mr. STAATS. We will attempt to do so.

Senator MILLER. Thank you.

(The information to be furnished follows:)

The General Services Administration, other civilian agencies, and the Department of Defense have developed many cost formulas intended for use in determining economic order quantities, deciding whether items should be stocked in central depots, procured locally, or supplied by other means, etc. These formulas are developed for specific items or groups of items, however, and overall estimates of item costs for entire supply systems are not suitable for such purposes.

A variety of overall figures has been used, however, to indicate the cost for managing an item, including (1) the Department of Defense has recently stated, in connection with its cost reduction program that " \* \* \* every new item added generates warehousing and industry management costs of at least \$100 per year." (2) GAO has cited annual management costs per item of \$803 in Army, \$1,018 in Navy, \$1,234 in Air Force, and \$1,070 for the Department of Defense as a whole (report of March 21, 1963, on management of electrical lamps), and (3) in December 1959, Assistant Secretary of Defense Perkins McGuire stated that " \* \* \* we save about \$1 million per year in management expenses for every 1,000 items eliminated from our supply systems \* \* \* " (a cost of about \$1,000 per item, which also was mentioned recently by General Shoup, Commandant of the Marine Corps).

Such figures as these are useful in emphasizing and dramatizing the need for standardizing on weapons systems to eliminate unnecessary differences in parts and components and in eliminating unnecessary items which have entered a supply system. However, we doubt that any such overall figure can be considered more than a very rough guideline or indicator. The necessary assumptions and variable factors are so numerous and they affect the result so substantially that we do not know of any means to determine the validity of a cost index to be applied generally to an entire supply system.

For example, a cost estimate for items which have not yet entered a supply system will not be the same as for items which are in a supply system and being considered for deletion. When a new item enters a supply system it must be cataloged, stock records must be set up, inventories acquired and stored, etc. The costs of these processes are not incurred if action is taken to prevent entry of the item into the supply system. But when an item is taken out of a supply system in which it has been incorporated, the costs of deleting numbers from the catalog system and from stock lists, closing out stock records, disposing of excess and surplus inventories, etc., must be set off against the long-term savings which will accrue as unnecessary items are deleted from the supply system.

Not all items included in the Federal catalog system are supplied in the same manner. Some are stocked in depots and distributed to users who requisition them. Many others need not be carried in depots and are purchased locally as

needs arise. If stocks are carried in depots, the Government bears the cost of the money invested in the inventory as well as the costs of maintaining stock records, billing, packing, and shipping requisitions, receiving and storing incoming shipments, etc. None of these major cost elements are incurred on items which are purchased locally or purchased and delivered directly to users.

The unit prices, required inventory levels, and physical characteristics of items also affect any estimates of the costs incurred in their management. Heavy, bulky, breakable, and high-priced items obviously are more costly to manage than items which can be easily stored in a small space and which are low in price. Standard commercial items which can be sold on the market at relatively little loss are likely to be less costly to manage than special military items which become obsolescent quickly and which cannot be used commercially except as scrap. A single fast-moving item with a high unit price may involve an investment in inventory of several million dollars. Such an item probably will be more costly to manage than a low-priced item for which there is little demand.

These are only a few of many kinds of variables which interact with each other in so many unpredictable and immeasurable ways that we believe it is infeasible to develop an overall item-cost figure which can be relied upon for any purposes other than as extremely rough guides. For that reason we hesitate to select any figure as an overall cost estimate for handling an item of supply. We are inclined to believe that the estimate of \$100 per item which is used in the Defense Department's cost reduction program is quite conservative. The potential savings to be achieved by eliminating items in the supply system through such efforts as standardization and catalog cleanup certainly are very large.

ARTICLES ON USE OF TAX MONEY

Senator MILLER. There is one other item I would like to discuss. Mr. Ben Cole, head of the Washington bureau of the Indianapolis Star, wrote a series of eight articles on the Federal Government's use of tax money last year. In his findings he set forth a fairly extensive table of where our money goes. It is entitled "Where Your Tax Money Goes." I would like to offer this for the record, Mr. Chairman, and request that it be inserted at this point.

Chairman DOUGLAS. That will be done.  
(The article referred to follows:)

WHERE YOUR TAX MONEY GOES—U.S.-OWNED CORPORATIONS GET BREAKS IN PRIVATE COMPETITION

(By Ben Cole)

WASHINGTON.—The Federal Government owns corporations or agencies of a type subject to the Corporation Control Act with equity totaling \$32,100 million in activities which are said to compete with private enterprise.

The corporations represent \$17,642,633,000 of equity.

The agencies, 37 in all, are operated with appropriated funds, representing \$11,118,050,000 in Government-owned equity.

Federal electric utility facilities exclusive of the Tennessee Valley Authority, which is counted as a corporation, represent \$3,200 million of allocated investment value.

The worldwide inventory of the armed services post exchange system is \$314,220,000, including the motion picture service. This included on January 24, 1961, cash amounting to \$47 million. Accounts payable were \$48 million, leaving a net value of the post exchange system of \$266,220,000.

Added together, these four categories of Federal equity make in excess of \$32,226 million.

That figure is apparently the only one ever compiled that in any way suggests the total Federal equity in activities which might be said in part or whole to compete with private business.

The Bureau of the Budget under former Director Maurice H. Stans once attempted to determine how many commercial-industrial-type activities the Government operated. Stans, however, never attempted to establish what the equity value of these might be. Nor did anybody else, insofar as is known.

## 214 PROCUREMENT ACTIVITIES OF THE DEPARTMENT OF DEFENSE

TABLE 21

The Government-owned corporations or corporate agencies and their equity value as set out in the 1963 Federal budget are:

Commodity Credit Corporation.....	\$4, 522, 524, 000
Federal Crop Insurance Corporation.....	45, 210, 000
Inland Waterways Corporation.....	11, 033, 000
St. Lawrence Seaway Corporation.....	127, 532, 000
Virgin Islands Corporation.....	15, 860, 000
Federal Prison Industries, Inc.....	31, 631, 000
Development Loan Fund.....	354, 930, 000
Office of Defense Lending <sup>1</sup> .....	125, 000, 000
Export-Import Bank of Washington.....	3, 306, 000, 000
Banks for Cooperatives (U.S. part).....	118, 287, 000
Banks for Cooperatives Investment Fund.....	185, 918, 000
Federal Farm Mortgage Corporation Fund <sup>2</sup> .....	2, 384, 000
Federal Intermediate Credit Banks.....	144, 917, 000
Federal Home Loan Bank Board <sup>3</sup> .....	[160,000]
Federal Facilities Corporation <sup>4</sup> .....	8, 687, 000
Federal Savings and Loan Insurance Corporation <sup>5</sup> .....	915, 822, 000
Reconstruction Finance Corporation <sup>6</sup> .....	4, 271, 000
Federal Housing Administration.....	1, 160, 107, 000
Federal National Mortgage Association.....	1, 477, 434, 000
Public Housing Administration.....	102, 642, 000
Panama Canal Company.....	467, 223, 000
Tennessee Valley Authority.....	2, 225, 075, 000
Federal Deposit Insurance Corporation <sup>7</sup> .....	2, 290, 000, 000

<sup>1</sup> Includes old RFC assets, old Defense Plant Corporation, etc. Figure from General Accounting Office.

<sup>2</sup> In liquidation several years.

<sup>3</sup> Brackets indicate negative figure.

<sup>4</sup> Dissolved June 30, 1961.

<sup>5</sup> Retained earnings.

<sup>6</sup> Dissolved; in liquidation. Some assets transferred to other agencies for liquidation.

<sup>7</sup> Not tax funds; \$3 billion borrowing authority never used.

TABLE 22

The Government Corporation Control Act provides that the fiscal affairs of the corporations subject to it be audited by the General Accounting Office, which is an instrumentality of the Congress.

The 37 other activities with Government-owned equity, some of them classifiable as commercial-industrial and others strictly of a governmental nature, are as follows:

Air Force industrial fund.....	\$61, 668, 000
Alaska Railroad.....	122, 823, 000
Alien property fund, Philippines, World War II, revolving.....	1, 511, 000
Army industrial fund.....	121, 390, 000
Aviation war risk insurance fund.....	23, 000
Central American abaca fiber fund <sup>1</sup> .....	101, 000
Capehart housing <sup>2</sup> .....	25, 535, 000
Check forgery insurance fund (Treasury).....	40, 000
Civil defense loans.....	587, 000
College housing loans.....	1, 602, 077, 000
Community disposal operation.....	5, 000
Contingency fund for emergency expenses, Fort Peck project, Montana.....	17, 625, 000
Defense production guarantees <sup>3</sup> .....	6, 350, 000
Development and operation of helium properties.....	81, 986, 000
Direct loans to veterans.....	1, 733, 347, 000
Farmers Home Administration.....	27, 522, 000
Federal ship mortgage insurance fund.....	12, 522, 000
Foreign investment guarantee fund.....	42, 827, 000
General Services Administration building management fund.....	440, 000
Government Printing Office <sup>4</sup> .....	43, 724, 000
Hoonah Indian housing project revolving fund <sup>5</sup> .....	171, 000

<sup>1</sup> Abolished.

<sup>2</sup> Represents amount of mortgage reduction.

<sup>3</sup> Retained earnings.

<sup>4</sup> An agency of the Congress.

<sup>5</sup> In liquidation.



Housing and Home Finance Agency revolving fund, liquidation programs.....	\$21,762,000
Housing for the elderly loans.....	12,729,000
Indian loan revolving fund.....	16,805,000
Informational media guarantee fund.....	145,000
Narcotics hospitals commissaries.....	63,000
Naval Academy laundry.....	234,000
Navy industrial fund.....	275,140,000
Public facility loans.....	147,566,000
Public works planning fund.....	45,052,000
Rural Electrification Administration.....	3,949,021,000
Small Business Administration.....	1,199,602,000
Upper Colorado River Basin fund.....	437,058,000
U.S. prison commissaries.....	692,000
Veterans' Administration canteen service.....	11,786,000
Veterans' Administration loan guarantee revolving fund.....	702,372,000
Wherry Act housing.....	423,276,000

During former President Eisenhower's administration, determined efforts were made to reduce the number of commercial industrial activities of the Federal Government.

Eisenhower's tough-minded Budget Director Stans reported January 13, 1961, on the status of commercial-industrial activity. Here is a table from his report:

TABLE 23  
*Status of commercial-industrial activities*

	Total	Civilian agencies	Department of Defense
Identified commercial-industrial activities.....	24,100	19,100	5,000
Agency evaluations not yet completed.....	2,100	-----	1,200
Total.....	22,000	19,000	2,900
Accepted agency evaluations justifying Government operations.....	17,000	17,000	-----
Total.....	5,000	2,100	2,900
Agency evaluations under review.....	2,950	500	2,450

<sup>1</sup> To be evaluated by Mar. 31, 1961.  
<sup>2</sup> Of which 400 have been or will be curtailed.  
<sup>3</sup> Of which 1,500 will be curtailed.

Placing a value on the business-type activities of the Government apparently defied Stans. The Budget Bureau cannot supply such a figure.

The reason for the difficulty is easily seen. First, identifying a commercial-industrial activity is hard enough; next, finding out what part of the investment in it is chargeable to such activity is still harder.

Stans told the President, "About 17,500 of the (civilian) installations are determined by the agencies to be of such a nature that they do not represent substantial or significant competition with free enterprise. In these cases, compelling reasons were found for not procuring the goods or services through ordinary channels. For example, about 8,000 of these were custodial and janitorial activities carried on in post offices and another 3,900 installations were bins owned by the Commodity Credit Corporation for the storage of grain.

"Of the approximately 2,100 installations in which compelling reasons for continued Government operations have not been established, some 1,600 have been or are scheduled to be discontinued or will be curtailed. Installations discontinued or curtailed include such activities as general and livestock farms, road construction work, production of bakery items, operation of gasoline service stations, and operation of local trucking and draying services.

"Because of the large concentration of commercial-industrial installations in the Department of Defense, special arrangements have been made for its evaluating and reporting.

"Of the 2,900 evaluations completed, some 450 were decisions to discontinue the installations; and some 2,450 were determinations to continue the installation for compelling reasons. Of those to be continued over 150 are to be curtailed.

"Among installations discontinued there are automobile repair shops, bread

and bakery shops, horticultural services and specialities, printing plants, ice plants, sawmills, shoe repair shops, laundries, ice cream plants, etc."

Stans concluded, "It is significant that a large number of the activities that were identified in the inventory are of such a nature that there appear to be compelling reasons why the Government should continue to carry them on. The activities that are questionable have been isolated for detailed study. The program has demonstrated that unjustified activities can be effectively deterred."

Senator MILLER. I would like to ask Mr. Staats—perhaps you have seen it, it came out last year, but if you have not—I would appreciate it if you might comment upon it in the light of your remarks on commercial-industrial activities.

I would like to have an evaluation of this article by Mr. Cole by your office. I think it would be very helpful. Because, looking at it, it does indicate a very substantial amount of competition, and if your policy is to reduce this competition I would hope that your comments would be favorable. But I can also understand how your comments might indicate that in some of these areas, the competition situation is more apparent than real.

I recognize that there are some situations where, for the sake of security or the overall considerations of national defense, it may not be feasible to use private enterprise. But I will offer it for the record and request that you supplement your statement by a review of this and your comments.

Would that be feasible for you to do?

Mr. STAATS. I would be happy to do so.

(The material referred to follows:)

The activities named in Mr. Cole's article consist of wholly owned and mixed ownership Government corporations subject to the Government Corporation Control Act and other activities of the Government which operate through revolving funds for which business-type budgets are required. Each of the activities was specifically created or authorized by act of Congress and its program is regularly reviewed both in the executive branch and by the Congress. Corporations such as the Tennessee Valley Authority, St. Lawrence Seaway, and the Federal Crop Insurance Corporation were created by the Congress to carry out a public purpose involving programs which private businesses were unwilling or unable to undertake because of the risks involved, the magnitude of capital needed or the lack of profit potential. They include developmental programs, credit and insurance activities, and intra-Governmental programs.

The Bureau of the Budget's Bulletin 60-2 provides that executive agencies shall conduct systematic reviews of commercial-industrial activities under their control in order to implement a general policy that the Government shall not engage in commercial or industrial activities unless it is found to be necessary or advisable to do so in the public interest after considering all pertinent factors. Such reviews by agencies directly concerned have been effective in avoiding or curtailing performance by the Government of a variety of commercial-industrial activities such as coffee roasting facilities, paint factories, laundries, etc. However, we have not considered the internal agency reviews called for in our Bulletin 60-2 as either appropriate or necessary for the types of activities listed in Mr. Cole's article which are based upon specific authorizing statutes passed by the Congress and which are subject to the fiscal and program controls provided by the budgetary and appropriations processes in the executive and legislative branches of the Government and by the special requirements of the Government Corporation Control Act.

Senator MILLER. I have nothing further, Mr. Chairman.

Chairman DOUGLAS. Congressman Curtis?

Representative CURTIS. Yes, Mr. Chairman.

I will go over some of the material that has been examined before but I am anxious to establish some points here. First, I was very pleased with the statement on page 3 of the Bureau of the Budget's basic support of the Defense Supply Agency and second, your belief

that the Secretary of Defense should continue to have authority to organize common supply and service functions.

I want to emphasize service functions, but I also want to have a little clearer understanding of this. Common supply does not refer solely to common-use supply. Am I correct?

It might include and does include in some instances combat supply, if they are common to the three services.

Am I correct?

Mr. STAATS. Yes; that is correct. That is our understanding.

Representative CURTIS. There has been some dispute on that subject and I wanted to clarify it. I think it is quite clear.

Chairman DOUGLAS. But not major combatant units. It doesn't include weapons?

Representative CURTIS. Yes, it could. Am I not correct? If it is common, Mr. Chairman.

I would say, that we got into this primarily through the common-use area. But the point was quite clearly made that in developing the unification and the common-use area, that is, common with civilian-type goods and services, there could be an incident where the Secretary of Defense would meet a common-use rivalry. In fact, I think this lies at the base of the controversy, as I understand it, on the TFX. At least as the Secretary of Defense brought out the fact that this is an area in which there seems to be some controversy.

Chairman DOUGLAS. We have two.

Representative CURTIS. We have three. Each has its own little Air Force, little Navy and Army.

Chairman DOUGLAS. I thought you were speaking of land forces. The weapons are common, both small arms and artillery. I would hate to see General Services—

Representative CURTIS. This is not GSA.

Chairman DOUGLAS. I would hate to see the General Services Administration take over the purchase of these weapons.

Representative CURTIS. Not at all, this is DSA.

Chairman DOUGLAS. I would hate to see DSA take over weapons. It may well be that the Secretary of Defense can prescribe unification of weapons, but I would really hate to see the procurement of combat weapons turned over to DSA.

Representative CURTIS. I would not like to see that either. I think the point is quite clearly made that those weapons that are peculiar to the three services—and each does have its peculiarity on the land, on the sea, and in the air—would not fit in the common-item range.

But brass knuckles certainly would. I dare say that all three of the services have brass knuckles. I don't know if they do. But they could have.

Also, a revolver. There are weapons that are common. At any rate, I wanted to point that up. I think the chairman and I would probably agree that this is an area where decisions need to be rendered, but if something is clearly a common item, either in service or supply, even though it has a combat aspect, it would not be ruled out of the McCormack-Curtis amendment.

I think you have agreed with that.

Mr. STAATS. Yes. I would simply like to add at this point. I think the question whether or not it is done through DSA or whether

it is done in pursuance of the McCormack-Curtis amendment is a different matter.

I think the Secretary indicated in his statement his efforts to try to develop, as far as practical, a common weapon system for the requirements of the different services. This, it seems to me, is an objective which relates to the overall effectiveness and economy of our Military Establishment.

I would therefore not feel that to get into his area, you have to rely necessarily on the text of the particular amendment that we have been commenting on today.

Representative CURTIS. In fact, there has always been a question in my mind whether or not the original Unification Act gave this authority.

In many respects, I felt the O'Mahoney-Douglas and McCormack-Curtis amendments were redundant.

The authority, in my judgment, always existed. But each step of the way, the three services have resisted these attempts in pursuit of their own determination.

The O'Mahoney-Douglas amendment is, in my judgment, essentially a restatement of what the law really is and has been since the Defense Unification Act.

I always felt that the McCormack-Curtis amendment was no more than a restatement, but in order to avoid all of this argument as to whether or not this authority is vested, it was restated. Again we are running into the same problem.

I have said this in these hearings before. We have a compliance problem—the question of top ranking military men carrying out orders. Decisions have been rendered and there has been an unwillingness to go along with those decisions.

If the Military Establishment, patriotic men, think this law should be changed, there is a process for changing it.

But that is only done after a proper hearing and full investigation. It is not done by subversion. I see again this same technique being employed.

I think the Secretary of Defense has the power, without the McCormack-Curtis amendment, to bring about a common weapons system based upon, I emphasize, efficiency. I like his point.

I was in aviation maintenance in World War II. I know well that the big problem is how many airplanes can you keep in the air, not how many airplanes you have.

How many airplanes you have bears on how many you can keep in the air. But, if you have a proliferation of different weapons, you lose the efficiencies in maintenance, which means spare parts availability, maintenance techniques, and skills.

These are matters of very delicate judgment. But, I did want to emphasize this second point, because this is under attack.

The Secretary of Defense knows it. I think the public knows it. Last year, I took the floor of the House at the time Chairman Vinson of the Armed Services Committee created a subcommittee of Mr. Hardy and Mr. Bates. The sole objective of that subcommittee, in my judgment, was to undermine the effect of the McCormack-Curtis amendment and the basic concept. I had an exchange of views with both Congressman Hardy and Congressman Bates on the floor of the

House in discussing the meaning of the McCormack-Curtis amendment and whether it extended into the common weapons area.

I tried to make it clear that I, myself, felt very strongly that we should never take away from the Army, Navy, or Air Force their basic power over their peculiar weapons.

This was just as important, in my judgment, as the fact that in those areas where there could be commonality, the DSA or the Secretary, through however he saw fit, should have that authority.

The third item that DSA will accelerate progress for is further improvement in procurement, storage, and distribution functions. You have gone on to point out that part of this, too, is the further utilization of GSA, the General Services Administration?

Mr. STAATS. That is correct.

#### USE OF GSA BY DOD REFUTES CHARGE OF EMPIRE BUILDING

Representative CURTIS. I am happy to see that further utilization of GSA is occurring. We must get the uniform off these supplies and services that don't have to have the uniform on them. The extent to which Secretary McNamara is utilizing GSA, moving things out of the uniform into the Civilian Supply Agency, is refutation of what I felt is an unfair charge that he is trying to build an empire in the Department of Defense.

Surely, if we were doing that, he would try to keep under his control everything he could. I am not pleased with the progress here, though.

The criteria still do not seem to be clearly established. You refer to this:

An orderly procedure has been developed based upon an agreement by the Department of Defense and the GSA.

Have we had that agreement put in the record, Mr. Chairman?

Mr. WARD. Yes. (See p. 380.)

Representative CURTIS. I understand it is in our report here.<sup>21</sup> What disturbs me is when we get into the details.

We have gotten into the details of paint and handtools only as examples.

#### ARGUMENTS WHY DSA SHOULD MANAGE CERTAIN ITEMS

You said that DSA has some valid arguments in this area that holds back this decision. Let us take paint. What do you regard as some of the valid arguments that DSA has presented as to why the military should be handling these items and why it should not go into GSA?

Mr. STAATS. I would like to answer the first part of your question and then to turn to Mr. Mullins for the second part of it.

As I indicated in my remarks earlier, I think we are in agreement that these criteria need to be spelled out with greater precision than they have been, that is, if we are to avoid the kind of misunderstandings and failure of communications and errors of judgment, if you will, made by the people who are actually procuring these items.

#### TASK GROUP TO DEFINE CRITERIA

As I indicated, we have agreed to set up a task group of the Budget Bureau, Defense, and GSA to try to define these criteria more sharply,

<sup>21</sup> Staff report, 1963, app. 5, p. 182.

to be sure that there is a common understanding in both agencies and down the line to the point where we get to the people who are making the day-to-day judgments.

With respect to the validity of the argument, with respect to an item in the paint field, for example, being retained in the Defense Department rather than being procured by GSA, I believe Mr. Mullins indicated a while ago that one of the criteria may be a judgment as to the quantity to be purchased.

Representative CURTIS. Let me interrupt, because I want to get each one of these on the specifics. Quantity would make no difference because the GSA would buy the quantity just as DSA would.

In other words, the criteria for DSA must be some reason that relates to having a uniform on it, as I put it.

Mr. STAATS. I quite agree that GSA or Defense could buy the same quantities. There is no question about that. There might be some question as to the economy of one as against the other if the item were procured almost entirely for the Defense requirement.

Representative CURTIS. I don't see that either. How would that make a difference?

Mr. STAATS. The principal argument here, as I have understood it, has to do with the specifications and whether or not you can get agreement on specifications and forms which would take care of the needs of both the civilian and defense agencies.

Representative CURTIS. In other words, they are arguing that their specifications are different in many respects.

Mr. MULLINS. There are some special listed kinds of paint, the kind that goes on ship bottoms, for example.

Representative CURTIS. And civilian ship bottoms, too. I really want to find out what they are using as so-called valid arguments. Maybe they have some, but let us get them out in the open and see what they are.

Putting paint on ship bottoms doesn't seem to me to make any difference whether it is a military ship or a civilian ship. You ought to have good paint on the bottoms.

Mr. MULLINS. I would like to say, first, that I think your questions are valid. That is the point in reopening the matter of these understandings between GSA and DOD.

As I understand it, both Assistant Secretary Morris and Mr. Boutin share the feeling, that this area needs to be reexamined in the light of the experience that we have had up to this time.

All I can do is to give you the reasons that are offered without offering a judgment whether those reasons are good until analyzed.

Representative CURTIS. I will make the comment, sir.

#### MOBILIZATION RESERVES

Mr. MULLINS. One of them is that these stocks, even though they may be common as anything that you could buy in any hardware store, may have been determined to be needed in a general mobilization reserve.

This means that if the GSA assumes the responsibility for storing and distributing them, that it assumes the inventory responsibility on something that doesn't turn over because it is based on a future demand and also one that is totally controlled by a military judgment.

So far we have held that it would be a mistake for the GSA to be made responsible for the storage and distribution of general mobilization reserve items.

We have not said that we think the procurement should be divided. It is still possible to have one agency do the procurement, even if we need to have the storage function in the two agencies. We could keep the procurement together.

Representative CURTIS. Could I interrupt so that I can follow this? You are discussing storage and distribution of items that are needed in the event of mobilization.

That would be any item, practically. It wouldn't seem to me that is the test—whether it is used in mobilization. The test is whether it is available.

#### COFFEE AS A MOBILIZATION RESERVE ITEM

I have used coffee roasting as an illustration, which I think should be the criteria here. You have 180 million people in a society drinking coffee, whether it is war or peace or cold war or what.

It doesn't matter, theoretically, whether 10 million are in uniform and 170 million out, or 5 million in uniform and 175 million out. You are going to use the same amount of coffee.

So far as the coffee being available, it is there. All you need in the event of a mobilization is to tag these items for military priority, which is a relatively simple thing. I would say that the bulk of these items having already been classified as civilian-type goods for supply and distribution in the civilian economy.<sup>22</sup>

What do they mean when they are talking about those items for mobilization? How do they identify them? Can you give me any criteria on that?

Mr. MULLINS. Yes. I can.

The theory of mobilization reserve is to have enough stock on hand in addition to current consumption requirements, to take care of needs during the first period of impact in the case of a war or a general mobilization.

Representative CURTIS. This is related to one item. Let us apply it to handtools and apply it to a monkey wrench. That would mean that they would have to have in supply enough monkey wrenches in their own warehouses to meet this, even though there might be plenty of them that could be requisitioned in the civilian economy?

Mr. MULLINS. If there are plenty of them that could be requisitioned in the civilian economy, it should not be in the general mobilization reserve.

Representative CURTIS. So you would use the criteria I am proposing to determine whether it should be reserve?

Mr. MULLINS. Not me; I am not the one. But the Department of Defense under their criteria would make a distinction between an item that can be readily obtained in almost any quantity from the present market, and an item which in their judgment could not be obtained in that quantity in time to tide them over during the early periods of a general mobilization.

<sup>22</sup> See staff report, 1963, app. 6, p. 217.

Representative CURTIS. I am still interested in an example. We are now talking about items that are common use. We are not talking about the combat items here. This is in relation to GSA and DSA.

We are talking about desks, typewriters, and paper. We are talking about food, I would think, to some degree. We are talking about things like paint and handtools.

For the life of me, I would have to stretch my imagination to find some item that during military mobilization would create the demand where these items would not be requisitioned in the private sector.

I can think possibly of bandages where, if you had a number wounded, because of the nature of war, you are going to increase the need.

But coffee, again, to use it as an illustration, is not like this. Maybe we get more jittery in wartime, but theoretically we consume the same amount.

We are talking about human beings whether they are in uniform or out. We are talking about common use items. Can you give me an example of a DSA-GSA item that the military has tagged as necessary for mobilization? (See p. 156.)

#### MILITARY VS. CIVILIAN ITEMS

Mr. MULLINS. Yes. I think I can. I agree with you that on an item like coffee presumably we will all drink coffee or not drink coffee regardless of whether we are in uniform.

Representative CURTIS. I want to put this in because I have been so misunderstood. Maybe, the military should have a priority on this, but the amount available is the same.

Mr. MULLINS. I agree that is another question. For an example, the Department of Defense has a flaring tool kit. It is a small kit which is called a flaring tool set.

What it does is to take copper tubing as used for gasoline lines and spread it out at the ends so that a nut will fit over it. You have the same kinds of fittings, perhaps, on your lawnmower, or in the gasoline of your car.

The problem is that the Department of Defense, the Air Force, requires that kind of a flaring tool with a different angle of flare than is used in civilian markets.

Their flaring tool bears the same general specification numbers as one that is stocked by GSA. It looks the same. It would take an expert to tell that they are different items.

The only difference is in the angle of the flare. If you do have mobilization with a sudden increase in the volume of repair work, rebuild jobs, and repairing of gaslines, there could be a very substantial increase in the needs for that kind of flaring tool.

Representative CURTIS. I appreciate your example and that is why I would like examples. I would like to follow that one through and find out why the laws of physics differ for a military item and a civilian one. Why is it that you have to have different flares?

Either the military one is better or the civilian one is better. This gets into the need for having one design in the military and a different one in civilian mechanisms that require different flaring tools.



We could go to the bottom of this very example you gave and we would probably end up by having a common tool for the military and the civilians.

I don't think the laws of physics vary when you get in uniform, although there are many who seem to contend that.

Mr. MULLINS. I believe the reason for it is in the greater pressure of gasoline in an airplane motor.

Representative CURRIS. That is what I am trying to say. You have airplanes in the civilian society and the same pressures are there. You have other kinds of machines that require these pressures in the civilian society.

This concept that something is peculiar about an instrument or a weapon or an airplane or a ship because it is called military is part of our trouble.

You have given me the example which is what I asked for. All I would say is that I am most anxious to see these criteria. I think they need to be established.

If the military have arguments on any of these items, they should be brought out in the open. I don't see it in paint or tools.

When I find the DSA in some instances resisting the normal development of taking it out of uniform and putting it into GSA, I get quite disturbed about it.

Paint and handtools only serve as a warning flag. If they are using this kind of argument there—and they will need to get some better arguments than I have heard to date—they will be used all along the line and keep us from getting this into GSA.

I hope someone will take a close look at mobilization reserves along the lines I have suggested, to see if it hits that particular criterion.

There is one other criterion that I have hinted at. This is not just a question of whether the military might use more of a particular item than the civilian governmental sectors.

This has to have the interjection of the civilian sector. I daresay on most items the military probably will buy a lot more than all the rest of the nonmilitary bureaus in the Government.

This is to be related to the civilian market and the civilian enterprise. If it can be handled in the civilian sector, in my judgment, that is when we expect it to be handled by GSA.

#### VOLUME AS A CRITERION

The one argument that I did hear on paint was that the military bought more of it. I have no doubt they do. If that is going to be the criteria, you will have very little passed over to GSA.

I was happy to see you distinguish between procurement in one area which you could centralize and perhaps distribution and servicing which would be different for other reasons.

#### DISTRIBUTION AND WAREHOUSING COSTS

I am very much concerned about this concept of saving money by bypassing the distributive system. It is true that if the military, in buying automobiles, can place their orders to be filled during the slack periods of civilian demand, there is some real saving.

But the concept that you can buy 10,000 hammers from the factory, for example, on the assumption that you are getting them for a dollar apiece when it would cost you \$2 if you bought it at the retail outlet and thereby save a dollar, is very shallow thinking.

Someone has to do the warehousing, the distribution and so on. The costs of that are considerable. I suspect, in this instance, the military would probably be paying \$3 a hammer by bypassing the civilian distributive system, including retailing in some instances.

I was a little worried when Mr. Boutin from GSA was testifying about some of these savings that he thought he was gaining through the lower price of mass purchasing, without relating it to how is he going to get it distributed, how is he going to stock his warehouses, and so forth.

I am sure it is very much in your mind that this should be one of the criteria when you say this should be based upon the cost analysis criteria.

#### GAMUT OF COSTS

A good cost analysis would include, would it not, the whole economic gamut of delivering from the mine, as it were, to the retail outlet?

Mr. STAATS. I believe obviously it would have to include all of these elements of cost.

Representative CURTIS. Then I will move over to this cost analysis. During the Bonner hearings, this was most disturbing. One of the administration's witnesses, who was a civilian temporarily brought into the Government services, made the remark, "I think that the cost-accounting system in the military was about 60 years outdated, compared to the modern techniques in the private sector." That was 10 years ago.

Chairman DOUGLAS. There has been a big improvement in the last 2 years.

Representative CURTIS. That is what I was going to ask, whether in your judgment, Mr. Staats, we have moved forward with better cost accounting in the Military Establishment.

How up to date are we?

Mr. STAATS. I wouldn't want to pass judgment how far behind we are.

This does represent an area that is of concern to us and to the Secretary. I think the Secretary has moved ahead very well in this regard since he has taken over there. We have a staff assigned to the Department of Defense to work with his staff in this area in the field of cost base budgeting which has now been applied pretty generally all through the Government except Defense.

That is an area that is going to take some 2 or 3 years, in our judgment, before we are out of the woods. This is difficult.

Representative CURTIS. I remember interrogating the colonel who was in charge of automotive repair shops at Camp McPherson. I remember Colonel Libasci, who was running the largest optical shop in the United States, grinding lenses for the U.S. Army.

I asked both of these gentlemen, how much they allocated in this operation for their salaries. They both said, none. Colonel Libasci made a classic remark when he said that the Army would have to pay

him anyway. I didn't ask the obvious questions, such as how much is put in for the sharing of maintaining sewers, police, fire, and so forth, because those items were not even contemplated in the cost accounting of those days.

Even the very fine machinery they had was not amortized from a cost standpoint. When that wore out, they would simply replace it through an appropriation request in the budget, which came in a different way.

I think we have advanced beyond those stages. If we are going to use cost analysis as the criteria, entirely apart from policy matters, we must get some up-to-date cost accounting into the Military Establishment.

Now, I do come to a policy question. It seems to me that cost analysis, basic as it is, should not be the entire criterion. I think there should be a presumption that the marketplace is probably the best place to get the price.

As long as the marketplace is functioning, it is pretty presumptuous of any of us in Government to assume that Government could do it for less.

So, even though you might run into an item that looks on a cost analysis basis, as though it could be done cheaper by setting up a Government bureau, department, or whatever, the burden of proof would be very heavily on that.

Would you agree that it should be a matter of basic policy to utilize the private sector, unless the case is proved affirmatively? Where is the burden of proof? The burden of proof should be, in my judgment, on the Government.

#### PRESIDENT'S POLICY PLACES BURDEN ON GOVERNMENT

Mr. STAATS. That is almost precisely what the President's statement of policy contemplates which has now been specifically restated within the Department of Defense.

In the recent issuance they have put out they reflect the Bureau of the Budget Bulletin 60-2. In my earlier remarks, I indicated we are attempting to take another look to see whether we can provide more definitive agreement as to some of these elements of cost.

But the cost analysis approach is very important unless, as I have indicated, you have overriding considerations.

Representative CURTIS. They must not be superfluous. I recall at Fort Bragg they were overhauling civilian trucks and automobiles. Adjacent to this unit was a school to teach recruits in field maintenance of the automotive equipment.

Naturally I thought there was some connection between maintaining a school alongside of an overhaul unit. So I interrogated some of the students and some of the instructors. I said it is fine that this overhaul unit is available, because you can gain something in your instruction.

The instructors and students said they were not allowed in there at all, because they would interfere with the maintenance line. Yet, when we got back to Washington, D.C., to interrogate the top military command—this is a matter of record—the general testifying said that, in regard to our overhaul of civilian type automobiles, Congressman,

you must realize that this fits in with our military mission. We are training our people in field maintenance, and the fact we may not be as efficient as we should comes from the fact that we are using this in conjunction with the school.

I said to the general at the time that I had anticipated that as an argument and that is why I checked it and found it sounded good, but it just didn't happen to be true.

I must confess that I think we have to examine very closely these arguments that sound good when they are advanced, because they will come up with beauties.

Some of them are sound. I don't mean they are not. I think we have to get behind them and find out whether they are really sound.

Mr. STAATS. Because I think it bears on the point you just made, the present bulletin provides as a statement of general policy that the Federal Government will not start or carry on any commercial industrial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels.

#### PRIVATE ENTERPRISE SYSTEM BASIC TO AMERICAN ECONOMY

In exceptions, it says, because the private enterprise system is basic to the American economy, the general policy established a presumption in favor of Government procurement from commercial sources.

This has the twofold benefit of furthering the free enterprise system and permitting agencies to concentrate their efforts on their primary objectives.

It does provide that certain exceptions can be made. But the only exception of any consequence is this one on national security. This is a difficult area of judgment to draw.

The other element is of cost. With respect to cost, it provides that compelling reasons for exceptions to the general policy include national security, relatively large and disproportionately higher costs and clear in feasibility.

It is in the area of cost analysis that I think we have to be clear as to whether we are including on both sides the same elements of cost.

Representative CURTIS. That is true. You need to get use and up-to-date cost analysis system in the military, in order to see what their costs really are, because it is so easy to hide real costs in a bureaucracy.

Mr. STAATS. If the Comptroller General's statement is correct, in the letter he sent to us with respect to petroleum storage where he feels we are spending \$10 million a year more by contracting out than if we performed it in-house, the question of judgment is, is that a price we want to pay for contracting out in that particular case? (See p. 137.)

Representative CURTIS. Much as I tend to agree with the Comptroller General on most things, I would surely like to look over someone's shoulders on the cost.

If this had been properly contracted out to the private sector, with real advertised bidding and real competition, I would be very surprised if we could do a more efficient job under the governmental sector.

Mr. STAATS. As I indicated, this communication has just come to us in the past few days.

#### FEDERAL CATALOG

Representative CURTIS. Now, just briefly on the Federal cataloging. I think I know the answers, but I want to be sure. In establishing the Federal catalog, we are working very closely, I hope, with the civilian catalogs so that there is as much commonness in our spare parts as possible. Am I correct in that? Is that being worked closely, for instance, in automobiles, with the big automobile companies on their part numbers and standardization? Am I correct?

Mr. MULLINS. Yes. The latest cataloging statute brought the civilian and the military systems together. It is called the Federal Cataloging System. (See p. 195.)

There can still be slipups and mistakes and duplications sometimes creep in. But there is a machinery for catching them. As a matter of fact, the Department of Defense does the assigning of numbers to avoid the duplications you have in mind.

The Department of Defense assigns the numbers not only for its own items but also for the items in the civilian side of the Government.

It also reviews the items that the civilian agencies use which they find to be the same as those already in the Defense system. Such items get the same numbers as already assigned by Defense.

Representative CURTIS. In the same item there is being developed, and has been for a number of years, a coordination among other nations, particularly in the Western Hemisphere, to try to get commonality there.

This is likewise being coordinated with our allies militarily, I understand, and also in this overall picture. Is that one of the criteria?

Mr. MULLINS. Yes. There is a program with NATO on cataloging and there is a regular mechanism for coordination.

#### STOCK FUNDS

Representative CURTIS. Now, turning to stock funds, I merely want to express my very deep concern, because this has not been mentioned in your report nor the Secretary of Defense's report. The point that this committee made was that two of the services used stock funds and the third service did not—the Air Force.

The question was that if, on a review, it is found that they are usable and efficient, why should one use the 90 percent and the other only 4 percent? It looks like we are just where we were at the very beginning.

Furthermore, one criteria—and I would have been happy to have some of our language come back to us here—is that stock funds are valuable for fast-moving items. That is, if you agree, it is certainly inapplicable under any theory to items that do not move rapidly.

Maybe that criteria is wrong. We have gotten nowhere on stock funds, as far as reporting back is concerned. It is the same talk without any relation to actuality.

Mr. STAATS. Mr. Curtis, in my statement we have covered briefly this point.

Representative CURTIS. You have covered it, but you don't mention the points I just raised. The fact is that two of the services use it, the third doesn't.

We have no report as to whether the Air Force has changed. We still don't have the criteria on just the point I made, that it is applicable and seems workable in regard to fast-moving items, but it is completely inapplicable to items that are not fast moving.

I don't find any discussion along these lines and I didn't find it in the Secretary of Defense's testimony. Yet, this is what we directed attention to in this committee.

Mr. STAATS. The line has not been drawn, to my knowledge, in terms of fast moving or items that do not move fast, although it may tend to work that way.

Stock funds have been used, as you know, since about 1953.

Representative CURTIS. Yes; by two of the services and not by the third.

Mr. STAATS. That is true. I am not sure what conclusion we reach from that. It has, in our opinion, turned out to be a valuable instrument with respect to a large number of items.

#### DIFFERENT STOCK FUND POLICIES

Representative CURTIS. If that is true, why has it not been utilized in the Air Force? All I am saying is that we have been over this before. There is no sense in going over it again.

We are right where we started at the beginning. How can you explain the use, if it is so good, by two of the services and not by the third?

Mr. STAATS. In general, I expect your question should be addressed to the Secretary of Defense, but we will be happy to do the best we can with it.

Representative CURTIS. I think you are all in it. The Comptroller General is in it, the Budget Bureau is in it, and Secretary of Defense.

Incidentally, if the stock-fund theory is sound, GSA might be implementing it. Then if that is so, in what areas is it usable and in what areas is it not? I don't want to dwell on it now because I can see there is no prepared statement that I can direct my attention to.

Let me leave the record open and you can put in any comments that you would like to make, directed to the observances I have just made here.

Mr. STAATS. I believe I understand certainly more specifically the nature of your question in light of this discussion here today certainly beyond what I had understood previously.<sup>23</sup>

We can either go into it now or prepare a statement which addresses itself more precisely to these points.

Representative CURTIS. I would prefer to have the statement prepared for the record, because what I had expected was the prepared statement from the Secretary of Defense, your own, and the Comptroller General to hit at the area of concern.

As I say, this statement has been made now for the past 10 years.

<sup>23</sup> See Hearings, 1960.

(The information requested follows:)

STATEMENT CONCERNING POLICIES AND PRACTICES IN USE OF STOCK FUNDS

This statement is addressed to three questions raised in the discussion: (1) Why hasn't the Air Force used stock funds to the extent they have been used in the other services; (2) should slow moving items be excluded from stock funds, and (3) if stock funds are sound should GSA be using them?

*1. Why are stock funds used less in the Air Force than in other services*

The major differences with respect to the application of stock funds in the past have been among categories of material. Through fiscal year 1962, aeronautical material, missile items, and related electronics items were not included under the stock funds in any of the services and since July 1, 1962, only the Army has included such material in the stock fund. Since these kinds of material constitute a very large part of the total inventories of the Air Force, the proportion of materials carried in the Air Force stock fund to total Air Force inventories has been much smaller than in the other services. However, the Air Force has included in stock funds for a number of years clothing, petroleum, subsistence, and certain other items. In fact, its sales volume from stock fund inventories in 1962 was over \$1.3 billion, which is slightly greater than the volume in the Navy stock fund although smaller than that in the Army.

Other factors also have contributed the fact that the Air Force has used stock funds relatively less than the other services. For example, the Air Force bases have requisitioned substantial quantities of materials from depots of the Army, Navy, GSA and now DSA, when they are carried in stock funds. This means that part of the stock funds in Army, Navy, DSA and GSA actually are being used to provide supply support for the Air Force. Furthermore, some categories of electronics and other material which have been financed under appropriated fund systems in the Air Force are being transferred to the DSA where they will be carried in the Defense stock fund.

Under recently developed criteria for determining which items should be financed and controlled through stock funds (furnished for the record at Senator Miller's request at page 210), it is expected that use of stock funds should be increased considerably, and that the trend toward more uniform application of stock funds within the Department of Defense will continue.

*2. Should slow moving items be excluded from stock funds*

Under the recently developed criteria for determining which items should be financed and controlled through stock funds, insurance items (which have no predictable failure rate in normal usage and the failure of which would seriously impair the operational capability of a weapon system) are not to be carried in stock funds. Since most such items tend to be slow moving, the effect of this criterion will be to remove some slow moving items from the stock funds.

However, it is believed that the rate of usage of an item should not be a controlling factor in deciding whether it should be included in a stock fund. All of the military services stock many items on which rate of demand is relatively low. Rate of demand for many spare parts line items is relatively low, for example. Yet investments in these slow moving items are very large and the need to bring them under better control has been demonstrated clearly.

It is feasible and appropriate to manage principal items such as tanks, aircraft, ships and replacement assemblies on a line item basis and stock fund management of such items is unnecessary. But it has not been feasible to manage more than a relatively small number of items on an individual line item basis. Other methods of fiscal and management control are necessary in a supply system of over 4 million items which include many that are slow moving, and it is believed that stock funds provide a needed means for effective management of supplies when it is not feasible to exercise line item controls.

*3. If stock funds are used, should GSA be using them*

The General Service Administration finances its supplies through a stock fund which is called the general supply fund. It is managed and used in essentially the same manner as the stock funds in the Department of Defense and Veterans' Administration.

## COMMERCIAL-INDUSTRIAL ACTIVITIES

Representative CURTIS. Moving to commercial industrial activities, I simply want to call attention to the Harden subcommittee report and the second Hoover Commission report listing the kinds of commercial and industrial activities in which the military was engaged.

## PROGRESS RE: HARDEN AND HOOVER REPORTS

In order to gain continuity it would be helpful if you would have your group refer to those two reports and show what progress has been made in relation to them, if you could.

I am referring to the second Hoover Commission and the Harden subcommittee of the Government Operations Committee, whose report was around 1954.

I am now directing attention only to commercial industrial activities just to see where we are in that contention.

I think you have been quite responsive, I might say, in your presentation here. This is not in any sense adverse criticism. It is simply to keep it in the context of those previous reports.

Mr. STAATS. We will do the best we can on it.

(The information requested follows:)

In June of 1953 the Intergovernmental Relations Subcommittee of the House Committee on Government Operations, chaired by Congresswoman Cecil M. Harden, initiated a series of hearings on commercial and industrial-type activities in the Federal Government. These hearings were extended through July of 1953 and resumed in March of 1954. Included in the published hearings was a listing of different types of commercial and industrial activities of the Government. That listing was expanded and classified in further detail in the second Hoover Commission's task force reports on "Business Enterprises," published in June of 1955. In January of 1955, the Bureau of the Budget published its Bulletin 55-4 which established a general policy (with some specified exceptions) that "the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels." That policy has remained in force although the procedures called for have been modified somewhat.

As indicated in the prepared statement, 19,000 commercial and industrial installations were identified in the civilian agencies and about 5,000 in the Department of Defense. About 2,500 installations were discontinued or curtailed including many of those named in the 1953 hearings of the Harden subcommittee and the second Hoover Commission's task force reports. For example the Government no longer operates coffee roasting plants or paint factories. Among the installations which have been discontinued, curtailed, or reduced in number are laundries, ice cream plants, bread and bakery shops, horticultural services and specialties, ice plants, motor vehicle repair shops, sawmills, etc.

## IMPACT OF SET-ASIDE, DEPRESSED AREAS AND BUY-AMERICAN PROGRAM

Representative CURTIS. This is a general observation in regard to the set-asides. We also have other policies that go contrary to the concept of the military getting the most defense per dollar.

The depressed areas legislation is also a deviation, is it not, from this goal?

Mr. STAATS. I think in the same way.

Representative CURTIS. We can argue whether overall economic policy is not sound. I simply point it out.

The third one is this "Buy America" that relates to offshore procurement. Would you not agree as to that?



Mr. STAATS. Again, for what appear to be overriding policy reasons.

Representative CURTIS. That is right. This committee is particularly concerned in those areas and should be, because our concern is this overall economic policy. I, myself, do not share any one of those three concepts. I think the best thing to do is to have as our criteria getting the most out of our dollar for Defense. If we want to subsidize something, let us not use Defense procurement in that subsidy.

We have a hard enough problem trying to direct efficiencies toward procurement and distribution without getting into these areas.

That is just a personal observation, but I would hope it would become administration policy.

#### SMALL BUSINESS-ADVERTISED BIDS

However, I do want to say this on small business: I have argued against this set-aside theory. Although, I understand the reasons why they did it. It was due to real frustration and exasperation. The real way to help small business in my judgment, and the facts bear it out, is to move toward sounder procurement practices.

That is the use of advertised bids with proper specification and standard procedures and ample notifications. Because this committee has found, as others before it, as the percentage of advertised bidding goes up over negotiated bidding, the participation of small business increases.

#### SMALL BUSINESS NEEDS OPPORTUNITY TO COMPETE

In other words, small business doesn't need any subsidy. All it needs is a fair opportunity to compete. There I think we could have this efficiency idea of getting the most for your dollar, going hand-in-hand with the desire to give small business its proper share.

Mr. STAATS. I don't disagree with that.

Representative CURTIS. I am pleased with the progress that has been made.

Mr. STAATS. I don't disagree with this point. I believe the information made by DOD and GSA does indicate very sizable strides.

I recall very clearly in our hearings 3 years ago, you and Senator Sparkman both pointed out statistics here which were very helpful in connection with the point that Congressman Curtis is making at the moment.

Representative CURTIS. Secretary McNamara brought it out, too, in his testimony and elsewhere. It is simply a question of emphasis.

I think I would like to see ultimately the set-aside disappear. As I say, it is a clumsy method resulting from frustration and doesn't seem to move forward in developing what we regard as proper procurement practices.

In this area, one thing that has not received too much attention, which I think is most important, is subcontracting. The advertised bidding is the original contract.

A great deal of this procurement is through the prime. It is the techniques that the prime contractor employs in opening up in his bidding techniques.

I know you have been devoting attention to that, too. But, it has not been particularly mentioned. I want to confirm it. Am I not correct?

Mr. STAATS. That is correct.

Representative CURTIS. More power to you in your development of this, because here, too, we can move forward to get more for the dollar.

My final comment is, on "Buy American"—

#### SET-ASIDES IN LABOR SURPLUS AREAS

Mr. STAATS. Could I correct one thing which I may have misstated? With respect to the set-asides for the labor surplus areas it is true we have such. But I believe there is a provision in the Defense Appropriation Acts for the last several years which prohibits the use of appropriated funds for payment of a premium on any contract to give a preference to a labor surplus area.

These are not necessarily inconsistent. It still permits contract awards to a business in a labor surplus area to go through but they must meet the competitive price.

Representative CURTIS. Actually this, too, could go with, instead of working against, the concept of getting the most for the dollar. If an area is depressed, theoretically they could offer a better price in bidding on the contract due to the fact that they have excess labor.

I think if we look at the market place a little more closely and work with it, we will find that these things can go hand-in-hand.

#### BUY AMERICAN ACT

That was my concluding remark, that this "Buy American," in my judgment, is a very bad development. I understand the reasons for it fully. I have great sympathy for our problems of our domestic industries in these areas.

I think they are seeking a solution that is no solution at all and simply are requiring that our procurement be done on these shores, when we could actually procure at 25 percent less.

What is the figure they now use? It is more than 50 percent, isn't it?

#### BUY AMERICAN POLICY UNDER REVIEW

Mr. STAATS. I think I should say that the whole subject of the "Buy American" policy is under review. At the President's request this is something that the Bureau of the Budget has responsibility for. Differentials within the Department of Defense have exceeded 25 percent.

#### BALANCE OF PAYMENTS VS. COSTS

This is related to the problem of the balance of payments. We have to recognize that we have serious problems there. I think the question really goes to the extent to which the differentials do affect the gold flow as against what effect it has on the cost in the defense budget.

This is the kind of judgment the President is going to have to make.

Representative CURTIS. This is right. This is why this committee has cognizance over this and why I am so happy it exists. This is what we should examine. If the economic theory is unsound, this is the way to help in improving over the long range the gold flow and the balance-of-payments problems and stimulating our own economy.

I suspect that we are paying a penalty in inefficient military procurement, and in paying that penalty, we are actually doing damage to economic growth instead of helping it.

I suspect we are doing damage to our employment picture, as well as the balance of payments. Whether that is right or wrong, certainly this is the area this committee must be concerned about and one reason I feel very strongly we should be in this field.

We have to have some committee of Congress that overlooks these economic implications beyond just the military procurement. That is why I wanted to end on that note.

#### BUY-AMERICAN DIFFERENTIAL

Mr. STAATS. The Buy American program involves all Government procurement. There is an Executive order which has provided for a 6-percent differential between domestic and foreign procurement except that in the case of labor surplus areas and in the case of small business, it has been a 12-percent differential.

This has been in effect for some time. The problem is what should be done, if anything, in the light of the balance-of-payments problem.

Representative CURTIS. Let me say I am well aware of the fact that the views I am expressing here are very much the minority of the Congress.

The President is not out of step, I regret to say, with the majority feeling of the Congress.

Mr. STAATS. We do not have the facts as we need them and we are in process of obtaining some of those facts with respect to the total amount of business which is affected by this. We hope to get that within a matter of a few weeks.

Representative CURTIS. Thank you for your patience, Mr. Chairman.

Chairman DOUGLAS. In view of the fact that you have been kept as a witness for a very long period, I shall confine myself to one statement and one question.

With much and with most of what Congressman Curtis has said I find myself in agreement, but to the degree that the discussion here will influence policy, I must make a demurer on the question of weapons.

#### DSA'S FUNCTIONS IN DOD

I believe very strongly in the Defense Supply Agency. I think its functions can be still further increased inside the Department of Defense.

I believe there are many common items which can be turned over to the General Services Administration. It is quite possible that the Defense Supply Agency can purchase pistols more efficiently.

But when you get into the field of weapons I do not want to see the Defense Supply Agency usurp functions now performed by the ordnance divisions of the Armed Forces.

The Defense Supply Agency in the nature of the case is primarily quartermaster work. I do not regard them as competent to appraise weapons, rifles, machineguns, mortars, artillery and the rest.

I think it would be a great step backward if they were to take these items over. I do think that the Secretary of Defense can work in

the direction of unification of weapons but he should do so through the ordinance sections rather than through the Defense Supply Agency.

Representative CURTIS. May I say to my chairman, I don't think I disagree. As I say, when we get discussing it, we may disagree on some, but the basic principle I think I agree with. (See p. 57.)

#### COMMON SERVICE ACTIVITIES—WEATHER

Chairman DOUGLAS. That is good. The one question I wanted to ask was in the field of weather. How many agencies of Government are conducting research on the weather?

#### 14 AGENCIES IN WEATHER RESEARCH

Mr. STAATS. As I recall, there is a total of about 14 agencies of the Government.

Chairman DOUGLAS. Would you name some of them?

Mr. STAATS. The Weather Bureau, of course, the National Aeronautics and Space Administration, the Federal Aviation Agency, the several services of the Department of Defense.

Chairman DOUGLAS. The three or four services?

Mr. STAATS. In this case, three services, plus research and development activities which are conducted centrally within the Department of Defense.

Chairman DOUGLAS. We are up to seven.

Mr. STAATS. The National Science Foundation; the Department of Agriculture.

Chairman DOUGLAS. That is nine.

Mr. STAATS. I have about run out of examples. I think undoubtedly the overall figure is approximately correct. I would be happy to supply the remainder.

(The information follows:)

In addition to the agencies named above, the following are engaged in meteorology programs: The Atomic Energy Commission, the Bureau of Standards, and the Departments of Treasury (Coast Guard), Interior, and Health, Education, and Welfare. A total of 14 agencies is involved.

#### EXPENDITURES ON WEATHER RESEARCH

Chairman DOUGLAS. Do you have any estimate as to the total amount spent on weather research?

Mr. STAATS. We can supply you with that figure. It so happens that we are currently making a review of the organization of the weather activities of the Government with the view to trying to centralize as much as possible the basic research work.

(The information follows:)

The following table indicates the new obligational authority for Federal meteorological research and development programs as stated in the President's budget for fiscal year 1964 at pages 400-401. (Includes both basic and applied research.)

TABLE 24

*New obligational authority for research and development in meteorology*

[In millions of dollars]

Agency	1962 actual	1963 estimate	1964 estimate
Department of Agriculture.....	1.2	1.3	1.4
Atomic Energy Commission.....	3.9	4.6	4.6
Department of Commerce:			
Bureau of Standards.....	.3	.3	.4
Weather Bureau.....	8.9	10.8	12.8
Department of Defense:			
Advanced Research Projects Agency.....	1.7		
Army.....	9.2	11.2	12.6
Navy.....	4.1	3.7	4.4
Air Force.....	8.8	9.1	8.9
Federal Aviation Agency.....	8.8	4.7	4.3
Department of Health, Education, and Welfare.....	7.3	10.0	12.1
National Aeronautics and Space Administration.....	.8	.9	1.1
Department of the Interior.....	34.4	57.3	63.7
National Science Foundation.....	5.2	8.8	12.3
Total.....	94.6	122.7	138.6

Mr. STAATS. We recognize that the utilization of weather data is going to have to always be, like statistics or any other data, by a large number of agencies who need it in their day-to-day operations.

Chairman DOUGLAS. But these 14 agencies are all conducting basic research?

Mr. STAATS. Not all 14 agencies. My statement related both to the agencies engaging in research and with respect to utilization of this research.

Chairman DOUGLAS. How many do you think are engaged in basic research on weather?

Mr. STAATS. At least NASA, the Weather Bureau, the National Science Foundation and the Defense Department. These are all engaged in basic research.

The question is whether this can be centralized to give greater effectiveness at less cost to the Government.

Chairman DOUGLAS. It would seem to me this could be true. Do you intend to pursue this actively?

REPORT FORTHCOMING ON WEATHER RESEARCH

Mr. STAATS. Yes. We have a report which is about at the completion stage at the moment. In fact, it is before the agencies for their views at the present time.

Chairman DOUGLAS. That is fine. Thank you very much, Mr. Staats.

Mr. STAATS. Thank you very much.

PROCUREMENT OF HANDTOOLS

Chairman DOUGLAS. Before we adjourn, may I say we have received a number of communications from the hand tool industry on this question of the decentralization or centralization and duplication of hand tool purchasing.

I understand that members of the industry are here in the room. I wonder if Mr. Briggs would be willing to come forward and testify briefly on this matter.

We are very happy to have you with us, Mr. Briggs. I would like to put in the record a letter with its enclosures, which you addressed to Mr. Ward on March 20, together with correspondence from other members of the handtool industry.

(The letter referred to follows:)

KRAEUTER & Co., INC.,  
Newark, N.J., March 20, 1963.

Mr. RAY WARD,  
Secretary, Joint Economic Committee,  
U.S. Capitol Building, Washington, D.C.:

We understand, Mr. Ward, that the Joint Economic Committee, will hold hearings starting April 28.

We have been vitally concerned with the duplication of effort in handtool purchasing by DSA in Richmond, Va., and GSA in Washington.

So much so in fact, that we have sent letters to President John Kennedy and to the GSA office in Washington.

Enclosed are copies of these letters for your information and review.

In view of the fact that we are quite familiar with the inefficiency in Government purchasing, of handtools in particular, we would welcome an opportunity to appear at the hearing.

Since we have had firsthand experience, as a manufacturer and supplier to the Government, I believe we can contribute worthwhile information to these hearings.

The writer will plan to call you on Friday morning, March 22, 1963, to determine if our presence at the hearings would be helpful and beneficial to the American taxpayers.

Cordially,

BRUCE BRIGGS,  
Vice President and General Manager.

KRAEUTER & Co., INC.,  
Newark, N.J., February 6, 1963.

Mr. JOHN H. HOLMEAD, JR.,  
Chief, Machine and Handtools Section, General Services Administration,  
Federal Supply Service, National Buying Division,  
Washington, D.C.

DEAR MR. HOLMEAD: A copy of your letter dated January 23, addressed to George P. Byrne, has been passed along to our company for information.

Since a major decision is about to be made, we feel, that we as a manufacturer (taxpayer) would like to voice our opinion regarding this decision.

We are a supplier who has had the advantage of experience in supplying the Government on both individual awards and GSA annual contracts, therefore our views may be helpful.

For the last 3 years we have been the low bidder on a portion of the GSA term contracts covering pliers. During that period, we have supplied over 1,500,000 pairs of pliers to the Government under contract through GSA. Also during this period of time we have been able to evaluate factually the deciding advantages of term bidding for our company through GSA in comparison to the spot-type bids for the same items through other agencies of the Government.

Therefore we believe it is important to express our views. We want to be on record as to the advantages that we know are beneficial to both the Government and our company, under GSA term purchasing.

#### GOVERNMENT TERM PURCHASING

##### I. Advantages GSA term contracts

A. The supply of finished material at point of usage is nearly "guaranteed" by the quantity projection and perpetual control method with predetermined minimum inventory levels established.

B. Requirements watched and projections made by the GSA from experience benefits both the Government and the manufacturer as follows:

1. The Government can go through the paperwork and ordinary expenses of preparing bids and awarding contracts once a year versus many, many times a year.

The paper saving alone to the Government is a factor—not to mention the personnel required and time expended on each bid, each award, and each performance on an individual requirements basis.

2. The manufacturer can:

(a) Forecast his inventory level required to perform over the period of the contract resulting in: (1) Quantity purchasing of raw materials:

and supplies; (2) a steady flow of materials through the plant; (3) a steady working force, leading to better labor-management relations; (4) a steady performance on the contract leading to better and "sure" supply at the end-user level.

These factors make it possible to lower the manufacturer's inventory investment on Government items.

The manufacturer knows what and approximately how many items he will need to produce for a period of time, versus "spot" quantity orders at an inconvenient time (such as factory vacations) and unpredictable quantities, with 90-day delivery requirements.

(b) When an emergency arises in making necessary high-quantity purchases, the Government can procure at least some quantity immediately from sources already under contract, eliminating delays for bidding, et cetera (this has been done from time to time through GSA on our products).

A manufacturer already performing on a Government contract, can perform on an emergency basis.

(c) Experienced help is already employed in the plant thus a minimum of time required to increase production requirements.

(d) Overtime can easily go into effect to increase production.

When a big requirement is required from a manufacturer not producing the same items, the lag or leadtime could be detrimental to the national defense.

**C. Cash flow:**

**Government:** On a predicted-term basis the Government can forecast requirements and expenditures to fit and keep within a budget.

Under a multibid per year basis the element of unknown requirements in any month is a deterrant to good planning and budget control.

**Manufacturing:** Can plan their budgets and purchasing with a more reasonable assurance of continuing orders, keeping unit prices to the Government at the lowest possible level.

**D. Bid prices:** To support our statement of reduced unit prices, purely as a result of the advantage of term bidding introduced by GSA we submit the following information:

6-inch needle nose plier, 1957 price, low bidder.....	\$1.15
6-inch needle nose plier, 1962 price, low bidder.....	\$1.02
Reduction.....	\$0.13
Percentage difference.....	-11.3
<hr/>	
6-inch diagonal pliers, 1957 price, low bidder.....	\$1.10
6-inch diagonal pliers, 1962 price, low bidder.....	\$0.93
Reduction.....	\$0.17
Percentage difference.....	-15.5

Please note these percentage differences. Cost of labor, materials, and variable operating expenses have all increased in this 5-year period.

Through the process of knowing the level of plant activity required to produce the projected GSA quantities in term bids, we have been able to intelligently plan and schedule all phases of our company operations. This has resulted in lower prices to the Government and consistent standard of quality, to meet Government specifications.

**E. Summary:** We believe that our comments and supporting facts make it quite clear that an annual contract with specified quantities puts both the Government and the manufacturer in the best possible position to:

1. Plant and budget expenditures.
2. Assure constant delivery.
3. Assure a consistent standard of quality.
4. Maintain competent sources of supply who will bid on large contracts at the lowest possible price.

In addition, the advantages of one agency doing the purchasing on our type of product is extremely important.

We sincerely hope that our voice may be heard and consideration given to our thoughts, in this important decision.

Cordially,

BRUCE BRIGGS,  
*Vice President and General Manager.*

KRAEUTER & Co., INC.,  
Newark, N.J., February 8, 1963.

THE PRESIDENT,  
The White House,  
Washington, D.C.

Mr. PRESIDENT: Recently you have inferred that less duplication of effort in Government would effect savings to the taxpayers.

The enclosed letter, I am sure, will not have a full meaning to you, unless you become familiar with some of the facts.

To save you some time here is the picture as we see it:

1. Two branches of the Government are purchasing identical items—handtools.

2. GSA purchases on a 6-month or yearly contract basis.

3. DSA at Richmond, Va., purchases on an individual bid basis as requirements arise from contracting officers.

Many times during 1962, we received inquiries from Richmond for the identical items GSA is purchasing under contract with our company.

In some cases we receive telephone calls from Richmond requesting price and delivery on identical items purchased by GSA. We referred Richmond to GSA in Washington saying, "Have you checked GSA for delivery?" Undoubtedly these items are in a GSA warehouse for immediate delivery.

The reaction to this suggestion from Richmond was always unfavorable. Why? Simply because they are trying to justify the existence of the Richmond group, without consideration given to "what is good for the Government and the taxpayer."

We have been in contact with Mr. George Mullins, Bureau of the Budget, concerning this duplication of effort, giving him specific examples.

GSA as a group has done an outstanding job for the Government in procurement of handtools. These people know what they are doing: How to coordinate the purchasing to effect savings; are conversant about quality characteristics needed. In short, this group is a real credit to the Government purchasing.

Why not let the GSA do all procuring on handtools? Is this too simple an approach? When in fact this group has proved its efficiency.

This decision of who is going to buy handtools—GSA or DSA—has been bandied around for too long. In the meantime, we manufacturers are the bouncing ball between the two.

Maybe you, Mr. President, can get the Joint Economic Committee to make the right decision.

Respectfully yours,

BRUCE BRIGGS,  
Vice President and General Manager.

Chairman DOUGLAS. I would like to have you make your statement any way you wish.

#### STATEMENT OF BRUCE BRIGGS, VICE PRESIDENT AND GENERAL MANAGER, KRAEUTER & CO., INC.

Mr. BRIGGS. Thank you very much, Mr. Chairman. I believe my statement would be simply one of observation and more particularly related to the importance of the ultimate objective, which is to reduce the duplicate buying in all sections of the Government for all types of commodities, not only in our particular product, and ultimately to save the taxpayer money.

This is my single purpose in submitting the information that we have. To observe just a little bit the statements that have been made here this morning, No. 1, in terms of purchasing, whether it be for mobilization or whether it be for civilian use, within an industry most of the manufacturers who manufacture for each are the same manufacturers.

Therefore, there doesn't seem to be much of a reason to try to define these two segments of the Government as nonrelated in terms of the



items. We had a visit this past week from Richmond by the commander, Commander Dunn, who is the chief of handtool procurement down there, who told us that steps were underway for better communication with General Services Administration as related to our items.

DUPLICATE BIDS FOR HAND TOOLS

I have here before me an invitation to bid for a Federal stock number of 5,000, which is the same Federal stock number that the General Services Administration has under contract at the present time with a manufacturer within the handtool industry.

These are the things—

Chairman DOUGLAS. Is the number of the item what?

Mr. BRIGGS. 5120-293-3486.

Chairman DOUGLAS. What type?

Mr. BRIGGS. It is a short, needlenose plier, 4 inches long, without a cutter.

It would help if you go to the index because it will give you the exact page number on the back. As late as last Friday I had a procurement requisition on my desk from California for 3,000 6-inch diagonal pliers, for which the specification they were using was out of date.

This particular item we are under contract for with the General Services Administration. They have many of these in the warehouses. Several of these illustrations have been sent to George Mullins, incidentally, to run down.

DSA ASKS BID ON GSA FURNISHED ITEM

In the past, on one occasion specifically, we bid to Richmond, which is DSA, on an invitation to bid for an item that we were under contract for to General Services Administration.

Bear in mind, on this item we were under a yearly contract to GSA at a price of \$1.20. We quoted to Richmond \$1.35 on the same identical item and were low bidder.

We immediately reported this to the General Services Administration with the thought that they could get this order switched around and get it put through GSA, which they did.

Chairman DOUGLAS. You were ready to take a 15-percent reduction?

Mr. BRIGGS. Yes, sir. We did take it. The order came through GSA. But the point that is so frustrating to us is this:

Really this is isolated because it is down to a little item like handtools. But to us it is the significance that if it is going on with handtools, it is going on with a lot of other items.

INDUSTRY CONFUSED

We don't see where the problem is, frankly, in terms of the communications or the recognition by the people in Richmond in doing business with the people at GSA in Washington.

This seems absolutely ridiculous to us. Because we are a manufacturer who is caught in the middle. We must try to do business with both of them.

It is not economically feasible nor is it sound for the Government to have two agencies buying identical items. I believe if you have any

questions concerning these matters we would be happy to try to answer them. But again, I point out that our single objective is to the total, more efficiency, less cost.

Chairman DOUGLAS. I appreciate that.

#### DSA/GSA PRICES

May I ask which agency do you generally get the higher price?

Mr. BRIGGS. Through Richmond, which is DSA.

Chairman DOUGLAS. You generally get a higher price from the Defense Department than you do from General Services?

Mr. BRIGGS. Yes; that is correct.

Chairman DOUGLAS. In spite of this you want to have General Services handle this?

Mr. BRIGGS. Yes.

Chairman DOUGLAS. That is very commendable.

Mr. BRIGGS. We have turned down orders at the higher price. As I say, we have turned them down. We have sent the information to Washington with the idea of getting that same item through on the contract that we have at the present time at the reduced price.

Chairman DOUGLAS. I think you should get at the very least a Good Conduct Medal.

Mr. BRIGGS. Do you have any other questions, Mr. Chairman.

Chairman DOUGLAS. Are there many items where this is true or are these isolated occurrences?

Mr. BRIGGS. I can only speak for our particular end of the hand-tool business, which is pliers. This has happened a number of times in our particular item.

Chairman DOUGLAS. Thank you very much, Mr. Briggs.

There are other gentlemen, I believe, from the industry here. We have only 7 or 8 minutes that we can devote but if any of them would care to come forward and make a statement we would be very glad to have them. It can either be corroborative or noncorroborative.

Speak up or forever hold your peace.

Would you identify yourself?

#### STATEMENT OF B. L. CLARK, PENDLETON TOOL INDUSTRIES, INC.

Mr. CLARK. B. L. Clark of the Pendleton Tool Industries, Inc., of Los Angeles, Calif.

Chairman DOUGLAS. Do you agree with what Mr. Briggs has said?

Mr. CLARK. I agree, Senator, in the fact that it is very confusing to the industry to be, as Mr. Briggs told you, a contractor for a definite period of time on a definite item and then have to submit invitations to other branches of the services, knowing that they have the rights to draw from the particular contract or that you have the contract with.

We feel that certain items known as common handtools, are as common as they can be. We don't see where there should be any definition in common handtools. We do agree that there are certain items, military items, but they are so few and so far away from the ordinary common handtool that we don't think there should be two divisions.

Chairman DOUGLAS. I appreciate that.

May I ask you the same question that I asked Mr. Briggs? From which service do generally you get the higher price or from which agency?

Mr. CLARK. That would depend a great deal on the quantities.

Chairman DOUGLAS. For equal quantities?

Mr. CLARK. For equal quantities we would quote the same price.

Chairman DOUGLAS. In which case would you get the contract and in which case would you not?

In other words, in which agency is there more competitive bidding?

GSA DOING GOOD JOB

Mr. CLARK. At the present time GSA buying for civilian agencies and buying in turn for DSA have done a tremendous job in buying, pricewise and servicewise.

Chairman DOUGLAS. Necessary initials are very confusing. Which agency are you saying is doing the excellent job, General Services or Defense?

Mr. CLARK. General Services Administration at the present time are recognized by the industry as being the buyer of common handtools.

Chairman DOUGLAS. Is there more competition in General Services purchases than Department of Defense purchases?

Mr. CLARK. Yes, we would say so.

Chairman DOUGLAS. Do you have anything to add to that and would you identify yourself first?

STATEMENT OF MAX TINSLEY, REPRESENTING SEVERAL HANDTOOL MANUFACTURERS

CONFLICTING RESPONSIBILITIES A PROBLEM TO INDUSTRY

Mr. TINSLEY. I am Max Tinsley. I represent several handtool manufacturers, sir. I agree with the statements that have been made that the present setup with conflicting responsibilities between the General Services Administration and the Defense Supply Agency is a constant problem to the industry.

We see one office of the Government buying an item this week the same identical item may be bought by the military departments in spite of what we understand are agreements that this will not be happening.

So it is confusing and certainly not in the interest of the industry or the taxpayer and the Government itself. It is not an efficient way to conduct business.

Chairman DOUGLAS. I will ask you the same question that I have asked the two preceding witnesses. Which agency has more competitive bidding?

Mr. TINSLEY. I think generally speaking the General Services Administration, based on quality, value per dollar. You get a better competitive situation.

Chairman DOUGLAS. And a lower price for the Government?

Mr. TINSLEY. Yes, sir. As I say, taking into consideration quality per dollar the General Services Administration definitely does a superior job.

Chairman DOUGLAS. I want to thank you gentlemen. I think your testimony will have a great deal of influence. You have performed a public service coming here. I am sometimes critical of business trying to drive hard bargains with the Government. I am glad to commend all of you for taking a financial sacrifice in order to save money for the taxpayer. May your tribe increase.

(Whereupon, at 12:45 p.m., the hearing recessed, to reconvene at 2 p.m. the same day.)

## AFTERNOON SESSION

Chairman DOUGLAS. We are very happy to have with us today Mr. Perry Shoemaker, representing the Committee of the Hoover Commission, and also Mr. Upman, the executive secretary. Both of you gentlemen have taken a keen interest in the possibilities of economy and efficiency in the field of supply management, and Government competition with business. You have been of great help to us in the move to get greater economy and efficiency in the military sector. We are very happy to welcome you today.

Will you not proceed in your own way, Mr. Shoemaker?

**STATEMENT OF PERRY M. SHOEMAKER, VICE CHAIRMAN, ON BEHALF OF THE COMMITTEE OF HOOVER COMMISSION TASK FORCE MEMBERS; ACCOMPANIED BY FRANK UPMAN, JR., EXECUTIVE SECRETARY OF THE COMMITTEE OF HOOVER COMMISSION TASK FORCE MEMBERS**

Mr. SHOEMAKER. Thank you, Mr. Chairman.

Our Committee of Hoover Commission Task Force Members appreciates your invitation to give testimony at these hearings, and it is in my capacity as vice chairman that I appear before you today.

We had hoped to have two other greatly interested gentlemen with us. They send their respects and regrets to you, sir, Gen. Robert E. Wood and Lt. Gen. Willard S. Paul, both of whom were very active with the Second Hoover Commission, and who had hoped to be here today.

Also, just to keep the record straight with respect to my business affiliation, Mr. Chairman, when I appeared before you before, I was president of the Delaware, Lackawanna & Western Railroad. I am one of the railroad people who merged himself out of a job, and, after becoming chairman of the Erie Lackawanna Railroad a year ago, I resigned and became president of the Central Railroad of New Jersey.

Chairman DOUGLAS. We are glad that you are still a president, Mr. Shoemaker.

Mr. SHOEMAKER. Thank you, sir.

Based upon your letter of March 12, 1963, it is my understanding that these are followup hearings on those of January 1960, and are intended as a review of accomplishments, current obstacles to progress and a consideration of possible programs that may further reduce unnecessary impacts on the economy.

Therefore, before proceeding with our testimony, I should like, with your permission, to read a letter from the Honorable Herbert Hoover.

Mr. Chairman, you have received a personal letter from Mr. Charles R. Hook, who is the chairman of our committee, which further emphasizes the important work of this committee. With your permission, I can read it into the record.

Chairman DOUGLAS. I think it would save time if we simply had it printed in the record together with my letter to which you referred.

Mr. SHOEMAKER. I would appreciate it very much if you would, sir.

(The letters referred to follow :)

MARCH 12, 1963.

Mr. FRANK UPMAN,  
*Executive Secretary,*  
*Committee of Hoover Commission Task Force Members,*  
*Washington, D.C.*

DEAR MR. UPMAN: The Subcommittee on Defense Procurement of the Joint Economic Committee held hearings in January 1960 on the impact of defense procurement and related activities on the economy. A report dated October 1960 contained a number of recommendations intended to improve common supply and service management in the defense and civilian agencies of Government.

Recommendation No. 1 unequivocally urged the Secretary of Defense to use his broad authority, especially under the O'Mahoney and McCormack-Curtis amendments, to consolidate the many supply activities in the DOD into a common agency operating at the Office of the Secretary of Defense level.

This recommendation, which closely conforms to the Hoover Commission recommendations, has, as you know, been implemented by Secretary McNamara through the creation of the Defense Supply Agency (DSA).

Secretary McNamara has recently stated that the cost reduction programs now underway in the DOD will result in savings amounting to several billions of dollars annually when they are fully implemented in a few years.

It is my belief that this is an appropriate time to have a followup hearing based largely upon the report of October 1960. Inasmuch as your group furnished witnesses and gave valuable testimony at that time, you are invited to do so again. We are particularly anxious to have an objective review of accomplishments, current obstacles to progress, and a consideration of possible programs that may further reduce unnecessary impacts on the economy.

Your witness or witnesses are scheduled to testify at 2 p.m., April 1, in the Senate caucus room. Please advise if this date is acceptable and the name or names of those who will testify. One hundred copies of prepared statements should be filed with the committee, room G-133, New Senate Office Building, by March 29. Additional information may be obtained from Mr. Ray Ward, economic consultant to the subcommittee, on Capitol 4-3121, extension 5220, or room 502, George Washington Inn.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

NEW YORK, N.Y., *March 19, 1963.*

Mr. PERRY M. SHOEMAKER,  
*Jersey Central Lines,*  
*Jersey City, N.J.*

DEAR MR. SHOEMAKER: As you know, Secretary of Defense McNamara has reviewed some of the Hoover Commission's recommendations on reduction of expenses and greater efficiency and has adopted a substantial amount of them. His action is a great compliment to the Commission and to the committee of task force chairmen which has so devotedly followed it.

I am now informed that the Joint Economic Committee has scheduled further hearings late this month on "The Impact of Defense Supply and Related Activities on the National Economy."

The initial hearings of the Joint Economic Committee in January of 1960 were of material help in supporting and encouraging the substantial improvement in defense supply management which has since taken place.

The current hearings can be an important element of support to the action of the Department of Defense. Beyond this, the current hearings are important in urging other agencies of Government to cooperate in further actions of economy so vital to our economy as a whole.

An important segment of the studies and the recommendations of the Second Hoover Commission was the whole subject of Government competition with private taxpaying enterprises. In your testimony, I hope that you will call the attention of the Joint Economic Committee to the potentialities in his field.

Yours faithfully,

HERBERT HOOVER.

NAPLES, FLA., *March 22, 1963.*

Hon. PAUL H. DOUGLAS,  
*Chairman, Joint Economic Committee,*  
*Washington, D.C.*

DEAR CHAIRMAN DOUGLAS: I am pleased to learn from your letter of March 12, 1963, that followup hearings have been scheduled on "The Impact of Defense Procurement and Related Activities on the Economy."

The hearings held by your committee on this subject in 1960 brought into clear focus the continuing urgent need for the consolidation of the common use supply and service activities in the Department of Defense into a separate agency operating at the Office of the Secretary of Defense level. As you know, this was recommended by the Hoover Commission and its Committee on Business Organization of the Department of Defense, of which I was privileged to serve as Chairman. Without doubt, it was the Hoover Commission recommendation with the greatest saving potential.

Those hearings also definitely reestablished and reemphasized, as Speaker McCormack has often stated so well, that the McCormack-Curtis amendment to the Defense Reorganization Act of 1958 "removed any possible doubt as to the authority of the Secretary of Defense to integrate supply and service functions when it would be in the best interest of the Government" and "vests the Secretary of Defense with clear authority to deal positively in obtaining economy, efficiency, and effectiveness in these areas which use some 60 percent of the annual military budget."

In his establishment of the Defense Supply Agency, Secretary of Defense McNamara has, as your report so strongly urged, used the broad authority of the McCormack-Curtis amendment to consolidate the common use supply and service activities in the Department of Defense into a single agency operating at the Office of the Secretary of Defense level. In this he deserves great credit and strong support.

I am confident that had it not been for Secretary McNamara's cost reduction program, of which the Defense Supply Agency is a vital part, and the steps he has already taken, the Defense budget would have been far higher than \$52 billion for the fiscal year 1964.

The Hoover Commission Report on Business Organization of the Department of Defense was one within which reorganization and the application of sound principles of business management were closely intertwined. I am, therefore, delighted to note the remarks of Chairman Vinson of the House Armed Services Committee that "through the superb business management that is going on in the Department of Defense, there will be and there should be large savings \* \* \*"

Very cordially yours,

CHARLES R. HOOK, *Chairman.*

Mr. SHOEMAKER. As you know, Mr. Chairman, Gen. Robert E. Wood and I were privileged to represent this committee at your initial hearings in January 1960—that was the first overall review by a committee of this kind—with respect to the impact of defense procurement and related activities on the Nation's economy. At that time our testimony was primarily directed to the recommendations of the Second Hoover Commission calling for integrating the common supply and service activities of the military as a means of reducing expenditures, increasing efficiency, and thus lessening unnecessary impacts on the economy.

Prior to those hearings, some progress had been made by the Department of Defense in line with these recommendations of the Hoover Commission, but, as we then testified, it had been frustratingly slow and failed to effect real integration, and, further, that the authority of the Secretary of Defense to effect such integration was not being fully utilized. This obtained despite the fact that it had long been expressed as the intent of Congress and such authority—along with intent that it be fully utilized—actually written into law as early as the O'Mahoney-Douglas Amendment of 1952, in which you had such an important part, Mr. Chairman, and then more specifically

in the McCormack-Curtis amendment to the Defense Reorganization Act of 1958, with respect to which another member of the committee, Mr. Curtis, had such an important part.

Incidentally, Mr. Chairman, in connection with both of these items, I would like to compliment you for the particular recognition you gave Ray Ward at the opening of the session this morning. I have been in touch with the activities of Mr. Ward in this field since 1954. There is no more devoted public servant, more dedicated person to this than he is, and your commendations were particularly appropriate, sir.

Chairman DOUGLAS. They were only a fraction of what I should have said.

#### CONGRESSIONAL INTENT TO INTEGRATE MILITARY SUPPLY

Mr. SHOEMAKER. Clearly, the intent of Congress in this regard is nothing new. Ever since the passage of the National Security Act of 1947, there have been recurring and positive expressions by congressional committees that there should be integration of the military supply systems designed to meet without duplication the needs of the military departments.

This has been true not only of legislative committees but also the Appropriations Committee of both the House and the Senate. For example, the House Appropriations Committee cut procurement appropriations in the Department of Defense appropriation bill for fiscal 1961 by 3 percent. In its report accompanying the bill, under Title III: Procurement and Supply Management, the committee states:

Time and time again congressional committees and the General Accounting Office point out to the Department of Defense procedural errors and make recommendations for improvements in procurement and supply practices and activities.

Later, in the same section, the report said:

In recognition of the admitted waste of which all the foregoing cases are but representative samples, and in an effort to compel prompt remedial action, the committee recommends reduction of each procurement appropriation by 3 percent, a total decrease of \$400,473,000.

The Senate Appropriation Committee report of the same year had the following to say with reference to procurement and supply management:

The committee notes with grave concern the numerous and admitted examples of waste and duplication in Defense procurement which have been reported to this and other congressional committees. The audit reports of the General Accounting Office show that these are not isolated examples; rather they underscore the urgency of integrating the "supply systems and service activities" of the military departments as repeatedly expressed as the intent of Congress. Such integration is provided for in the O'Mahoney-Douglas amendment to the 1953 Defense Appropriation Act and the McCormack-Curtis amendment to the Department of Defense Reorganization Act of 1958.

While some progress has been made in this direction, it has been far from satisfactory. The committee calls upon the Department of Defense to take immediate and vigorous steps to integrate its procurement, supply, and service activities in order to provide maximum utilization of the defense dollar.

The 3-percent procurement appropriation cut was approved and thus, for the first time, the Congress reduced procurement appropriations in a defense budget for the stated purpose of urging the Department of Defense to bring about economies in procurement and supply management.

## SUBCOMMITTEE REPORT, 1960

Your own report issued subsequent to the hearings of January 1960, strongly urged the Secretary of Defense to use his broad authority especially under the O'Mahoney-Douglas and McCormack-Curtis amendments to consolidate the many common supply activities in the Department of Defense into a common agency operating at the Office of the Secretary of Defense level.

As of today the recommendations of your committee and of the Hoover Commission have received initial implementation by Secretary of Defense McNamara through the creation of a single Defense Supply Agency and other steps in his broad cost-reduction program.

## PRESIDENT TRUMAN'S REMARK

As former President Truman said in speaking of the Defense Supply Agency, "it is high time we got it."

While these programs have been underway only a little over 1 year, savings actually reflected in the defense budget for fiscal 1964 amount to approximately \$750 million. In addition, Secretary McNamara in testimony before the House Armed Services Committee, earlier this year, stated:

## POTENTIAL SAVINGS FROM DSA

Our goal for end fiscal 1965 is to initiate actions which will increase the rate of savings to over \$3.4 billion each year.

No less an authority than Chairman Carl Vinson of that committee said:

And I think he is going to do it.

At the same time and of equal, if not greater, importance is the assurance of greater efficiency and a military supply system that provides for central screening of requirements, responsible as well as responsive inventory control, along with simplified procurement practices without duplication in personnel or facilities.

## USE OF GSA

In this connection, we have been pleased to note Secretary McNamara's statement that the General Services Administration buys about \$770 million worth of common-use items per year for the Department of Defense and that he has directed that the services of GSA be used wherever that agency can do the job more efficiently than Defense can.

## MONUMENTAL PROGRESS

All of which represents monumental progress in an area wherein is spent 60 percent of the defense budget, and Secretary McNamara deserves the thanks and support of every one of us.

You will recall, Mr. Chairman, that you invited Mr. Maurice Stans, a former Director of the Budget, to appear before this committee.

(The letter follows:)<sup>1</sup>

MARCH 12, 1963.

Mr. MAURICE STANS,  
Los Angeles, Calif.

DEAR MR. STANS: The Subcommittee on Defense Procurement of the Joint Economic Committee will hold hearings on March 28, 29, and April 1, 1963, on the impact of defense procurement and related activities on the economy.



You will recall that the subcommittee previously held hearings on this subject and issued a report in October 1960 with respect thereto. Among other things the subcommittee recommended the establishment of an agency such as the Defense Supply Agency (DSA), more competitive bidding, closer relationships on military and civilian buying, etc.

We expect to have Secretary McNamara, the Comptroller General, the Director of the Budget, the Administrator of GSA, a representative from the Hoover Commission Task Forces, and others of similar caliber at the hearing. Because of your interest in and knowledge of the subject, the subcommittee extends to you an invitation to appear as a witness, if you desire, at 2 p.m. March 29 in room 457, Senate Office Building. We would particularly like your ideas on how cost reduction may be secured in the gamut of supply management activities in the military and civilian agencies and how unnecessary impacts on the economy may be prevented. Your views on an effective program on reduction or elimination of commercial- and industrial-type activities would be appreciated. Please advise at an early date if you will be able to accept this invitation. In case you are not able to appear personally and desire to submit a statement in lieu thereof, we will be pleased to have it.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

#### STANS UNABLE TO TESTIFY—STATEMENT

Mr. SHOEMAKER. He was in touch with us. He was just leaving the country. He expressed tremendous interest in the hearings which are being conducted, and suggested specifically that, with your permission, we read into the record four paragraphs from an article which he gave to the newspapers on the 12th of last August.

Mr. Stans said:

To his great credit, Defense Secretary McNamara, aided by able Assistant Secretary Tom Morris, has pursued this program aggressively since taking office.

Leapfrogging the single-manager concept for common-use commodities, he has now established a Defense Supply Agency and merged into it all of the functions performed by the single managers. To it he has also transferred responsibilities in disposing of surplus property and some other functions and has added more categories of goods to be centrally managed.

DSA will procure annually more than \$2.5 billion of supplies and materials and will manage a \$21 billion inventory of peacetime and military requirements. It will provide integrated control of 1.4 million items of the 3.8 million items in military supply. This can turn out to be a major step in holding down defense costs. But already the effort is threatened—

Mr. Stans stated.

And he ended his column with the remark:

That would be a tragedy. Secretary McNamara needs all of the encouragement and help and support we can give him.

Mr. Stans stated to us, Mr. Chairman, that the strength of that statement is doubly important today, as he sees and fears the possibility that this great effort will be undermined in some way before it becomes implemented to a successful conclusion.

Now, Mr. Chairman, with respect to the committee's consideration of possible programs that may further reduce unnecessary impacts on the economy:

First, while the single Defense Supply Agency under General McNamara, who, I think, incidentally is doing a very able job, now manages slightly under 1 million items of supply, and has programed in the next few months 300,000-odd more, there remains numerous others that should be brought under the single management of DSA. As a basis for this statement, there is, among others, the report of the Armed Forces Supply Support Center of September 1959, which showed that, of the approximately 3.4 million items then counted in

the military supply systems, at least 2.3 million were common-type items.

#### FEW COMMON SERVICES INTEGRATED

Insofar as common services are concerned, only a few of these have been brought under integrated management. They include communications, intelligence activities, and, in part, transportation. Many others, such as hospitals, medical services, financial management, disbursing, legal, construction, real property management, and engineering, just to mention a few, are readily subject to integrated management.

You will recall, Mr. Chairman, that in the proceedings of the Joint Economic Committee after its hearing in 1961, you had listed the potentialities in the field.<sup>24</sup>

If I am not mistaken, your letter to Secretary McNamara urged that they receive active consideration.

#### COMMERCIAL-INDUSTRIAL ACTIVITIES

Second, elimination of the commercial-industrial type operations of the Government would, without question, greatly reduce unnecessary impacts on the economy. Insofar as the Department of Defense is concerned, these activities are closely interwoven in the supply operations.

However, my remarks are directed not only to such activities of the military or any other single agency of Government, but, in the broader sense, to Government competition per se.

As Mr. Hoover points out in his letter, an important segment of the studies and recommendations of the Second Hoover Commission dealt with the subject of Government competition with private taxpaying enterprises. In fact, the law establishing the Second Commission specifically charged it with the responsibility of recommending methods for eliminating non-essential services, functions and activities which are competitive with private enterprise.

You, as members of the Joint Economic Committee, are familiar with the statement that taxes must be reduced so as to spur the private economy to greater production. What better way of stimulating the private economy to greater production is there than by getting the Government out of competition with private taxpaying enterprises? The benefits would be threefold in that it would reduce the cost of Government, broaden the tax base and stimulate the private economy to greater production.

Secretary McNamara's recent statement before the House Armed Services Committee some 2 months ago re terminating necessary operations is a concrete example of the threefold benefits.

Secretary McNamara stated:

To date, we have announced plans to close or reduce in scope 313 activities, of which 71 are located overseas and 242 in the United States. These actions, when completed, will release nearly 264,000 acres of land for nondefense use. The original acquisition cost of the land and the improvements was \$1.9 billion. Three important benefits result from these actions:

(i) There is a reduction in annual operation and maintenance costs. Savings reflected in the fiscal year 1964 budget for actions already announced are \$106 million.

(ii) Military personnel are released for other tasks. Through fiscal year 1964, over 11,000 military personnel will have been released for other essential assignments by base closure or reduction actions already announced. The mili-

<sup>24</sup> "Hearings, 1961," p. 58.

tary pay and allowance costs of these personnel are estimated at \$57 million. Thousands of additional military personnel will be released by similar actions for assignment to other tasks during the next 3 years.

Secretary McNamara went on to his point (iii) and said:

The facilities released are turned to productive uses. The Treasury benefits directly from the proceeds of sale. When private interests acquire the property, a tax revenue benefit accrues to local communities and States. When other Government agencies claim and use the property, it becomes unnecessary for them to request funds for new property acquisitions.

And he summarized his remarks at that time by saying:

Actions anticipated through the end of fiscal year 1963 should produce an annual saving of \$292 million when completed. Our goal is to initiate actions by end fiscal year 1965 which will increase the annual rate of savings to \$442 million.

And those, Mr. Chairman, I would understand to be recurring savings.

Chairman DOUGLAS. That is right.

Mr. SHOEMAKER. I believe this statement of Secretary McNamara underscores the fact that there are great potentialities in the field of Government competition.

In view of an annual budget in excess of \$98 billion, a current deficit already approaching \$9 billion and a national debt in excess of \$300 billion, can we afford less than maximum economy and efficiency in the conduct of the essential functions of Government? On the other hand, can we allow the Government to continue activities which are competitive with private enterprise?

#### ENDORSES M'NAMARA'S COST REDUCTION PROGRAM

Therefore, we strongly endorse the Secretary of Defense's cost reduction program, of which the Defense Supply Agency is a pivotal part. Further, we urge a forceful program to eliminate, in all agencies and departments of Government, those nonessential activities which are in competition with private enterprise.

In closing, may I commend the committee for its continuing recognition of the importance of these Government activities and their impact on the economy.

I would urge that it continue its objective surveillances of military supply management and that, so long as the Defense Supply Agency by its performance merits support and approbation, this committee give the encouragement which the results thus far so conclusively merit. And of even greater importance, this committee should continue to unequivocally support the integrity of the legislation of 1952 and 1958; namely, the O'Mahoney-Douglas amendments and the McCormack-Curtis amendments, which pieces of legislation are so vital to the Secretary's "right to manage."

And, even further, Mr. Chairman, the Joint Economic Committee can perform a great national service by stimulating the reexamination by all agencies of Government of every activity competitive with private business, by affirming reasonable guidelines of policy with respect thereto, and by carrying out a continuing policing action with respect to progress accomplished.

Chairman DOUGLAS. Thank you very much, Mr. Shoemaker. That is, characteristically, constructive testimony. You have been of great help to us throughout this battle. I want to thank you again.

## MILITARY COMMISSARIES

I would like to ask you if your committee gave some study of the question of commissaries in the military service?

Mr. SHOEMAKER. Indeed, we did, sir.

Chairman DOUGLAS. What was your conclusion?

Mr. SHOEMAKER. Mr. Chairman, at the time of the Commission's study, which included commissaries, on the one hand, and PX's, on the other, in 1954, there were in commissaries alone some 438 units worldwide, of which 199 were in the United States. There was a previous peak of some 239 commissaries, when the Harden committee went actively into this field ahead of the Second Hoover Commission and stimulated a reexamination so that at the time of the Hoover Commission study it was down to 199.

But with total sales of \$306 million in these commissaries, \$185 million of sales were in the United States back in 1954, and the commissaries in the United States alone had some 7,411 employees, of which 4,800 were military.

Now, we have had a number of discussions on this over the years with people at the Pentagon and with successive Directors of the Bureau of the Budget, and, yet, we have the situation today that there are some 260 commissaries in the United States.

We have sales in the aggregate of something over, or just under, I am not sure which, sir, a half billion dollars. We have here in the Washington area Cameron Station, the largest commissary in the world, and one of the largest supermarkets in the world, if I may say so; commissaries at Fort Myer and Walter Reed, which has two substations nearby, Fort McNair.

It seems to us that what is needed here is for the Appropriations Committee to be encouraged by this committee to take a hard look at the money which is released for the perpetuation of these elements that are in such close and immediate competition to business, when they are in our cities, when they are in the suburbs of our metropolitan areas.

They are not fulfilling the original purpose of commissaries. We recognize on the Commission, Mr. Chairman, that the use of commissaries has become almost a fringe benefit, and is so regarded by many military people.

We would say this:

That if it is a question of military pay, let us let military pay stand on its own feet. But let us not damage our private business enterprise by continuing these supermarkets adjacent to them.

Chairman DOUGLAS. It is not merely the damage to private industry, is it? It is also the fact that you lock up in nonmilitary tasks the equivalent of two regiments of troops, is that not true?

Mr. SHOEMAKER. Exactly true, sir.

Chairman DOUGLAS. Now, are these figures that you give for commissaries alone? If you add in PX's, that is an additional group, is that not true?

Mr. WARD. That is true.

Mr. SHOEMAKER. At the time of the Commission's study with respect to PX's, Mr. Chairman, there were approximately four times as many PX's worldwide as there were commissaries. They were already extending rapidly into the department store status, as contrasted with the convenience status for military people in isolated locations. I think the number in 1954 was about 2,600.

Chairman DOUGLAS. And do you have any estimate as to the number of military personnel?

Mr. SHOEMAKER. The military personnel in the PX's was substantially less, proportionately, than it was in the commissaries.

Chairman DOUGLAS. Less in total or less per store?

Mr. SHOEMAKER. Less in proportion. Let me see if we cannot find you the exact figures here.

In 1954—this brings it back to me a little—there were 19,780 civilian employees alone in the PX's, with a payroll of some \$48 million.

We could get no breakdown of the military personnel involved at that time, no meaningful breakdown.

Chairman DOUGLAS. Probably in the thousands, was it not; the number of military personnel was, in all probability, in the thousands?

Mr. SHOEMAKER. It would be my judgment that it was all of that, sir.

If I am not mistaken, you raised a question about this, Mr. Chairman, in the 1961 hearings.

Chairman DOUGLAS. I did then, and prior to that time, receive the most voluminous and bitter mail that I have ever received in my life. It was as though all of the Armed Forces had descended upon me, and it was said that I was trying to undermine the morale of the armed services; that I was trying to reduce the enlistments in the military forces; that I was breaking implicit contracts which had been made between the Government and the Armed Forces.

I received almost no letters of commendation.

I think I did receive 5 letters of commendation from grocery stores, but something like 2,000 letters of attack.

Mr. UPMAN. Maybe, Mr. Chairman, if the housewives and the private citizens had known about that, you would have received letters of commendation.

Chairman DOUGLAS. It is an illustration of some of the difficulties.

And, of course, the very able Congressman from Connecticut, who went into the question of the number of orderlies—I think he found it was how many—in the thousands I believe, whom he found performing duties of household servants.

Mr. SHOEMAKER. Mr. Chairman, neither this committee nor the Hoover Commission was antimilitary in the studies that it made. To the contrary, I think both the Commission and certainly this committee has emphasized, "Let's let military people work in military fields," and I think that makes a great deal of sense, sir.

Chairman DOUGLAS. Precisely. I would like to get an estimate as to what the percentage of savings is from the commissaries and the PX's and what these come to in annual amounts.

Let me say for the record I would be very glad to increase military pay by that amount, so that there would be no loss of income.

In the case of commissaries, I am convinced that the savings allowances are mostly effected by the officers rather than the enlisted men, who are single, not many who have families to feed.

You are still a continuing committee, are you not?

Mr. SHOEMAKER. Mr. Chairman, the Committee of the Hoover Commission Task Force Members is a continuing committee, supported by voluntary contributions. Only two paid members working on it are Mr. Upman and his secretary.

Chairman DOUGLAS. I would like to have Mr. Upman work with Mr. Ward to see if we can get an estimate as to the total volume of

savings to military personnel from commissaries and PX's and how distributed and what adjustment in the pay schedule would be needed to compensate for them, because we certainly could effect great combatant savings by transferring the thousands of men who are now grocery clerks and drugstore clerks into the combat units.

In my judgment if we could weed out the personnel that is performing nonmilitary functions we would have the equivalent of another Army division.

Mr. SHOEMAKER. Mr. Chairman, not only will Mr. Upman be glad to work with Mr. Ward on this, but Mr. Upman will have the benefit of the advice from the chairman of the committee, Mr. Charles Hook, who, while not well at the time, is exceedingly well informed on the subject of military pay, having been on two advisory groups with Secretaries of Defense on that very question. (See app. 5, p. 410.)

Chairman DOUGLAS. I think this would be fine, and this time I am going to ask you gentlemen to take the initiative before the public in advocating this proposal, because I have just begun to pull out from my body some of the poisoned arrows which were inserted there, and I think you ought to take your turn in stepping forward and becoming, in a sense, Sebastian for a moment.

Mr. SHOEMAKER. You do not think we ought to turn this over to the chamber of commerce, Mr. Chairman?

Chairman DOUGLAS. I would much prefer to have you do it.

There is some further material which we have received from the National Association of Businessmen, which will be included in the record.

I regret I have another very pressing appointment, and I must leave.

Mr. SHOEMAKER. Thank you very much.

Senator PROXMIRE. Mr. Curtis?

Representative CURTIS. I would like to add my commendation to the Hoover Commission group for the great help that they have provided over a period of years in getting on top of this very critical problem. I say this personally, because throughout the years they have provided the kind of help that is so necessary.

I was not here when we opened this morning, so I missed the tribute paid to our consultant, Mr. Ray Ward. I certainly want to add my expression of appreciation to him. He, indeed, has been a one-man Hoover Commission in this area, and, if I have ever seen a dedicated civil servant, it is Ray Ward.

I would also like to add my vote to that which you have expressed that neither your actions nor the actions of this committee have been in any sense antimilitary. Quite the contrary. I feel very deeply that what we have been trying to do is in the best interests of the military organization and its personnel, for whom I have the highest regard.

These differences of opinion of how we attain the best efficiencies can occur without this recrimination. I hope that everyone will remember that our objectives are the same.

I am sure those who disagree with me in the Military Establishment are quite as sincere in their efforts.

The other general statement I wanted to make is this: How basic to national policy and the present administration's policy is the projected savings that Secretary of Defense McNamara anticipates in this de-

fense area, savings up to, or approximating, \$4 billion a year? I will put this in context with a difference of opinion expressed between Dr. Arthur Burns and Secretary of the Treasury Dillon, when they were projecting the Federal deficits into the future while pursuing a policy of tax reform and tax reduction with increased expenditures.

Dr. Burns, testifying before this full committee, stated that he felt that under his projections the budget would not be balanced until 1972.

#### IMPACT OF DOD SAVINGS ON THE ECONOMY

Secretary Dillon, before the Ways and Means Committee, took exception to this estimate on the grounds that he felt Dr. Burns had overestimated the increases in Federal expenditures, and Dr. Burns' increases were predicated upon what have been the increases in the immediate past, from the \$81 billion of the last years of the outgoing administration to the \$98 or \$99 billion projected for fiscal 1964.

Secretary Dillon said, however, this will taper off around 1965 and 1966. The reason he has made those statements is on the assumption that these reforms Secretary McNamara is talking about will be carried through.

So those who adhere to the administration's theory, which, I must say, I do not for other reasons, certainly must give weight to the fact that it plays an important part in the fiscal policies of this administration, because, certainly, without this, I am sure Secretary Dillon would agree with Dr. Burns that 1972 is a more realistic figure for balancing the budget.

This is how important this area is in making basic economic policy, and we are talking about very sizable amounts.

I just have about two specific areas I want to examine with you.

One, in listing the various services, you refer to common services. The Commission fully contemplated that the McCormack-Curtis amendment did not include only supplies, but also a unification of common services; is that correct?

Mr. SHOEMAKER. Without any question, sir.

#### INTEGRATION OF COMMON SERVICES

Representative CURTIS. Yes, and I was pleased to see your noting some.

The thing that I still fail to understand is: Why, if it has proved so successful in some of these areas, are we not moving forward on a broader front? You mentioned hospitals, medical service, financial management, disbursement, legal, construction, real property, management, and engineering, and you said, "just to mention a few."

I think it might be well, if you would, to prepare for us an exhaustive list from your own standpoint. I can add to them.

We were talking this morning about weather and the Chaplains Corps. There are just so many. There have been lists made; have there not?

Mr. SHOEMAKER. Mr. Curtis, in connection with the June 12, 1961, progress hearings by this committee, following the testimony of Assistant Secretary Morris, there is on page 58 of the report or the transcript of that hearing at least a partial list of supply and service activities in the Department of Defense, which, I assume, represents—

Representative CURTIS (interrupting). Yes.

Mr. SHOEMAKER (continuing). Matters which the Defense Department concedes are susceptible to study, at least from the standpoint of being common service or supply.

Representative CURTIS. Thank you very much for calling that to my attention.

#### SUBCONTRACTING

I think we need to use this constantly as a checklist to see how far we are going, or whether we are moving fast at all. The other area, among others, that I am most anxious to get more definitive testimony about is in this field of subcontracting. We have talked in terms of the very fine advancement that has been made in increasing the techniques of advertised bids versus negotiated, but there is another big area in the encouragement of the prime contractor.

Frequently, you are the recipient of a negotiated bid to, in turn, use the techniques; when the prime contractor subcontracts, which he does a great deal of in most instances, he uses these similar techniques. I think there is a good record on this. The testimony to date indicates this, but this is an area, I think, where we could use some help from your group, possibly, again working with Mr. Ward, or whoever else can help us, to bring light on to this subject.

Would you agree that this is an important area, and maybe you might comment on the extent to which you have already looked into that?

Mr. SHOEMAKER. Mr. Curtis, the matter of subcontracting goes back down to some fundamentals. I think sometimes we get the forest mixed up with the trees on these things. What are we trying to do here? We are trying to get the lowest possible price, consistent with quality, on Government procurement.

I would like to start with the thesis that the first thing we need, and must have, are procurement officers of the highest quality and highest integrity. We have the same problem in business.

#### NEED FOR QUALIFIED SUPPLY PERSONNEL

We will get completely messed up on buying programs for business if we do not have good purchasing officers who know their business, and we cannot have good purchasing officers in the business field if we rotate them out of their jobs every 3 or 4 years.

Mr. Bonner referred to that in his discussion before this committee last week, (see p. 67) and it is particularly valid to get a continuity of experience in this purchasing field.

I heard some discussions of paint this morning and hand tools. Well, one of the big considerations, it seems to me, was not mentioned at all: namely, that when you concentrate the buying of a particular commodity in the hands of one organization, if you permit a continuity of personnel to take place, you develop experts in the buying of that particular item, men who have the experience, the feel, the knowledge to know how to handle themselves and get the best possible price.

Now, that is the kind of an individual that, independent of statute, independent of guidelines, is going to examine into subcontracting, can a subcontract give him a net lower price for an article, or a composite article.

What we are after is price control here, and the subcontracting, in itself, does not automatically give that, except as you project in the



subcontracting an extension of competitive purchase, which you cannot control in a complex, composite article, a weapons system, perhaps, handled by a prime contractor. But you can extend it into the subcontracting field, and I thoroughly believe it.

Representative CURTIS. You have responded in a way that gratifies me, because you have pointed to an area that we have not stressed until now: The importance of the adequately trained supply and procurement officers in the Military Establishment.

I happen to have a high regard for those who are there and who think that this is the emphasis. I was relating it essentially to our experiences that we have found in the use of advertised bids over negotiated, which Secretary McNamara has been able to document now, not only in savings, but also in the participation of small business in them.

We have found, I think, many horrible examples of improvident procurement in component parts, the purchase of component parts and the supplying thereof, which is the area where proper competitive bidding below the prime has definite direction. It was more in the nature of a study on this.

#### COMPETITIVE BIDDING ON COMPONENTS

I well recall, and I call attention again to the statement of Admiral Rickover, that in the procurement of the Polaris submarine—nothing could, I guess, be a more secret weapon than that—he had been able to procure way below the estimated costs. Furthermore, a sizable percentage of the procurement was done through advertised bidding, because they broke down this secret ship, into components, most of which—99 percent, I dare say—there was nothing secret about at all. Thus, through this kind of procurement technique, using the emphasis on competitive bidding they were enabled not only to come, you might say, way below the original cost estimates, but, also, they were able to get it done months ahead of their scheduled production time.

I have often thought the operation of Admiral Rickover would serve as a guide to how this could be done. So often, I have listened to military witnesses say, "Well, you cannot do anything about this because this missile," or whatever it is, "is a secret weapon."

But the components make it up.

Mr. SHOEMAKER. Mr. Curtis, the testimony of Secretary McNamara last week, which I had the opportunity of reading yesterday, is extremely encouraging in the recognition of this very thing. I think I would have gone, perhaps, further than he did in this way. I do not think small business, as such, gives us any insurance of quality or price or anything else. But it is the expansion of competition which has made the business system of this country. That is the important thing here.

Representative CURTIS. That is the important thing, and it is the techniques especially the advertised bid technique that provides that sort of thing. This is recognizing that there are certain areas where, because of their nature, bids are going to have to be negotiated. We know that. But there is an extent to which we can use competition—and I have been very gratified with the Secretary's point there.

The final point I want to make by way of observation is one that I made this morning, the picking up of small business. I never felt that small business needs a crutch, nor should we use defense procurement as a form of subsidy.

If these other proper procurement techniques are developed, that is all that small business needs to get into this picture.

#### AREAS FOR STUDY

This committee, I think, needs to get into three areas which do interfere with efficiency, as far as Government and military procurement are concerned.

One is the Small Business Administration Act, which sets up a subsidy basis.

The second is the depressed-area legislation.

And the third is "Buy American."

I think all three, if we fully analyzed them, would make us realize that they are not meeting their objective, while, at the same time, they are making this problem of efficient military procurement much more difficult and costly than it needs to be.

Anything that your Commission could do to affirm or disaffirm the thesis here would be helpful to this committee. This is one area that I think we have a responsibility to comment upon to the other committees of Congress.

Mr. SHOEMAKER. At this time, Mr. Curtis, I am not qualified to comment on the impact of the "Buy American" program on either military or nonmilitary procurement, for that matter.

I do not know to what extent it is a handicap with respect to quality and price.

I have heard loose statements on it, but I do not know the facts. I do know that the set-aside program on small business has been troublesome sometimes.

Representative CURTIS. I think all three of the areas need to be examined objectively. I think in all three instances we can again share a mutual concern: First, for small business; second, for depressed areas; and, third, for our American versus the foreign concerns.

We have a problem here of, one, maintaining a military procurement as efficiently as possible, and I do not think, even if these three approaches would solve the economic problems, it would be desirable to use military procurement as a technique for the subsidy. That is the first observation.

The second one, though, is an examination into the three theories themselves. Does the set-aside really help small business? I suspect it does not. I do not think a crutch helps anyone. Can small business be helped? Yes, by something that goes in the same direction; that is, good procurement practices in advertised bids, proper specifications, known procedures and publication of the information. Small business—and the record will show—receives a very heavy share. Secondly, in depressed areas, again, what techniques will help? I think the two can go in line.

The third area, on which there has been a lot of emphasis recently because of our balance-of-payments problem and gold flow, becomes very critical. I do not think there is any question that the military is important—in fact, in testimony by the Secretary of the Treasury, I can remember the figures. He said something to the effect that we were able to hold back the gold flow to about \$50 million because of the implementation of "Buy American," which was, frankly, out of the hide of the increased costs to the military to do it.

Now, if this is necessary, that is one thing; but if it is an erroneous economic theory in the first place, and it is an added burden to the military in this objective we are seeking, then it is doubly bad. That is why I posed the question to your group, because I think we could use some sound advice in this area.

Mr. SHOEMAKER. What you are saying, I think, Mr. Curtis, is that they are confusing the issue of good, clean, competent, military buying in a mixture of social objectives and economic objectives.

Representative CURTIS. That is right.

Mr. SHOEMAKER. Which may be perfectly good, but your point is that the committee should take a look at them?

Representative CURTIS. Yes.

Mr. SHOEMAKER. And I think that is particularly appropriate. We will be glad to help, sir.

Representative CURTIS. You have stated it better than I have. Thank you.

Senator PROXMIRE. Senator Miller?

Senator MILLER. Mr. Shoemaker, let me add my words of commendation to those of others on the work that you people have been doing.

Mr. SHOEMAKER. Thank you.

#### NAVY SHIPBUILDING PROGRAM

Senator MILLER. I would like to ask you, first, about the Navy shipbuilding program.

About a year ago there was considerable comment about the fact that there was a lot of in-house shipbuilding by using Navy facilities which private contractors would like to have had come to them. I believe that the solution ultimately arrived at last year was some kind of an arbitrarily set percentage.

Now, as I understand it, you would advocate getting the Government out of the shipbuilding business, if it could be handled appropriately, and certainly with no greater cost, and particularly if it could be handled with substantially less cost by private contractors. Is that correct?

Mr. SHOEMAKER. It is correct to a degree, Mr. Miller. Let me see if I can sharpen that just a bit.

The Commission did not take the position that all Government competition with business per se was wrong or bad. It acknowledged that there were areas of Government manufacture of goods or services for which there could be, and indeed was, good reason.

The Commission did urge that there be a realistic appraisal of these activities on the part of Government; that all elements of cost, the kind of costs that any businessman has to have as a part of the economics of his own enterprise, that those all be taken into consideration in appraising Government's justification or nonjustification for its activities.

Now, with respect to naval shipyards, that is one area where the Commission did not make a black-and-white recommendation. Frankly, we concluded that we did not know enough about it to make a complete yes-and-no recommendation.

What the Commission said in its first recommendation in its business enterprise report:

That the Congress provide for the appointment of a commission to study the effect on the private shipbuilding industry of the construction and repair of

naval vessels in Government shipyards. The Commission should make recommendations for the transfer, where advisable, of such construction and repair to private facilities and for the best disposition of the Government facilities. That this Commission include representatives of the Department of Defense and Commerce and of the private shipbuilding and repair industry, and that the majority of this Commission consist of independent citizens having no connection with either the Department of the Navy or the private shipbuilding and repair industry.

That recommendation was never acted upon by the Congress, and there continues to be this difference of opinion and belief as to where the naval shipyards should be in relation to the existence of private yards.

Senator MILLER. May I commend you for being as objective as you were in that recommendation and in your statement that you did not know enough about it to really make a specific recommendation.

However, I assume that there was enough research given to this area by the Commission to enable you to reach certain conclusions that this was an area of real interest in this matter of avoiding Government competition with private interests?

Mr. SHOEMAKER. Without any question, Mr. Miller.

Our studies indicated that the naval yards seemed to be involved with greater costs, greater labor costs per hour, at least as much, if not greater, fringe benefits, activities located on high and valuable property, the naval shipyard at New York being an example, and that there was a real question here as to where the needs of the Navy were with respect to the essential function of wartime vessel maintenance and building being protected without their own people.

Now the one question that came up again and again was: "Well, if the labor force is on the Navy's payroll, we have greater assurance of dependability of production free from labor strikes."

That is one of the things that we on the Commission could not answer, whether that was true or not. We doubted that it was. We felt that in time of emergency that the Government had, or could have, pretty strong powers with respect to our labor supply, as it has, in fact, indeed, exercised many times before. But we still felt that the Commission ought to look at all of the facts objectively and come up with some answers.

Senator MILLER. Of course, that answer that was given you, if carried to its logical conclusion, could result in having the Federal Government take over everything?

Mr. SHOEMAKER. Including railroad transportation, sir.

Senator MILLER. That is correct, so I agree with you that I do not believe that that is necessarily a responsive answer.

Let me ask you this: Do you have any reports that your committee or your Commission worked up in arriving at this general conclusion, any reports which would outline some of the areas of excessive costs or duplication, or at least would give an indication that this is an area which ought to very carefully be looked into?

Mr. SHOEMAKER. We have, indeed.

Senator MILLER. I wonder are they very voluminous, or do you have any summaries of those reports which we might, Mr. Chairman, put in the record at this point?

Mr. SHOEMAKER. Yes, Mr. Miller, the subcommittee's detailed report—this is the working report—and the Commission's own report, summarizing all of its activities in the business enterprise field. Both of those are widely available to the Congress.

Senator MILLER. May I say perhaps I did not make my question clear. I am referring to the shipbuilding area.

Mr. SHOEMAKER. The shipbuilding area is included in this data here, sir.

Senator MILLER. And May I ask, is that very lengthy, that portion of it?

Mr. SHOEMAKER. It is not.

Senator MILLER. I wonder if that could be included?

Senator PROXMIRE. Without objection, that will be included in the record at this point.

(The document referred to follows:)

#### NAVAL SHIPYARDS

The Department of Defense owns a total of 48 shipyards of which 38 are maintained in the Navy's departmental industrial reserve. The Navy itself operates 10 shipyards; 32 of those in the Industrial Reserve are leased to private parties, and 6 of them are inactive. These shipbuilding and ship repair facilities originally cost \$1,600 million. The 10 active shipyards are part of the Navy's basic industrial facilities. Their primary mission is to render services and logistical support to the active fleet. They engage in construction of new vessels and in ship repair and conversions.

The postwar tendency of the Navy to achieve self-sufficiency in this area is evident from the prewar and postwar employment levels in Government-owned and privately owned shipyards. During the 11 prewar years, 1930 through 1940, the Government employed 36 percent of all shipyard workers in the United States. During the post-World War II shipbuilding decline from 1947 through 1950, the Navy employed 44 percent of all shipyard workers. In October 1954 the Navy employed 105,900 persons or 51 percent of all the shipyard workers in this country.

One of the reasons for the intensive operation of the Government yards is that section 2 of the Vinson-Trammell Act of 1934, as amended, requires that " \* \* the first and each succeeding alternate vessel \* \* " of each type of ship specified and their replacements be built by the Government. However, the act authorizes the President to have such " \* \* vessel or vessels built in [either] a Government or private yard \* \* " if he thinks it would be "inconsistent with the public interest \* \* " to follow the alternate construction requirement.

While this requirement may have been necessary when it was enacted in 1934, the Subcommittee on Business Enterprises has found that the situation which it was designed to remedy has been reversed. Today private yards lack the construction and repair activity needed to maintain their capacity, skills, and military mobilization utility.

Due to the distressed conditions of the private shipbuilding industry and the serious competition engendered by Government shipyards, the private industry is weakened as a war reserve. Considering the idle capacity of private shipyards to construct and repair all types of naval vessels, the subcommittee considers that the Navy's operation of all these 10 shipyards represents a destructive intrusion into the private shipbuilding industry of this country.

#### *Recommendation No. 1<sup>1</sup>*

That the Congress provide for the appointment of a commission to study the effect on the private shipbuilding industry of the construction and repair of naval vessels in Government shipyards. The Commission should make recommendations for the transfer, where advisable, of such construction and repair to private facilities, and for the best disposition of the Government facilities; that this Commission include representatives of the Department of Defense and Commerce and of the private shipbuilding and repair industry; and that the majority of this Commission consist of independent citizens having no connection with either the Department of the Navy or the private shipbuilding and repair industry.<sup>2</sup>

Senator MILLER. I think it would be helpful to have that portion of the report inserted.

<sup>1</sup> Commissioner Bridges wants it known that he did not participate in this recommendation.

<sup>2</sup> For more extended discussion, see Report of Subcommittee on Business Enterprises of the Department of Defense.

## GOVERNMENT COMPETITION BILL

Now, may I say, Mr. Shoemaker, that several of us in the Senate are trying to implement your ideas in the form of S. 1093. I do not know whether you are familiar with this bill.

Mr. SHOEMAKER. I am familiar with it, and I applaud its purpose.

Senator MILLER. Thank you very much. That is something I wanted to have in the record. We hope that we will have favorable action on it, and the sooner the better.

One final question :

There seems to have been a great amount of attention given to various types of services to the exclusion of maintenance. I am sure that you recognize that the possibility of contractor maintenance still offers one of the great areas for getting the Government out of certain activities and giving more of it to private enterprise, assuming, of course, that this can be done with the appropriate assurance of availability and reliability necessary to national security.

## CONTRACTOR MAINTENANCE

Here, again, may I ask if you have a rather short portion of that report which delves into this subject of contractor maintenance?

Mr. SHOEMAKER. I am sorry to tell you that we do not in that field. We refer to it. We acknowledge the fact that General Services Administration was getting further and further into contracts in that field, and I think at the time of our study General Services had some 2,600 various contracts in all aspects of maintenance, building maintenance, vehicle maintenance, equipment maintenance, and so on.

We did not get into that side of it in the military.

Senator MILLER. Would it be your suggestion that this is another area where the probabilities of turning more of this activity over to private industry are substantial?

Mr. SHOEMAKER. Certainly with respect to civilian departments, there would be no question in my mind.

With respect to the military, I would want to know the facts of the situation. I do not know that it is one that we can generalize upon. Let us go back to the navy yard, for example. Private shipyards can do certainly the bulk, if not all, of Navy maintenance, but some place there comes a time when there should be some core of military personnel, be they civilian or otherwise, who can be taken to any part of the world and used for this kind of business.

With respect to the maintenance of airplane motors, for example, I would suspect that a great deal of it could be contracted out. The least we could do would be combine the maintenance for the three military services.

But some part of that work, I would think, without being a military man, would make sense to be kept in the Military Establishment for wartime necessities.

Senator MILLER. Thank you.

Mr. SHOEMAKER. Where the balance is, I just cannot say, sir; of course.

Senator MILLER. I am happy that you mentioned that matter of aircraft engines, because, if the information I have received is reliable, we have actually transported back to the United States from overseas aircraft engines for major overhaul, which overhaul could have been conducted overseas, but which, in fact, was cut off and designated for

the U.S. continental limits activity, notwithstanding the fact that this resulted in a considerably higher cost to the Air Force than it would have cost if it had been done overseas, even through the use of, or with the use of, counterpart funds available.

Now, do you have any comment on a situation like that, assuming that this information is correct?

Mr. SHOEMAKER. I think, first, Mr. Miller, that in our thinking on this, we need to make a distinction between military weaponry and other maintenance obligations of the Department of Defense.

Senator MILLER. May I say, before you answer, this is a matter of civilian activity in either case on military weapons. I am referring to the contractor maintenance by private enterprise overseas versus United States, on military weaponry. So in either case it would have been handled by private enterprise.

Mr. SHOEMAKER. What I was approaching, it makes no sense at all, from our point of view, to have military payroll people involved in shops for typewriters and vehicle maintenance and that sort of thing, as we found when we made our studies.

Now, with respect to the maintenance of equipment directly related to wartime capacities, such as airplane engines, there is no justification for saying that we can do it better at Akron or at San Francisco than we can do it near a military base in Germany, no basis whatsoever. It can be done in either case.

Now, where I am a little foggy as to precisely what is behind your question, because you referred to private enterprise here, do we want to put all of our maintenance of airplane engines belonging to the Department of Defense in the hands of private enterprise exclusively?

Senator MILLER. No.

Mr. SHOEMAKER. I do not think we do.

Senator MILLER. May I interrupt you to point out that that is not what I am driving at. I am driving at the situation where, in either case, private contractor maintenance is going to be conducted, and the sole question is: Will it be conducted overseas where the aircraft engines are in use, or will it be conducted back in the United States with the engines being transported back to the United States where private enterprise in the United States will conduct it?

Now, the reason for advocating it being done overseas by private contractors is because it will cost less.

Mr. SHOEMAKER. Of course.

Senator MILLER. And the difference, as I understand it, is very substantial.

Mr. SHOEMAKER. Particularly if the engines are flown back to this country.

Senator MILLER. That is correct.

And so I am asking you whether you have any comments on that area, whether the committee has gone into this problem of where will the private contractor maintenance be done.

Is it proper to do it in the United States as against overseas where the difference in cost is great, or are there other factors which have got to be taken into account, such as the employment situation, for one thing, although recognizing that, perhaps, certain employees could be transported overseas?

This is a problem that came up, and I think is continuing to provide additional costs of maintenance to our Military Establishment today.

Mr. SHOEMAKER. I do not think there is any question but that you are right. In response to your question, the Hoover Commission did not make any studies of that matter, and this is why.

We tried to meticulously stay out of the matter of military weaponry or anything related to it. Our studies related to common-use items, to common type of service activities. We felt we were not equipped to get into the shadings of military opinion as to it being militarily said we must have maintenance at point A or point B or point C.

The principles of what you enunciated are no different whatever as applied to airplane engines than they are to some of the common-use items that are in our report.

Senator MILLER. That is the point I wanted to make—That your Commission, in a situation such as I have described, would have no difficulty in evaluating it, because the decision has already been made by the military that the weapon, that is, a part of the weapon, will be maintained or will receive its maintenance by a civilian activity. That decision has already been made.

So the sole question is whether or not that should be conducted overseas where the equipment is, or whether it should be flown back to the United States and maintained in a private contractor establishment in the United States at a greatly increased cost. That is the question.

You say the Commission has made no such—

Mr. SHOEMAKER. There were no studies directly responsive to that phase of the matter, sir.

Senator MILLER. Would it be feasible for you to look into this?

Mr. SHOEMAKER. The Commission, itself, is out of existence, Mr. Miller.

Senator MILLER. Yes.

Mr. SHOEMAKER. And we have no staff that permit us to make such studies. I have stated a few minutes ago Mr. Upman and the secretary are the only people who still remain working for the committee.

I might say, in explanation to you, sir, that at the time that the Commission officially expired by statute, Mr. Hoover asked that the task force chairman and the membership of the committees who had worked on these various reports be kept together through this small organization to the end that we might be as helpful as possible to the members of the House and Senate committees who were studying these things, and, by the same token, be as helpful as possible to the executive department.

We have tried to do exactly that.

Perhaps I should say perhaps we have been a little tenacious in hoping that more of the Hoover Commission recommendations would be successfully implemented.

Senator MILLER. May I say I hope you continue that tenacity.

Thank you, Mr. Shoemaker.

Mr. SHOEMAKER. Thank you, Mr. Miller.

Senator PROXMIRE. I am distressed, as you said in your last remark, that you gentlemen are—that the Hoover Commission is no longer operating at full tilt. It seems a shame to me that you are not working on the same broad basis as before.

Mr. SHOEMAKER. Working, Senator Proxmire, not in the sense of new studies but in the sense of being helpful in securing implemen-



tation and the recommendations which flowed from the studies of the Commission.

Senator PROXMIRE. Well, we certainly need your work. There is no question but that we need this kind of independent, competent voice with the kind of authority and respect that the Hoover Commission can command.

Mr. SHOEMAKER. Perhaps the Congress will have a Third Hoover Commission some day.

Senator PROXMIRE. I certainly hope so.

#### SAVINGS POTENTIAL

I would like to ask, do you think on the basis of your studies that something in the order of \$2 to \$3 billion per year could have been saved in the areas of procurement and supply, say over the past 10 years, if we had had proper organization, proper centralization, and so forth? Do you think this is a reasonable estimate, or can we make an estimate?

Mr. SHOEMAKER. No, I do not, Mr. Proxmire. Those estimates—that kind of an estimate is reasonable as of right now. I agree with Secretary McNamara's estimates as being realistic. They are attainable. If anything, I think they are conservative.

Senator PROXMIRE. He has estimated what, three and a half?

Mr. SHOEMAKER. \$3.4 billion, I think, by 1965.

Now perhaps I am interpreting your question a little bit in the area of black and white in the sense that have we wasted that much money during the past 10 years during each year? In a sense we have, but let us recognize that the Federal catalog, insofar as the Defense Department was not ready, we had not gotten through the evolution of joint procurement with the services, coordinated procurement. We hadn't gotten to even the experiments with single managers until 1956.

Senator PROXMIRE. What you are telling us is that the Defense Department wasn't properly organized to save this money. It didn't have the various techniques and approaches, and so forth that it has now to save the money. I presume, then, that if they had had the techniques, say in 1952 and on, they could have saved perhaps \$2 to \$3 billion, in view of the fact that Secretary McNamara now says, as you say, \$3.4 billion can be saved in the future this way.

Mr. SHOEMAKER. Let me comment—

Senator PROXMIRE. The procurement here is certainly very substantial, particularly during the Korean war years.

Mr. SHOEMAKER. Certainly. But let us recognize that some of this improvement has been evolutionary. First steps have had to come first in the Defense Department and I give great credit to the evolutionary concepts of the last 10 years because there have been improvements in those times. They have been frustratingly slow and in part they have been slow because no previous Secretary of Defense has taken hold of this thing aggressively and said: "We are going ahead with this and do it right now."

#### BEGINNING OF CENTRALIZED MANAGEMENT IN 1952

Senator PROXMIRE. It is true we had a beginning of centralized management in 1952 and then we backed away from it for a while,

so it hasn't proceeded—it has only proceeded by fits and starts until just recently; isn't that correct?

Mr. SHOEMAKER. That is correct.

Senator PROXMIRE. Now, in the areas that you have referred to on page 58 of the 1961 hearing, procurement really would account for perhaps 80 percent of the dollar value, although these other areas are extremely important. Nevertheless the Secretary of Defense is already working in the biggest area by far, isn't that correct?

Mr. SHOEMAKER. I think, Mr. Proxmire, the first five items on that list pretty well go together—procurement, warehousing, distribution, the cataloging being kept right up to the minute and surplus disposal. Those all tie together.

Senator PROXMIRE. The Defense Department is already hard at work along the lines you propose.

Mr. SHOEMAKER. Yes, sir; that is correct.

Senator PROXMIRE. And this is the biggest and most significant part, not that these others can't result in savings, but this is where the payoff, the big payoff would be; is that right?

#### HOOVER COMMISSION AWARDED SUPPLY MANAGEMENT A KEY AREA

Mr. SHOEMAKER. The recommendations of the Commission in this area, Mr. Chairman, were by far the most significant recommendations of the Second Hoover Commission in any of its fields of study.

Senator PROXMIRE. Thank you very much.

Now, we have a bill before another committee, regarding set-asides on contract construction. An argument was made in a hearing we had last year on this bill and a very strong argument by contractors and labor unions and others that this set-aside provision is a cost to the taxpayer. The set-aside program as you know restricts some bidding to small business. Large business is not allowed to competitively bid.

Now, in your judgment, based on your experience, do you feel the set-aside program, in general, has resulted in greater cost to the taxpayer, leaving aside, for the moment, whether or not it is a good thing from the standpoint of small business or not, just from the standpoint of cost? Do you feel that it has increased costs significantly?

Mr. SHOEMAKER. In my judgment, it has been more expensive, and for just one reason, Mr. Chairman. Instead of intelligent competition, the set-aside program restricts competition, results in the small business group not having to sharpen their pencil against the larger business enterprises, and vice versa.

Senator PROXMIRE. Do you feel, then, that the—let me just go one step further. Do you feel that the set-aside program has been necessary in that it has permitted small business to continue or to grow or develop in a way in which it would not otherwise be able to continue and grow and develop?

That is, now I am asking the question from the small business standpoint rather than from the taxpayer's standpoint.

Mr. SHOEMAKER. I am not at all sure, Mr. Chairman, that I agree with the philosophy of this program. What is small business? Let us go back, relatively a few years, and look at any commercial type business in this country, whether it is automobiles or steel or washing machine manufacture or what have you. Our enterprise system started with small business.

Now, it has gradually grown. Sometimes it has grown too fast and sometimes grown irresponsible, and we have antitrust laws and that sort of thing. But this coming along at this day and age and saying that we have two classes of business, small business and big business, and big business is bad because it doesn't give small business a chance, therefore we are going to segregate a part of our procurement and give it to small business automatically, that, from my point of view, is disruptive of the principles of our competitive business systems. I don't think it helps competition, sir, and, from that standpoint, I think it is bad for our economy, because I believe in competition.

#### IMPACT OF SET-ASIDE PROGRAM

Senator PROXMIRE. On the basis of your studies, you feel—Mr. Upman may want to comment on this—you feel that there have been instances in which the set-aside program, by preventing larger business from bidding, from competing, has resulted in definite instances of a higher price to the Government than you would otherwise have had.

Mr. SHOEMAKER. Speaking for myself, I can't prove that, but—

Senator PROXMIRE. I am not asking any proof. Of course you can't prove it. Nobody can. It can't be proved. All I am asking is if you know of instances whether this is probably true. I think your argument is a very logical argument, but I am asking whether you have—whether you have seen instances where, in your judgment, this is probably the case. I am not asking you to adduce instances, because it is asking too much, of course.

Mr. SHOEMAKER. I think it is true.

Senator PROXMIRE. Do you want to comment?

Mr. UPMAN. I wouldn't comment in any way different from Mr. Shoemaker's observation, Mr. Chairman. However, before you close, I would like to comment on your first question, on the procurement percentage, and one factor that Congressman Curtis was talking to, with the chairman's permission.

Senator PROXMIRE. I would like to have you do that right now. That would be fine.

#### NEED FOR SERVICE INTEGRATION

Mr. UPMAN. When we were speaking of the procurement and the percentage against the others, and Mr. Shoemaker referred to the first five as being the most important to the Commission, I think we have to relate the actual procurement of items, of commodities, to the services that go in connection with them. In other words, by just procurement alone, even though a high percentage of the defense dollar is involved there, you would not get the full savings possible unless you got the service integration that related to that procurement and the service integration in some of these other areas to go along with it.

For example, warehousing is, we will say, a service in part, as it relates to the procurement. If you don't get the integration of your warehouse facilities, you don't get the full benefits.

Senator PROXMIRE. I got the impression, Mr. Shoemaker, that the first five categories we were making progress on. The Defense Department was not only aware of the necessity or the desirability of centralization but was making real advances in these regards.

Now, the second category was warehousing, the third was distribution, the fourth cataloging, and the fifth surplus disposal. You feel,

however, that the whole procurement process could be helped if centralization is achieved in many more of these categories that are listed here?

Mr. UPMAN. Without disagreeing at all that we are making—that there is definite progress that has been made in those first five, that much more progress and real further progress is dependent upon inclusion of other service areas.

Mr. Chairman, the other point that I had in mind, with your permission, relating back to the point that Congressman Curtis made, in speaking to the savings and in fact the importance of these in the face of the size of the budget, projected deficits, and proposed tax cuts, the importance of these management and organization changes which are affecting and can affect further savings in whatever figures they are, I would assume, Congressman, that you would also relate that to and mean it to apply to these other areas such as the commercial industrial activities which are possibly in competition with Government.

Representative CURTIS. Very much so.

#### AREA OF GOVERNMENT COMPETITION

Mr. UPMAN. Because from this morning, listening to the testimony of the Budget Bureau, and I noticed the extent that you tied that in, I am just a little fearful that on this broad area of Government competition, we are still somewhat in the stage that we were some years back on the integration of defense supply, the stage of considerable study but very little concrete or specific action. As the Budget Bureau witnesses pointed out, yes, you have such a large number. Their reports show up to 24,000 such activities in the Government. We know that many of those are infinitesimal and many of them would be under question as to whether they are really competition. Even if you take out the large number that they speak to, custodial services and others which you write out, you probably come down to just a few hundred; but in those remaining ones, those of size and importance, and what is involved in manpower, the loss of tax, and in the actual money expended or put in there as capital investment by the Government—if you aggressively pursue some of these, you get at real possibilities for savings.

Senator PROXMIRE. What is your estimate of the area of Government competition with business in terms of, well, any terms you want to offer, in terms of number of jobs, in terms of the value involved?

Mr. UPMAN. Well, might I answer that this way, sir. I think in terms of the number of jobs it runs into many thousands. Take the Budget Bureau figures there and—

Senator PROXMIRE. I am talking about the segment of Government competition that might be eliminated, not the overall area.

Mr. UPMAN. Well, my judgment, Mr. Chairman, would be that in the area of the activities that I think there is the largest percentage of profit for the Government, it might come down to a few hundred operations and activities, but that would include probably well over half of the capital investment that we estimate—we are only estimating—is involved in those. Maybe something in the neighborhood of \$10 billion, \$12 billion, or \$15 billion. I think also it would come down to well into the thousands in numbers of jobs. I think it might—

Senator PROXMIRE. Would you guess—

Mr. UPMAN. To the extent of 100,000 of those.

Senator PROXMIRE. 100,000?

Mr. UPMAN. 100,000 or more.

Senator PROXMIRE. Or more.

Mr. UPMAN. 100,000 or more. And I think the thing that is more important is the chance for a three fold benefit in the reduction of Government expenditures, both in personnel and in the cost involved in the operation of these facilities, the possible increase of the tax base by getting the Government out of these activities, and a prod in itself to the private economy.

Mr. SHOEMAKER. Mr. Chairman, if I may comment on that point, what I think we are all groping for here is how much meat is there in this thing?

Senator PROXMIRE. Right.

Mr. SHOEMAKER. Reasonably meat that we can get. In the 1960 study of the Bureau of the Budget, they identified in the civilian area agencies alone some 19,000 activities in which Government was in competition with business. It identified 2,900 in the Department of Defense. The 2,900 has not substantially changed from the time of the Commission's study, at which time there was a capital investment of some \$15 billion and some 600,000 people involved in these various activities. Some of them are pretty small, like drycleaning establishments. You get up into sawmills. You get up into tire recapping plants. And finally up into smelters and the TVA's fertilizer plants, and so forth. We get up into areas approaching big business as well as areas in the very small business field.

Now, part of the problem, it seems to me, is that whereas the Budget Bureau, as expressed this morning, says that the policing of this matter, that we have a directive out, and they have, the policing of this matter is essentially in the hands of department heads, the various elements of government, well that is fine if somebody will check them. If somebody will police it and coordinate it and, providing one thing more, and this comes to the new legislation to which you refer, Mr. Miller, which has been introduced, something that will define and formalize guidelines with respect to competition and with regard to the cost elements which the Government must take into consideration if they are going to objectively consider it. There are not adequate guidelines today. So when we leave this up to the departments and agencies and bureaus to decide as to whether their particular competitive operation should be continued under Government hands or put back in the hands of private business, bureaucracy, being such as it is, without any policing guidelines that have any teeth in them, I am not surprised that we have found very little so far.

#### NEED FOR GUIDELINES ON GOVERNMENT COMPETITION

Senator PROXMIRE. These guidelines are just immensely important. Without them it is hard to tell and I think one certainly very vital consideration in guidelines would be a showing that the Federal Government, all costs considered, can do it more cheaply, for less cost, which is true in some of the instances.

Mr. SHOEMAKER. Even if it is at the same cost.

Senator PROXMIRE. What is that?

Mr. SHOEMAKER. Even if it does not show an improvement in cost.

Senator PROXMIRE. Well, I think—

Mr. SHOEMAKER. Then we get into taxes.

Senator PROXMIRE. Dollar cost. At least there is an argument there. But it is not the only argument. I would concede our Government is too big as it is. We want to do all we can to keep it limited.

## UTILITY RATES FOR THE GOVERNMENT

I want to ask you just one more question. This deals with the possibility that there may be a tendency for the taxpayer to lose when we eliminate some of the functions of government. I am particularly concerned, for example, with the GSA staff which has the responsibility of representing the Government before quasi-judicial agencies in fighting for lower rates for the Government, in effect for the taxpayer, to pay. We have dollar-a-year men or experts from industry coming into government, very helpful, and they often make a vital and important contribution, but because they come in, say, in an area like the communications industry or transportation industry, they have their connections and their viewpoints and their bias and sometimes their real interests.

If we don't have the GSA working to defend the Government's interests and the taxpayers' interests, it seems to me there may well be a tendency for the Government to have to pay more for its services, utilities and so forth, than they should pay. I know that you are an expert in this field and I would like your comment on it.

## GSA'S AUTHORITY

Mr. SHOEMAKER. Mr. Chairman, I am glad to comment on that matter and to be responsive to your question, I think we have got to go back just a little.

GSA came into being as a result of an extensive study by the first Hoover Commission. It came into being because the Commission found and Congress concurred that there should be in the executive branch of the Government a housekeeping agency, if you will, one that could take on and bring together functions that were spread all over the agencies and bureaus and departments of Government.

The custody of Federal buildings, for example. The matter of services in connection with them.

Now, one of the many things that the first Commission found was that the matter of traffic management with respect to transportation, the matter of buying transportation, was spread all over Government with activities in the Department of Agriculture, in the State Department, and the Interior Department, in the Defense Department, of course, and as a result Public Law 152, which established GSA, set up responsibility, general responsibility for the buying of transportation.

At the time of our study in 1954 and 1955 when we particularly went into this field of activity on the part of GSA, we did not find that General Services Administration had in fact taken over the matter of professional traffic management for the commercial transportation which the Government was buying from all forms of transportation. But that, in effect, it had to too great a degree assumed merely advisory powers to the continuing traffic bureaus and staffs within each of the departments.

By Presidential edict an exception was made with respect to the Department of Defense. That carried on and still carries on its own traffic management.

Now, as you bring the buying of transportation or as you bring the buying of electric power or the buying of communications into someone's responsibility, you bring with it responsibility for knowing that the rate, the price you are paying, is reasonable or not.

There is the opportunity to negotiate rates with those selling the service. In most cases GSA has done a considerable amount of that.

It is a part of any traffic management responsibility. But then we get to the broader question of over and above the Government's position as a buyer or user of these services. The question of its being a public protector.

Now, GSA has in many instances assumed the responsibility of being a private protector as differentiated from having a confined interest in Government costs as such. That was not the concept of the establishment of General Services Administration. It encroaches upon the statutory responsibilities of the regulatory commissions.

Now, to that extent I think GSA has somewhat gotten out of its element. I don't think that was their purpose. I don't think it is their job today.

Senator PROXMIRE. Well, the law as I read it says that :

Contracts for public utility services may be made for periods not exceeding 10 years, and with respect to transportation and other public utility services for the use of executive agencies, GSA shall represent such agencies in negotiations with carriers and other public utilities in proceedings involving carriers or other public utilities before Federal and State regulatory bodies.

Maybe the law is wrong, but the law, it seems to me, is very explicit, is very clear.

Mr. SHOEMAKER. The intent of that law, Mr. Chairman, was with respect to the governmental use of these transportation or utility services, as the case may be.

Senator PROXMIRE. I see. Well, that is a little—

Mr. SHOEMAKER. There is that distinction.

Senator PROXMIRE. I appreciate your patience in answering and I just feel that the Government needs representation here. There is a distinct possibility of, not fraud, of course, but of bias on the part of the people in the communications industry in favor of the suppliers, private industry suppliers, compared with the interests of the taxpayer, and I would think that the GSA's independent action here could be helpful. But I think your answer is a thoughtful one.

Any more questions?

Mr. SHOEMAKER. Mr. Chairman, if you have completed your questioning, I would like to make one concluding remark, if I may.

Senator PROXMIRE. Yes, indeed.

#### NEED FOR CONTINUITY OF COMMITTEE WORK

Mr. SHOEMAKER. I have a great deal of respect for the responsibility of the Joint Economic Committee. I hear altogether too many comments that in this matter of defense, the committee is getting into fields that are none of its business, that we have the Armed Services Committees, we have the Appropriations Committees, and that is all we need.

I would like to emphasize to you, if I may, and if I am not out of order in so doing, that there is no other committee that looks at this problem on an overall countrywide, nationwide basis. The Armed Forces committees have great interest in military adequacy and the competence of our military people, the organization of the Department to produce military readiness. The Appropriations Committees have great responsibility with respect to the spending of money. But there is no other committee that goes into this on the overall basis of what is the impact of this whole picture on our economy as a whole, and I hope there will be a great continuity of the efforts of this committee with respect to policing the broad picture as you have ap-

proached it so far. I hope it will continue. Certainly in this matter of Government competition, progress is not going to continue unless there is a steady prod of someone who will police it and who will require explanations as to what we have or have not accomplished in that field.

You have involved in the background, as you know perhaps much better than I do, you have those who would undermine the Defense Supply Agency, those who would undermine, in fact, the authority of the Secretary of Defense as he now has it, particularly under the McCormack-Curtis amendment.

#### SUPPORT NEEDED FOR DSA

Now, we know that massive spending for military equipment brings problems and benefits to geographical areas of competitive supply. We know also that economic considerations are added and superimposed upon broad commercial and political pressures. None of these things are easy, but there is a temptation to confuse the attainment of several objectives with the already complex problems of military procurement. And if we back away from supporting DSA, and I would emphasize to you that DSA has only made a beginning, so far, if we put a fence around DSA and say that its million or million, two hundred thousand items are the extent of its capability and future responsibility, we will be defeating the purpose which we are trying to attain because the military department has twice that much in the way of items that are common and identifiable as common supply items.

And until we give DSA this entire responsibility and DSA has got to grow to the capability of assuming it, they have got to be supported in the meantime, but until we give it all, we are still going to have competing supply systems within the separate and independent segments of the Military Establishment.

So I think it is most important, Mr. Chairman, that this committee assume the continuing responsibility which it has done so much to implement so far to follow this matter, to know that the responsibility and opportunity of the Secretary of Defense to manage is not being undermined in these fields.

We have got some emotional things going on right now. Those things happen in our kind of government. Perhaps it is good that they do, from time to time. But we don't want to be thrown off our stride and into the picture that we should constrict or reduce the management responsibility of the Defense Department or any other department, for that matter. So I earnestly hope the committee will continue its work, sir.

Senator PROXMIRE. Thank you very much, Mr. Shoemaker. Your last remark—your testimony has been excellent and your last remark was mighty heartening to all of us on this committee, I am sure. We appreciate it a great deal.

Before the subcommittee adjourns, I ask unanimous consent to have the staff put appropriate materials in the record, and without objection, the subcommittee then stands adjourned.

Thank you very much.

Mr. SHOEMAKER. Thank you.

(Whereupon, at 3:55 o'clock p.m., the subcommittee adjourned.)



APPENDIXES

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APPENDIX I

REPORT TO  
THE CONGRESS OF THE UNITED STATES

STUDY OF  
FINANCIAL ADVANTAGES OF PURCHASING OVER LEASING  
OF  
ELECTRONIC DATA PROCESSING EQUIPMENT  
IN THE FEDERAL GOVERNMENT



BY  
THE COMPTROLLER GENERAL OF THE UNITED STATES  
MARCH 1963

GAO Wash., D. C.



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON 25

MAR 6 - 1963

B-115369

To the President of the Senate and the  
Speaker of the House of Representatives

Herewith for the information of the Congress is the report on our study of the relative financial advantages of purchasing over leasing of electronic data processing equipment in the Federal Government.

The Federal Government is a large user of data processing equipment in its operations, but most of the equipment is leased. Of a total of 1,006 electronic computers installed in the Government at June 30, 1962, 867, or 86 percent, were leased. Rental payments for the fiscal year 1962 on such equipment were about \$145 million. These statistics exclude equipment used in certain classified military, intelligence, and surveillance operations.

Our study shows that very substantial amounts of money could be saved if the Federal Government purchased more of its data processing equipment needs. The detailed cost comparisons of 16 different electronic machine models, which constituted the principal part of our study, indicate potential savings of about \$148 million over a 5-year period. These significant possible savings apply to only 523 of approximately 1,000 electronic data processing systems installed or planned for installation on a lease basis by June 30, 1963. For additional use of the 523 machines after 5 years, there would be further savings at the rate of over \$100 million annually.

We believe that, to fully realize savings of such magnitude, basic changes in the Government's overall management system will be necessary. Decisions as to the financial advantages of purchasing will have to be made from the standpoint of the Government as a whole, and not primarily from the standpoint of individual using agencies as has been the practice in the past. In addition, more attention needs to be given to obtaining more complete utilization of the equipment acquired. We believe that the only practicable way in which the kind of coordinated management can be practiced to achieve the possible financial savings cited is through the establishment of a small, highly placed central management office in the executive branch of the

Government. Accordingly, we are recommending to the President of the United States that he establish such an office in his organization.

The report also contains a general recommendation to the heads of all using departments and agencies that they arrange for a prompt and complete reappraisal of their current plans to lease data processing equipment and take such action as is possible to realize the financial savings that may be available from purchasing such equipment and fully utilizing it.

Copies of this report are being sent to the President of the United States, to the Director, Bureau of the Budget, and to the heads of all departments and agencies that use electronic data processing equipment.



Comptroller General  
of the United States

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APPENDIXES

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REPORT ON STUDY  
OF FINANCIAL ADVANTAGES OF PURCHASING OVER LEASING  
OF ELECTRONIC DATA PROCESSING EQUIPMENT  
IN THE FEDERAL GOVERNMENT

INTRODUCTION

In the period of a little over 10 years since the introduction of the first general-purpose electronic computer at the Bureau of the Census in the Department of Commerce, the use of electronic computing devices has expanded widely throughout the Federal Government. This equipment is being used in a great variety of Government operations and for many different purposes.

As of June 30, 1962, there were approximately 1,006 electronic computers<sup>1</sup> installed in Federal Government agencies. Of this total, 867, or 86 percent, were leased and only 139 had been purchased by the Government. Rental payments for the use of leased equipment were approximately \$145 million for the fiscal year 1962.

The General Accounting Office has made a study of the relative financial advantages of purchasing the electronic data processing (EDP) equipment used by the Federal Government over the practice of leasing such equipment. This study was prompted in the first instance by the Subcommittee on Census and Government Statistics of

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<sup>1</sup>Electronic data processing machines estimated to be installed in Federal Government operations, exclusive of those used for military tactical operations, intelligence, surveillance systems, and certain other military programs. The source of these statistics is the Inventory of Automatic Data Processing (ADP) Equipment in the Federal Government published by the Bureau of the Budget, August 1962.

the Committee on Post Office and Civil Service, House of Representatives, which conducted hearings in 1959 on the use of electronic data processing equipment in the Federal Government.

At that time, members of the Subcommittee raised a question as to the economic aspects of the apparently predominant practice in the Federal Government of leasing electronic data processing equipment rather than purchasing it. The suggestion was made that the General Accounting Office and the Bureau of the Budget inquire into this policy. Other congressional committees have also expressed interest in this problem.

Federal agency policies and practices in the procurement of EDP equipment were studied by both our Office and the Bureau of the Budget. On August 26, 1960, and November 8, 1961, our Office submitted to the Subcommittee two short reports on the results of these joint studies. The second of these reports transmitted a copy of Bureau of the Budget Circular No. A-54, which had been issued in October 1961 to prescribe policies on selection and acquisition of automatic data processing equipment to be observed by Federal agencies and contractors operating Government-owned facilities. These reports and the Circular A-54 summarize the principal factors requiring consideration in management decisions as to the method of acquiring ADP equipment and are accordingly included in this report as appendix I.

In the meantime, the General Accounting Office undertook a more comprehensive study of the relative financial advantages of the two basic methods of procuring the use of EDP equipment,

and the results of this extended work is the subject of this report.

General scope of study

The principal part of our additional study consisted of selecting 18 electronic data processing system models, which we consider to be generally representative, and computing the comparative costs over a 5-year period of use of such machines by leasing and by purchasing.

The factors considered in making these computations are described on pages 15 to 18, and the results of these computations are summarized in exhibits A, B, and C.

During this study, we also reviewed selected instances as to individual Federal agency action on price reductions announced by manufacturers for the purchase of data processing equipment.

SUMMARY OF CONCLUSIONS AND RECOMMENDATION

The cost comparisons made in our study demonstrate that very substantial amounts of money can be saved by the Federal Government in the years to come if, in acquiring the use of needed data processing equipment, proper cost comparisons are made in advance, action is taken to purchase equipment when such comparisons indicate the financial advantage of such action, and effective procedures exist to obtain the fullest, practicable utilization of such equipment by Government agencies.

The cost comparisons with respect to 16 of the 18 machine models studied during our review indicate potential savings of approximately \$148 million over a 5-year period (see exhibit A). The



16 different electronic machine models used for our study represent 523 of the approximately 1,000 electronic data processing systems installed or planned for installation on a lease basis by June 30, 1963. For additional use of the 523 machines after 5 years, there would be further savings at the rate of over \$100 million annually.

The general conclusions which we have reached on the basis of our study are as follows:

1. If possible and substantial savings are to be fully realized, management decisions as to whether data processing equipment should be purchased or leased should be made from the standpoint of advantage to the Government as a whole and not from the standpoint of the individual using agencies.
2. Because of the substantial savings that may be available, all decisions to acquire the use of data processing equipment should be supported by specific computations showing the comparative costs of acquiring by lease and by purchase.
3. Where purchasing is financially advantageous, the realizable savings increase in proportion with the increase in utilization of the machines.
4. The savings possible through purchasing are more pronounced for the larger and more complex machine systems.
5. While significant savings may be realizable in many instances through purchasing rather than leasing, for some types of electromechanical equipment, it is more advantageous financially to lease rather than to purchase.

With the present system of decentralized management in the Federal Government under which each agency makes its own decisions as to whether the use of data processing equipment should be acquired by lease or by purchase, there is no effective coordinating machinery at work to give consideration to these alternatives from the standpoint of benefit to the Government as a whole. Because of

the very substantial financial savings that can be realized through more extensive purchasing of such equipment and the related need for directing and coordinating its utilization throughout the Government, we are recommending to the President of the United States that a central management office suitably empowered to perform these functions be established in his organization. We are convinced that the establishment of such an office is the only practicable way to provide the kind of management that will make possible the realization of savings of hundreds of millions of dollars in the years to come.

EXPANDING USE OF ELECTRONIC DATA PROCESSING SYSTEMS  
IN THE FEDERAL GOVERNMENT

In our report to the Congress on "Review of Automatic Data Processing Developments in the Federal Government" (B-115369, December 30, 1960), we stated that there had been a continuous, upward trend in both the quantity and complexity of electronic data processing equipment being used in Government operations. This trend continues. New areas of computer use are being pioneered in such fields as automatic retrieval of information and in communication systems where electronic computers seem destined to play an increasing role. Also, the application of many new scientific management techniques depends on computers to process the enormous number of calculations that are required to carry out such advanced techniques.

Evolution of equipment

During fiscal year 1960, Federal agencies began receiving deliveries of the more advanced solid-state equipment. This new equipment was brought about through the development of the transistor and other solid-state devices which are used in place of the vacuum tube found in earlier computer models. Transistors are but a fraction of the size of vacuum tubes, require less power, generate less heat, and are generally more reliable. The diminutive size of transistors has led to miniaturization of circuitry so that whole circuits can be placed on small card forms. In contrast to the vacuum tube systems, the solid-state systems are more compact, require less floor space and reinforced flooring, require less special power and air-conditioning facilities, are more easily

maintained, and operate at faster speeds and with greater versatility. Today, suppliers offer a broad range of solid-state equipment that can be applied to many operations throughout Government, as well as business and industry.

Number of systems in use or planned

For the past several years, the Bureau of the Budget has published an inventory report setting forth statistics on the Federal Government's use of automatic data processing equipment. These reports are based on data submitted by all Federal agencies. They exclude information on data processing systems used for military tactical operations, intelligence, surveillance systems, and certain other military programs.

Statistics on electronic systems set forth in these reports show:

<u>At June 30</u>	<u>Number of systems</u>	<u>Number leased</u>	<u>Number purchased</u>	<u>Percent purchased</u>
1960 (actual)	531	433	98	18.5
1961 (actual)	730	613	117	16
1962 (estimated)	1,006	867	139	13.8
1963 (projected)	1,169	1,006	163	13.9

THE PRACTICE OF LEASING

The Federal Government's practice of leasing data processing equipment originated prior to the development of electronic computers, at a time when mechanized data processing systems consisted primarily of electric accounting machines (EAM). Most of these machines were supplied by the International Business Machines Corporation (IBM), whose policy was to lease rather than to sell this

type of equipment. In view of this policy, as well as certain conditions considered to be of a monopolistic nature, the Attorney General of the United States, on January 21, 1952, entered a complaint against this company in the District Court of the United States for the Southern District of New York, charging violations of sections 1 and 2 of the "act to protect trade and commerce against unlawful restraints and monopolies" (commonly known as the Sherman Anti-Trust Act).

Final judgment was filed and entered in a consent decree 4 years later on January 25, 1956, by which time IBM was also manufacturing electronic data processing equipment. Among other provisions, the judgment provided that IBM offer data processing equipment for sale as well as for lease. In accordance with this decree, IBM has since offered its equipment for lease or for sale.

This change in policy did not have any immediate effect on the practice of Government agencies of leasing this kind of equipment, and it has not subsequently had any material effect on the practice. For example, at the present time, more than 7 years after the equipment was offered for sale, most EAM equipment manufactured by IBM is leased and, of the 670 EDP machines manufactured by IBM and reported to be on hand at the close of fiscal year 1962, only 37, or 6 percent, had been purchased.

In addition to the International Business Machines Corporation, about 20 other manufacturers supply the Government with electronic data processing equipment. All of these manufacturers offer equipment on a purchase as well as on a lease basis. The following

tabulation lists the manufacturers furnishing such equipment to the Federal Government as of June 30, 1962, and shows the total number of systems in use, the number leased and purchased, and the percentage the purchased systems bear to the total number of systems. This information is summarized from the Inventory of Automatic Data Processing Equipment in the Federal Government, published by the Bureau of the Budget, August 1962.

Manufacturer	Total number of systems	Number leased	Number purchased	Percentage purchased
Advanced Scientific Instruments, Incorporated	1	-	1	100
Bendix Computer Division, Bendix Corporation	36	26	10	28
Burroughs Corporation	37	23	14	38
Control Data Corporation	28	20	8	29
Alvac Computer Division, El-Tronics, Incorporated	7	-	7	100
General Electric Corporation	6	6	-	-
General Mills	1	-	1	100
Librascope Division, General Precision, Incorporated	4	1	3	75
Minneapolis-Honeywell Regulator Company	9	9	-	-
International Business Machines Corporation	670	633	37	6
Monroe Calculating Machine Company	2	2	-	-
Autonetics Division, North American Aviation, Incorporated	24	12	12	50
The National Cash Register Company	11	9	2	18
Packard Bell Electronics Corporation	5	4	1	20
Philco Corporation	6	6	-	-
Radio Corporation of America	42	40	2	5
Univac, Division of Sperry Rand Corporation	64	48	16	25
Royal McBee Corporation	37	27	10	27
Sylvania Electric Products, Incorporated	1	1	-	-
Others (note a)	15	-	15	100
Total	1,006	867	139	13.8

\*Manufacturers that furnish computer systems built specifically for a particular application. Generally, they are not easily adapted to other applications.

### Increased use of electronic data processing systems

The following tabulation shows as of the close of fiscal year 1962 the number of computer systems used by each department or agency, the number leased, the number purchased, and the percentage those purchased bear to the total.

<u>Department or agency</u>	<u>Number of computer systems</u>	<u>Number leased</u>	<u>Number purchased</u>	<u>Percentage purchased</u>
Department of Defense:				
Office of the Secretary	27	26	1	4
Department of the Air Force	263	244	19	7
Department of the Army	158	133	25	16
Department of the Navy	<u>178</u>	<u>151</u>	<u>27</u>	<u>15</u>
Total	626	554	72	12
Atomic Energy Commission	112	72	40	36
National Aeronautics and Space Administration	83	76	7	8
Department of the Treasury	34	34	-	-
Department of Commerce	29	20	9	31
Department of Health, Education, and Welfare	28	28	-	-
Department of Agriculture	15	13	2	13
Federal Aviation Agency	15	12	3	20
Post Office Department	13	13	-	-
General Services Administration	10	10	-	-
Veterans Administration	9	8	1	11
Department of the Interior	8	6	2	25
All others	<u>24</u>	<u>21</u>	<u>3</u>	<u>13</u>
Total	<u>1,006</u>	<u>867</u>	<u>139</u>	<u>13.8</u>

Bureau of the Budget Circular No. A-54

After studying the various factors affecting lease-purchase decisions, the Bureau of the Budget issued Circular No. A-54, in October 1961, prescribing policies to be observed by Federal agencies in acquiring ADP equipment. This Circular requires that agencies use a 6-year factor in ascertaining which method is most favorable from the standpoint of expenditures. In other words, if rental charges over a 6-year period exceed purchase and related

maintenance costs, the decision to purchase should be made. Normally, most systems would be purchased under this policy. However, the application of the policy is dependent upon the user's having a continued need for the particular equipment throughout the 6-year period. If a user anticipates changes in data processing requirements which might necessitate equipment changes prior to the expiration of the amortization period, he need not purchase.

As indicated by the statistics on computers in use or planned (see p. 7), the Bureau's Circular has apparently had little effect so far on lease-purchase decisions by individual agencies.



LIMITED PERSPECTIVE USED IN DETERMINING THE USEFULNESS  
OF DATA PROCESSING EQUIPMENT TO THE GOVERNMENT

With more than 1,000 systems now in use (exclusive of certain military tactical, intelligence, and surveillance systems), the Federal Government is the world's largest user of electronic data processing equipment. For the most part, the equipment is general purpose in nature, that is, it can be used to perform numerous different kinds of tasks once programed to do so. Because of the wide variety of Government equipment needs, most equipment installed can be considered to be useful to the extent that, if purchased and no longer needed for its originally intended purpose, it can be placed in use for other purposes in other activities.

Government applications range from critical scientific and defense operations to many less demanding administrative functions. In making lease versus purchase determinations, each Federal agency considers only the various factors involved from its own standpoint, and this practice has had much to do with the fact that 86 percent of the systems now in use are leased. If, however, the usefulness of equipment is considered from the standpoint of advantage to the Government as a whole, including consideration of use for subsequent or less demanding tasks as well as for the primary or originally intended purposes, the economic advantage of purchasing becomes more evident. Had this viewpoint been used in making lease versus purchase decisions in the past and if an effective procedure had existed for transferring equipment within the Government, the fears of a loss of flexibility through purchasing,

which has to some extent influenced individual agency decisions to lease, should have been overcome.

In some cases, because of defense or other critical national needs, it is necessary to use the latest models of equipment. However, most EDP equipment is general purpose in nature and it could fulfill data processing needs in less demanding areas for a number of years after it has outlived its usefulness for the original task.

#### Economic obsolescence versus technological obsolescence

Development of new equipment has been so rapid that much electronic equipment is technologically surpassed by more advanced models by the time it is installed. However, from an economic point of view, considering overall Government needs, most equipment can be considered as having a useful life of at least 5 years. The physical life of such equipment may extend well beyond a 5-year period after which maintenance and upkeep charges become the main cost factors to be considered. If the originally installed equipment can be productively and satisfactorily used at a lower cost than newly developed equipment, it would seem that, unless timeliness of data processing or some other feature becomes the overriding factor, the older equipment should be retained in use until the cost advantage favors conversion to the technically superior equipment.

#### DETAILED COST COMPARISONS

During our study, we selected 18 electronic data processing models and determined for each component the costs of leasing,

purchasing, and maintenance and the interest applicable to these costs. For each component, we then compared the total cost of rental over a 5-year period with the cost of outright purchase plus the cost of maintenance. All comparisons were made for one-, two-, and three-shift operations. These comparisons are summarized in exhibit B and are set forth in detail for each machine system in exhibit C.

A condensed summary of the results of these comparisons is shown below.

Manufacturer	System identification	Savings or losses (-) from purchasing instead of leasing		
		One shift (176 hours)	Two shift (352 hours)	Three shift (528 hours)
International Business Machines Corporation	7090	\$644,000	\$2,184,000	\$3,724,000
Philco Corporation	2000	-143,000	1,181,000	2,505,000
International Business Machines Corporation	7080	333,000	1,397,000	2,461,000
Control Data Corporation	1604 <sup>a</sup>	923,000	1,830,000	2,737,000
Minneapolis-Honeywell Regulator Company	800	112,000	673,000	1,233,000
Burroughs Corporation	5000	315,000	886,000	1,456,000
Univac, Division of Sperry Rand Corporation	UNIVAC-III	-15,000	276,000	566,000
International Business Machines Corporation	7070	70,000	432,000	795,000
The National Cash Register Company	315	38,000	83,000	143,000
International Business Machines Corporation	1410	67,000	323,000	579,000
Univac, Division of Sperry Rand Corporation	UNIVAC SS-90	-21,000	149,000	335,000
Minneapolis-Honeywell Regulator Company	400	23,000	171,000	318,000
International Business Machines Corporation	1401 <sup>a</sup>	27,000	158,000	288,000
International Business Machines Corporation	1401 <sup>b</sup>	7,000	137,000	267,000
International Business Machines Corporation	1401 <sup>c</sup>	-11,000	41,000	94,000
Control Data Corporation	160A	24,000	75,000	127,000
		(200 hours)	(484 hours)	(612 hours)
Radio Corporation of America	501	80,000	42,000	45,000
Radio Corporation of America	301	26,000	18,000	21,000

<sup>a</sup>Card and tape system operated as off-line equipment to a larger system.

<sup>b</sup>Card and tape system.

<sup>c</sup>Card system.

Factors considered in making cost comparisons

The factors considered in our computations were:

Time period:	5 years.
Lease:	Rentals and interest on rentals.
Purchase:	Purchase price, interest on purchase price, maintenance costs, and interest on maintenance costs.

These factors are described more fully in the following sections. Other costs related to the acquisition and use of data processing systems, such as transportation, site preparation, and training costs, are identical under either lease or purchase arrangements and consequently for comparison purposes can be excluded.

Five-year period

Federal Government experience with electronic data processing devices over the past 12 years has shown that with proper maintenance this type of equipment has a useful life span of at least 5 to 10 years. Some of the machines installed in Federal agencies in the early and mid-1950's are still in service. Generally speaking, the older machines that are still in use are those which were purchased outright by the Government. Also, despite the rapid changes that have taken place in equipment design, a large number of machines that were rented were used for periods of 5 years or more before being replaced by more modern equipment.

It is generally agreed that the new "second generation" solid-state machines will have a considerably longer useful life than the "first generation" vacuum tube type of machines. The question of economic obsolescence versus technological obsolescence

related to the useful life of electronic equipment is discussed briefly on page 13.

We selected 5 years as being a conservative estimate of the economic useful life of electronic data processing machines for purposes of making comparisons of lease costs with purchase costs. It should be noted that to the extent that this period is less than the actual useful life of the equipment, the computed savings are understated.

#### Rentals

Each year since fiscal year 1958, the General Services Administration on behalf of the Federal Government has entered into contracts with equipment suppliers for the rental of EDP equipment. In fiscal year 1962, 17 rental contracts were in effect. Through January 15, 1963, 16 contracts had been written covering fiscal year 1963.

Basically these contracts are concerned with rental rates and the terms and conditions that bear upon the application of these rates. The rates are established by the supplier and are the same as those charged commercial users of this equipment. These rates are accepted by the General Services Administration for use throughout the Government without further negotiation. The terms and conditions, however, are negotiated. The rental rates appearing in these contracts for use of equipment are the rates used in our computations.

Purchase price

For fiscal year 1962, for the first time, two of these contracts contained purchase and maintenance sections as well as sections on rental arrangements. In fiscal year 1963, 14 contracts containing purchase sections and 13 containing maintenance sections had been written through January 15, 1963. As in the case of rental prices, purchase prices are set by the suppliers and are not further negotiated by the General Services Administration. Terms and conditions relating to purchasing are, however, negotiated.

Where purchase contracts had been established, the contract prices were used in our computations. In those cases where no purchase contract was in effect, purchase price information was obtained directly from the supplier.

Purchase price data used in our computations relate to new equipment. Most installed equipment is offered for sale to users at reduced prices, usually depending on the length of time that the equipment has been installed. On the other hand, in almost all cases, rental prices do not decrease with the aging of the equipment. To the extent that used equipment was included in our determinations of projected savings, the cost of purchasing is overstated and estimated savings from purchasing are understated.

Maintenance costs

As mentioned previously, contracts providing for the maintenance of purchased equipment have been written with equipment suppliers for fiscal years 1962 and 1963. For these contracts, as for

the rental and purchase contracts, rates proposed by the suppliers are accepted and the terms and conditions are negotiated.

#### Interest

It is our position that interest is a cost which is related to all Government expenditures. In our calculations of applicable interest costs, we used the average rate of marketable obligations of the outstanding public debt as of December 31, 1961 (3.146 percent).

#### Significance of computed savings on individual systems

As indicated in the condensed summary on page 14, 14 of the 18 systems compared for the 5-year base period show a purchase advantage on a one-shift basis. All 18 systems show a purchase advantage on a two- and three-shift basis. These comparisons show clearly that purchase, rather than lease, of electronic data processing equipment can result in substantial savings. Some widely used models of electronic data processing equipment offer the greatest purchase advantages.

For example, the purchase of a representative IBM 7090 system could result in savings of \$644,000 if operated on a one-shift basis, \$2,184,000 if operated on a full two-shift basis, and \$3,724,000 if operated on a three-shift basis. Continued use of the system past the 5-year period would produce additional savings of from \$772,000 to \$1,512,000 annually depending upon the extent of use. (These additional savings are measured by equipment rentals not paid less estimated maintenance costs.)

According to the Inventory of Automatic Data Processing Equipment in the Federal Government, issued by the Bureau of the Budget in August 1962, there will be 42 IBM 7090 and 7094 systems in use by June 1963. Of these, six are to be purchased and 36 are to be leased. To illustrate the magnitude of savings available through purchasing, the following tabulation projects the estimated amount of savings that could be realized over a 5-year period for the 36 systems if they were purchased rather than leased and the estimated amount of annual savings for each year of continued use beyond the initial 5 years. These projected savings are based on the computed savings applicable to the representative IBM 7090 system shown in Exhibit C and on the planned use per month as reported by the respective agencies to the Bureau of the Budget.



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ESTIMATED SAVINGS AVAILABLE TO THE GOVERNMENT  
THROUGH PURCHASING 36 IBM 7090 AND 7094 SYSTEMS  
SCHEDULED TO BE LEASED BY JUNE 30, 1963

Agency	Location	Hours	Shift equiv- alent	Estimated	Estimated
				savings over 5-year period available through purchase	annual savings after initial 5-year period
Atomic Energy Commission	Albuquerque, N. Mex.	300	1-3/4	\$ 1,799,000	\$ 994,000
do.	New York, N.Y.	176	1	644,000	772,000
do.	New York, N.Y.	350	2	2,184,000	1,068,000
do.	San Francisco, Calif.	616	3-1/2	4,494,000	1,512,000
do.	San Francisco, Calif.	616	3-1/2	4,494,000	1,512,000
Department of Commerce	Washington, D.C.	200	1-1/4	1,029,000	846,000
do.	Washington, D.C.	176	1	644,000	772,000
do.	Denver, Colo.	176	1	644,000	772,000
do.	Washington, D.C.	480	2-3/4	3,339,000	1,290,000
do.	Washington, D.C.	200	1-1/4	1,029,000	846,000
Department of the Air Force	Dayton, Ohio	210	1-1/4	1,029,000	846,000
do.	Dayton, Ohio	354	2	2,184,000	1,068,000
do.	Pt. Walton, Fla.	176	1	644,000	772,000
do.	Washington, D.C.	450	2-1/2	2,954,000	1,216,000
do.	Washington, D.C.	215	1-1/4	1,029,000	846,000
do.	Omaha, Nebr.	340	2	2,184,000	1,068,000
do.	Omaha, Nebr.	176	1	644,000	772,000
Department of the Army	Washington, D.C.	125	1	644,000	772,000
do.	Huntsville, Ala.	260	1-1/2	1,414,000	920,000
do.	White Sands, N. Mex.	264	1-1/2	1,414,000	920,000
Department of the Navy	Washington, D.C.	183	1	644,000	772,000
do.	China Lake, Calif.	176	1	644,000	772,000
do.	Dahlgren, Va.	407	2-1/4	2,569,000	1,142,000
do.	Baltimore, Md.	272	1-1/2	1,414,000	920,000
do.	Pt. Mugu, Calif.	176	1	644,000	772,000
do.	Washington, D.C.	287	1-3/4	1,799,000	994,000
Federal Aviation Agency	Atlantic City, N.J.	211	1-1/4	1,029,000	846,000
National Aeronautics and Space Administration	Cleveland, Ohio	240	1-1/4	1,029,000	846,000
do.	Newport News, Va.	200	1-1/4	1,029,000	846,000
do.	Huntsville, Ala.	528	3	3,724,000	1,364,000
do.	Huntsville, Ala.	528	3	3,724,000	1,364,000
do.	Washington, D.C.	347	2	2,184,000	1,068,000
do.	Washington, D.C.	140	1	644,000	772,000
do.	Washington, D.C.	140	1	644,000	772,000
do.	Washington, D.C.	140	1	644,000	772,000
do.	Mountain View, Calif.	176	1	644,000	772,000
<b>Total</b>				<b>\$57,449,000</b>	<b>\$34,378,000</b>

The foregoing tabulation shows that total estimated savings of \$57,449,000 could be achieved over an initial 5-year period of use through purchasing rather than leasing these 36 systems. It shows also that estimated savings for each year of continued use past this period would be \$34,378,000. (These annual savings represent

the amount of rental costs not incurred less maintenance costs.) Thus, if these systems were purchased, rather than rented, and used for 7 years, the Government would realize savings of approximately \$126,200,000.

Another example of savings available through purchasing is offered by the IBM model 7080 system. The purchase of this model would produce savings of \$333,000 when the system is operated on a one-shift basis. Operation on a two-shift basis would produce savings of \$1,397,000. On a three-shift basis, the savings would be \$2,461,000. Continued use past the initial 5-year period would produce additional annual savings of from \$537,000 to \$945,000 depending on the extent of use of the equipment.

According to the Bureau of the Budget inventory published in August 1962, there will be 16 IBM 7080 systems in use in the Government by June 30, 1963. One of these is to be purchased and 15 are to be leased. Based on the computed savings applicable to the representative IBM 7080 system, shown in Exhibit C, and on the planned monthly use as reported by the respective agencies to the Bureau of the Budget, estimated savings available through purchase, rather than lease, of the 15 IBM 7080 systems would be as shown in the following tabulation:

ESTIMATED SAVINGS AVAILABLE TO THE GOVERNMENT  
THROUGH PURCHASING 15 IBM 7080 SYSTEMS  
SCHEDULED TO BE LEASED BY JUNE 30, 1963

Agency	Location	Use per month		Estimated savings over 5-year period available through purchase	Estimated annual savings after initial 5-year period
		Hours	Shift equiv- alent		
Office of Secretary of Defense	Dayton, Ohio	550	3	\$ 2,461,000	\$ 945,000
do.	Battle Creek, Mich.	480	2-3/4	2,195,000	894,000
Department of the Air Force	Dayton, Ohio	400	2-1/4	1,663,000	792,000
do.	Ogden, Utah	450	2-1/2	1,929,000	843,000
do.	Oklahoma City, Okla.	400	2-1/4	1,663,000	792,000
do.	Harrisburg, Pa.	400	2-1/4	1,663,000	792,000
do.	Mobile, Ala.	400	2-1/4	1,663,000	792,000
do.	San Antonio, Texas	400	2-1/4	1,663,000	792,000
do.	Memphis, Tenn.	367	2	1,397,000	741,000
Department of the Army	St. Louis, Mo.	250	1-1/2	865,000	639,000
Department of the Navy	Harrisburg, Pa.	220	1-1/4	599,000	588,000
do.	Washington, D.C.				
Department of Health, Educa- tion, and Welfare	Baltimore, Md.	442	2-1/2	1,929,000	843,000
do.	Baltimore, Md.	372	2	1,397,000	741,000
Veterans Administration	Chicago, Ill.	380	2-1/4	1,663,000	792,000
<b>Total</b>				<b>\$24,413,000</b>	<b>\$11,778,000</b>

This tabulation shows that, through purchasing rather than leasing, estimated savings of \$24,413,000 could be realized over an initial 5-year period of use and that there would be additional savings of \$11,778,000 for each year of continued use past this period. If used for a total of 7 years, the purchase of the 15 systems would produce estimated savings of \$47,969,000.

These projections of estimated savings applicable to the IBM 7090, 7094, and 7080 systems and similar projections applicable to 14 systems<sup>1</sup> of the remaining 16 involved in our study show that the

<sup>1</sup>Two of the systems (Burroughs B-5000 and Sperry-Rand UNIVAC III) for which we made cost comparisons are new, and the Bureau of the Budget inventory report showed none of these two systems scheduled to be under lease by June 30, 1963.

possible total savings available over a 5-year period would approximate \$148 million. These projections are summarized in exhibit A. For additional use after the initial 5-year period, there would be further savings at the rate of over \$100 million a year.

These significant possible savings apply to only 523 of the approximately 1000 systems that will be leased throughout the Federal Government by June 30, 1963. The full potential of the possible savings that could be realized through a management system that would give full recognition to these possibilities is difficult to estimate. However, we believe that the Government could save hundreds of millions of dollars in the next several years as a result of proper consideration of the financial benefits of purchasing and appropriate action, including the establishment of effective arrangements to promote the fullest, practicable utilization by all Federal agencies of data processing systems.

Need to consider separately each component for lease or purchase

The detailed cost comparisons of the 18 systems set forth in exhibit C demonstrate that each component of a system should be considered separately for lease or purchase. These computations show that the cost advantage of purchasing some electromechanical components, such as printers, card readers, and card punches, is not as great as the cost advantage available through the purchase of electronic components. In some cases, it is clearly disadvantageous to purchase electromechanical components. This is due in part to pricing policies of equipment suppliers and to the greater

need for maintenance on electromechanical components because of the inherent wearing characteristics of mechanical parts. These factors would have to be weighed heavily in considering the purchase of these components. It might well be that, for the small cost advantage available, it would not be worth the risk of purchasing a component that may cause a serious maintenance problem or one that may have to be completely replaced because of constantly increasing maintenance requirements.

Because of these factors, detailed computations such as those shown in exhibit C should be made in order to provide the financial information necessary for deciding which components should be purchased and which ones should be leased.

Savings available through full use  
of Government-owned facilities

Our comparisons demonstrate two additional points that should be emphasized. First, the larger or more sophisticated a system, the greater the rate of purchase advantage. This point is illustrated in the following tabulation of selected IBM systems analyzed. The rate of purchase advantage may be expressed as the percentage the purchase advantage (savings) bears to the total cost of purchasing.

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IBM system	Cost to purchase (note a)	One-shift		Two-shift		Three-shift	
		Amount of purchase advantage	Rate of purchase advantage	Amount of purchase advantage	Rate of purchase advantage	Amount of purchase advantage	Rate of purchase advantage
7090	\$3,632,000	\$644,000	18%	\$2,184,000	57%	\$3,724,000	94%
7080	2,653,000	333,000	13	1,397,000	50	2,461,000	84
7070	967,000	70,000	7	432,000	42	795,000	74
1410	711,000	67,000	9	323,000	42	579,000	70
1401 <sup>b</sup>	415,000	27,000	7	158,000	34	288,000	57
1401 <sup>c</sup>	411,000	7,000	2	137,000	31	267,000	55
1401 <sup>d</sup>	188,000	-11,000	-6	41,000	20	94,000	42

<sup>a</sup>Includes maintenance for one-shift only.

<sup>b</sup>Card and tape system operated as off-line equipment to a larger system.

<sup>c</sup>Card and tape system.

<sup>d</sup>Card system.

On a one-shift basis, the percentage of purchase advantage steadily increases with each more costly system--from minus 6 percent for the least costly system to 18 percent for the most costly. On a two-shift basis, these rates run from 20 to 57 percent, and for three-shifts, they run from 42 to 94 percent.

A second important point is that the more use made of equipment, the greater the rate of purchase advantage. This factor is also illustrated by the foregoing tabulation which shows in each case that the rate of purchase advantage increases with greater use of the system. For example, the IBM 7090 system shows an increase in the rate from 18 percent for a one-shift operation to 57 percent for two-shifts and 94 percent for three-shifts.

When considered together, these two points demonstrate that significant economies are available through purchase and joint or multiple use of large data processing facilities. The Bureau of the Budget's published inventory of automatic data processing equipment shows that a number of electronic data processing systems are

scheduled for operation on a one- or two-shift basis. For example, 22 of the 23 IBM 7070, 7072, and 7074 systems that will be leased by June 1963 are scheduled to be operated for less than two-shifts. Twelve of these systems will be operated for one-shift or less. The low utilization scheduled for these machines is a result of individual agency planning and, since the potential savings available from purchasing increases with additional use of the equipment, it seems evident that more effective procedures are needed to coordinate throughout the Government the use of large data processing facilities. This kind of management action should help to significantly reduce the Government's overall data processing costs.

FAILURE TO TAKE PROMPT ADVANTAGE  
OF REDUCED SALES PRICES

During our study we noted a number of instances where savings could apparently have been realized if prompt action had been taken to purchase installed data processing equipment at reduced sales prices offered by the manufacturers. In these instances, the possible savings are based on considering the action from the standpoint of advantage to the Government overall and not from the standpoint solely of the individual using agencies.

IBM model 704 systems

On September 19, 1960, the International Business Machines Corporation announced that it would sell certain components of IBM 704 systems at 30 percent of the original price. This significant reduction in purchase price was not accompanied by a corresponding reduction in the rental charges for the particular components. According to the Bureau of the Budget inventory as of June 30, 1960, the Government had on hand 30 IBM 704 systems of which 4 had been purchased and 26 were leased. Had prompt action been taken by using agencies to purchase such equipment, the possible savings to the Government would have been relatively significant. Following are some examples:

Federal Aviation Agency

The Federal Aviation Agency in December 1959, leased an IBM 704 system for use at Oklahoma City, Oklahoma, for use in the control of aircraft in flight and in the flight inspection of ground navigational aids. Under the discounted pricing policy, components of this system renting for \$23,400 per month and originally priced at



\$1,116,800 became available for purchase for \$335,000. The agency decided not to buy this system, however.

Had these components been purchased in December 1960, the Government would have saved \$87,500 through June 1962 and would be adding to these savings at the rate of \$21,800 for each month of use after that date. These estimates of savings take into consideration the cost of maintaining purchased equipment under a manufacturer's maintenance service contract.

In this case, if the Federal Aviation Agency had purchased rather than continued to lease the components subject to the discount prices, it would have saved \$349,000 through June 1963, the anticipated replacement date. At that time, the Government would own the equipment and could relocate it in a less critical area in place of other leased equipment and this procedure would create additional monthly savings to the extent that the rental of the replaced equipment would exceed the cost of maintaining the Government-owned equipment.

#### Atomic Energy Commission

The Atomic Energy Commission leased an IBM 704 system for use in research and development work at the Argonne National Laboratory in Argonne, Illinois. The equipment was installed in November 1957, at a monthly rental of \$47,340. If the system had been purchased originally rather than leased, it would have cost approximately \$2,000,000.

On March 1, 1961, 5 months after IBM offered to sell the system at the discounted purchase price, the Atomic Energy Commission purchased certain components of the system for \$598,000 for which it had been paying monthly rentals of \$41,290. Had this equipment been purchased in October 1960 when it was first offered for sale at the discounted price, the Government would have saved over \$200,000 (5 months' rental charges at \$41,290 less estimated maintenance costs).

In this case, the agency attributed the delay in purchasing to fund limitations but has stated that it will give special attention to future situations where delays may cause the incurrence of otherwise avoidable expenditures of Government funds.<sup>1</sup>

IBM model 650 systems

On May 12, 1961, the IBM Corporation established an accelerated discount purchase plan on components of IBM model 650 systems. At that time, 136 of these systems were in use throughout the Government, 5 of which had been purchased and 131 were leased. Under the accelerated discount purchase plan, components were discounted 15 percent for each year used up to a maximum of 5 years or 75 percent. Consequently, components that had been in use for 5 years could be purchased for as little as 25 percent of the original selling price. Examples of possible savings follow.

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<sup>1</sup>This transaction is also described in our report to the Congress on Review of Selected Automatic Data Processing Activities Under Atomic Energy Commission Cost-Type Contracts with University of Chicago and Midwestern Universities Research Association (B-146763, February 7, 1963).

Air Force Logistics Command

At the time of the announced price change, the Air Force Logistics Command of the Department of the Air Force was leasing 36 IBM 650 systems. The rentals for these machines range from \$4,200 to \$23,000 per month. Purchase of some of this equipment under the accelerated discount plan could have resulted in significant savings. For example, eight of the nine components that made up three of this Command's small-scale systems could have been purchased at approximately the cost of 1 year's rental; purchasing would have produced savings of about \$146,000 over the intended period of use.

Air Materiel Area, Hill Air Force Base, Ogden, Utah--At this location, two of the three components of a small-scale 650 system originally priced at \$167,540 could have been purchased under the accelerated discount plan in July 1961 for 31 percent of the original price or \$52,000. This amount was less than 1 year's rental for these components. If these components had been purchased at the time of the announcement and taking into account the cost of maintaining purchased equipment under a manufacturer's maintenance service contract, the Government could have realized savings through June 1962 of \$600. Beginning in July 1962, recurring monthly savings of \$4,300 would have accrued to the Government. We have been advised that this system is to be replaced in April 1963; however, savings to the Government of \$43,600 could have been realized up to that date had these two components been purchased under the accelerated discount purchase plan. In addition, this equipment would be Government owned at that point in time and would be available for transfer to another Government electronic data processing facility for use in lieu of other identical equipment being rented.

Air Materiel Area, Oklahoma City, Oklahoma--At this location, all three components of the system could have been purchased under this plan in July 1961 for \$68,000--less than 1 year's rental. This action would have produced savings of \$1,500 through June 1962 plus recurring monthly savings, beginning July 1962, of \$5,500. This system also is scheduled to be replaced in April 1963; however, the purchase of these components under the discount plan would have produced total savings to the Government of \$56,500.

2709th Air Force Vehicle Group, Memphis, Tennessee--At this location, all three components of the system could have been purchased in July 1961 at 25 percent of the original price of \$209,000, or \$52,000. The purchase of this system would have produced savings of \$2,100 through July 1962, and beginning in August 1962 recurring monthly savings of \$4,000 would have accrued to the Government. The purchase of this system, scheduled to be replaced in June 1963, would have produced total savings of \$46,100.

At these three Air Force installations, for each month after the replacement dates that the eight components could be productively used, additional savings to the Government of at least \$10,750 would be obtained.

The Department of the Air Force has informed us of its awareness that "had the selected 650's in the Air Force Logistics Command been purchased at the time the discount was announced, a savings in equipment cost would have resulted." This agency also informed us that it was not notified by the manufacturer of the price reduction for the IBM model 650.

#### Post Office Department

In the Post Office Department 13 small-scale IBM model 650 systems have been leased for use in a number of Post Office regional offices. These machines were installed over a period of 4 years beginning in September 1956.

Under the accelerated discount plan, two of the three components of the system operated in the Richmond office, originally priced at \$161,000, could have been purchased in July 1961 at 26 percent of the original price or \$42,000. If these two components had been purchased at that time, the Government would have realized savings of \$500 through the end of August 1962. Then,

beginning with September 1962 recurring savings of \$3,000 would be realized for each month that the Post Office Department used the equipment productively, either at the original location or at other locations to replace the 650 type equipment being rented.

At Minneapolis, all three components of a similar system, originally priced at \$199,000, could have been purchased in July 1961 at 29 percent of the original price or \$57,000. Had this system been purchased, the Government would have realized savings of \$3,000 to October 1962 and in November 1962 would have started realizing recurring monthly savings of \$3,700.

Other model 650 components in use in the Post Office Department could also have been purchased at greatly reduced prices. The percentage of the original sales prices at which these components could have been purchased as of July 1, 1962, is shown below.

<u>Location</u>	<u>IBM 650 components</u>		
	<u>650</u>	<u>655</u>	<u>533</u>
Philadelphia	31%	31%	31%
Cincinnati	31	31	25
Atlanta	29	29	29
Boston	41	41	41

In November 1962, an IBM 1401 system was installed in the Richmond office to replace the existing IBM 650 system. Current Post Office plans call for the replacement of the remaining 12 IBM 650 systems with 10 IBM 1401 systems. It is anticipated that this conversion will be completed prior to December 1963. As in the case of the IBM 704 systems, savings could have been realized had some components of the 650 equipment been purchased when the

accelerated discount plan was announced. For example, if the two components at the Richmond office had been purchased at the discounted price in July 1961, savings of \$15,500 would have been realized through January 31, 1963; additional savings would be realized at the rate of \$3,000 for each month that the components could be productively used at either Richmond or some other Post Office regional office.

If the system at Minneapolis had been purchased in July 1961, savings of \$14,100 would have been realized through January 1963. Also, additional savings would be realizable at the rate of \$3,700 for each month past that date during which there was productive use of the system at either Minneapolis or some other Post Office regional office. Upon replacement, these five components would contribute further savings at the rate of \$6,700 for each month that they could be used productively elsewhere in the Government in lieu of rented equipment.

The Post Office Department has expressed disagreement with these observations on the basis that funds were not available to it for purchasing such equipment at the time the reduced prices were announced and that by the time funding authority could have been obtained purchase action would have resulted in losses rather than savings.

The Department's views are expressed primarily from the standpoint of its own management problem. We recognize that the availability of funds is an important problem. However, our observations concerning the acquisition of such equipment and the possible

savings from such action are based on the advantage to the Government overall rather than the advantage to an individual agency.

POSSIBLE EFFECTS OF INCREASED GOVERNMENT PURCHASING

The cost comparisons made in our study as to the relative financial advantage of purchasing or of leasing data processing equipment are based on the pricing terms of existing contracts between the Government and the manufacturers or on pricing information obtained directly from the manufacturers.

The possibility that prices would be increased if the Government purchased more equipment is a factor that cannot be fully evaluated at this time. We believe that there is some protection against increased purchase prices under the terms of the consent decree filed and entered in 1956 by the United States of America against the International Business Machines Corporation. Paragraph (a) of section IV of this judgment, identified as Civil Action No. 72-344, states:

"(a) It is the purpose of this section IV of this Final Judgment to assure to users and prospective users of IBM tabulating and electronic data processing machines at any time being offered by IBM for lease and sale an opportunity to purchase and own such machines at prices and upon terms and conditions which shall not be substantially more advantageous to IBM than the lease charges, terms and conditions for such machines."

As IBM is the Government's largest supplier of EDP equipment, with 67 percent of the numerical volume, this provision should give some protection against unwarranted price increases.

Maintenance

The purchase of equipment carries with it the responsibility for maintaining it in efficient working order. Maintenance service may either be provided by employees of the Government or be obtained by contract with manufacturers. For our cost comparisons, we used the quoted maintenance price terms of the manufacturers under their maintenance contracts.

Throughout our study, we could find no indication that the quality of maintenance provided under the terms of manufacturers' maintenance service contracts was not as good as that provided under lease agreements. As in the case of prices, the possibility that the quality of maintenance provided for purchased equipment might suffer if the Government were to adopt a purchase policy cannot be fully evaluated at this time. Here again, however, we believe that the interests of the Government are reasonably well protected by the terms of the above-mentioned final judgment. Section VI provides as follows:

"IBM is hereby ordered and directed:

"(a) to offer to render, without separate charge, to purchasers from it of tabulating or electronic data processing machines the same type of services, other than maintenance and repair services, which it renders without separate charge to lessees of the same types of machines;

"(b) to offer, commencing one year after the entry of this Final Judgment and so long thereafter as IBM shall continue to render repair and maintenance service, to maintain and repair at reasonable and nondiscriminatory prices and terms IBM tabulating and electronic data processing machines for the owners of such machines; provided that, if any such machine shall be altered, or connected by mechanical or electrical means to another machine, in such a manner as to render its maintenance and



repair impractical for IBM personnel having had the standard training and instruction provided by IBM to such maintenance and repair personnel, then IBM shall not be required by this Final Judgment to render maintenance and repair service for such IBM machine; and

"(c) to offer to sell at reasonable and nondiscriminatory prices and terms, to owners of IBM tabulating or electronic data processing machines (whether or not the purchaser receives IBM repair and maintenance service) and to persons engaged in the business of maintaining and repairing such machines and during the period when IBM has such parts and subassemblies available for use in its leased machines, repair and replacement parts and subassemblies for any tabulating machines or electronic data processing machines manufactured by IBM." (Underscoring supplied.)

It is of interest to note that, in addition to the maintenance services covered in paragraphs (b) and (c), the services, such as machine time to test programs, training, systems analysis, counseling, and software, which are extended without charge to lessees of equipment are guaranteed to purchasers of equipment under paragraph (a).

CONCLUSIONS

On the basis of our study, we conclude that the Government can save very substantial amounts of money through more extensive purchasing of data processing equipment. We have also reached the following general conclusions:

1. If possible and substantial savings are to be fully realized, management decisions as to whether data processing equipment should be purchased or leased should be made from the standpoint of advantage to the Government as a whole and not from the standpoint of the individual using agencies.
2. Because of the substantial savings that may be available, all decisions to acquire the use of data processing equipment should be supported by specific computations showing the comparative costs of acquiring by lease and by purchase.
3. Where purchasing is financially advantageous, the realizable savings increase in proportion with the increase in utilization of the machines.
4. The savings possible through purchasing are more pronounced for the larger and more complex machine systems.
5. While significant savings may be realizable in many instances through purchasing rather than leasing, for some types of electromechanical equipment, it is more advantageous financially to lease rather than to purchase.

NEED FOR MORE EFFECTIVE MANAGEMENT OF THE PROCUREMENT  
AND UTILIZATION OF DATA PROCESSING EQUIPMENT  
IN THE FEDERAL GOVERNMENT

In our report to the Congress on review of automatic data processing developments in the Federal Government (B-115369, December 30, 1960), we stated that:

"Generally, the practice of each Government agency is to procure equipment for its own needs (on either a purchase or a rental basis) and to trade in purchased equipment or exchange older rented equipment for newer models in accordance with its own particular needs. Possible needs of other agencies for the traded-in or exchanged equipment are generally not considered. However, it is possible that such equipment can be used to serve the needs of other Government agencies.

"At least one major equipment supplier offers terms under which used equipment can be purchased at a reduced price depending on the period of time the equipment has been in use. However, we believe that a Government-wide approach is needed to determine which machines should be purchased at the reduced prices and retained for Government use in lieu of new procurement. Likewise, before trading in purchased equipment which is no longer suitable for the original using organization, efforts should be made to determine the possibility of transferring the purchased equipment to other Government organizations requiring such equipment in lieu of new procurement.

"We believe that a mechanism should be established in the Government to provide the necessary arrangements whereby the procurement and transfer of data processing equipment between Government activities would be fully coordinated so as to keep costs as low as possible consistent with obtaining needed processing facilities."

We are aware of no significant progress toward an effective coordinating mechanism in the Federal Government for achieving the interrelated objectives cited.

Our current study of the financial advantages of purchasing data processing equipment over leasing it further emphasizes the great need in the Federal Government for a better coordinated and

integrated management system for achieving the fullest degree of economy and efficiency in acquiring and utilizing this kind of equipment.

Under the present system of decentralized management, each agency makes its own decision as to the method of acquiring this equipment. There is no effective coordinating machinery at work to give proper consideration to lease-purchase decisions from the standpoint of advantage to the Government as a whole. Unless adequate measures are taken to provide a stronger management system, millions of dollars of unnecessary expenditures will continue to be made. We are convinced that the establishment of a strong central management office in the executive branch of the Federal Government is essential to bring about the kind of management improvement that is needed to minimize such wasteful expenditures.

Recommendation to  
the President of the United States

In view of the need for more effective and coordinated management of the procurement and utilization of data processing equipment in the Federal Government and the substantial financial savings that can be realized through improved management of this function, we recommend that the President of the United States establish in his organization a central management office suitably empowered with authority and responsibility to make decisions on the procurement and utilization of data processing equipment with the objective of obtaining and utilizing all needed facilities at least cost to the Government.

Recommendation to heads of  
using departments and agencies

In view of the substantial savings that may be realized from more extensive purchasing, we recommend that the heads of all using departments and agencies, as an interim measure pending action on the above recommendation, arrange for a prompt and complete reappraisal of their current plans to lease data processing equipment and take such action as is possible to realize the financial savings that may be available from purchasing such equipment and fully utilizing it.

EXHIBITSEXHIBIT A

ESTIMATED SAVINGS AVAILABLE TO THE GOVERNMENT THROUGH PURCHASING  
523 OF THE 1006 ELECTRONIC COMPUTER SYSTEMS SCHEDULED TO BE LEASED AS  
OF JUNE 30, 1963

<u>Manufacturer</u>	<u>System identi- fication</u>	<u>Number of systems</u>	<u>Estimated savings available through purchase over 5-year period</u>	<u>Estimated annual savings after initial 5-year period</u>
International Business Machines Corporation (note a)	7090	36	\$ 57,449,000	\$ 34,378,000
Philco Corporation	2000	6	13,706,000	6,821,000
International Business Machines Corporation	7080	15	24,413,000	11,778,000
Control Data Corporation	1604	7	8,956,000	3,825,000
Minneapolis-Honeywell Regulator Company	800	8	3,700,000	3,194,000
International Business Machines Corporation (note b)	7070	23	4,148,000	4,787,000
The National Cash Register Company	315	2	76,000	300,000
International Business Machines Corporation	1410	27	5,713,000	4,500,000
Univac, Division of Sperry Rand Corporation (note c)	SS-90	16	1,902,000	1,987,000
Minneapolis-Honeywell Regulator Company	400	3	217,000	322,000
International Business Machines Corporation (note d)	1401	310	24,693,000	26,965,000
Control Data Corporation (note e)	160-A	16	474,000	431,000
Radio Corporation of America	501	27	1,666,000	4,648,000
Radio Corporation of America	301	27	654,000	1,344,000
Total		<u>523<sup>f</sup></u>	<u>\$147,767,000</u>	<u>\$105,280,000</u>

<sup>a</sup>Includes IBM 7090 and 7094 systems.

<sup>b</sup>Includes IBM 7070, 7072, and 7074 systems.

<sup>c</sup>Includes Univac SS-80 and SS-90 systems.

<sup>d</sup>Because there is no available analysis of the many types of IBM 1401 systems included in the Inventory of Automatic Data Processing (ADP) Equipment in the Federal Government published by the Bureau of the Budget, August 1962, we have projected savings for all 310 systems based on the medium-sized card and tape system for which computations were made in our study.

<sup>e</sup>Includes Control Data Corporation 160 and 160A systems.

<sup>f</sup>These projections are based on the number of systems that will be leased on June 30, 1963, as shown by the Bureau of the Budget inventory report. The same report shows no plans for leasing the Burroughs B-5000 and the Sperry-Rand Univac III, and therefore no projections for these systems are made above.

EXHIBIT B

SUMMARY OF COMPARISON OF LEASE AND PURCHASE COSTS  
OF SELECTED RDP SYSTEMS OVER A  
FIVE-YEAR PERIOD

Manufacturer	System identification	One shift or 176 hours per month (note b)			Two shifts or 352 hours per month (note a)			Three shifts or 528 hours per month (note a)		
		Cost to lease (note b)	Cost to purchase (note c)	Savings (-)loss on purchase basis	Cost to lease (note b)	Cost to purchase (note c)	Savings (-)loss on purchase basis	Cost to lease (note b)	Cost to purchase (note c)	Savings (-)loss on purchase basis
International Business Machines Corporation	7090	\$4,276,000	\$3,632,000	\$644,000	\$5,986,000	\$3,802,000	\$2,184,000	\$7,696,000	\$3,972,000	\$3,724,000
Philco Corporation	2000	4,218,000	4,361,000	-143,000	5,905,000	4,784,000	1,181,000	7,592,000	5,087,000	2,505,000
International Business Machines Corporation	7080	2,986,000	2,653,000	333,000	4,180,000	2,783,000	1,397,000	5,375,000	2,914,000	2,461,000
Control Data Corporation	1604	2,748,000	1,825,000	923,000	3,848,000	2,018,000	1,830,000	4,947,000	2,210,000	2,737,000
Minneapolis-Honeywell Regulator Company	800	1,942,000	1,830,000	112,000	2,715,000	2,042,000	673,000	3,489,000	2,256,000	1,233,000
Burroughs Corporation	5000	1,527,000	1,212,000	315,000	2,139,000	1,253,000	886,000	2,750,000	1,294,000	1,456,000
Univac, Division of Sperry Rand Corporation	Univac-III	1,218,000	1,233,000	-15,000	1,706,000	1,430,000	276,000	2,193,000	1,627,000	566,000
International Business Machines Corporation	7070	1,037,000	967,000	70,000	1,452,000	1,020,000	432,000	1,867,000	1,072,000	795,000
The National Cash Register Company	315	886,000	848,000	38,000	1,019,000	936,000	83,000	1,196,000	1,053,000	143,000
International Business Machines Corporation	1410	778,000	711,000	67,000	1,089,000	766,000	323,000	1,401,000	822,000	579,000
Univac, Division of Sperry Rand Corporation	Univac SS-90	674,000	695,000	-21,000	945,000	796,000	149,000	1,215,000	880,000	335,000
Minneapolis-Honeywell Regulator Company	400	603,000	580,000	23,000	844,000	673,000	171,000	1,084,000	766,000	318,000
International Business Machines Corporation (note d)	1401	442,000	415,000	27,000	619,000	461,000	158,000	795,000	507,000	288,000
International Business Machines Corporation (note e)	1401	418,000	411,000	7,000	586,000	449,000	137,000	753,000	486,000	267,000
International Business Machines Corporation (note f)	1401	177,000	188,000	-11,000	248,000	207,000	41,000	319,000	225,000	94,000
Control Data Corporation	160-A	157,000	133,000	24,000	220,000	145,000	75,000	282,000	155,000	127,000
		200 HOURS PER MONTH (note a)			484 HOURS PER MONTH (note a)			612 HOURS PER MONTH (note a)		
Radio Corporation of America	501	1,049,000	959,000	80,000	1,225,000	1,183,000	42,000	1,324,000	1,279,000	45,000
Radio Corporation of America	301	892,000	266,000	26,000	340,000	322,000	18,000	369,000	346,000	23,000

\*Shift hours for one, two, and three shifts are based on multiples of the monthly 176 hour use period designated in General Services Administration, Federal Supply Service electronic data processing rental contracts with equipment suppliers, except for the contract with RCA which is based on one shift of 200 hours, and extended use for five days and seven days converted to 484 and 612 hours for two and three shifts, respectively.

<sup>b</sup>Calculations for two and three shift rental amounts are based on full use for 352 and 528 hours, respectively, of all components of each system. In actual practice, rental amounts for peripheral devices would be slightly lower than the amounts shown in this exhibit because of contract provisions which allow averaging of use of multiple units of these components for contract payment purposes. Use of the figures as shown has the effect of slightly overstating the cost to lease.

<sup>c</sup>Calculations for two and three shift maintenance amounts are based on full shift charges for manufacturers' maintenance service contracts. As a practical matter, most installations would arrange for extra shift maintenance on an on-call basis which would be somewhat lower than the amounts shown in this exhibit. The use of the full amount has the effect of slightly overstating the cost to purchase and tends to offset the conditions noted in (b).

<sup>d</sup>Card and tape system operated as off-line equipment to a larger system.

<sup>e</sup>Card and tape system.

<sup>f</sup>Card system.

EXHIBIT C

IBM 7090 TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Lease alternative			Purchase alternative					Savings (-loss) on purchase basis			
	Quantity	Components Type Model	Cost to lease	Interest on		Cost to purchase	Interest on			Total cost to purchase		
				cost to lease	Total cost to lease		cost to purchase	Cost to maintain			Total cost to purchase	
One-shift	1	Instruction processing	7108	\$ 636,000	\$ 26,261	\$ 662,261	\$ 449,500	\$ 42,423	\$ 4,380	\$ 526,916	\$ 135,344	
	1	Arithmetic sequence	7109	520,500	21,492	541,992	368,000	34,731	33,612	1,125	431,253	110,739
	1	Console control	7151	73,500	3,034	76,534	61,700	5,823	780	32	68,135	8,399
	1	Core storage	7302	1,050,000	43,355	1,093,355	840,000	79,279	34,800	1,436	955,516	137,839
	1	Multiplexor	7606	234,000	9,662	243,662	156,300	14,751	8,928	364	180,344	63,317
	1	Data channel	7607	256,500	10,591	267,091	197,500	18,640	11,016	452	227,608	39,482
	2	Data channel	7607-2	393,000	16,227	409,227	318,000	30,012	14,304	587	362,904	46,323
	1	Power converter	7608	42,000	1,734	43,734	25,000	2,359	96	3	27,459	16,274
	3	Data channel console	7617	40,500	1,672	42,172	32,700	3,086	312	12	38,627	17,501
	1	Power control	7618	54,000	2,229	56,229	35,000	3,303	2,952	12	38,858	3,313
	1	Printer	7116	72,000	2,972	74,972	54,200	5,115	7,656	899	67,701	7,701
	1	Card punch	721	38,100	1,573	39,673	21,820	2,059	4,620	181	28,680	10,992
	12	Tape drives	729-4	648,000	26,752	674,752	495,000	46,718	93,312	3,825	638,550	35,900
	1	Card reader	711	48,000	1,981	49,981	32,000	3,020	4,191	163	39,374	10,607
				<b>\$4,106,100</b>	<b>\$169,545</b>	<b>\$4,275,645</b>	<b>\$3,086,720</b>	<b>\$291,324</b>	<b>\$243,975</b>	<b>\$ 9,987</b>	<b>\$3,632,007</b>	<b>\$ 643,638</b>
Two-shift	1	Instruction processing	7108	\$ 890,400	\$ 36,765	\$ 927,165	\$ 449,500	\$ 42,423	\$ 47,056	\$ 1,932	\$ 540,913	\$ 386,252
	1	Arithmetic sequence	7109	728,700	30,088	758,788	368,000	34,731	38,354	1,247	442,662	316,126
	1	Console control	7151	102,900	4,248	107,148	61,700	5,823	780	32	68,566	38,588
	1	Core storage	7302	1,470,000	60,698	1,530,698	840,000	79,279	48,730	2,011	970,010	560,687
	1	Multiplexor	7606	327,600	13,526	341,126	156,300	14,751	12,499	515	184,061	157,065
	1	Data channel	7607	359,100	14,827	373,927	197,500	18,640	10,422	633	232,196	141,731
	2	Data channel	7607-2	550,800	22,718	573,518	318,000	30,012	20,025	822	368,860	204,657
	1	Power converter	7608	58,800	2,427	61,227	34,200	3,134	134	5	27,499	33,728
	3	Data channel console	7617	56,700	2,341	59,041	32,700	3,086	4,132	168	40,087	18,953
	1	Power control	7618	75,600	3,121	78,721	35,000	3,303	5,115	436	38,757	39,965
	1	Printer	7116	100,800	4,152	104,952	64,200	5,115	15,312	599	75,226	29,735
	1	Card punch	721	53,340	2,202	55,542	21,820	2,059	4,840	363	33,482	22,059
	12	Tape drives	729-4	907,200	37,459	944,659	495,000	46,718	186,624	7,651	735,993	208,665
	1	Card reader	711	67,200	2,774	69,974	32,000	3,020	4,382	327	43,129	26,255
				<b>\$5,748,540</b>	<b>\$237,363</b>	<b>\$5,985,903</b>	<b>\$3,086,720</b>	<b>\$291,324</b>	<b>\$407,432</b>	<b>\$16,665</b>	<b>\$3,802,192</b>	<b>\$2,183,761</b>
Three-shift	1	Instruction processing	7108	\$1,144,800	\$ 47,270	\$1,192,070	\$ 449,500	\$ 42,423	\$ 60,501	\$ 2,484	\$ 554,910	\$ 637,159
	1	Arithmetic sequence	7109	936,900	38,585	975,485	368,000	34,731	45,312	1,247	451,071	524,414
	1	Console control	7151	132,300	5,462	137,762	61,700	5,823	780	32	68,985	68,777
	1	Core storage	7302	1,890,000	78,040	1,968,040	840,000	79,279	62,640	2,586	984,505	983,534
	1	Multiplexor	7606	421,200	17,221	438,421	156,300	14,751	16,070	856	187,778	250,613
	1	Data channel	7607	461,700	19,064	480,764	197,500	18,640	19,828	814	236,183	243,980
	2	Data channel	7607-2	707,400	29,209	736,609	318,000	30,012	25,747	1,057	374,817	361,792
	1	Power converter	7608	75,600	3,121	78,721	25,000	2,359	172	6	27,539	51,182
	3	Data channel console	7617	75,900	3,010	78,910	32,700	3,086	5,313	216	41,316	34,593
	1	Power control	7618	97,200	4,013	101,213	35,000	3,303	5,211	22	62,387	38,827
	1	Printer	7116	129,600	5,251	134,851	54,200	5,115	22,968	899	83,182	51,768
	1	Card punch	721	68,580	2,831	71,411	21,820	2,059	5,444	364	38,284	33,127
	12	Tape drives	729-4	1,166,400	46,532	1,212,932	495,000	46,718	279,936	11,477	833,311	381,430
	1	Card reader	711	86,400	3,587	89,987	32,000	3,020	4,273	491	48,084	41,883
				<b>\$7,390,980</b>	<b>\$305,182</b>	<b>\$7,696,162</b>	<b>\$3,086,720</b>	<b>\$291,324</b>	<b>\$570,889</b>	<b>\$23,342</b>	<b>\$3,972,277</b>	<b>\$3,723,885</b>

Note: Amounts may not add in dollar columns because of omission of cents.



EXHIBIT C - Continued

PHILCO 2000 CARD AND TYPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components			Lease alternative			Purchase alternative			Savings (-loss) on purchase basis	
		Type	Model	Model	Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Total cost to purchase		
One-shift	1	Arithmetic and control	211	\$ 660,000	\$ 27,252	\$ 687,252	\$ 500,000	\$ 47,190	\$ 105,000	\$ 4,335	\$ 656,525	\$ 30,726
	1	Floating point option	1100	54,000	2,229	56,229	40,000	3,775	8,400	346	52,522	3,707
	1	Index register	1111-B	78,000	3,289	81,289	60,000	5,662	12,600	520	78,783	2,437
	1	Core storage	2232	1,230,000	50,788	1,280,788	925,000	87,301	198,250	8,020	1,211,572	66,215
	1	I/O processor	236	264,000	10,900	274,900	200,000	18,876	42,000	1,734	262,610	12,290
	15	Tape drives	234	765,000	31,587	796,587	570,000	53,796	119,700	4,942	748,439	48,148
	2	Printers	256	280,800	11,594	292,394	320,000	30,201	67,200	2,774	420,176	-127,781
	2	Card readers	258	95,000	3,963	98,963	95,000	9,050	20,160	832	126,052	-26,088
	2	Card punch control	259	163,800	6,763	170,563	190,000	17,932	39,900	1,647	249,479	-78,916
	2	Card punch	265	42,000	1,734	43,734	30,000	2,831	6,300	260	39,391	4,342
	2	Universal buffer control	260	187,200	7,759	194,959	220,000	20,763	46,200	1,907	288,811	-93,841
	2	Paper tape system	241	216,000	8,918	224,918	160,000	15,100	33,600	1,387	210,088	14,830
	1	Accounting clock	293	13,500	557	14,057	10,000	943	2,100	86	11,130	2,926
				<u>\$4,050,300</u>	<u>\$167,241</u>	<u>\$4,217,541</u>	<u>\$3,321,000</u>	<u>\$313,435</u>	<u>\$697,410</u>	<u>\$28,796</u>	<u>\$4,360,626</u>	<u>\$-143,101</u>
Two-shift	1	Arithmetic and control	211	\$ 924,000	\$ 38,153	\$ 962,153	\$ 500,000	\$ 47,190	\$ 157,500	\$ 6,503	\$ 711,193	\$ 250,959
	1	Floating point option	1100	75,600	3,121	78,721	40,000	3,775	12,600	520	56,895	21,826
	1	Index register	1111-B	109,200	4,509	113,709	60,000	5,662	18,900	780	89,343	28,365
	1	Core storage	2232	1,728,000	71,103	1,799,103	925,000	87,301	291,775	12,031	1,315,707	477,395
	1	I/O processor	236	360,000	15,861	375,861	200,000	18,876	63,000	2,601	294,477	100,383
	15	Tape drives	234	1,071,000	44,222	1,115,222	570,000	53,796	179,500	7,413	810,760	304,462
	2	Printers	256	393,120	16,232	409,352	320,000	30,201	100,800	4,162	495,163	-145,811
	2	Card readers	258	134,400	5,549	139,949	130,000	12,060	30,240	1,248	136,549	3,400
	2	Card punch control	259	229,320	9,468	238,788	190,000	17,932	59,850	2,471	270,253	-31,614
	2	Card punch	265	58,800	2,427	61,227	30,000	2,831	9,450	390	42,671	18,556
	2	Universal buffer control	260	262,080	10,821	272,901	260,000	20,763	63,200	2,601	312,926	-40,023
	2	Paper tape system	241	307,200	12,486	319,686	160,000	15,100	50,400	2,081	227,581	87,304
	1	Accounting clock	293	18,900	780	19,680	10,000	943	3,150	130	14,223	5,456
				<u>\$5,670,420</u>	<u>\$234,138</u>	<u>\$5,904,558</u>	<u>\$3,321,000</u>	<u>\$313,435</u>	<u>\$1,046,115</u>	<u>\$43,195</u>	<u>\$4,723,626</u>	<u>\$1,180,811</u>
Three-shift	1	Arithmetic and control	211	\$ 1,188,000	\$ 49,053	\$ 1,237,053	\$ 500,000	\$ 47,190	\$ 210,000	\$ 8,671	\$ 765,861	\$ 471,192
	1	Floating point option	1100	87,200	4,013	91,213	40,000	3,775	16,800	693	61,628	39,944
	1	Index register	1111-B	140,400	5,797	146,197	60,000	5,662	26,200	1,040	91,903	54,293
	1	Core storage	2232	2,214,000	91,418	2,305,418	925,000	87,301	388,500	16,031	1,416,843	888,574
	1	I/O processor	236	475,200	19,621	494,821	230,000	18,876	84,000	3,468	306,344	188,477
	15	Tape drives	234	1,377,000	56,857	1,433,857	570,000	53,796	239,400	9,885	873,081	560,776
	2	Printers	256	505,440	20,870	526,310	320,000	30,201	134,400	5,549	490,151	36,159
	2	Card reader	258	172,800	7,135	179,935	95,000	9,050	40,220	1,664	187,045	38,889
	2	Card punch control	259	294,840	12,174	307,014	190,000	17,932	79,800	3,295	291,027	15,987
	2	Card punch	265	75,600	3,121	78,721	30,000	2,831	12,600	520	45,951	32,769
	2	Universal buffer control	260	336,960	13,913	350,873	220,000	20,763	32,400	2,815	336,978	13,894
	2	Paper tape system	241	368,800	16,054	384,854	150,000	15,100	67,200	2,774	245,075	159,778
	1	Accounting clock	293	24,300	1,003	25,303	10,000	943	8,200	173	15,317	9,986
				<u>\$7,290,540</u>	<u>\$301,034</u>	<u>\$7,591,574</u>	<u>\$3,321,000</u>	<u>\$313,435</u>	<u>\$1,394,820</u>	<u>\$7,593</u>	<u>\$5,086,849</u>	<u>\$2,504,725</u>

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued

IBM 7080 TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Lease alternative			Purchase alternative					Savings (-loss) on purchase basis			
		Components Type	Model	Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain		Total cost to purchase		
One-shift	1	Arith/logic unit	7102	\$ 870,000	\$ 35,923	\$ 905,923	\$ 685,000	\$ 64,650	\$ 3,716	\$ 1,799	\$ 795,166	\$ 110,757	
	1	Console control unit	7153	96,000	3,963	99,963	80,250	7,574	2,730	112	90,666	9,297	
	1	Core storage 80K	7302	600,000	24,774	624,774	480,000	45,302	22,800	941	549,043	75,730	
	1	Central storage and I/O control 2 channels	7305	438,000	18,085	456,085	385,000	5,662	14,196	583	392,341	63,744	
	1	Power unit	7804	96,000	3,963	99,963	60,000	5,662	1,995	81	67,739	32,224	
	1	Console card reader	7502	16,500	681	17,181	13,500	1,274	999	36	15,729	1,451	
	7	Tape control	7621	208,200	8,596	216,796	153,800	14,515	14,148	580	183,043	33,752	
	1	Tape drives	729-5	315,000	13,006	328,006	260,400	24,576	52,080	2,130	339,187	-11,180	
	4	Tape drives	729-6	228,000	9,414	237,414	169,800	16,025	32,544	1,324	219,704	17,709	
					<b>\$2,867,700</b>	<b>\$118,410</b>	<b>\$2,986,110</b>	<b>\$2,247,750</b>	<b>\$212,142</b>	<b>\$185,118</b>	<b>\$ 7,601</b>	<b>\$2,652,612</b>	<b>\$ 333,498</b>
	Two-shift	1	Arith/logic unit	7102	\$1,218,000	\$ 50,292	\$1,268,292	\$ 685,000	\$ 64,650	\$ 61,202	\$ 2,519	\$ 813,372	\$ 454,919
		1	Console control unit	7153	134,400	5,549	139,949	80,250	7,574	3,822	156	91,802	48,146
		1	Core storage 80K	7302	840,000	34,684	874,684	480,000	45,302	31,920	1,318	558,540	316,144
1		Central storage and I/O control 2 channels	7305	613,200	25,319	638,519	345,000	32,561	19,874	817	398,252	240,266	
1		Power unit	7804	134,400	5,549	139,949	60,000	5,662	2,793	114	68,570	71,379	
1		Console card reader	7502	23,100	963	24,063	13,500	1,274	1,818	73	16,666	7,397	
7		Tape control	7621	291,480	12,035	303,515	153,800	14,515	19,907	812	188,935	114,580	
1		Tape drives	729-5	441,000	18,209	459,209	260,400	24,576	104,160	4,261	393,337	65,811	
4		Tape drives	729-6	319,200	13,180	332,380	169,800	16,025	65,088	2,669	253,583	78,796	
					<b>\$4,014,780</b>	<b>\$165,774</b>	<b>\$4,180,554</b>	<b>\$2,247,750</b>	<b>\$212,142</b>	<b>\$310,485</b>	<b>\$12,743</b>	<b>\$2,783,121</b>	<b>\$1,397,433</b>
Three-shift		1	Arith/logic unit	7102	\$1,566,000	\$ 64,661	\$1,630,661	\$ 685,000	\$ 64,650	\$ 78,688	\$ 3,239	\$ 813,579	\$ 799,082
		1	Console control unit	7153	172,800	7,135	179,935	80,250	7,574	4,914	201	92,339	86,995
		1	Core storage 80K	7302	1,080,000	44,594	1,124,594	480,000	45,302	41,040	1,694	568,036	556,557
	1	Central storage and I/O control 2 channels	7305	788,400	32,553	820,953	345,000	32,561	25,552	1,051	404,164	416,789	
	1	Power unit	7804	172,800	7,135	179,935	60,000	5,662	3,591	147	69,400	110,534	
	1	Console card reader	7502	29,700	1,226	30,926	13,500	1,274	2,727	110	17,612	13,314	
	7	Tape control	7621	374,760	15,474	390,234	153,800	14,515	25,466	1,044	194,826	195,407	
	1	Tape drives	729-5	567,000	23,412	590,412	260,400	24,576	156,240	6,391	447,608	142,803	
	4	Tape drives	729-6	410,400	16,945	427,345	169,800	16,025	27,632	8,004	287,461	139,884	
					<b>\$5,161,860</b>	<b>\$213,139</b>	<b>\$5,374,999</b>	<b>\$2,247,750</b>	<b>\$212,142</b>	<b>\$435,852</b>	<b>\$17,885</b>	<b>\$2,913,630</b>	<b>\$2,461,368</b>

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued

CDC 1604 CARD AND TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components		Lease alternative			Purchase alternative				Savings (-) or loss on purchase basis		
		Type	Model	Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain	Interest on cost to maintain		Total cost to purchase	
One-shift	1	Central processor	1604	\$1,806,000	\$ 74,571	\$1,880,571	\$ 990,000	\$ 93,436	\$118,200	\$ 4,880	\$1,206,516	\$ 674,055	
	2	Tape drive banks	1607	606,000	25,022	631,022	290,000	27,370	90,000	3,716	411,686	219,336	
	1	Printer	1612	110,400	4,568	114,968	73,500	6,936	24,000	990	105,427	9,530	
	1	Control unit	1610A	90,000	3,716	93,716	57,000	5,379	11,400	470	74,250	19,465	
	1	Card reader	(Modified) IBM 088		21,480	886	22,366	16,170	1,526	4,129	154	21,979	387
	1	Card punch	(Modified) IBM 523		5,640	232	5,872	4,730	446	898	33	6,108	-235
				<u>\$2,639,520</u>	<u>\$108,988</u>	<u>\$2,748,508</u>	<u>\$1,431,400</u>	<u>\$135,095</u>	<u>\$248,627</u>	<u>\$10,246</u>	<u>\$1,825,369</u>	<u>\$ 923,139</u>	
Two-shift	1	Central processor	1604	\$2,528,400	\$104,400	\$2,632,800	\$ 990,000	\$ 93,436	\$178,500	\$ 7,370	\$1,269,306	\$1,363,493	
	2	Tape drive banks	1607	846,400	35,071	881,471	290,000	27,370	180,000	7,432	504,802	376,668	
	1	Printer	1612	154,560	6,381	160,941	73,500	6,936	48,000	1,981	130,418	30,523	
	1	Control unit	1610A	126,000	5,202	131,202	57,000	5,379	17,400	718	80,498	50,704	
	1	Card reader	(Modified) IBM 088		30,072	1,241	31,313	16,170	1,526	8,258	308	26,263	5,050
	1	Card punch	(Modified) IBM 523		7,896	326	8,222	4,730	446	1,796	67	7,040	1,181
				<u>\$3,695,328</u>	<u>\$152,584</u>	<u>\$3,847,912</u>	<u>\$1,431,400</u>	<u>\$135,095</u>	<u>\$433,954</u>	<u>\$17,872</u>	<u>\$2,018,330</u>	<u>\$1,829,582</u>	
Three-shift	1	Central processor	1604	\$3,250,800	\$134,222	\$3,385,022	\$ 990,000	\$ 93,436	\$238,500	\$ 9,847	\$1,331,784	\$2,053,245	
	2	Tape drive banks	1607	1,090,800	45,040	1,135,840	290,000	27,370	270,000	11,148	598,518	537,321	
	1	Printer	1612	198,720	8,205	206,925	73,500	6,936	72,000	2,972	155,409	51,515	
	1	Control unit	1610A	162,000	6,689	168,689	57,000	5,379	23,100	953	86,433	82,255	
	1	Card reader	(Modified) IBM 088		38,664	1,596	40,260	16,170	1,526	12,387	463	30,547	9,713
	1	Card punch	(Modified) IBM 523		10,152	419	10,571	4,730	446	2,694	101	7,972	2,598
				<u>\$4,751,136</u>	<u>\$195,179</u>	<u>\$4,947,315</u>	<u>\$1,431,400</u>	<u>\$135,095</u>	<u>\$618,682</u>	<u>\$25,488</u>	<u>\$2,210,665</u>	<u>\$2,736,650</u>	

Note: Amounts may not add in dollar columns because of omission of cents.

## EXHIBIT C - Continued

## HONEYWELL 800 TAPE SYSTEM

## COMPARISON OF LEASE AND PURCHASE COSTS

## OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components Type	Model	Lease alternative			Purchase alternative				Savings (Loss) on purchase basis	
				Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain	Interest on cost to maintain		Total cost to purchase
One-shift	1	Central processor	801	\$ 513,000	\$ 21,182	\$ 534,182	\$ 410,400	\$ 38,733	\$ 27,540	\$ 1,089	\$ 477,762	\$ 56,419
	1	Floating point unit	801-B	126,000	5,202	131,202	100,800	9,513	6,480	256	117,049	14,152
	2	Additional memory	802	192,000	7,927	199,927	153,600	14,496	10,368	409	178,874	21,053
	2	Tape controls	803	240,000	9,909	249,909	192,000	18,120	12,960	512	223,593	26,316
	8	Tape drives	804-1	432,000	17,837	449,837	345,600	32,617	3,689	475,219	-25,381	
	1	Printer control	806-3	87,000	3,592	90,592	69,600	6,568	9,396	371	85,936	4,655
	1	Printer	822-3	117,000	4,762	121,762	79,800	7,531	30,780	1,217	119,328	2,502
	1	Card reader control	807-2	66,000	2,725	68,725	52,800	4,983	3,888	153	61,825	6,900
	1	Punch control	808-1	63,000	2,601	65,601	50,400	4,756	3,888	153	59,958	6,402
	1	Card punch	824-1	9,240	381	9,621	7,435	701	2,616	102	10,054	-1,233
	1	Card reader	823-2	19,500	805	20,305	14,700	1,387	3,753	140	19,980	324
				\$1,864,740	\$ 76,997	\$1,941,737	\$1,477,135	\$139,412	\$204,981	\$ 8,096	\$1,829,624	\$ 112,112
Two-shift	1	Central processor	801	\$ 718,180	\$ 29,684	\$ 747,835	\$ 410,400	\$ 38,733	\$ 55,080	\$ 2,178	\$ 506,391	\$ 241,443
	1	Floating point unit	801-B	176,371	7,262	183,653	100,800	9,513	12,960	512	123,785	59,867
	2	Additional memory	802	268,875	11,102	279,977	153,600	14,496	20,736	819	189,652	90,326
	2	Tape controls	803	329,760	13,616	343,376	192,000	18,120	25,920	1,024	237,065	106,310
	8	Tape drives	804-1	605,184	24,988	630,172	345,600	32,617	186,624	7,375	572,221	57,951
	1	Printer control	806-3	121,848	5,031	126,879	69,600	6,568	18,792	743	95,703	31,175
	1	Printer	822-3	163,780	6,762	170,542	109,800	10,461	61,560	2,434	153,995	19,277
	1	Card reader control	807-2	92,400	3,815	96,215	52,800	4,983	7,776	307	55,866	30,348
	1	Punch control	808-1	88,238	3,643	91,881	50,400	4,756	7,776	307	63,240	28,641
	1	Card punch	824-1	13,886	573	14,459	7,435	701	5,232	204	13,573	886
	1	Card reader	823-2	29,215	1,206	30,421	14,700	1,387	7,506	280	23,874	6,247
				\$2,607,741	\$107,676	\$2,715,418	\$1,477,135	\$139,412	\$409,962	\$16,192	\$2,042,714	\$ 672,716
Three-shift	1	Central processor	801	\$ 923,361	\$ 38,126	\$ 961,488	\$ 410,400	\$ 38,733	\$ 82,620	\$ 3,267	\$ 535,020	\$ 426,467
	1	Floating point unit	801-B	225,742	9,362	236,104	100,800	9,513	19,440	768	130,522	105,582
	2	Additional memory	802	345,753	14,276	360,030	153,600	14,496	31,104	1,229	200,430	159,599
	2	Tape controls	803	419,520	17,322	436,842	192,000	18,120	38,880	1,537	250,538	186,304
	8	Tape drives	804-1	778,368	32,139	810,507	345,600	32,617	279,926	11,069	569,223	141,284
	1	Printer control	806-3	156,696	6,470	163,166	69,600	6,568	28,188	1,114	105,471	57,694
	1	Printer	822-3	219,861	8,694	228,555	79,800	7,531	92,340	3,651	183,322	35,932
	1	Card reader control	807-2	118,800	4,905	123,705	52,800	4,983	11,664	461	69,908	53,796
	1	Punch control	808-1	113,476	4,685	118,162	50,400	4,756	11,664	461	67,282	50,880
	1	Card punch	824-1	18,532	765	19,298	7,435	701	7,848	306	16,391	3,006
	1	Card reader	823-2	38,930	1,607	40,537	14,700	1,387	11,259	421	27,787	12,770
				\$3,350,743	\$138,356	\$3,489,099	\$1,477,135	\$139,412	\$614,943	\$24,289	\$2,255,779	\$1,233,320

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued

BURROUGHS B-5000 CARD AND TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Lease alternative			Purchase alternative					Savings (-loss) on purchase basis			
		Components Type Model	Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain	Interest on cost to maintain		Total cost to purchase		
One-shift	1	Central processor	B-5280	\$ 384,000	\$ 15,855	\$ 399,855	\$ 265,600	\$ 25,067	\$ 11,112	\$ 451	\$ 302,230	\$ 97,625	
	2	I/O channel	B-5282	270,000	11,148	281,148	186,750	17,625	9,888	401	214,664	66,483	
	4	Memory module	B-460	300,000	12,387	312,387	207,500	19,583	11,088	451	238,622	73,764	
	1	Storage drum	B-430	102,000	4,211	106,211	70,550	6,658	3,072	125	80,405	25,806	
	1	Card reader	B-124	24,000	990	24,990	15,600	1,566	3,696	150	22,013	2,977	
	1	Printer	B-321	72,000	2,972	74,972	49,800	4,700	9,240	375	64,115	10,856	
	1	Card punch	B-303	27,000	1,114	28,114	18,675	1,762	3,396	137	23,971	4,143	
	6	Tape drives	B-422	288,000	11,891	299,891	199,200	18,800	46,296	1,881	266,177	33,714	
					<u>\$1,457,000</u>	<u>\$ 60,574</u>	<u>\$1,527,574</u>	<u>\$1,014,675</u>	<u>\$25,765</u>	<u>\$ 37,788</u>	<u>\$ 3,974</u>	<u>\$1,212,202</u>	<u>\$ 315,371</u>
	Two-shift	1	Central processor	B-5280	\$ 537,600	\$ 22,198	\$ 559,798	\$ 265,600	\$ 25,067	\$ 15,556	\$ 632	\$ 306,856	\$ 252,941
2		I/O channel	B-5282	378,000	15,608	393,608	186,750	17,625	13,843	562	218,730	174,877	
4		Memory module	B-460	420,000	17,342	437,342	207,500	19,583	15,523	631	243,238	194,103	
1		Storage drum	B-430	142,800	5,896	148,696	70,550	6,658	4,300	175	81,684	67,011	
1		Card reader	B-124	33,600	1,387	34,987	16,600	1,566	5,174	210	23,551	11,435	
1		Printer	B-321	100,800	4,162	104,962	49,800	4,700	12,936	526	67,962	36,999	
1		Card punch	B-303	37,800	1,560	39,360	18,675	1,762	4,754	193	25,385	13,975	
6		Tape drives	B-422	403,200	16,648	419,848	199,200	18,800	64,814	2,633	285,448	134,400	
					<u>\$2,053,800</u>	<u>\$ 84,803</u>	<u>\$2,138,603</u>	<u>\$1,014,675</u>	<u>\$25,765</u>	<u>\$136,903</u>	<u>\$ 5,564</u>	<u>\$1,252,907</u>	<u>\$ 885,696</u>
Three-shift		1	Central processor	B-5280	\$ 691,200	\$ 28,540	\$ 719,740	\$ 265,600	\$ 25,067	\$ 20,001	\$ 812	\$ 311,481	\$ 408,258
	2	I/O channel	B-5282	486,000	20,067	506,067	186,750	17,625	17,798	722	222,896	283,170	
	4	Memory module	B-460	540,000	22,297	562,297	207,500	19,583	19,583	811	247,854	314,443	
	1	Storage drum	B-430	183,600	7,581	191,181	70,550	6,658	5,859	225	82,963	108,217	
	1	Card reader	B-124	43,200	1,783	44,983	16,600	1,566	6,652	270	25,090	19,893	
	1	Printer	B-321	129,600	5,351	134,951	49,800	4,700	16,632	676	71,808	63,142	
	1	Card punch	B-303	48,600	2,006	50,606	18,675	1,762	6,112	288	26,798	23,808	
	6	Tape drives	B-422	518,400	21,405	539,805	199,200	18,800	83,332	3,389	304,719	235,086	
					<u>\$2,640,600</u>	<u>\$109,033</u>	<u>\$2,749,633</u>	<u>\$1,014,675</u>	<u>\$25,765</u>	<u>\$176,018</u>	<u>\$ 7,153</u>	<u>\$1,293,612</u>	<u>\$1,456,021</u>

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued  
UNIVAC III CARD AND TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components			Lease alternative			Purchase alternative				Savings (-loss) on purchase basis
		Type	Model		Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain	Interest on cost to maintain	Total cost to purchase	
One-shift	1	Central processor	4121	\$ 480,000	\$19,819	\$ 499,819	\$390,000	\$36,808	\$ 35,100	\$ 1,449	\$ 463,357	\$ 36,462
	1	Tape synchronizer	4135	174,000	7,184	181,184	145,000	13,685	14,400	594	173,679	7,504
	1	Tape power supply	4123	21,000	867	21,867	17,500	1,651	2,400	99	21,650	216
	10	Tape units	4126	300,000	12,387	312,387	240,000	22,651	78,000	3,220	343,871	-31,484
	1	Card reader	4133	45,000	1,858	46,858	35,000	3,303	12,000	495	50,798	-3,940
	1	Card punch	4127	51,000	2,105	53,105	40,000	3,775	22,800	941	67,516	-14,410
	1	Printer	4152	99,000	4,087	103,087	79,000	7,456	24,600	1,015	112,071	-8,983
					<u>\$1,170,000</u>	<u>\$48,310</u>	<u>\$1,218,310</u>	<u>\$946,500</u>	<u>\$89,330</u>	<u>\$189,300</u>	<u>\$ 7,816</u>	<u>\$1,232,947</u>
Two-shift	1	Central processor	4121	\$ 672,000	\$27,747	\$ 699,747	\$390,000	\$36,808	\$ 70,200	\$ 2,898	\$ 499,906	\$199,840
	1	Tape synchronizer	4135	243,600	10,058	253,658	145,000	13,685	28,800	1,189	188,674	64,984
	1	Tape power supply	4123	29,400	1,213	30,613	17,500	1,651	1,800	198	24,149	6,464
	10	Tape units	4126	420,000	17,342	437,342	240,000	22,651	156,000	6,441	425,092	12,249
	1	Card reader	4133	63,000	2,601	65,601	35,000	3,303	24,000	490	63,294	2,307
	1	Card punch	4127	71,400	2,948	74,348	40,000	3,775	45,600	1,882	91,258	-16,909
	1	Printer	4152	138,600	5,722	144,322	79,000	7,456	49,200	2,031	137,687	6,635
					<u>\$1,638,000</u>	<u>\$67,634</u>	<u>\$1,705,634</u>	<u>\$946,500</u>	<u>\$89,330</u>	<u>\$378,600</u>	<u>\$15,632</u>	<u>\$1,430,063</u>
Three-shift	1	Central processor	4121	\$ 864,000	\$35,675	\$ 899,675	\$390,000	\$36,808	\$105,300	\$ 4,347	\$ 535,456	\$363,219
	1	Tape synchronizer	4135	313,200	12,932	326,132	145,000	13,685	43,200	1,783	203,668	122,463
	1	Tape power supply	4123	37,800	1,580	39,380	17,500	1,651	7,200	297	28,648	12,711
	10	Tape units	4126	540,000	22,297	562,297	240,000	22,651	234,000	9,662	506,313	55,983
	1	Card reader	4133	81,000	3,344	84,344	35,000	3,303	36,000	1,486	75,789	8,554
	1	Card punch	4127	91,800	3,790	95,590	40,000	3,775	68,400	2,824	114,999	-19,408
	1	Printer	4152	178,200	7,358	185,558	79,000	7,456	73,800	3,047	163,303	22,254
					<u>\$2,106,000</u>	<u>\$86,959</u>	<u>\$2,192,959</u>	<u>\$946,500</u>	<u>\$89,330</u>	<u>\$567,900</u>	<u>\$23,449</u>	<u>\$1,627,179</u>

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued

IBM 7070 TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components Type	Model	Lease alternative			Purchase alternative			Savings (-loss) on purchase basis		
				Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Total cost to purchase			
One-shift	1	Console control	7150	\$ 18,000	\$ 743	\$ 18,743	\$ 13,050	\$ 1,231	\$ 1,008	\$ 39	\$ 15,329	\$ 3,413
	1	Core storage	7301	210,000	8,671	218,671	195,000	18,404	2,025	80	215,509	3,161
	1	Console card reader	7501	4,500	185	4,685	3,100	292	351	14	3,757	927
	1	I/O control	7600	49,500	2,043	51,543	34,200	3,227	1,317	51	38,195	12,747
	1	Arith. and prog. control	7601	180,000	7,432	187,432	145,500	13,732	5,694	224	165,150	22,281
	1	Core storage control	7602	96,000	3,963	99,963	73,950	6,979	2,037	80	83,046	16,917
	1	Tape control	7604	162,000	6,689	168,689	125,500	11,844	5,469	219	143,033	25,655
	1	Power converter	7802	24,000	990	24,990	20,000	1,887	378	15	22,280	2,710
	6	Tape drives	729-2	252,000	10,405	262,405	216,000	20,386	42,480	1,737	280,503	-18,197
					<u>\$ 996,000</u>	<u>\$41,126</u>	<u>\$1,037,126</u>	<u>\$826,300</u>	<u>\$77,986</u>	<u>\$ 60,759</u>	<u>\$ 2,462</u>	<u>\$ 967,508</u>
Two-shift	1	Console control	7150	\$ 25,200	\$ 1,040	\$ 26,240	\$ 13,050	\$ 1,231	\$ 1,411	\$ 55	\$ 15,748	\$ 10,492
	1	Core storage	7301	294,000	12,139	306,139	195,000	18,404	2,835	112	216,351	89,788
	1	Console card reader	7501	6,300	260	6,560	4,100	292	702	28	4,123	2,436
	1	I/O control	7600	69,300	2,861	72,161	45,200	3,227	1,843	72	49,344	32,817
	1	Arith. and prog. control	7601	292,000	10,405	262,405	185,500	13,732	7,971	314	167,518	94,886
	1	Core storage control	7602	134,400	5,549	139,949	73,950	6,979	2,851	112	83,893	56,055
	1	Tape control	7604	226,800	9,364	236,164	125,500	11,844	7,650	307	145,308	90,856
	1	Power converter	7802	33,600	1,387	34,987	20,000	1,887	539	21	22,438	12,549
	6	Tape drives	729-2	352,800	14,567	367,367	216,000	20,386	84,990	3,474	324,820	42,547
					<u>\$1,394,400</u>	<u>\$7,576</u>	<u>\$1,451,976</u>	<u>\$826,300</u>	<u>\$77,986</u>	<u>\$110,761</u>	<u>\$4,499</u>	<u>\$1,019,546</u>
Three-shift	1	Console control	7150	\$ 32,400	\$ 1,337	\$ 33,737	\$ 13,050	\$ 1,231	\$ 1,814	\$ 71	\$ 16,167	\$ 17,570
	1	Core storage	7301	378,000	15,608	393,608	195,000	18,404	3,645	144	217,193	176,414
	1	Console card reader	7501	8,100	334	8,434	5,100	292	1,053	43	4,488	3,945
	1	I/O control	7600	89,100	3,679	92,779	54,200	3,227	2,370	93	39,891	52,887
	1	Arith. and prog. control	7601	324,000	13,378	337,378	145,500	13,732	10,249	404	169,685	167,492
	1	Core storage control	7602	172,800	7,135	179,935	73,950	6,979	3,666	144	84,444	95,494
	1	Tape control	7604	291,600	12,080	303,680	125,500	11,844	9,844	395	147,584	156,095
	1	Power converter	7802	43,200	1,783	44,983	20,000	1,887	680	27	22,595	22,388
	6	Tape drives	729-2	453,600	18,729	472,329	216,000	20,386	127,440	5,211	369,037	103,292
					<u>\$1,792,800</u>	<u>\$74,026</u>	<u>\$1,866,826</u>	<u>\$826,300</u>	<u>\$77,986</u>	<u>\$160,763</u>	<u>\$6,535</u>	<u>\$1,071,584</u>

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued

NCR 315 CARD AND PAPER TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components Type	Model	Lease alternative			Purchase alternative				Savings (-Loss) on purchase basis	
				Cost to lease	Interest on		Cost to purchase	Cost to purchase	Interest on			Total cost to purchase
					cost to lease	cost to lease			cost to maintain	cost to maintain		
<b>One-shift</b>	2	File processor	315-3	\$ 360,000	\$14,864	\$ 374,864	\$330,000	\$31,145	\$ 24,000	\$ 990	\$ 365,135	\$-11,271
	1	Printer	340-3	85,500	3,530	89,030	72,500	6,842	15,600	544	99,486	-6,556
	5	CRAM	353-1	285,000	11,767	296,767	190,000	17,932	47,500	1,361	259,293	39,374
	1	Card punch buffer	354-1	27,000	1,114	28,114	25,000	2,359	1,800	74	29,233	-1,118
	1	Interconnector	435	11,400	470	11,870	7,500	707	810	33	9,051	2,819
	1	Paper tape R/P	472-1	27,000	1,114	28,114	15,000	1,415	3,000	123	19,539	8,575
	1	Card reader	472-2	27,000	1,114	28,114	20,000	1,887	5,000	206	27,094	1,020
	1	Card punch	7550	28,200	1,164	29,364	20,250	1,911	1,890	78	24,129	5,235
				<b>\$ 851,100</b>	<b>\$35,142</b>	<b>\$ 886,242</b>	<b>\$680,250</b>	<b>\$64,202</b>	<b>\$ 99,600</b>	<b>\$ 4,112</b>	<b>\$ 848,164</b>	<b>\$ 33,076</b>
<b>Two-shift</b>	2	File processor	315-3	\$ 414,000	\$17,054	\$ 431,054	\$330,000	\$31,145	\$ 44,400	\$ 1,833	\$ 407,378	\$ 23,715
	1	Printer	340-3	98,325	4,059	102,384	72,500	6,842	28,860	1,191	109,394	-7,009
	5	CRAM	353-1	327,750	13,533	341,283	190,000	17,932	87,500	3,628	299,435	41,847
	1	Card punch buffer	354-1	31,050	1,282	32,332	25,000	2,359	1,330	137	30,827	1,505
	1	Interconnector	435	13,110	541	13,651	7,500	707	1,498	61	9,768	3,883
	1	Paper tape R/P	472-1	31,050	1,282	32,332	15,000	1,415	5,550	229	22,194	10,137
	1	Card reader	472-2	31,050	1,282	32,332	20,000	1,887	9,250	381	31,519	812
	1	Card punch	7550	32,430	1,339	33,769	20,250	1,911	3,490	144	25,662	7,966
				<b>\$ 978,765</b>	<b>\$40,414</b>	<b>\$1,019,179</b>	<b>\$680,250</b>	<b>\$64,202</b>	<b>\$184,260</b>	<b>\$ 7,608</b>	<b>\$ 536,320</b>	<b>\$ 82,859</b>
<b>Three-shift</b>	2	File processor	315-3	\$ 486,000	\$20,067	\$ 506,067	\$330,000	\$31,145	\$ 71,520	\$ 2,953	\$ 435,618	\$ 70,448
	1	Printer	340-3	115,825	4,766	120,591	72,500	6,842	46,488	1,619	127,750	-7,559
	5	CRAM	353-1	384,750	15,886	400,636	190,000	17,932	141,500	5,844	335,325	45,309
	1	Card punch buffer	354-1	36,450	1,505	37,955	25,000	2,359	5,364	221	39,944	5,010
	1	Interconnector	435	15,390	635	16,025	7,500	707	2,413	99	10,721	5,304
	1	Paper tape R/P	472-1	36,450	1,505	37,955	15,000	1,415	8,940	369	25,724	12,230
	1	Card reader	472-2	36,450	1,505	37,955	20,000	1,887	14,900	615	37,402	552
	1	Card punch	7550	38,070	1,571	39,641	20,250	1,911	5,632	232	26,025	11,615
				<b>\$1,148,985</b>	<b>\$47,442</b>	<b>\$1,196,427</b>	<b>\$680,250</b>	<b>\$64,202</b>	<b>\$296,808</b>	<b>\$12,255</b>	<b>\$1,053,515</b>	<b>\$142,912</b>

Note: Amounts may not add in dollar columns because of omission of cents.



EXHIBIT C - Continued

IBM 1410 CARD AND TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components			Lease alternative			Purchase alternative				Savings (-loss) on purchase basis	
		Type	Model		Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain	Interest on cost to maintain		Total cost to purchase
One-shift	1	Central processor	1411-3	\$ 340,800	\$14,072	\$ 354,872	\$273,475	\$25,810	\$ 5,052	\$ 206	\$304,544	\$ 50,327	
	1	Console	1415-1	15,000	619	15,619	13,600	1,283	645	25	15,554	64	
	1	I/O synchronizer	1414-3	77,100	3,183	80,283	55,575	5,245	1,869	76	62,765	17,517	
	1	Card read/punch	1402-2	36,900	1,523	38,423	32,700	3,086	4,344	174	40,304	-1,681	
	1	Printer	1403-2	51,000	2,105	53,105	37,125	3,503	11,724	472	52,825	280	
	1	I/O synchronizer	1414-1	58,500	2,415	60,915	43,500	4,105	858	35	48,496	12,417	
	4	Tape drives	729-2	168,000	6,936	174,936	144,000	13,590	28,320	1,158	187,068	-12,131	
					<u>\$ 747,300</u>	<u>\$30,856</u>	<u>\$ 778,156</u>	<u>\$599,975</u>	<u>\$56,625</u>	<u>\$ 52,812</u>	<u>\$ 2,149</u>	<u>\$711,561</u>	<u>\$ 66,595</u>
	Two-shift	1	Central processor	1411-3	\$ 477,120	\$19,700	\$ 496,820	\$273,475	\$25,810	\$ 10,104	\$ 413	\$309,803	\$187,017
		1	Console	1415-1	21,000	867	21,867	13,600	1,283	1,290	51	16,225	5,641
1		I/O synchronizer	1414-3	107,940	4,456	112,396	55,575	5,245	3,738	153	64,711	47,685	
1		Card read/punch	1402-2	51,660	2,133	53,793	32,700	3,086	8,688	349	44,823	8,969	
1		Printer	1403-2	71,400	2,948	74,348	37,125	3,503	23,448	944	65,021	9,326	
1		I/O synchronizer	1414-1	81,900	3,381	85,281	43,500	4,105	1,716	70	49,391	35,890	
4		Tape drives	729-2	235,200	9,711	244,911	144,000	13,590	56,640	2,316	216,546	-28,364	
					<u>\$1,046,220</u>	<u>\$43,199</u>	<u>\$1,089,419</u>	<u>\$599,975</u>	<u>\$56,625</u>	<u>\$105,624</u>	<u>\$ 4,298</u>	<u>\$766,523</u>	<u>\$322,896</u>
Three-shift		1	Central processor	1411-3	\$ 613,440	\$25,329	\$ 638,769	\$273,475	\$25,810	\$ 15,156	\$ 620	\$315,062	\$323,707
		1	Console	1415-1	27,000	1,114	28,114	13,600	1,283	1,935	77	16,896	11,218
	1	I/O synchronizer	1414-3	136,780	5,730	144,510	55,575	5,245	5,607	229	66,656	77,853	
	1	Card read/punch	1402-2	66,420	2,742	69,162	32,700	3,086	13,032	523	49,341	19,820	
	1	Printer	1403-2	91,800	3,790	95,590	37,125	3,503	35,172	1,416	77,217	18,373	
	1	I/O synchronizer	1414-1	105,300	4,347	109,647	43,500	4,105	2,574	105	50,284	59,363	
	4	Tape drives	729-2	302,400	12,486	314,886	144,000	13,590	84,960	3,474	246,024	-68,861	
					<u>\$1,345,140</u>	<u>\$55,542</u>	<u>\$1,400,682</u>	<u>\$599,975</u>	<u>\$56,625</u>	<u>\$158,436</u>	<u>\$ 6,447</u>	<u>\$821,484</u>	<u>\$579,198</u>

Note: Amounts may not add in dollar columns because of omission of cents.

## EXHIBIT C - Continued

## UNIVAC SS 90 TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components		Lease alternative			Purchase alternative			Savings (-loss) on purchase basis		
		Type	Model	Cost to lease	Interest cost to lease	Total cost to lease	Cost to purchase	Cost to purchase maintain	Interest on cost to maintain		Total cost to purchase	
One-shift	1	Central processor	7933	\$ 290,100	\$11,978	\$ 302,078	\$213,000	\$20,102	\$ 60,420	\$ 2,494	\$295,017	\$ 6,060
	1	Tape synchronizer	7914	60,000	2,477	62,477	50,000	4,719	15,000	619	70,338	-7,860
	6	Tape drives	7915	162,000	6,689	168,689	120,000	11,325	40,320	1,664	173,310	-4,621
	1	Card reader	7945	18,300	755	19,055	13,500	1,274	3,900	161	18,835	220
	1	Read/punch	7946	58,500	2,415	60,915	42,700	4,030	20,100	829	67,659	-6,744
	1	Printer	7912	59,100	2,440	61,540	43,300	4,086	21,000	867	69,253	-7,713
					<u>\$ 648,000</u>	<u>\$26,756</u>	<u>\$ 674,756</u>	<u>\$482,500</u>	<u>\$45,538</u>	<u>\$160,740</u>	<u>\$ 6,637</u>	<u>\$695,415</u>
Two-shift	1	Central processor	7933	\$ 406,140	\$16,769	\$ 422,909	\$213,000	\$20,102	\$ 96,672	\$ 3,991	\$333,766	\$ 89,143
	1	Tape synchronizer	7914	84,000	4,468	88,468	50,000	4,719	24,000	990	79,709	7,758
	6	Tape drives	7915	226,800	9,364	236,164	120,000	11,325	64,512	2,663	198,501	37,663
	1	Card reader	7945	25,620	1,057	26,677	13,500	1,274	6,240	257	21,271	5,406
	1	Read/punch	7946	81,900	3,381	85,281	42,700	4,030	32,160	1,327	80,217	5,063
	1	Printer	7912	82,740	3,416	86,156	43,300	4,086	33,600	1,397	82,374	3,782
					<u>\$ 907,200</u>	<u>\$37,459</u>	<u>\$ 944,659</u>	<u>\$482,500</u>	<u>\$45,538</u>	<u>\$257,184</u>	<u>\$10,619</u>	<u>\$795,841</u>
Three-shift	1	Central processor	7933	\$ 522,180	\$21,561	\$ 543,741	\$213,000	\$20,102	\$126,882	\$ 5,239	\$365,224	\$178,517
	1	Tape synchronizer	7914	108,000	4,459	112,459	50,000	4,719	31,500	1,300	87,519	24,939
	6	Tape drives	7915	291,600	12,040	303,640	120,000	11,325	84,672	3,496	219,493	84,146
	1	Card reader	7945	32,940	1,360	34,300	13,500	1,274	8,190	338	23,302	10,997
	1	Read/punch	7946	105,300	4,347	109,647	42,700	4,030	42,210	1,742	90,682	18,965
	1	Printer	7912	102,380	4,392	110,772	43,300	4,086	44,100	1,820	93,307	17,464
					<u>\$1,166,400</u>	<u>\$48,162</u>	<u>\$1,214,562</u>	<u>\$482,500</u>	<u>\$45,538</u>	<u>\$337,554</u>	<u>\$13,938</u>	<u>\$879,530</u>

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued

HONEYWELL 400 CARD AND TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Components			Lease alternative			Purchase alternative				Savings (-loss) on purchase basis		
	Quantity	Type	Model	Cost to lease	Interest on		Cost to purchase	Cost to purchase	Cost to maintain	Interest on		Total cost to purchase	
					cost to lease	Total cost to lease				cost to purchase			cost to maintain
One-shift	1	Central processor	401	\$ 238,500	\$ 9,847	\$ 248,347	\$178,875	\$16,882	\$ 32,136	\$ 1,270	\$229,164	\$ 19,183	
	1	Additional memory	402	78,000	3,220	81,220	58,500	5,521	4,212	156	68,399	12,820	
	4	Tape drives	404	216,000	8,918	224,918	172,800	16,308	46,656	1,844	237,609	-12,690	
	1	Card reader	423	19,500	805	20,305	14,700	1,387	3,753	140	19,980	324	
	1	Card punch	424	12,240	505	12,745	8,881	838	1,905	77	11,702	1,043	
	1	Multiply-divide	451	15,000	619	15,619	11,250	1,061	810	32	13,153	2,465	
					<u>\$ 579,240</u>	<u>\$23,917</u>	<u>\$ 603,157</u>	<u>\$445,006</u>	<u>\$41,999</u>	<u>\$ 89,472</u>	<u>\$ 3,532</u>	<u>\$580,010</u>	<u>\$ 23,147</u>
Two-shift	1	Central processor	401	\$ 334,068	\$13,794	\$ 347,862	\$178,875	\$16,882	\$ 64,272	\$ 2,541	\$262,570	\$ 85,291	
	1	Additional memory	402	109,257	4,511	113,768	58,500	5,521	8,424	333	72,778	40,990	
	4	Tape drives	404	302,592	12,494	315,086	172,800	16,308	93,312	3,689	286,110	28,975	
	1	Card reader	423	27,314	1,127	28,442	14,700	1,387	7,506	280	23,874	4,568	
	1	Card punch	424	15,936	658	16,594	8,881	838	3,810	155	13,685	2,908	
	1	Multiply-divide	451	21,019	867	21,887	11,250	1,061	1,620	64	13,995	7,891	
					<u>\$ 810,187</u>	<u>\$33,453</u>	<u>\$ 843,640</u>	<u>\$445,006</u>	<u>\$41,999</u>	<u>\$178,944</u>	<u>\$ 7,065</u>	<u>\$673,015</u>	<u>\$170,625</u>
Three-shift	1	Central processor	401	\$ 429,636	\$17,740	\$ 447,376	\$178,875	\$16,882	\$ 96,408	\$ 3,812	\$295,977	\$151,398	
	1	Additional memory	402	140,515	5,802	146,317	58,500	5,521	12,636	499	77,156	69,160	
	4	Tape drives	404	389,184	16,069	405,253	172,800	16,308	139,968	5,534	334,611	70,642	
	1	Card reader	423	35,128	1,450	36,579	14,700	1,387	11,259	421	27,767	8,811	
	1	Card punch	424	19,632	810	20,442	8,881	838	5,715	233	15,668	4,774	
	1	Multiply-divide	451	27,038	1,116	28,154	11,250	1,061	1,430	96	14,837	13,316	
					<u>\$1,041,134</u>	<u>\$42,989</u>	<u>\$1,084,124</u>	<u>\$445,006</u>	<u>\$41,999</u>	<u>\$268,416</u>	<u>\$10,598</u>	<u>\$766,019</u>	<u>\$318,104</u>

Note: Amounts may not add in dollar columns because of omission of cents.

## EXHIBIT C - Continued

## IBM 1401 CARD AND TAPE OFF-LINE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Components			Lease alternative			Purchase alternative			Savings (-loss) on purchase basis		
	Quantity	Type	Model	Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain		Interest on cost to maintain	Total cost to purchase
One-shift	1	Central processor	1401	\$216,900	\$ 8,956	\$225,856	\$164,185	\$15,495	\$ 7,962	\$ 324	\$187,967	\$ 37,888
	1	Card read/punch	1402	35,100	1,449	36,549	31,150	2,939	3,330	128	37,548	-963
	1	Printer	1403	46,500	1,920	48,420	34,000	3,208	11,724	472	49,405	-985
	3	Tape drives	729-2	126,000	5,202	131,202	108,000	10,193	21,240	868	140,301	-9,098
				<u>\$424,500</u>	<u>\$17,528</u>	<u>\$442,028</u>	<u>\$337,335</u>	<u>\$31,837</u>	<u>\$ 44,256</u>	<u>\$1,793</u>	<u>\$415,222</u>	<u>\$ 26,805</u>
Two-shift	1	Central processor	1401	\$303,660	\$12,538	\$316,198	\$164,185	\$15,495	\$ 15,924	\$ 649	\$196,254	\$119,943
	1	Card read/punch	1402	49,140	2,029	51,169	31,150	2,939	6,660	256	41,006	10,162
	1	Printer	1403	65,100	2,688	67,788	34,000	3,208	23,448	944	61,601	6,186
	3	Tape drives	729-2	176,400	7,283	183,683	168,000	10,193	42,480	1,737	162,410	21,273
				<u>\$594,300</u>	<u>\$24,539</u>	<u>\$618,839</u>	<u>\$337,335</u>	<u>\$31,837</u>	<u>\$ 88,512</u>	<u>\$3,587</u>	<u>\$461,272</u>	<u>\$157,566</u>
Three-shift	1	Central processor	1401	\$390,420	\$16,120	\$406,540	\$164,185	\$15,495	\$ 23,886	\$ 974	\$204,541	\$201,999
	1	Card read/punch	1402	63,180	2,608	65,788	31,150	2,939	9,990	384	44,564	21,323
	1	Printer	1403	83,700	3,456	87,156	34,000	3,208	35,172	1,416	73,797	13,358
	3	Tape drives	729-2	226,800	9,364	236,164	108,000	10,193	63,720	2,605	184,518	51,646
				<u>\$764,100</u>	<u>\$31,550</u>	<u>\$795,650</u>	<u>\$337,335</u>	<u>\$31,837</u>	<u>\$132,768</u>	<u>\$5,381</u>	<u>\$507,322</u>	<u>\$288,327</u>

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued

IBM 1401 CARD AND TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Lease alternative			Purchase alternative			Savings (-loss) on purchase basis					
	Quantity	Components Type	Model	Interest on cost to lease	Total cost to lease	Cost to purchase		Interest on cost to purchase	Interest on cost to maintain	Total cost to purchase		
One-shift	1	Central processor	1401	\$149,100	\$ 6,156	\$155,256	\$142,035	\$13,405	\$ 4,887	\$ 197	\$160,525	\$ -5,268
	1	Card read/punch	1402	33,600	1,337	34,937	30,215	2,851	3,090	116	36,275	-1,287
	1	Printer	1403	46,500	1,920	48,420	34,000	3,208	11,724	472	49,405	-985
	1	Additional storage	1406	34,500	1,424	35,924	24,500	2,312	816	33	27,661	8,262
	4	Tape drives	7330	108,000	4,459	112,459	88,000	8,305	12,732	521	109,558	2,900
	1	Paper tape reader	1011	30,000	1,238	31,238	22,400	2,114	2,880	111	27,505	3,733
				<u>\$401,700</u>	<u>\$16,586</u>	<u>\$418,286</u>	<u>\$341,150</u>	<u>\$32,197</u>	<u>\$ 36,129</u>	<u>\$1,454</u>	<u>\$410,931</u>	<u>\$ 7,355</u>
Two-shift	1	Central processor	1401	\$208,740	\$ 8,619	\$217,359	\$142,035	\$13,405	\$ 9,774	\$ 395	\$165,610	\$ 51,748
	1	Card read/punch	1402	47,040	1,942	48,982	30,215	2,851	6,180	236	39,483	9,498
	1	Printer	1403	65,100	2,688	67,788	34,000	3,208	23,448	944	61,601	6,186
	1	Additional storage	1406	48,300	1,994	50,294	24,500	2,312	1,632	67	28,511	21,782
	4	Tape drives	7330	151,200	6,243	157,443	88,000	8,305	25,464	1,042	122,811	34,631
	1	Paper tape reader	1011	42,000	1,724	43,724	22,400	2,114	5,760	222	30,496	13,237
				<u>\$562,380</u>	<u>\$23,221</u>	<u>\$585,601</u>	<u>\$341,150</u>	<u>\$32,197</u>	<u>\$ 72,258</u>	<u>\$2,908</u>	<u>\$448,514</u>	<u>\$137,086</u>
Three-shift	1	Central processor	1401	\$268,380	\$11,081	\$279,461	\$142,035	\$13,405	\$ 14,661	\$ 593	\$170,695	\$108,766
	1	Card read/punch	1402	60,480	2,497	62,977	30,215	2,851	9,270	355	42,691	20,285
	1	Printer	1403	83,700	3,456	87,156	34,000	3,208	35,172	1,415	73,797	13,358
	1	Additional storage	1406	62,100	2,564	64,664	24,500	2,312	2,448	100	29,360	35,303
	4	Tape drives	7330	194,400	8,027	202,427	88,000	8,305	38,196	1,563	136,065	66,361
	1	Paper tape reader	1011	54,000	2,229	56,229	22,400	2,114	8,640	333	33,487	22,742
				<u>\$723,060</u>	<u>\$29,855</u>	<u>\$752,915</u>	<u>\$341,150</u>	<u>\$32,197</u>	<u>\$108,387</u>	<u>\$4,363</u>	<u>\$486,098</u>	<u>\$266,817</u>

Note: Amounts may not add in dollar columns because of omission of cents.

## EXHIBIT C - Continued

## IBM 1401 CARD SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components		Lease alternative			Purchase alternative				Savings (-loss) on purchase basis	
		Type	Model	Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain	Interest on cost to maintain		Total cost to purchase
One-shift	1	Central processor	1401	\$ 90,900	\$ 3,753	\$ 94,653	\$ 91,100	\$ 8,598	\$ 3,183	\$ 127	\$103,008	\$ 8,355
	1	Card read/punch	1402	33,000	1,362	34,362	30,000	2,831	3,090	118	36,039	-1,677
	1	Printer	1403	46,500	1,920	48,420	34,000	3,208	11,724	472	49,405	-985
				<u>\$170,400</u>	<u>\$ 7,035</u>	<u>\$177,435</u>	<u>\$155,100</u>	<u>\$14,638</u>	<u>\$17,997</u>	<u>\$ 718</u>	<u>\$188,453</u>	<u>-\$11,017</u>
Two-shift	1	Central processor	1401	\$127,260	\$ 5,254	\$132,514	\$ 91,100	\$ 8,598	\$ 6,366	\$ 254	\$106,318	\$26,195
	1	Card read/punch	1402	46,200	1,907	48,107	30,000	2,831	6,180	236	39,248	8,859
	1	Printer	1403	65,100	2,688	67,788	34,000	3,208	23,448	944	61,601	6,186
				<u>\$238,560</u>	<u>\$ 9,850</u>	<u>\$248,410</u>	<u>\$155,100</u>	<u>\$14,638</u>	<u>\$35,994</u>	<u>\$1,436</u>	<u>\$207,168</u>	<u>\$41,241</u>
Three-shift	1	Central processor	1401	\$163,620	\$ 6,756	\$170,376	\$ 91,100	\$ 8,598	\$ 9,549	\$ 382	\$109,629	\$60,746
	1	Card read/punch	1402	59,400	2,452	61,852	30,000	2,831	9,270	355	42,456	19,396
	1	Printer	1403	83,700	3,456	87,156	34,000	3,208	35,172	1,416	73,797	13,358
				<u>\$306,720</u>	<u>\$12,664</u>	<u>\$319,384</u>	<u>\$155,100</u>	<u>\$14,638</u>	<u>\$53,991</u>	<u>\$2,154</u>	<u>\$225,883</u>	<u>\$93,501</u>

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued

CDC 160A PAPER TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE YEAR PERIOD

Extent of use	Quantity	Components Type	Model	Lease alternative			Purchase alternative				Savings (-loss) on purchase basis	
				Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain	Interest on cost to maintain		Total cost to purchase
One-shift	1	Central processor	160-A	\$135,000	\$ 5,574	\$140,574	\$ 90,000	\$8,494	\$13,500	\$ 557	\$112,551	\$ 28,022
	1	Input-Output										
		Typewriter	161	<u>15,720</u>	<u>649</u>	<u>16,369</u>	<u>10,500</u>	<u>990</u>	<u>8,400</u>	<u>346</u>	<u>20,237</u>	<u>-3,868</u>
				<u>\$150,720</u>	<u>\$ 6,223</u>	<u>\$156,943</u>	<u>\$100,500</u>	<u>\$9,485</u>	<u>\$21,900</u>	<u>\$ 904</u>	<u>\$132,789</u>	<u>\$ 24,153</u>
Two-shift	1	Central processor	160-A	\$189,000	\$ 7,804	\$196,804	\$ 90,000	\$8,494	\$21,000	\$ 867	\$120,361	\$ 76,442
	1	Input-Output										
		Typewriter	161	<u>22,008</u>	<u>908</u>	<u>22,916</u>	<u>10,500</u>	<u>990</u>	<u>12,600</u>	<u>520</u>	<u>24,611</u>	<u>-1,694</u>
				<u>\$211,008</u>	<u>\$ 8,712</u>	<u>\$219,720</u>	<u>\$100,500</u>	<u>\$9,485</u>	<u>\$33,600</u>	<u>\$1,387</u>	<u>\$144,972</u>	<u>\$ 74,748</u>
Three-shift	1	Central processor	160-A	\$243,000	\$10,033	\$253,033	\$ 90,000	\$8,494	\$27,000	\$1,114	\$126,609	\$126,424
	1	Input-Output										
		Typewriter	161	<u>28,296</u>	<u>1,168</u>	<u>29,464</u>	<u>10,500</u>	<u>990</u>	<u>16,800</u>	<u>693</u>	<u>28,984</u>	<u>479</u>
				<u>\$271,296</u>	<u>\$11,202</u>	<u>\$282,498</u>	<u>\$100,500</u>	<u>\$9,485</u>	<u>\$43,800</u>	<u>\$1,808</u>	<u>\$155,593</u>	<u>\$126,904</u>

Note: Amounts may not add in dollar columns because of omission of cents.

EXHIBIT C - Continued

RCA 501 TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components Type	Model	Lease alternative			Purchase alternative				Savings (-loss) on purchase basis	
				Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain	Interest on cost to maintain		Total cost to purchase
Base rental	1	Central processor	503	\$ 333,720	\$13,779	\$ 347,499	\$218,500	\$20,622	\$ 18,000	\$ 714	\$ 257,836	\$ 89,662
	1	Storage	561-2	210,120	8,676	218,796	150,500	14,204	3,024	115	167,843	50,952
	10	Tape units	581	340,200	14,047	354,247	297,000	28,030	85,440	3,465	413,936	-59,689
	1	Tape switching unit	547-6	18,540	765	19,305	11,800	1,113	1,032	40	13,986	5,318
	1	RM printer	535	105,060	4,338	109,398	85,000	8,022	21,672	873	115,567	-6,169
				<u>\$1,007,640</u>	<u>\$41,606</u>	<u>\$1,049,246</u>	<u>\$762,800</u>	<u>\$71,993</u>	<u>\$129,168</u>	<u>\$ 5,210</u>	<u>\$ 969,171</u>	<u>\$ 80,074</u>
Extended use five day	1	Central processor	503	\$ 390,000	\$16,103	\$ 406,103	\$218,500	\$20,622	\$ 30,745	\$ 1,221	\$ 271,089	\$135,013
	1	Storage	561-2	246,000	10,157	256,157	150,500	14,204	5,171	198	170,073	86,084
	10	Tape units	581	396,000	16,351	412,351	297,000	28,030	236,755	9,601	571,387	-159,035
	1	Tape switching unit	547-6	21,600	891	22,491	11,800	1,113	1,781	70	14,765	7,726
	1	RM printer	535	122,400	5,054	127,454	85,000	8,022	60,114	2,422	155,558	-28,104
				<u>\$1,176,000</u>	<u>\$48,558</u>	<u>\$1,224,558</u>	<u>\$762,800</u>	<u>\$71,993</u>	<u>\$34,568</u>	<u>\$13,513</u>	<u>\$1,182,874</u>	<u>\$ 41,683</u>
Extended use seven day	1	Central processor	503	\$ 420,000	\$17,342	\$ 437,342	\$218,500	\$20,622	\$ 36,490	\$ 1,450	\$ 277,063	\$160,279
	1	Storage	561-2	264,000	10,900	274,900	150,500	14,204	6,138	235	171,077	103,822
	10	Tape units	581	432,000	17,837	449,837	297,000	28,030	304,953	12,366	642,350	-192,512
	1	Tape switching unit	547-6	23,400	966	24,366	11,800	1,113	2,119	83	15,116	9,249
	1	RM printer	535	132,600	5,475	138,075	85,000	8,022	77,440	3,120	173,582	-35,507
				<u>\$1,272,000</u>	<u>\$52,522</u>	<u>\$1,324,522</u>	<u>\$762,800</u>	<u>\$71,993</u>	<u>\$427,142</u>	<u>\$17,255</u>	<u>\$1,279,191</u>	<u>\$ 45,331</u>

Note: Amounts may not add in dollar columns because of omission of cents.



EXHIBIT C - Continued

RCA 301 CARD AND PAPER TAPE SYSTEM

COMPARISON OF LEASE AND PURCHASE COSTS  
OVER A FIVE-YEAR PERIOD

Extent of use	Quantity	Components		Lease alternative			Purchase alternative				Savings (-Loss) on purchase basis		
		Type	Model	Cost to lease	Interest on cost to lease	Total cost to lease	Cost to purchase	Interest on cost to purchase	Cost to maintain	Interest on cost to maintain		Total cost to purchase	
Base rental	1	Central processor	304	\$145,250	\$ 5,997	\$151,257	\$112,900	\$10,655	\$ 5,788	\$ 230	\$123,528	\$21,723	
	1	Paper tape reader	311	7,440	307	7,747	5,900	566	414	16	6,887	859	
	1	Data file control	317	7,740	319	8,059	6,250	589	474	19	7,332	726	
	1	Paper tape R/P	321	10,500	433	10,933	7,800	736	1,158	45	9,739	1,194	
	1	Data record file	361	18,540	765	19,305	14,900	1,406	6,126	246	22,978	-3,373	
	1	Printer	333	43,260	1,786	45,046	32,200	3,039	11,748	472	47,459	-2,413	
	1	Printer control	316	9,300	384	9,684	7,850	740	540	21	9,152	531	
	1	Typewriter verifier	326	9,300	384	9,684	4,500	424	1,176	43	6,146	3,537	
	1	Card reader	323	21,660	894	22,554	15,850	1,495	2,092	80	19,478	3,076	
	1	Card reader control	314	8,040	331	8,371	6,900	651	480	19	8,050	221	
					<u>\$281,040</u>	<u>\$11,604</u>	<u>\$292,644</u>	<u>\$215,050</u>	<u>\$20,296</u>	<u>\$ 29,916</u>	<u>\$1,196</u>	<u>\$266,459</u>	<u>\$26,185</u>
	Extended use Five day	1	Central processor	304	\$168,000	\$ 6,936	\$174,936	\$112,900	\$10,655	\$ 15,937	\$ 640	\$140,133	\$34,803
		1	Paper tape reader	311	8,700	359	9,059	5,900	566	1,163	45	7,622	1,392
1		Data file control	317	9,000	371	9,371	6,250	589	1,326	54	8,220	1,151	
1		Paper tape R/P	321	12,300	507	12,807	7,800	736	2,236	126	11,999	908	
1		Data record file	361	21,600	891	22,491	14,900	1,406	16,997	684	33,987	-11,495	
1		Printer	333	60,400	2,481	62,881	32,200	3,039	32,739	1,312	62,190	-16,709	
1		Printer control	316	10,800	445	11,245	7,850	740	1,460	57	10,109	1,136	
1		Typewriter verifier	326	10,800	445	11,245	4,500	424	3,254	126	8,306	2,939	
1		Card reader	323	25,200	1,040	26,240	15,850	1,495	6,430	219	23,196	3,044	
1		Card reader control	314	9,200	384	9,584	6,900	651	1,400	55	9,006	577	
					<u>\$326,100</u>	<u>\$13,465</u>	<u>\$339,565</u>	<u>\$215,050</u>	<u>\$20,296</u>	<u>\$ 83,046</u>	<u>\$3,323</u>	<u>\$321,716</u>	<u>\$17,848</u>
Extended use Seven day		1	Central processor	304	\$183,000	\$ 7,556	\$190,556	\$112,900	\$10,655	\$ 20,530	\$ 824	\$144,910	\$45,645
		1	Paper tape reader	311	9,300	364	9,664	5,900	566	1,561	49	8,017	1,646
	1	Data file control	317	9,300	408	10,308	6,250	589	1,710	70	8,619	1,688	
	1	Paper tape R/P	321	13,200	545	13,745	7,800	736	4,173	162	12,872	872	
	1	Data file record	361	23,400	966	24,366	14,900	1,406	21,897	881	39,084	-14,718	
	1	Printer	333	54,600	2,254	56,854	32,200	3,039	42,054	1,591	70,985	-22,130	
	1	Printer control	316	11,700	483	12,183	7,850	740	1,874	74	10,540	1,642	
	1	Typewriter verifier	326	11,700	483	12,183	4,500	424	4,191	163	9,279	2,903	
	1	Card reader	323	27,600	1,139	28,739	15,850	1,495	7,243	282	24,972	3,767	
	1	Card reader control	314	10,200	423	10,623	6,900	651	1,814	71	9,437	1,183	
					<u>\$354,600</u>	<u>\$14,611</u>	<u>\$369,211</u>	<u>\$215,050</u>	<u>\$20,296</u>	<u>\$106,992</u>	<u>\$4,281</u>	<u>\$346,620</u>	<u>\$22,620</u>

Note: Amounts may not add in dollar columns because of omission of cents.

APPENDIXES

APPENDIX I-a

COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON 25



B-115386

August 26, 1960

Honorable John Lesinski  
Chairman, Subcommittee on Census  
and Government Statistics  
Committee on Post Office and Civil Service  
House of Representatives

Dear Mr. Chairman:

During the hearing held by your Subcommittee on June 5, 1959, on the use of automatic data processing equipment in the Federal Government, representatives of the General Accounting Office and the Bureau of the Budget were requested to make a study of Federal agency policies with regard to lease vs. purchase of automatic data processing equipment.

A considerable amount of work has been done by our agencies on this study, working with representatives of other Government agencies and ADP equipment suppliers in an effort to ascertain the basis for present agency practices in acquiring the use of this kind of equipment. Since a significant amount of detailed analysis work remains to be done, we are submitting this interim progress report at this time to advise you of the status of the study and to summarize some of the information obtained.

Interagency ADP report on rental  
vs. purchase of ADP equipment

In April 1958, a task force of the Interagency ADP Committee completed a report entitled "Rental vs. Purchase Criteria for ADP and EAM Equipment." This report was widely circulated in the Federal Government and it has been extensively used as a reference document in connection with individual agency studies of the lease vs. purchase problem.

Background of Government practice  
with regard to lease vs. purchase

Over the years, it has been the practice of Federal agencies to lease rather than to purchase punched card and electronic data processing machines. As of the present time, most of the punched card and electronic equipment used in Government operations is on a lease basis. Numerous reasons have been advanced as justification for this practice. Chief among these reasons are the following:

1. Leased equipment can more easily be replaced by new, improved equipment, thereby encouraging the use of the most modern equipment.
2. Maintenance of the equipment is the supplier's responsibility, which carries with it the need for the suppliers' organization, rather than the Government, to retain a trained maintenance staff and to supply maintenance material and spare parts.
3. Modification and improvement of leased equipment can be more readily provided by the trained maintenance staff of the equipment supplier.
4. Systems and procedures help is more readily available from the equipment supplier if the equipment is being leased.
5. Leasing is a hedge against obsolescence.
6. Capital investment is not required.
7. The risk of major loss by fire or other disaster is avoided.
8. Leasing provides a hedge against failure of the system to operate as expected.
9. Leasing provides a hedge against changing missions and military or other requirements.

On the other hand, agencies that have purchased equipment outright contend that overall costs to the Government are lower, particularly when the equipment is used on a multiple-shift basis. Among the principal arguments that have been advanced in favor of purchasing ADP equipment are the following:

1. Overall costs to the Government are lower over a long period of time.
2. Data processing systems that were installed six and seven years ago are still in use and performing dependable service.
3. If the equipment ceases to be economically efficient for the original activity, the equipment might well be used in another Government activity.
4. If it is necessary to exchange equipment for any reason, the trade-in allowance can be applied to the purchase price of the new equipment.

5. Purchase prevents additional charges by the suppliers for multiple-shift usage.
6. There is no danger of being unable to renew a lease or having to pay a premium rental for renewal.

Out of the 540 computers installed in Government as of June 1960, only 85 have been purchased. The continuation of the trend toward leasing is evidenced by the fact that for the current fiscal year, only 4 machines are scheduled to be purchased out of the approximately 100 computers scheduled for installation.

In our studies, we have found that in some instances agency regulations favor leasing as a matter of agency policy by considering leasing to be the normal practice and requiring specific cost study justifications for the purchase of equipment. Also, our reviews have disclosed that some agencies have recently concluded studies which support the contention that purchase of certain kinds of equipment is less costly in the long run, particularly where extra shifts of usage of the equipment is involved.

In view of the results of these agency studies, we plan to pursue our review along the lines of attempting to more specifically develop the criteria which should be considered in arriving at lease vs. purchase decisions in the agencies. At the present time, since the preponderance of all Government EDP equipment is leased, it is apparent that under existing agency programs, present practices favor leasing rather than outright purchase of equipment. We feel, therefore, at this point in our studies, that agencies should give more favorable consideration to purchasing ADP equipment in those instances where savings can be demonstrated over a period of several years even though large capital outlays would be involved initially. This requirement can be established through Bureau of the Budget regulation, or other Executive Branch action; and provision could be made for a review of individual agency determinations during the regular budget review cycle, using criteria established by the Bureau of the Budget as an outgrowth of our present study.

This status report has been reviewed with representatives of the Bureau of the Budget and the information discussed herein has their concurrence. We will continue to carry out our studies of this matter and we will keep you advised as further developments occur.

Sincerely yours,

Joseph Campbell

Comptroller General  
of the United States



## APPENDIX I-b

COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON 25

B-115386

November 8, 1961

Honorable John Lesinski  
Chairman, Subcommittee on Census  
and Government Statistics  
Committee on Post Office and Civil Service  
House of Representatives

Dear Mr. Chairman:

In an interim progress report to your Committee on the subject of lease vs. purchase of automatic data processing equipment in the Federal Government, dated August 26, 1960, we advised you of the status of the study of this matter which we were conducting jointly with the Bureau of the Budget at the request of your Committee.

We commented in the report that our studies to that point indicated that agencies should give more favorable consideration to purchasing ADP equipment in instances where savings could be demonstrated over a period of several years even though large capital outlays would be involved initially. We further stated that this requirement could be established through Bureau of the Budget regulations or other executive branch action, and provision could be made for a review of individual agency determinations during the regular budget review cycle, using criteria established by the Bureau of the Budget as an outgrowth of the studies being conducted.

On October 14, 1961, the Bureau of the Budget issued its Circular No. A-54 to the heads of executive departments and establishments on policies on selection and acquisition of automatic data processing equipment. A copy of this circular is enclosed for your information and use. This document establishes executive branch policy with regard to not only the question of lease vs. purchase of ADP equipment, but also the matter of selection and acquisition of such equipment by the agencies.

We believe that with the release of this circular the initial joint study with the Bureau of the Budget of this matter has been completed. However, our Office plans to carry out additional reviews in individual agencies with respect to the utilization of ADP equipment, including the lease vs. purchase subject, and we will keep you informed on the results of this work.

Sincerely yours,

Joseph Campbell

Comptroller General  
of the United States

APPENDIX I-c

EXECUTIVE OFFICE OF THE PRESIDENT  
BUREAU OF THE BUDGET  
WASHINGTON 25, D. C.

October 14, 1961

CIRCULAR NO. A-54

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Policies on selection and acquisition of automatic data processing (ADP) equipment

1. Purpose. This Circular prescribes policies on (a) making selections of equipment to be acquired for use in the automatic data processing (ADP) program of the executive branch, and (b) making determinations as to whether the ADP equipment to be acquired will be leased, purchased, or leased with an option to purchase.

2. Scope. The ADP equipment affected by the policies stated herein includes:

- a. Electronic digital computers, irrespective of use, size, capacity, or price;
- b. All peripheral or auxiliary equipment used in support of electronic computers, whether or not cable-connected and whether selected and acquired with the computer or separately;
- c. Punched-card equipment, whether used in conjunction with or independent of an electronic computer; and
- d. Data transmission or communications equipment that is selected and acquired solely or primarily for use with a configuration of ADP equipment which includes an electronic computer.

Analog computers are covered only when computers of this type are being used as equipment peripheral to a digital computer.

Items of ADP equipment that are (a) physically incorporated in a weapon, or (b) manufactured for the Government under a developmental contract, are not affected by the policies stated herein.

3. Applicability. The policies herein apply to ADP equipment acquired by the Government and to that ADP equipment which is acquired and operated by Government contractors solely to process Government data at Government expense (e.g., Government-owned, contractor-operated facilities). These policies do not apply to ADP equipment acquired by universities and similar institutions with financial assistance through grants-in-aid of Government funds.

(No. A-54)

The policy provisions of this Circular become applicable when a determination has been made that the utilization of ADP equipment is essential. It is assumed that such determinations have been preceded by and are based upon the results of well-documented studies which provide an adequate factual basis for concluding (a) that the functions or processes for which the ADP equipment can be used are essential to perform, and (b) that the systems, procedures, and methods to be employed in performing these functions or processes have been designed to achieve the highest practicable degree of effectiveness with optimum efficiency and operational economy. Guidelines for planning and conducting studies preceding a decision to utilize ADP equipment, for the development of system specifications, and for equipment evaluation and selection are contained in Bureau of the Budget Bulletin No. 60-6, "Automatic Data Processing (ADP) Program of the Executive Branch: Studies preceding the acquisition of ADP equipment," dated March 18, 1960.

4. Policies on equipment selection. The selection of ADP equipment includes the initial selection of ADP equipment, the selection of ADP equipment additional to that on hand, the selection of ADP equipment to replace ADP equipment on hand, the modification of equipment on hand, usually for the purpose of increasing memory capacity, computational capability, or speed of input or output, or combinations of the foregoing. In all these circumstances, the following policies apply:

a. The selection of ADP equipment will not be made until system specifications are available to serve as a basis for selection. For purposes of this Circular, the term "system specifications" means (1) the delineation of the objectives which the system is intended to accomplish; (2) the data processing requirements underlying that accomplishment, i.e., a description of the data output and its intended uses, the data input, data files, volumes of data, processing frequencies and timing; and (3) such ADP equipment capabilities as may need to be identified. System specifications will be designed to insure free competition among equipment manufacturers.

b. The officials responsible for making decisions on the selection of ADP equipment will assure that the selection process accords equal opportunity and appropriate consideration to all manufacturers who offer equipment capable of meeting the system specifications. In this connection, the selection process may be facilitated by written invitations to manufacturers to submit proposals as a means for obtaining information regarding the capabilities of ADP equipment to meet the system specifications.

c. Two prime factors will be considered in the selection of equipment: (1) its capability to fulfill the system specifications, and (2) its overall costs, in terms of acquisition, preparation for use, and operation. The term overall costs, as used in this paragraph, will be interpreted to include such cost elements as personnel, purchase price or rentals, maintenance of purchased equipment, site preparation and installation, programming and training. When ADP equipment of two or more manufacturers meets the system specifications, the equipment which represents the least overall cost to the Government will be selected. Factors which do not relate directly or indirectly to the capability of ADP equipment to meet system specifications or overall costs normally will not be included in the considerations unless a conclusive judgment cannot be made on the basis of the two prime factors.

5. Policies on equipment acquisition. Most commercially available ADP equipment can be acquired by purchase or by lease, with or without an option to purchase. The General Services Administration has contracts with principal manufacturers, listed in Federal Supply Schedules (FSS), for the rental of ADP equipment. GSA currently is negotiating contracts for the purchase (including provisions for trade-in allowances) and maintenance of ADP equipment. Until such time as these contracts appear on the Federal Supply Schedule, it will be necessary for departments and agencies to negotiate purchase and maintenance transactions. All ADP equipment acquisition transactions are subject to prevailing policies, laws and regulations governing procurement by Federal Government agencies. In addition, except for equipment that can be acquired by the purchase method only, the following policies are applicable:

a. The method of acquiring ADP equipment will be determined after careful consideration of the relative merits of all methods available (i.e., purchase, lease, or lease-with-option-to-purchase). The method chosen will be that which offers the greatest advantage to the Government under the circumstances which pertain to each situation. In this connection, the following general guidelines will be taken into account:

(1) The purchase method is preferred when all of the following conditions exist:

(a) The system study which preceded the selection of the equipment has established a reasonable expectancy that the ADP equipment under consideration can be successfully and advantageously used.



(b) A comparative cost analysis of the alternative methods of acquisition, of the types illustrated by Attachments A and B, indicates that a cost advantage can be obtained by the purchase method in six years or less after the date of delivery. This analysis usually will include the following cost elements under each method: for the lease method--rental costs, including maintenance; for the purchase method--purchase costs, including purchase price, maintenance, and other one-time costs applicable only to purchase; for the lease-with-option-to-purchase method--rental costs, and purchase costs less credits applicable upon purchase. In addition to the cost elements described above, the residual value of equipment to the Federal Government will be considered as a factor in a comparative cost analysis. Trade-in allowances quoted by manufacturers may be used as a representation of the residual value.

(c) The capabilities of the ADP equipment will continue to be needed and will be sufficient to satisfy the system requirements, current and projected, for a period beyond the point in time at which the purchase method begins to provide a cost advantage. The possibility that future technological advances will render the selected equipment comparatively obsolete before the cost advantage point is reached should not rule out purchase if the selected equipment is expected to be able to satisfy the system requirements.

(2) The lease-with-option-to-purchase method is indicated when it is necessary or advantageous to proceed with the acquisition of the equipment that meets system specifications, but it is desirable to defer temporarily a decision on purchase because circumstances do not fully satisfy the conditions which would indicate purchase. This situation might arise when it is determined that a short period of operational experience is desirable to prove the validity of a system design on which there is no previous experience, or where decisions which might substantially alter the system specifications are imminent.

(3) The lease method, without option to purchase, is indicated only when it is necessary or advantageous to proceed with the acquisition of equipment that meets system specifications and it has been established conclusively that any one of the conditions under which purchase is indicated is not attainable.

b. Negotiations or renegotiations of equipment delivery dates will be conducted in a manner which insures that firm and final commitments by the Government to accept delivery of ADP equipment on a specific date will not be made until it has been determined through a readiness review that the using agency will be prepared to use the equipment productively as soon as it becomes operational

6. Review of current or pending lease transactions.

a. Lease or lease-with-purchase-option transactions in effect at the time this Circular is issued, and which are expected to remain in effect until fiscal year 1964, will be reviewed in the light of the provisions of paragraph 5. If it is found to be to the advantage of the Government to purchase leased ADP equipment in this category, steps will be taken to make such purchases during the earliest fiscal year in which funds for this purpose are available to the agency. Reviews of current lease transactions should be undertaken as soon as practicable and completed by June 30, 1962.

b. The method of acquisition of ADP equipment selected but not yet accepted for delivery at the time this Circular is issued will be reviewed for adherence to the policies herein stated, and, when indicated, the basis of acquisition will be changed to conform if permitted by the terms of the contract or agreement.

7. Documentation. System studies (sometimes referred to as applications studies, feasibility studies, and by other terms), system specifications, and readiness reviews will be fully documented. Decisions on the selection of ADP equipment, on the method of acquisition, and on the review of the current status of the method of acquisition also will be documented to reflect adequately the considerations taken into account and the basis for the decisions.

8. Administration of policies. The head of each executive department and establishment will establish the necessary framework of procedures, including appropriate reviews and controls, that will assure compliance with the policies herein stated.

By direction of the President:

DAVID E. BELL  
Director

Attachments 2

ATTACHMENT A  
CIRCULAR NO. A-54

LEASE VS. PURCHASE  
REPRESENTATIVE ADP COMPUTER SYSTEM  
BASED ON TWO-SHIFT USE

ITEM OF COST	COSTS BY FISCAL YEAR					
	1962*	1963	1964	1965	1966	1967
1. Purchase basis:	\$	\$	\$	\$	\$	\$
a. Purchase costs.	600,000	0	0	0	0	0
b. Maintenance, cumulative.	45,000	90,000	135,000	190,000	245,000	300,000
c. Cumulative, purchase basis.	645,000	690,000	735,000	790,000	845,000	900,000
2. Lease basis, cumulative (including maintenance).	200,000	400,000	600,000	800,000	1,000,000	1,200,000
3. Purchase basis exceeds lease basis.	445,000	290,000	135,000	--	--	--
4. Lease basis exceeds purchase basis.	--	--	--	10,000	145,000	300,000

\* Year acquired, utilized full year.

ATTACHMENT B  
CIRCULAR NO. A-54

LEASE VS. LEASE-WITH-  
OPTION-TO-PURCHASE  
REPRESENTATIVE ADP COMPUTER SYSTEM  
BASED ON ONE-SHIFT USE

ITEM OF COST	COSTS BY FISCAL YEAR					
	1962*	1963	1964	1965	1966	1967
1. Lease basis, with-option-to-purchase: (Option exercised at end of first year).	\$	\$	\$	\$	\$	\$
a. Lease.	150,000	--	--	--	--	--
b. Less, credit upon purchase.	-75,000	--	--	--	--	--
c. Purchase costs.	600,000	0	0	0	0	0
d. Maintenance, cumulative.	26,000	52,000	78,000	108,000	138,000	168,000
e. Cumulative, lease/option basis.	701,000	727,000	753,000	783,000	813,000	843,000
2. Lease basis, cumulative (including maintenance).	150,000	300,000	450,000	600,000	750,000	900,000
3. Lease/option exceeds lease basis.	551,000	427,000	303,000	183,000	63,000	--
4. Lease basis exceeds lease/option basis.	--	--	--	--	--	57,000

\* Year acquired, utilized full year.

## APPENDIX 2

(Correspondence between Chairman Douglas and Department of Commerce re surplus property sales and their impact in the economy)

MARCH 12, 1963.

Hon. LUTHER H. HODGES,  
*Secretary of Commerce,*  
*Washington, D.C.*

DEAR MR. SECRETARY: The Procurement Subcommittee of the Joint Economic Committee will hold hearings on March 28, 29, and April 1, 1963, as a follow-up on recommendations contained in its report of October 1960 on Economic Aspects of Military Procurement and Supply, as amplified by the subcommittee's hearings on June 12, 1961.

While it will not be necessary for your Department to have a witness at the forthcoming hearings, it would be appreciated if you would supply for the record by that date a listing of surplus property market impact actions since June 1961, a copy of the updated 1954 agreement on disposal to which you refer in your letter of July 11, 1961, to me, and such other information as you may consider valuable to the subcommittee.

You may contact Mr. Ray Ward, economic consultant to the subcommittee for additional information if desired on Capital 4-3121 (code 180), extension 5220.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

DEPARTMENT OF COMMERCE,  
BUSINESS AND DEFENSE SERVICES ADMINISTRATION,  
*Washington, March 29, 1963.*

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

DEAR MR. CHAIRMAN: This is in further reference to your request of March 12, 1963, which was acknowledged by our General Counsel on March 19, 1963.

We are pleased to report herein on the surplus property activities of the Business and Defense Services Administration and on related developments during the period June 16, 1961, through March 15, 1963. Your letter requested three items of information: a listing of market impact recommendations made by BDSA since our report to you of June 19, 1961; a copy of the revised DOD-BDSA agreement covering market impact referrals and recommendations; and finally, other related information that we consider of value to the Procurement Subcommittee.

In response to the first item requested there is attached hereto a 10-page listing of "BDSA Surplus Property Market Impact Recommendations." This list includes 135 actions of which 134 concerned DOD surplus and 1 covered Atomic Energy Commission (AEC) property (lithium). For each action there is shown the name of the product, quantity, acquisition cost, date of the report to the requesting agency, our evaluation of the degree of impact—none, slight, moderate or severe—and our disposal recommendation. The last column shows the action taken by the disposing agency if it is known. In the interest of economy, we do not as a rule ask for a report of action taken when the market impact is likely to be insignificant.

We regret that we cannot comply with your request for a copy of the revised DOD-BDSA agreement since it has not been consummated. This has not been due to lack of agreement between the agencies but rather preoccupation of the few qualified experts in this field with other problems and to some extent a lessening of the need for a major change in procedure. In our June 19 and July 11, 1961, letters to you, the problem of increased disposals, both as to size of individual lot and repetitive offering of the same item in different sales, was described. We had observed this phenomenon in the first half of 1961 as a corollary of base closings and establishment of the consolidated surplus sales offices in that period. The incidence of these increased disposals declined in the latter half of 1961 and in 1962 was almost nonexistent.

Part of this change may be due to lowered cut-off points for impact referral which were informally agreed to between the agencies. DOD officials attribute it in part to better screening for reutilization, and improved procurement through expansion of single manager operations.

There is, nevertheless, a need for a revised agreement to formalize some existing practices, and further modify referral criteria. This will be undertaken as soon as staff time permits.

Finally, as regards your last item, we are describing below disposal problems and developments pertaining to individual products which may be of interest to the subcommittee.

At the time of our June 19, 1961, report, discussions were underway with DOD regarding the disposal of surplus smokeless powder and TNT. The recommendation made by BDSA was accepted by DOD and sales of surplus are now proceeding at a maximum annual rate of 17 million pounds for the two products combined.

Similarly, our recommendation on disposal of 16,000 contaminated containers of 1-ton liquid capacity was in suspense pending a determination as to whether they could be decontaminated. It was found that 6,000 were beyond recovery and that restoration of the balance would cost more than could be realized in a surplus sale. We therefore recommended that the containers be scrapped. A method of accomplishing this is now being developed.

#### LITHIUM

As noted in our report of June 19, 1961, this Agency proposed to make a survey of the lithium industry in early 1962 covering operations in the calendar year 1961. This was to provide a basis for reevaluating our recommendations not to sell which were made to AEC and the Air Force in April 1961.

Our survey revealed that the distribution of U.S. produced lithium compounds had risen to about 8,500,000 pounds from the approximately 7,500,000-pound level of 1960, but that nearly all of this could be accounted for by increased exports, with very little change in size of domestic markets. Therefore, recommendations were made in June 1962 that no disposals be made for the present. At the same time, the agencies were provided with a summary of several potential new uses for lithium, which indicated that if one or more of these should develop there would be an enlarged market that could absorb some of the surplus.

In the fall of 1962 the Air Force declared the Model City, New York, Plant No. 68, to be excess to its needs. This is where the Air Force lithium, consisting of 120,000 pounds of metal and 940,000 pounds of chloride (impure and processed), is stored. The General Services Administration (GSA) now has the plant for disposal. If no need for it develops elsewhere in the Federal Government or by an eligible donee, GSA advises that it will be offered for sale in the very near future. On January 23, 1963, the GSA requested us to provide market advice and impact recommendations as regards the lithium.

On February 18, 1963, the AEC requested that we reevaluate the lithium disposal problem. That Agency advised they had received an audit report from the General Accounting Office which stated:

"The matter of devising an acceptable disposal program should be vigorously pursued with the Business and Defense Services Administration and, if necessary, with the Secretary of Commerce and the Executive Office of the President."

On March 15, 1963, representatives from AEC, GSA, and BDSA met and discussed all aspects of the problem.

During March, BDSA surveyed the industry again, and is presently tabulating the results. When the tabulation is completed a new appraisal and appropriate recommendation will be made.

#### ANCHORS

For the past 3 years, following a recommendation by BDSA, the DOD has sold all anchors weighing 8,000 pounds and over with a warranty requiring the purchaser to reduce them to scrap. This policy was based on findings that disposal as anchors would cause a serious adverse impact on the domestic economy.

In 1962 a number of complaints were lodged with BDSA and DOD to the effect that this scrap policy should be reevaluated, modified, or reversed.

Following several discussions and meetings with DOD, a reevaluation program was developed and is now being carried out. This includes the updating of economic and statistical facts about the industry and the conduct of test sales to determine the rate of return to the Government when sold as anchors and as scrap. Results of the study are expected by midyear.

## BEARINGS, ANTI-FRICTION

In the fall of 1961 a number of representations were made to BDSA and DOD that the sale of anti-friction bearings, especially those recognized in the industry as "specials" was inadvisable from the point of view of public safety and could reflect adversely on the manufacturers' reputation.

An ad hoc industry task group met under BDSA auspices on April 10, 1962, with officials of the Defense Supply Agency, General Services Administration, and BDSA to discuss this and related problems of surplus bearing disposal. Since this meeting several recommendations have been submitted to DOD by industry representatives and a number of informal meetings have been held. A generally applicable disposal policy and methods for implementing it are still being worked out.

## MERCURY

The Atomic Energy Commission (AEC) has recently alerted BDSA to the fact that a large quantity of prime virgin mercury has been reported to the General Services Administration as excess to AEC needs. The property, in 50,000 metal flasks of 76 pounds each aggregating 3,800,000 pounds, is of commercial grade and had an acquisition cost of \$11,700,000. GSA in a recent Excess Property Bulletin has announced this property as available for transfer to Federal agencies without reimbursement. Failing other agency acquisition of any appreciable quantity of the mercury we expect to be requested to undertake a market impact study. BDSA findings and recommendations for the disposal of the property will be reported to AEC at that time.

## SMALL ARMS

For a number of years the military services have been disposing of surplus nonautomatic .22 caliber and .30 caliber rifles and shotguns through National Rifle Association authorized sales under the civilian marksmanship program and through DOD retail outlets. The aggregate rate of disposal, however, was insufficient to keep pace with accumulated surplus plus currently generated surplus. While that program was underway, DOD requested that a stepped-up rate of disposal be planned. A revised program was recommended by BDSA and accepted by DOD. It provided for complete disposal of the above types by mid-1964. Details are given in the attached listing.

Subsequently, DOD advised that it was reviewing its policy of scrapping all automatic and semiautomatic weapons and requested comments from BDSA and other interested agencies. This policy, which had been established in the interests of public health, safety, and security was under increasing public and congressional criticism. Secretary Hodges on August 21, 1962, informed DOD as follows: (Italics added.)

"The sale of *automatic* weapons to the general public is controlled under the National Firearms Act. This Department favors a continuation of your policy of demilitarizing (scrapping) this type of surplus weapons.

"With respect to your policy concerning semiautomatic military surplus conventional rifles, pistols, and shotguns, we believe that these types of weapons should not be scrapped. Instead, a program should be developed which will permit their orderly disposal to the general public. It is true that it is possible to modify some of these weapons into fully automatic arms. However, U.S. produced semiautomatic arms which have been sold to foreign governments in the past are now being imported and are advertised for public sale. In addition, semiautomatic arms produced in foreign countries are also permitted entry into the United States for general sale, and similar weapons are produced and sold domestically. In view of the general availability to the public from these sources, it does not appear to serve any useful purpose to destroy U.S. military surplus of the same types.

"In determining the quantity of surplus semiautomatic firearms which may be sold at any one time, consideration should be given to impact upon the domestic sporting arms industry. This Department will be glad to cooperate in the development of a program which will permit the orderly disposal of the surplus semiautomatic firearms, similar to the program which was recently developed by our two Departments with respect to the sale of other weapons."

A meeting was convened by DOD on January 11, 1963, to discuss the position of interested Federal agencies and to reassess its own policy of scrapping or demilitarizing semiautomatic arms. As of this date, no final decision has been forthcoming.

## MACHINE TOOLS

Machine tools and related production equipment items are considered by BDSA at the "excess" stage; i.e., while being offered for Government acquisition outside the holding activity. Market impact referrals for other commodities take place after the property has been screened for possible acquisition by all military and civilian agencies outside the holding activity, and is thus surplus to the needs of the entire Government.

During the period June 16, 1961, to March 15, 1963, approximately 16,200 machine tools and 4,000 furnaces, welders, and other types of related production equipment were declared excess by various operational units of the DOD. At DOD's invitation the Metalworking Equipment Division of BDSA formed industry inspection teams to make on-site inspections and evaluations of the equipment at seven different locations. Of the approximately 4,400 machines examined, the joint industry-Government recommendations provided for the transfer of 765 machines to a standby status in the national industrial equipment reserve (NIER) and retention of some additional units for specialized use in other Government establishments. Altogether 2,800 of the total 20,200 tools and equipment items were transferred for reutilization or to the NIER. Schools working under the donation programs of the Department of Health, Education, and Welfare selected about 8,000 tools for training purposes. The Agency for International Development obtained about 400 for assistance programs in underdeveloped countries. The residual surplus of 9,000 was disposed of in sales spaced so as to minimize impact on the domestic economy.

## NATIONAL STOCKPILE DISPOSALS

The General Services Administration, under direction of the Office of Emergency Planing, carries out disposal programs for surplus strategic materials in the national stockpile and the Defense Production Act inventory. Since we understand that GSA is submitting a report to your committee on stockpile disposals, no further discussion of that subject is contained herein.

We trust this report contains the information desired. We shall of course be pleased to supplement it as you wish.

Sincerely yours,

DANIEL L. GOLDY, *Administrator.*



BDSA surplus property market impact recommendations, June 16, 1961, to Mar. 15, 1963

Product	Quantity	Cost to Government	Date of recommendation	Degree of impact	Recommendation <sup>1</sup>	Action taken (if known) <sup>2</sup>	
<b>A</b>							
Aircraft engines:							
J-40.....	24	\$2,424,000	Jan. 5, 1962	None.....	Sell.....	Sold.	
J-44.....	144	3,339,360	Dec. 6, 1961	do.....	do.....		
J-48.....	20	1,120,000	Dec. 17, 1962	do.....	do.....		
R1300-1B.....	24	329,976	Nov. 27, 1961	Slight.....	do.....		
R1340-48.....	6	132,000	Mar. 7, 1962	None.....	do.....		
R1340-52.....	18	306,000	do.....	do.....	do.....		
Aircraft components and aircraft engine parts:							
Control:							
Automatic pilot.....	362	340,435	July 7, 1961	do.....	do.....	Do.	
Do.....	373	256,251	Sept. 18, 1962	do.....	do.....		
Fuel.....	39	282,360	Dec. 18, 1961	do.....	do.....		
Do.....	38	648,960	Dec. 28, 1962	do.....	do.....		
Cover assembly.....	3,422	256,650	Apr. 16, 1962	do.....	do.....		
Electronic subassemblies (servoamplifiers, antenna controls, gyros):							
Items.....	3	1,109,019	Aug. 31, 1962	do.....	do.....		
Pieces.....	5,059						
Electronic subassemblies: <sup>3</sup>							
Items.....	13	8,045,222	Aug. 30, 1962	do.....	do.....		
Pieces.....	2,944						
Engine transmissions.....	98	347,900	Dec. 1, 1961	Slight.....	do.....		
Indicators, gyroscopic.....	357	253,113	Apr. 27, 1962	None.....	do.....		
Input resolver units.....	884	2,690,782	Sept. 19, 1962	do.....	do.....		
Periscopes.....	72	275,760	Mar. 30, 1962	do.....	do.....		
Position indicator and navigation system.....	1	308,273	Mar. 9, 1962	do.....	do.....		
Receiver-transmitter.....	46	414,000	Aug. 17, 1962	do.....	do.....		
Do.....	691	794,650	Jan. 17, 1962	do.....	do.....		
Resolver assembly.....	240	728,880	Mar. 14, 1963	do.....	do.....		
Servoamplifier.....	471	382,923	do.....	do.....	do.....		
Sextants, periscopic.....	1,010	449,450	Sept. 13, 1962	do.....	do.....		
Slight head assembly.....	128	267,008	Nov. 2, 1962	do.....	do.....		
Tanks, fuel.....	8,848	1,327,200	Sept. 10, 1962	do.....	do.....		
Do.....	3,264	489,000	Feb. 26, 1963	do.....	do.....		
Transceivers:							
Radio.....	400	904,000	Sept. 13, 1961	do.....	do.....		
Radar.....	32	288,000	Nov. 16, 1962	do.....	do.....		
Turbine stator blades (jet turbine).....	34,923	670,522	Dec. 14, 1961	do.....	do.....		
anchors..... 68 pounds each.....	4,340	1,388,800	May 31, 1961	Slight.....	Original recommendation to sell all; rechecked and revised at time of offering, Aug. 14, 1961, to sell half. Residual half was rechecked Feb. 16, 1962, and DOD advised to sell.		

See footnotes at end of table.

BDSA surplus property market impact recommendations, June 16, 1961, to Mar. 15, 1963—Continued

Product	Quantity	Cost to Government	Date of recommendation	Degree of impact	Recommendation <sup>1</sup>	Action taken (if known) <sup>2</sup>
Antenna assemblies, radar	91	273,000	Aug. 17, 1961	None	Sell	
Bearings:						
Antifriction types	298	1,157,915	Feb. 13, 1962	do	do	
Sleeve	7,440	312,480	Feb. 1, 1963	do	Sell. Note silver content to maximize return.	
Boots:						
Felt, arctic pair	97,587	1,873,670	Jan. 15, 1963	do	Sell	Withdrawn for utilization.
Felt, combat do	46,772	898,022	Dec. 6, 1961	do	do	
Brake-lining kits	113,550	285,011	May 9, 1962	do	do	
Cable, power:						
Copperweld feet	4,468,939	446,894	Oct. 6, 1961	do	do	
Type PP-AASA do	775,000	387,500	Nov. 1, 1961	do	do	
No. 10 A WG do	40,920	353,100	Nov. 17, 1961	do	do	
Cable assemblies:						
Magnetic mine sweeping	115	1,845,750	Feb. 8, 1962	do	do	
Telephone	9,391	272,339	July 12, 1962	do	do	
Camera drive assemblies	24	357,600	June 20, 1962	Moderate	Sell singly in 4 offerings of 6 each at 3-month intervals	As recommended.
Containers, 1-ton, liquid gas	10,000	2,760,000	Aug. 16, 1961	Severe	Dispose of as scrap. Probable decontamination and reconditioning cost would exceed return from sale. Reconditioned cylinders would supplant new production.	
None						None.
Cover, folding cot	119,149	476,596	July 21, 1961	None	Sell	
Cranes:						
Gantry:						
35-ton	3	162,981	Nov. 30, 1961	do	do	
45-ton	5	299,473	do	do	do	
Locomotive	2	109,116	Oct. 18, 1961	Slight	do	Sold.
Crane-trucks, warehouse	4					
Cranes, locomotive	7	429,000	Oct. 19, 1961	do	do	Do.
Crane shovels	25	429,200	do	Severe	Sell at rate of 2 per month	
Do	3					As recommended.
Cranes, basic unit	8	249,332	Oct. 18, 1961	do	do	
None						Do.
Electrical equipment:						
Runway lighting assembly	63,152	1,332,896	Mar. 14, 1963	None	Sell	
Transfer power switching units	351	525,500	Mar. 1, 1963	do	do	
Electronic equipment:						
Amplifier	92	270,940	Mar. 14, 1963	do	do	
Carrier monitors	1,194	324,768	July 6, 1962	do	do	
Control, radio set	2,433	605,817	July 7, 1961	do	do	
Indicators, cathode ray	799	399,500	July 21, 1961	do	do	
Intercept controls	18	720,000	Dec. 17, 1962	do	do	
Powerswitching units, transfer	204	265,200	Dec. 4, 1962	do	do	

Radar computing tracking groups.....	7	280,000	do	do	do	
Do.....	7	420,000	do	do	do	
Radar course directing groups.....	6	1,618,800	do	do	do	
Do.....	5	1,349,000	Mar. 14, 1963	do	do	
Radio receiver.....	174	348,000	Dec. 7, 1961	do	do	
Radio sets, multichannel.....	27	358,290	Dec. 4, 1962	Slight	do	Sold.
Radio transmitters.....	94	263,200	Sept. 21, 1962	None	do	
Do.....	100	387,300	Dec. 4, 1962	Severe	Sell at 6-month intervals in lots of 25	As recommended.
Receivers, electronic.....	1,438	1,127,392	July 7, 1961	None	Sell	
Signaling unit, universal.....	54	414,442	May 8, 1962	do	do	
Telephone repeater.....	587	1,080,080	Aug. 10, 1961	do	do	
Tubes, image.....	3,653	387,218	July 14, 1961	do	do	
Engines, diesel.....	112	446,375	Nov. 13, 1961	do	do	
Engine parts, diesel (cylinder liners).....	11,750	296,100	Dec. 26, 1962	do	do	Do.
Engines, jeep.....	1,000	516,000	Mar. 22, 1962	Moderate	Sell 500 at once, 500 in 90 days	
Engines, marine, Packard.....	14	264,320	Oct. 18, 1961	None	Sell	
Fans:						
Centrifugal.....	868	589,009	July 27, 1961	Severe	Sell 1/4 in fall, balance in 6 months	Do.
Do.....	450	248,060	Nov. 2, 1961	do	Defer sale until May or June 1962	Do.
Vaneaxial.....	1,148	1,349,978	July 27, 1961	do	Sell 1/4 in fall, 1/2 and 1/4 at 6-month intervals	Do.
Do.....	334	534,814	Nov. 2, 1961	do	Defer sale until May or June 1962	Do.
Lithium chloride:						
Crude..... pounds.....	773,000	( <sup>o</sup> )	Nov. 13, 1961	do	Do not sell	Do.
Purified..... do.....	166,500	( <sup>o</sup> )	do	do	do	Do.
Lithium metal..... do.....	132,000	( <sup>o</sup> )	do	do	do	Do.
Lithium hydroxide.....	( <sup>o</sup> )	( <sup>o</sup> )	June 25, 1962	do	do	Do.
Nets, camouflage.....	18,804	400,250	July 21, 1961	do	Sell	
Oil seals, truck.....	174,000	645,540	Feb. 13, 1963	do	do	
Pallets:						
Box.....	4,500	( <sup>o</sup> )	July 31, 1961	do	do	
Do.....	5,041	( <sup>o</sup> )	May 2, 1962	do	do	
Flat.....	4,400	( <sup>o</sup> )	Sept. 8, 1961	Moderate	Sell 1/2 now and balance in 30 days	Do.
Do.....	6,575	( <sup>o</sup> )	Nov. 15, 1961	None	Sell	
Do.....	8,206	( <sup>o</sup> )	May 2, 1962	do	do	
Do.....	9,200	( <sup>o</sup> )	Sept. 8, 1961	Moderate	Sell 1/2 now and balance in 30 days	Do.
Tire.....	1,250	( <sup>o</sup> )	Nov. 22, 1961	None	Sell	
2-way.....	1,462	( <sup>o</sup> )	Nov. 1, 1961	do	do	
Propellers, ship.....	277	274,230	Sept. 8, 1961	do	do	
Pump assemblies.....	3,500,000	250,000	Feb. 26, 1963	Severe	If recoverable quartz represents 15 percent or more, sell in small lots over 5 years. If possible to separate lasca grade, that portion could be sold more quickly. Dove-tail offerings of subspecification electronic grade with those of GSA from national stockpile.	Pending.
Quartz..... pounds.....						
Railway cars, mortuary.....	33	4,455,000	June 30, 1961	None	Sell	
Recorder controller, temperature.....	230	250,700	Feb. 28, 1962	do	do	
Searchlight lamp assemblies.....	120	410,400	Aug. 30, 1961	Slight	do	Sold.
Searchlights.....	82	2,132,000	Sept. 26, 1962	None	do	

See footnotes at end of table.

BDSA surplus property market impact recommendations, June 16, 1961, to Mar. 15, 1963—Continued

Product	Quantity	Cost to Government	Date of recommendation	Degree of impact	Recommendation <sup>1</sup>	Action taken (if known) <sup>2</sup>
Ships:						
Barge:						
Cargo.....	1	58,500	July 27, 1961	do	do	
Do.....	1	24,000	Aug. 22, 1961	do	do	
Fuel oil.....	3	( <sup>3</sup> )	Feb. 23, 1962	do	do	
Gasoline.....	1	( <sup>3</sup> )	do	do	do	
Battle damage, repair.....	3	( <sup>3</sup> )	Nov. 1, 1961	do	Refer to Maritime Administration	
Cargo, light.....	6	( <sup>3</sup> )	do	Severe	Defer sale for period of 6 to 8 months	As recommended.
Derrick (lighter).....	1	( <sup>3</sup> )	Nov. 29, 1961	Slight	Sell	Sold.
Freight and supply.....	3	3,620,000	July 12, 1961	None	do	
Landing craft, repair.....	4	( <sup>3</sup> )	Nov. 1, 1961	do	Refer to Maritime Administration	
Mineplanter and cable.....	1	1,600,000	July 27, 1961	None	Sell	
Minesweeper, coastal.....	1	( <sup>3</sup> )	Nov. 1, 1961	do	do	
Motor mine planter.....	2	( <sup>3</sup> )	Feb. 23, 1962	do	do	
Net-laying.....	1	( <sup>3</sup> )	Nov. 1, 1961	Severe	Defer sale for period of 6 to 8 months	As recommended.
Passenger and cargo.....	1	186,500	July 3, 1961	None	Sell	
Small, miscellaneous.....	6	798,500	Nov. 29, 1961	Slight	do	Sold.
Do.....	6	4,149,804	Sept. 27, 1962	do	do	Do.
Do.....	5	1,825,800	Dec. 21, 1961	None	do	
Tug:						
Harbor.....	1	270,000	July 7, 1961	do	do	
Do.....	1	400,000	Oct. 16, 1961	do	do	
Do.....	1	( <sup>3</sup> )	Nov. 1, 1961	do	do	
Do.....	2	( <sup>3</sup> )	Nov. 29, 1961	Slight	do	Do.
Do.....	1	334,460	Mar. 6, 1962	do	do	Do.
Ocean.....	1	1,000,000	July 12, 1961	None	do	
Do.....	1	1,019,804	Feb. 21, 1963	do	do	
Do.....	1	382,186	Sept. 27, 1961	do	do	
Shirts, men's wool serge.....	22,981					
Shoe lasts:						
Metal.....	8,683	( <sup>3</sup> )	Feb. 12, 1963	do	do	
Wood.....	12,529	( <sup>3</sup> )	do	do	do	
Sights, grenade launcher.....	250,000	800,000	Feb. 14, 1963	do	do	
Small arms:						
Shotguns.....	70,379	5,812,725	Apr. 3, 1962	Severe	Sell 4,200 every other month	As recommended.
Rifles:						
.30 caliber.....	182,555	19,549,516	do	do	Continue with current disposal through National Rifle Association of about 7,000 per month.	Do.
.22 caliber.....	25,232	998,185	do	do	Sell 4,000 every other month	Do.
Stone, cylinder and holder (abrasive).....	303,412	107,711	Nov. 9, 1962	None	Sell	
Turbine, power, generator drive.....	81	324,000	Mar. 14, 1963	do	do	
Vehicular heater kits.....	1,299	492,321	July 2, 1962	do	do	

<sup>1</sup> "Sell" means without qualification or limitation.  
<sup>2</sup> Where recommendation is "Sell" (without qualification), BDSA need not receive notice of action taken.  
<sup>3</sup> This item consisted of azimuth and elevation input resolvers, coordinate converters, electronic control stabilization amplifiers, elevation gyros, frequency converters, gyro-drive units, radar modulators, radar set groups, and synchronizers.

<sup>4</sup> Not available.  
<sup>5</sup> Secret, A E C.  
<sup>6</sup> Estimated \$250,000-plus.

U.S. DEPARTMENT OF COMMERCE,  
 BUSINESS AND DEFENSE SERVICES ADMINISTRATION,  
 OFFICE OF THE ADMINISTRATOR,  
 Washington, D.C., April 15, 1963.

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

DEAR MR. CHAIRMAN: This is to supplement our letter and report of March 29, 1963, on domestic surplus property activities. The following should be added to the list of market impact recommendations we made.

In February of 1962 the Atomic Energy Commission (AEC) requested advice as to the impact likely to flow from the disposal of \$5.5 million of surplus yttrium metal, compound and concentrates. A survey we conducted showed that annual commercial sales were less than \$1 million. Additionally, several producing companies with large excess capacities were currently sponsoring research for new uses and at least one possibility looked promising. We advised AEC that disposal at that time would cause a severe adverse impact and suggested withholding the surplus from the market pending outcome of the new-use research project. The property was withheld from disposal.

Sincerely yours,

DANIEL L. GOLDBY, Administrator.

APPENDIX 3

(Senator Javits' questions to Department of Defense, General Services Administration, Budget Bureau, and the General Accounting Office re Buy American Act, labor surplus areas, and small business set-asides and answers thereto)

APRIL 8, 1963.

HON. ROBERT S. McNAMARA,  
 Secretary of Defense,  
 Washington, D.C.

DEAR MR. SECRETARY: You will recall that at the time you testified before the Subcommittee on Defense Procurement of the Joint Economic Committee, on March 28, 1963, Senator Javits requested permission to submit questions to you to be answered for inclusion in the printed record of the hearings. The questions follow:

(A) *The application by Defense of the Buy American Act*

(1) Is there not a 6-percent differential prescribed by the Executive order of December 17, 1954—with exception of labor surplus areas where it was amended to 12 percent?

(2) What differential does Defense Department apply? Fifty percent?

(a) Is this covered by the Executive order or an amendment?

(b) Do you rely on section 3(d) of the Executive order for this?

(c) Is this differential covered by the Armed Services Procurement Regulations (ASPR)?

(3) Does GSA or any other Government agency apply a larger differential?

(4) What is your estimate of the cost, in terms of the Defense Department budget, of your policy?

(5) Has the Defense Department differential encouraged domestic producers to bid higher on contracts? What is the eventual cost of that?

(6) Is there any statistical reason why Defense has picked the differential it is using?

(7) Is this differential used by Defense in all oversea bids?

(a) If so, is this not in direct conflict with the stated differential in the Executive order?

(b) If not, how can United States and foreign business place any reliance on a rational judgment of the bids?

(8) Does the differential used by Defense override the prescribed differentials for labor surplus areas and the set-aside program for small business, if the labor surplus firm or a small business imports a part of the product to be purchased, while another domestic firm manufactures it wholly in the United States?

(9) How does this policy affect the foreign relations of the United States?

(a) What countries are mainly affected?

(b) How much foreign exchange are you saving?

(c) Have there been reprisals in terms of foreign government purchases of U.S. goods?

*(B) Labor surplus areas and small business set-asides*

(1) How does the program for contract set-asides for areas of substantial labor surplus work and how successful has it been?

(2) What is the authority for this program?

(3) How does this program dovetail with the small business set-aside program?

(a) How do you know that set-asides for labor surplus areas are not made at the expense of small business—and vice versa?

As we are anxious to have these hearings in printed form as soon as possible we will appreciate your replies at your early convenience.

Faithfully,

PAUL H. DOUGLAS, *Chairman.*

ASSISTANT SECRETARY OF DEFENSE,  
*Washington, D.C., April 18, 1963.*

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

DEAR MR. CHAIRMAN: This replies to your letter of April 8, 1963, to Secretary McNamara regarding his testimony before the Subcommittee on Defense Procurement of the Joint Economic Committee on March 28, 1963. As your letter states, Senator Javits requested permission to submit questions to Secretary McNamara to be answered for inclusion in the printed record of the hearings. We enclose a statement, with the pertinent answer being set forth following each of the questions submitted.

Sincerely,

THOMAS D. MORRIS,  
*Assistant Secretary of Defense, Installations and Logistics.*

THE APPLICATION BY DEFENSE OF THE BUY AMERICAN ACT

1. Is there not a 6-percent differential prescribed by the Executive order of December 17, 1954—with exception of labor surplus areas where it was amended to 12 percent?

Answer. Executive Order 10582 of December 17, 1954, does prescribe a standard 6-percent price differential. Section 3 of the order permits departures from the standard differential where an executive agency determines—

(i) to reject a bid for reasons of the national interest not described or referred to in the order;

(ii) to place a fair proportion of its total purchases with small business concerns;

(iii) to accept a low domestic bid from a labor surplus area concern; or

(iv) to reject any bid for materials of foreign origin to protect essential national security interests.

As a matter of administrative practice, the Department of Defense—as well as a number of other Government agencies—has added an additional 6 percent to the differential that is used where a low American bid is received from a small business or labor surplus area concern.

2. What differential does Defense Department apply? Fifty percent?

(a) Is this covered by the Executive order or an amendment?

(b) Do you rely on section 3(d) of the Executive order for this?

(c) Is this differential covered by the Armed Services Procurement Regulation (ASPR)?

Answer. Since last summer, in order to alleviate the impact of Defense expenditures outside the United States on the Nation's balance of payments, we have followed a procedure under the Buy American Act under which bids and proposals offering foreign products in competition with American products are evaluated in accordance with the 6-12-percent rules established under the Executive order.

However, where this evaluation indicates award for a foreign product, the matter is referred to the secretarial level for decision on whether to buy American, notwithstanding a price differential in excess of 6 or 12 percent. If the procurement involves more than \$100,000, the decision is made by Secretary McNamara or Deputy Secretary Gilpatric. For lesser amounts, the decision is made at the secretarial level within the military department concerned or the

Defense Supply Agency. These decisions are made on a case-by-case basis; neither 50 percent nor any other specific differential is applied.

Although, as stated, there is no specific differential prescribed, in order that the various officials who are called upon to decide these cases may have a common way of coming at them, a benchmark or point of departure of 50 percent has been used. But we would emphasize, very strongly, that this is no more than a point of departure—there have been decisions to buy American notwithstanding differentials in excess of 50 percent, and to buy foreign notwithstanding differentials below 50 percent.

Each case in which a departure from the normal 6-12 percent rules has been made has relied on section 3(a) of the Executive order, which provides for exceptions to the normal rules for reasons of the national interest. We do not rely on section 3(d). These procedures are not set forth in the armed services procurement regulation because they are interim in nature. In this connection, it should be noted that the Bureau of the Budget is conducting a study of the entire subject of foreign procurement policies and procedures throughout the Government. The study, which involves a reassessment of Executive Order 10582, is expected to be completed in the near future.

3. Does GSA or any other Government agency apply a larger differential?

Answer. So far as we are aware, neither GSA nor any other Government agency applies a differential larger than 6-12 percent.

4. What is your estimate of the cost, in terms of the Defense Department budget, of your policy?

Answer. During the period of July 1962-February 1963, domestic origin procurements (under military functions appropriations), above the 6-12 percent differentials, following decision not to accept low foreign origin bids, were valued at \$7,359,000. The total added cost (included in above figure) was \$1,615,000, or a differential of 28 percent above the foreign bid price.

5. Has the Defense Department differential encouraged domestic producers to bid higher on contracts? What is the eventual cost of that?

Answer. It is, of course, possible that our current procedures have encouraged domestic producers to bid higher than they otherwise might. We have no information indicating that this has, in fact, been the case. We have checked informally with a few of our activities which procure items on which there has been both foreign and domestic competition. On this informal check, we found no evidence whatsoever of any increase in American prices and some indication that—at least in one or two commodity areas—foreign prices have decreased as a result of our giving greater preference to American products.

6. Is there any statistical reason why Defense has picked the differential it is using?

Answer. As stated above, there is no particular differential prescribed by the Department of Defense for the cases in question. The 50-percent benchmark reflects the fact that, for procurements to be used outside the United States, which are exempt from the Buy American Act, we have in general required procurement of American supplies where the cost of American supplies is not expected to exceed the cost of foreign supplies by more than 50 percent.

7. Is this differential used by Defense in all oversea bids?

(a) If so, is this not in direct conflict with the stated differential in the Executive order?

(b) If not, how can U.S. and foreign business place any reliance on a rational judgment of the bids?

Answer. As indicated in our answer to question 2, all foreign bids on procurement, subject to the Buy American Act, are evaluated in accordance with the procedures summarized in that answer. It is true that the case-by-case procedure which is applied makes it difficult for bidders offering foreign products to predict exactly how their bids will be evaluated in comparison with domestic bids. As to the matter of "rational judgment," decisions are made at the secretarial level, as indicated above, only after the most careful consideration, which does not take into account what has been done in comparable cases.

8. Does the differential used by Defense override the prescribed differentials for labor surplus areas and the set-aside program for small business, if the labor surplus firm or a small business imports a part of the product to be purchased, while another domestic firm manufactures it wholly in the United States?

Answer. Regarding labor surplus area and small business set-asides, it has been true, under these programs, for some years that a concern offering foreign products does not qualify as a small business or labor surplus area concern. The interim Buy American Act procedures which the Department of Defense

has followed since last summer do not alter this conclusion. Hence, if a labor surplus firm or a small business imports so much of the product to be purchased that the product is regarded as foreign for purposes of the Buy American Act (i.e., if the cost of foreign components is 50 percent or more of the cost of all components), the bid of that concern is not eligible for consideration under the set-aside portion of the procurement.

As to the question of whether "the differential used by Defense overrides the prescribed differentials for labor surplus areas," there is no specific differential prescribed by this Department, as indicated in the answer to question 2. Moreover, no particular additional preference is established for labor surplus area and small business concerns under our current procedures, although the fact that a low domestic bid may have been submitted by such a concern could properly be taken into account by the Secretary concerned in determining whether or not to buy American.

9. How does this policy affect the foreign relations of the United States?

(a) What countries are mainly affected?

(b) How much foreign exchange are you saving?

(c) Have there been reprisals in terms of foreign government purchases of U.S. goods?

Answer. (a) The countries mainly affected are: Japan, the United Kingdom, and Germany.

(b) Based on the information given in response to question 4 above, foreign exchange savings are estimated at approximately \$5.7 million for the period July 1962 to February 1963.

(c) We are not aware of reprisals in terms of purchases by foreign governments of U.S. goods. There has been some adverse reaction on the part of foreign suppliers who have been precluded from obtaining DOD contracts, and this has been expressed through diplomatic channels. We have attempted to deal with these complaints through diplomatic and other channels, explaining the purpose of our present policies. In this connection, it should be noted that during the period July 1962 to February 1963 foreign origin procurement under military functions appropriations by the Department of Defense for use in the United States totaled \$27,040,000.

#### LABOR SURPLUS AREAS AND SMALL BUSINESS SET-ASIDES

1. How does the program for contract set-asides for areas of substantial labor surplus work, and how successful has it been?

2. What is the authority for this program?

2. How does this program dovetail with the small business set-aside program?

Answer. The answers to all three questions will be found in the attached enclosure No. 1.

3(a). How do you know that set-asides for labor surplus areas are not made at the expense of small business—and vice versa?

Answer. Defense policy, as stated in ASPR 1-803(a) (ii), and quoted below, gives preference to labor surplus area set-asides:

"(ii) where appropriate, procurements shall be made from labor surplus area concerns by partial set-aside procedures, in accordance with 1-804, and such set-asides shall be given preference over any small business set-aside (but no total set-aside shall be made for labor surplus area concerns) ;".

#### SET-ASIDES FOR SUBSTANTIAL UNEMPLOYMENT AREA FIRMS<sup>1</sup> AND SMALL BUSINESS CONCERNS

*The difference in authority for making set-asides for substantial unemployment area firms and small business concerns*

The provisions of the Small Business Act, Public Law 85-536 (sec. 15) authorize set-asides for small businesses. On the other hand, the basis for set-asides for labor surplus area firms is found in Defense Manpower Policy No. 4, revised June 6, 1960. However, the Defense Appropriation Act annually carries a provision which prohibits the payment of price differentials on contracts for the purpose of relieving economic dislocations.

<sup>1</sup>A "substantial unemployment area concern" is a concern that agrees to incur more than 50 percent of the contract costs on account of manufacturing or production in substantial unemployment areas.



*Substantial unemployment area set-asides*

The primary method by which Defense procurement is used to assist areas of substantial unemployment is to set aside or reserve a specified portion of a given order for exclusive negotiation with firms in those areas. In order to use a set-aside, the order must be of sufficient quantity to allow two economic production runs. One part is bought in open competition, thus establishing the market price. The other part is then offered at this market price to firms which, in bidding on the non-set-aside portion, bid within 120 percent of the price paid for that portion, and will produce in a labor surplus area. If the successful bidder on the non-set-aside portion will perform in a labor surplus area, it is eligible for award of the set-aside portion as well.

Negotiations for Defense set-aside offerings are conducted in the following order or priority:

Group 1. Substantial and persistent labor surplus area concerns which are also small business concerns.

Group 2. Other substantial and persistent labor surplus area concerns.

Group 3. Substantial labor surplus area concerns which are also small business concerns.

Group 4. Other substantial labor surplus area concerns.

Group 5. Small business concerns which are not labor surplus area concerns.

Within each of the above groups, negotiation with such concerns are in the order of their bids on the non-set-aside portion, beginning with the lowest responsive bid.

In February 1961, in an effort to try every possible way of increasing procurement in areas of substantial unemployment, the Defense Department urged the Comptroller General to allow DOD to initiate a policy of 100 percent set-aside for firms located in labor surplus areas. That is, DOD sought to obtain a ruling which would permit the military departments in selected cases to negotiate for the purchase of an order exclusively with firms located in labor surplus areas. Defense pointed out that in view of the large number of labor surplus areas which existed at that time, enough firms would bid on a given contract to assure fair and reasonable prices, and thus no price differential would be involved. The Comptroller General, however, ruled that such a policy would not provide against payment of price differentials, and thus would violate the Appropriations Act restriction.

In fiscal year 1962, \$160 million in set-aside awards were made to firms located in areas of substantial unemployment. In addition, in the normal course of business, \$7.3 billion in contract awards were made to labor surplus area firms without preference. Because of the substantial reduction in the number of major unemployment areas since July of 1962, DOD placed only \$1,678 million in such areas during the period July-December 1962, with only \$37.5 million of that being made in preferential awards under the set-aside and tie-bid procedures.

*Small business set-asides*

Because of the authorities contained in the Small Business Act DOD is permitted to make 100 percent set-asides for small business firms. Under this preferential procedure, where the contracting officer expects that a sufficient number of qualified small business firms will participate in the competition thus assuring the Government of receiving fair and reasonable prices, he is authorized to set aside the order for competition exclusively among small firms. During fiscal year 1962 small firms received a total of \$4.6 billion in prime contract awards of which \$1.7 billion resulted from small business set-asides.

In addition to the 100 percent set-aside procedure the military departments on occasion used a partial small business set-aside. This is similar to the technique used in labor surplus area preferential awards. In this procedure the Department must be buying a sufficient quantity of items to constitute at least double an economic production run. This is because the quantity must be split into two parts. One part is bought with open competition. The other part is then offered to small business firms.

After the price has been established on the non-set-aside portion, small bidders who have submitted bids within 120 percent of the price paid on the non-set-aside portion are treated as preferred bidders and given the opportunity to accept a contract for all or part of the set-aside portion at the non-set-aside price.

## 360 PROCUREMENT ACTIVITIES OF THE DEPARTMENT OF DEFENSE

Negotiations for small business set-aside offerings are conducted in the following order of priority:

- Group 1. Small business concerns which are also persistent labor surplus area concerns.
- Group 2. Small business concerns which are also substantial labor surplus area concerns.
- Group 3. Small business concerns which are not labor surplus area concerns.

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[Reprinted from the Federal Register, Saturday, Dec. 29, 1962 (27 F.R. 12935)]

### TITLE 32A—NATIONAL DEFENSE, APPENDIX

#### CHAPTER I—OFFICE OF EMERGENCY PLANNING

[Defense Manpower Policy 4, Revised, Amdt. 1]

#### DMP 4—PLACEMENT OF PROCUREMENT AND FACILITIES IN AREAS OF PERSISTENT OR SUBSTANTIAL LABOR SURPLUS

##### IMPLEMENTATION

1. Defense Manpower Policy No. 4 (Revised) (25 F.R. 5283), effective July 6, 1960, is hereby amended by revising Section 4(b) (4) to read as follows:

(b) All procurement agencies shall:

\* \* \* \* \*

(4) In the event of tie-bids or offers on any procurement, award the contract to the firm which will perform a substantial proportion of the contract in persistent or substantial labor surplus areas by incurring costs on account of production or manufacturing in such labor surplus areas (by itself or its first-tier subcontractors) that amount to a substantial proportion of the contract price, giving first preference, other things being equal, to the firm that will perform in persistent labor surplus areas.

2. *Effective date.* This amendment shall take effect 90 days after publication in the FEDERAL REGISTER.

EDWARD A. McDERMOTT, *Director.*

[F.R. Doc. 62-12830; Filed, Dec. 28, 1962; 8:45 a.m.]

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[Reprinted from the Federal Register of June 14, 1960]

### TITLE 32A—NATIONAL DEFENSE, APPENDIX

#### CHAPTER I—OFFICE OF CIVIL AND DEFENSE MOBILIZATION

[Defense Manpower Policy 4]

#### DMP 4—PLACEMENT OF PROCUREMENT AND FACILITIES IN AREAS OF PERSISTENT OR SUBSTANTIAL LABOR SURPLUS

##### REVISION

1. *Introduction.* Success of the defense program depends upon efficient use of all our resources, including manpower and facilities, which are preserved through practice of the skills of both management and workers.

A primary aim of Federal manpower policy is to encourage full utilization of existing production facilities and workers in preference to creating new plants or moving workers, thus assisting in the maintenance of economic balance and employment stability. When large numbers of workers move to already tight areas, heavy burdens are placed on community facilities—schools, hospitals, housing, transportation, utilities, etc. On the other hand, when unemployment develops in certain areas, unemployment compensation costs increase and plants, tools, and workers' skills remain idle and unable to contribute to our defense program.

2. *Purpose.* It is the purpose of this Defense Manpower Policy No. 4 to direct attention to the potentialities of areas of persistent or substantial labor

surplus, hereafter referred to as labor surplus areas, for the placement of procurement contracts or the location of new plants or facilities, and to assign responsibilities to specified departments and agencies of the Government to carry out the policy stated below.

3. *Policy.* It is the policy of the Federal Government to encourage the placing of contracts and facilities in areas of persistent or substantial labor surplus, with first preference being given in areas of persistent labor surplus, and to assist such areas in making the best use of their available resources in order to achieve the following objectives :

(a) To preserve management and employee skills necessary to the fulfillment of Government contracts and purchases ;

(b) To maintain productive facilities ;

(c) To improve utilization of the Nation's total manpower potential by making use of the manpower resources of each area ;

(d) To help assure timely delivery of required goods and services and to promote readiness for expanded effort by locating procurement where the needed manpower and facilities are fully available.

4. *Implementation.* By virtue of the authority vested in me by Executive Order 10480 and Executive Order 10773, as amended, and to carry out the purpose and policy objectives set forth above, the following assignments of responsibilities are made to the specified departments and agencies of the Government :

(a) The Department of Labor shall :

(1) Classify areas having a persistent or substantial surplus of labor, under standards to be established by the Secretary of Labor.

(2) In cooperation with the States and labor surplus areas, provide labor market data and related economic information in efforts to assist in the initiation of industrial expansion programs in these areas.

(3) Identify skills which are in surplus supply within such areas and make this information available to firms requiring such skills and interested in establishing new plants and facilities.

(4) Identify occupations and skills for which labor will be needed by new or expanding industries ; and, in collaboration with other governmental agencies, make assistance available to area institutions and manpower users in developing on-the-job apprentice or other training programs for developing skills of the workforce.

(b) All procurement agencies shall :

(1) Use their best efforts to award negotiated procurement contracts to contractors who will perform a substantial proportion of the production on those contracts within labor surplus areas, giving first preference to contractors performing in persistent labor surplus areas, to the extent that procurement objectives will permit : *Provided*, That in no case will price differentials be paid for the purpose of carrying out this policy.

(2) Where deemed appropriate, set-aside portions of procurements for negotiation at prices no higher than those paid on the balance of these procurements exclusively with firms which will perform or cause to be performed a substantial proportion of the production on these contracts within labor surplus areas, giving first preference to firms in persistent labor surplus areas : *Provided further* that firms which will perform in areas not meeting the minimum size qualifications for classification by the U.S. Department of Labor shall be eligible for participation in set-asides, if these firms submit a certificate issued by the U.S. Department of Labor that a persistent or substantial labor surplus exists in the area in accordance with standards and procedures prescribed by the U.S. Department of Labor.

(3) Assure that firms in labor surplus areas which are on appropriate bidders' lists will be given the opportunity to submit bids or proposals on all procurements for which they are qualified. Whenever the number of firms on a bidders' list is excessive, there will be included a representative number of firms from labor surplus areas.

(5) Encourage prime contractors to award subcontracts to firms which will perform a substantial proportion of the production on those subcontracts in labor surplus areas, particularly in areas of persistent labor surplus.

(6) The preferential actions described in this policy shall be in addition to other such actions to which firms may be entitled because of performance in substantial labor surplus areas, such as additional preference under the "Buy American Act."

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(7) Cooperate with the other agencies listed herein in achieving the objectives of this policy.

(c) The Department of Commerce shall:

(1) In cooperation with State development agencies, the Department of Defense, the General Services Administration, and the Small Business Administration, assist manufacturers in areas of persistent labor surplus in obtaining Government procurement business by (a) providing such firms with timely information on proposed Government procurements; (b) maintaining current information on the manufacturing capabilities of labor surplus area firms with respect to Government procurement and disseminating such information to Federal procurement agencies.

(2) Urge firms planning new production facilities (where Federal assistance or interests are involved) to consider the industrial location advantages of labor surplus areas.

(3) Provide technical advice and counsel to groups and organizations in labor surplus areas on planned industrial parks, industrial development organizations, expanding tourist business, and available Federal aids.

(d) The Small Business Administration shall make available to small business concerns in labor surplus areas all of its services, endeavor to insure opportunity for maximum participation by such concerns in Government procurement, and give consideration to the needs of these concerns in the making of joint small business set-asides with Government procurement agencies.

(e) There is hereby created within the Office of Civil and Defense Mobilization a Surplus Manpower Committee:

(1) This Committee shall be chaired by the Deputy Assistant Director for Manpower of the Office of Civil and Defense Mobilization and shall include representation from the Department of Defense (including the three military departments), Department of Commerce, Department of Labor, General Services Administration, and Small Business Administration.

(2) The Committee shall advise the Director of the Office of Civil and Defense Mobilization and its member agencies on policies, procedures, and activities in existence or needed to carry out the purpose of this policy.

(3) When an entire industry, which sells a significant proportion of its production to the Government, is generally depressed or has a significant proportion of its production units located in areas of persistent or substantial labor surplus, the Committee may make appropriate recommendations relative to that industry in lieu of recommendations relative to specific geographical areas. In such cases, after notice to and hearing of interested parties, the Director of the Office of Civil and Defense Mobilization will give consideration to appropriate measures applicable to the entire industry.

(f) The Regional Directors of OCDM shall, with the advice and assistance of the Regional Civil and Defense Mobilization Boards, recommend actions considered desirable to carry out the purposes of this policy to the Chairman of the Office of Civil and Defense Mobilization Surplus Manpower Committee.

(g) All Federal departments and agencies shall give consideration to labor surplus areas, particularly to persistent labor surplus areas, in the selection of sites for Government-financed facilities expansion, to the extent that such consideration is not inconsistent with essential economic and strategic factors that must also be taken into account.

(h) All agencies assigned responsibilities under this policy shall submit such reports on their activities as may be requested in connection therewith to the Office of Civil and Defense Mobilization, and shall submit such additional information as may be necessary.

(i) All existing notifications of labor surplus areas issued by the U.S. Department of Labor pursuant to Defense Manpower Policy No. 4, dated November 4, 1953, as amended July 29, 1955, continue in force. Notifications No. 38, 39, 53, 57, and 58, dealing with the placement of procurement with the textile, shoe, apparel, shipbuilding, and petroleum and petroleum products industries, are continued in effect to the extent that they are not inconsistent with this revised policy.

*Effective date.* This revised policy shall take effect on July 6, 1960.

LEO A. HOEGH, *Director.*

[F.R. Doc. 60-5387; Filed, June 13, 1960; 8:50 a.m.]

APRIL 8, 1963.

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

DEAR MR. BOUTIN: You will recall that at the time you testified before the Subcommittee on Defense Procurement of the Joint Economic Committee, on March 28, 1963, Senator Javits requested permission to submit questions to you for further comment for inclusion in the printed record of the hearings. Senator Javits submitted the following questions to be answered by the Department of Defense, and would like you to comment on that marked with two stars:

(A) *The application by Defense of the Buy American Act*

(1) Is there not a 6-percent differential prescribed by the Executive order of December 17, 1954—with exception of labor surplus areas where it was amended to 12 percent?

(2) What differential does Defense Department apply? 50 percent?

(a) Is this covered by the Executive order or an amendment?

(b) Do you rely on section 3(d) of the Executive order for this?

(c) Is this differential covered by the Armed Services Procurement Regulations (ASPR)?

(3) Does GSA or any other Government agency apply a larger differential?\*

(4) What is your estimate of the cost, in terms of the Defense Department budget, of your policy?

(5) Has the Defense Department differential encouraged domestic producers to bid higher on contracts? What is the eventual cost of that?

(6) Is there any statistical reason why Defense has picked the differential it is using?

(7) Is this differential used by Defense in all oversea bids?

(a) If so, is this not in direct conflict with the stated differential in the Executive order?

(b) If not, how can United States and foreign business place any reliance on a rational judgment of the bids?

(8) Does the differential used by Defense override the prescribed differentials for labor surplus areas and the set-aside program for small business, if the labor surplus firm or a small business imports a part of the product to be purchased, while another domestic firm manufactures it wholly in the United States?

(3) How does this program dovetail with the small business set-aside program?

(a) What countries are mainly affected?

(b) How much foreign exchange are you saving?

(c) Have there been reprisals in terms of foreign government purchases of U.S. goods?

(B) *Labor surplus areas and small business set-asides*

(1) How does the program for contract set-asides for areas of substantial labor surplus work and how successful has it been?

(2) What is the authority for this program?

(3) How does this program dovetail with the small business set-aside program?

(a) How do you know that set-asides for labor surplus areas are not made at the expense of small business—and vice versa?

As we are anxious to have these hearings in printed form as soon as possible we will appreciate your reply to the question starred at your earliest convenience.

Faithfully,

PAUL H. DOUGLAS, *Chairman.*

GENERAL SERVICES ADMINISTRATION,  
*Washington, D.C., April 16, 1963.*

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

DEAR MR. CHAIRMAN: Reference is made to your letter of April 8, 1963, requesting information with respect to the application by the General Services Administration and other Government agencies of the cost differentials prescribed by Executive Order 10582, dated December 17, 1954 (19 F.R. 8723), for use in connection with procurement which is subject to the Buy American Act.

Regulations governing GSA procurement require that bids and proposals be evaluated so as to give preference to domestic bids. For the purpose of such

evaluation, the 6-percent differential set forth in section 2(c) of Executive Order 10582 is added to the bid or offered price of otherwise acceptable materials of foreign origin. In connection with GSA supply contracts, an additional 6-percent differential (a total of 12 percent) is added to each such foreign bid where the firm submitting the low acceptable domestic bid is a labor surplus area concern or a small business concern.

With respect to other civilian agencies, we are informed that the minimum 6-percent differential authorized by Executive Order 10582 is uniformly applied and that, when appropriate, most agencies add an additional 6 percent (a total of 12 percent) in order to provide a greater preference for labor surplus area concerns. A few agencies similarly add this additional 6 percent in preference for domestic small businesses. However, to our knowledge, no agency is currently applying a differential in excess of 12 percent with respect to either labor surplus area concerns or small businesses.

Sincerely yours,

BERNARD L. BOUTIN, *Administrator.*

APRIL 8, 1963.

HON. JOSEPH CAMPBELL,  
*Comptroller General of the United States,*  
*Washington, D.C.*

DEAR MR. CAMPBELL: You will recall that at the time you testified before the Subcommittee on Defense Procurement of the Joint Economic Committee, on March 29, 1963, Senator Javits requested permission to submit questions to you for further comment for inclusion in the printed record of the hearings. Senator Javits submitted the following questions to be answered by the Department of Defense, and would like you to comment on those marked with an asterisk:

(A) *The application by Defense of the Buy American Act*

(1) Is there not a 6-percent differential prescribed by the Executive order of December 17, 1954—with exception of labor surplus areas where it was amended to 12 percent?

(2) What differential does Defense Department apply? 50 percent?

(a) Is this covered by the Executive order or an amendment?\*

(b) Do you rely on section 3(d) of the Executive order for this?\*

(c) Is this differential covered by the Armed Services Procurement Regulation (ASPR)?\*

(3) Does GSA or any other Government agency apply a larger differential?\*

(4) What in your estimate of the cost, in terms of the Defense Department budget, of your policy?

(5) Has the Defense Department differential encouraged domestic producers to bid higher on contracts? What is the eventual cost of that?\*

(6) Is there any statistical reason why Defense has picked the differential it is using?

(7) Is this differential used by Defense in all oversea bids?

(a) If so, is this not in direct conflict with the stated differential in the Executive order?\*

(b) If not, how can U.S. and foreign business place any reliance on a rational judgment of the bids?\*

(8) Does the differential used by Defense override the prescribed differentials for labor surplus areas and the set-aside program for small business, if the labor surplus firm or a small business imports a part of the product to be purchased, while another domestic firm manufactures it wholly in the United States?

(9) How does this policy affect the foreign relations of the United States?

(a) What countries are mainly affected?

(b) How much foreign exchange are you saving?

(c) Have there been reprisals in terms of foreign government purchases of U.S. goods?

(B) *Labor surplus areas and small business set-asides*

(1) How does the program for contract set-asides for areas of substantial labor surplus work and how successful has it been?

(2) What is the authority for this program?

(3) How does this program dovetail with the small business set-aside program?\*

(a) How do you know that set-asides for labor surplus areas are not made at the expense of small business—and vice versa?

As we are anxious to have these hearings in printed form as soon as possible we will appreciate your replies to those questions starred at your earliest convenience.

Faithfully,

PAUL H. DOUGLAS, *Chairman.*

COMPTROLLER GENERAL OF THE UNITED STATES,  
*Washington, May 6, 1963.*

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

DEAR MR. CHAIRMAN: We refer to your letter dated April 8, 1963, in which you request our comments on a number of questions, as marked by an asterisk; submitted by Senator Javits on the application of the Buy American Act and labor surplus area and small business set-asides. The questions posed to the Department of Defense are set out in pertinent part below and our comments follow those marked by an asterisk.

(A) The application by Defense of the Buy American Act:

(1) Is there not a 6 percent differential prescribed by the Executive order of December 17, 1954—with exception of labor surplus areas where it was amended to 12 percent

(2) What differential does Defense Department apply? 50 percent?

(a) Is this covered by the Executive order or an amendment?\*

(b) Do you rely on section 3(d) of the Executive order for this?\*

(c) Is this differential covered by the Armed Services Procurement

Regulations (ASPR)?\*

We understand informally that differentials in excess of 6 and 12 percent are being applied by the Department of Defense in a number of instances. Executive Order No. 10582 of December 17, 1954, as amended by Executive Order No. 11051, September 28, 1962, 27 Federal Register 9683, prescribes a standard 6 percent price differential. However, departures from the 6 percent differential are permitted by sections 3 and 5 of the order. In addition, paragraph 6-104.4(b) of the Armed Services Procurement Regulation (ASPR) provides, inter alia, that where the firm submitting the low acceptable domestic bid is a small business concern, or a labor surplus area concern, or both, then a 12-percent differential shall be used unless the proposed award is required to be submitted to the Secretary of the Department concerned pursuant to ASPR 6-104.4(c).

Section 3 of Executive Order No. 10582, as amended, provides, in pertinent part, that the order shall not affect the authority or responsibility of an executive agency:

“(a) To reject any bid or offer for reasons of the national interest not described or referred to in this order; or

“(b) To place a fair proportion of the total purchases with small business concerns \* \* \*; or

“(c) To reject a bid or offer to furnish material of foreign origin in any situation in which the domestic supplier offering the lowest price for furnishing the desired materials undertakes to produce substantially all of such materials in areas of substantial unemployment \* \* \*; or

“(d) To reject any bid or offer for materials of foreign origin if such rejection is necessary to protect essential national-security interests after receiving advice with respect thereto from the President or from the Director of the Office of Emergency Planning. \* \* \*”

Section 5 of the order provides, in pertinent part, as follows:

“Sec. 5. \* \* \* In any case in which the head of an executive agency proposing to purchase domestic materials determines that a greater differential than that provided in this order between the cost of such materials of domestic origin and materials of foreign origin is not unreasonable or that the purchase of materials of domestic origin is not inconsistent with the public interest, this order shall not apply. A written report of the facts of each case in which such a determination is made shall be submitted to the President through the Director of the Bureau of the Budget by the official making the determination within 30 days thereafter.”

As these quoted provisions of the Executive order indicate, departures from the 6-percent differential provided therein are permitted but the amount of the differential that may be paid in the event of such departures is not specified.

It is our understanding that the Department of Defense relies generally upon section 3(a) of the Executive order when departures from the 6 percent differential are made. Although we recognize that the order does authorize departures from the 6 percent differential in appropriate cases, we do not think that section 3(a) of the order can properly be relied upon as authorizing such departures without additional preexisting authority. B-150655, March 7, 1963; B-150471, April 30, 1963, copies enclosed. In the latter decision we held that section 3(a), while expressing the intent not to interfere with any existing authority or responsibility of executive agencies to reject any bid for reasons of national interest, did not and legally could not confer on executive agencies any new or additional authority. In other words, before that section becomes effective there must have already existed authority in the agency head to reject any bid or offer for reasons of national interest. We also held, however, that once a determination is made that the purchase of materials of domestic origin at a greater differential than that provided in the order would not be unreasonable or would not be inconsistent with the public interest, there then would be for application the provision in section 5 of the order which states that under those circumstances the "order shall not apply," thus placing the matter squarely within the purview of the Buy American Act itself which provides that only domestic supplies shall be acquired for public use, unless the head of the department determines their cost to be unreasonable. In making such determination of unreasonable cost, the agency head would not be limited to the price differentials specified in the Executive order and would have the right to consider a greater price differential reasonable. The Department of Defense has been notified of our decision in this matter by letter of May 2, 1963, B-150471, copy enclosed.

As previously noted, ASPR does not specify the amount of the larger differential when departures from the 6 percent figure are to be made, except for those procurements involving small business or labor surplus area concerns in which case the differential specified (ASPR 6-104.4(b)) is 12 percent. However, the internal procedures under which departures are accomplished are set forth in paragraph 6-104.4(c) of ASPR. That paragraph provides as follows:

"(c)(1) Notwithstanding that the low acceptable bid or proposal as to any item or group of items under (b) above may be a foreign bid, proposed awards shall be submitted, in accordance with departmental procedures, to the Secretary concerned for decision where all acceptable domestic bids exceed the low acceptable foreign bid plus 6 percent (determined in accordance with (b) above) and the sum of any low acceptable domestic bid from any single (i) small business concern or (ii) labor surplus area concern, exceeds \$100,000: *Provided*, That this subparagraph (c) (1) shall not apply where the low foreign bid offers a Canadian end product.

"(2) Proposed awards shall be submitted, in accordance with departmental procedures, to the Secretary concerned for decision where—

"(i) rejection of an acceptable low foreign bid is considered necessary to protect essential national security interests, such as maintenance of a mobilization base; or

"(ii) rejection of any bid or proposal for other reasons of the national interest is considered necessary.

Prior to final action, cases within this subparagraph (2) shall be referred by the Secretary concerned to the Assistant Secretary of Defense (Installations and Logistics)."

"(3) Does GSA or any other Government agency apply a larger differential?\*"

We have been informally advised that the General Services Administration does not apply a larger differential than that specified in the Executive order except for those procurements involving small business concerns or labor surplus area concerns in which case the differential applied is 12 percent. We have no direct or independent knowledge as to the differential used by other Government agencies.

"(5) Has the Defense Department differential encouraged domestic producers to bid higher on contracts? What is the eventual cost of that?\*"

While we have no information which might serve as a basis for a definitive answer to this question, we believe that general use of a higher differential could conceivably encourage domestic producers to bid higher on contracts.



Such a result might occur if domestic producers know for a certainty that the Department of Defense is consistently applying a differential higher than that specified in the Executive order. This would be especially true in those situations where the procurement involves products which have a limited or sole-source domestic supply base and the known competition to the domestic supplier consists largely of foreign producers. However, we recognize that in those cases where there are a number of domestic suppliers higher bidding would not necessarily follow from the application of a larger differential. In such cases domestic suppliers would be competing against other domestic suppliers in the same preferred position and the submission of a high bid would result, as in normal circumstances, in the loss of a product. Moreover, the likelihood of receiving higher than normal bids is diminished where it is not known in advance that a larger differential will, in fact, be applied or where it is not known with any degree of certainty just how great the larger differential will be. Apparently, this is the situation which exists today since the Department of Defense has not published or announced any detailed criteria which it will utilize in determining when a larger differential will be applied or just how great the differential will be in those instances where it is decided to depart from the differential specified in the Executive order.

"(7) Is this differential used by Defense in all oversea bids?

"(a) If so, is this not in direct conflict with the stated differential in the Executive order?\*

"(b) If not, how can United States and foreign business place any reliance on a rational judgment of the bids?\*"

While we have no information as to the extent of application of the larger differential by the Department of Defense, use of a larger differential is, as explained under question 2, permitted by the Executive order in appropriate instances. Thus it cannot be concluded that utilization of a larger differential is in conflict with the stated differential in the Executive order. However, in regard to question 7(b) we believe that a nonuniform or inconsistent application of a differential greater in amount than that specified in the order may very well lead to confusion and suspicion on the part of all bidders, domestic and foreign. If it is the intention of the Department of Defense to continue application of a larger differential for any appreciable length of time we believe that it would be desirable, and would alleviate any confusion or suspicion that may exist, if definite criteria as to application of the differential were established at the earliest practicable date. In other words, if application of a differential larger than that specified in the Executive order is to be the rule rather than the exception prospective bidders should be made aware of this fact and should also be told the amount of differential, or differentials, as the case may be, that will be applied.

"(B) Labor surplus areas and small business set-asides :

"(1) How does the program for contract set-asides for areas of substantial labor surplus work and how successful has it been?

"(2) What is the authority for this program?

"(3) How does this program dovetail with the small business set-aside program?\*

"(a) How do you know that set-asides for labor surplus areas are not made at the expense of small business—and vice versa?\*"

The labor surplus area set-aside program dovetails with the small business set-aside program chiefly with respect to preferences to be accorded various categories of bidders in negotiations for award of set-aside portions in procurements that have been partially set aside for either small business and/or labor surplus area concern participation. Parenthetically, it should be noted that due to a provision which has appeared for some time in the annual Department of Defense appropriation acts which precludes payment of a price differential for the purpose of relieving economic dislocations (see sec. 523 of the 1963 act, 76 Stat. 332) total set-asides for labor surplus area procurements are specifically precluded both by decisions of our Office and by ASPR. See 40 Comp. Gen. 489 and ASPR 1-803(a)(ii). See, also, paragraph 4(b)(1) of Defense Manpower Policy No. 4 (revised), 32A CFR, chapter I (applicable to all procurement agencies), which contains a provision prohibiting payment of price differentials for the purpose of carrying out the Government's labor surplus area policy.

Procedures for implementing the policy of the Department of Defense with reference to small business concerns are set forth in section 1, part 7, of ASPR,

while those with respect to labor surplus area concerns are contained in section 1, part 8, of ASPR. These procedures, as presently constituted, give preference to labor surplus area set-asides over small business set-asides. See ASPR 1-803 (a) (ii) which states that "(ii) where appropriate, procurements shall be made from labor surplus area concerns by partial set-aside procedures, in accordance with 1-804, and such set-asides shall be given preference over any small business set-aside (but no total set-aside shall be made for labor surplus area concerns)." The preference given by this paragraph to the labor surplus area program is apparently absolute; that is, a partial labor surplus area set-aside is to be given preference over either partial or total small business set-asides. See ASPR 1-706.5 which provides, in pertinent part, that:

"(a) *Subject to any applicable preference for labor surplus area set-asides as provided in 1-803(a) (ii), the entire amount of an individual procurement or class of procurements \* \* \* shall be set aside for exclusive small business participation \* \* \* where there is a reasonable expectation that bids or proposals will be obtained from a sufficient number of responsible small business concerns so that awards will be made at reasonable prices. \* \* \**" [Italic supplied.]

Identical language to that underscored above appears in ASPR 1-706.6 which deals with partial small business set-asides.

The impact of the labor surplus area preference on the small business program is lessened considerably by additional ASPR provisions dealing with the order of priority for negotiation for awards of set-aside portions under labor surplus area set-asides. ASPR 1-804.1(a) (2) provides that in furtherance of the policy that a fair proportion of procurements be placed with small business concerns, each labor surplus area set-aside shall provide that, in addition to labor surplus area concerns, small business concerns not performing in such areas are also eligible for participation in the set-aside for such quantities as are not awarded to labor surplus area concerns. Moreover, ASPR 1-804.2(b) requires that the following notice be used in the invitation for bids or request for proposals, as the case may be, in all procurements involving labor surplus area set-asides:

"NOTICE OF LABOR SURPLUS AREA SET-ASIDE (OCTOBER 1962)

"(a) *General.*—A portion of this procurement, as identified elsewhere in the schedule, has been set aside for award only to one or more labor surplus area concerns, and, to a limited extent, to small business concerns which do not qualify as labor surplus area concerns. Negotiations for award of the set-aside portion will be conducted only with responsible labor surplus area concerns (and small business concerns to the extent indicated below) who have submitted responsive bids or proposals on the non-set-aside portion at a unit price no greater than 120 percent of the highest award made on the non-set-aside portion. Negotiations for the set-aside portion will be conducted with such bidders in the following order of priority:

"Group 1. Persistent labor surplus area concerns which are also small business concerns.

"Group 2. Other persistent labor surplus area concerns.

"Group 3. Substantial labor surplus area concerns which are also small business concerns.

"Group 4. Other substantial labor surplus area concerns.

"Group 5. Small business concerns which are not labor surplus area concerns. \* \* \*

Labor surplus area procurement policy is also furthered by the order of priorities for negotiation set up in partial small business set-asides. ASPR 1-706.6(c) provides for a notice (similar to that quoted above for labor surplus area set-asides) to be included in invitations for bids and requests for proposals. This notice contains the following order of priorities:

"Group 1. Small business concerns which are also persistent labor surplus area concerns.

"Group 2. Small business concerns which are also substantial labor surplus area concerns.

"Group 3. Small business concerns which are not labor surplus area concerns."

We appreciate the opportunity given us to comment on the foregoing questions and if we can be of any further assistance in this matter please let us know.

Because of our views on certain aspects of the problems discussed herein we

have taken the liberty of forwarding a copy of this letter to the Secretary of Defense.

Sincerely yours,

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

COMPTROLLER GENERAL OF THE UNITED STATES,  
*Washington, April 30, 1963.*

B-150471.

KEUFFEL & ESSER Co.  
*Hoboken, N.J.*

(Attention Mr. Marsh W. Bull, General Sales Manager.)

GENTLEMEN: Reference is made to your letter of December 4, 1962, protesting against the action taken by the Department of the Army and the General Services Administration under invitations for bids Nos. ENG-11-184-62-BE-733 and FNGC-R-26697-A-8-28-62, respectively. Specifically, you request a clarification of rulings issued by the two agencies which you characterize as being "diametrically opposed," which rulings were made under Executive Order 10582, issued on December 17, 1954.

With respect to the first invitation referred to above, which was issued by the Department of the Army, it appears to be your contention that the amount of \$72,691, representing the difference between your low bid offering foreign supplies and that of the next low bid submitted by the Brunson Instrument Co. which offered domestic supplies, "might be considered excessive when favoring a product manufactured in the United States over a foreign product."

An examination of the record now before this Office indicates that the subject invitation for 455 surveying theodolites was issued on June 22, 1962, to 48 potential suppliers, and 4 bids were received. Upon receiving the four bids, two of which offered domestic items and two foreign items, the matter was referred to the Assistant Secretary of Defense (Installations and Logistics) for advice. This action is reported to have been taken in compliance with Department of Defense policy directed toward relieving the chronic deficit in the U.S. balance of payments which would result in an adverse flow of gold. On October 8, 1962, the Deputy Secretary of Defense, purportedly acting pursuant to section 3(a) of the aforementioned Executive order, directed that the award in this case be made to the lowest bidder offering domestic material for reasons of national interest.

The act of March 3, 1933, 47 Stat. 1520, as amended, 41 U.S.C. 10(a) to 10(d), commonly referred to as the Buy American Act, as implemented by Executive Order 10582, December 17, 1954, was designed to accord preferential treatment to domestic producers and manufacturers in the case of purchases of materials and supplies by Federal agencies and establishments, as well as by construction contractors with such agencies and establishments. Exceptions to the requirement that purchases be made from domestic producers and manufacturers were made where (1) the materials or supplies were to be used outside the United States; or (2) the head of the Department or agency concerned determined that it would be inconsistent with the public interest or the cost of domestic supplies or materials would be unreasonable. Executive Order 10582 issued on December 17, 1954, sets forth certain guidance for making determinations of unreasonable cost on a uniform basis.

However, section 3(a) of the Executive order, which appears to have been relied upon in the instance of your bid, reads as follows:

"Nothing in this order shall affect the authority or responsibility of an executive agency:

(a) to reject any bid or offer for reasons of the national interest not described or referred to in this order;

And section 5 of the same order provides, in pertinent part, as follows:

"\* \* \* In any case in which the head of an executive agency proposing to purchase domestic materials determines that a greater differential than that provided in this order between the cost of such materials of domestic origin and materials of foreign origin is not unreasonable or that the purchase of materials of domestic origin is not inconsistent with the public interest, this order shall not apply. \* \* \*" [Italic supplied.]

With respect to the above-quoted section 3(a) of the Executive order, we recently expressed the view, in an opinion dated March 7, 1963, B-150655, that such section, while expressing the intent not to interfere with any existing authority or responsibility of executive agencies to reject any bid for reasons of national interest, did not and legally could not confer on executive agencies any new or additional authority. In other words, in order for that section to become effective, there must have already existed authority in the agency head to reject any bid or offer for reasons of national interest; and since we are aware of no such preexisting authority, we believe that section 3(a) of the order was erroneously relied upon. These views are being communicated to the Department involved.

On the other hand, however, we are of the opinion that once a determination is made that the purchase of materials of domestic origin at a greater differential than that provided in the order would not be unreasonable or would not be inconsistent with the public interest, there then would be for application the provision in section 5 of the Executive order which states that under those circumstances the "order shall not apply," thus placing the matter squarely within the purview of the Buy American Act itself which provides that only domestic supplies shall be acquired for public use, unless the head of the department determines their cost to be unreasonable. In making such determination of unreasonable cost, the agency head would not be bound by the price differentials specified in the Executive order, and would have the right to consider a greater price differential reasonable. Consequently, the mere fact that the price for domestic supplies was higher than that for foreign supplies plus the differentials stated in the Executive order would not require a determination that the domestic cost was unreasonable. No determination of unreasonable cost was in fact made by the Department of the Army, and we therefore find no legal basis for disturbing the award made by that Department.

Concerning the second invitation No. FNGC-R-26697-A-8-28-62, which was issued by the General Services Administration, you state that reviewing the bid results it was found that you were "8-percent high in group 1, 15.5-percent high in group 2, 14-percent high in group 3 and 7-percent high in group 25." You further advise that on item No. 19 you were 5.7-percent low, and you were the only bidder on group 26: therefore, you were awarded the items specified in groups 19 and 26. However, notwithstanding this situation, you contend that averaging the first five listed groups covering products which you had furnished to various Government agencies for a number of years, the difference between your bid, which in this case offered domestic supplies, and that of the foreign products amounted to 8.4 percent after you had received the allowance for a distressed area plus the allowance for domestic products.

The record furnished us by the General Services Administration reveals that the subject invitation which was issued on August 8, 1962, and scheduled for opening on August 28, covered their indefinite quantity requirements for instruments and laboratory equipment for the contract period November 1, 1962, through October 31, 1963. It also indicates that special notice No. 1, dated August 21, 1962, notified prospective bidders of changes in the invitation and extended the bid opening to September 4, 1962. And, in this connection, it is significant to note that the changes made by the special notice specifically pointed out that items 3, 4, 19, 25, 26, 32 and 33 would be awarded on an individual basis. Thus, items or groups to be awarded separately could not be averaged as you seem to contend. Since upon this basis you were low only on item 19—and this after taking into consideration the additional differential because of your location in an area of substantial labor surplus—and being the only bidder on item 26, you were awarded those two items.

Your letter expresses the opinion that the provisions of Executive Order 10582 could well have applied in this instance. In response to this contention, the General Services Administration advised that it considers the application of both national security and national interest problems to its procurements as they arise, but generally such findings by a nondefense agency require preparation of broad and strong determinations which it did not believe would have been justified in this case.

The gist of your complaint is that the Department of the Army (for the stated national interest reason of preventing an adverse flow of gold) preferred a domestic bid which was some 9 percent higher than your foreign bid as evaluated under Executive Order 10582, whereas the General Services Administration refused to prefer domestic bids by you which ranged from 7- to 15.5-percent higher than competing foreign bids as evaluated under the Executive

order. As stated above, the Buy American Act specifically permits purchases of foreign supplies where the cost of similar domestic supplies is unreasonable. The Executive order fixes the differentials which shall be considered in determining unreasonable cost, unless the agency head determines under section 5 of the order that a greater differential is not unreasonable or that the purchase of domestic materials is not inconsistent with the public interest. We view section 5 of the order as vesting discretionary authority in the agency head to make these determinations. No such determination was in fact made by the Administrator of the General Services Administration, and the provisions of the Executive order therefore precluded acceptance of your bid because of unreasonable price.

We do not disagree with your contention that the action taken by the two agencies was inconsistent. However, as we have stated, it is our view that section 5 of the Executive order gives discretionary authority to each agency head, and we find no basis for concluding that there was an abuse of such discretion in the instances you cite. Your protest is therefore denied.

Very truly yours,

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

B-150655.

COMPTROLLER GENERAL OF THE UNITED STATES,  
*Washington, March 7, 1963.*

SUN SHIPBUILDING & DRY DOCK Co.,  
*Chester, Pa.*

GENTLEMEN: Further reference is made to your telegram of January 17, 1963, and to your subsequent letters of January 19 and 24, February 13 (including accompanying supporting memorandum of your counsel, Mr. John D. M. Hamilton), and February 25, 1963, protesting the proposed award of a contract to Puget Sound Bridge & Dry Dock Co. under invitation for bids No. 600-531-63-S, dated October 8, 1962, issued by the Bureau of Ships, Department of the Navy, for the conversion of two naval fleet oilers.

The record shows that the cited invitation covers, in addition to prescribed incidental services and work, the so-called "jumboizing" of the vessels, a process involving the removal of the midsection and the installation of a new and larger midsection in each of the vessels. Of the 7 bids received from the 23 firms solicited, the lowest bid, in the total amount of \$14,949,563, was submitted by Puget Sound and the second low bid, in the total amount of \$16,548,900, was submitted by your firm. The grounds upon which you predicate your protest to the proposed award of the contract to Puget Sound, as the lowest responsive bidder, are hereinafter separately considered.

You contend that the Secretary of the Navy has discretionary authority under the law to consider factors other than price in making an award under this invitation and that, based on the fact that a portion of the material proposed to be furnished by Puget Sound is of foreign origin whereas your bid is based on furnishing material entirely of domestic origin, this factor, involving considerations of alleged national interest or national defense, may properly form and should form the basis of an award of the contract to your firm. In support of your position, the following authorities are cited in your letter of February 13, 1963:

"1. Under section 2305 of the Armed Services Procurement Act of 1956 (10 U.S.C.A. par. 2305) and ASPR 2-407.1, other factors than price may be considered in the award of competitively bid contracts;

"2. Under subsection 3(a) of Executive Order No. 10582 of December 17, 1954, as properly construed, all executive agencies are given the authority to reject any bid 'for reasons of the national interest', and

"3. Under section 1 of the National Defense Contracts Act of 1958 (50 U.S.C.A. par. 1431) and Executive Order No. 10789, dated November 14, 1958, as amended September 28, 1962, the Secretary is authorized 'to enter into contracts \* \* \* without regard to other provisions of law relating to the making \* \* \* of contracts, whenever he deems that such action would facilitate the national defense.'"

Concerning this contention, it is evident you recognize that any authority which may be vested in the Secretary of the Navy to make an award, under the facts and circumstances of this case, to other than the low bidder is completely discretionary. In that connection it is administratively reported that "The Secretary of the Navy has determined that, subject to the disposition of the protest filed with your Office, award should be made to the low responsible and responsive bidder, Puget Sound." Further, with specific reference to the alleged discretionary authority to make an award to your firm under the terms of this invitation, the administrative report on behalf of the Secretary of the Navy in effect denies the existence of this authority, stating that—

"\* \* \* it must be borne in mind that the bid of Puget Sound is a domestic bid and not a foreign one under the express provisions of the invitation. Consequently, there is no basis for the rejection of the Puget Sound bid and the award to Sun Shipbuilding Co. contrary to the terms of such invitation. Award to Sun Shipbuilding Co. under this advertisement would be in violation of the Armed Services Procurement Regulation and the cardinal principle of formal advertising that bidders be permitted to bid on an equal basis and that the ground rules for bidding not be changed after bid opening."

In the light of the foregoing and since the failure or refusal to exercise discretionary authority is not subject to review by this Office, we would ordinarily decline to comment on whether, under the facts of a particular case, an attempt to exercise such discretionary authority would be legal and proper (41 Comp. Gen. 70; 39 id. 309). In this case, however, in support of your request for a ruling on your contention, it is stated in your letter of February 13, 1963, that—

"We request a ruling from you that the Secretary of the Navy does have discretion under the law to award this contract to our company if he feels such an award to be advisable for national defense reasons. If a ruling to this effect is forthcoming we are confident that an award to us will then be made."

While we have no knowledge of the basis for your confidence as to the effect of a favorable ruling on the matter by this Office, in view of the otherwise indicated importance of a decision on this issue and for the purpose of serving as a guideline in any future similar case, we feel called upon to make the following comments.

The Buy American Act of March 3, 1933, as amended, 41 U.S.C. 10a—10d, provides, in pertinent part, as follows:

**"10a. American materials required for public use**

"Notwithstanding any other provision of law, and unless the head of the department or independent establishment concerned shall determine it to be inconsistent with the public interest, or the cost to be unreasonable, only such unmanufactured articles, materials, and supplies as have been mined or produced in the United States, and only such manufactured articles, materials, and supplies as have been manufactured in the United States substantially all from articles, materials, or supplies mined, produced, or manufactured, as the case may be, in the United States, shall be acquired for public use. This section shall not apply with respect to articles, materials, or supplies for use outside the United States, or if articles, materials, or supplies of the class or kind to be used or the articles, materials, or supplies from which they are manufactured are not mined, produced, or manufactured, as the case may be, in the United States in sufficient and reasonably available commercial quantities and of a satisfactory quality.

**"10b. Contracts for public works: specification for use of American materials; blacklisting contractors violating requirements.**

"(a) Every contract for the construction, alteration, or repair of any public building or public work in the United States growing out of an appropriation heretofore made or hereafter to be made shall contain a provision that in the performance of the work the contractor, subcontractors, material men, or suppliers, shall use only such unmanufactured articles, materials, and supplies as have been mined or produced in the United States, and only such manufactured articles, materials, and supplies as have been manufactured in the United States substantially all from articles, materials, or supplies mined, produced, or manufactured, as the case may be, in the United States except as provided in section 10a of this title: *Provided, however,* That if the head of the department or independent establishment making the contract shall find that in

respect to some particular articles, materials, or supplies it is impracticable to make such requirement or that it would unreasonably increase the cost, an exception shall be noted in the specifications as to that particular article, material, or supply, and a public record made of the findings which justified the exception.

"(b) If the head of a department, bureau, agency, or independent establishment which has made any contract containing the provision required by subsection (a) of this section finds that in the performance of such contract there has been a failure to comply with such provisions, he shall make public his findings, including therein the name of the contractor obligated under such contract, and no other contract for the construction, alteration, or repair of any public building or public work in the United States or elsewhere shall be awarded to such contractor, subcontractors, material men, or supplies with which such contractor is associated or affiliated, within a period of three years after such finding is made public."

In order that the provisions of the Buy American Act might be uniformly administered, and for other purposes, the President of the United States issued Executive Order No. 10582, dated December 17, 1954, 19 F.R. 8723, which, as amended by Executive Order No. 11051, dated September 28, 1962, 27 F.R. 9683, provides, in part, as follows:

"Sec. 2. (a) For the purposes of this order materials shall be considered to be of foreign origin if the cost of the foreign products used in such materials constitute fifty per centum or more of the cost of all products used in such materials.

"(b) For the purpose of the said act of March 3, 1933, \* \* \* the bid or offered price of materials of domestic origin shall be deemed to be unreasonable, or the purchase of such materials shall be deemed to be inconsistent with the public interest, if the bid or offered price thereof exceeds the sum of the bid or offered price of like materials of foreign origin and a differential computed as provided in subsection (c) of this section.

"(c) The executive agency concerned shall in each instance determine the amount of the differential referred to in subsection (b) of this section on the basis of following-described formulas, subject to the terms thereof:

"(1) The sum determined by computing six per centum of the bid or offered price of materials of foreign origin."

\* \* \* \* \*

"Sec. 3. Nothing in this order shall affect the authority or responsibility of an executive agency:

"(a) To reject any bid or offer for reasons of the national interest not described or referred to in this order; or

\* \* \* \* \*

"(d) To reject any bid or offer for materials of foreign origin if such rejection is necessary to protect essential national-security interests after receiving advice with respect thereto from the President or from the Director of the Office of Emergency Planning. In providing this advice the Director shall be governed by the principle that exceptions under this section shall be made only upon a clear showing that the payment of a greater differential than the procedures of this section generally prescribe is justified by consideration of national security.

"Sec. 5. \* \* \* In any case in which the head of an executive agency proposing to purchase domestic materials determines that a greater differential than that provided in this order between the cost of such materials of domestic origin and materials of foreign origin is not unreasonable or that the purchase of materials of domestic origin is not inconsistent with the public interest, this order shall not apply. \* \* \*"

The record shows that, as prescribed by ASPR 6-104.5, implementing section 2 (41 U.S.C. 10a) of the Buy American Act and the cited Executive order, covering the procurement of supplies, bidders were advised of the requirement that they certify that "the vessels are a domestic source end product," defined in clause 37 of the accompanying General Provisions as "an end product manu-

factured in the United States if the cost of the components thereof which are mined, produced, or manufactured in the United States or Canada exceeds 50 percent of the cost of all its components." In documents accompanying its bid, Puget Sound showed that the midsections for the two vessels would be constructed in Japan at a total cost, including towing, duty, and miscellaneous expenses, of \$2,610,350. Since the cost shown for the domestic components materially exceeded the cost of the components of foreign origin, under the terms of section 2(a) of the Executive order and the provisions of the invitation, the bid was properly regarded as a domestic bid. Based on the terms of the invitation which, in compliance with the requirements of 10 U.S.C. 2305, provide that "The contract will be awarded to that responsible bidder whose bid, conforming to the invitation for bids, will be most advantageous to the Government, price and other factors considered," the Navy proposes to make the award to Puget Sound. It is your contention that, on the basis of the authorities cited, such action is not required and that the Department has discretionary authority to award the contract to your firm under this invitation. We do not agree with this view.

It has been consistently held by our Office and the courts that the rules of competitive advertised bidding and the integrity of the competitive bidding system require that bidders be informed of the basis upon which their bids will be evaluated and the award will be made. The invitation here involved complies with that requirement. We have also uniformly held that if bids are to be evaluated on some basis in addition to price these additional factors and the weight to be given them should be clearly stated in the invitation so that all bidders may be aware thereof in the preparation of their bids. The purpose of statutes requiring the award of contracts to the lowest, responsible, responsible bidder after advertising is to give all persons equal right to compete for Government contracts, to prevent unjust favoritism, collusion, or fraud in awarding Government contracts, and to secure for the Government the benefits which flow from free and unrestricted competition. See *United States v. Brookridge Farm*, 111 F. 2d 461. Also, the application of these principles protects the administrative officers themselves from charges of favoritism, thus preserving to the Government the confidence and trust of the people, 8 Comp. Gen. 252. We regard it of paramount importance in the protection of the interests of the Government that these rules and principles of the competitive bidding system be strictly and impartially enforced. Nor do we find, with respect to the comprehensive procedures prescribed by the Congress governing procurement by the military agencies, 10 U.S.C. 2301-2314, either in the express language used or in the legislative history thereof, any intent to depart from or weaken these rules and principles in making awards under formally advertised procurements.

With specific reference to the force and effect of the phrase "other factors considered" as used in 10 U.S.C. 2305, it should be noted that this statutory provision first appeared in section 3(b) of the Armed Services Procurement Act of 1947, 62 Stat. 23, and the legislative history of that statute indicates clearly that it was not intended to broaden the scope of then existing authority or to introduce new factors into the evaluation of bids submitted in response to advertised procurements. Rather, as set forth in 28 Comp. Gen. 662, wherein we reviewed the language of the act, as well as its legislative history, the phrase "other factors considered" does not authorize and was not intended to authorize the awarding of contracts under advertised procurements to other than the low, responsible, qualified bidder. While, as reflected in your correspondence, you disagree with the conclusion reached therein, you have presented no facts or legal authority in support of a contrary conclusion. Also, see 37 Comp. Gen. 550 and sec. 523 of the Department of Defense Appropriation Act, 1963, Public Law 87-577, 76 Stat. 318, 332, which expressly provides "That none of the funds appropriated in this act shall be used except that, so far as practicable, all contracts shall be awarded on a formally advertised competitive bid basis to the lowest responsible bidder." [Emphasis supplied.]

Likewise, in our opinion, section 3(a) of Executive Order No. 10582, in providing that nothing in that order shall affect the "authority or responsibility" of an executive agency to reject any bid or offer "for reasons of the national interest" not described or referred to in that order, affords no authority in advertised procurements to award the contract to one domestic bidder in disregard of the lower bid quoted by another responsible domestic bidder. The cited section of the Executive order, while expressing the intent not to interfere with



any existing authority or responsibility of executive agencies to reject any bid for reasons of the national interest, did not and legally could not confer on executive agencies any new or additional authority contrary to the mandates of the Congress. While, under the provisions of the Buy American Act and the implementing Executive order, executive agencies are authorized by the Congress and the President to favor a domestic bid over a lower foreign bid, neither that act, the laws applicable to advertised procurements, nor any other enactment of the Congress of which we are aware, authorizes any agency of the Government to favor one domestic bidder over another domestic bidder under advertised procurements. It necessarily follows that where, as here, the low domestic bidder, Puget Sound, proposes to furnish, as authorized by the act and the invitation forbids, "substantially all" domestic products, as defined by the Executive order, an executive agency is not vested with any discretionary authority award the contract to a higher domestic bidder on the ground that the latter will furnish "all" domestic products.

Finally, with respect to the act of August 28, 1958, Public Law 85-804, 72 Stat. 972, 50 U.S.C. 1431-1435, providing authority during time of national emergency for agencies designated by the President "to enter into contracts \* \* \* without regard to other provisions of law relating to the making \* \* \* of contracts \* \* \*" this authority is confined to the negotiation of contracts and provides no authority for the exercise of administrative discretion in making an award under a formally advertised procurement such as here involved. Moreover, while admittedly the negotiation authority under this act is broad, your attention is invited to the fact that the Congress has explicitly provided that nothing contained therein "shall be construed to constitute authorization \* \* \* for \* \* \* the negotiation of \* \* \* contracts \* \* \* required by law to be procured by formal advertising and competitive bidding." The procurement here involved is, at least at this time, the subject of "formal advertising and competitive bidding."

In summarization, the evaluation of bids in this case has been made by the Department of the Navy in accordance with the provisions of the armed services procurement regulations, the terms of the invitation, and the Executive order involved, and does not, in our opinion, violate the provisions or intent of the Buy American Act. It necessarily follows that, except for reasons hereafter to be discussed in connection with another ground advanced by you for the rejection of Puget Sound's bid, award, if any, under this invitation must be made to that firm.

Separate and apart from the foregoing, we, of course, recognize and have consistently held that no bidder has an absolute right to public business but, rather, that the public interest is of primary consideration in determining whether any award should be made under an invitation for bids. An invitation for bids does not import an obligation to accept any of the offers received and, consequently, as expressly authorized by 10 U.S.C. 2305(c), "all bids may be rejected if the head of the agency determines that rejection is in the public interest." See 37 Comp. Gen. 12 and the court decisions and other Office decisions cited therein. In making the above observation, it should be clearly understood both by you and the Secretary of the Navy that we are not recommending such action in this case. In view of the obvious adverse effects on the spirit and purpose of the competitive bidding system by the rejection of all bids and the readvertisement or, if authorized by 10 U.S.C. 2304, the negotiation of the needs of the Government, this discretionary authority should and must be exercised with the greatest of care and only upon a bona fide determination that the public interest, which must always be the paramount consideration, would thereby be served (*Massman Construction Co. v. United States*, 102 Ct. Cl. 699).

You further protest the proposed award of this contract to Puget Sound on the ground that the work involved, the alteration of two vessels, is governed by section 3 of the Buy American Act, 41 U.S.C. 10b, covering contracts for public works, and under that provision of the law the use of Japanese midbodies, as proposed by Puget Sound, is prohibited. You, therefore, contend that, on that basis, the Navy must reject Puget Sound's bid with the result that you will then be the low bidder and thus entitled to the award.

Assuming, arguendo, that the work involved is governed by section 3 of the act, rather than by section 2, 41 U.S.C. 10a, covering contracts for supplies, as set forth in the invitation for bids, we do not agree that, standing alone, this would necessarily require the rejection of Puget Sound's bid. While conceding that under section 3 of the act the Japanese midbodies would be regarded

as a foreign product, your contention overlooks the fact that, while the act gives preference to domestic products, it does not prohibit, without any exception, the use of foreign products. To the contrary, the act expressly provides under section 3 for the same exceptions as provided under section 2, including that the restrictions against the purchase of foreign products do not apply where it is determined that the cost of domestic products is unreasonable, as well as a further express provision, to the same effect, that those restrictions do not apply if it is found "that it would unreasonably increase the cost." The provisions of Executive Order No. 10582, setting forth criteria for use in making such determinations apply equally to both sections 2 and 3 of the act. Further, while section 3a requires that the exceptions so authorized shall be noted in the specifications, we do not agree, as apparently urged on your behalf, that they must be noted in the specifications of the invitation. Rather, a proper determination may be made at any time, including at the time of award, or during performance of the contract, to add items to, or delete them from, the exempt list. See 40 Comp. Gen. 644. The invitation for bid form prescribed by the Armed Services Procurement Regulation for construction contracts specifically requests bidders to indicate whether they intend to furnish any foreign products in addition to those listed in the invitation and, if so, supporting data from which a determination can be made whether the cost of similar domestic products would be unreasonable. The fact remains, however, that since a supply invitation form was used, Puget Sound did not furnish necessary data from which it may now be determined whether the cost of domestic midbodies would be reasonable or unreasonable. Under such circumstances, were we to hold that section 3 of the act is applicable the effect would not be, as stated by you, that Puget Sound's bid must be rejected but that all bids must be rejected. If by reason of a defect in the invitation award cannot be made in accordance therewith, the principle of fairness to bidders and the integrity of the formal advertising system require that all bids be rejected and the Government's needs readvertised on the basis of proper specifications, 35 Comp. Gen. 7.

Whether contracts for the construction, alteration, or repair of naval vessels should be governed by section 3 (public works), or section 2 (supplies), of the Buy American Act is not an easy matter to resolve. We recognize that there are strong and convincing arguments on both sides as ably presented in the detailed briefs by your counsel on your behalf and by the counsel, Bureau of Ships, presenting a contrary view on behalf of the Navy. Both sides admit that the question has never been submitted to a court for judicial determination and a most thorough review of the legislative history of this act discloses no positive statement by any Member of the Congress as to the intended meaning of the term "public works" as used in this act. In its commonly accepted meaning, a "public work" is a fixed improvement, is associated with real property, and does not include movable or personal property, such as naval vessels. Likewise, as stated by your counsel, "supplies" are defined as "Provisions, clothing, arms, raw materials, etc., set aside to be dispensed at need; stores; as, to lay in supplies for the winter; in charge of supplies in a factory." We agree that this definition scarcely includes vessels.

The most persuasive argument presented in support of your view is the opinion of the Supreme Court in *Title Guaranty & Trust Co. v. Crane*, 219 U.S. 24 (1910), wherein, in holding that the Heard Act, of August 13, 1894, 28 Stat. 278, as amended by the act of February 24, 1905, 33 Stat. 811, requiring that a penal bond be furnished for the protection of laborers and materialmen under Government contracts for any "public work," applied to the construction of a vessel, it was stated that "Whether a work is public or not does not depend upon its being attached to the soil" and "we do not think that . . . we are bound to read 'any public work' as confined to work on the land." The court therein applied a so-called title criteria in determining what was a "public work." If title to the work passed to the Government during the progress of the work, or if the work belonged to the Government, it was a public work. Following that decision, the Attorney General held in 38 Op. Atty. Gen. 418 (1936), that three other acts containing the term "public work" or "public works," including the Miller Act (supplanting the Heard Act), of August 24, 1935, 49 Stat. 793, 40 U.S.C. 270a-270d, and the Davis-Bacon Act of August 30, 1935, 49 Stat. 1011, as amended, 40 U.S.C. 276a-276a-5, applied to the construction of vessels. Until the subsequent passage of legislation, specifically removing or authorizing the waiver of those acts from applying to contracts for the construction or

alteration of vessels, we likewise so held. The argument that the term "public works" under the Buy American Act should be similarly interpreted is, at least, persuasive.

In support of Navy's view that a naval vessel is not a "public work" within the meaning of the Buy American Act, attention has been invited to the Armed Service Procurement Act of 1947, as amended, codified as permanent law in 10 U.S.C. 2301, et seq., which lists under 10 U.S.C. 2303 the property covered by the act as: (1) public works; (2) buildings; (3) facilities; (4) vessels, (5) floating equipment; (6) aircraft; (7) parts; (8) accessories; (9) equipment; and (10) machine tools. It is contended that in listing vessels separately from public works, the Congress clearly indicated that under that act the term "public works" did not include naval vessels. It is further stated that since the enactment of that act in 1947, contracts for the construction or alteration of vessels have been uniformly considered as supply contracts under that act as well as the Buy American Act. It is also stated, and confirmed by our review thereof, that indicated provisions of the Armed Services Procurement Regulation as well as the Federal procurement regulations authorize this action. These regulations have the force and effect of law. See 38 C.G. 248 and *G. L. Christian & Assocs. v. United States*, Ct. Cl. No. 56-59, decided January 11, 1963. It is further pointed out that the Congress, on three separate occasions, to overcome the effect of decisions holding that the construction or alteration of vessels was subject to the Davis-Bacon Act, supra, enacted legislation, 1938 Naval Expansion Act, 52 Stat. 403; 1940 Naval Expansion Act, 54 Stat. 395; and 10 U.S.C. 7299, providing that contracts for such work were subject to the Walsh-Healey Act of June 30, 1936, 49 Stat. 2036, as amended, 41 U.S.C. 35-45, covering such matters as minimum wages and maximum hours under all contracts exceeding \$10,000 for the manufacture or furnishing of supplies. Likewise, the Navy brief refers to the fact that, for the same reason, the Congress enacted legislation on April 29, 1941, 55 Stat. 147, 40 U.S.C. 270e, authorizing the Army and the Navy to waive the requirements of the Miller Act, supra, under contracts for the construction, alteration or repair of vessels. Though no mention is made thereof by the Navy, we note that by the amendment of this waiver authority, act of June 3, 1955, 69 Stat. 83, to extend its application to other agencies, this legislation now reads that the agencies designated therein are authorized to waive the Miller Act with respect to certain types of contracts "for the construction, alteration, or repair of any public building or *public work* of the United States and with respect to contracts for the \* \* \* construction, alteration, repair \* \* \* of *vessels*." [Italics supplied.] We deem it significant that here again the Congress has deliberately differentiated between "public works" and "vessels." While a number of other significant factors have been presented in support of Navy's view that the Congress did not and does not intend that the construction of vessels be characterized as "public works," we shall, in closing the arguments in support thereof, only refer to the fact that in the military appropriation bills, Congress distinguishes between "public works" and naval vessels by making separate appropriations therefor. See the Military Construction Appropriation Act, 1963, Public Law 87-684, 76 Stat. 576, and title III: Procurement, under subheading "Shipbuilding and conversion, Navy," in the Department of Defense Appropriation Act, 1963, Public Law 87-577, 76 Stat. 318, 324, respectively.

It is a well-established rule of statutory construction that when a statute is fairly susceptible of different constructions, the construction given it by those charged with its administration is always entitled to the highest respect and, though not controlling, if acted upon for a number of years will not be disturbed except for the most cogent reasons and unless clearly erroneous. See *Webster v. Luther*, 163 U.S. 331, 342; *McLaren v. Fleischer*, 256 U.S. 477; *National Land Co. v. United States*, 102 Ct. Cl. 180; *Plunket v. United States*, 58 Ct. Cl. 359; and *Day v. United States*, 123 Ct. Cl. 10. Since we find no such basis for disturbing the action followed by the Navy for approximately 15 years in classifying the construction or alteration of naval vessels as the procurement of items of supplies covered by section 2 of the Buy American Act and since such action has at least received the tacit approval of the Congress, we find no legal basis for objection to the proposed award of the contract to Puget Sound.

Very truly yours,

JOSEPH CAMPBELL,  
Comptroller of the United States.

378 PROCUREMENT ACTIVITIES OF THE DEPARTMENT OF DEFENSE

COMPTROLLER GENERAL OF THE UNITED STATES,  
Washington, D.C., May 2, 1963.

The Honorable the SECRETARY OF DEFENSE.

DEAR MR. SECRETARY: Enclosed for your information in a copy of our letter dated April 30, 1963 (B-150471), to Keuffel & Emser Co., in response to its protest which concerns the application of the Buy American Act in connection with awards of contracts under invitations for bids issued by the Department of the Army and the General Services Administration.

Sincerely yours,

JOSEPH CAMPBELL,  
Comptroller General of the United States.

APRIL 9, 1963.

Hon. ELMER STAATS,  
Deputy Director,  
U.S. Bureau of the Budget,  
Executive Office of the President,  
Washington, D.C.

DEAR MR. STAATS: You will recall that at the time you testified before the Subcommittee on Defense Procurement of the Joint Economic Committee, on April 1, 1963, Senator Javits requested permission to submit questions to you for further comment for inclusion in the printed record of the hearings. Senator Javits submitted the following questions to be answered by the Department of Defense, and would like you to comment on the questions marked with three asterisks:

(A) *The application by Defense of the Buy American Act*

(1) Is there not a 6-percent differential prescribed by the Executive order of December 17, 1954—with exception of labor surplus areas where it was amended to 12 percent?

(2) What differential does Defense Department apply? Fifty percent?

(a) Is this covered by the Executive order or an amendment?

(b) Do you rely on section 3(d) of the Executive order for this?

(c) Is this differential covered by the Armed Services Procurement Regulations (ASPR)?

(3) Does GSA or any other Government agency apply a larger differential?

(4) What is your estimate of the cost, in terms of the Defense Department budget, of your policy?\*\*\*

(5) Has the Defense Department differential encouraged domestic producers to bid higher on contracts? What is the eventual cost of that?\*\*\*

(6) Is there any statistical reason why Defense has picked the differential it is using?

(7) Is this differential used by Defense in all oversea bids?

(a) If so, is this not in direct conflict with the stated differential in the Executive order?

(b) If not, how can U.S. and foreign business place any reliance on a rational judgment of the bids?

(8) Does the differential used by Defense override the prescribed differentials for labor surplus areas and the set-aside program for small business, if the labor surplus firm or a small business imports a part of the product to be purchased, while another domestic firm manufactures it wholly in the United States?

(9) How does this policy affect the foreign relations of the United States?

(a) What countries are mainly affected?

(b) How much foreign exchange are you saving? \* \* \*

(c) Have there been reprisals in terms of foreign government purchases of U.S. goods?

(B) *Labor surplus areas and small business set-asides*

(1) How does the program for contract set-asides for areas of substantial labor surplus work and how successful has it been?

(2) What is the authority for this program?

(3) How does this program dovetail with the small business set-aside program?

(a) How do you know that set-asides for labor surplus areas are not made at the expense of small business—and vice versa?

As we are anxious to have these hearings in printed form as soon as possible we will appreciate your replies to the three questions starred at your earliest convenience.

Faithfully,

PAUL H. DOUGLAS, *Chairman.*

EXECUTIVE OFFICE OF THE PRESIDENT,  
BUREAU OF THE BUDGET,  
Washington, D.C., April 23, 1963.

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

DEAR MR. CHAIRMAN: This is in response to your letter of April 9, 1963, requesting our comments on three of the questions which Senator Javits has raised concerning the application of the Buy American Act by the Department of Defense. Our comments on these questions are as follows:

*What is your estimate of the cost, in terms of the Defense Department budget of your policy?*

During the first 8 months of fiscal year 1963, the Department of Defense has paid \$1.6 million more than the lowest prices quoted by foreign producers in order to award purchase contracts to domestic producers. That amount constitutes an average price differential of 28 percent and is the direct identifiable cost which may properly be attributed to these price differentials.

*Has the Defense Department differential encouraged domestic producers to bid higher on contracts? What is the eventual cost of that?*

We have been unable to estimate the amount of any such additional costs or to determine with certainty that they are being incurred. The existence or amount of such costs is conjectural because there is no way to determine with certainty the amount that a producer would have bid under circumstances other than those which actually existed when he did submit a bid.

*How much foreign exchange are you saving?*

On the basis of 8 months' experience from July 1962 until February 1963, it is estimated that \$5.7 million in foreign exchange was saved.

As specified by Senator Javits, all of the above answers pertain to purchases which are subject to the Buy American Act. That act applies only to purchases of supplies which are for use within the United States and does not affect purchases by the Government of property which is not brought into the United States.

The Bureau of the Budget is conducting a general survey of procurement and contracting practices affecting the balance of payments, including the price differentials being applied under the Buy American Act. The purpose of this study is to develop more complete facts concerning the relationship of buy American and related policies to the balance of payments, Federal budgetary, and other relevant considerations.

Sincerely,

ELMER B. STAATS,  
*Deputy Director.*

APPENDIX 4

(Miscellaneous correspondence concerning procurement of handtools)

GENERAL SERVICES ADMINISTRATION ROUTING SLIP																																						
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<p>REMARKS</p> <p><u>Attached are copies of letters on hand tools, per your request.</u> Have also included a letter dated 1/23 from Mr. Holmead, who is our chief tool buyer, to Mr. Byrne of the Service Tool Institute, along with an amending letter of February 11. I have included Mr. Holmead's letter since it is referred to in the February 6 Kraeuter letter.</p> <p>Attachments <span style="float: right;"><i>OK</i></span></p>																																						
FROM	CO	R1	R2	R3	R4	R5	R6	R7	R8	R9	R10																											
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						TELEPHONE				DATE 4/5/63																												

PENDLETON TOOL INDUSTRIES, INC.,  
Los Angeles, Calif., February 7, 1963.

Mr. JOHN H. HOLMEAD, Jr.,  
Chief, Machine and Hand Tools Section, General Services Administration, Federal Supply Service, Procurement Operations Division, Washington, D.C.

GREETINGS: At the recent Service Tools Institute meeting in Palm Beach, Fla., we learned from you, and from representatives from DGSC, that there were high level conferences in progress in Washington pertaining to the common service hand tool procurement procedures.

As you know, this company has supplied the Federal Government through its various procurement agencies, and at various locations, both special and common standard hand tools continuously over the past 25-30 years. In fact, in January of 1942 to support the Air Force, we set up a corporation with specific capabilities to meet the Air Force's then urgent needs. At other times our executives have gone beyond the normal requirements of corporate duty to assist various departments and agencies of the Federal Government in meeting its requirements.

Now, as to the current discussions, we have two thoughts which you can convey to such conferees as you wish:

First, special tools for special requirements for any branch of our Military Establishment should be purchased through such agencies, and by such means as they determine, and in such quantities, and to such specifications, as will meet the then need.

Second, there is an extensive number of hand tools that are common to all branches of our Military Establishment which are currently manufactured by a number of responsible firms who have had extensive experience in meeting the quality requirements, as well as the specifications, of the Government. To make a simple illustration, a common adjustable wrench as made by, perhaps, a dozen firms, will equally supply the needs of Air Force, Army, Navy, Marine Corps, the space program, as well as the civilian agencies that normally buy through GSA.

While this firm, and our fine competitors, can be depended upon to conform to any purchasing program that may finally be determined, our collective experience indicates that, for common hand tool items desired by numerous defense and civilian agencies, GSA is currently very well organized to meet the specifications, contracting, and procurement demands for distribution through GSA field warehouses already in being.

The capabilities of the manufacturers and their quality commercial trade makes it possible for manufacturers of common hand tools to carry sufficient inventories under quality control programs so that the varying needs of the Government can be met out of current production and at the same time accommodate the varying, and at times fluctuating, demands of the various agencies.

As taxpayers with experience in World War II, Korea, and Cuba, as well as in the current accelerating space program, we find the GSA distribution system is well designed to eliminate gaps in the pipelines as well as bulges therein. (Admittedly, there will be errors in judgment in procurement just as there is in every other human endeavor, be it private, corporate, or government.)

Prior to GSA becoming a major procurement agency, the then purchasing policies required no samples from manufacturers, specifications were loose, in many cases, and firms not actively in the business of manufacturing hand tools were often successful bidders, producing products just meeting minimum specifications. We have noted official complaints, as well as memorandums prepared by committees, pointing out many examples of substandard tools in the hands of maintenance personnel working on extremely expensive mechanical gear with Government-furnished handtools, that they as mechanics considered substandard.

The Government should be appreciative of GSA contracting and procurement policies because the Government has been getting better tools at lesser costs in 1962-63 dollars than the military was receiving in World War II in 1942 dollars. Therefore, in the conferences currently in progress as to procurement, recognition should be given to the quality and prices that GSA has been obtaining.

Rumors indicate that there may be decentralized buying of common tool items with special marking of Federal stock numbers. These cause us concern because costs will be greater to the hand tool makers, and the Government, because the orders will be smaller, will have to be run as special and separate orders, which will not have the benefit of mass production of uniform quality as is the case presently with your contractors.

The relations of this company particularly, and our competitors in general, with DGSC in Richmond as well as with GSA in Washington have been, so far as I know, both pleasant and cooperative. Therefore, I would want anyone reading this letter to know that whatever may be the judgment of the top authorities in the Department of Defense as well as in the civilian agencies as to how they want to acquire tools, that this industry will cooperate. We will not take sides as to one method as opposed to another. Since the increased mechanization of our Military Establishment over the past 30 years and as it will continue in the future and will require more and more hand tools, the tool manufacturers with their adequate manufacturing capacity can be depended upon to do whatever may be necessary, come what may.

The purpose of this letter, then, is to state that the present GSA methods as to quality control, distribution through its warehouses, procurement of standard items which fit into contractors operations, cause us to feel that any material changes in this arrangement would, in our opinion, work to the disadvantage of the Government, its various agencies, and to the manufacturers. Further, it would likely result in greater total inventories in various pipelines and interfere with the current constant availability of hand tools for those agencies whose current demands cannot always be predicted.

Respectfully,

M. B. PENDLETON,  
*President,*

N. F. S. BAUDOB,  
*Senior Vice President—Marketing (President, Service Tools Institute).*

KRAEUTER & Co., INC.,  
*Newark, N.J., February 8, 1963.*

THE PRESIDENT,  
*The White House,*  
*Washington, D.C.*

MR. PRESIDENT: Recently you have inferred that less duplication of effort in Government would effect savings to the taxpayers.

The enclosed letter, I am sure, will not have a full meaning to you, unless you become familiar with some of the facts.

To save you some time, here is the picture as we see it:

1. Two branches of the Government are purchasing identical items (handtools).
2. GSA purchases on a 6-month or yearly contract basis.
3. DSA at Richmond, Va., purchases on an individual bid basis as requirements arise from contracting officers.

Many times during 1962, we received inquiries from Richmond for the identical items GSA is purchasing under contract with our company.

In some cases, we receive telephone calls from Richmond requesting price and delivery on identical items purchased by GSA. We referred Richmond to GSA in Washington saying "Have you checked GSA for delivery? Undoubtedly, these items are in a GSA warehouse for immediate delivery.

The reaction to this suggestion from Richmond was always unfavorable. Why? Simply because they are trying to justify the existence of the Richmond group, without consideration given to what is good for the Government and the taxpayer.

We have been in contact with Mr. George Mullins, Bureau of the Budget, concerning this duplication of effort, giving him specific examples.

GSA as a group has done an outstanding job for the Government in procurement of handtools. These people know what they are doing \* \* \*. How to coordinate the purchasing to effect savings \* \* \*. Are conversant about quality characteristics needed \* \* \*. In short this group is a real credit to the Government purchasing.

Why not let the GSA do all procuring on handtools. Is this too simple an approach? When, in fact, this group has proved its efficiency.

This decision of who is going to buy handtools—GSA or DSA has been bandied around for too long. In the meantime, we manufacturers are the bouncing ball between the two.

Maybe you, Mr. President, can get the Joint Economic Committee to make the right decision.

Respectfully yours,

BRUCE BRIGGS,  
*Vice President and General Manager.*



KRAEUTER & Co., INC.,  
Newark, N.J., February 6, 1963.

Mr. JOHN H. HOLMEAD, JR.,  
Chief, Machine and Hand Tools Section, General Services Administration, Federal  
Supply Service, National Buying-Division, Washington, D.C.

DEAR MR. HOLMEAD: A copy of your letter dated January 23, addressed to George P. Byrne, has been passed along to our company for information.

Since a major decision is about to be made, we feel that we as a manufacturer (taxpayer) would like to voice our opinion regarding this decision.

We are a supplier who has had the advantage of experience in supplying the Government on both individual awards and GSA annual contracts; therefore, our views may be helpful.

For the last 3 years we have been the low bidder on a portion of the GSA term contracts covering pliers. During that period we have supplied over 1,500,000 pairs of pliers to the Government under contract through GSA. Also during this period of time we have been able to evaluate factually the decided advantages of term bidding for our company through GSA in comparison to the spot-type bids for the same items through other agencies of the Government.

Therefore, we believe it is important to express our views. We want to be on record as to the advantages that we know are beneficial to both the Government and our company under GSA term purchasing.

#### GOVERNMENT TERM PURCHASING

##### I. Advantages GSA term contracts

A. The supply of finished material at point of usage is nearly "guaranteed" by the quantity projection and perpetual control method with predetermined minimum inventory levels established.

B. Requirements watched and projections made by the GSA from experience benefits both the Government and the manufacturer as follows:

1. The Government can go through the paperwork and ordinary expenses of preparing bids and awarding contracts once a year versus many, many times a year.

The paper saving alone to the Government is a factor—not to mention the personnel required and time expended on each bid, each award, and each performance on an individual requirement basis.

2. The manufacturer can:

(a) Forecast his inventory level required to perform over the period of the contract—resulting in: (1) quantity purchasing of raw materials and supplies, (2) a steady flow of materials through the plant, (3) a steady working force, leading to better labor-management relations, (4) a steady performance on the contract leading to better and "sure" supply at the end-user level.

These factors make it possible to lower the manufacturers inventory investment on Government items.

The manufacturer knows what and approximately how many items he will need to produce for a period of time, versus "spot" quantity orders at an inconvenient time (such as factory vacations) and unpredictable quantities, with 90-day delivery requirements.

(b) When an emergency arises in making necessary high-quantity purchases, the Government can procure at least some quantity immediately from sources already under contract, eliminating delays for bidding, et cetera (this has been done from time to time through GSA on our products).

A manufacturer already performing on a Government contract can perform on an emergency basis.

(c) Experienced help is already employed in the plant; thus, a minimum of time required to increase production requirements.

(d) Overtime can easily go into effect, to increase production.

When a big requirement is required from a manufacturer not producing the same items, the lag or leadtime could be detrimental to the national defense.

##### C. Cash flow:

Government: On a predicted term basis, the Government can forecast requirements and expenditures to fit and keep within a budget.

Under a multibid per year basis the element of unknown requirements in any month is a deterrent to good planning and budget control.

Manufacturing: Can plan their budgets and purchasing with a more reasonable assurance of continuing orders, keeping unit prices to the Government at the lowest possible level.

D. Bid prices: To support our statement of reduced unit prices, purely as a result of the advantage of term bidding introduced by GSA we submit the following information:

6" needlenose plier, 1957 price, low bidder.....	\$1. 15
6" needlenose plier, 1962 price, low bidder.....	\$1. 02
Reduction.....	\$0. 13
Percentage difference.....	-11. 3
6" diagonal pliers, 1957 price, low bidder.....	\$1. 10
6" diagonal pliers, 1962 price, low bidder.....	\$0. 93
Reduction.....	\$0. 17
Percentage difference.....	-15. 5

Please note these percentage differences: Cost of labor, materials and variable operating expenses have all increased in this 5-year period.

Through the process of knowing the level of plant activity required to produce the projected GSA quantities in term bids, we have been able to intelligently plan and schedule all phases of our company operations. This has resulted in lower prices to the Government and consistent standard of quality to meet Government specifications.

E. Summary: We believe that our comments and supporting facts make it quite clear that an annual contract with specified quantities puts both the Government and the manufacturer in the best possible position to:

1. Plan and budget expenditures.
2. Assure constant delivery.
3. Assure a consistent standard of quality.
4. Maintain competent sources of supply who will bid on large contracts at the lowest possible price.

In addition, the advantages of one agency doing the purchasing on our type of product is extremely important.

We sincerely hope that our voice may be heard and consideration given to our thoughts in this important decision.

Cordially,

BRUCE BRIGGS,  
*Vice President and General Manager.*

PROCUREMENT OPERATIONS DIVISION,  
*January 23, 1963.*

MR. GEORGE P. BYRNE, Jr.,  
*Secretary and Legal Counsel,*  
*Service Tools Institute,*  
*New York, N.Y.*

DEAR MR. BYRNE: There has been a reorganization in the Federal Supply Service of GSA affecting the tool buying activities as follows.

As you know, previously, there was a National Buying Division under the direction of Mr. L. L. Dunkle under which the Machine and Hand Tools Section of which I am chief was placed. Under the new setup NBD has been abolished. Mr. Dunkle is now Acting Assistant Commissioner, Office of Procurement, reporting directly to the Commissioner, FSS, Mr. Bean, or to Mr. McGee, Deputy Commissioner. In place of NBD we now have two divisions; namely, Procurement Operations Division and the Program Management Division.

The Procurement Operations Division is headed by Mr. English, who formerly handled machine and hand tools. This Division will encompass all of the branches and sections engaged in buying operations. There have been no changes to date in the sections and commodity assignments. There still is pending a revision in the branch setup which would affect the Machine and Hand Tools Section as well as a new section handling building materials and hardware. A new branch with these two sections under it is proposed. Action is being withheld pending budget approval for funds.

The Procurement Management Division under Mr. L. F. Donahue will handle the staff work which had previously been included under NBD.

It is interesting to note, in view of the comments of Commander Dunn at the recent meeting in Palm Beach, that a major difference between GSA policy and DSA policy is that in DSA the requirements functions and the purchase functions are separated. In the Machine and Hand Tools Section of GSA, however, we combine the commodity management, requirements, and purchase functions. In my section we select the tool items to be carried in stores stock or otherwise within the Federal supply system. We are responsible for establishing method of purchase, assembling requirements data, doing the procurement planning, doing the actual contracting, and the contract administration. We obtain necessary specifications from Mr. Petrie of Standardization Division and we cooperate closely in this responsibility. Mr. Downes, Quality Control Division, heads up the inspection services on tools. In fact, buying, specifications, and inspection personnel form a closely knit team, encompassing most of our tool functions. We feel that the overall control and close teamwork cited above are essential both in stock management and in effecting efficient contracting.

I thought this information might be of interest to your organization and to your members.

I appreciate, greatly, the invitation to the meeting in Palm Beach. I believe the industry contacts are mutually advantageous. It may be noted that policy discussions within the Government relative to assignment of supply responsibility on hand tools, which took place in Washington simultaneously with the meeting in Palm Beach, have so far resulted in no material change in our relative positions. DSA still wishes to withdraw from GSA stock Air Force requirements on approximately 550 items, which would amount to about 50 percent of our dollar volume in hand tools. They, reportedly, would assign GSA the buying responsibility for these items which would be put into their stores system for issue to Army and Navy as well as Air Force. GSA would still have to furnish most of these tools to civilian agencies. My remarks at the meeting to the point that we can undertake to do this buying only if we were furnished requirements data which would enable us to make coordinated type contracts, such as we have been making for our own system. During the period we have had temporary assignment from Richmond, the requisitions have come up for a single item at a time without any grouping of related items. The fact that we have had term contracts for the same items has enabled us, with much manipulations, to present to the trade, in most cases, reasonable requirements.

Sincerely yours,

J. H. HOLMEAD, Jr.,  
*Chief, Machine and Hand Tools Section.*

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PROCUREMENT OPERATIONS DIVISION,  
*February 11, 1963.*

MR. GEORGE P. BYRNE, JR.,  
*Secretary and Legal Counsel,  
Service Tools Institute,  
New York, N.Y.*

DEAR MR. BYRNE: It has come to my attention that certain remarks in the last paragraph of my letter to you of January 23, 1963, may be subject to misinterpretation.

It was my intent to say that where DSA assigns the buying functions to GSA for items they withdrew from our system for military uses, we would hope to obtain requirements data from them which would permit us to contract on the same basis that we have found so satisfactory for these items to date.

I did not intend to convey the impression that we would not contract for military requirements unless we received all of the data from the military that we have available in the GSA system.

I hope that my letter has not created any erroneous impression or serious misunderstanding.

Sincerely yours,

J. H. HOLMEAD, Jr.,  
*Chief, Machine and Hand Tools Section.*

SNAP-ON TOOLS CORP.,  
Kenosha, Wis., June 7, 1962.

Re: Contract GS-00S-35988, Term—  
November 1, 1961–April 30, 1962.

GENERAL SERVICES ADMINISTRATION,  
National Buying Division,  
Washington, D.C.

(Attention: Mr. John Holmead, Jr., Chief, Machine & Hand Tools Section).

GENTLEMEN: We believe at this time it would be appropriate to give you a detailed report on the results of our most recent contract, GS-00S-35988, terminated as of April 30, 1962.

We are attaching reports on all of the items covered by this contract, giving you the original estimate usage over a period of 6 months, the actual orders received, and the resultant inventory to the contractor.

We believe that after reviewing this report you will realize why we are complimenting you and your organization on a program we feel has been very advantageous to everyone concerned. The procurement of handtools by the General Services Administration has kept a constant flow of quality mechanics' handtools going to our defense program at a minimum of cost.

As you know, we have, on several occasions, checked the operation and handling of contracts from GSA against other types of military contracts and have found that, from every standpoint of operation, the procurement through GSA has resulted in considerable overall savings, both to the contractor and to the Government. These savings have been reflected in lower prices to the Government, and the methods used in procurement have enabled the contractor to affect better production schedules, more expeditious handling of purchase orders, a minimum time expenditure in shipping and invoicing individual purchase orders.

In further explanation of the reports attached, all of the Federal stock numbers preceded by an asterisk are those items under the contract which have been shipped complete as of today's date. There are no longer any requirements open under the basic contract or any additional contracts placed through GSA by the Defense General Supply Center at Richmond.

Take note of the estimate quantity column and the actual usage column and you will realize why it is a distinct advantage for a contractor to schedule his production against your estimate quantities. We feel that an outstanding job has been done in estimating the usage over a period of 6 months, inasmuch as we understand the difficulty from a contractor's standpoint trying to forecast disappearance of this number of items.

You will notice that from the very low surplus inventory that we have on hand on many of these items, we were able to schedule our production to the best advantage of everyone concerned.

We are looking forward to the handling of future GSA contracts and would appreciate your retaining the list of inventories on hand in the event that an emergency should arise where you would be able to utilize some of this surplus inventory to the best advantage of the Government. Please do not hesitate to contact us not only on these items, which we have inventoried, but on any other items which might cause you difficulty in delivering where we would be in a position to help you. Thank you very much for your past cooperation, and if there is anything further that we might do to help you in furthering your handtool program, please let us know.

Yours very truly,

SNAP-ON TOOLS CORP.,  
GOVERNMENT CONTRACTING DIVISION,  
ALLEN C. WISCH.

Orders placed during the last 15 days of the contract

Federal stock No.	Units	Number of orders	Federal stock No.	Units	Number of orders
5120-449-8200	232	2	5120-237-4974	1,296	1
5120-293-3537	2,268	6	5120-237-0979	1,296	2
5120-224-9219	3,168	2	5120-237-0980	3,168	4
5120-243-1666	1,376	1	5120-181-6785	624	1
5120-243-1686	1,968	2	5120-189-7924	1,104	1
5120-230-6364	384	1	5120-237-0984	1,200	1
5120-243-7322	624	2	5120-189-7946	1,440	1
5120-240-8702	2,592	1	5120-189-7915	3,000	1
5120-236-2262	4,636	2	5120-189-7933	3,168	2
5120-236-2263	2,160	1	5120-189-7934	2,976	2
5120-236-2264	3,360	2	5120-189-7935	6,728	3
5120-242-3345	2,736	1	5120-189-7927	3,480	2
5120-235-5878	1,344	1	5120-189-7913	768	1
5120-242-3352	4,800	1	5120-189-7914	1,200	1
5120-235-5889	2,496	1	5120-189-7917	576	1
5120-232-5711	3,024	2	5120-235-5898	1,344	1
5120-227-6703	2,592	1	5120-243-7346	1,440	1
5120-232-5706	5,280	2	5120-242-8349	1,440	1
5120-239-0018	3,264	2	5120-243-7345	5,424	4
5120-277-4252	1,296	1	5120-243-7342	1,200	1
5120-235-5879	2,688	2	5120-243-7340	1,392	1
5120-242-3354	2,736	2	5120-243-7341	1,392	2
5120-242-3355	1,008	1			
5120-237-0978	2,928	2	Total	104,616	76

Report on contract GS-OOS-35988

Federal stock No.	Stock order No.	Invoice June 6	Estimated quantity	Actual quantity	Net price	Open orders
*5120-180-0974	FVS-141	4,157	26,600	11,568	\$0.22	
*5120-181-6785	FVU-28		2,550	4,104	.82	
*5120-181-6813	LV-302	197	100	1,392	.85	
*5120-181-6816	LV-282	705	900	396	.68	
*5120-189-7910	LV-502	578	700	240	1.56	
*5120-189-7913	SV-341	1,511	8,350	6,816	.97	
*5120-189-7914	SV-361	3,328	8,550	7,764	.42	
*5120-189-7915	SV-251		1,350	8,292	.24	B-1320, 1.
*5120-189-7917	SV-401	2,123	4,000	6,144	.48	
*5120-189-7924	SV-141	358	11,450	6,816	.21	
*5120-189-7927	SV-321		9,800	5,720	.31	B-2887, 2.
*5120-189-7928	LV-342	655	800		.64	
*5120-189-7932	SV-181		16,250	9,144	.22	
*5120-189-7933	SV-261	6,065	14,600	9,888	.24	R-3466 (stock), 3.
*5120-189-7934	SV-281	3,056	16,150	15,720	.28	
*5120-189-7935	SV-301		10,800	15,632	.28	B-2400 (stock), 1.
*5120-189-7946	SV-201	1,531	17,150	19,152	.21	
*5120-189-7985	SV-241	6,518	18,900	15,424	.23	
*5120-189-8010	MV-16	13,256	15,900	23,952	.13	
*5120-199-7771	LV-722	161	200	312	2.97	
*5120-224-9215	FV-6	929	18,550	19,274	.64	
*5120-224-9219	MVA-3		14,150	15,000	.16	
*5120-227-8095	FVA-1	1,087	1,000	10,960	1.18	
*5120-227-8103	LVA-124		100	432	1.32	
*5120-227-8129	FV-67	1,387	100	4,212	1.43	
*5120-227-6702	FV-121	2,581	26,400	15,984	.16	
*5120-227-6703	FV-141		20,900	20,544	.16	
*5120-227-6704	FV-181	10,111	33,750	32,292	.14	B-2592, 1.
*5120-227-6705	FV-241	202	25,000	23,088	.18	
*5120-230-6364	SV-4		4,560	5,160	1.23	
*5120-232-5706	FV-221		30,560	26,592	.17	
*5120-232-5711	FV-101		10,500	12,000	.18	B-2016, 2.
*5120-235-5889	MV-14		39,100	29,808	.12	B-2496, 1.
*5120-235-5870	SV-221		16,750	10,272	.20	R-7536 (stock), 4.
*5120-235-5871	LV-402	574	1,000	528	.89	
*5120-235-5872	FVU-12		7,950	10,812	.58	
*5120-235-5878	MV-10		25,900	28,032	.12	
*5120-235-5879	FVS-241		13,950	17,640	.30	B-4200, 3.
*5120-235-5895	SVS-201	1,781	13,050	9,120	.39	
*5120-236-2262	MSV-6		3,000	20,764	.15	
5120-236-2263	MSV-7		16,000	4,736	.15	
*5120-236-2264	MSV-8		22,700	16,752	.13	R-1668, 3.

\*These items shipped complete against basic contract.

388 PROCUREMENT ACTIVITIES OF THE DEPARTMENT OF DEFENSE

Report on contract GS-OOS-35988—Continued

Federal stock No.	Stock order No.	Invoice June 6	Estimated quantity	Actual quantity	Net price	Open orders
*5120-237-0978	FVU-18		19,650	22,560	\$ .58	
*5120-237-0979	FVU-22		7,150	9,552	.66	
*5120-237-0982	SV-121		10,350	9,024	.22	R-17040, 2.
*5120-237-0980	FVU-24		6,100	12,540	.68	
*5120-237-0984	SV-161		15,700	12,468	.22	R46032, 3.
5120-237-0977	FV-161		42,000	32,688	.15	R55536, 3.
*5120-237-0999	LV-322	717	1,500	576	.69	
*5120-237-4973	FV-201		30,000	20,256	.16	R26390, 5.
*5120-237-4974	FVU-20		18,650	14,664	.62	R-1776, 1.
*5120-239-0017	FVS-181		20,750	18,720	.21	R-9024, 1.
*5120-239-0018	FVS-201	3,372	13,950	12,672	.24	
*5120-239-0019	SV-191		3,500	6,192	.23	
*5120-239-0021	LV-362	504	900	144	.75	
*5120-239-0022	LV-332	146	200	1,056	.87	
*5120-240-8702	SVA-4		23,750	17,904	.26	R-9994, 2.
*5120-240-8702	FVA-2		14,050	21,000	.18	R-21024 (stock), 3.
*5120-241-3185	FVS-161		19,600	16,392	.20	R-18816, 2.
5120-242-3345	MVS-9		8,300	17,376	.12	
*5120-242-3349	SVS-241	870	15,000	11,172	.44	
*5120-242-3351	MV-11		30,100	20,592	.12	
*5120-242-3352	MV-12		33,850	29,664	.13	B-5376, 1.
5120-242-3354	FVU-14		20,350	19,140	.56	B-3552, 3.
5120-242-3355	FVU-16		18,400	16,010	.57	B-1428, 2.
*5120-243-1666	MVA-8	12,988	15,950	5,024	.16	
5120-243-1686	MVU-8		22,800	27,940	.53	B-1008, 1.
*5120-243-1687	LV-82		300	228	3.05	
*5120-243-1688	MVA-6	8,250	22,800	7,968	.15	
*5120-243-7322	SV-67	4,930	3,950	3,888	1.78	
5120-243-7340	SVS-321		5,250	15,410	.55	B-3936, 6.
*5120-243-7341	SVS-341	782	4,100	4,464	.58	
*5120-243-7342	SVS-281		12,050	10,500	.47	R-6048, 2.
*5120-243-7343	SVS-301	370	7,450	7,392	.51	
*5120-243-7344	SVS-251	577	1,400	1,901	.45	
*5120-243-7345	SVS-261		22,700	26,424	.45	R26064, 6.
*5120-243-7346	SVS-221	221	11,850	8,736	.39	
*5120-243-7348	SVS-181	4,483	7,600	5,904	.40	
*5120-243-7351	SVS-161		8,900	7,920	.41	B-2850, 1.
*5120-269-7971	SV-8	12,344	14,100	6,960	.93	
*5120-276-8882	SV-426	295	200	144	.46	
*5120-277-1207	MV-67		100	3,336	1.26	
*5120-277-1463	FVS-121	567	14,200	20,760	.22	
*5120-277-4251	FV-111	2,627	3,800	2,736	.17	
*5120-277-4252	FVS-221	330	10,000	10,560	.28	
*5120-277-8823	MV-6		100	2,784	.15	
*5120-288-8155	FV-081	4,502	5,950	6,144	.19	
*5120-293-0091	FV-191	1,579	2,100	2,496	.15	
*5120-293-0093	SV-381	2,691	4,200	3,648	.46	
5120-293-3537	115-TM-B		2,800	8,334	3.85	B-3474, 11.
*5120-449-8200	219-FB Set		300	2,994	10.17	
*5120-596-0834	LV-702	89	150	240	2.71	

\*Note: These items shipped complete against basic contract.

SNAP-ON TOOLS CORP.,  
Kenosha, Wis., March 2, 1961.

GENERAL SERVICES ADMINISTRATION,  
Washington, D.C.

(Attention: Mr. John H. Holmead, Jr., Chief, Machine and Hand Tools Section.)

GENTLEMEN: You may be interested in this observation regarding the finishing operations necessary to supply the General Services Administration with the high quality handtools which are now being procured for the military.

There are several things we would like to point out with reference to Snap-on Tools and the part which we have played in furnishing the high quality tools to General Services. Your invitations have specifically spelled out the requirements for bidding insofar as the Federal specification GGG-W-00641C is concerned. As you know, the material which we use, our production and inspection procedures, and our final finishing and plating operations not only conform to the existing specification on the high limits, but, in many cases, are in excess of the requirements under the specification.

It is our feeling in the matter that since GSA is handling the buying of tools required for the military, particularly the Air Force, that the level of quality has risen remarkably. I am quite sure that this comment will be borne out by those agencies within the Department of Defense who have procured tools through the GSA.

We have always been of the opinion that raising the level of quality on handtools presently being used within the military was of utmost importance, we do not feel that the primary concern should rest with the type and quality of the finish. Although this is one factor which would enter into consideration and justify the buying of quality tools, there are other basic factors of equal importance such as the use of high-grade materials, proper production facilities, adequate in-process and final inspection, manufacturing to close tolerances, and expeditious handling of orders and processing orders from receipt to day of shipment.

We are attaching to this letter a listing of the various phases of the procurement procedure used by the GSA which we feel have a direct bearing on your success in furnishing a high-quality tool to the military at a minimum cost. We feel that the procedures adopted have enabled tool manufacturers to handle the quantities as set forth in your invitation at a minimum of cost, and thereby reflecting cost reductions to the Government. We have always felt that in this age of jet aircraft, guided missiles, and space equipment that the quality of the hand tools being used to repair and maintain this equipment was far behind the advances we have made in these fields. It becomes very serious and costly when this repair and maintenance must be done with inadequate tools.

We are thoroughly convinced that the General Services Administration has set the pattern which will bring the quality of the tools being used to the level of the equipment that they are being used on for maintenance and repair.

Please feel free to use the attached comments in any way that you see fit to further your program on handtool procurement.

Yours very truly,

ALLAN C. WISCH,  
*Government Contracting Division.*

#### GENERAL SERVICES ADMINISTRATION

#### BUSINESS PRACTICES WHICH OBTAIN MAXIMUM QUALITY HANDTOOLS AT MINIMUM COST

##### 1. Term (6-month—12-month) contracts.

A. Term contracts enable the manufacturer to plan production over the period of the contract, decreasing costs by scheduling large production runs.

##### 2. Guaranteed quantities. Estimated 6-month requirements. Standby stocks.

A. Enables a manufacturer to schedule production in accordance with estimated usage, taking advantage of guaranteed quantities for production runs, and providing standby stocks for immediate deliveries.

##### 3. Standardization of packaging and marking requirements. Minimum shipping quantities.

A. Enables the manufacturer to standardize his packaging procedures, enabling the procurement of large quantities of like items in cartons, boxes,

etc. Shipping quantities help to keep shipping charges at a minimum due to minimum quantities and limited destinations.

4. Grouping of like tools and awarding on aggregate total price.

A. This method permits a manufacturer to level out his cost computations over a group of items rather than having each individual tool in a line item bid stand on the individual quantity ordered.

5. Preaward survey (financial and production capacity).

A. Permits the awarding of a contract to a manufacturer who has been predetermined to have the financial capacity and production capacity to carry out the terms of the contract before award, eliminating the possibility that after an award, failure to perform might necessitate emergency buys, and additional cost and expenditures related to these emergency buys or the possibility of readvertising the entire invitation.

6. Quality assurance.

A. Under the provisions of the contract, quality assurance is given to a manufacturer based on previous samples submitted upon request and through normal inspection procedures eliminating costly time factors occasioned through individual inspection of each shipment on orders placed under the contract.

We submit the above list of reasons that we have found that, under the General Services Administration, procurement of handtools has been so successful in their program to upgrade the quality of tools and the elimination of many costly items involved in the normal procurement of handtools.

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DECEMBER 4, 1962.

Director, Technical Assistance Division—FI Office of Supply Management, FSS.  
Chief, Machine and Hand Tools Section, Industrial Supplies and Equipment  
Branch, National Buying Division, FSS.  
AF Catalog corrections on handtools.

Reference is made to my memorandum of July 13, addressed to the Director, NBD, relative to 249 items included in the GSA/AF handtool program, sales total \$1,077,397 per year, which have been cataloged by AF and/or DSA to show sources of supply other than GSA, and to subsequent correspondence on the same subject. Specifically, reference is made to my memorandum of October 15 forwarding a listing of the necessary corrections which, it is understood, pursuant to agreement with Mr. Costner of DSA were forwarded to him for necessary correction on October 23.

You will recall on our recent visit to DGSC this matter was discussed with Mr. Costner who, at that time, had taken no action.

Please see attached copy of telegram from Mobile Air Materiel Area, Brookley Air Force Base, Ala., requesting to be advised by return wire of the status of this case. It is obvious that DGSC has not advised the AF of the necessary corrections as they originally agreed to do.

The original catalog changes may have been inadvertent. Continued failure of DGSC to take corrective action would seem to warrant referral to higher DOD authority. Will you please furnish me necessary information to make reply to the AF.

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J. H. HOLMEAD, Jr.

DECEMBER 5, 1962.

Director, National Buying Division, FSS-FPN  
Chief, Machine and Hand Tools Section, Industrial Supplies and Equipment  
Branch.  
Hacksaw frames.

Item 5110-289-9657, Hacksaw frame: type I, class 1, flat frame, open grip; Style B. See figure 1, page 4 of attached Federal specification. This is the standard hacksaw which has been in the GSA and predecessor agencies stores stock probably in excess of 20 years. Current catalog price—87 cents.

Item 5110-542-3491—type I, class 2, flat frame, closed grip. See figure 2, page 5 of attached specification. Current catalog price—\$1.54. This item was one of the 27,000 items offered GSA by MGSA on April 24, 1961. The item was one of those accepted and added to the GSA Stores Stock Catalog November 1, 1961. On November 8, 1961 we were informed by MGSA that all tool items selected by GSA as above would be retained by MGSA for supply support pend-



ing completion of simplification studies on FSC group 51 and 5210. It was stated that after completion of these studies a period of 6 months would be required to make final determination as to disposition of these items. No further advise has been received to date. These items selected and incorporated in the GSA Stores Catalog prior to November 8, 1961 were left in the catalog but action toward adding the balance of the items selected was suspended. This item as presently stocked is in accordance with the specification furnished by MGSA.

DGSC in advertising for this item recently apparently neglected to specify the type and class of hacksaw and simply asked for a closed grip hacksaw in accordance with Federal Specification GGG-F-671b. This was 100 percent small business set-aside and apparently no one questioned the inadequacy of the description. Contract was made and the contractor delivered an item similar to figure 3 on page 6, except that the end of the hacksaw opposite the handle is of die cast metal which is not covered by the Federal specification. Just how this item was accepted when it did not comply with the Federal specification is not clear.

The question arises as to why the minimum tension between the saw grips on the tubular type II hacksaw frame is 300 pounds whereas tension on type I, class 1 and type I, class 2 is 275 pounds. No specific information can be obtained on this point inasmuch as the specification was prepared by the Navy Department and files are no longer available. It is my understanding that at the time the tubular item was added to the specification there was only one manufacturer of this particular model (English, I believe). This particular model was tested and the specifications made to conform to that of the item available.

The primary difference between type I, class 1 and type I, class 2 and type I, class 3 is that the latter two are closed grip whereas the first one is open pistol grip as shown in the illustrations. All three models serve the same end use. The difference between the open pistol grip and the closed grip is a matter of personal preference.

It is further believed that certain military agencies specified closed grip hacksaw frames in both flat and tubular type primarily in an effort to get a better quality hacksaw than was then being bought by the procurement agency as type I, class 1, style B. However, item 5110-289-9657 is of good quality and the need for subterfuge to obtain good quality hacksaw frames no longer exists. I therefore, believe we should standardize on this item as the most economical item meeting service requirements. I propose to delete 5110-542-3494 in the next supplement to the Stores Stock Catalog.

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JULY 13, 1962.

Director, National Buying Division, FSS.  
Chief, Machine and Hand Tools Section Industrial Supplies and Equipment  
Branch.  
Handtools.

A review of the Supply Management Data, AF C6-4, -5, -6, -7, and -8 SM catalogs, effective July 1, 1962 show that a total of 249 items included in the GSA/AF handtool program have been removed from the program without notice to GSA. The stores sales on these items totaled \$1,077,397, last calendar year.

One hundred and thirty-eight items show sources other than GSA (principally DGSC) ; 111 items are not listed.

It was the first understanding between GSA and AF that GSA would be notified prior to any action removing items from the agreement in order that we could prevent loss to the Government on items in stores stock or under contract obligation for AF account.

The above catalog actions by DGSC are a direct violation of this agreement and leave GSA with stock on hand bought specifically for AF requirements plus contract obligations entered into for the same reason.

Whether these actions are inadvertent or deliberate, the end results are the same. You will recall the recent GAO report relative to long supply on AF items. Many of the above items will fall in a similar long supply position through no fault of GSA unless corrective action is taken.

The 240 items are a loss from the approximate 1,800 in the program and represent a significant percentage of the items. This matter involves a serious policy problem which requires prompt decisive action if we are to protect our interest. It is referred to you for your consideration.

J. H. HOLMEAD, Jr.

392 PROCUREMENT ACTIVITIES OF THE DEPARTMENT OF DEFENSE

*Air Force support items not listed in Air Force supplementary data catalog*

Federal stock No.	Name	Yearly value	Federal stock No.	Name	Yearly value
5110-203-6893	File	\$1,678	5133-190-5826	Drill, twist	
5110-239-8253	Pliers	110,636	5133-228-1389	do	873
5110-242-5386	File	10,212	5133-266-9470	do	397
5110-604-5013	Alignment tool	1,536	5136-729-5675	Tap	420
5110-618-4786	Brace, bit	37,840	5136-729-5676	do	198
5110-618-6907	Saw	1,427	5136-729-5677	do	320
5110-720-1315	Machete	616	5136-729-5678	do	275
5120-221-1279	Jack	3,089	5136-729-5679	do	428
5120-221-1506	Cap, vise	386	5136-729-5680	do	173
5120-224-7528	Jack	229	5136-729-5681	do	191
5120-224-9924	Lead joint runner	170	5136-729-5682	do	815
5120-237-8174	Screwdriver	7,890	5136-729-5683	do	1,20
5120-239-0017	Socket	6,093	5136-729-5685	do	732
5120-242-5940	Jack	209	5136-729-5687	do	587
5120-294-9514	Wrench	3,992	5136-729-5688	do	1,488
5120-293-0110	Vise	8,871	5136-729-5690	do	341
5120-293-2333	Anvil	211	5136-729-5691	do	964
5120-293-2344	Bar, wrecking	1,756	5136-729-5692	do	1,153
5120-293-3306	Screwdriver	2,993	5136-729-5694	do	3,387
5120-293-3330	Shovel	21,159	5136-729-5695	do	3,000
5120-293-3336	do	20,720	5136-729-5696	do	745
5120-293-3337	do	7,302	5136-729-5697	do	107
5120-293-3389	Clamp, C	5,796	5136-729-5698	do	342
5120-293-3396	Mallet	681	5136-729-5699	do	453
5120-293-3466	Punch	7,939	5136-729-5700	do	3,144
5120-299-8412	Pliers	295	5136-729-5701	do	844
5120-490-4713	Wedge	1,024	5136-729-5702	do	1,096
5120-521-3062	Fork, rail	834	5136-729-5704	do	100
5120-540-0526	Force cup	9,160	5136-729-5705	do	138
5120-542-4748	Handle, socket wrench	12,312	5136-729-5706	do	35
5120-542-4749	Wrench		5136-729-5707	do	28
5120-542-4751	Socket	2,276	5136-729-5708	do	85
5120-542-4844	Punch	777	5136-729-5709	do	2,791
5120-555-9367	Wrench	1,010	5136-729-5710	do	473
5120-555-9485	do	665	5136-729-5711	do	237
5120-555-9616	Swage	25	5136-729-5712	do	114
5120-580-7023	Hook	34	5136-729-5713	do	115
5120-585-8505	Pliers	1,762	5136-729-5714	do	363
5120-618-4906	Screwdriver	168	5136-729-5715	do	941
5120-618-4907	do	255	5136-729-5716	do	606
5120-618-4908	do	303	5136-729-5717	do	439
5120-618-4909	do	427	5136-729-5718	do	198
5120-618-4910	do	232	5210-221-1894	Gage	5,354
5120-618-4911	do	310	5210-221-2050	Square	11,641
5120-618-7351	Grip	1,025	5210-223-9606	Level	4,257
5120-640-1432	Finder	6,276	5210-229-3052	Caliper	342
5120-640-1433	Tool, clip assembly	262	5210-274-2857	Gage	103,351
5120-678-2779	Head, stick	215	5210-278-9635	Rule	7,675
5120-720-0877	Screwdriver	3,272	5210-293-3514	do	13,369
5130-277-2698	Drill, masonry	10,938	5210-293-3523	Caliper	1,382
5130-277-2699	do	2,398	5210-541-3324	Tape	28,487
5130-277-2702	do	5,741	5210-543-3685	Square	1,009
5130-277-2704	do	3,043	5210-619-7036	Level	2,555
5130-277-2705	do	3,868			
5130-277-2706	do	2,093	Total		550,631
5130-277-2707	do	2,530	Total of both lists.		1,077,401
5130-277-2708	do	2,154			
5130-277-2709	do	2,641			

*Air Force support items indicating sources other than GSA*

Federal stock No.	Name	Source	Yearly value
5110-142-5009	Saw	COM	\$186
5110-142-5013	do	COM	1,535
5110-156-0065	File	CX	2,961
5110-180-0652	Cutter	REF <sup>1</sup>	975
5110-186-7099	Drill	GSR	23
5110-186-7105	do	CX	2,600
5110-186-8205	Gouge	COM	65
5110-188-0592	do	COM	3
5110-193-4986	do	COM	
5110-193-4999	do	GSR	7
5110-193-5012	do	CX	12
5110-203-4781	File	CX	1,382
5110-203-9032	Cleaver	CX	373
5110-204-1953	Scraper	COM	268
5110-221-1055	Cutter	GSR	
5110-221-1500	Nippers	GSR	284
5110-221-1502	do	GSR	257
5110-221-8144	Drill, masonry	REF <sup>1</sup>	209
5110-222-1932	Hardy	REF <sup>1</sup>	
5110-222-2708	Pliers	CX	21,696
5110-223-6296	Saws	CX	5,844
5110-223-7341	Drill	GSR	447
5110-224-7053	Cutter	REF <sup>1</sup>	6,711
5110-224-7068	do	CX <sup>1</sup>	9,012
5110-224-7911	Plane, jack	GSR	11,637
5110-224-9244	Cutter	GSR	15,210
5110-227-1726	do	REF <sup>1</sup>	459
5110-227-5026	Gouge	COM	
5110-236-2047	Drill	GSR	642
5110-240-6209	Pliers	CX	50,163
5110-242-2827	Plane	GSR	8
5110-243-0867	Ax	CX	6,950
5110-243-1525	Plane	GSR	1,247
5110-244-9088	Chisel	CX	570
5110-245-4177	File	CX	2,148
5110-254-3469	Handle	CX	385
5110-254-8962	Gouge	CX	8
5110-289-0001	Die set	CX	471
5110-289-0003	do	CX	335
5110-289-0007	do	GSR	1,482
5110-293-0248	Chisel	REF <sup>1</sup>	104
5110-293-2245	Saw	CX	1,889
5110-293-2296	Cutter	REF <sup>1</sup>	1,789
5110-293-2494	Blade	CX	647
5110-293-3435	Saw	CX	27,022
5110-293-3472	Ax	REF <sup>1</sup>	9,434
5110-449-3743	Chisel	CX	167
5110-529-3658	Gouge	CX	13
5110-529-3660	do	CX	11
5110-529-3662	do	CX	
5110-529-4974	do	CX	13
5110-529-5297	do	COM	
5110-529-5692	do	COM	
5110-555-9359	Frame	CX	1,075
5110-595-8886	Drill	REF <sup>1</sup>	313
5110-596-9581	Shears	REF <sup>1</sup>	4,368
5110-618-4787	Brace bit	REF <sup>1</sup>	14,262
5110-640-5419	Chisel	GSR	4,892
5110-640-5423	do	GSR	972
5110-640-5424	do	GSR	2,565
5110-640-5432	Gouge	CX	6
5110-640-5433	do	CX	6
5110-640-5460	do	GSR	25
5120-024-7208	Pick	COM	132
5120-024-7210	do	COM	106
5120-024-7211	do	COM	104
5120-024-7213	do	COM	67
5120-180-0556	Screwdriver	NFUB	397
5120-181-6819	Pliers	GSR	4,406
5120-188-8446	Scoop	CX	5,795
5120-188-8450	Shovel	CX	37,441
5120-189-7910	Socket	CX	782
5120-203-4801	Wrench	CX	21
5120-203-4812	do	CX	138
5120-221-1440	Awl	CX	139
5120-222-2384	Driftpin	CX	111

<sup>1</sup> Air Force withdrew.

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*Air Force support items indicating sources other than GSA—Continued*

Federal stock No.	Name	Source	Yearly value
5120-222-4284	Extractor	CX	4
5120-222-4447	Stake	NPUB	\$13,983
5120-224-7528	Jack	GSR	64
5120-224-9327	Shovel	CX	229
5120-235-6870	Socket	CX	32,407
5120-235-6872	do	CX	4,620
5120-237-8172	Screwdriver	CX	8,129
5120-239-8251	Pliers	CX	6,628
5120-247-0867	Tweezers	CX	18,649
5120-254-6618	Handle, mattock	CX	5,008
5120-263-3665	Tweezers	CX	7,784
5120-277-1461	Wrench, pipe	NPUB	3,013
5120-277-1463	Socket	CX	10,810
5120-277-4071	Tire iron	CX	7,310
5120-277-4251	Socket	CX	2,037
5120-288-6568	Puller, fuse	CX	1,418
5120-288-8155	Socket	COM	1,480
5120-293-3347	Screwdriver	CX	2,486
5120-293-3450	Vise	NPUB	1,358
5120-293-3471	Calking gun	CX	10,686
5120-299-8411	Pliers	KX	6,569
5120-408-1256	Hammer	CX	283
5120-490-3749	Arm	CX	1,791
5120-543-6350	Pliers	KX	67
5120-542-4571	Wrench	CX	1,652
5120-555-9568	Swage	CX	2,029
5120-555-9571	do	CX	179
5120-555-9614	do	CX	12
5120-555-9615	do	CX	134
5120-555-9617	do	CX	11
5120-555-9627	Fuller	CX	107
5120-555-9628	do	CX	20
5120-555-9629	Swage	CX	175
5120-565-2500	Tweezers	KX	2,706
5120-596-1032	Auger	CX	2,555
5120-596-9313	Crimping tool	CX	15,997
5120-595-8472	Yarning iron	CX	63
5120-595-8473	do	CX	82
5120-618-4904	Tweezers	COM	674
5130-596-1062	Etcher	CX	2,680
5130-596-7466	do	COM	10,992
5133-262-2194	Drill, twist	CX	1,645
5133-266-9247	do	CX	9,582
5136-729-5684	Tap	COM	2,282
5136-729-5686	do	COM	3,086
5136-729-5689	do	COM	1,070
5136-729-5693	do	COM	2,950
5136-729-5703	do	COM	275
5210-223-9604	Level	CX	1,748
5110-193-5001	Gouge	GSR	
5110-227-5031	do	Not listed	
5110-595-8232	Cutter	GSR	10,432
5110-595-9575	Scraper	SR	687
5120-220-9280	Stand, vise	COM	9,762
5120-331-5502	Holder, screwdriver bit	NGSR	4,695
5120-534-0465	Screwdriver	GSR	727
5120-554-9977	do	Not listed	
5120-537-3379	Tire iron	GSR	3,612
5120-620-1434	Key, cowl	CX	538
5210-229-3062	Caliper	CX	3,664
6210-293-1872	Gage, screw	CX	1,515
5210-501-6280	Rule	GSN	5,261
		CX	5,669
	Total		526,770

U.S. SENATE,  
 COMMITTEE ON APPROPRIATIONS,  
 March 25, 1963.

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

DEAR MR. CHAIRMAN: I have been informed that your Subcommittee on Defense Procurement of the Joint Economic Committee will reopen hearings this week on the subject of Department of Defense-General Services Administration supply relationship. It is my further understanding that the question of hand tool procurement, which has been the subject of inquiry in past years, will be brought up again.

I have been following the progress on purchase of hand tools by GSA for the military departments for several years. You will recall that in January of 1960 your subcommittee was given repeated assurances by the Defense Department that it was their intention to utilize the facilities of GSA to the greatest extent possible in obtaining commercial-type tools for the services. This policy was confirmed to me by letters from the Assistant Secretary of Defense for Supply and Logistics dated June 21, 1960, and from the Director of the Bureau of the Budget dated June 20, 1961. I am enclosing herewith copies of these letters for your information. I therefore was under the impression that the matter had been resolved to the satisfaction of all concerned.

However, it has now been brought to my attention that in recent months the existing agreement between DOD and GSA with respect to procurement of common-use items, particularly hand tools, has deteriorated to the point where there is considerable duplication of effort between the Defense General Supply Agency in Richmond and the General Services Administration. If this is so, in my opinion it will result in confusion in procurement and waste of funds. Utilization of GSA for procurement of common-use hand tools for the military services has the unanimous support of the entire hand tool industry.

I would think it would be most useful to all of us who have been concerned with the problem of procurement of common-use items if this situation would be fully discussed by representatives of the Defense Department, the General Services Administration, and the Bureau of the Budget at your subcommittee hearings. I would appreciate being advised of any information which the subcommittee obtains in this connection.

Thank you for your consideration of this matter.

Sincerely yours,

LEVERETT SALTONSTALL,  
 U.S. Senator.

EXECUTIVE OFFICE OF THE PRESIDENT,  
 BUREAU OF THE BUDGET,  
 Washington, D.C., June 20, 1961.

Hon. LEVERETT SALTONSTALL,  
 U.S. Senate, Washington, D.C.

MY DEAR SENATOR SALTONSTALL: This is in response to your letter of April 27, 1961, regarding the current status of plans to transfer responsibility from the Department of Defense to the General Services Administration for managing supplies of hand tools used by the Army, Navy, and Air Force.

As stated in a meeting held several months ago and attended by staff from your office, Congressman Conte's office, the Bureau of the Budget and a representative from the hand tool industry, the plans to transfer additional supply management responsibility for hand tools to the GSA are part of a broad program to reorganize and consolidate the management of supplies used by the Armed Forces. It is necessary to give some background regarding the overall program in order to explain the decisions that have been made and the remaining steps affecting hand tools.

The principal feature of the overall plan has been the establishment of several additional single manager agencies in the Department of Defense. The first step in establishing each new single manager was to analyze each item of supply in the classes assigned in order to determine whether it should be purchased and distributed by the service in which it is used, by the single manager, by GSA, or by each post, camp, and station. Responsibility for the management of hand tools was assigned to the Military General Supply Agency, a part of the

Quartermaster Corps located in Richmond, Va., and started during the fall of 1959. Hand tools comprise approximately 60 percent of all items assigned to that agency. During the spring of 1960 a total of about 53,000 hand tool items were identified and analyzed. Of these, about 25,000 were classed as being special items still under development or testing or so closely related to a weapon that supply management should be retained by the using military service. About 7,900 were classed as items used exclusively by the Department of Defense which the single manager should manage. About 10,100 were classed as items on which mobilization reserve stocks were deemed necessary by one or more of the services (usually the Army or the Navy) and therefore to be managed by the single manager, although some of them matched items stocked by the GSA. The remainder of the 53,000 hand tools, comprising about 10,000 items, were classed as being appropriate for local procurement or for management by the GSA.

It was found that the GSA was stocking a total of 1,910 hand tool items which matched those being used in the military services. Of these, 1,240 were items on which mobilization reserve stocks were deemed necessary and 670 were items scheduled for local purchase or assignment to the GSA. It was agreed immediately that the GSA should assume full responsibility for both procurement and distribution of these 670 items. In January 1961, 120 of these items were assigned to GSA and the remainder are to be assigned in July 1961 when the single manager is scheduled to assume full accountability for managing the requirements of all services for the classes of supplies assigned.

The hand tools classed as being under development for a special purpose or used on weapons systems are being procured and distributed by the military services in which they are used. No issue is involved in this decision although further analysis to be conducted after the single manager is fully operational may indicate that some of them are not as specialized as originally believed and that responsibility for managing them should be assumed either by the single manager or the GSA.

The items which were classed as appropriate for local procurement or transfer to the GSA have been offered to the GSA. If GSA finds that they should be centrally procured and stocked, GSA will assume responsibility for them. Otherwise, each post, camp, and station will locally purchase its needs. To date, 8,415 such items have been offered to the GSA, GSA has reviewed about 1,200, and has decided to assume responsibility for 138 of them.

The remaining hand tools not yet accounted for consist of 1,240 mobilization reserve items which match items presently carried by the GSA. A final decision on assignment of management responsibility for these items has not been reached. It is agreed that the GSA should not carry slow moving general mobilization reserve stocks in its inventories but the question of which agency handles the purchasing and contracting responsibilities has not been settled. Representatives from GSA generally have argued that military and civilian requirements should be consolidated in order to take full advantage of purchasing in larger quantities with resultant pricing and transportation savings, administrative economies and simplified dealings with manufacturers. Others have argued that procurement responsibility should not be separated from storage and distribution responsibility which cannot be assigned to the GSA for mobilization reserve items.

Neither the Department of Defense nor the Bureau of the Budget has taken a formal position on this issue as yet because it appears that a more intelligent decision can be reached after further analysis of the items involved. All of these items were coded for mobilization reserve inventories before the current policies for retention of mobilization reserve stocks became effective. Some of the items involved may not meet present standards for mobilization reserves and when so determined can be assigned to the GSA without further question. Furthermore, the original coding operations were performed under very heavy work pressures and tight schedules and were processed by a new organization not yet fully staffed. It is believed that further analysis will disclose instances in which items can be reclassified and assigned to GSA. The necessary analysis and rechecking is underway and final decisions have been reserved until the work can be completed. In the meantime, the GSA will continue to act as the central procurement agency for all of these items. In addition, the GSA will continue to supply the needs of the Air Force since the Air Force generally is not involved in the mobilization reserve aspects of the problem. This interim arrangement is scheduled to be continued until about January 1, 1962, when the

reviews are to be completed. At that time any of these items for which mobilization reserve stocks are determined to be required will be referred to the Assistant Secretary of Defense for Installations and Logistics for decision on where the permanent procurement responsibility should be assigned. This arrangement is included in the formal written agreement between the DOD and the GSA which was adopted last year.

We intend to keep in touch with the officials concerned in the DOD and the GSA as proposals for settling the issues are considered.

Sincerely yours,

DAVID E. BELL, *Director.*

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ASSISTANT SECRETARY OF DEFENSE,  
*Washington, D.C.*

HON. LEVERETT SALTONSTALL,  
*U.S. Senate.*

DEAR SENATOR SALTONSTALL: As you requested in your letter of June 8, 1960, I am writing to clarify policies, plans, and intentions with respect to our management of handtools.

Our present program for integrating and improving the supply management of the Department of Defense is predicated upon our conviction, which is shared by the military departments, that items of supply can be segregated on the basis of their characteristics and applications into three broad classifications for the purposes of determining the best mode of management. In the first of these classifications are those items which, because of their developmental status, engineering complexity, or intimate relationship with primary weapons, are best managed by the military department that requires the item. In the second category are those items which are susceptible to integrated management, but which are best managed within the Department of Defense because they require stockage in war readiness depth or are used exclusively for military purposes. The third category embraces all other items used by the military. These items can be managed on the basis of economic considerations, largely by procurement from the General Services Administration or direct from commercial sources. It is because we believe this third category is of significant magnitude, both from the viewpoint of items and dollars, that we are confident that our dependence on GSA for support will increase in a substantial way.

When we create a single manager assignment, for convenience we define the scope of this assignment in terms of Federal supply classes. Thus we create a DOD manager for a given commodity range, although we recognize in advance that there will be items within that range that require various methods of management. The single manager provides us with a clearinghouse for these items and a point at which characteristics, applications and usage can be analyzed against management criteria so that the best management made can be determined.

Our preliminary analysis indicates that there are classes within the commodities presently being analyzed by single managers that do not contain a single item that can qualify for unilateral management by the requiring department and other classes where we cannot visualize the justification for DOD management of any items. There are still other classes within the FSC structure where military management of the entire class may make very good sense. Most classes will contain items requiring diversified types of management.

The single manager assignment for General Supplies embraces 92 classes comprehending over 100,000 items. For these classes he will perform certain management functions for the entire Department of Defense, such as classification and cataloging, but he will procure and stock only those items that qualify for some degree of integrated military management on the basis of approved DOD criteria. Of the 92 classes assigned to the single manager for General Supplies are 7 classes of handtools. The coding and classification of handtools are scheduled for completion by July 1, 1960, and progressively thereafter the single manager will assume his supply management functions, including procurement, for those items within his assignment that qualify for military management. If there are among the group of some 45,000 items used by the military and not handled by GSA, tools which qualify for integrated military management, we would expect the single manager to undertake any procurement necessary. Such a procurement would not conflict with the expanded role we envisage for GSA. Should the items classified for military

management include any items previously supplied to one of the departments by the GSA, the item will be withdrawn from the GSA only upon our approval of a clearly justified case.

Our present program is designed to assure that in the future all departments utilize GSA on a consistent basis for the supply of those items which, on the basis of objective application of sound criteria, are determined best managed by that agency. This will include in addition to those items now managed by GSA which do not require military management, items previously managed by the military department which do not qualify for Department of Defense management.

Thus, the good work done by GSA in the field of common handtools will continue, applied to a broader base than before. The companies in Massachusetts should be able to continue to supply high quality tools to Government users just as they have in the past.

I apologize for this lengthy letter, but I wanted to fully clarify our position. Since, as you point out, we have the same objectives, it is necessary that we have a mutual understanding of our program for attaining these objectives. If I can be of further assistance, please do not hesitate to call on me.

Sincerely yours,

PERKINS MCGUIRE,  
*Assistant Secretary of Defense*  
*(Supply and Logistics).*

KRAEUTER & Co., INC.,  
*Newark, N.J., February 6, 1963.*

Mr. JOHN H. HOLMEAD, JR.,  
*Chief, Machine and Hand Tools Section, General Services Administration, Federal Supply Service, National Buying Division, Washington, D.C.*

DEAR MR. HOLMEAD: A copy of your letter dated January 23, addressed to George P. Byrne, has been passed along to our company for information. Since a major decision is about to be made, we feel, that we, as a manufacturer (taxpayer) would like to voice our opinion regarding this decision.

We are a supplier who has had the advantage of experience in supplying the Government on both individual awards and GSA annual contracts, therefore, our views may be helpful.

For the last 3 years we have been the low bidder on a portion of the GSA term contracts covering pliers. During that period, we have supplied over 1,500,000 (one million and a half) pairs of pliers to the Government under contract through GSA. Also during this period of time, we have been able to evaluate factually the decided advantages of term bidding for our company through GSA in comparison to the spot-type bids for the same items through other agencies of the Government.

Therefore, we believe it is important to express our views. We want to be on record as to the advantages that we know are beneficial to both the Government and our company, under GSA term purchasing.

#### GOVERNMENT TERM PURCHASING

##### *I. Advantages GSA term contracts*

A. The supply of finished material at point of usage is nearly "guaranteed" by the quantity projection and perpetual control method with predetermined minimum inventory levels established.

B. Requirements watched and projections made by the GSA from experience benefits both the Government and the manufacturer as follows:

1. The Government can go through the paperwork and ordinary expenses of preparing bids and awarding contracts once a year versus many, many times a year.

The paper saving alone to the Government is a factor not to mention the personnel required and time expended on each bid, each award and each performance on an individual requirement basis.

2. The manufacturer can:

- (a) Forecast his inventory level required to perform over the period of the contract—resulting in (1) quantity purchasing of raw materials and supplies (2) a steady flow of materials through the plant (3) a steady working force, leading to better labor-management relations (4)



a steady performance on the contract leading to better and "sure" supply at the end-user level.

These factors make it possible to lower the manufacturers inventory investment on Government items.

The manufacturer knows what and approximately how many items he will need to produce for a period of time, versus "spot" quantity orders at an inconvenient time (such as factory vacations) and unpredictable quantities, with 90-day delivery requirements.

(b) When an emergency arises in making necessary high quantity purchases, the Government can procure at least some quantity immediately from sources already under contract, eliminating delays for bidding, et cetera (this has been done from time to time through GSA on our products).

A manufacturer already performing on a Government contract, can perform on an emergency basis.

(c) Experienced help is already employed in the plant, thus, a minimum of time required to increase production requirements.

(d) Overtime can easily go into effect, to increase production.

When a big requirement is required from a manufacturer not producing the same items, the lag or leadtime could be detrimental to the national defense.

C. Cash flow:

Government: On a predicted term basis, the Government can forecast requirements and expenditures to fit and keep within a budget.

Under a multibid per year basis, the element of unknown requirements in any month is a deterrent to good planning and budget control.

Manufacturing: Can plan their budgets and purchasing with a more reasonable assurance of continuing orders, keeping unit prices to the Government at the lowest possible level.

D. Bid prices: To support our statement of reduced unit prices, purely as a result of the advantages of term bidding introduced by GSA we submit the following information:

6 inch needle nose pliers, 1957 price, low bidder.....	\$1. 15
6 inch needle nose pliers, 1962 price, low bidder.....	\$1. 02
Reduction.....	\$0. 13
Percentage difference.....	-11. 3
6 inch diagonal pliers, 1957 price, low bidder.....	\$1. 10
6 inch diagonal pliers, 1962 price, low bidder.....	\$0. 93
Reduction.....	\$0. 17
Percentage difference.....	-15. 5

Please note these percentage differences, cost of labor, materials and variable operating expenses have all increased in this 5 year period.

Through the process of knowing the level of plant activity required to produce the projected GSA quantities in term bids, we have been able to intelligently plan and schedule all phases of our company operations. This has resulted in lower prices to the Government and consistent standard quality, to meet Government specifications.

E. Summary: We believe that our comments and supporting facts make it quite clear that an annual contract with specified quantities puts both the Government and the manufacturer in the best possible position to:

1. Plan and budget expenditures.
2. Assure constant delivery.
3. Assure a consistent standard of quality.
4. Maintain competent sources of supply who will bid on large contracts at the lowest possible price.

In addition, the advantages of one agency doing the purchasing on our type of product is extremely important.

We sincerely hope that our voice may be heard and consideration given to our thoughts, in this important decision.

Cordially,

BRUCE BRIGGS,  
Vice President and General Manager.

KRAEUTER & Co., INC.,  
Newark, N.J., February 8, 1963.

THE PRESIDENT,  
The White House,  
Washington, D.C.

MR. PRESIDENT: Recently you have inferred that less duplication of effort in Government would effect savings to the taxpayers.

The enclosed letter, I am sure, will not have a full meaning to you, unless you become familiar with some of the facts.

To save you some time here is the picture as we see it:

1. Two branches of the Government are purchasing identical items—(handtools).
2. GSA purchases on a 6-month or years contract basis.
3. DSA at Richmond, Va., purchases on an individual bid basis as requirements arise from contracting officers.

Many times during 1962, we received inquiries from Richmond for the identical items GSA is purchasing under contract with our company.

In some cases we receive telephone calls from Richmond requesting price and delivery on identical items purchased by GSA. We referred Richmond to GSA in Washington, saying "Have you checked GSA for delivery? Undoubtedly these items are in a GSA warehouse for immediate delivery.

The reaction to this suggestion from Richmond was always unfavorable. Why? Simply because they are trying to justify the existence of the Richmond group, without consideration given to "What is good for the Government and the taxpayer."

We have been in contact with Mr. George Mullins, Bureau of the Budget, concerning this duplication of effort, giving him specific examples.

GSA as a group has done an outstanding job for the Government in procurement of handtools. These people know what they are doing. How to coordinate the purchasing to effect savings. Are conversant about quality characteristics needed. In short this group is a real credit to the Government purchasing.

Why not let the GSA do all procuring on handtools? Is this too simple an approach? When in fact, this group has proved its efficiency.

This decision of who is going to buy hand tools—GSA or DSA has been bandied around for too long. In the meantime, we manufacturers are the bouncing ball between the two.

Maybe you, Mr. President, can get the Joint Economic Committee to make the right decision.

Respectfully yours,

BRUCE BRIGGS,  
Vice President and General Manager.

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EXECUTIVE OFFICE OF THE PRESIDENT,  
BUREAU OF THE BUDGET,  
Washington D.C., March 19, 1963.

MR. BRUCE BRIGGS,  
Kraeuter & Co., Inc.,  
Newark, N.J.

DEAR MR. BRIGGS: Thank you for sending the pliers to me which are returned herewith. We have been doing a great deal of work on the various problems you have brought to our attention and I believe we are making some progress. I have just returned from Richmond where GSA and Defense staffs reviewed the various operating problems which have arisen. Agreement was reached on many points although some difficulties still have not been resolved. I also discussed the various specific cases which you brought to my attention.

If any further matters arise which you feel should have attention, I hope you will continue to let me know about them.

Sincerely yours,

GEORGE G. MULLINS,  
Assistant Chief, Office of Management and Organization.

SNAP-ON TOOLS CORP.,  
Kenosha, Wis., March 25, 1963.

JOINT ECONOMIC COMMITTEE,  
Capitol Building,  
Washington, D.C.

GENTLEMEN: In your current consideration of the Government procurement procedure, the attached file of letters may be of interest to you. In these letters Snap-on Tools has expressed its approval of the General Services Administration and its professional handling of the purchasing function.

We have had no reason to change this appraisal in the subsequent period and would again endorse GSA—as professionally trained to obtain the best quality merchandise for the least amount of taxpayers' money.

Sincerely yours,

ROGERS PALMER, *Senior Vice President.*

JANUARY 14, 1960.

JOINT ECONOMIC COMMITTEE,  
Capitol Building,  
Washington, D.C.  
(Attention of Mr. Ray Ward).

GENTLEMEN: We have heard that the Joint Economic Committee has recently taken some interest in the procurement of hand service tools for the Government and military agencies. Tools are of vital importance in the maintenance and repair of all machinery, equipment, and mobile units. This critical necessity was established during World War II. It also emphasized the importance of quality in handtools.

During the past 2 years, there has been an effort to establish single-agency procurement, particularly for the military agencies. In theory, it would be most economical for the Government to buy through a single buying office, but there has been much confusion due to interservice complications unless the agency is more or less neutral.

Based on our own experience as a manufacturer dealing with all agencies, we firmly believe the best interests of the Government would be served by procurement of handtools through the General Services Administration (GSA). Procedures have been established in GSA which eliminate much of the redtape and confusion normally encountered. GSA is a professional buying agency with facilities for testing and evaluating specifications for the end use of the product. This is important in the case of handtools where a screwdriver that is used occasionally in post office maintenance would not be economic for an aircraft mechanic making constant use of the screwdriver on costly equipment, hardened screws, and under hazardous working conditions.

On the same item, with identical quantities, we have been able to quote lower prices to GSA than to other agencies. The reason is that procedures of delivery, inspection, billing, and payment are made definite and businesslike.

We trust that the Joint Economic Committee may give some consideration to this problem in connection with procurement of handtools.

Yours very truly,

SNAP-ON TOOLS CORP.,  
*Vice President.*

MARCH 2, 1961.

GENERAL SERVICES ADMINISTRATION,  
Washington, D.C.

(Attention of Mr. John H. Holmead, Jr., Chief, Machine and Hand Tools Section).

GENTLEMEN: You may be interested in this observation regarding the finishing operations necessary to supply the General Services Administration with the high-quality handtools which are now being procured for the military.

There are several things we would like to point out with reference to Snap-on Tools and the part which we have played in furnishing the high quality tools to General Services. Your invitations have specifically spelled out the requirements for bidding insofar as the Federal specification GGG-W-00641C is concerned. As you know, the material which we use, our production and inspec-

tion procedures, and our final finishing and plating operations not only conform to the existing specifications on the high limits, but, in many cases, are in excess of the requirements under the specification.

It is our feeling in the matter that since GSA is handling the buying of tools required for the military, particularly the Air Force, that the level of quality has risen remarkably. I am quite sure that this comment will be borne out by those agencies within the Department of Defense who have procured tools through the GSA.

We have always been of the opinion that raising the level of quality on handtools presently being used within the military was of utmost importance, we do not feel that the primary concern should rest with the type and quality of the finish. Although this is one factor which would enter into consideration and justify the buying of quality tools, there are other basic factors of equal importance such as the use of high-grade materials, proper production facilities, adequate in-processes and final inspection, manufacturing to close tolerances, and expeditious handling of orders and processing orders from receipt today of shipment.

We are attaching to this letter of the various phases of the procurement procedure used by the GSA which we feel have a direct bearing on your success in furnishing a high-quality tool to the military at a minimum cost. We feel that the procedures adopted have enabled tool manufacturers to handle the quantities as set forth in your invitation at a minimum of cost, and thereby reflecting cost reductions to the Government. We have always felt that in this age of jet aircraft, guided missiles, and space equipment that the quality of the handtools being used to repair and maintain this equipment was far behind the advances we have made in these fields. It becomes very serious and costly when this repair and maintenance must be done with inadequate tools.

We are thoroughly convinced that the General Services Administration have set the pattern which will bring the quality of the tools being used to the level of the equipment that they are being used on for maintenance and repair.

Please feel free to use the attached comments in any way that you see fit to further your program on handtool procurement.

Yours very truly,

SNAP-ON TOOLS CORP.,

*Government Contracting Division.*

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#### GENERAL SERVICES ADMINISTRATION

##### BUSINESS PRACTICES WHICH OBTAIN MAXIMUM QUALITY HANDTOOLS AT MINIMUM COST

###### 1. Term (6 month to 12 month) contracts.

A. Term contracts enable the manufacturer to plan production over the period of the contract, decreasing costs by scheduling large production runs.

###### 2. Guaranteed quantities. Estimated 6-month requirements. Standby stocks.

A. Enables a manufacturer to schedule production in accordance with estimated usage, taking advantage of guaranteed quantities for production runs, and providing standby stocks for immediate deliveries.

###### 3. Standardization of packaging and marking requirements. Minimum shipping quantities.

A. Enables the manufacturer to standardize his packaging procedures, enabling the procurement of large quantities of like items in cartons, boxes, etc. Shipping quantities help to keep shipping charges at a minimum due to minimum quantities and limited destinations.

###### 4. Grouping of like tools and awarding on aggregate total price.

A. This method permits a manufacturer to level out his cost computations over a group of items rather than having each individual tool in a line item bid stand on the individual quantity ordered.

###### 5. Preaward survey (financial and production capacity).

A. Permits the awarding of a contract to a manufacturer who has been predetermined to have the financial capacity and production capacity to carry out the terms of the contract before award, eliminating the possibility that after an award, failure to perform might necessitate emergency buys, and additional costs

and expenditures related to these emergency buys or the possibility of readvertising the entire invitation.

6. Quality assurance.

A. Under the provisions of the contract, quality assurance is given to a manufacturer based on previous samples submitted upon request and through normal inspection procedures eliminating costly time factors occasioned through individual inspection of each shipment on orders placed under the contract.

We submit the above list of reasons that we have found that, under the General Services Administration, procurement of handtools has been so successful in their program to upgrade the quality of tools and the elimination of many costly items involved in the normal procurement of handtools.

SEPTEMBER 11, 1958.

LLOYD L. DUNKLE,  
*Director, National Buying Division, General Services Administration, Washington, D.C.*

DEAR MR. DUNKLE: Now that we have reached the end of our 6-month contract with GSA for various items of hand tools purchased in behalf of the U.S. Air Force, we would like to express our appreciation for the fine manner in which GSA has administered this rather complicated procurement program. From our viewpoint as a supplier, we have been quite impressed with the businesslike procedures and the practical understanding of supplier problems.

However, we have been even more impressed with the value of your program from the viewpoint of Government buying. Careful inspection of product—both before placing the order and before delivery—has assured the best possible value for the receiving agency. The checks on delivery performance against promised delivery dates and the general follow-up procedures have been very efficient.

We wish to commend your organization highly for the very superior job of procurement that is being done at this time.

Very truly yours,

SNAP-ON TOOLS CORP.,  
\_\_\_\_\_, Vice President.

SNAP-ON TOOLS CORP.,  
*Kenosha, Wis., June 7, 1962.*

Re contract GS-OOS-35988, Term—November 1, 1961, to April 30, 1962.

GENERAL SERVICES ADMINISTRATION,  
NATIONAL BUYING DIVISION,  
*Washington, D.C.*

(Attention: Mr. John Holmead, Jr., Chief, Machine and Hand Tools Section).

GENTLEMEN: We believe at this time, it would be appropriate to give you a detailed report on the results of our most recent contract, GS-OOS-35988, terminated as of April 30, 1962.

We are attaching reports on all of the items covered by this contract, giving you the original estimate usage over a period of 6 months, the actual orders received, and the resultant inventory to the contractor.

We believe that after reviewing this report you will realize why we are complimenting you and your organization on a program we feel has been very advantageous to everyone concerned. The procurement of hand tools by the General Services Administration has kept a constant flow of quality mechanics' hand tools going to our defense program at a minimum of cost.

As you know, we have, on several occasions, checked the operation and handling of contracts from GSA against other types of military contracts and have found that, from every standpoint of operation, the procurement through GSA has resulted in considerable overall savings, both to the contractor and to the Government. These savings have been reflected in lower prices to the Government and the methods used in procurement have enabled the contractor to affect better production schedules, more expeditious handling of purchase orders, a minimum time expenditure in shipping and invoicing individual purchase orders.

In further explanation of the reports attached, all of the Federal stock numbers preceded by an asterisk are those items under the contract which have been shipped complete as of today's date. There are no longer any requirements

open under the basic contract or any additional contracts placed through GSA by the Defense General Supply Center at Richmond.

Take note of the estimate quantity column and the actual usage column and you will realize why it is a distinct advantage for a contractor to schedule his production against your estimate quantities. We feel that an outstanding job has been done in estimating the usage over a period of 6 months, inasmuch as we understand the difficulty from a contractor's standpoint trying to forecast disappearance of this number of items.

You will notice that from the very low surplus inventory that we have on hand on many of these items, we were able to schedule our production to the best advantage of everyone concerned.

We are looking forward to the handling of future GSA contracts and would appreciate your retaining the list of inventories on hand in the event that an emergency should arise where you would be able to utilize some of this surplus inventory to the best advantage of the Government. Please do not hesitate to contact us not only on these items, which we have inventoried, but on any other items which might cause you difficulty in delivering where we would be in a position to help you. Thank you very much for your past cooperation, and if there is anything further that we might do to help you in furthering your hand-tool program, please let us know.

Yours very truly,

ALLEN C. WISCH,  
*Government Contracting Division.*

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KRAEUTER & CO., INC.,  
*Newark, N.J., March 20, 1963.*

Mr. RAY WARD,  
*Secretary, Joint Economic Committee,  
U.S. Capitol Building, Washington, D.C.*

We understand, Mr. Ward, that the Joint Economic Committee will hold hearings starting April 28.

We have been vitally concerned with the duplication of effort in handtool purchasing by DSA in Richmond, Va., and GSA in Washington.

So much so, in fact, that we have sent letters to President John Kennedy and to the GSA Office in Washington.

Enclosed are copies of these letters for your information and review.

In view of the fact that we are quite familiar with the inefficiency in Government purchasing, of handtools in particular, we would welcome an opportunity to appear at the hearing.

Since we have had firsthand experience, as a manufacturer and supplier to the Government, I believe we can contribute worthwhile information to these hearings.

The writer will plan to call you on Friday morning, March 22, 1963, to determine if our presence at the hearings would be helpful and beneficial to the American taxpayers.

Cordially,

BRUCE BRIGGS,  
*Vice President and General Manager.*

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JANUARY 8, 1963.

In accordance with your request I am writing to pass along to you some of my observations relative to the seeming lack of progress concerning the turning over of responsibility of common handtool procurement and issue to GSA by the military.

As you are well aware this subject was discussed at length during hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee in January 1960 and at that time extensive promises and commitments were made by the Defense Department as to their intentions of turning over all common handtools to GSA. Subsequent to this, correspondence between the DOD and both the House and Senate Appropriations Committees gave positive assurances of this intention.

The changeover seemed to be functioning smoothly and efficiently during the last half of 1961 and the early part of 1962 and quite a substantial number of common handtools were offered to GSA by DGSC (formerly MGSA) in Richmond. Accordingly, as a result of this progress and indications of further cooperation between GSA and the military via various agreements that were in effect GSA proceeded to organize their procurement staff in order to efficiently cope with the anticipated workload.

The entire program seemed to be steadily building up toward the anticipated and promised objective of ultimately relieving the military departments from handling such commercial items as common handtools. GSA obviously has to supply these identical items to civil agencies and had for several years been supplying the major portion of this type of tools to the Air Force to the complete satisfaction of all concerned.

Due to alleged misunderstandings and oversights at the working level DGSC continued to duplicate buying many of the items simultaneously being purchased by GSA with the result that the two Government departments became competitors, this being to the detriment of the Government, the handtool industry and the taxpayer. At this point the Bureau of the Budget became interested in the matter and made numerous efforts to persuade the DGSC that they should abide by the existing agreements and turn over the procurement of these tools to GSA.

For a short time, as a result of intervention by BOB the picture improved; however, as the months went on, the duplication of items being purchased by both Richmond and GSA reappeared and it is difficult to believe that these incidents are strictly by oversight or error.

A couple of months ago a large number of items that had been turned over to GSA by DSA on an "interim" basis were turned over to GSA permanently "except" for a number of about 249 items which it had been decided should be designated as mobilization reserve items which would have to be under military jurisdiction. It so happened that this 249 items accounts for more than 25 percent of the annual dollar volume of handtools processed by GSA. It is understood that since then nearly 200 additional items have been placed in this mobilization reserve status and if this total of more than 400 items is taken away from GSA as far as military support is concerned the entire concept of buying which has been so satisfactory in producing superior quality tools at prices previously paid for low quality ones will have been scuttled.

In addition to the above another more subtle means of scuttling the entire GSA-DSA tool program is by means of so-called standardization. In this manner where items have been assigned to GSA for support under a specific stock number, under the simplification program conducted by DGSC where there is a duplicate number it is their practice to use this as subterfuge for removing the item from GSA support by the simple means of making the GSA support item nonstandard and using the duplicate number as standard they merely change the source in the supply catalog to show DGSC as the source, thus in effect negating any obligation to draw this item from GSA stocks as covered under previous agreements.

This situation described in the preceding paragraph is becoming increasingly prevalent with the obvious result that GSA is now being left "holding the bag" since they have in many instances built up stocks of the item under the former stock number for which they had promised supply support to the military under existing agreements.

It seems rather incredible that through this type of subterfuge, which happens with such increasing frequency that it is difficult to believe that it is done purely through error or oversight, sabotaging of agreements is effectively accomplished with amazing ease through this subtle "back door" procedure. Inasmuch as this very sort of thing was covered in detail in your committee's previous hearings and many promises given that special care would be taken to make sure that future negotiations between the military and GSA would be accomplished with greater efficiency, it seems that it would now be in order for the committee to reopen hearings on this matter and perhaps it would be apropos to refresh some memories concerning those promises.

Should the above-described tactics continue to flourish unabated it would be only a very short time until the desires of Congress, as outlined in detail in the previous hearings during which it was made quite clear that GSA should assume their obligation to support the military for such items as handtools, will have been cast by the wayside. Further, this would be diametrically

opposed to the intent of the Federal Property Act of which one of the principal objectives was to utilize to a much greater extent, the Federal Supply Service, for supplying all Government activities with such common commercial items as handtools.

We trust that these comments and observations will prove helpful to your committee.

(Author asks to be anonymous for "obvious reasons.")

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ASSISTANT SECRETARY OF DEFENSE,  
INSTALLATIONS AND LOGISTICS,  
Washington, D.C., May 7, 1963.

HON. PAUL H. DOUGLAS,  
U.S. Senate, Washington, D.C.

DEAR SENATOR DOUGLAS: I am most grateful for this opportunity to comment on the letters you have received from manufacturers and other sources with respect to relationships between the Department of Defense and the General Services Administration in the management of handtools. My comments are confined to the more significant points raised in one or more of them.

First, let me assure you that there has been no change in our determination to avoid dual procurement of identical items by the Department of Defense and the General Services Administration and to eliminate dual storage and distribution of identical items to the fullest extent consistent with military needs. To this end, we have significantly expanded the use of the General Services Administration over the past 2 years as a source of supply for the military services. In fiscal year 1962, the first year the Defense General Supply Center (formerly Military General Supply Agency) was in full operation, the volume of GSA Stores Depot sales to DOD increased by \$60 million. It is estimated that these sales to DOD will increase by an additional \$53 million in fiscal year 1963. Approximately 85 percent of the increased sales result from the transfer of supply support from the Defense General Supply Center to the General Services Administration.

In his testimony before your subcommittee, Mr. Boutin outlined the series of understandings reached since 1960 between the General Services Administration and the Department of Defense to "clarify and expand GSA's procurement and supply support to the Department of Defense." During this period, we have been engaged in the coding and management classification of more than 2 million items—more than one-half the total number of items in all military supply systems.

Criteria used in these determinations were developed in agreement with the General Services Administration and the Bureau of the Budget.

The criteria used as the basis for management determination provide generally for the following assignments:

(a) *Management by the military services.*—Items directly and peculiarly related to weapon systems and items subject to continuing redesign during production.

(b) *Management by the Defense Supply Agency.*—Items susceptible to integrated management and which are best managed within the Department of Defense because of a requirement for stockage in war readiness depth or because they are used exclusively within the Department of Defense.

(c) *Management by the General Services Administration or released for local procurement.*—All other items.

(d) *Procurement by the General Services Administration.*—Items required to be stocked in war readiness depth but not used exclusively within the Department of Defense.

Our policy is designed to prevent procurement of the same item by both the Department of Defense and the General Services Administration. Nevertheless, as evidenced by the complaints in the letters you have received, some dual procurement has occurred. Our examination of our procurements reveals that this has been due to the complexities inherent in bringing hundreds of thousands of items under integrated management—either within the Department of Defense or by the General Services Administration—in a short period of time. Our experience with handtools exemplifies this.

The handtool "package" reviewed for management method determination contained more than 53,000 items, ranging from the simplest tools available in



the local hardware store to the highly complex and specialized tools used exclusively in the maintenance and operation of weapons. Many items were found with different stock numbers which were identical or had insignificant differences; many others were described only by manufacturer's part numbers or were designated simply as components of repair kits.

Recognizing the complexities involved in identifying handtools under these circumstances, the General Services Administration and the Military General Supply Agency initiated a joint catalog cleanup project in February 1961. In May 1961, more than 2,000 common handtools were transferred to GSA for supply support of DOD, on the basis of existing catalog identifications. The number of handtools transferred to GSA management rose to 2,780, out of a total of more than 9,000 such items offered for GSA management during the cleanup process. In addition, procurement responsibility was transferred to GSA for 1,280 handtools, for which one or more services had indicated a mobilization reserve requirement.

By mutual agreement the Military General Supply Agency proceeded with the independent purchase of other handtools during the catalog cleanup process in order to insure uninterrupted support of military service customers. Some of these tools were found, as a result of the joint catalog cleanup project but after procurement action was initiated or completed, to be identical to tools being procured by the General Services Administration. The frequency of dual procurement actions has progressively declined in step with the progress of the joint agency catalog cleanup project. An analysis of our records discloses that, in early 1961, the initial operational period of the Military General Supply Agency, duplicate purchase of handtools with stock numbers identical to GSA-managed tools accounted for almost 27 percent of all handtool procurement actions undertaken by Richmond. This figure had been reduced to 1.4 percent (27 items) by the end of the first quarter of 1963.

The anonymous letter, as well as several letters from Mr. Briggs of Kraeuter & Co., refers to alleged actual or threatened withdrawal of handtools from GSA distribution management. No withdrawal has occurred. At one time, the Defense General Supply Center omitted GSA as a source of supply in the Air Force catalog for some 249 handtools. The omissions were traced to errors in data furnished to the General Supply Center and were corrected to the full satisfaction of the General Services Administration.

Certain Air Force handtools supplied by GSA have given rise to a problem which has yet to be resolved. In 1958, prior to the activation of the single manager of general supplies, the Air Force transferred supply supports to GSA for approximately 2,000 common handtools for which the Air Force had no war reserve stockage requirement. After the activation of the single manager for general supplies, one or more of the other services indicated a mobilization reserve requirement for 1,280 of these handtools. Under existing policy and criteria, as agreed to by GSA, distribution management of these items would revert to the Defense General Supply Center. However, the General Services Administration would continue as the sole procurement agency for all Government users. Nevertheless, we have taken no action to remove the distribution of these Air Force items from GSA stores depots. No action will be taken without my personal review, which will require full justification and careful consideration of the views of the Administrator of the General Services Administration.

As previously noted, the General Services Administration procures items which are not used exclusively within the Department of Defense, including those which are stocked and distributed by the Defense General Supply Center to satisfy a war readiness requirement. Procurement responsibility includes both quality control and source inspection. Mr. Briggs' fear that the latter two functions would not accompany the procurement assignment is unfounded.

Letters from the four handtool manufacturers state or imply that the General Services Administration secures lower prices for handtools because it is a more efficient procurement agency. This belief appears to be based, at least in part, on GSA's utilization of term contracts. We are also aware many other producers believe that term contracts tend to restrict competition and are less susceptible to precise price quotations than fixed quantity contracts. Term contracts are utilized by our contract officers whenever appropriate, price and all other factors considered. We have reviewed contracts placed by the Defense General Supply Center during the catalog cleanup process for items also procured by the General Services Administration and find no conclusive evidence of a price advantage for either agency. There were at least as many instances of lower prices secured

by the Defense General Supply Center as there were instances where the General Services Administration secured the more favorable price.

The anonymous letter contains a completely unfounded allegation that "so-called standardization" has been used as "another more subtle means of scuttling the entire GSA-DSA tool program." The Defense Supply Agency has been engaged since its activation in a vigorous item reduction program as part of a continuing Defense-wide effort to eliminate more items from the supply system. Since January 1, 1963, DSA Supply Centers have reached agreements with the military departments to eliminate 37,000 items, of which some 14,000 were accounted for by the Defense General Supply Center alone. I know that your subcommittee appreciates the value of this program. Its sole motivation is to promote more effective and economical supply.

In conclusion, I share Mr. Boutin's sense of satisfaction with the progress achieved since the last hearings of your subcommittee as well as his desire for further progress toward optimum effectiveness and economy in the procurement and supply support of the Government as a whole. To this end, I have joined him in a request that the Bureau of the Budget conduct a thorough study of the problem at that early date. I trust that this will lay a foundation for continued progress toward the objectives your subcommittee has consistently fostered.

If it is your intention to insert the letters received from the handtool industry in the record and report of testimony presented to your subcommittee, I would like to ask that you also insert this response.

Sincerely,

THOMAS D. MORRIS,  
*Assistant Secretary of Defense, Installations and Logistics.*

(See also pp. 101, 103.)

MARCH 19, 1963.

HON. KERMIT GORDON,  
*Director, Bureau of the Budget,  
Washington, D.C.*

DEAR MR. GORDON: Our experience emphasizes the necessity for an examination of the responsibilities for the overall management of Government supplies and for the operation of such supply systems as are required to meet the needs of all agencies of the Federal Government.

This examination should result in the establishment of clearly defined and understood Government-wide supply management and supply operational responsibilities of GSA under the Federal Property and Administrative Services Act. It should define with equal clarity the supply management role of the Department of Defense as authorized under Public Law 152 and the National Security Act and amendments thereto. The examination should reveal overlapping and duplicating responsibilities among GSA, DOD, and the other civil agencies, and include specific proposals for their delineation.

This is a highly complex and important task. To accomplish its objectives, we recommend that:

(1) A steering group be established to monitor this study, which would be composed of the following: Deputy Director, Bureau of the Budget, Chairman; Assistant Secretary of Defense (Installations and Logistics); Administrator of General Services; appropriate officials of other interested departments and agencies, as selected by the Chairman.

(2) The Bureau of the Budget establish within its staff a study group representing those elements of the Bureau most concerned with DOD-GSA relationships to conduct factfinding and analysis, and develop conclusions and recommendations essential to resolution of this task.

(3) Affected departments and agencies designate a representative to provide such input to the Bureau of the Budget study group, as required, during its fact-finding stage.

(4) The steering group establish the precepts to guide the study group toward logistics concepts which will satisfy the needs of all Federal agencies with maximum effectiveness and economy.

(5) The study group prepare a study plan to be coordinated with the steering group before proceeding with its examination.

(6) The report of the study group be submitted to the steering group for appropriate coordination and action.

(7) Policy decisions resulting from this examination as approved be formally promulgated by Executive order, or in the event it is required, new legislation be proposed.

Sincerely yours,

BERNARD L. BOUTIN,  
*Administrator of General Services.*  
 THOMAS D. MORRIS,  
*Assistant Secretary of Defense*  
*(Installations and Logistics).*

APRIL 19, 1963.

HON. BERNARD L. BOUTIN,  
*Administrator of General Services,*  
*Washington, D.C.*

HON. THOMAS D. MORRIS,  
*Assistant Secretary of Defense (Installations and Logistics),*  
*Washington, D.C.*

DEAR MESSRS. BOUTIN AND MORRIS: In response to your joint letter of March 19, 1963, the Bureau of the Budget is prepared to assist in organizing and conducting an examination of the supply management responsibilities and operations of the Federal Government, with particular respect to the relationships among GSA, the Department of Defense, and civilian agencies with major supply programs, and including enlargement of studies now underway to determine the extent of supply support services which GSA should perform.

Although we agree that close and continuing working relationships with all of the agencies concerned would be necessary and that there must be consultation concerning plans, conclusions, and recommendations, it is our view that it would be inadvisable to organize a formal interagency steering group which would share responsibilities for planning and conducting the work. Operating conditions, program requirements, and internal organizational situations are so different for each agency that interagency sharing of responsibility would be of limited value and not entirely consistent with our statutory responsibilities.

We believe that it will be necessary to deal with each of the major civilian agencies and the Department of Defense as separate areas of study. This view is supported by our findings during reconnaissance studies which we have had underway for the past few months in those civilian agencies which continue to operate substantial procurement and supply programs. We propose to move forward with these studies with additional emphasis in order to bring them to a satisfactory conclusion.

We anticipate that an examination of supply management relationships between the Department of Defense and GSA will be more complex and difficult than the work which is underway in the other civilian agencies. We recommend that there be an early meeting to explore the scope and context of the studies to be undertaken, to identify issues and problem areas more clearly, and to agree upon working arrangements and time schedules. Mr. Robert W. Jones will be available to join with you in such a meeting at a time which is mutually convenient.

We suggest that as a backdrop for these discussions, there be an initial agreement that existing joint arrangements between GSA and the Department of Defense remain in force while our studies are in progress, but that there be no major shifts of responsibility in either direction unless there is a three-way agreement among us on settlement of unresolved existing problems in areas recently discussed. In our judgment such an agreement need not preclude procedural changes to clarify existing working arrangements or to handle new operating problems. We believe that it would be well to discuss unresolved issues as soon as possible.

The main goal of the work to be undertaken should be development of factual information and policy criteria which can be used to settle organizational issues, and provide a rationale for supply jurisdiction which is justified "in terms of economy, efficiency, or service," as the Property Act provides. This will make it necessary, in our judgment, not to adopt in advance any assumptions as to where ultimate responsibilities should be vested. For example, we think there should be an open mind with respect to such questions as the procurement and management of mobilization reserves; the advantages and disadvantages of cen-

tralized procurement of any class of supplies for all agencies by the chief user; and operation of procurement and supply management systems, as opposed to the placement of responsibility for formulating supply policies. It is only by the objective examination of such broad questions and probable abandonment of further attempts to reach what might be called "individual item agreements" that we can accomplish the most efficient and effective supply system possible for the Government as a whole. Certainly reexamination of experience gained under arrangements which have been worked out over the past several years would be appropriate and timely in the light of the statutory authorities vested in the General Services Administrator and the increasingly complex operational requirements faced by the military departments and the Department of Defense.

In the light of the foregoing suggestions, we are reluctant at this time to express any judgment on your joint letter of March 27 requesting our evaluation of the study on surplus personal property sales. Just as there presently appear to be no clear and compelling arguments for savings and economies which outweigh all other considerations in procurement and management of supplies, so also there appears to be no clear and compelling economic support for the transfer of surplus property functions. Accordingly, we suggest that the policy and operational implications contained in that study be deferred for later consideration and that the existing pattern for handling surplus property sales not be disturbed at the present time.

I shall be glad to join you and Mr. Jones for discussion of further arrangements.

Sincerely,

ELMER B. STAATS, *Deputy Director.*

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#### APPENDIX 5

(Commercial-industrial-type activities in the Government)

##### STATEMENT OF NATIONAL ASSOCIATED BUSINESSMEN, WASHINGTON, D.C.

Your committee's present study of progress made in efficiency of the supply and procurement activities of the Department of Defense and their impact on the economy involves a segment—a very important segment—of the whole broad subject of Government competition with taxpaying private enterprise.

But it is hardly possible to consider a fraction of this situation without at the same time looking at the whole picture. Bills that are now before the 88th Congress, looking to the establishment of a Federal policy concerning the termination, limitation, or establishment of business-type operations of the Government which may be conducted in competition with private enterprise relate to the supply and procurement activities of the Defense Department—and also to supply and procurement activities of all other departments and agencies. Senate Resolution 100, proposing investigation of "the extent to which departments and agencies of the Government are engaged in the production or furnishing of goods and services which can be supplied by private enterprise" does not mention DOD specifically, but it is obvious that the Defense Department is one of those to be investigated.

National Associated Businessmen has been mainly interested, for the past 10 years, in the termination of amelioration of Government's invasion of the field of private enterprise. Our 800 members include individuals, partnerships, and corporations, located in every State and engaged in probably every one of the businesses listed by congressional committees that have studied Government's competition with taxpayers. It is likely that many of our members might be found among the suppliers of the Department of Defense; we know from a study made several years ago that some of our members have been among the purchasers of Defense reserve plants that have been put on the market. We believe that your committee will be interested also in what we have found and what we have observed as to the competition that private enterprise experiences from other departments and agencies of the Government.

Nine years ago, on February 9, 1954, the Harden Subcommittee on Intergovernmental Relations of the House Committee on Government Operations, submitted to the 83d Congress its general report on Government in business. Extensive hearings had been held during the subcommittee's study of Government competition with private enterprise, and though the Bonner committee had made a somewhat similar study during the 82d Congress, the Harden report was the first on this subject to be made public since the Shannon committee

report 22 years earlier, in 1932. We believe it interesting and proper to quote from the introductory statement of the Harden subcommittee's report, since the words of 1954 are fully descriptive of the situation that exists in 1963. We quote:

"The subject 'Government in Business' is wide in scope and extremely important in this era of big government, big and unbalanced budgets, enormous debts, heavy taxes, and complex intergovernmental relations. This report deals with the general philosophy of the subject, the background, the trends, the dangers in the present situation and conclusions and recommendations designed to induce improvements \* \* \*. The subcommittee is gratified that awareness of the problem has been generated. This is the first step in reversing the trend."

Unfortunately the trend has been by no means sufficiently reversed, though a good many items of competition have been eliminated and more are promised. We are encouraged by the fact that the Joint Economic Committee is giving us an opportunity to state the case against Government competition with taxpaying private enterprise; that effective legislation has been introduced to both the Senate and the House of Representatives of the 88th Congress, and that other hearings, pinpointed to legislative action, are in prospect.

The exact problem of Government competition in business is one of very long standing. Mrs. Harden's subcommittee report said:

"The Federal Government has through the years, for one reason or another, moved into many activities that have been or might be performed by the States or by 'the people' (private enterprise). Nowhere in the Constitution is there specific authority for the Federal Government to engage in the manufacturing business, or transportation or other business activities and professional service fields reserved to the people. The power to regulate and the operation of businesses are vastly different. The Founding Fathers did not conceive that the Federal Government would engage in business in competition with citizens striving for a livelihood. The Federal agencies now have many business operations employing thousands of people and with capital assets running into billions upon billions of dollars. These are largely tax free, but competitive with private industry which pays taxes."

In 1932 the Shannon subcommittee listed 100 kinds of business in which Government was then engaged. They included such items as transportation of all kinds, amusements, architecture, artificial limbs, bakeries, banking, barbershops, brickmaking, cordage, canning, canvas goods, cement, chemicals, maps, fertilizer, cleaning and pressing, clothing, coffee roasting, electric light and power, explosives, engraving, furniture, gold refining, gas and oil, hospital supplies, hotels, ice cream, ink, insurance, lumber, meat markets, paints, parcel post, all kinds of printing, rubber stamps, shipbuilding, tailoring, truck farming, woodworking, and so forth.

The list did not change much in 22 years. The Harden committee report showed a few subtractions—not many—and a number of additions including false teeth, synthetic rubber, atomic energy, aluminum, buses, car pools, fur sealing, tire retreading, the sale of whisky and beer, repairs of furniture, adding machines, rural electrification, and so on.

Today, 9 years later, the coffee roasting plants are gone; the Navy's paint factories at Norfolk and Mare Island are out of business; the Mississippi Barge Line, which the Federal Government operated in competition with other river lines for nearly 30 years—almost always at a loss—was sold to a privately owned company for \$9 million and became a Federal income taxpayer; the synthetic rubber plants, which Government built during the rubber shortage of World War II, were sold to taxpaying private companies; the Reconstruction Finance Corporation has been liquidated; the Defense Department's plant and tree nurseries went out of business; a good many of the laundries and drycleaning establishments and cobbler shops were terminated; and some of the big defense plants that were built in World War II, were sold at an average of 22 cents on the dollar of original cost, which is a bargain for the purchasers but a good deal less of a sacrifice for Government than it may seem at first glance—idle and unoccupied these plants cost money for maintenance; in the hands of active, going concerns they make profits on which they pay taxes, and right away they become assets to Uncle Sam instead of liabilities.

Less than a year ago, a letter from the Assistant Secretary of Defense for Installations and Logistics stated that Secretary McNamara had directed that immediate steps be taken to relieve the Department of Defense of ownership and management of Government-owned, contractor-operated (GOCO) industrial

facilities in accordance with the policy that mobilization plant capacity be promptly available if needed, but that it meantime be put to productive use in the civilian economy.

"The Government is thus able to reduce its annual expenditures for preventing the deterioration of its plant inventory, and to also recover, from the sale of these plants, a substantial portion of the initial capital outlay expended for their construction during World War II \* \* \*. Since these policies were established, a total of 28 GOCO industrial plants, having a total acquisition cost of \$405 million, have been offered for sale. Twelve of these plants were offered for sale without restriction, and 16 were offered for sale provided the purchaser agrees to meet required military production.

"We shall continue this program of reviewing our industrial plant holdings, with the objective of retaining industrial facilities only where it can be clearly demonstrated that private enterprise is unable, unwilling, or not organized to perform the services or provide the products necessary to meet military requirements. We are in complete agreement with you that this is an important element in our goal of achieving maximum economies and efficiency in the Department of Defense."

It is, we should like to point out, the Government businesses of big capital investment and high annual maintenance cost that should be examined with eagle eyes and without emotion. The termination of little cobbler shops, little bakeries, little typewriter repair shops and the like is important in its way because these are the competitors of little taxpaying businesses, but in the long run it is the air transport, the tugboat and barge operations, the communications systems, the shipping, the warehousing, the engineering jobs, the powerplants and such like that should be studied and in many cases eliminated from competition with taxpaying companies.

We call special attention to three items :

First is the Rural Electrification Administration, which was authorized by Congress in the depression days of the mid-1930's to bring electric light and power to farm homes at Government expense. Even before the second Hoover Commission made its final report to the Congress in 1955, the REA had completed 90-odd percent of the job it was set up to do and the Commission recommended :

"It is our belief that the time has arrived for the reorganization of the Rural Electrification Administration into a self-supporting institution securing its own finance from private sources in a manner similar to that of other agencies. Moreover, the operations of rural electrification should be made subject to the Government Corporation Control Act in order to secure the advantages of more efficient organization under that act."

We call attention to H.R. 5065, recently introduced by Representative Charles M. Teague, of California, which proposes that borrowing from Government by REA cooperatives must be at the rate Government has to pay for money in the open market, now about 4 percent.

It will, of course, take more than Congressman Teague's proposed substitution of 4-percent money for 2-percent money to stop the parasitical, paternalistic, socialistic trend of REA and to reestablish the fact that the free enterprise system is the cornerstone of the United States of America, but H.R. 5056 will make a very good beginning of getting Government out of a business in which no longer belongs.

Second is the Post Office Department, which continues to operate a savings bank, though it should have been discontinued years ago; and also continues to manufacture mailbags and, of all things, locks, which could and should be purchased from taxpaying companies at undoubted economies.

Third are the PX stores and the commissaries. The post exchange stores today rank in dollar volume of chain retail business below only Sears, Roebuck, J. C. Penney, Montgomery Ward, and F. W. Woolworth. Three years ago their sales ran to \$895 million, with profits of \$60 million on which no income tax was paid. And the prohibition of sales to any except the families of persons in the Armed Forces appears to be mostly fiction, since authorized members frequently buy for all their neighbors and friends.

Senator Proxmire said recently, in another connection, that one of the toughest jobs in Government "is to get rid of old programs which have outlived their usefulness." Nowhere is that statement more true than in relation to Govern-

ment's business enterprises. The Harden subcommittee, examining the reasons given for the initiation and continuance of such operations, listed "Economy; quality control; security; self-sufficiency; research and development," and commented:

"When one analyzes the reasons given against the facts for the initiation or continuation of business-type activities in the Government, the conclusion is reached that they are frequently excuses. For example, cost is often given as the reason for starting or continuing an operation such as coffee manufacturing, rope manufacturing, paint manufacturing, etc. When the agencies are asked for comparative cost analyses upon which the conclusions are based, it is frequently found that either the statement is incorrect, that adequate costs have not been kept, or that all elements of direct and indirect costs are not included in the statements which are obviously designed to prove a point \* \* \*. While cost is often given as a reason for Government commercial-type activities, witnesses advised the subcommittee that their cost systems are antiquated and inadequate."

Well, what can be done to correct the situation—to get Government out of competition with taxpaying citizens and companies; to recover at least a percentage of the billions of dollars that have been invested in Government enterprises and to use this money to reduce the national debt; and finally to reestablish needed enterprises in the hands of private enterprisers who will pay Federal income tax on profits and thus add to the revenues of the Treasury instead of subtracting therefrom?

A number of very excellent bills have been introduced to the 88th Congress:

Senator Tower, of Texas, has submitted S. Res. 100, authorizing the Committee on Government Operations to investigate the extent of Government's production of goods and services that might be supplied by private enterprise and the best ways to get Government out of business and its enterprises into the hands of private enterprise. National Associated Businessmen is in favor of such a study.

Representative Alger, of Texas, has introduced H.J. Res. 6, to prohibit the Federal Government from engaging in business in competition with citizens. NAB likes that bill, too.

Senator Bennett, of Utah, with the bipartisan cosponsorship of Senator McClellan, of Arkansas, Senator Mundt, of South Dakota, Senator Harry F. Byrd, of Virginia, Senator Williams of Delaware, Senator Thurmond, of South Carolina, Senator Tower, of Texas, Senator Miller, of Nebraska, and Senator Dirksen, of Illinois, has introduced S. 1093, "to establish a Federal policy concerning the termination, limitation, or establishment of business-type operations of Government which may be conducted in competition with private enterprise."

That same bill, numbered H.R. 4926, has been introduced in the House by Representative Alger, of Texas.

National Associated Businessmen ventures to suggest that the Joint Economic Committee give its endorsement to these five bills. It is essential, as the first step in the process of getting Government out of competitive business, whether in the Defense Department or elsewhere—and keeping it out in the future—that Congress establish a policy stating that this be done. As the Harden subcommittee said, in its 1954 report:

"It is recognized that the Government should pay a reasonable profit for what it gets, and the making of a fair profit is not a crime nor a reason for Government intervention or competition. On the other hand, every profitable and unprofitable activity of a nation could be usurped by a socialized bureaucracy devoid of the urge of personal incentive. As big government gets bigger, there is a tendency for Government agencies to take over more and more activities. As all things are related, one enterprise leads to still another. This trend must be stopped.

ELTON KILE,  
*President, National Associated Businessmen.*

SHIPBUILDERS COUNCIL OF AMERICA,  
Washington, D.C., April 15, 1963.

HON. PAUL H. DOUGLAS,  
Chairman, Subcommittee on Defense Procurement,  
Joint Economic Committee,  
Senate Office Building,  
Washington, D.C.

DEAR MR. CHAIRMAN: During the recent hearings of your Subcommittee on Defense Procurement dealing with "Efficiency in Department of Defense, Procurement and Supply," there were several references to the question of Federal competition with private enterprise. You may recall Mr. Perry M. Shoemaker, a spokesman for the Committee of Hoover Commission Task Force Members, in his testimony on April 1, 1963, included a letter from former President Hoover which, in part, read as follows:

"An important segment of the studies and the recommendations of the second Hoover Commission was the whole subject of Government competition with private taxpaying enterprises. In your testimony, I hope that you will call the attention of the Joint Economic Committee to the potentialities in his field."

The private shipyard industry of the United States has long been subjected to intense competition from the federally owned, Government-operated naval shipyards. As a matter of fact, over the last decade slightly more than half of all Navy vessel procurements, by dollar value, have been arbitrarily assigned to these Government facilities without reference to the ultimate costs to the taxpayers or availability of idle capacities in privately owned commercial facilities.

In an effort to place this disparity in clearer focus, the Shipbuilders Council of America—the national industry trade association of private shipbuilding and ship repairing firms—asked the Management Services Division of Ernst & Ernst, certified public accountants, early last year to undertake a "Survey of Cost Differentials and Other Factors Relating to Private and Naval Shipyards." Their complete report dated April 1962 is available if desired, but their summary conclusions, as follows, might be of interest to you and the members of your subcommittee within the framework of your recent hearings:

"(1) Naval shipbuilding and repair is the largest industrial activity conducted by the Federal Government.

"(2) The Navy industrial fund 'statement of revenue and costs' indicates that utilization of plant at naval shipyards averaged 90 percent during the first half of fiscal year 1962. By comparison, the private shipyard companies indicate many of their yards are operating below 50 percent of capacity.

"(3) Total costs of naval ship work are greater in the naval shipyards than in the private yards. Ship work accomplished in naval shipyards is estimated to be 20 to 28 percent more costly than at private shipyards. This indicates that ship work accomplished at private shipyards, rather than at naval shipyards, can result in significant savings to the Government.

"(4) Aircraft maintenance is the second largest industrial activity of the Federal Government. The proportion of work assigned to private industry in this field has been considerably greater than with comparable naval ship work. For example, in recent years, over 50 percent of depot level aircraft maintenance and overhaul has been awarded to private contractors, whereas the Department of the Navy has awarded approximately 20 percent of ship repair work to private shipyards.

"(5) A comparison of employment on naval work only for the years 1956 through 1960 indicated a 5-year average of 41,890 personnel in the private shipyards and 98,911 in the naval shipyards.

"(6) Higher wages and more liberal vacation, holiday, and sick leave benefits result in higher naval shipyard costs of approximately 15 percent per hour worked. The higher personnel costs account for approximately one-half of the total differential. Had naval shipyards operated at private industry salary, wage, and fringe benefit cost levels during the first half of fiscal year 1962, savings estimated to be \$55 million would have accrued."

We sincerely hope that you will regard the magnitude and scope of naval shipyard competition with private industry of sufficient importance to warrant consideration and the inclusion of this letter as a part of the record of your hearings. Should you require any further information, please feel free to call on us.

With all good wishes, I am,

Cordially,

EDWIN M. HOOD, *President.*



## QUESTIONS AND ANSWERS RE MILITARY COMMISSARIES AND PX'S

OFFICE OF THE SECRETARY OF DEFENSE,  
Washington, D.C., April 29, 1963.

## MEMORANDUM FOR COLONEL MEYERS

During hearings before the Subcommittee on Defense Procurement of the Joint Economic Committee conducted March 27 and 28 and April 1, 1963, testimony by Mr. Perry M. Shoemaker, Vice Chairman, Committee of Hoover Commission Task Force Members, stated, in response to a question by Chairman Douglas, that the Hoover Commission studied the question of commissaries in the military service. Mr. Shoemaker stated that in 1954 there were 438 commissaries worldwide, of which 199 were located in the United States. He cited further figures as to the total sales and the number of employees who were military personnel. He further stated, "Let us let military pay stand on its own feet. But let us not damage our private business enterprise by continuing these supermarkets adjacent to them." Mr. Shoemaker further stated, "Let us let military people work in military fields." Chairman Douglas stated, "I would like to get an estimate as to what the percentage of savings is from the commissaries and PX's and what these come to in annual amounts. Let me say for the record I would be very glad to increase military pay by that amount so that there would be no loss of income."

Pursuant to this general line of thinking, Mr. Ray Ward, staff administrator for the subcommittee, has today certified the following questions, which he requested be answered by Friday, May 3, 1963:

1. The number of commissaries and PX's in the continental United States.
2. The number of commissaries and PX's overseas.
3. The volume of business in commissaries in the continental United States.
4. The volume of business in commissaries overseas.
5. The volume of business in PX's in the continental United States.
6. The volume of business in PX's overseas.
7. The number of personnel, both officer and enlisted, who utilize the services of commissaries.
8. The number of personnel, both officer and enlisted, who utilize the services of PX's.
9. The amount of money spent by officers annually at commissaries in the continental United States.
10. The amount of money spent by officers annually at commissaries overseas.
11. The amount of money spent by officers annually at PX's in the continental United States.
12. The amount of money spent by officers annually at PX's overseas.
13. The amount of money spent by enlisted men annually at commissaries in the continental United States.
14. The amount of money spent by enlisted men annually at commissaries overseas.
15. The amount of money spent by enlisted men annually at PX's in the continental United States.
16. The amount of money spent by enlisted men annually at PX's overseas.
17. The annual savings accruing to officers as a result of the existence of commissaries.
18. The annual savings accruing to officers as a result of the existence of PX's.
19. The annual savings accruing to enlisted men as a result of the existence of commissaries.
20. The annual savings accruing to enlisted men as a result of the existence of PX's.
21. How much of a pay raise would be required to offset the monetary value of the fringe benefit accruing from the existence of commissaries and PX's of officer and enlisted personnel and the number of military people, officer and enlisted, who could be released to combatant/operational duties if commissaries and PX's worldwide were closed.

A copy of the transcript relative to the genesis of the above questions is available in the office of the undersigned.

J. H. FITZGEREL,  
Commander, U.S. Navy.

## OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D. C.

MEMORANDUM FOR COMDR. J. H. FITZGEREL

Subject: Questions pertaining to commissary and exchange operation.

Reference your memorandum to Colonel Meyers dated April 29 pertaining to the questions certified by Mr. Ray Ward regarding commissary and exchange operation.

In reply to these questions the following information is submitted.

Question No. 1. There are 281 sales commissaries and 321 exchanges in operation in the United States.

Question No. 2. There are 197 sales commissaries and 258 exchanges in operation overseas. In addition, there are 678 ships stores located on ships.

Question No. 3. The annual volume of business in sales commissaries in the United States is \$659,385,000.

Question No. 4. The annual volume of business in the sales commissaries overseas is \$219,901,000.

Question No. 5. The annual volume of business in the exchanges in the United States is \$778,700,000.

Question No. 6. The annual volume of business in the exchanges overseas is \$600,300,000. There is \$43,300,000 of sales through the ships' stores.

Question No. 7. There are no statistics available as to the exact number of officers and enlisted personnel who utilize the sales commissaries. A sample Army survey indicates that 91 percent of the married officers and 78 percent of the married enlisted men use their sales commissary privileges. Applying the Army percentage to all the services would indicate that approximately 820,000 enlisted personnel and 240,000 officers use the sales commissaries.

Question No. 8. Again there are no statistics available as to the exact number of officers and enlisted personnel who utilize the exchanges. Military exchanges, in some form, are available to practically all active duty military personnel. Certain of the exchange facilities probably are used to some extent by all personnel.

Questions Nos. 9-16. No figures are maintained for determining or estimating by category the amount of money spent by officers or by enlisted personnel at sales commissaries and exchanges either overseas or within the United States.

Questions Nos. 17-20. No effective means exist to place a definite price tag on savings which accrue annually to officers and enlisted personnel as the result of existence of sales commissaries and exchanges. Several factors exist which make any "average" or per capita savings inaccurate. Specifically, the size of a military man's family, for the most part, determines the savings that he receives rather than the rank or the rating of the individual. An enlisted man, therefore, with a wife and several children would enjoy a substantially greater savings through the utilization of a commissary store than would the young enlisted man with no dependents to support. In addition, the area of the country at which the military man is stationed would have a decided effect on the degree of savings which would accrue to a man who shops in a military sales commissary and exchange. The sales commissary and exchange prices tend to be stable on a worldwide basis; hence, military personnel who are able to utilize such facilities in the high cost of living areas receive a greater degree of savings than do personnel in stabilized areas.

Question No. 21. Although the existence of sales commissaries has several advantages to military personnel, their value would be difficult to match through pay increases or changes in other cash benefits. A pay increase would presumably not be proportional to family size or to the area to which military personnel may be involuntarily assigned. Exchanges operate to provide military personnel, wherever stationed, with items and services of necessity and convenience at uniformly reasonable prices. Their profits provide and maintain welfare and recreation facilities otherwise provided by the Government.

There are 742 officers and 5,112 enlisted personnel assigned to duty in the commissaries and exchanges worldwide. This does not include the Navy personnel who operate the ships' stores afloat. Of the 5,112 enlisted personnel assigned these duties 2,091 are Navy enlisted personnel who are assigned duty in sales commissary stores in the United States primarily to provide Navy enlisted personnel possessing essentially "seagoing skills" with an equitable opportunity for duty ashore in the United States. While these skills are vital to effective shipboard operations, there are relatively few requirements ashore for these skills. Other military personnel are only assigned to these duties (a) for executive control and essential supervision, (b) in locations where qualified civilians are not available, (c) as required for purposes of rotation and training not available at other activities, and (d) military in a temporary or transit status not to exceed 60 days.

JAMES M. CAMPBELL,  
*Colonel, U.S. Air Force, Directorate, Compensation Affairs.*



March 5, 1963  
NUMBER 4100.15

ASD(I&L)

## Department of Defense Directive

**SUBJECT** Commercial or Industrial Activities.

- References:**
- (a) BOB Bulletin 60-2, "Commercial-Industrial Activities of the Government Providing Products or Services for Governmental Use," September 21, 1959
  - (b) DOD Directive 4100.15, "Commercial and Industrial Type Facilities," April 27, 1955 (hereby cancelled)
  - (c) Deputy Secretary of Defense Multi-address Memorandum to the Secretaries of the Army, Navy, Air Force and ASD(S&L), "BOB Bulletin 60-2, Commercial-Industrial Activities Program," November 30, 1959 (hereby cancelled)
  - (d) Assistant Secretary of Defense (Installations and Logistics) Multi-address Memorandum to the Secretaries of the Army, Navy and Air Force, "Bureau of the Budget Bulletin 60-2, Commercial - Industrial Activities Program," March 20, 1961 (hereby cancelled)

### I. PURPOSE

The purpose of this Directive is to establish the Department of Defense policy with respect to the operation of commercial or industrial activities.

### II. DEFINITION

As used in this Directive, commercial or industrial activities are those providing products or services which normally can be obtained from private enterprise through ordinary business channels.

### III. BACKGROUND

Reference (a) outlines the principle that the private enterprise system is basic to the American economy, and that the Government will not start or continue in operation commercial or industrial activities unless compelling reasons such as national security, costs, or clear infeasibility necessitate exceptions to this principle.

IV. POLICY

In conformance with the principle outlined in III above, it is the policy of the Department of Defense that no commercial or industrial activities within the United States will be started or continued in operation under military control unless a clear determination is made that one of the following compelling reasons exists:

- A. There is danger of compromising information which would aid potential or known enemies, or which would otherwise be prejudicial to the interests of the United States, where adequate provision can be made only through Government operation.
- B. The training of personnel in order to assure their self sufficient capability for service in overseas areas where commercial sources of the product or service will be unavailable necessitates operation of the particular activity.
- C. The necessity for meeting urgent military requirements without delay, where abnormal or fluctuating demands make private sources or operation impracticable to the extent that the current or mobilization need cannot be met.
- D. Procurement from private enterprise is not in the best interests of the Defense effort because the product or service is an integral part of the basic mission, and is essential to the maintenance of a ready military capability for operations under emergency conditions.
- E. The product or service is not available commercially, nor likely to become available because of unique or highly specialized military requirements or geographic isolation of the location where required.
- F. Other special circumstances which indicate that military operation of the activity is in the public interest. Under such instances, a request for an exception to the policy stated in IV above should be submitted to the Assistant Secretary of Defense (Installations and Logistics) for consideration.

- G. Where none of the foregoing compelling reasons exist, no commercial or industrial activities will be started or continued in operation under military control unless a clear determination is made that the cost of procurement from private sources exceeds the total Government cost to produce the same product or service, based on an analysis, on a comparable basis, of all costs involved.

V. RESPONSIBILITIES AND DELEGATIONS

A. Assistant Secretary of Defense (Installations and Logistics)

The Assistant Secretary of Defense (Installations and Logistics) will:

1. Issue to the Military Departments and Defense Agencies the necessary instructions to implement the requirements of this Directive;
2. Approve or disapprove all requests for the establishment of new commercial or industrial activities within the Department of Defense; and
3. Maintain, in collaboration with the Office of the Assistant Secretary of Defense (Comptroller) an inventory covering the nature and extent of commercial or industrial activities conducted within the Department of Defense.

B. Military Departments and Defense Agencies

The Secretaries of the Military Departments and the Directors of Defense Agencies will carry out the requirements of this Directive in accordance with the instructions issued by the Assistant Secretary of Defense (Installations and Logistics), and are authorized to act for the Secretary of Defense in making decisions to continue, discontinue, or curtail commercial or industrial activities within their respective Departments and Agencies. Within the Military Departments, this authority may be redelegated to an Assistant Secretary, and in Defense Agencies, to an Executive Director, or comparable executive level.

VI. IMPLEMENTATION

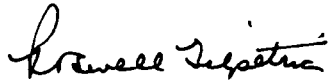
It is intended that the continued implementation of this policy will result in the maximum practicable reduction in military operation of commercial or industrial activities, consistent with IV above.

VII. CANCELLATION

References (b), (c) and (d) are hereby cancelled.

VIII. EFFECTIVE DATE

This Directive is effective immediately.

A handwritten signature in cursive script, appearing to read "Rowell T. Sargent".

Deputy Secretary of Defense



NUMBER 4100.33  
DATE March 8, 1963

## Department of Defense Instruction

ASD (I&L)

SUBJECT

Commercial or Industrial Activities - Operation of

- References:
- (a) DoD Directive 4100.15, "Commercial or Industrial Activities"
  - (b) BoB Bulletin 60-2, "Commercial-Industrial Activities of the Government Providing Products or Services for Governmental Use"
  - (c) DoD Directive 4151.1, "Policies Governing the Use of Commercial and Military Resources for Maintenance of Military Materiel"
  - (d) DoD Directive 4275.2, "Industrial Facilities Funded from Procurement and Production Appropriations"
  - (e) DoD Directive 5126.8, "Delegation of Authority with Respect to Certification of Construction, Replacement or Reactivation of Bakery, Laundry or Dry Cleaning Facilities"
  - (f) DoD Directive 5126.15, "Delegation of Authority with Respect to Facilities and Equipment for Metal Scrap Baling or Shearing or for Melting or Sweating Aluminum Scrap"
  - (g) DoD Instruction 1410.1, "Basic Policies Governing Actions Resulting in Civilian Personnel Reductions"
  - (h) DoD Directive 5410.10, "Coordination and Clearance of Announcements of Personnel Reductions, Closures of Installations, and Reduction of Contract Operations Within the United States"
  - (i) DoD Directive 5410.12, "Policies and Procedures for Minimizing Economic Impact on Communities Resulting from Adjustments in Defense Programs"
  - (j) ASD(S&L) memorandum to Secretaries of the Army, Navy and Air Force, "Commercial-Industrial Activities Program, BoB Bulletin 60-2, " November 30, 1959 (cancelled herein)
  - (k) DoD Directive 4100.22; DoD Instructions 4100.16 through 4100.19; 4100.21; 4100.23 through 4100.27 (cancelled herein)
  - (l) ASD(S&L) memorandums to Materiel Assistant Secretaries, Army, Navy, and Air Force, "Commercial-Industrial Activities Program," January 31, 1956; April 19, 1957; January 28, 1958; May 27, 1960 (cancelled herein)

### I. PURPOSE

This Instruction implements the policies and principles established in references (a) and (b), and outlines the procedures to be followed by the Military Departments and Defense Agencies in starting, continuing, curtailing, or discontinuing commercial or industrial activities. Specifically, this Instruction requires that all Military Departments and Defense Agencies:



- A. Conduct a periodic review to assure that commercial or industrial activities carried out under their control are limited to those for which there are compelling reasons for Government provision of the product or service involved, as prescribed in reference (a).
- B. Obtain the approval of the Assistant Secretary of Defense (Installations and Logistics) prior to making any new start of a commercial or industrial activity.
- C. Make maximum use of interdepartmental and interagency cross-servicing arrangements in order to minimize the number and extent of commercial or industrial activities carried out under their control.
- D. Maintain records covering commercial and industrial activities carried out under their control.

## II. DEFINITIONS

The following definitions are applicable to this Instruction:

- A. Commercial or industrial activities are those providing products or services which normally can be obtained from private enterprise through ordinary business channels.
- B. New starts are defined as the establishment, acquisition, reactivation or major expansion (whether by volume of output or change in product) of a commercial or industrial activity.

## III. BACKGROUND

The phased review of all existing military controlled commercial or industrial activities specified in reference (b) was completed on 31 March 1961. Since completion of that over-all review, all new starts of commercial or industrial activities, regardless of the annual cost or value of the product or service, have required approval by the Assistant Secretary of Defense (Installations and Logistics), using BoB Form C. This requirement for ASD(I&L) approval of all new starts continues under the procedures outlined in Section VI. C. Those commercial or industrial activities now in operation, and those subsequently begun after new start approval, will be periodically reviewed within each Military Department and Defense Agency, under the procedures outlined in Section VI. A.

## IV. APPLICABILITY

- A. This Instruction applies to all Military Departments and Defense Agencies, and covers all commercial or industrial activities within the United States which are Defense-owned and operated; Defense-owned and contractor-operated; and partly Defense-owned and contractor-operated.

- B. This Instruction also applies to activities engaged in depot maintenance only, as well as those engaged in depot maintenance as a part of their missions in conjunction with new construction, such as shipyards.
- C. Whenever a commercial or industrial activity is operated exclusively as an integral part of another commercial or industrial activity (such as a sheet metal shop within a shipyard), it will be included with the evaluation of the major activity, and need not be reported or reviewed separately (except for new starts as explained in Section VI below). If, however, it produces for or serves activities other than the parent activity, or if it is a commercial or industrial activity that provides support to the parent activity in its role as a base, station or installation (such as an auto repair shop at an air base), it will be reported and reviewed separately.
- D. This Instruction does not apply to:
  - 1. Commercial or industrial activities which involve an equipment investment of less than \$5,000, and a product or service with an approximate annual cost or value of less than \$25,000, except those activities set forth in references (e) and (f).
  - 2. Functions which are a part of the normal management responsibilities of a Government agency or a private firm of comparable size (such as accounting, mimeograph work and the like).
  - 3. Commissaries, post exchanges and non-appropriated fund activities.
  - 4. Printing plants which are under the control of Congress.
  - 5. Civil works activities such as flood protection and navigation improvement projects, conducted by the Department of the Army.

V. CRITERIA

Section IV of reference (a) outlines the only compelling reasons which justify military operation of commercial or industrial activities. In reaching determinations as to the applicability of these compelling reasons to individual activities, the following criteria will be observed:

A. Danger of Compromising Information

The necessity for enforcing security requirements is not an acceptable justification of all types of classified commercial or industrial activities, as private production operations under proper security safeguards are regularly performed, and will be continued. In applying this criterion, there must be a clear showing that for reasons of National security, the activity cannot be turned over to private enterprise.

B. Training of Personnel

This includes the need for troop units to achieve a self-sufficient military capability for the direct maintenance support of their essential equipment, as outlined in DoD Directive 4151.1.

C. Urgent Military Requirements

Application of this criterion necessitates frequent and critical reassessment of private enterprise capability, to assure that military commercial or industrial activities conducted for these reasons do not exceed current or mobilization needs.

D. Basic Mission Integrity

This includes the need for Military Departments to retain an in-being depot level maintenance capability for their mission-essential equipment, as outlined in DoD Directive 4151.1.

E. Commercial Unavailability

In these instances, all reasonable efforts will be made to induce private enterprise to provide the product or service before reaching a determination to start or continue Government operation.

F. Excess Costs

In reaching determinations to start or continue production in Defense-owned commercial or industrial activities, the existence of Defense-owned capital assets is not in itself sufficient justification for the Department of Defense to provide its own products or services. When considerations of cost are applied as justification, the need for Department of Defense ownership and operation must be fully substantiated, under the criteria outlined in paragraph 3 B of reference (b), and in conformance with the policies specified in references (c) and (d). Also, in computing the costs of products or services provided in a Defense commercial or industrial activity, the principles outlined in Inclosure 1 will be used.

VI. PROCEDURES

The Secretaries of the Military Departments, or their designees, and the Directors of Defense Agencies, or their designees, are responsible for:

- A. The conduct of periodic reviews of all commercial or industrial activities carried out under their respective control in order to assure that only those activities which conform to the policies specified in reference (a) are continued. These reviews will be scheduled so that each activity will be examined at intervals of not less than three years, starting with the beginning of FY 1964. These reviews will be impartial and searching, with the primary objective of discontinuing each activity which no longer meets the criteria specified in V above.
- B. Reaching decisions to continue, discontinue, or curtail commercial or industrial activities under their control, based on the results of their periodic reviews of these activities.
- C. Obtaining the approval of ASD(I&L) prior to making any new start of a commercial or industrial activity. Requests for new start approval will be submitted in quadruplicate to ASD(I&L) using Bureau of the Budget Form C, as described in reference (b). However, the submittal of a Form C is not required if specific facilities intended to be occupied by the new start are approved as a separate action by the Secretary of Defense:
  1. For inclusion in the military construction authorization and appropriation programs for FY 1965 and subsequent years; or
  2. For construction under the authority contained in reference (a).
- D. Actively seeking, wherever feasible and economical, to obtain the required product or service through cross-servicing from an existing activity under Government control before reaching a decision to continue a commercial or industrial activity, or requesting approval for a new start. This includes efforts to merge or consolidate, wherever practicable, activities which are being operated separately within Departments, or by other Departments or Agencies.
- E. Providing proper employee and community notification prior to the curtailment or discontinuance of existing commercial or industrial activities, in conformity with the provisions of reference (g), (h) and (i).

- F. Assuring that those commercial or industrial activities determined to be essential for continuance are operated at a reasonable level of efficiency and economy.
- G. The maintenance, in a central location, of an inventory of all commercial or industrial activities under their control and adequate records covering:
  - 1. The periodic reviews specified in VI. A., above; and
  - 2. The results of those reviews, and the basis for the decisions reached on the individual activities.
- H. The submittal to ASD(I&L), prior to September 30th of each year, of an annual machine prepared inventory report of commercial or industrial activities in operation under their control at the close of each fiscal year having an annual output of product or service in excess of \$250,000. The first inventory required will be due on September 30, 1963, and annually thereafter.

VII. REPORTS

The annual inventory report to ASD(I&L) specified in Section VI. H. will be submitted in quadruplicate, and will consist of Parts I and II, as specified in the format attached as Inclosure 2. This inventory report requirement has been assigned Report Control Symbol DD-I&L(A)485.

VIII. CANCELLATIONS

References (j), (k) (including DD Form 833), and (l) are hereby cancelled.

IX. IMPLEMENTATION

Within 90 days from the date of this Instruction, the Military Departments and Defense Agencies will furnish to ASD(I&L) three copies of each document implementing the requirements outlined herein.

X. EFFECTIVE DATE

This Instruction is effective immediately.

*Thomas D. Morris*  
 Assistant Secretary of Defense  
 (Installations and Logistics)

Inclosures - 2

- 1. Cost Principles
- 2. Industry Format

OUTLINE OF COST PRINCIPLES FOR USE IN DETERMINATION OF PRODUCT AND SERVICES COSTS  
OF COMMERCIAL OR INDUSTRIAL ACTIVITIES OPERATED BY THE DEPARTMENT OF DEFENSE

I. PURPOSE

It is the purpose of the following to outline the accounting methods to be employed in determining the comparative costs involved in the establishment or continuance of commercial or industrial activities operated by the Department of Defense. Military Departments and Defense Agencies are authorized to develop more specific cost criteria within guidelines provided herein, applicable to the particular types of activities under study.

II. COST ESTIMATING

- A. Cost estimates, in terms of units of product or service, must include all applicable elements cited herein, and should be validated, wherever possible, by actual cost records from past operation, or from operation of comparable installations, taking into consideration the differences in workload and other factors.
- B. When the cost studies being made are for the purpose of making decisions involving selection of one or more facilities among several of the same type for continuing use, or the closing of higher cost facilities, the cost data of all facilities under study should be subjected to the same detailed comparisons, and be determined on an over-all comparable basis.
- C. Reports of cost estimates of a given installation or facility should show the aggregate cost for the planned production classified by direct labor, direct material and overhead for the projected period. Where overhead is estimated on a Departmental or cost center basis, such Departmental overhead cost estimates should be shown. Estimates of the aggregate and unit costs of product or service of the installation or facility should also be shown in the report of cost estimates; the sum of the estimated total costs of all products and services should be in agreement with the aggregate cost of labor, material and overhead for the total planned production.

III. REVIEW OF COST DATA

Cost data for each establishment prepared for the purposes stated above, should be reviewed and an expression of opinion furnished, as to reasonableness by the departmental audit agency, after preparation by the establishment or operating agency concerned.

IV. DEFINITION OF COST

- A. All elements of cost which are necessary to make a product or render a service at a commercial or industrial activity shall be included, whether or not those costs are normally considered in the cost accounting system employed in the activity or are borne by the Defense activity or immediate department concerned.
- B. Where the commercial or industrial activity is part of a larger installation from which it receives supervision or supporting services, the costs of the commercial or industrial activity will include (1) the cost of direct, and a proportionate share of indirect, support services; and (2) the cost of supervision which is directly applied to the operation of the commercial or industrial activity. However, in those cases where the particular support service or supervisory capability would be required whether or not the commercial or industrial activity were located on the installation, no cost should be included. The cost of a commercial or industrial activity will not include any administrative overhead costs of supervisory or staff offices of echelons above that of the installation of which the commercial or industrial activity is a part.
- C. Cost estimates shall not include the element of profit, as would be required in order to match all the elements that may be found in price comparisons with similar private commercial or industrial operations.

V. ELEMENTS OF COSTS

Subject to the above over-all criteria for determining costs, the following elements shall be included. Failure to mention any specific item is not intended to imply that it shall not be included.

A. Personnel Services

1. Civilian personnel

Services performed by civilian personnel will be priced at the actual current rate of pay or estimated at an average rate per service grade, increased to include a factor for leave computed in accordance with the principles prescribed in DoD Directive 7410.1. There shall be included also, as a cost of civilian personnel, the amount of Government contribution to the civil service retirement fund and employee insurance and health plans, and when applicable, the Government share of social security taxes.

2. Military personnel services

Military personnel services shall be priced at standard rates developed by the Military Departments which will include the following elements:

- a. Basic pay by pay-grade and allowances for quarters, subsistence and clothing; the average cost, computed separately for officers and enlisted personnel, of amounts provided for in the current year budget for re-enlistment and terminal leave or separation payments, employer's social security contributions, the cost of travel performed in connection with the functions of the commercial or industrial activity;
  - b. Estimated cost of medical, hospital and retirement expense; and
  - c. Cost of incentive and special pay, e.g., physicians and dentists, hazardous duty pay, and proficiency pay to the extent that the duty assignment within the commercial or industrial activity of the applicable individual entitles him to such pay.
3. Personnel services (whether civilian or military) will be classified as direct labor when the costs are incurred in performing work identifiable with a product or service. Labor costs should be estimated on the basis of the best available work measurement and performance data. While labor cost estimates for such factors as machine set-up, rework time, waiting and other excess time should be treated in most cases as indirect costs, it will be permissible to include these factors as direct costs, if the cost estimating methods are not so refined. Supervision, maintenance and similar personnel services should be classified as indirect costs.

B. Material and Supplies

1. Direct materials include all items purchased, supplied, manufactured or fabricated which enter directly into the end-product. Wherever feasible, estimates of material quantities required for production should be based on estimated or actual bills of material. In addition, proper consideration should be given to costs of reasonable material over-runs, spoilage and defective work. Such material estimates should be costed by applying the



current replacement price to the quantity required as may be established by published service-wide catalogs or price lists or other available sources of current market prices. Freight, transportation and material handling costs shall be included whether such costs are treated as direct or indirect. Government-furnished material received for assembly or fabrication shall be costed in the same manner as other materials.

2. In calculating the total costs of materials, there shall be deducted all trade discounts, rebates, and other allowances. Deductions will be made from either material costs or aggregate costs for cash discounts or other credits including estimates for recovery or sale of production scrap.

C. Indirect Costs (Overhead)

1. Indirect or overhead costs in commercial or individual activities generally fall into the following categories:
  - a. Manufacturing or production expenses -- i.e., indirect cost of production departments.
  - b. General and administrative expenses -- costs incurred in general management and supervision of the installation as a whole.
2. Budgets for indirect costs should be projected on the basis of the planned schedule of production. If varied products or services are to be produced, indirect costs should be departmentalized and separate Department overhead rates should be estimated. Where only one product or service is to be produced (or where all products are generally subject to the same processing) an over-all overhead rate for the plant will suffice for product or service costing purposes. Where feasible, overhead rates should be applied to direct labor hours for cost allocation to the product.
3. To take care of any future changes in the planned volume of production, it would be advisable initially to segregate the fixed and variable overheads to the extent feasible, so that the basis for estimating different overhead rates for several production levels may be available for future estimates if needed.

4. Overhead costs which represent the costs of functions necessary to the support of direct effort in producing the products or services under study should be distinguished from costs of maintenance, support and service functions provided for other purposes, i.e., tenant or satellited activities and unutilized or underutilized capacity maintained for mobilization reserve.
5. Some special items of overhead for inclusion are the following:

- a. Interest on invested capital

Interest on capital estimated to be normally invested in plant and equipment (at depreciated values), land and inventories used in production of the end-product or service is to be included as a cost of operation. Such interest shall be computed at the current rate for long-term Treasury obligations. The rate used and the amounts of invested capital should be disclosed in the cost estimates.

- b. Depreciation

- (1) Depreciation of plant and equipment (buildings, machinery and equipment used in carrying on operations) shall be applied by formula to product or services as a part of overhead costs. The method of allocating depreciation should be one that aims to distribute fairly the cost of plant and equipment over its estimated useful life, considering the factors of wear and tear, but not loss of property due to fire or other similar hazards. The straight-line method of depreciation is suggested for use for major property classes and not by individual items. The estimated useful lives of plant and equipment indicated in Depreciation Guidelines and Rules, Publication No. 456 (7/62), U. S. Treasury Department, Internal Revenue Service, may be used as a guide in estimating the cost of depreciation. The method and rates used should be explained in comments supporting the cost estimates. The basis for depreciation should be actual costs of the facilities, if available, otherwise in accordance with engineering advice.
- (2) No depreciation should be allowed to cost of product or service for excess plant and equipment when the amounts are significant.

c. Utility services

Utility services such as communication, power, gas and water, whether or not to be paid directly by the industrial facility, should be costed based on estimates prepared by departmental engineering or other services. Usage should be estimated and predetermined rates established to be applied to estimates of labor or machine-time, space occupied or other appropriate factors.

d. Maintenance and repair (including protective services)

- (1) Operating costs should include cost estimates of maintenance and repairs and protective services for buildings and structures, grounds and equipment. Generally accepted accounting principles should be followed in distinguishing between a capital charge and operating expenses. Thus, all additions and replacements to property will be treated as a capital charge with depreciation thereon reflected in operating costs. Costs of maintenance and repairs may be computed at an annual rate per square foot for the type of plant and equipment in accordance with engineering advice.
- (2) If desired, occupancy rates equivalent to rentals, may be computed and used in cost estimating to include all maintenance and repairs, depreciation on buildings, protective services and utilities. This is especially appropriate where only a portion of a building is occupied by the activity.

e. Injuries and damages paid through the U. S. Employees Compensation Commission

- (1) Cost of compensation to employees shall be estimated based on previous years' disability and death experience. Accident experience data (including total costs and cost per employee) are reported annually by the Bureau of Employees Compensation, Department of Labor, to each Federal department and agency.
- (2) The estimates shall include compensation plus cost of medical services (generally furnished by Public Health dispensaries) but shall exclude leave cost. Since casualties fluctuate considerably from year to year,

the estimate shall be based on the average experience of the most recent four years reported for the particular installation, bureau or command or department.

f. Insurance

- (1) Operating costs should include an estimate for insurance for the purpose of arriving at an allocable charge for replacement or repair of plant, equipment and inventories damaged or destroyed by fire or other hazards. It is not intended that costly independent appraisals of insurable values should be obtained. Based on engineering advice, a percentage factor should be applied to cost of insurable assets to arrive at approximate replacement costs. Annual premium rates prescribed by each department for the various types of buildings and contents may then be applied to the amount of coverage. In order to preclude duplication of costs in estimating fire insurance costs, allowances should be made for operation of fire departments and repairs to damaged buildings and facilities that may already be included in operating costs.
- (2) Costs equal to premiums for public liability compensation for bodily injury and property damage should be estimated at payroll rates prescribed by each department in accordance with advice of Government insurance experts and lawyers pursuant to the Federal Torts Claims Act.

g. Property and other taxes

Estimates should include an allowance for Federal, State, and local taxes required to arrive at costs comparable with those of private enterprise. In any instance where a Government installation is subject to property or other taxes under State and local laws, the amount of such taxes should be excluded to avoid duplication in this element of cost. Advice concerning the methods of computing the allowance for taxes may be obtained from the Office of the Assistant Secretary of Defense (Comptroller).

VI. EXCLUDED COSTS

Costs applicable to maintaining unutilized and underutilized plant and equipment will be determined and excluded from the cost of end-products or services.

**VII. CONTINUING COSTS OF UNUTILIZED OR UNDERUTILIZED FACILITIES**

If it is determined that procurement of the goods or services from private industry will cause an existing commercial or industrial activity of the Department of Defense to be converted to a standby status or to be operated at such a reduced level that costs will be incurred for maintenance of underutilized plant and equipment, a separate statement shall be included describing the nature of the continuing costs, such as depreciation, interest on invested capital, maintenance, insurance and taxes, and estimates of the amounts. These costs will be considered in determining total costs to the Government of alternative courses of action in procurement of the products or services under review.

ANNUAL INVENTORY (f)

COMMERCIAL OR INDUSTRIAL ACTIVITIES IN OPERATION AT END OF FISCAL YEAR \_\_\_\_  
 (Having an Individual Annual Output of Products or Services in Excess of \$250,000)

Name of Installation Where C or I Activity Is in Operation	Code Denoting State in Which Installation Is Located (a)	Standard Indus- trial Classifi- cation Code of C or I Activity	Code Denot- ing GOGO or COCO Opera- tion (b)	Personnel Engaged in C or I Activity (c)			Annual Output of C or I Activity (d)			Total Govt- Owned Plant & Equip.Assets of C or I Activity (d)
				Civilian	Military	Total	Annual Cost of Personnel	Annual Cost of Supplies and Materials	Total	
Totals (a)				--	--	---	--	--	---	--

Notes

(a) Alphabetical by number - viz: for Alabama use Code 1; for Alaska use Code 2; etc. Installations will be listed in alphabetical order within each State. Installations having two or more C or I activities will be listed two or more times, in the numerical order of the SIC Code of their respective C or I activities, viz:

Aberdeen Proving Ground	20	1711	1	113	0	113	620	120	740	1,300
Aberdeen Proving Ground	20	3599	1	<u>40</u>	<u>20</u>	<u>60</u>	<u>450</u>	<u>500</u>	<u>950</u>	<u>1,900</u>
				153	20	173	1,070	720	1,690	3,200

(b) For COGO operation use Code 1; for COCO operation use Code 2.

(c) Use the personnel strengths assigned at end of the Fiscal Year being reported on.

(d) Expressed in thousands of dollars. Annual personnel costs will include both civilian and military personnel.

(e) Totals will be given by State, as shown under Note (a) above; and by SICC grouping, as shown under note (f) below.

(f) This machine prepared inventory will be in two parts--i.e.--Part I in the format shown under Note (a) above. Part II will show the same data specified in the column headings above, but regrouped so as to show together all activities having the same SIC Code, listed in the numerical order of their respective SIC Codes; viz:

Aberdeen Proving Ground	20	1711	1	113	0	113	620	120	740	1,300
Fort Belvoir	46	1711	1	<u>97</u>	<u>2</u>	<u>99</u>	<u>560</u>	<u>140</u>	<u>700</u>	<u>900</u>
				210	2	212	1,180	260	1,440	2,200

## STATEMENT OF REPRESENTATIVE BRUCE ALGER, FIFTH DISTRICT OF TEXAS

I present this statement of the Joint Economic Committee in behalf of my bill, H.R. 4926, and its companion bill, S. 1093, proposing the establishment of a Federal policy that Government—including the Defense Department, though it is not specifically named—get out of business in competition with taxpaying individuals and companies and stay out.

I commend to the committee's attention the statement filed by National Associated Businessmen, Inc., which approaches the matter at hand straightforwardly and realistically.

The stated subject of your subcommittee's hearings is "progress made in efficiency of the supply and procurement activities of the Department of Defense and their impact on the economy"—which I understand raises the question as to whether the Defense Department is getting what it needs efficiently and with reasonable economy without putting a lot of privately owned companies out of business in the process.

It is my studied conclusion and belief that the Defense Department, like all the rest of Government, must start taking reducing exercises—and that the best place to begin is where bureaucracy is in direct competition with taxpaying citizens and their businesses. The Department of Defense is generally considered the No. 1 offender in this matter of business competition, and that is the reason why I am here today—to oppose the continued retention of obsolete reserve plants, antiquated ship repair yards, unnecessary cobbler shops and drycleaning establishments and laundries, competitive airlines and ships, so-called "fringe" commissaries and PX stores, and all the rest.

Yes, DOD is probably the No. 1 offender in clinging to its business activities in competition with taxpaying private companies, but it is by no means alone. National Associated Businessmen, in its statement, called attention to the postal savings bank, which should be of blessed memory but is not; and especially to the Rural Electrification Administration, which is one of the finest examples we have of a bureaucracy that gets bigger and more costly when the job for which it was created has been completed. I commend to your attention the bill, H.R. 5065, introduced by my colleague from California, Mr. Charles M. Teague, which would tend to clip the wings of REA. It is, in my opinion, a matter to which the Joint Economic Committee should give careful attention, for the present situation is costing the taxpayers of the Nation millions upon hundreds of millions of dollars a year—and destroying companies that are among our biggest and most important taxpayers.

National Associated Businessmen, in its statement that has been filed with your committee, points out that while the categories of Government business competition changed very little from 1932 to 1954, when congressional committees conducted investigations, certain competitive businesses have nevertheless been discontinued—and therefore have established precedent for further action along the same line. I quote:

"The coffee-roasting plants are gone; the Navy's paint factories at Norfolk and Mare Island are out of business; the Mississippi bargeline, which the Government operated in competition with other river lines for nearly 30 years—almost always at a loss—was sold to a privately owned company for \$9 million and became a Federal taxpayer; the synthetic rubber plants, which the Government built during the rubber shortage of World War II, were sold to taxpaying companies; the Reconstruction Finance Corporation has been liquidated; the Defense Department's plant and tree nurseries went out of business; a good many of the laundries and drycleaning plants and cobbler shops were terminated; and some of the big defense plants that were built in World War II were sold at an average of 22 cents on the dollar of original cost, which is a bargain for the purchasers but a good deal less of a sacrifice for the Government than it may seem at first glance—idle and unoccupied plants cost money for maintenance; in the hands of active, going concerns they make profits on which they pay taxes, and right away they become assets to Uncle Sam instead of liabilities."

You will note, gentlemen of the committee, that practically all of the items named—all, I think, except RFC—formerly belonged to the Department of Defense. It is for that reason that I make bold to suggest to you that you direct the immediate further investigation of your staff to still other items of Government competition in business, both in and out of DOD.

And again I direct to your attention H.R. 4926 and S. 1093—the latter being the Senate bill introduced by Senator Bennett, of Utah, with the bipartisan cosponsorship of Senator McClellan, of Arkansas, Senator Mundt, of South Dakota, Senator Harry Byrd, of Virginia, Senator John Williams of Delaware, Senator Thurmond of South Carolina, Senator Tower, of my own State of Texas, Senator Miller, of Iowa and Senator Dirksen, of Illinois.

Progress in the efficiency of the supply and procurement activities of the Department of Defense can best be promoted at this time, I believe, by terminating most of the Department's competitive business activities. Certainly the economy will benefit greatly by getting Government out of business and giving private enterprise a chance.

APPENDIX 6

(Use of proceeds from sales by DOD)

OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE,  
Washington, D.C., April 18, 1962.

Mr. RAY WARD,  
Staff Member, Joint Economic Committee,  
U.S. Congress.

DEAR MR. WARD: Pursuant to agreement between yourself and Col. Harold E. Reichenberg of this Office, the attached statement concerning use of surplus disposal proceeds for certain construction purposes is submitted. It would be appreciated if this material could be considered in connection with the statements made by the Comptroller General before the Joint Economic Committee. (See pp. 58 and 157.)

Sincerely,

JOSEPH R. DELUCA,  
Brigadier General, USAF, Director, Supply Management Policy.

Over the past 4 years, a marked increase has been noted in the reuse by DOD activities, of property declared excess by such activities. This increase is reflected in the following table:

Fiscal years:	<i>Reuse of excess (million)</i>
1959.....	\$366
1960.....	525
1961.....	748
1962.....	759

A significant factor contributing to this trend has been the reduced rate of deterioration in stored property resulting from improvements in storage facilities. The greatest improvement in this area has been shown by the Air Force which, though possessed of generally poor facilities in 1959, has made such progress as to be able to contribute over 50 percent of the reused property cited above.

The importance of increasing the amount of excess property reused within DOD (or within the Government as a whole) can be appreciated only if one considers the fact that the rate of return from the sale of such property is, even at best, extremely low. The present average return on surplus items sold as items is only 7 percent of original cost; items sold as scrap bring even less. Thus, greater reusability means significant savings to the Government.

Because the disposal program's relatively low priority has generally precluded the use of military construction funds for much needed improvements in facilities, the procurement of transitory property shelters with operations and maintenance funds, which are then reimbursed from proceeds of sales of surplus and scrap property, is thought to be a prudent management action.

The Comptroller General has alleged that portions of the disposal facility improvement program, particularly the transitory shelter procurement program, have violated Revised Statutes, section 3733, 41 U.S.C. 12, which require specific authorization by Congress for the construction of so-called public improvements. In the opinion of DOD this provision is inapplicable to the vast majority of the projects criticized by the Comptroller. Many of these projects involved only the acquisition and installation of personal (as opposed to real) property. In our view, such property does not constitute a "public improvement" or "public building" within the meaning of section 3733; thus the accomplishment of such projects involves no violation of that statute. Other projects, though admittedly



involving a public improvement or public building, were clearly within the exception to section 3733 established by 10 U.S.C. 2674, the so-called "minor construction" provision.

In a few cases, closer review, instituted by the Air Force as a result of the GAO's draft report on this subject, did reveal projects which should have been included in the military construction program and specifically authorized under section 3733. These were recognized in the Air Force replies to the Comptroller General, and strict and detailed guidelines have since been issued to the field in order to prevent any recurrence.

In summary, we believe the vast majority of projects criticized by the Comptroller General were properly accomplished. Such projects are deemed essential to the "more rapid and effective disposition of surplus supplies, equipment, and materiel" called for in the House Report on the Department of Defense Appropriation Act for fiscal year 1960." (H.R. Rept. (i) No. 408, 86th Cong., 1st sess. (i), 48 (1959)).

The DOD position on this matter is more fully developed in two letters from Deputy Secretary of Defense Gilpatric to the Comptroller General, dated September 24, 1962, and December 3, 1962, respectively, copies of which are attached hereto.

THE SECRETARY OF DEFENSE,  
Washington, D.C., September 24, 1962.

THE HONORABLE COMPTROLLER GENERAL OF THE UNITED STATES.

DEAR MR. CAMPBELL: I refer to your letter of July 23, 1962, B-146728, forwarding a report entitled "Review of the Use of Proceeds from Scrap, Salvage, and Surplus Property Sales for Construction Purposes by the Air Force Logistics Command, Department of the Air Force."

*Report summary.*—Your report discusses the erection, modification, and alteration of structures by the Air Force for use in connection with the surplus property disposal program. It states that during fiscal years 1957 through 1961, the Air Force used approximately \$4 million of proceeds from the sale of scrap, salvage, and surplus property to finance the erection, improvement, and modification of redistribution and marketing structures at 12 Air Force installations. It is your opinion that the provisions of the appropriation acts authorizing the use of proceeds from the sale of scrap, salvage, and surplus property to meet the expenses of the program do not include this type of work, which would otherwise be subject to the specific controls imposed by the Congress on military construction. You conclude (i) that because the structures erected and the improvements to those and other structures are of such a nature as to constitute public improvements within section 3733, Revised Statutes (41 U.S.C. 12), which requires specific statutory authority for the erection, repair, or furnishing of any public building or public improvement, they should have been funded under the military construction appropriation; and (ii) that other modification and alteration projects which were properly charged to "Operation and maintenance" funds should not have been the basis for reimbursement from surplus sales proceeds because they were capital improvements, and for this reason could not be considered direct expenses of the surplus property disposal program.

*Draft report.*—In August 1961, the Associate Director of your Defense Accounting and Auditing Division transmitted a draft report on this subject to the Air Force. The Air Force letters of October 26, 1961, and January 18, 1962, copies of which are attached, responded in detail to the draft report. The letters, which were concurred in the Office of the Secretary of Defense, gave separate treatment to each project discussed in the draft report, and contained an analysis as to whether the use of proceeds of surplus property sales was proper. In general, our position has been and remains that work which has resulted only in austere, transitory structures for a limited purpose, which could be removed without substantially harming the structure or impairing the usefulness of more permanent facilities which remain, is a proper charge to "Operation and maintenance" appropriations and reimbursable from the proceeds of surplus property sales. Where particular structures did not meet this test, we have acknowledged that they should have been financed through the military construction program. As a result of your draft report, we have taken administrative action to insure that these errors will not occur in the future. That these errors occurred in the past indicated the need for greater administrative controls, but it in no way undermines the desirability of this program, which your report does not question, or the authority of the military departments to conduct the program within the limits established by the Congress.

*New material.*—Since the prior letters from the Air Force have responded to the bulk of the issues raised in your report, we will limit ourselves to those points which appear for the first time in the final report.

(1) Minor construction: The draft report contended that all of the expenses of erecting, modifying, and altering structures which the Air Force had charged to "Operation and maintenance" appropriations, which in turn had been reimbursed from the proceeds of surplus property sales, should have been charged to military construction appropriations. Our replies pointed out that 10 U.S.C. 2674(e) permits the use of "Operation and maintenance" appropriations for construction determined to be urgently needed and not in excess of \$25,000. Section 611 of the 1962 Department of Defense Appropriation Act states in pertinent part that—

"Appropriations of the Department of Defense available for operation and maintenance, may be reimbursed during the current fiscal year for all expenses involved in the preparation for disposal and for the disposal of military supplies, equipment, and materiel \* \* \* from amounts received as proceeds from the sale of any such property."

Similar language appears in appropriation acts for prior years. The Congress established two limitations on the use of sales proceeds to meet the expenses of the disposal program: First, only expenses properly charged to "Operation and maintenance" funds could be reimbursed. Second, only the direct costs of the disposal program could be reimbursed. As you have been informed, all structures which were erected, modified, or altered through the use of surplus sales proceeds have been used exclusively for the disposal program. Although your report does not dispute this, it contends that minor construction projects properly charged to "Operation and maintenance" funds under 10 U.S.C. 2674(e) represent "capital improvement" and, therefore, cannot be considered a direct expense of the disposal program. Your conclusion is totally devoid of support from the language of the appropriation act.

It is true that the proceeds of surplus property sales may not be used to reimburse the military construction appropriation, even where those funds are used to meet a direct expense of the disposal program. But this is so only because the appropriation act limits reimbursement to those expenses properly charged to the "Operation and maintenance" appropriation. The transitory shelters, concrete segregation bins, and other work financed from "Operation and maintenance" funds as minor construction are as much a direct cost of the disposal program as the canvas tarpaulins previously used to protect property awaiting sale or the salaries of civilian personnel connected with the disposal program. We therefore must take exception to your position in this matter and insist that expenses of the disposal program including minor construction, which are properly charged to "Operation and maintenance" funds may be reimbursed from the proceeds of surplus property sales.

(2) Separate treatment of floors: Apparently the earlier replies failed to make clear the Air Force's method of funding floors. In some instances, the Air Force erected shelters, treated as personal property, over existing floors so that no construction was involved. In other cases, existing floors were repaired or new floors installed incident to the erection of transitory shelters treated as personal property. In those cases, the only construction was the repair or installation of the floor and such work was chargeable to O. & M. under 10 U.S.C. 2674(e), provided that it did not exceed \$25,000, and other requirements of that statute were met. On the other hand, there were some instances in which floors were repaired or installed incident to the erection of transitory shelters which were determined to be construction, so that the cost of the entire project was considered in deciding whether it fell within the \$25,000 limit of 10 U.S.C. 2674(e). While this factor is not a significant one in terms of the entire program, we wish to make it clear that construction work was not divided in order to come within the limits of 2674(e) but, rather, that the seemingly nonuniform treatment of floors was due to their being parts of different categories of work.

(3) Future use of shelters: We have informed you, as stated at page 22 of your report, that the transitory shelters acquired through disposal proceeds are limited to use in the disposal program; that should such structures become excess to requirements at a particular Air Force installation, they will be reported to Headquarters AFLC for redistribution to other disposal activities, rather than reuse for other purposes at the same installation; and that in fact none of the structures have been utilized other than as part of the disposal program. You interpret the Air Force General Counsel's 1957 opinion as requir-

ing a permanent restriction on the use of these structures so that transitory shelters would not be available for use outside the disposal program solely because of the source of funds used to finance them. This is based on speculation that transitory shelters will become excess to Air Force requirements in the disposal program. To date, this has not occurred, and there is no basis for assuming that it will in the future. Furthermore, if this should occur, we do not believe that it would be a unique problem or that the impractical result you suggest would follow. Suppose that the Congress authorizes and appropriates funds for the construction of aircraft hangars at a particular installation and years later, as a result of operational changes, there is no longer a requirement for those hangars at that installation. Surely you would not suggest that these facilities must be left idle, notwithstanding the fact that they were authorized to be constructed for use as hangars. We freely acknowledge that a transitory shelter could not be constructed out of disposal proceeds with the expectation of using the shelter for another purpose. Indeed, the opinion of the Air Force General Counsel so states. But if, years later, a transitory shelter becomes excess to the overall needs of the disposal program, we know of no requirement that the shelter be left idle rather than used to meet other requirements of the military service. We would reiterate that in no instance has a transitory shelter financed with disposal proceeds been used outside the disposal program nor do we expect this to occur. Further, we would not finance a shelter through surplus property proceeds with the expectation of using it for other purposes or transfer such shelters to other programs while still purchasing additional shelters for the disposal program.

(4) Congressional knowledge of transitory shelter program: Your draft report states that the Air Force had failed to advise the Congress of the transitory shelter program and had avoided congressional review. The earlier replies to the draft report informed you of certain incidents through which the staff of the Subcommittee on Department of Defense Appropriations of the House Committee on Appropriations was made aware of the existence of the transitory shelter program. Your final report notes this and then states (p. 19) that in your opinion "notifying the staff of one subcommittee of the House of Representatives \* \* \* does not satisfy the specific requirements for congressional authorization of military construction, which Congress has seen fit to establish in the statutes." We are in complete agreement that incidents of the type described in our previous letters do not satisfy the statutory requirements of specific congressional authorization of expenditures for military construction. As previously pointed out, however, we regard the transitory shelter program to be within the authority of section 611 of the Department of Defense Appropriation Act. Since, in our view, military construction requiring specific congressional authorization was not involved (other than where it was done through error), we were not suggesting that informing the staff of a congressional committee met the requirements of congressional review for military construction. Rather, as indicated quite clearly in our letter of October 26, 1961, this information was provided to rebut the contention that "the Congress was totally unaware of the processes by which disposal facilities were programmed and obtained."

*Benefits of program.*—Because we believe that, within the limits set forth above, it was proper to finance the acquisition of transitory shelters from the proceeds of surplus property sales, it is important to recognize the role these shelters played in the surplus property disposal program and the twofold benefits derived from that program. The first benefit to the Government from the surplus property disposal program is the actual revenue derived from sales to the public. Since these receipts net of expenses of the program are transferred to the Treasury, there is no direct benefit to the Department of Defense. Because of the emphasis on reusing property within the Government, the acquisition value of property available for sale has decreased from \$551 to \$285.3 million from 1959 to 1962. Notwithstanding this decrease in the value of the property sold, the use of transitory shelters has contributed to an increase in the percentage of return on sales from 5.5 to 6.3 percent. Thus, the decline in the revenue received was less than the decline in the value of property sold, going from \$30.6 to \$18.1 million.

The second is a direct benefit through reuse of surplus property. Every time surplus property can be turned back into the inventory of a military department or another Federal agency, the approximate savings to the Government is the acquisition cost of a new item since, under the best of conditions, the amount which would have been realized from sale of these items would constitute only a small fraction of the acquisition cost, averaging only 6.3 percent in

1962. Use of the transitory shelters has been a vital factor in preserving surplus material and providing for its more rapid redistribution. One result has been that, from 1959, when the transitory shelter program was just gaining momentum, to 1962, the Air Force has almost tripled the value of surplus property (in terms of acquisition cost) which it has returned to the Air Force inventory for reuse, totaling \$459.7 million in 1962. At the same time, transfers to other Government agencies have more than doubled, for a total of \$167.9 million in 1962, and donations to federally approved programs have increased to \$96 million. Comparing the same years, the acquisition cost of usable surplus property (this excludes scrap and waste) has only increased by something over 10 percent. It must be concluded that the use of transitory shelters has been a prime factor in achieving this increased reuse of surplus property through better protection and preservation of the property as well as more efficient identification and more rapid distribution of the property. This increased reuse is in line with the intention of the Congress in removing the dollar ceiling on reimbursement for expenses of the surplus property disposal program. The House report states that: "It is the purpose of the removal of the dollar ceiling to encourage more rapid and effective disposition of surplus supplies, equipment, and materiel. Testimony indicated that \$26.7 billion worth of material is previously awaiting disposition, and that the ceiling presently imposed was hampering the efforts of the Department \* \* \*. The committee has cautioned Defense officials against disposing of material as surplus where there is a clear need for retaining such material in the military inventories." (H.R. Rept. No. 408, 86th Cong., 1st sess. 48 (1959)).

*Conclusion.*—Department of Defense appreciates the role played by the General Accounting Office in pointing up administrative deficiencies in the operation of the transitory shelter program. We must, however, inform you that we cannot accept your conclusions that transitory shelters can never be financed out of surplus property disposal proceeds and that minor construction for the disposal program, properly charged to operation and maintenance appropriations, cannot be reimbursed from disposal proceeds. In light of the benefits of the disposal program and the clear legal basis therefor, we will continue to make use of transitory shelters within the authority granted by the Congress.

As mentioned earlier in this report, we are mindful that errors of judgment have occurred in the past in providing facility support for the surplus disposal program and agree that a clarification of procedures and strengthened management control in this area are necessary to preclude any possible misunderstanding or misapplication of funds in the future. As an immediate step, preliminary regulations are being placed into effect by the Air Force, to be followed by a formal Department of Defense directive covering all military departments and agencies upon the completion of more careful study. Among other facets, this proposed directive would control the scope and character of work to be performed, define the limits of individual projects (particularly with respect to the use of minor construction authority), and prescribe the conditions under which reimbursement of operations and maintenance funds from sale proceeds are allowable.

Sincerely,

ROSWELL GILPATRICK,  
*Deputy Secretary of Defense.*

DECEMBER 3, 1962.

The Honorable the COMPTROLLER GENERAL OF THE UNITED STATES.

DEAR MR. COMPTROLLER GENERAL: This is in further reply to your letter of October 22, 1962, relative to your report to the Congress entitled "Review of the Use of Proceeds from Scrap, Salvage, and Surplus Property Sales for Construction Purposes by the Air Force Logistics Command, Department of the Air Force."

Your letter reviews early decisions of the Comptroller of the Treasury as well as those of your office relating to the payment of expenses of sales from proceeds of sale of Government property admittedly involving statutory provisions, principally, the act of June 8, 1896 (29 Stat. 268), which restricted the use of proceeds of sale of property to certain specified expenses. That review also pointed out that the restrictive effect of these decisions required the addition of specific language to the Military Appropriation Act, 1948, so as to permit the utilization of the proceeds from the sales of scrap for "expenses of transportation, demilitarization and other preparation for sale \* \* \*."

You then state: "similar provisions of law have been included in all subsequent annual appropriation acts for military departments with only *minor* changes other than the elimination of the dollar limitation. However, nothing in the legislative histories of such acts indicating that the change in the language from expenses of transportation, demilitarization and other preparation for sale or salvage of equipment and material' to 'for *all* expenses involved in the preparation for disposal and for the disposal of military supplies, equipment, and materiel' which latter language was used in fiscal year 1959 and subsequent appropriation acts was intended to change the scope or effect of the prior language \* \* \*." [Italic supplied.]

Without any resort to legislative history, a cursory examination of the two quoted phrases would indicate significant differences between them in scope as well as in effect.

With respect to change in scope, it would seem clear that a change from language which specified "expenses of transportation, demilitarization or other preparation for sale or salvage" to language which eliminated such specificity by utilizing the word "all" (meaning the whole of—the aggregate) without other specification, constitutes a significant change in scope.

As to change in effect, the phrases should be read in context:

Previous version (sec. 612, Department of Defense Appropriation Act, 1958): "Not more than \$41 million of the amounts received during the current fiscal year by the Department of Defense as proceeds from the sale of scrap, salvage or surplus materials, shall be available during the current fiscal year for expenses of transportation, demilitarization, and other preparation for sale or salvage of military supplies, equipment, and material; \* \* \*"

Current version (sec. 511, Department of Defense Appropriation Act, 1963): "Appropriations of the Department of Defense *available for operation and maintenance*, may be *reimbursed* during the current fiscal year for all expenses involved in the preparation for disposal and for the disposal of military supplies, equipment, and materiel. \* \* \* from amounts received as proceeds from the sale of any such property: \* \* \*." [Italic supplied.]

It is apparent that the previous language constituted a separate appropriation of a specific amount from the proceeds of sales for expenses of transportation, demilitarization and other preparation, and made no reference to the availability of the operation and maintenance appropriations of the Department of Defense for such expenses or for any other expenses of the disposal program.

It is equally clear that the current version renders the operation and maintenance appropriations of the Department of Defense available for any expenses directly related to disposal or preparation therefor and, in addition, authorizes such appropriations to be reimbursed for all such expenses. It is submitted that such language, on its face, indicates a significant change in effect.

Pertinent legislative history (which may not have been given sufficient weight in other analyses of the problem), where the Department of Defense was recommending language identical to the current version, reflects the significance of these changes and supports the conclusion that the intent was to remove the restrictive effect of the previous language and to resolve doubts as to application of the principles of the earlier decisions such as those cited in your letter, in determining which appropriations or funds were chargeable with authorized expenses of the program, e.g.:

18 Comp. Dec. 5, where it was held that the cost of a paper bailing machine used in preparing waste paper for sale was chargeable neither to the proceeds of the sale nor to the appropriations of the Department of the Interior;

5 Comp. Gen. 680, where it was held that salaries of employees being paid compensation from proceeds of sales were required to be specifically appropriated for;

6 Comp. Gen. 348, where it was held since no regular funds appropriated to the biological survey were available during the current fiscal year, the proceeds of the sale of wild animals, etc., could be charged with the cost of herding, corralling, feeding, etc.;

15 Comp. Gen. 886, where it was held that pay of certain arsenal employees was not chargeable to the sale of scrap material but no charges were required to be lodged against the regular appropriations supporting the arsenals;

28 Comp. Gen. 594, where it was held that due solely to an insufficiency of funds in the regular appropriations of the Remount Service that costs of transporting Government-owned horses to a place of auction sale could be charged to the proceeds of the sale;

16 Comp. Gen. 876, where it was held that proceeds of sales could not be charged with the compensation of appraisers or expenses of appraisals; and 37 Comp. Gen. 59, where it was held that such costs could be charged to the proceeds of sale.

In the hearings on the Department of Defense Appropriations for 1959 (H.R. 12738, 85th Cong.) before the Subcommittee on Appropriations of the Senate, the Secretary of Defense testified as follows:

"A formal request for amendment of section 611, dealing with scrap and salvage, is being submitted separately for congressional approval. Briefly, this would permit the various operation and maintenance appropriations to be reimbursed directly from sales proceeds for all expenses involved in preparation and disposal of military supplies, equipment, and materiel. This would enable us to move more vigorously to reduce the backlog of materiel awaiting disposal, thereby increasing the ultimate return to the Government and reducing storage costs. This charge is necessary to eliminate the restrictive effect of the present language." P. 18. (See also pp. 305, 367, 433, 563, 858, and 1346 of the same hearings.)

Following enactment of the Appropriation Act, Department of Defense Instruction 7310.1 was issued on January 5, 1959, providing "as a general rule reimbursable expenses \* \* \* include all expenses for a fiscal year which can be directly related to preparation for and disposal of scrap, salvage, excess, surplus or foreign excess and personal property \* \* \*."

This contemporaneous administrative interpretation, which was and is clearly in line with both the letter and intent of the language of the section, has been continued in effect to date without objection on the part of the Congress or the accounting officers.

The Congress enacted language identical in the current version in the Department of Defense Appropriation Act for fiscal year 1960, when the House Committee on Appropriations stated in its report (House Report No. 408, 86th Cong., p. 48):

"Under Title V, General Provisions, sec. 611 provides that operation and maintenance appropriations may be reimbursed for all expenses involved in the disposal of surplus property from the proceeds of sale of such property. Unlike prior years, the provision this year is without a fixed dollar ceiling. Unlike purpose of the removal of the dollar ceiling to encourage more rapid and effective disposition of surplus supplies, equipment and materiel. Testimony indicated that \$36.7 billion worth of material is presently awaiting disposition, and that the ceiling previously imposed was hampering the efforts of the Department. As previously, quarterly reports are required, however, the form of reporting should be revised in view of the appropriation reimbursement feature. It is requested that future reports indicate the appropriation to which reimbursement is made, and the budget program or programs involved within the appropriation.

"The committee has cautioned Defense officials against disposing of material as surplus when there is a clear need for retaining such material in the military inventories. Defense officials maintained that while some minor mistakes might be made, greater freedom in disposing of surplus will on the whole save large sums."

The Congress reenacted identical language for fiscal years 1961, 1962, and 1963.

On the basis of the foregoing, the Department of Defense takes the position that, to the extent appropriations for operation and maintenance are legally available to the Department of Defense, they are available for all expenses of the disposal program and to the extent they are available for the expenses of this program they may be reimbursed from the proceeds of the sales.

Your letter further states that "The only question for determination insofar as the fiscal year 1963 is concerned is whether the language 'expenses involved in the preparation for disposal and for the disposal of military supplies, equipment, and materiel' includes the cost of minor construction projects not in excess of \$25,000" and you conclude that "it clearly cannot be interpreted as including any construction project which constitutes a 'public building' or a 'public improvement' within the meaning of those terms as used in section 3733, Revised Statutes, 41 U.S.C. 12, \* \* \*."

It is the opinion of the Department of Defense that such a conclusion does not give effect to the provisions of 10 U.S.C. 2674. This statute, to which your attention may not have been directed in reaching your conclusion, provides as follows:

"§ 2674. Establishment and development of military facilities and installations costing less than \$200,000

"(a) Under such regulations as the Secretary of Defense may prescribe, the Secretary of a military department may *acquire, construct, convert, extend, and install*, at military installations and facilities, urgently needed *permanent or temporary public works not otherwise authorized by law, including the preparation of sites and the furnishing of appurtenances, utilities, and equipment*, but excluding the construction of family quarters. However, a determination that a project is urgently needed is not required for a project costing not more than \$3,000.

"(b) This section does not authorize a project costing more than \$200,000. A project costing more than \$50,000 must be approved in advance by the Secretary of Defense, and a project costing more than \$25,000 must be approved in advance by the Secretary concerned.

"(c) Not more than one allotment may be made for any project authorized under this section.

"(d) Not more than \$50,000 may be spent under this section during a fiscal year to convert structures to family quarters at any one installation or facility.

"(e) Appropriations available for military construction may be used for the purposes of this section. *In addition, the Secretary concerned may spend, from appropriations available for maintenance and operations, amounts necessary for any project costing not more than \$25,000 that is authorized under this section.*

"(f) The Secretary of each military department shall report in detail every six months to the Committees on Armed Services of the Senate and House of Representatives on the administration of this section." [Italic supplied.]

It is submitted that what is authorized under this statute can be characterized as nothing other than buildings and public improvements within the meaning of section 3733 Revised Statutes (41 U.S.C. 12). Under the provisions of subsection (e) above, the operation and maintenance appropriations of the Department of Defense are made available for projects authorized by this statute when their cost does not exceed \$25,000.

There is clear recognition on the part of the Appropriations Committees and the Congress of the fact that this statute renders operation and maintenance appropriations available for minor construction projects under \$25,000. See in this connection hearings before the Subcommittee of the House Committee on Appropriations on the Department of Defense Appropriation Act, 1963, part 3, Operation and Maintenance, pp. 896, 897, and 898, where estimates of the amounts for minor construction were submitted. See also, House Committee Report No. 1607, 87th Congress, 2d session, page 29, and section 536 of the Department of Defense Appropriation Act, fiscal year 1963.

An analysis of each of the cases cited at page 3 of your letter indicates that none of the agencies concerned there possessed authority comparable to that provided the Department of Defense in 10 U.S.C. 1674. In passing, it is noted that there was not cited 17 Comp. Gen. 636, where it was held that a concrete or macadam surface covered with wood stringers and corrugated metal for storage of 50,000 tons of manganese ore to remain in storage indefinitely did not constitute a building or improvement of public property within the meaning of section 3733, but was "merely the adaptation of public property for storage purposes." It was also held that in that case:

"A special appropriation made to accomplish a specific purpose is available for all expenditures essential to the accomplishment of the specific object for which it was made, notwithstanding the provisions of any general statute which otherwise would prohibit such expenditures."

The benefits to the United States being derived from this program were outlined in detail in our letter of September 24, 1962. These benefits were anticipated by the Congress and flow from its repeated reenactment of the language of section 511. In the light of these substantial benefits and of the foregoing analysis, the Department of Defense does not agree with the conclusions reached in your letter of October 22, 1962.

We appreciate the extent to which the General Accounting Office has pointed up deficiencies in the disposal program and can assure you that our current actions are designed to eliminate such deficiencies.

Sincerely,

ROSSELL L. GILPATRICK,  
Deputy Secretary of Defense.

