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ECONOMY IN GOVERNMENT

145

HEARINGS
BEFORE THE
JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES
NINETIETH CONGRESS
FIRST SESSION

MAY 8, 9, 10, AND 16, 1967

PART 1

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ECONOMY IN GOVERNMENT

MONDAY, MAY 8, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to notice, in room S-407, the Capitol, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire, Sparkman, Symington, Jordan, and Percy; Representatives Patman, Curtis, and Rumsfeld.

Also present: John R. Stark, executive director, and Ray Ward, economic consultant.

Chairman PROXMIRE. The committee will be in order.

This is the first meeting of the Subcommittee on Economy in Government which was previously called the Subcommittee on Federal Procurement and Regulation.

In general, this year, we are continuing and expanding somewhat on the work of that subcommittee.

Specifically, we have asked our witnesses to testify upon the recommendations of our last report, dated May 1966.

We hope to complete this year's hearings in four morning sessions on May 8, 9, 10, and 16. If necessary, however, we will go over to afternoon sessions so principal witnesses may have ample time. The members of this subcommittee have long contended that our economic dilemma of high debts, taxes, and budgets on the one hand, and vital human needs on the other hand can be partly, if not wholly, solved by greater economy in Government. We are dedicating our efforts to this concept.

Our first witness this morning is the Honorable Elmer B. Staats, Comptroller General of the United States, who is well known to all of us from his long and notable service in the executive branch, particularly the Bureau of the Budget. Mr. Comptroller General, the committee is indebted to you and your staff for the excellent studies you have made in the past years. I have read your very fine prepared statement which includes material relevant to many important subjects we will wish to pursue so I will not impinge upon your time. I understand you will read the general section of your statement.

For the benefit of the members of the Subcommittee on Economy in Government, some of the reports which we requested of the GAO and which we have here today have not been checked with Pentagon staff merely because time has been too short.

At this point, I would like to have inserted in the record my letters to Comptroller General Staats, dated March 1, 1967, and April 27, 1967.

(The letters referred to follow :)

MARCH 1, 1967.

HON. ELMER B. STAATS,
Comptroller General of the United States,
Washington, D.C.

DEAR ELMER: I was pleased to confer with you and your staff recently about the 1967 program of the Subcommittee on Economy in Government of the Joint Economic Committee.

Later you will be advised in detail of the plans of the Subcommittee for hearings this spring, but there is a subject which deserves immediate attention.

This involves the identification and disposal to the highest economic use of Federal Government real properties which are no longer needed by the holding agencies and which do not serve the highest economic purpose nor contribute to the tax base.

Previous hearings and reports of the predecessor subcommittee pointed to the need for high level action to identify these properties and challenge the retention of all sites which may not now be required. We plan on pursuing this subject at our upcoming hearing.

In this connection, I have read with interest your report B-156167, "Operation of a Dairy Farm by the U.S. Naval Academy—March, 1966" which is an excellent case study along the lines of the subcommittee's economic interests.

Since we will review the report and its implications, I would appreciate early receipt of a copy for each member (10). I hope also that you will testify on the report in connection with the real property program I have mentioned and also Budget Circulars A-2 and A-76.

Copies of this letter are being furnished to Secretary McNamara, Budget Director Schultze and GSA Administrator Knott.

Warmest regards.

Sincerely,

WILLIAM PROXMIRE, *United States Senator,*
Chairman.

APRIL 27, 1967.

HON. ELMER B. STAATS,
Comptroller General of the United States,
General Accounting Office,
Washington, D.C.

DEAR MR. STAATS: The Subcommittee on Economy in Government of the Joint Economic Committee has scheduled hearings for May 8, 9, 10, and 16, with you and your staff testifying on Monday, May 8, 1967, 10:00 a.m., (hearing room to be announced later).

In addition to the specific subjects which you were requested to cover in the May 1966 report of the Subcommittee on Federal Procurement and Regulation, it is understood that you will report on the use of receipts and other methods of program financing as requested by Congressman Curtis. Your full views on the operation of the dairy farm at Gambrills, Maryland, have previously been requested. We would wish to relate this subject to a discussion of Budget Circular A-76.

Your testimony concerning programs for the improved administration of common activities such as recruiting, engineering, mapping, timber sales, construction, printing and binding, automatic data processing, etc., will be appreciated.

Inasmuch as previous General Accounting Office studies and reports on the management of short shelf-life items and contractor inventory indicate glaring deficiencies in inventory management, your recommendations for a broad program to better protect the billions of dollars worth of Government personal property will be timely.

As a Subcommittee on Economy in Government, we wish information as to savings made by your agency during the past year.

Please also give us your ideas on subjects or programs requiring priority attention as revealed by General Accounting Office's studies and reports during the past year.

If additional information is required, you may contact Mr. Ray Ward, Staff Director of the Subcommittee, phone 173/8169.

We would like 100 copies of your prepared statement at least one day before your scheduled appearance on May 8, 1967. Please address your copies to Room G-133, New Senate Office Building, Washington, D.C. 20510.

Sincerely,

WILLIAM PROXMIRE, *Chairman.*

Mr. Staats, you may proceed, and will you please identify your assistants for the record?

STATEMENT OF HON. ELMER B. STAATS, COMPTROLLER GENERAL OF THE UNITED STATES; ACCOMPANIED BY FRANK H. WEITZEL, ASSISTANT COMPTROLLER GENERAL; ROBERT F. KELLER, GENERAL COUNSEL; WILLIAM A. NEWMAN, JR., DIRECTOR, AND JAMES H. HAMMOND AND DANIEL BORTH, ASSOCIATE DIRECTORS, DEFENSE ACCOUNTING AND AUDITING DIVISION; GREGORY J. AHART, DEPUTY DIRECTOR, CIVIL ACCOUNTING AND AUDITING DIVISION; OYE V. STOVALL, DIRECTOR, INTERNATIONAL OPERATIONS DIVISION; FRED THOMPSON, LEGISLATIVE LIAISON STAFF

Mr. STAATS. Thank you very much, Mr. Chairman. We are pleased to be here this morning.

To my immediate right is Mr. Frank Weitzel, Assistant Comptroller General. To my left, Mr. William Newman, who is head of our Defense Division. Mr. Gregory Ahart, to Mr. Weitzel's right, is Deputy Director of our Civil Division. Immediately behind me, Mr. Oye Stovall, head of our International Division; Mr. Bob Keller, General Counsel, and Mr. Fred Thompson, of our legislative liaison staff.

We have other members here whom we may wish to call on for specific points.

Mr. Chairman, I have a prepared statement and with your permission I would like to read that statement at this point.

Chairman PROXMIRE. Very good.

Mr. STAATS. I am pleased to be here today to discuss some of the significant aspects of the work of the General Accounting Office during the past year. I know of no more effective means available to us each year to outline for the Congress and focus its attention on the broad scope of our efforts in the far-reaching areas of Government activities, particularly the management of its resources.

This type of hearing, in which the Comptroller General appears as the agent of Congress in the same forum with principal policymakers and resource managers of the executive branch of Government, has become an annual event for this subcommittee. We believe such a review makes a substantial contribution to good government.

The total impact of the Government's vast operations on the Nation's economy is significant. In calendar year 1966, the Federal Government procured \$77 billion worth of goods and services. This amounts to 10.4 percent of the gross national product, which was \$739.5 billion in calendar 1966. Federal procurement for defense purposes represented 8.1 percent, while nondefense purchases of goods and services equaled 2.3 percent of the GNP.

The role of the General Accounting Office does not involve policy determinations as to the volume or purposes of Government spending. As you know, our function, briefly stated so far as is pertinent here, is to evaluate the manner in which Government agencies carry out their authorized programs and to report our findings and recommendations to agencies and to Congress. Included in this duty is the responsibility for determining that financial transactions are carried out within the laws enacted by the Congress. It is our function also to prescribe proper principles and standards to be employed by executive agencies in accounting for the Government's financial and physical assets.

Refunds, collections, and other measurable financial savings or additional revenues resulting from the recommendations of the General Accounting Office in fiscal year 1965 amounted to \$186,780,000 and in fiscal year 1966, \$130,637,000. Of the totals, actual refunds and collections made by or through our efforts during 1965 amounted to \$24,949,000 and in 1966, \$17,192,000. Substantial amounts of the savings or additional revenues are recurring in nature and will continue in future years. The principal area in which the greatest measurable financial savings were realized occurred in supply management of Government-owned materials.

The audit and review work we are discussing today was performed by three of our operating divisions—the Civil Division, the Defense Division, and the International Division. The International Division is our newest. Organized in 1963 it has the responsibility for audit of State Department programs and the oversea program of all agencies and departments. The Civil Division is responsible for the audit of domestic programs and operations of all other Agencies of Government except the Department of Defense; the Defense Division covers that Department and the three military departments.

To save time we have included as attachments to my statement much of the detail on some of the subjects we will cover today, as well as other subjects not actually discussed in the text. We have furnished copies of this material for each member in advance of the hearings so they might identify areas of interest.

We have conducted several special surveys and reviews during the past year covering Department of Defense activities in which your subcommittee has expressed particular interest. I will discuss the results of that work first.

RESPONSIVENESS OF THE MILITARY SUPPLY SYSTEMS IN MEETING OPERATIONAL NEEDS

The U.S. military supply systems involve the greatest diversity of items and the largest inventories to be found in any organization in the world. Approximately 4 million different items are classified, identified, and cataloged within the Department of Defense. Inventories on hand are valued at about \$37 billion, excluding aircraft, ships, and supplies and equipment in the hands of using units.

Last year, we advised you of our plans to undertake a broad long-range defensewide survey of supply system's responsiveness to military needs. Our survey was conducted at various military installations and activities in the continental United States as well as overseas. The

survey was performed with close cooperation from the Office of the Secretary of Defense. The Department's active participation contributed materially toward the completion of the survey in a compressed period of time, has served to expedite consideration of our observations, and at the same time has assured that our presence did not hamper military operations.

We have provided the Secretary of Defense with a summary of our overall observations which, in our opinion, warrant high level and long-range consideration and management attention. Our major observations are as follows:

1. At the present time there is no one organization within the Army with the overall responsibility for inventory management and design of supply systems. As a result, there is a loss of control over material, supply practices, and procedures are not standardized, maximum use is not made of skilled personnel, and supply support is not as responsive to the demands of combat units as it should be.

2. The standard DOD requisitioning system, as presently implemented by the Army, is not permitting the processing of large volumes of transactions in a timely manner during periods of rapid force changes. We believe that a large part of the problem with the system is attributable to an unnecessarily large number of Federal catalog changes and the lack of adequate training on the part of supply personnel at the requisitioning level.

3. The stock fund method of financing the acquisition of supplies by using units is not sufficiently responsive to the needs during periods of rapidly increasing demands. Accordingly, we believe that certain modifications to the stock fund system are necessary with respect to their application to combat support units.

4. Practices involving the incremental funding of procurement requirements need improvement in order to preclude delays and increased costs in the purchasing of critically needed material.

5. There is a need to provide better service to requisitioning activities by improving transportation management and the reliability of the communication system.

6. The utilization of the productive capacity of contractors in the aircraft industry requires, in our opinion, further study for the purpose of determining methods for increasing that capacity available to the military departments.

7. Information regarding increased force levels and flying hour programs needs to be provided to responsible inventory management officials more promptly in order to effect timely requirement determinations and procurement actions.

8. Increased attention needs to be given to the distribution and training of logistics personnel and the ratio of logistics units to tactical and other units supported.

In addition to the above, we identified 82 further opportunities for improving the supply systems at various operating levels. They involve requirements computations, inventory controls, requisition processing, and supply manpower management, as well as others.

At the direction of the Secretary of Defense, a procedure was developed within the Department to review each of the above recommendations and to report to the Secretary and the Comptroller General on actions taken.

Progress reports received from the Department of Defense indicate that corrective actions have been taken and are complete in 58 of the areas, and are in process in the other 24. We plan to conduct a follow-up review of the effectiveness of the improvement actions within the next few months.

ADEQUACY OF INVENTORY CONTROLS

There is approximately \$10.4 billion in spare parts, components, and supplies held in 43 major depots of the military departments in the continental United States. Annual issues from these depots amount to over \$7 billion.

During the past year, we have performed considerable work within the area of inventory controls at the U.S. depots of the military services and the Defense Supply Agency. Our findings indicate that increased emphasis and attention are needed at all management levels to improve the usefulness of stock records for control of inventories.

We found in our review, for example, that significant differences existed between stock record balances and the actual quantities of items in depot inventories throughout the supply systems. This was evidenced by frequent and voluminous adjustments being made to the stock records by the services. The depot supply activities in the Department of Defense adjusted inventory records up or down, that is, gross adjustment, an average of \$2.4 billion annually in fiscal years 1965 and 1966. For instance, at one location with an average inventory of \$442 million, approximately 61 percent of the records for the 239,000 items physically inventoried during fiscal years 1965 and 1966 contained significant errors requiring gross inventory adjustments totaling \$33 million.

Factors which we feel contributed to the significant amount of inventory adjustments were (1) inaccurate stock locator cards; (2) physical inventories frequently made without proper control of documentation for receipts and issues occurring during the period of the inventory; (3) lack of proper reconciliations between the physical inventory counts and the stock records at the completion of these inventories and determinations as to the causes of the imbalances; and (4) failure of supply personnel to follow inventory control procedures.

We are suggesting to the Secretary of Defense that he establish a group, made up of representatives from the military departments and Defense Supply Agency, whose sole function would be to study inventory controls in depth. The objective of this study should be the determination of broad basic causes for inadequate inventory control with a view toward making recommendations for improvements. We plan to continue our work, also, and in order to avoid duplication of effort, we plan to coordinate our efforts with those of any such groups designated by the Secretary of Defense.

CONTROL OVER GOVERNMENT-OWNED PROPERTY IN THE POSSESSION OF DEFENSE CONTRACTORS

In the report of the Subcommittee on Federal Procurement and Regulation released in May 1966, it was recommended that the General Accounting Office cooperate with the Department of Defense in

the development of an adequate contractor inventory accounting system and that a thorough review be made of any misuse or unauthorized use of Government property in the hands of contractors.

We have devoted a considerable amount of time to these areas during the past year, but there is more work to be done.

PROPERTY ACCOUNTING SYSTEMS

Records of the Department of Defense indicate Government-owned facilities and material in the possession of contractors approximate a value of \$11 billion located at about 5,500 plants. This does not include the value of special tooling, special test equipment, and military property as the Department does not require contractors to report the value of such property in their possession.

The Armed Services Procurement Regulation (ASPR) places responsibility on the contractor for maintaining official records of Government property in its possession under a property accounting system approved by the property administrator. The property administrator is required periodically to test the contractor's system to insure that adequate control over Government-owned property exists.

We found the approval process to be of questionable value. For example, at one location we found that the contractor's system had been approved in August 1962. Selective floor checks subsequently conducted by the Government property administrator disclosed numerous instances where commercial work was performed with industrial plant equipment for which the contractor had not requested advance approval as prescribed. Although corrective action was promised, the incidence of discrepancies rose from 7.5 percent of items tested during late 1964 and early 1965, to 13.5 percent of items tested during the first 9 months of 1966. The approved status of the contractor's system had not changed.

Many contractors did not maintain financial control accounts for Government-owned material and special tooling. For example, at one contractor's plant the Government, about 12 years ago, acquired \$55 million in special tooling. The value and quantity of such tooling now on hand cannot be readily determined. The contractor indicated that, to identify Government-owned special tooling, a physical inventory would have to be taken and that such an inventory would take 20 men 1 full year to complete.

Many of the contractors we visited either were not taking periodic physical inventories, or applied improper inventory procedures. For example, at one location the same contractor personnel that had custody of the material also took inventories, and in addition, maintained the stock records. We believe that appropriate segregation of the duties of personnel taking physical inventories is essential to good property control.

For the past 1½ years, relatively few audits have been made of the effectiveness of property administration at all of the contractors' plants having Government-owned property.

We have made a number of recommendations for improvement in controls over Government-owned property in possession of contractors and many revisions to the ASPR are in process to effect improvements.

However, the work requested by your subcommittee has not been fully completed. We will continue to cooperate with the Department in its efforts to implement the numerous changes to property regulations which are now in process.

UTILIZATION OF GOVERNMENT-OWNED PROPERTY

We were unable to determine the usage of equipment at many contractor plants we visited because most property accounting systems did not include utilization records. However, at certain locations where limited utilization records were maintained, we questioned retention by contractors of 328 items of industrial plant equipment costing an estimated \$15.9 million. We questioned retention where no use had been made of the equipment over an extended period of time, where 75 percent or more of the equipment use had been for commercial work, or where usage of the equipment was low.

None of this equipment had been reported as idle and available for relocation. Further, our examination of records at the Defense Industrial Plant Equipment Center (DIPEC) revealed that 81 of the items we questioned were in critical or short supply.

The Office of Emergency Planning in July 1957, established a requirement for contractors to request advance approval to use Government-owned machine tools on commercial work exceeding 25 percent of the total usage. This procedure was established primarily to prevent contractors from obtaining a favored competitive position. We found that, generally, contractors were not requesting such advance approval. For example, in one case an 8,000-ton press, costing \$1.4 million, was installed in a contractor's plant on the basis that less efficient Government-owned 4,000 ton presses at the plant could not handle all Government orders for jet engine blades. During a subsequent 3-year period, 78 percent of the use of the large press was for commercial work, without approval of the Office of Emergency Planning having been obtained and the majority of Government blades were produced on the small presses.

We found a lack of uniformity in the rates charged for rental of Government-owned equipment. In some cases, this resulted in inequities between contractors. We also found cases where negotiated rentals were below the prescribed rates. For example, at one contractor's plant, rent applicable to a Navy standby facility is based upon 2 percent of the sales price of the products. We estimated that determination of the rent based upon prescribed uniform rates would have increased the annual rental from \$83,000 to about \$194,000.

A program for replacement of Government-owned machine tools was initiated in 1965 for the purpose of maintaining such tools in a modern condition. Expenditures amounted to about \$50 million in fiscal year 1966 for modernization and replacement purposes. The trend of expenditures has shown a continuous increase over prior years. While the Department of Defense policy is very restrictive as to the conditions under which new Government facilities will be furnished to contractors, the Department's program for modernization and replacement of machine tools appears to provide a means to acquire new machines for older ones under different and less restrictive criteria.

The program, as presently administered will, in our opinion, perpetuate the large Government investment in general purpose machine tools in possession of contractors, and thus defer indefinitely the time when contractors would furnish all facilities, in accordance with the Department's basic policy, for performance of Government contracts.

PROGRAM FOR OBTAINING INCREASED COMPETITION IN PROCUREMENT OF PARTS AND COMPONENTS

The Department of Defense and the military Departments have initiated well-conceived programs placing increased emphasis on achieving competition to the maximum practicable extent in the buying of spare parts.

However, many of the problems we identified in our previous work in the area of aeronautical replacement spare parts still prevail. These problems were reported to the Congress in 1961 and 1963, and were discussed in hearings before interested congressional committees. Our recent survey indicates that incomplete or inadequate technical data still contribute significantly to the award of noncompetitive procurements.

Our survey showed that of about \$2 billion worth of aeronautical spare parts bought in fiscal year 1966 by four major purchasing centers, about \$425 million or 21.5 percent was reported to have been purchased competitively. Of this amount \$114 million, or less than 6 percent of the total was accomplished by use of advertising while \$311 million or 16 percent was procured by competitive negotiation wherein the number of firms requested to bid was somewhat limited.

A large percentage of the actions which were classified and reported to higher management levels within the Department of Defense as competitive procurements, in our opinion, were in fact made without competition.

The primary cause for misclassifying procurements as having been awarded on the basis of price competition appears to stem from the criteria in the Armed Services Procurement Regulation. The regulation permits a contract award to be classified as competitively priced, even when only one response is received, as long as two or more proposals were solicited and the accepted proposal meets certain other evaluation tests.

In addition, the Armed Services Procurement Regulation permits purchases of \$2,500 and under to be reported as competitive even though many are not. The four locations we visited reported in the fiscal year 1966 a total of about \$80 million in procurement actions of \$2,500 and under as being awarded on the basis of price competition. Of the total amount, however, an estimated \$55 million, or 69 percent, represented noncompetitive procurements.

We are proposing changes in the Armed Services Procurement Regulation to provide additional guidance to contracting officers for classifying and reporting of negotiated contracts.

Our survey tests of \$174 million in procurements classified as noncompetitive showed that about \$103 million or 59 percent was procured noncompetitively because of determinations that technical data were either not adequate or not available. Let me illustrate the inaccuracy of some of these determinations:

"On March 9, 1966, the Army awarded a contract valued at almost \$150,000 to a prime contractor for 879 filters for use on a helicopter. This noncompetitive award was made on the basis that it was impossible to draft adequate specifications for the part in time for the procurement.

"However, we found that adequate technical data to support a competitive procurement was on hand. When we advised the contracting officer of this fact, he canceled the contract and solicited bids from three companies of which two responded. In August 1966 a new contract was awarded at a price of about \$81,000 or at a savings of about \$69,000 when compared with the initial sole-source price obtained from the prime contractor in March 1966 for the same number of filters."

Other principal reasons given by the centers for awarding contracts without competition, although not nearly as predominant as inadequate technical data, included critical manufacturing techniques, urgency of the requirement, and administrative expediency relative to awards of \$2,500 and under.

Mr. Chairman, we turn next to a discussion of certain work we have performed in the civilian agencies, in which we believe the committee has a strong interest. The first subject concerns the progress being made in the development of a national supply system. This was the first recommendation in the subcommittee's report last year.

NATIONAL SUPPLY SYSTEM

An important step toward the development of a national supply system was taken with the transfer of about \$65 million worth of handtool and paint stocks from the Department of Defense to the General Services Administration. The transfer was substantially completed in 1966.

The management responsibility for 52 other Federal Supply Classifications is scheduled for transfer in July 1967.

We reviewed handtool and paint inventories at the Defense Department depots after management responsibility had been assumed by GSA and found that there were significant quantities of GSA-owned stocks on hand which were not recorded on the GSA inventory records. As a result, these stocks were "lost" to the supply system.

After we brought this situation to the attention of Defense and GSA officials, complete physical inventories were taken at the Defense depots and about \$4 million worth of stocks were found which had not been—but which should have been—recorded on the GSA inventory records. During the period when the stocks were unrecorded, GSA purchased about \$1.1 million worth of stocks that were identical to the unrecorded stocks.

In our opinion, the transfer difficulties would have been largely avoided if:

1. Defense inventory records had been accurate when the stocks were transferred.

2. Effective controls had been maintained over GSA-owned stocks in Defense depots after the transfers.

3. GSA and Defense had cooperated more closely in solving their mutual problems.

In January 1967, we proposed to the Secretary of Defense and the Administrator of General Services that certain steps be taken in future stock transfers to eliminate these difficulties. We proposed that detailed physical inventories be taken of all stocks to be transferred, the inventory records be reconciled to the physical counts, and the warehouse stock locator records be updated. We proposed also that, prior to the transfer of management responsibility, a joint committee be made responsible for providing operating procedures to carry out the transfers, acting as liaison and coordinators, and settling promptly any problems relating to inventory shortages during the transfers. Defense and GSA have agreed with our proposals.

COMPETITION IN PROCUREMENT

Further on competition in procurement, and this on the civilian side, as in the case of the aeronautical spare parts procured by the Defense Department, we have noted several instances where competition—in this case, formal advertising—could have been used to an advantage in the procurement of common use items and services by the General Services Administration.

For example, about \$17 million worth of automobile tires and tubes are purchased annually under negotiated Federal supply schedule contracts. We suggested to GSA that the formal advertising method of contracting could be used for procuring the bulk of the Government's requirements since the essential elements for advertised contracts are present, that is, Federal specifications have been established, items meeting such specifications are widely sold on the commercial market, and there are a sufficient number of potential suppliers to permit effective competition for the bulk of the Government's requirements.

The GSA has now advised us that formal advertising will be used for high volume tire and tube items and that consideration would be given to advertising for other tires and tubes. We estimate that savings in this case will amount to a million dollars a year.

In another case, we found that the prices paid for repair and maintenance of office machines under national contracts negotiated by GSA with machine manufacturers were higher than the prices charged for the same type of services under regional contracts awarded on an advertised basis.

The administration agreed to expand the use of regional contracts and to encourage their use by Government agencies. We estimate that savings of up to \$1.2 million annually will result from the actions being taken here.

Also, we found that the Government incurs costs of about \$1.9 million for short-term rental of cars under informal arrangements made by Government agencies with commercial rental firms. Similar cars are rented by GSA under contracts awarded generally through formal advertising. We estimated that savings as much as \$350,000 annually could be realized if cars being rented under informal arrangements were rented at GSA contract rates.

The Administration is studying the matter with a view to increasing the relative share of such rentals made under GSA formally advertised contracts. We intend to continue to follow this work.

CIVIL AGENCY CONSTRUCTION

In the civilian agency construction area, we have intensified our audit efforts, and have reported on a wide range of subjects relating to construction directly managed by Federal agencies. Our reviews have led to recommendations that:

The Department of the Interior make a study to determine the full extent of the differences in transmission line construction practices of the Bureau of Reclamation and Bonneville Power Administration to determine the degree of construction coordination necessary and practicable, and adopt more uniform construction practices where possible.

The Post Office Department use standards comparable to those established by the General Services Administration for determining the office space needs of other Federal agencies in planning of office space in new postal facilities.

The Federal Aviation Agency amend its orders and issue appropriate instructions to clarify its policy relating to the selection of designs for use in the construction of airport traffic control towers.

The General Services Administration develop soils and foundation engineering capability within the Public Buildings Service to assist in avoiding or minimizing construction difficulties and related costs associated with foundation design problems and unanticipated soils conditions.

The General Services Administration (1) strengthen controls over on-site inspection of building construction to help assure compliance with contract specifications related to delivery and placement of concrete and (2) revise its policies and procedures so that laboratories engaged to test concrete for compliance with specifications would be responsible directly to the Government rather than to the contractor.

The Bureau of Indian Affairs revise their school construction standards to avoid excess seating capacity in school dining facilities.

The Corps of Engineers formally amend its existing regulations to require that field requests for permission to enter into fixed-price contracts for major relocations be supported by detailed cost analyses or other justifications to enable the headquarters office to properly evaluate the circumstances requiring a deviation from the prescribed procedures.

I cite these, Mr. Chairman, to emphasize that we feel that this is an important area for the GAO and as illustrations of our recommendations.

In general, we have found agency management receptive to our suggestions. Actions have been taken or planned in response to most of our recommendations which, if effectively implemented, should result in significant improvements and economies in construction activities.

In a closely related area, we recently reported on our review of the interpretation by Federal agencies of statutory limitations on fees paid for architect-engineer services and related matters. I have included a summary of the results of our review in Appendix No. 11. (See p. 27.) In brief, we concluded that the present limitations are impracticable and unsound and we recommend that they be repealed by the Congress. We believe that the requirements for competitive

negotiation and the submission and certification of cost or pricing data under Public Law 87-653, that is the "Truth in Negotiations" law, should, if properly applied, provide adequate assurance of reasonable fees. However, because the agencies concerned and the professional architectural and engineering societies do not agree with us that the competitive negotiation provisions of the statute are for application in the procurement of such services, we have suggested that the Congress clarify its intent in this regard.

AUTOMATIC DATA PROCESSING

As indicated in the hearings last year, we are conducting Governmentwide studies of present and planned uses of ADP systems in the Federal Government with particular emphasis on compatibility and standardization of such systems and equipment, including related communication facilities. These studies include further inquiry into the trend and development, use, and cost of ADP systems in relation to flow of data and information within Government systems and between Government and industry systems.

For example, we are looking into various possibilities for sharing through use of service centers or other arrangements which would provide for increased utilization of computer resources already acquired. Our studies are also directed at such questions as how to achieve greater interchange of data automatically between ADP systems and how to reduce duplication of effort in the development and use of ADP systems.

We intend to continue our efforts to review the need, application, and utilization of ADP equipment by Federal departments and agencies as well as the effects of Defense Procurement Circular No. 52, issued only on March 24, 1967, on the purchase of such equipment by Defense contractors. This subject is discussed more fully in Attachment No. 12. (See p. 404.) We will certainly keep the subcommittee advised of our studies in this area because we know of your interest in it.

INTERAGENCY COORDINATION TO IMPROVE ADMINISTRATION OF COMMON ACTIVITIES

Mr. Chairman, in your letter of April 27, 1967, you referred to "programs for the improved administration of common activities." You referred to timber sales under this category and this is indeed a good example of a common activity which can be improved by closer coordination between the Agencies involved.

In a review we made, we found significant differences in the appraisal practices followed by the Forest Service, Department of Agriculture, and the Bureaus of Indian Affairs and Land Management, Department of the Interior, to arrive at minimum selling prices for standing timber. Differences had continued to exist despite a statement of congressional intent in 1965 and a Bureau of the Budget request in 1959 for consistency in such practices.

While the timber management agencies had taken action to eliminate some of the differences in their appraisal practices, maximum uniformity in the best interests of the Government had not been achieved.

We recommended that the Director of the Bureau of the Budget take action to insure that the agencies jointly develop and apply the most desirable set of appraisal procedures. We have been informed that the departments have agreed to develop uniform appraisal methods.

Closer coordination between agencies can be of benefit in other ways. We have found opportunities for savings in situations where the program of one agency could be modified so that it would also serve the needs of another.

Two such situations were discussed by us in reports issued during the past year. One report involves research projects by the Federal Aviation Administration and the Public Health Service on the effects of aging on pilots; the other concerns activities of Federal agencies in the establishment of geodetic control points. I have included more detailed discussion of these reports in attachment No. 13. (See p. 30.)

AUDIT WORK OVERSEAS

I would like to turn briefly to our work overseas, besides the subject of military supply systems which we discussed earlier, our efforts in oversea areas have been concentrated for the most part on the military construction and economic assistance programs in South America and certain other countries; and operation FRELOC—the relocation of United States and NATO forces from France.

In view of the increased U.S. Government activity in Vietnam and the surrounding area, we have during the past year increased the application of our audit manpower in Southeast Asia. We have established offices in Saigon and in Manila under the direction of our Far East Branch in Honolulu. We are also in the process of establishing an office in New Delhi under the direction of the European branch in Frankfurt.

Our audit work in Vietnam has included a survey of the \$1.2 billion U.S. construction program, on which we expect to submit a report to the Congress before the end of May; a survey of the commercial import program administered by the Agency for International Development, on which we plan to send a report to the Congress within the next month; and reviews of the adequacy of the internal audits and management inspections of these and other major U.S. programs in Vietnam. The results of our initial survey on these audits and management inspections were reported to the Congress last July. A few days ago we submitted a further report on the progress made and areas of continuing need. This followup report showed that there had been significant increases in the number and scope of internal reviews, but that there remained a need to maintain and increase management surveillance over U.S. activities in Vietnam.

We have continued to review the administration of U.S. foreign assistance programs in other parts of the world, including South America. In addition to audits of selected segments of the economic assistance, military assistance, and food-for-peace programs in various countries, we are endeavoring to broaden our audit coverage by reviewing on a more comprehensive basis all of the major U.S. programs in a given country. Some of the countries where we have either segmented or more broadly based reviews in process or planned

are Chile, Peru, the Dominican Republic, Tunisia, Nigeria, Turkey, Korea, and India.

With regard to operation FRELOC, we plan to examine into whether the best interests of the Government are being protected in connection with the disposal of about \$550 million worth of U. S. real property in France, including surplus commodity housing.

Also, a recent survey indicates that over \$100 million worth of new construction is planned, mostly in Germany. We plan to review the requirements for the construction of these new facilities and the adequacy of procedures following in contracting for the construction.

In connection with supply operations under the FRELOC program, most of the physical inventories at military installations in France have been transferred to other sites in Europe. In the past, when mass movements of inventories have occurred, inventory controls have tended to weaken or break down. We plan to look into whether adequate stock control procedures were in effect for the FRELOC operation and whether any great loss of assets occurred. We will also review selected disposal actions.

In conclusion, Mr. Chairman, and with reference to your request for our ideas on programs requiring priority attention in the future, we believe that all of the areas we have discussed need further attention by the administrative agencies. As we have pointed out, the agencies have responded favorably to most of our findings and recommendations but increased effort must be applied continuously if permanent and far-reaching improvements are to be expected. The extent of our own work, in those areas, will depend on the rate of progress we observe in improvement of the administration of the programs.

One other area on which we are placing more emphasis is the revenue collecting activities of the Internal Revenue Service. On the basis of limited work there, we have successfully recommended some improvements both in the law and procedures.

The control of short shelf-life items also continues to need attention. While progress has been made in this area, there is more to be done. Other areas no doubt exist and some perhaps will develop during our discussions here today. Also, we will be glad to work closely with your staff in identifying subjects for consideration by the subcommittee for further inquiry.

This concludes my prepared statement. We will be glad to answer any questions you may have.

I would like to call your attention to the list of attachments. We found this necessary because our statement otherwise would have been prohibitively long. But we would be happy to answer questions or go into any details.

(List of attachments referred to above follows:)

LIST OF ATTACHMENTS

1. Identification and Disposal to the Highest Economic Use of Federal Government Real Properties No Longer Needed by the Holding Agencies. (P. 16.)
2. Defense Logistics Services Center Facilities for Promoting Greater Inter-service Utilization of Excess Stocks. (P. 17.)
3. Maintenance of Idle Production Equipment Reserves by General Services Administration, Department of Defense, and National Aeronautics and Space Agency. (P. 19.)

4. Requisitioning of Small Quantities of Low-Value Material from the Defense Supply Agency. (P. 20.)
5. Activities of the Defense Contract Administration Services, Defense Supply Agency. (P. 21.)
6. Use of General Services Administration as Sources of Supply by Government Contractors. (P. 23.)
7. Defense Supply Agency Management of Supply Items Having Little or No Demand. (P. 24.)
8. Potential Savings by Consolidation of Field Organizations and Facilities for Recruiting Military Personnel. (P. 25.)
9. Opportunities for Savings in Contracting for the Printing of Technical Manuals and in Other Aspects of the Management of Technical Manuals in the Department of Defense. (P. 25.)
10. Military Facilities and Construction. (P. 26.)
11. Government-Wide Review of the Administration of Certain Statutory and Regulatory Requirements Relating to Architect-Engineer Fees. (P. 27.)
12. Automatic Data Processing. (P. 29.)
13. Modification of Agency Activities to Meet Needs of Other Agencies. (P. 30.)

IDENTIFICATION AND DISPOSAL TO THE HIGHEST ECONOMIC USE OF FEDERAL GOVERNMENT REAL PROPERTIES NO LONGER NEEDED BY THE HOLDING AGENCIES

We share the Committee's interest in the identification and disposal of Federal Government real properties which are no longer needed by the holding agencies and which do not serve the highest economic use nor contribute to the tax base.

It is to be recognized, however, that there is no specific requirement of law that Federal property be used to take advantage of its highest potential value. Policy guidelines, however, are set forth in Bureau of the Budget Circular A-2, dated April 5, 1967. It is stated in the Circular, so far as pertinent to situations where high-value property is used, that real properties or portions thereof generally should be declared excess when:

"b. Substantial net savings to the Government would result if properties used for essential purposes could be sold at their current market value and other suitable properties of substantially lower current values substituted for them * * *."

Within the past few years we have reported to the Congress on two instances where we believe land could be disposed of by the Department of Defense and result in either (1) a substantial return to the Government through sale of the land involved, or (2) a reduction in Government expenditures for maintenance and operation of the properties. These reports dealt with the questionable retention of high-value land for use as a golf course at Fort Gordon, Georgia, and the use of high-value land for recreation, reserve forces training, and military housing purposes at Fort DeRussy, Waikiki Beach, Hawaii.

In each of these cases the Department of Defense disagreed with us, generally on the basis that the properties involved were needed to provide recreational facilities for military personnel and their dependents. We do not question the need for recreational facilities for military personnel. We believe, though, that adequate alternate military or private facilities were available in the locations involved.

Your Subcommittee has expressed particular interest in our report on the operation of a dairy farm by the United States Naval Academy (B-156167, March 23, 1966). On the basis of the results of operations during 1964, we estimated annual savings of about \$84,000 would be realized by the Government if the Academy dairy farm was sold and the Academy's milk products obtained from commercial sources. We brought out in our report, however, that the estimated savings were based on the assumption that the proceeds from sale of the farm would accrue to the United States Government. We made it clear that any other disposition of the proceeds would alter the comparative costs and thus, the savings to the Government.

At the request of the Department of the Navy, we are currently reviewing a conclusion of the Department that funds from a disposal of the Academy farm should, under the provisions of section 485(c), Title 40, U.S.C., be credited to the midshipmen's store fund, a nonappropriated fund activity, rather than to the Treasury. If the Navy is correct in its position, there will have to be a reexamination of the estimated interest savings in order to determine whether or not there would be an overall savings to the Government in the event the farm is sold.

Also, since our report was issued, staff members of the House Committee on Government Operations have spent considerable time in investigating the matter. As a result, we have recently agreed to conduct a review of current cost data on the dairy farm operation being developed by the Navy to see whether it is still in the best interest of the Government to close the dairy. Our review will include the interest savings factor mentioned above.

A special Subcommittee of the Committee on Armed Services also inquired into the proposed disposal of the Naval Academy dairy farm and issued a report on October 6, 1966. The Subcommittee recommended that no disposal actions be instituted by the Secretary of the Navy.

On April 5, 1967, the Bureau of the Budget issued a revised and expanded version of Circular A-2 on the utilization, retention and acquisition of Federal real property. A significant improvement in the Circular is a requirement for an annual review of real property holdings by the agencies. We also believe that the revised Circular provides more specific guidance to the agencies as to the need for the retention of real property. The extent of progress made, however, will be subsequently determined on the basis of the effectiveness of the agencies in implementing the policies and objectives outlined in the Circular.

We have been associated with matters concerning the substance of Bureau of the Budget Circular A-76 for a number of years. It is a complicated matter. It concerns problems not only of cost analyses but also other important factors, such as decisions to make or buy, the need for maintaining in-house capability, and the effects of Government competition with business.

Consistent interpretation and implementation of the principles of Circular A-76, as well as A-2, are most difficult to achieve and, many times, deep emotions are involved. This is true particularly with respect to activities which have been carried out many years by the Government. New starts are much more easily dealt with.

We feel that A-76 is sound but needs further improvement because it is important that all agencies operate under the same guidelines. Differing operations and interpretations cause confusion. We do not agree with the feeling by some that there is need for separate guidance in this area for differing kinds of services being procured. This is not a matter which can be dealt with on a formula basis. What is needed is good criteria.

Recently, we made several suggestions to the Bureau of the Budget for the purpose of clarifying certain parts of Circular A-76. One of the greatest difficulties in administering Circular A-76 concerns the question as to whether State and local taxes should be included in the cost comparisons and what differential should apply. State and local taxes are not a cost of the Federal Government except in a very remote sense, but this is compensated for somewhat by such Federal programs as aid to schools in impacted areas, sharing revenues, etc. We are still looking into this problem.

DEFENSE LOGISTICS SERVICES CENTER FACILITIES FOR PROMOTING GREATER INTER-SERVICE UTILIZATION OF EXCESS STOCKS

We are currently inquiring into materiel utilization operations at the Defense Logistics Services Center at Battle Creek, Michigan, and at selected activities of the military services. Our preliminary work at these installations indicates that the potential exists for increased utilization of available assets within the Department of Defense.

We believe that increased utilization can be obtained if improvements are made in the PLUS (Procedures for Long Supply Asset Utilization Screening), program. In this connection, we have found that most of the needed improvements have been previously identified by Defense study groups and internal auditors, but program operations have not improved significantly.

Under the PLUS program, the various military inventory control points report excess materiel and existing requirements for materiel to the Defense Logistics Services Center for centralized mechanical screening. When excess assets of one inventory control point are matched with requirements of another, the Center informs the requiring activity of the available materiel. The effectiveness of this program is dependent on the accuracy of data included in the mechanized file at the Defense Logistics Services Center and the propriety of decisions made by the services regarding potential transfers of available materiel.

The Defense study of the Materiel Utilization Program, dated January 1965, identified five broad problem areas and more than 20 subareas in need of man-

agement improvement. The study report contained 83 basic recommendations outlining future courses of action for optimum reutilization of materiel within DOD. The findings that we are developing in the course of our current work are directly related to one or more of the problem areas discussed in this latest of the Defense studies on materiel reutilization.

1. In the area of *Asset Knowledge*, the study pointed out that the systems used by the military services to determine asset positions—quantities of stock in various categories of need—vary widely. Some provide complete knowledge of all quantities on a world-wide basis, while others provide periodic information on only those quantities in the wholesale depot system. As a result, present asset reporting systems are often deficient in terms of either the depth or currency of information necessary for effective operations of Program PLUS.

Deficiencies in asset knowledge reflect on the accuracy and validity of computed requirements and, therefore, on the accuracy and validity of interserviceable net requirements and net releasable assets. Deficiencies in asset knowledge serve to inhibit item manager decisions on the release of assets to other service users and/or delay such decisions pending the availability of the latest data.

2. Regarding the *Validity of Requirements and Stratification of Military Stocks*, the study acknowledged that reliable identification of net requirements is precedent to effective interservicing of available excess materiel. One of the more significant deficiencies in the operation of the PLUS Program is the high rate at which offered assets are being rejected by requiring Inventory Control Points of other services.

Discrepancies between acceptable quantities of available assets and reported requirements often arise because of the use of different programs for determining valid requirements and for reporting requirements (often inflated) to be screened under Program PLUS—or difference between the formulas used for reporting requirements and that used in making decisions on the acceptance of materiel which has been offered. In other words, different data is often used in determining requirements reported under the PLUS Program and in determining quantities to be accepted under the program.

For example, requirements or available assets are often reported based on mechanized computations, but acceptance or rejection of subsequent offers of materiel are based on current manual recomputations. Mechanically determined requirements should coincide with manual computations used in accepting or rejecting offered assets.

3. In the section on *Releasable Assets*, the study indicates that Inventory Control Points do not report all releasable assets. Certain service policies preclude the reporting of system-wide releasable assets which are not in the wholesale supply system. The study recommends that interservicing computations for use in Program PLUS include all assets used by the Inventory Control Points in their requirements computations, and that differences between reported asset availability and released assets have an auditable basis.

The study also recommends that (1) the cyclic stratification of stocks, to identify long-supply or excess assets for interservicing under Program PLUS operations, coincide with the periodic computation of requirements, (2) all requirements and releasable assets be reported at the time of semiannual supply management reviews, and (3) all stocks above the procurement objective should be releasable.

4. In the area of *Item Intelligence*, the study establishes that item management data in the master catalog file at the Defense Logistics Services Center is incomplete and therefore all items, whether identified in the file as being used by more than one service or not, must be considered for interservicing.

The study also pointed out that under the present mechanized interservicing system, a presumption is made that interservicing actions are accomplished within specified time frames unless advice to the contrary is received. Consequently, available assets are often incorrectly removed from further consideration under Program PLUS when the results of a potential transfer (that did not occur) is not reported to the Defense Logistics Services Center.

In this connection, it was recommended that positive advice of potential transfer be reported. Further, to provide greater motivation for participation in the PLUS Program, credit under the Cost Reduction Program should be provided to activities releasing assets simultaneously with the establishment of credit for savings accruing to the receiving activity.

5. In an *audit report* issued by the Defense Supply Agency, Auditor General, on 30 June 1966 relative to the PLUS Program, it was indicated that the services

were not providing information to timely and accurately update the PLUS records to facilitate mechanical screening of available assets. Consequently, the effectiveness and efficiency of the program was adversely affected.

In addition, program accomplishments were substantially overstated. It was estimated that reported accomplishments in terms of reutilized materiel was overstated by as much as 75 percent because of incorrect assumptions that potential transfers actually occurred.

As stated earlier, we are identifying in the course of our current work essentially the same problem areas as were identified in the Department of Defense study. Although Defense officials have been aware of the matters discussed in the study for some time now, major improvements in the PLUS Program are not apparent.

We are of the opinion that an improved PLUS Program would contribute significantly towards increased utilization of available assets and would minimize the potential for concurrent buying and selling of similar items in the Department of Defense. We believe that the most significant contribution to program improvement would be the elimination of present asset reporting deficiencies that exclude consideration of world-wide asset data.

MAINTENANCE OF IDLE PRODUCTION EQUIPMENT RESERVES BY GENERAL SERVICES ADMINISTRATION, DEPARTMENT OF DEFENSE, AND NATIONAL AERONAUTICS AND SPACE AGENCY

We inquired into the reserves of idle production equipment maintained by the Department of Defense, the General Services Administration and the National Aeronautics and Space Agency.

The Department of Defense had the following inventories of industrial plant equipment reserves as of December 31, 1965:

[Dollar amounts in thousands]

	Number of pieces of equipment	Assigned values
Idle equipment.....	25, 200	\$280, 210
Laid away in production packages for mobilization requirements.....	41, 151	551, 790
Total.....	66, 351	832, 000

The idle equipment, which is managed by the Defense Industrial Plant Equipment Center, a Department of Defense agency, consists of Department of Defense owned equipment which has been declared excess by its former user and is either awaiting redistribution to another user, is being retained as a reserve to support current Department of Defense production requirements, or is in the process of being disposed of by the Department of Defense.

The items laid away in production packages for mobilization requirements are items of industrial plant equipment maintained for the purpose of producing specific military end items or components at production rates required by mobilization schedules. Each package must be reserved for the use of a specific contractor or Government plant and must be approved by the Department of Defense. The Defense Industrial Plant Equipment Center maintains an inventory of this equipment and its responsibility is primarily one of record-keeping since the owning service has the authority to place items into a package or release items from a package. In the event of a high priority requisition the Defense Industrial Plant Equipment Center may screen the packages and if an item is available, the requestor is notified of the availability and the requestor must proceed to process his request to obtain the item through the Secretary of the owning service.

The General Services Administration is responsible for administering the National Industrial Equipment Reserve. Public Law 883, 80th Congress, cited as the National Industrial Reserve Act of 1948, provided for the establishment of this reserve for immediate use to supply the needs of the armed forces in time of national emergency. The reserve consists of industrial production equipment, primarily metal-working machinery, selected by the Defense Industrial Plant Equip-

ment Center, from lists of such property declared excess to the needs of the Department of Defense and other Government agencies. As of June 30, 1966, the National Industrial Equipment Reserve inventory was valued at about \$86 million, of which about \$17,325,000 was on loan to nonprofit educational institutions and training schools for use in vocational training programs as provided by the law.

A recent study of the management of industrial plant equipment within the Department of Defense, conducted by the Defense Supply Agency with the approval of the Assistant Secretary of Defense (Installation and Logistics) identified the duplicate nature of the National Industrial Equipment Reserve and the reserves maintained by the Department of Defense. The report on this study which was issued in December 1966, pointed out the benefits and cost savings available from the elimination of duplicate management functions and reduction of facilities. It recommended that the Assistant Secretary of Defense (Installations and Logistics) initiate negotiations with the General Services Administration to merge the National Industrial Equipment Reserve with the Department of Defense industrial equipment reserves under Department of Defense management. We intend to follow this subject closely and particularly the action taken on this recommendation.

The National Aeronautics and Space Administration does not maintain any reserve of industrial plant equipment. Government-owned equipment held by contractors awarded contracts by various National Aeronautics and Space Administration centers is declared excess at the time it is no longer needed by that contractor. A list of such equipment is then circulated to the other National Aeronautics and Space Administration centers and if the equipment is not needed it is declared excess and disposed of through the General Services Administration.

REQUISITIONING OF SMALL QUANTITIES OF LOW-VALUE MATERIAL FROM THE DEFENSE SUPPLY AGENCY

Last year we told the Subcommittee that we were looking into the practice of the services ordering small quantities of low-cost material on a repetitive basis. We have since issued a letter report to the Secretary of Defense on the results of our examination at four Defense Supply Agency supply centers—the Construction, Electronics, General, and Industrial Supply Centers.

We estimated on the basis of our review that about 60 percent of the requisitions processed by these four centers during fiscal year 1965 were \$10 or less in amount. About 6.6 million requisitions fell into this category. From information given to us by the military services and the Defense Supply Agency, we estimated that about \$6 per requisition was expended in preparing, processing, and controlling requisitions and in handling material at the support depot and receiving activity.

Our review of requisitioning practices at three installations in each of the military services indicated that this large volume of low value requisitions was due, in large part, to the practice of the services of repetitively requisitioning small quantities of low value items instead of submitting less frequent requests for larger, more economical quantities. We were informed that fund limitations at the user levels have contributed to the lowering of stock levels for Defense Supply Agency material. In the interest of conserving funds, the services limited or reduced their ordering levels which, in turn, prevents the requisitioning of economical quantities.

For example, during an 8-month period, one location submitted 9 requisitions to the Defense Supply Agency for a total of 21 insulators costing 55 cents each, at a total cost of \$11.55. The average amount of the 9 requisitions was only \$1.28. At another location, during a 9-month period, 8 requisitions were submitted to the Defense Supply Agency for a total of 470 bolts costing four cents each, at a total cost of \$18.80. The average amount of the 8 requisitions was only \$2.35.

On the basis of our review, we believe that significant costs are being incurred by the military services and the Defense Supply Agency as a result of repetitive requisitioning of small quantities of low-value material from the Defense Supply Agency. We, therefore, recommended to the Secretary of Defense that he examine into the practices being followed by the military services in requisitioning low-value material from the Defense Supply Agency giving special emphasis to the

allocation of funds to support the ordering of economical quantities of such material.

The Assistant Secretary of Defense (Installations and Logistics) commented on our report in a letter dated April 13, 1967. Regarding the limited funds problem mentioned in our report, it is the position of the Department of Defense that funding has been adequate. However, it was also stated that at times available funds at lower levels have been strained for a variety of reasons. In summary, the Department of Defense is in general agreement with our report, fully supports the economic ordering quantity concept which has been expressed as Department of Defense policy, and has stated it will take additional steps to obtain more complete compliance with that policy.

ACTIVITIES OF THE DEFENSE CONTRACT ADMINISTRATION SERVICES, DEFENSE SUPPLY AGENCY

The Defense Contract Administration Services was established in June 1964, under the Defense Supply Agency, to eliminate duplicate efforts among the various Defense Agencies that were performing contract administration and to establish a single Defense organization as the sole representative in dealing with a contractor. At June 30, 1966, the organization had a Headquarters office and 11 regional offices with a staff of 21,500 personnel providing contract administration for 180,750 contracts at 17,500 contractor plants.

In our survey we observed a number of areas which we believe warrant management attention. Management was aware of some of the problems we noted and corrective action was being taken to achieve improvements.

ASSIGNMENTS OF CONTRACT ADMINISTRATION

Although the Department of Defense has the responsibility for making plant assignments for contract administration services and has established criteria for this purpose, it had not performed periodic reviews to ensure that its criteria had been met.

Under the criteria a military department may be assigned a plant for contract administration responsibility where contracts being performed at the plant are for a major system of such critical military importance that the program manager needs to retain close technical direction. Of the 508 plants assigned to the military departments 48 plants involved contracts for major systems.

In our tests at two of these plants located in Michigan, we found that the Army program managers were not performing the contract administration services but had delegated these functions to other Army components. Under the Department of Defense criteria, these plants should have been assigned to the Defense Contract Administration Services.

Further, under the Department of Defense guidelines, a procuring agency, at its option, may retain certain contract administration functions at plants assigned to the Defense Contract Administration Services. We observed differences and inconsistencies among and within military departments in retaining such functions. We found that a procuring agency in the Chicago area retained administration of contracts with seven contractors that could have been assigned to the Defense Contract Administration Services. At five of the contractors' plants the Defense Contract Administration Services was also performing services for other contracts. At these locations, therefore, two different organizations were responsible for similar contract administration functions.

PAYMENT OF CONTRACTORS' INVOICES AND LOST DISCOUNTS

As of November 30, 1966, the regional offices reported that they had on hand about 85,000 unpaid invoices, which included about 20,000 invoices on hand for 30 days or longer. Our survey at the Philadelphia office indicated that invoices were on hand for 30 days or longer principally because inspection reports evidencing acceptance of supplies had not been received. Other reasons were delays in receipt of contract documents and internal delays in processing invoices for payment.

For the 12-month period ended November 30, 1966, Defense Contract Administration Services regional offices reported lost discounts totaling about \$2.3 million.

We were advised that the Defense Supply Agency internal auditors expected to complete a review of lost discounts at all regional offices by the fall of 1967, and to identify causes and determine whether recommended corrective actions have been taken to minimize lost discounts in the future. On the basis of their findings at one regional office, the lost discounts may be considerably higher than the \$2.3 million reported.

QUALITY ASSURANCE

Our survey of quality assurance activities was performed at the agency's Detroit regional office, having responsibility at about 800 contractors' plants. Generally, the agency relies on selective inspection based on the effectiveness of the contractors' procedures for controlling product quality and tests of the acceptability of supplies and services.

However, at 47 of the plants in the Detroit Region, the procuring officials had imposed specific mandatory inspection requirements and the agency's records indicated that about one-third of all inspection man-hours was expended on these mandatory inspections. Agency inspection personnel considered that certain requirements imposed by the procuring officials could be eliminated. Some of their recommendations have been adopted. It appears that continued evaluations of the need for mandatory inspection requirements and relaxation of such requirements could result in savings in inspection manpower.

DELINQUENT DELIVERIES

The Defense Contract Administration Services' industrial specialists are responsible for analyzing contract performance to anticipate and correct circumstances that may result in delinquent deliveries. As of August 1966, the agency was administering about 17,200 contracts, of over \$5,000 each, which were classified as delinquent because supplies had not been delivered as of the date specified in the contract.

Our survey at the Chicago office, which reported about 2,200 delinquent contracts, indicated that delivery delinquencies may be caused by material and personnel shortages, engineering and quality problems, poor production planning, and unrealistic delivery schedules. Our tests indicated that during 1966 the number of such contracts had increased. As a result the specialists were doing little work to anticipate and head off additional delinquencies and apparently were devoting their main efforts to correcting existing delinquencies.

Furthermore, we found that corrective actions being taken by the industrial specialists were not properly documented so that management could determine whether adequate action had been taken.

TECHNICAL EVALUATIONS OF PRICE PROPOSALS

Technical personnel of the Defense Contract Administration Services and other components of the military departments are requested by contracting officials to evaluate various technical aspects of contractors' price proposals, including the need for types and quantities of material and labor.

We found in our survey of the agency's Chicago office, technical evaluations of contractors' price proposals were not adequately supported by records of work performed and conclusions were not supported in the reports. Similar deficiencies were noted in another review of 101 contracts awarded under the provisions of Public Law 87-653 where technical evaluations were performed by personnel of the military components, as well as the Defense Contract Administration Services. Since the Defense Contract Administration Services plays a major role in performing technical evaluations, it may be feasible to have it establish uniform requirements for these evaluations to be used throughout the Department of Defense.

We recognize that the establishment of a consolidated contract administration agency for the military services is a tremendous undertaking. Much has been accomplished in a relatively short period. However, as indicated by our survey findings, there is a need for improvement in the agency's operations.

USE OF GENERAL ADMINISTRATION SERVICES AS SOURCES OF SUPPLY BY
GOVERNMENT CONTRACTORS

Our reviews of procurement contracts negotiated by the Department of Defense indicates that the Government could realize substantial savings, if contractors engaged primarily in defense contract work had been authorized and required to procure office furniture and common operating supplies through the General Services Administration rather than from more costly commercial sources.

Specifically, in 1965 we reported to the Congress three instances (see note) when the Government should have been able to save as much as \$1.5 million annually, if the two contractors cited in these reports were authorized and required to procure certain office furniture and common operating supplies at prices that were no higher than the prices available to Government agencies for similar items from the General Services Administration.

For several years, these two contractors had been engaged almost exclusively in the design, development, and production of certain weapons and space systems for the Government. Over 98 percent of their work had been performed under numerous cost-reimbursement-type contracts and essentially all the remaining work was performed under other types of negotiated Government contracts. Under these contracts, the contractors had procured, for their own account, significant amounts of office furniture and common operating supplies from commercial sources at prices higher than the prices contained in General Services Administration schedules. The prices paid by the contractors were indirectly charged, through overhead, to Government contract costs.

The Armed Services Procurement Regulation provides for granting authorization for the use of General Services Administration supply sources to contractors performing under individual cost-reimbursement-type contracts. However, although the regulation provides for the use of General Services Administration sources by contractors where items obtained are charged direct to specific cost-reimbursement-type contracts, these sources cannot be used by contractors that have essentially all cost-reimbursement-type work under a number of contracts where the items are not charged direct to individual contracts but are charged to these contracts through overhead.

The Department of Defense has consistently expressed opposition to contractor procurements from General Services Administration sources under fixed-type contracts and for cost-type contracts when the items are to be procured under a number of contracts and charged to Government contract costs through overhead.

The General Services Administration has proposed a change in Federal Procurement Regulations. Under this proposal, contractors and subcontractors would be permitted, subject to conditions and limitations prescribed by the contracting agency, to use the Administration's supply sources where agencies determine it is in the best interest of the Government for contractors to utilize these sources in performing Government cost-reimbursement contracts and other types of contracts when a substantial dollar portion of a contractor's contracts are of a cost-reimbursement nature. The proposed regulation would provide for use of GSA services when items are procured and charged to Government contracts through overhead.

The Department of Defense has recently reconsidered the proposed change and advised us on April 26, 1967, that it would not recommend expanding the use of General Services Administration sources of supply by contractor.

NOTE

B-132992, dated February 9, 1965, entitled Potential Savings Through Procurement of Operating Supplies From General Services Administration Sources by Martin-Marietta Corporation, Denver Division, Denver, Colorado.

B-146975, dated April 30, 1965, entitled Potential Savings Through Procurement of Office Furniture From General Services Administration Sources by Lockheed Missiles & Space Company, Sunnyvale, California.

B-146975, dated May 13, 1965, entitled Potential Savings Through Procurement of Operating Supplies From General Services Administration sources by Lockheed Missiles & Space Company, Sunnyvale, California.

DEFENSE SUPPLY AGENCY MANAGEMENT OF SUPPLY ITEMS HAVING LITTLE OR NO DEMAND

We sent a letter report on March 30, 1967, to the Secretary of Defense advising him of the large volume of inactive and low demand items being managed by the Defense Supply Agency (DSA). In our November 1966 draft report regarding a similar situation in the Navy, we stated that potential savings were available either by elimination from the supply system or transferring those replacement parts that have little or no demand to decentralized management.

We indicated in our recent letter report that almost one-half of the DSA inventory since 1963 has been composed of inactive items—those having no demands within the past 21 months. The observations presented therein were based on a limited survey into the DSA program to eliminate items with no demand from its supply system. Under this program the Defense Supply Centers refer inactive items to military users, who either advise that they have no further need for the item(s) or verify that a continuing requirement exists.

Our work disclosed that although some form of inactive item review program has been in existence in the Defense Supply Agency since 1963, the number of inactive items centrally managed by this Agency ranged from 44 to 56 percent of the total inventory. We believe the principal cause for the slow progress is that military users often lack the technical capability to determine whether an item should be deleted or retained. In this connection, for example, the Air Force is returning all referrals coded for retention, as are certain activities of the Army. It is our opinion that, until the military services are fully capable of performing an adequate review of items referred by DSA Centers, little if any progress will be made in eliminating inactive items from the DSA supply system.

In addition to the problem of managing volumes of inactive items, DSA also manages thousands of low unit value/low demand type items. According to DSA reports for fiscal year 1966, over 390,000 items, or 56 percent, of the total active items managed by the four Defense Supply Centers, had a unit price of \$10 or less and an annual cumulative demand of \$100 or less.

The total demand value for the 390,000 active items amounted to \$9.6 million which is less than one percent of the total demand value for all items managed by Defense Supply Centers. It is evident that after DSA was established as the integrated manager for common usage items, it acquired many low unit value and low demand type items from the military services, as reported by the Assistant Secretary of Defense (Installations and Logistics) in the "Study of the Interface Between the Military Services and the Defense Supply Agency."

The DSA is currently preparing to introduce a completely new management system (Standard Automated Material Management System). The cost of procuring and installing new-data processing equipment for this type is approximately \$25 million. DSA informed us that the requirements for the new system are predicated on the present inventory stratification and no program is planned to expedite the elimination of inactive or slow moving items prior to the implementation of the new standard management system. The primary purpose for this new management system, according to DSA, is to provide uniformity in Supply Center operations and provide a basis for future improvements and growth in agency operations.

In commenting on our earlier Navy report of November 23, 1966, on inactive and low-demand items, Department of Defense officials advised us that, while they agree that inactive items should be eliminated from the supply systems when there is evidence of no future needs, they are of the opinion that the Item Entry Control Program, the Standardization Program, as well as the Inactive Item Review Program, are capable of reducing the number of items in the supply systems. While we believe that these programs will, in future years, lead to more effective controls over the number and types of items required to be managed, it is our opinion that more aggressive action is required to eliminate inactive items from the system until such a time the cited programs attain full effectiveness.

In this connection, we suggested that the Secretary of Defense consider granting the Defense Supply Agency reasonable discretionary authority to take unilateral action to delete inactive items without referral to the services. Although this approach could result in some subsequent reactivations, we believe that the advantages to be gained by reducing the volume of inactive items will more than offset the costs involved in reactivating some items.

With respect to the high percentage of low-cost, low-demand items in the Defense Supply Agency inventory, we believe some alternatives to the need to continue the present degree of centralized management of these items, even on an automated basis, should be studied by the Department of Defense.

POTENTIAL SAVINGS BY CONSOLIDATION OF FIELD ORGANIZATIONS AND FACILITIES FOR RECRUITING MILITARY PERSONNEL

In a report to the Congress in June 1966, we pointed out that the four military services were maintaining separate field recruiting organizations and facilities substantially in excess of their combined needs. We recommended that the Secretary of Defense direct that a field test of consolidation of military recruiting organizations and facilities be undertaken and completed as expeditiously as feasible.

On February 28, 1966, we were advised that action had been taken to have the 70 Armed Forces Examining and Entrance Stations conduct mental tests and physical examinations of all categories of personnel for all the military services and to have these stations also process qualified applicants into all the services. We were also advised that the Army had undertaken a reorganization of its recruitment function, the first phase of which resulted in some reductions in recruiting organizations and facilities, and that further consolidations were under consideration.

The Department of Defense agreed with our recommendation for conducting a field test of consolidations to the extent only that it refers to co-location of local recruiting offices in jointly occupied space and to consolidation of certain administrative, support and logistical functions where feasible and economical.

On September 26, 1966, the Department of Defense issued DOD Directive 5160.58 establishing uniform DOD policies and procedures for providing adequate space for use by recruiting offices and stations and for co-locating such facilities to the maximum extent practicable. In this connection, the Secretary of the Army was designated as Executive Agent for real property management connected with the acquisition, disposal and maintenance of space needed for recruiting offices and stations. By memorandum dated November 19, 1966, the Department of the Army, as Executive Agent, was requested by the Assistant Secretary of Defense (Manpower) to initiate facility surveys in 14 metropolitan areas for the purposes of establishing reasonable target dates for accomplishing the proposed co-locations which were identified as a result of the four Services reevaluating their recruiting office requirements. (The Services have tentatively proposed to reduce the number of locations in 14 metropolitan areas from 524 to 198.)

On December 1, 1966, the Secretary of the Army re-delegated its authority to the Chief of Engineers who is now designated the Executive Agent for recruiting facilities. In this connection, the Chief of Engineers issued implementing procedures and instructions to the Services and plans to report the results of its surveys, including reasonable target dates for accomplishing the proposed co-locations, by early May 1967.

OPPORTUNITIES FOR SAVINGS IN CONTRACTING FOR THE PRINTING OF TECHNICAL MANUALS AND IN OTHER ASPECTS OF THE MANAGEMENT OF TECHNICAL MANUALS IN THE DEPARTMENT OF DEFENSE

A report on our review regarding the opportunity for savings by the Department of Defense in the procurement of the printing of technical manuals was released to the Congress in November 1966. This review was made in cooperation with the Joint Committee on Printing which had requested that we examine the practices followed by the military departments in the procurement of printing.

On the basis of the review we concluded that in most cases the military departments can achieve significant savings by contracting for the printing of technical manuals with commercial printers under formally advertised contracts awarded by the Government Printing Office in lieu of procuring such printing from the manufacturers of the equipment to which the manuals relate. Based on our limited tests, we estimate that this savings could have amounted to about \$8 million for fiscal year 1964.

In April 1967 a report on our survey of the management of technical manuals within the Department of Defense was made to the Joint Committee on Printing and to the Subcommittee on Department of Defense, House Committee on Appropriations.

Our survey indicated that savings might be realized by single-service management of identical manuals that are used by two or more services. For designated items of equipment used by more than one military service, procurement responsibility has been assigned to one service. However, each service is responsible for the printing and distribution of its own technical manuals. For example, where an identical manual is required by both the Navy and the Air Force, the service responsible for procurement of the equipment purchases two sets of negatives—one set for each service. Then each service independent of the other incurs costs for the printing of its own technical manual requirements. As a result duplicate costs are incurred for negatives and for preparation of presses for two separate printing runs. We concluded that, in those situations where identical manuals are used by more than one service, the assignment of management responsibility to one service should be considered.

Our survey also indicated that savings might be realized by: considering the effect that reductions in requirements for technical manuals have on the prices established under negotiated contracts; eliminating duplicate numbering systems; increasing the use of less expensive certified mail in lieu of registered mail to transmit technical manuals classified as "confidential" within the continental United States; and increasing interservice liaison so that all the services will be currently informed of joint-usage manuals that are considered obsolete by any one service before disposal action is authorized.

We are working very closely with the Joint Committee on Printing in its efforts to achieve broader coordination and economy in the total printing effort of the Federal Government.

MILITARY FACILITIES AND CONSTRUCTION

Last year we established within our Defense Division a Facilities and Construction staff which is responsible for the accounting, auditing, and investigative work of the General Accounting Office involving real property in the Department of Defense, including the Departments of the Army, Navy and Air Force. These responsibilities include, but are not necessarily limited to, operation, management, maintenance and construction of facilities, barracks, quarters and family housing. In addition, the staff is responsible for reviews of award and administration of contracts for construction, management or maintenance of facilities; acquisition and utilization of real property; research into improvement of construction and facilities management practices; disposal of facilities and real property; and other matters involving facilities for training, communication, medical, reserve and active duty forces; and financial accountability for such real property.

Among the areas to which the efforts of this functional staff are being directed is the area of possible savings from joint utilization of common-type facilities by the military services or consolidation of activities relating to maintenance and construction of facilities.

Military contracts for construction are executed under the jurisdiction and supervision of the Corps of Engineers, Department of the Army, or the Naval Facilities Engineering Command, Department of the Navy, unless the Secretary of Defense or his designee determines that, because such jurisdiction and supervision is wholly impracticable, such contracts should be executed under the jurisdiction and supervision of another department or Government agency. These two agencies generally act as the construction agents for the Department of Defense except for construction of Department of the Air Force family housing in which case the Air Force acts as its own construction agency.

With regard to interservice use of facilities, none of our work has reached a stage of firm conclusions. Some of the specific matters that we are looking into or planning to look into in the near future are:

1. The management and operation of motion picture and photographic activities. The study among other things will cover the feasibility of improved efficiency by more joint utilization of facilities, and consolidation and interservice coordination of the activities.

2. The feasibility and economy of establishing a defense, or single service, public works center on Oahu, Hawaii, that would provide maintenance type services to installations of all the military departments. The Navy has consolidated a number of its installation maintenance activities at various locations into public works centers and claims the consolidations have resulted in substantial savings. Under this program a public works center was established in Oahu. There are, however, a number of Army and Air Force installations on the same island that are maintaining their own maintenance activities.

3. The construction of military hospitals and medical facilities. A major aspect to be reviewed in this survey will be whether in the requirements determinations maximum consideration is given to interservice use of the facilities.

4. The policies and procedures used in determining the requirements for family housing, bachelor officer quarters and barracks. There appear to be indications of a need for better coordination within and among the services, particularly in geographical areas of military concentration. Improved coordination should result in a better identification of common needs and combined existing facilities to meet such needs.

5. The validity of the need for training and other facilities included in recent military construction programs (particularly from the viewpoint of maximum interservice utilization).

6. The pricing of recently awarded military construction contracts and modifications.

7. Construction aspects pertaining to the move of United States forces out of France. Over \$100 million of new military construction is planned in Europe largely as a result of this move. We are planning to review the proposed construction projects to determine (1) whether all existing facilities have been considered for possible use, (2) whether stocks have been properly screened to eliminate any excesses and thus reduce storage facility requirements, and (3) the adequacy of the contracting procedures.

In the near future, we are planning to issue a report to the Congress on the compliance with Public Law 87-653 and implementing regulations in the negotiation of military construction contracts and modifications. This is our third report in 1967 informing the Congress of various specific steps that need to be taken in the Department of Defense in order to fulfill the purposes of Public Law 87-653, the "Truth-in-Negotiations" Act of 1962. This report concerns our review of 237 contract actions negotiated since November 1964 and totaling about \$128 million.

GOVERNMENT-WIDE REVIEW OF THE ADMINISTRATION OF CERTAIN STATUTORY AND REGULATORY REQUIREMENTS RELATING TO ARCHITECT-ENGINEER FEES

Our review of the interpretations and applications by Federal agencies of the statutory 6-percent fee limitations on architect-engineer fees under Government contracts and of certain related statutory and regulatory requirements was made in response to the request of the House Committee on Science and Astronautics and the Senate Committee on Aeronautical and Space Sciences.

We found that the major construction agencies contracted for architect-engineer services at fees in excess of the statutory provisions which limit the fees payable to architect-engineers to 6 percent of the estimated cost of construction. Generally, agencies interpreted the limitation as applying only to that portion of the total fee relating to the production and delivery of designs, plans, drawings, and specifications. Under this interpretation, most of the architect-engineer contracts under which the total fee exceeded 6 percent would be in compliance with the limitation. However, in our opinion, the military procurement statute and the Federal Property and Administrative Services Act of 1949 impose the 6-percent fee limitation on all architect-engineer services.

In our opinion, the present statutory fee limitation is impractical and unsound, and we recommended that the Congress repeal the 6-percent limitation imposed on architect-engineer fees by the United States Code (10 U.S.C. 2306(d), 4540, 7212, and 9540) and by section 304(b) of the Federal Property and Administrative Services Act of 1949, as amended (41 U.S.C. 254(b)). Representatives of the Federal agencies, the architectural-engineering professional societies, and the Bureau of the Budget advised us that they agree with this recommendation.

During our review, we examined into whether the agencies were requiring architect-engineer contractors to submit cost or pricing data prior to the award

of negotiated contracts as required by Public Law 87-653 which applies to the Department of Defense, the National Aeronautics and Space Administration, and the Coast Guard and by the Federal Procurement Regulations which apply to the remaining Federal agencies. Although the Federal Property and Administrative Services Act of 1949 has not been amended to require cost or pricing data, the General Services Administration has included a requirement for furnishing such data in the Federal Procurement Regulations similar to the requirement in Public Law 87-653. The General Services Administration determined, however, that the requirement should not be applied to architect-engineer contracts because of their special characteristics.

Representatives of the Department of Defense advised us that the cost or pricing data requirements of Public Law 87-653 are being applied without distinction as to whether or not architect-engineer services are involved. A representative of the General Services Administration advised us that consideration will be given to revising the Federal Procurement Regulations to provide for such application. We believe that cost or pricing data should be required by all agencies in contracting for architect-engineer services. The Bureau of the Budget advised us informally that it agrees with our views in the matter.

We also examined into the requirement of Public Law 87-653 that, in all negotiated procurements in excess of \$2,500, proposals be solicited from the maximum number of qualified sources consistent with the nature and requirements of the supplies or services to be procured and that discussions be conducted with all responsible offerors whose proposals are within a competitive range, price and other factors considered. The General Services Administration has included a similar requirement in the Federal Procurement Regulations. Although most of the construction agencies of the Government are subject to this requirement, they generally solicit a proposal only from the architect-engineer firm selected on the basis of technical ability. In our opinion, this negotiation procedure does not comply with the above statutory requirement.

Agency representatives advised us that they are opposed to the concept of soliciting multiple competitive proposals. The Department of Defense advised us that it believes that its present architect-engineer selection procedures constitute the maximum competition consistent with the nature and requirements of the services being procured. The Department of Defense also stated that, until the architect-engineer community demonstrates that it is prepared to countenance competition on price as well as on other factors, the Department, believing that it is complying with Public Law 87-653, would intend to proceed as before.

Representatives of the architect-engineer professional societies advised us of their belief that the legislative history of Public Law 87-653 constitutes substantial ground for concluding that the competitive negotiation requirements of the act were not intended to apply to architect-engineer services.

We find no present statutory basis which would exempt architect-engineer contracts from these requirements. Therefore, we are of the opinion that the present negotiation procedures and practices do not conform with these requirements. Recognizing, however, that the problem of how architect-engineer services can best be obtained is a complex one, we have advised the agencies that present procedures may be followed until the Congress has had an opportunity to consider the matter.

Although we are of the opinion that the procurement of architect-engineer services is and should be subject to the competitive negotiation requirements of Public Law 87-653, we think that, in view of past administrative practices in the procurement of such services, it is important that the Congress clarify its intent as to whether the competitive negotiation requirements of the law are to apply to such procurements. Should the Congress determine that it is not so intended, we believe that the law should be amended to specifically provide for an exemption for this type of procurement.

Absent a clarification of congressional intent, we are of the opinion that the Department of Defense should appropriately revise the Armed Services Procurement Regulation to reflect a proper implementation of Public Law 87-653. Also, we are of the view that the General Services Administration should similarly revise the Federal Procurement Regulations so as to ensure uniform procedures with reference to the procurement of architect-engineer services.

Further, we examined into the methods employed by Federal agencies to compute an estimate of the architect-engineer fee for purposes of negotiation. The most commonly used methods are the detailed analysis method and the

percentage-of-estimated-construction-cost method. We believe, however, that the detailed analysis method is more appropriate and should be used by all agencies in lieu of the percentage-of-estimated-construction-cost method.

AUTOMATIC DATA PROCESSING

The Federal Government has been in the forefront of computer technology since its beginning and is the world's largest user of computers. Current expenditures for Government ADP activities are estimated to be running at a rate of about \$3 billion annually.

The billions of dollars already invested in this field by the Government for the development and use of this equipment have led to the widespread use of computers and computer-related equipment, including data communication systems throughout the Government and industry. Almost all disciplines, and certainly almost all large-scale data-handling activities of the Government, have been affected to some extent so far. The future portends even greater impact through new developments and the wedding of computers and communication systems in advanced systems. The uses of computers range across the spectrum of all disciplines from education to medical research and from routine data-handling to scientific decisionmaking.

Because of the high costs involved, the extent and significance of this development, and its impact on Federal Government activities, we have, from time to time, reported to the Congress on Government-wide developments in this field. Currently, we are conducting Government-wide studies of present and planned uses of ADP systems in the Federal Government with particular emphasis on compatibility and standardization of such systems and equipment, including related communication facilities. These studies include further inquiry into the trend and development, use, and cost of ADP systems in relation to flow of data and information within Government systems and between Government and industry systems.

One of our studies that is nearing completion involves consideration of the various concepts under which computer systems are being utilized. We are concentrating, in this study, on the use of third-generation computers in relation to what has come to be known as the "public utility concept" wherein multiple users time-share equipment through the use of communication facilities. We are also considering, in this study, various possibilities for increased sharing of computer resources. For example, we are looking into various possibilities for sharing through use of service centers or other arrangements which would provide for increased utilization of computer resources already acquired.

Our studies are also directed at such questions as how to achieve greater interchange of data automatically between ADP systems and how to reduce duplication of effort in the development and use of ADP systems.

In our statement before the Subcommittee last year, we pointed out that significant economies were being achieved because of the increased emphasis being placed on purchasing rather than leasing of ADP equipment in Government agencies.

The Bureau of the Budget has estimated that over 50 percent of currently installed equipment is now owned by the Government and in its February 23, 1967, report to the President on computer management in the Federal Government the Bureau reported the avoidance of approximately \$200 million in annual rental costs by the selective purchase of computers, many of which were purchased within the past 3 years and have already been amortized.

As we pointed out during the hearings last year, we believe also that substantial savings can be achieved through purchasing rather than leasing of ADP equipment by Government contractors. The Bureau of the Budget has informed us that it considers that the criteria set forth in its Circular No. A-54 of October 14, 1961, prescribing conditions under which determinations are to be made by Government agencies as to whether to buy or rent ADP equipment, also should be applied to cost-reimbursement-type contracts.

Subsequently, on March 24, 1967, the Department of Defense issued its Defense Procurement Circular No. 52 which contains a revision to the Armed Services Procurement Regulation which provides new policy and procedural guidance on the acquisition of ADP equipment by Department of Defense contractors.

Previously, in commenting to the Department of Defense on the proposed revision to the Armed Services Procurement Regulation, we expressed certain

reservations regarding the limiting coverage provided by the proposed regulation and suggested that the provisions of the regulation should be broadened to cover a wider range of contractor ADP acquisition activities. However, until we have had an opportunity to review the system in actual operation, we will not be in a position to determine the effectiveness of the regulation.

We intend to continue our efforts to review the need, application, and utilization of ADP equipment by Federal departments and agencies and we will keep the Committee advised of our studies in this area.

MODIFICATION OF AGENCY ACTIVITIES TO MEET NEEDS OF OTHER AGENCIES

Report on review of long-term medical research on aging of aviation personnel (B-158515; April 12, 1966)

We reviewed a long-term project for medical research on the aging of aviation personnel, which was being financed by the Federal Aviation Agency.

The objective of the Federal Aviation Agency's efforts in this 25-year research project was to develop methods for measuring the physiologic age, as distinguished from the chronologic age, of aviation personnel. The Public Health Service, Department of Health, Education, and Welfare, also was supporting a project through a research grant to learn more about the process of physiological aging and its progress in relation to chronological age. The latter project was using pilots as a study group and was expected by the grantee to continue for a total of 30 years. The projects, which were being funded at annual rates totaling about \$365,000, would have cost the Government \$9.7 million (\$5 million for the Federal Aviation Agency and \$4.7 million for the Public Health Service) if financed to completion.

In our opinion, the need for the Federal Aviation Agency to undertake a separate long-term project on the aging of pilots and other aviation personnel was questionable because (1) the general objectives of each project are similar and each project is based on the same planning study and (2) the information being developed under the Public Health Service-supported research project could, it seems, have been adapted to meet the objectives of the project which the Federal Aviation Agency had recently initiated.

In 1960 the Federal Aviation Agency awarded a contract to the Lovelace Foundation for Medical Education and Research, Albuquerque, New Mexico, for a research planning study of aging criteria. The Lovelace Foundation advised the Agency that an extensive planning study was necessary before any long-term project on aging could be effectively initiated. Prior to the award of the contract, the Subcommittee on Independent Offices of the Committee on Appropriations, House of Representatives, expressed concern that the Federal Aviation Agency was about to undertake research in an area already being studied by the Public Health Service and by other Government agencies. The Agency informed the subcommittee that, to its knowledge, neither the Public Health Service nor any other research group was conducting research on aging related to the task of piloting. Subsequently, the Agency learned that the Foundation intended to apply to the Public Health Service for a grant to support a long-term project on the aging of pilots. However, the Agency proceeded to make the first examinations in its long-term aging project.

We concluded that, upon being advised of the Foundation's intention to apply to the Public Health Service for a grant to conduct long-term research on the aging of pilots, the Federal Aviation Agency could have formally communicated with the Service and the Foundation to determine whether one long-term project could be devised to meet the needs of both agencies.

In commenting on our findings, the Agency acknowledged that there were no formal procedures for coordinating research between it and the Public Health Service and advised us that it would establish such procedures for coordinating new research projects.

Subsequent to the issuance of our report on this matter, the Federal Aviation Agency discontinued its research project. This action will save an estimated \$3.8 million.

Report on review of geodetic surveying activities within the Federal Government (B-113188; January 25, 1967)

We made a review of the geodetic surveying activities of selected agencies of the Federal Government.

Geodetic surveys are basically land surveys made for the purpose of determining the precise position of specific points on the earth's surface in terms of

latitude, longitude, and elevation. Once the positions are identified and monuments are established to mark the positions, the area is considered to be under geodetic control. Our report concerned primarily horizontal control which identifies positions of known latitude and longitude. The Environmental Science Administration, Department of Commerce, has the responsibility for establishing a nationwide network of geodetic control points, and the Bureau of the Budget has the responsibility for coordinating geodetic surveying activities in the Federal Government.

Other Federal agencies—including the Geological Survey, Department of the Interior, in its national mapping program and the Bureau of Public Roads, Department of Commerce, in its highway programs—also establish geodetic control points. These geodetic control points generally are established, however, only to standards required for individual program needs and, for the most part, do not meet the standards of accuracy required to extend the national network. Consequently, the Environmental Science Services Administration plans to resurvey most of the same areas to establish geodetic control points that will meet the standards of the national network.

We believe that, if the initial surveys could be made to national network standards, substantial savings in effort and cost would result, because it would not be necessary for the Environmental Science Services Administration to resurvey the same areas. On the basis of data available during our review, we estimated that past or planned expenditures for geodetic surveys which would not contribute to the national network of geodetic control by the Bureau of Public Roads under its highway programs would total about \$30 million and by the Geological Survey under the topographic map program would total about \$15 million.

The Bureau of the Budget, in June 1966, agreed that it should continue to press for improved coordination and efficiency in the conduct of the Government's Geodetic control activities but doubted that it was either desirable or possible to ensure that all geodetic control work would extend the national network. Subsequently, in September 1966, the Bureau of the Budget advised us that the Geological Survey and the Environmental Science Services Administration had entered into an agreement whereby horizontal geodetic control to national network standards would be achieved as a part of the Geological Survey's topographic map program.

The agreement provides that, where other requirements are equal, preference in the authorization of mapping will be given to an area which has been basically controlled over an area which does not contain basic control. The Geological Survey will continue to advise the Environmental Science Services Administration of its mapping plans so that it may accomplish as much of the basic control as possible. In situations where a portion of a large uncontrolled area must be mapped, however, the Geological Survey will establish horizontal control to national network standards, with proper connections to existing control points.

We believe that this agreement is an important step in the right direction. In our opinion, however, a more economical arrangement may be possible by requiring Geological Survey to perform all the basic control required for those areas which are presently uncontrolled and which it plans to map under its current mapping program. Such an arrangement would result in only one field operation by the Geological Survey, whereas, if the Environmental Science Services Administration performs the control prior to the time the Geological Survey does its mapping, two field operations would be required—one by the Environmental Science Services Administration to establish the control and one by the Geological Survey to identify and utilize the control for mapping purposes.

The various agencies, in commenting on this matter, did not indicate that any specific action would be taken to improve the coordination of the geodetic surveying activities of the Bureau of Public Roads and other Federal agencies with those of the Environmental Science Services Administration. In our opinion, geodetic control surveys should be performed to national network standards whenever such surveys are performed in an area where they will fit into the overall nationwide geodetic control plan and whenever such control would eliminate the need for the Environmental Science Services Administration to resurvey the same area.

Accordingly, we recommended that the Director, Bureau of the Budget, determine whether the geodetic surveying activities conducted by Federal agencies

and under programs administered by Federal agencies are of such a nature and scope that it would be economically feasible to have such surveys, when undertaken in uncontrolled areas, performed to standards which would extend the national network of geodetic control. This recommendation contemplated that the Environmental Science Services Administration will continue to provide for the direction and coordination necessary for establishment of a national network of geodetic control and that consideration will be given to having it fund the additional costs incurred by other Federal agencies to bring their surveys up to the national network standards.

Chairman PROXMIRE. Thank you. We have many questions, and we will be with you with those questions in just a short time.

NAVAL ACADEMY DAIRY FARM

Chairman PROXMIRE. We are honored this morning to also have Congressman Mathias as a witness. In order to accommodate Congressman Mathias, since he is going to speak on a subject very dear to the heart of the chairman—he is speaking on the dairy industry—I'm going to ask him to make a short statement about the dairy farm which the Navy operates in the State of Maryland.

The Comptroller General has been requested to give us his views, as you know, on this subject. (See p. 16.)

The subcommittee's interest in the dairy are twofold: One, as a business activity under the President's policy; and, two, as a piece of Federal real property, which, among many others, should be objectively screened to determine if its retention by the Government can be justified.

I understand that other committees are studying other aspects of this case in great detail.

Congressman Mathias, you may begin.

STATEMENT OF HON. CHARLES McC. MATHIAS, JR., A REPRESENTATIVE IN CONGRESS FROM THE SIXTH CONGRESSIONAL DISTRICT OF MARYLAND

Representative MATHIAS. Thank you very much, Mr. Chairman.

I appreciate the opportunity to appear before you and the other members of the committee. I hope the Comptroller General won't mind if I interrupt his train of thought since I know he and I are in complete agreement on the subject of the Naval Academy Dairy Farm.

After listening to the Comptroller General's testimony and the broad range and magnitude of the topics that he has discussed, I am somewhat diffident about bringing up one small case of Government competition with private enterprise, but it is such a classic case that I think it does deserve a few moments' discussion.

I have a prepared statement and I ask unanimous consent that it might be made a part of the record.

Chairman PROXMIRE. Without objection it will be printed in full.

Representative MATHIAS. I say it is a classic case because the Naval Academy Dairy Farm is one of those instances in which the Government should have gone into what is normally a proprietary enterprise at the time that it did.

But now the Government ought to get out of the business because there is no longer any need for it. The Naval Academy established the

dairy farm in about 1911 at a time when there was not an adequate supply of healthy milk, of clean, sanitary milk in the vicinity of Annapolis. There was no way that they could commercially acquire the volume of milk that they needed for the midshipmen.

Today, of course, we have, with due deference to the chairman's views on this subject, I think we have the finest quality milk in the world in Maryland.

Chairman PROXMIRE. The second finest.

[Laughter.]

Representative MATHIAS. In the Maryland milkshed we have adequate quantities. About 35 percent of our area milk production goes into surplus in, say, a typical month such as June of last year. We can supply at competitive prices all of the milk the Naval Academy wants.

But, perhaps most significantly, and it is a matter of principle, for every hundredweight of milk that is produced at the Naval Academy Dairy Farm, some farmers have a hundredweight of milk go into surplus, and they receive less than a break-even price for the milk.

So, I think this is a case where there is no longer a need for the Government to continue in competition with taxpaying free enterprise farmers.

The Comptroller General has adequately confirmed that there will be a saving to the Government if we get out of private business in this particular case. I think that the land may very well have a reasonable Government use in the future. But whether you use it for another Government use or whether you sell it, there is a saving because you are not having to go out and buy something else for a Government facility that may be established in that area.

So, I think that by all odds the time has come to close the Naval Academy Dairy Farm. It has been a good neighbor and a good friend to Maryland farmers. It has provided needed leadership in farm management and leadership in stock raising. But all of these things do not justify the continued violation of the principle of Government competition of free enterprise.

(The prepared statement of Representative Mathias follows:)

PREPARED STATEMENT OF REPRESENTATIVE CHARLES McC.
MATHIAS, JR.

Mr. Chairman, I appreciate this chance to participate in your inquiry into government business and procurement operations, and particularly the chance to discuss with you the case for closing the Naval Academy Dairy Farm at Gambrills, Maryland.

In my judgment, the Naval Academy Dairy Farm is a relatively small example of the general tendency to continue operations long after they have outlived the conditions which prompted them. Establishment of a dairy farm to serve the midshipmen at Annapolis may have been necessary in 1911, when a consistent supply of healthy, high-quality milk could not be assured through commercial channels. But in 1967, when the Maryland dairy industry has assumed a high position in the Nation, and actually produces far more milk each year than the commercial market can absorb, the Dairy Farm is a Government operation in direct competition with tax-paying private enterprise, and should be closed as soon as an orderly liquidation can be accomplished.

Mr. Chairman, the Federal Government's general policy of reliance on private enterprise to furnish needed goods and services has been reiterated within the past year by the President (in a memorandum of March 3, 1966, to heads of Departments and Agencies), by the Bureau of the Budget (in BoB Circular A-76, March 3, 1966), and by the Department of Defense (in DoD Directive

4100.15, July 9, 1966, and DoD Instruction 4100.33, July 22, 1966). These documents emphasize the Government's intention to procure goods and services from private sources except in certain unusual cases where government-operated enterprises are essential to maintain programs or reduce costs substantially. I submit that the continued operation of a dairy farm is directly contrary to the thrust of these policy statements.

First, it is obvious that the dairy products required by the Naval Academy can be procured from commercial sources. The dairy farmers of Maryland are ready and willing to provide the high-quality milk and other products for the midshipmen's mess. In this regard, I might point out that no other military installation in this country, including both the Military Academy and the Air Force Academy, deems it unwise or unduly expensive to purchase dairy products from commercial sources, and certainly the Maryland dairy industry is at least comparable in quality to that of New York or Colorado.

Second, the report of the General Accounting Office (Report B-156167, submitted March 23, 1966) establishes that "potential savings would accrue to the Government if the Dairy Farm was sold and the milk and milk products were purchased by the Naval Academy from commercial concerns." (pp. 12-13.) Since this report is available to the subcommittee, and since representatives of the GAO are scheduled to testify, I would like to discuss briefly only two aspects of this question of comparative costs.¹

(A) Some individuals have asserted that the GAO's conclusions are not accurate, since the Proceeds from sale of the Dairy Farm's assets might accrue to the Midshipmen's Store rather than to the Treasury. I would only point out in this regard that, if these funds were assigned to that special account, they would be available to benefit the midshipmen and thus would offer potential advantages which, while they may not be precisely calculable, should not be considered unsubstantial.

(B) Others have asserted that the GAO's conclusions would not be relevant if the Dairy Farm property were not offered for sale, but rather was converted to some other public use. But obviously if this was the case, the taxpayers would be saved the cost of purchasing other property for that purpose.

Mr. Chairman, it is not my intent to remove the Federal presence from Anne Arundel County. I would like, however, to see the Dairy Farm acreage converted to public purposes which do not conflict with the operations of private enterprise. Certainly there are other Federal operations which could be located at Gambrills, and which could bring even greater direct and indirect economic benefits to the area. Certainly, too, the tremendous growth of Anne Arundel County makes preservation of open space, in public ownership and for public enjoyment, extremely important. I am convinced that appropriate uses of the Dairy Farm property can be assured, through full and frank discussions between the Department of the Navy and the officials of the County, so that the eventual disposition of the land will be in the best interests of all concerned.

I am convinced, above all, that it is time to get the government out of the dairy business. While the amount of milk produced by the Naval Academy Dairy Farm is relatively small, the fact remains that the dairy farms of Maryland are being denied this market. For every hundredweight of milk produced at the Dairy Farm, a hundredweight of privately-produced milk is being driven into surplus. This situation seems especially incongruous at a time when the Department of Agriculture is expending billions every year to try to uphold farm prices and expand agricultural markets. The current situation is, in short, absurd in principle and unconstructive in practice.

In conclusion, Mr. Chairman, closing the Naval Academy Dairy Farm will be clear evidence that the Federal Government intends to bring a bit more order and consistency into its operations, and intends to minimize Government competition with private enterprise. Continuing the farm would be a victory only for inertia, and a clear loss for American taxpayers and the Maryland dairy industry. But closing the Farm, and converting the property to other uses in an orderly and perceptive way, would bring great benefits to the taxpayers, Maryland's dairy farmers, and the people of the area concerned. I trust that this subcommittee will join me and many others in urging the Department of the Navy to begin phasing out the Farm without further delay.

¹ See staff study, 1967, p. 189.

Chairman PROXMIRE. Thank you very much, Congressman Mathias. You certainly make a strong case.

Anything else?

Congressman CURTIS, you have questions for Congressman Mathias?

Representative CURTIS. I am very pleased to have Congressman Mathias bring this matter to our attention because one of the basic matters this committee has been looking into over a period of years is this question of Government in business. Involved here is the utilization of real estate by the Federal Government. When the Federal Government takes it, it withdraws that real estate from the local tax base which finances schools and community facilities.

But I would like to broaden this just a bit. A similar situation, only on a grand scale, has been going on in the Canal Zone since we acquired it in 1904.

Now, maybe many of those business-type operations at their inception were necessary, as was apparently the case here. But if you leave the Military Establishment alone they would be running all the farms, because they want to be sure of quality control.

This becomes significant in the Canal Zone as it relates to our relationship to the less-developed countries.

The only reason I emphasize this point here is that it is through these specific examples, such as Congressman Mathias gives us, that this committee can gain understanding of what overall Government policies are.

BUDGET BUREAU CIRCULAR NO. A-76

I would like to have the attention of the committee counsel so I will be right on this. We have presently pending in the Bureau of the Budget a review of the Circular A-76 which sets out these standards that the Federal Government is supposed to follow in respect to commercial enterprises.

We have asked the GAO from time to time to comment on this. What is the status right now, as far as you know in your comments on the Circular A-76, which would pertain to the subject that Mr. Mathias has raised?

(Budget Bureau Circular No. A-76 follows:)

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., March 3, 1966.

CIRCULAR NO. A-76

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

Subject: Policies for acquiring commercial or industrial products and services for Government use.

1. *Purpose.*—This Circular replaces the statement of policy which was set forth in Bureau of the Budget Bulletin No. 60-2 dated September 21, 1959. It restates the guidelines and procedures to be applied by executive agencies in determining whether commercial and industrial products and services used by the Government are to be provided by private suppliers or by the Government itself. It is issued pursuant to the President's memorandum of March 3, 1966, to the heads of departments and agencies.

2. *Policy.*—The guidelines in this Circular are in furtherance of the Government's general policy of relying on the private enterprise system to supply its needs.

In some instances, however, it is in the national interest for the Government to provide directly the products and services it uses. These circumstances are set forth in paragraph 5 of this Circular.

No executive agency will initiate a "new start" or continue the operation of an existing "Government commercial or industrial activity" except as specifically required by law or as provided in this Circular.

3. Definitions.—For purposes of this Circular:

a. A "*new start*" is a newly established Government commercial or industrial activity or a reactivation, expansion, modernization or replacement of such an activity involving additional capital investment of \$25,000 or more or additional annual costs of production of \$50,000 or more. Consolidation of two or more activities without increasing the overall total amount of products or services provided is not a "new start."

b. A *Government commercial or industrial activity* is one which is operated and managed by an executive agency and which provides for the Government's own use a product or service that is obtainable from a private source.

c. A *private commercial source* is a private business concern which provides a commercial or industrial product or service required by agencies and which is located in the United States, its territories and possessions, the District of Columbia, or the Commonwealth of Puerto Rico.

4. *Scope.*—This Circular is applicable to commercial and industrial products and services used by executive agencies, except that it

a. Will not be used as authority to enter into contracts if such authority does not otherwise exist nor will it be used to justify departure from any law or regulation, including regulations of the Civil Service Commission or other appropriate authority, nor will it be used for the purpose of avoiding established salary or personnel limitations.

b. Does not alter the existing requirement that executive agencies will perform for themselves those basic functions of management which they must perform in order to retain essential control over the conduct of their programs. These functions include selection and direction of Government employees, assignment of organizational responsibilities, planning of programs, establishment of performance goals and priorities, and evaluation of performance.

c. Does not apply to professional staff and managerial advisory services such as those normally provided by an office of general counsel, a management and organization staff, or a systems analysis unit. Advisory assistance in areas such as these may be provided either by Government staff organizations or from private sources as deemed appropriate by executive agencies.

d. Does not apply to products or services which are provided to the public. (But an executive agency which provides a product or service to the public should apply the provisions of this Circular with respect to any commercial or industrial products or services which it uses.)

e. Does not apply to products or services obtained from other Federal agencies which are authorized or required by law to furnish them.

f. Should not be applied when its application would be inconsistent with the terms of any treaty or international agreement.

5. *Circumstances under which the Government may provide a commercial or industrial product or service for its own use.*—A Government commercial or industrial activity may be authorized only under one or more of the following conditions:

a. *Procurement of a product or service from a commercial source would disrupt or materially delay an agency's program.* The fact that a commercial or industrial activity is classified or is related to an agency's basic program is not an adequate reason for starting or continuing a Government activity, but a Government agency may provide a product or service for its own use if a review conducted and documented as provided in paragraph 7 establishes that reliance upon a commercial source will disrupt or materially delay the successful accomplishment of its program.

b. It is necessary for the Government to conduct a commercial or industrial activity for purposes of combat support or for individual and unit retraining of military personnel or to maintain or strengthen mobilization readiness.

c. A satisfactory commercial source is not available and cannot be developed in time to provide a product or service when it is needed: Agencies' efforts to find satisfactory commercial sources should be supplemented as appropriate by obtaining assistance from the General Services and Small Business Administrations

or the Business and Defense Services Administration. Urgency of a requirement is not an adequate reason for starting or continuing a Government commercial or industrial activity unless there is evidence that commercial sources are not able and the Government is able to provide a product or service when needed.

d. The product or service is available from another Federal agency: Excess property available from other Federal agencies should be used in preference to new procurement as provided by the Federal Property and Administrative Services Act of 1949, and related regulations.

Property which has not been reported excess also may be provided by other Federal agencies and unused plant and production capacity of other agencies may be utilized. In such instances, the agency supplying a product or service to another agency is responsible for compliance with this Circular. The fact that a product or service is being provided to another agency does not by itself justify a Government commercial or industrial activity.

e. Procurement of the product or service from a commercial source will result in higher cost to the Government: A Government commercial activity may be authorized if a comparative cost analysis prepared as provided in this Circular indicates that the Government can provide or is providing a product or service at a cost lower than if the product or service were obtained from commercial sources.

However, disadvantages of starting or continuing Government activities must be carefully weighed. Government ownership and operation of facilities usually involve removal or withholding of property from tax rolls, reduction of revenues from income and other taxes, and diversion of management attention from the Government's primary program objectives. Losses also may occur due to such factors as obsolescence of plant and equipment and unanticipated reductions in the Government's requirements for a product or service. Government commercial activities should not be started or continued for reasons involving comparative costs unless savings are sufficient to justify the assumption of these and similar risks and uncertainties.

6. *Cost comparisons.*—A decision to rely upon a Government activity for reasons involving relative costs must be supported by a comparative cost analysis which will disclose as accurately as possible the difference between the costs which the Government is incurring or will incur under each alternative.

Commercial sources should be relied upon without incurring the delay and expense of conducting cost comparison studies for products or services estimated to cost the Government less than \$50,000 per year. However, if there is reason to believe that inadequate competition or other factors are causing commercial prices to be unreasonable, a cost comparison study will be directed by the agency head or by his designee even if it is estimated that the Government will spend less than \$50,000 per year for the product or service. A Government activity should not be authorized on the basis of such a comparison study, however, unless reasonable efforts to obtain satisfactory prices from existing commercial sources or to develop other commercial sources are unsuccessful.

Cost comparison studies also should be made before deciding to rely upon a commercial source when terms of contracts will cause the Government to finance directly or indirectly more than \$50,000 for costs of facilities and equipment to be constructed to Government specifications.

a. Costs of obtaining products or services from commercial sources should include amounts paid directly to suppliers, transportation charges, and expenses of preparing bid invitations, evaluating bids, and negotiating, awarding, and managing contracts. Costs of materials furnished by the Government to contractors, appropriate charges for Government owned equipment and facilities used by the contractors and costs due to incentive or premium provisions in contracts also should be included. If discontinuance of a Government commercial or industrial activity will cause a facility being retained by the Government for mobilization or other reasons to be placed in a standby status, the costs of preparing and maintaining the facility as standby also should be included. Costs of obtaining products or services from commercial sources should be documented and organized for comparison with costs of obtaining the product or service from a Government activity.

b. Costs of obtaining products or services from Government activities should include all costs which would be incurred if a product or service were provided by the Government and which would not be incurred if the product or service were obtained from a commercial source. Under this general principle, the following costs should be included, considering the circumstances of each case:

(1) Personal services and benefits: Include costs of all elements of compensation and allowances for both military and civilian personnel, including costs of retirement for uniformed personnel, contributions to civilian retirement funds (or for Social Security taxes where applicable), employees' insurance, health, and medical plans (including services available from Government military or civilian medical facilities), living allowances, uniforms, leave, termination and separation allowances, travel and moving expenses, and claims paid through the Bureau of Employees' Compensation.

(2) Materials, supplies, and utilities services: Include costs of supplies and materials used in providing a product or service and costs of transportation, storage, handling, custody, and protection of property, and costs of electric power, gas, water, and communications services.

(3) Maintenance and repair: Include costs of maintaining and repairing structures and equipment which are used in providing a product or service.

(4) Damage or loss of property: Include costs of uninsured losses due to fire or other hazard, costs of insurance premiums and costs of settling loss and damage claims.

(5) Federal taxes: Include income and other Federal tax revenues (except Social Security taxes) received from corporations or other business entities (but not from individual stockholders) if a product or service is obtained through commercial channels. Estimates of corporate incomes for these purposes should be based upon the earnings experience of the industry, if available, but if such data are not available. *The Quarterly Financial Report of Manufacturing Corporations*, published by the Federal Trade Commission and the Securities and Exchange Commission may be consulted. Assistance of the appropriate Government regulatory agencies may be obtained in estimating taxes for regulated industries.

(6) Depreciation: Compute depreciation as a cost for any new or additional facilities or equipment which will be required if a Government activity is started or continued. Depreciation will not be allocated for facilities and equipment acquired by the Government before the cost comparison study is started. However, if reliance upon a commercial source will cause Government owned equipment or facilities to become available for other Federal use or for disposal as surplus, the cost comparison analysis should include as a cost of the Government activity, an appropriate amount based upon the estimated current market value of such equipment or facilities. The Internal Revenue Service publication, *Depreciation; Guidelines and Rules* may be used in computing depreciation. However, rates contained in this publication are maximums to be used only for reference purposes and only when more specific depreciation data are not available. Accelerated depreciation rates permitted in some instances by the Internal Revenue Service will not be used.

(7) Interest: Compute interest for any new or additional capital to be invested based upon the current rate for long-term Treasury obligations for capital items having a useful life of 15 years or more and upon the average rate of return on Treasury obligations for items having a useful life of less than 15 years. Yield rates reported in the current issue of the *Treasury Bulletin* will be used in these computations regardless of any rates of interest which may be used by the agency for other purposes.

(8) Indirect costs: Include any additional indirect costs incurred by the agency resulting from a Government activity for such activities as management and supervision, budgeting, accounting, personnel, legal and other applicable services.

7. Administering the policy.—

a. Inventory: Each agency will compile and maintain an inventory of its commercial or industrial activities having an annual output of products or services costing \$50,000 or more or a capital investment of \$25,000 or more. In addition to such general descriptive information as may be appropriate, the inventory should include for each activity the amount of the Government's capital investment, the amount paid annually for the products or services involved, and the basis upon which the activity is being continued under the provisions of this Circular. The general descriptive information needed for identifying each activity should be included in the inventory by June 30, 1966. Other information needed to complete the inventory should be added as reviews required in paragraphs 7b and c are completed.

b. "New starts":

(1) A "new start" should not be initiated until possibilities of obtaining the product or service from commercial sources have been explored and not until it is approved by the agency head or by an assistant secretary or official of equivalent rank on the basis of factual justification for establishing the activity under the provisions of this Circular.

(2) If statutory authority and funds for construction are required before a "new start" can be initiated, the actions to be taken under this Circular should be completed before the agency's budget request is submitted to the Bureau of the Budget. Instructions concerning data to be submitted in support of such budget requests will be included in annual revisions of Bureau of the Budget Circular No. A-11.

(3) A "new start" should not be proposed for reasons involving comparative costs unless savings are sufficient to outweigh uncertainties and risks of unanticipated losses involved in Government activities.

The amount of savings required as justification for a "new start" will vary depending on individual circumstances. Substantial savings should be required as justification if a large new or additional capital investment is involved or if there are possibilities of early obsolescence or uncertainties regarding maintenance and production costs, prices and future Government requirements. Justification may be based on smaller anticipated savings if little or no capital investment is involved, if chances for obsolescence are minimal, and if reliable information is available concerning production costs, commercial prices and Government requirements. While no precise standard is prescribed in view of these varying circumstances a "new start" ordinarily should not be approved unless costs of a Government activity will be at least 10 percent less than costs of obtaining the product or service from commercial sources.

A decision to reject a proposed "new start" for comparative cost reasons should be reconsidered if actual bids or proposals indicate that commercial prices will be higher than were estimated in the cost comparison study.

(4) When a "new start" begins to operate it should be included in an agency's inventory of commercial and industrial activities.

c. Existing Government activities:

(1) A systematic review of existing commercial or industrial activities (including previously approved "new starts" which have been in operation for at least 18 months) should be maintained in each agency under the direction of the agency head or the person designated by him as provided in paragraph 8. The agency head or his designee may exempt designated activities if he decides that such reviews are not warranted in specific instances. Activities not so exempted should be reviewed at least once before June 30, 1968. More frequent reviews of selected activities should be scheduled as deemed advisable. Activities remaining in the inventory after June 30, 1968, should be scheduled for at least one additional follow-up review during each three-year period but this requirement may be waived by the agency head or his designee if he concludes that such further review is not warranted.

(2) Reviews should be organized in such a manner as to ascertain whether continued operation of Government commercial activities is in accordance with the provisions of this Circular. Reviews should include information concerning availability from commercial sources of products or services involved and feasibility of using commercial sources in lieu of existing Government activities.

(3) An activity should be continued for reasons of comparative costs only if a comparative cost analysis indicates that savings resulting from continuation of the activity are at least sufficient to outweigh the disadvantages of Government commercial and industrial activities. No specific standard or guideline is prescribed for deciding whether savings are sufficient to justify continuation of an existing Government commercial activity and each activity should be evaluated on the basis of the applicable circumstances.

(4) A report of each review should be prepared. A decision to continue an activity should be approved by an assistant secretary or official of equivalent rank and the basis for the decision should appear in the inventory record for the activity. Activities not so approved should be discontinued. Reasonable adjustments in the timing of such actions may be made, however, in order to alleviate economic dislocations and personal hardships to affected career personnel.

8. Implementation: Each agency is responsible for making the provisions of this Circular effective by issuing appropriate implementing instructions and by providing adequate management support and procedures for review and follow-up to assure that the instructions are placed in effect.

If overall responsibility for these actions is delegated by the agency head, it should be assigned to a senior official reporting directly to the agency head.

If legislation is needed in order to carry out the purposes of this Circular, agencies should prepare necessary legislative proposals for review in accordance with Bureau of the Budget Circular No. A-19.

9. Effective date: This Circular is effective on March 31, 1966.

CHARLES L. SCHULTZE,
Director.

Mr. STAATS. Are you addressing the question to me?

Representative CURTIS. Yes, to you, because we have this before us in our hearings—we had this in our hearings last year,² and I know the General Accounting Office has been following this with interest, too.

Mr. STAATS. This is correct, Mr. Chairman. The area of decision-making as to when the Government engages in a commercial or industrial type activity as against going into the commercial market for the same item of services is one we have had a great deal of interest in, and it obviously involves cost consideration in a great many cases.

The Budget Circular A-76 in its present form was issued on March 3, 1966. It was accompanied by a very strong statement of policy by the President at the time the Budget Circular was approved, in which he emphasized that we must seek very feasible way—I'm reading from his statement—"to reduce the cost of carrying out the governmental programs."

He also pointed out, however, that "we must remember that our budgetary costs, our current out-of-pocket expenditures, do not always provide a true measure of the cost of Government activities. This is often true when the Government undertakes to provide for itself a product or service which is obtainable from commercial sources."

I will not read the whole statement.

Chairman PROXMIRE. Without objection, the full statement will be printed in the record at this point.

Mr. STAATS. Very fine.

(The memorandum referred to follows:)

PRESIDENT JOHNSON'S MEMORANDUM ON GOVERNMENT COMMERCIAL
INDUSTRIAL ACTIVITIES

EXECUTIVE OFFICE OF THE PRESIDENT,
Washington, D.C., March 3, 1966.

MEMORANDUM FROM THE PRESIDENT TO HEADS OF DEPARTMENTS AND AGENCIES

Each of you is aware of my determination that this administration achieve maximum effectiveness in the conduct of day-to-day operations of the Government.

We must seek in every feasible way to reduce the cost of carrying out governmental programs. But we must remember that our budgetary costs—our current out-of-pocket expenditures—do not always provide a true measure of the cost of Government activities. This is often true when the Government undertakes to provide for itself a product or a service which is obtainable from commercial sources.

At the same time, it is desirable, or even necessary, in some instances for the Government to produce directly certain products or services for its own use. This action may be dictated by program requirements, or by lack of an acceptable commercial source, or because significant dollar savings may result.

² Hearings, 1966, p. 137.

Decisions which involve the question of whether the Government provides directly products or services for its own use must be exercised under uniform guidelines and principles. This is necessary in order—

To conduct the affairs of the Government on an orderly basis :

To limit budgetary costs ; and

To maintain the Government's policy of reliance upon private enterprise.

At my direction the Director of the Bureau of the Budget is issuing detailed guidelines to determine when the Government should provide products and services for its own use. These guidelines are the result of long study, based on experience over the past 6 years since the current guidelines were issued.

Each of you is requested to designate an assistant secretary or other official of comparable rank to—

Review new proposals for the agency to provide its own supplies or services before they are included in the agency's budget ;

Review experience under the new guidelines ; and

Suggest any significant changes to the guidelines which experience may indicate to be desirable.

I do not wish to impose rigid or burdensome reporting requirements on each agency with respect to the new guidelines. However these guidelines will require that appropriate records be maintained relative to agency commercial or industrial activities. I am also requesting the Budget Director to report to me from time to time on how the new directives are being carried out, and whether experience suggests changes in the guidelines or in agency reporting requirements.

LYNDON B. JOHNSON.

Mr. STAATS. The circular lists a number of policy or operating considerations which might make it justifiable for the Government to continue or undertake a commercial operation. But absent those determinations which must be made by the head of the agency, then a cost analysis should be undertaken, and the Budget Circular A-76 sets forth in considerable detail the cost criteria which should be applied consistently by all the agencies in making such a cost determination.

Representative CURTIS. That would be a determination of something new. This is something which is already in, which would be a redetermination.

Mr. STAATS. It applies to both, Congressman Curtis. But the rule for new starts, as it is called, new determinations, is a tougher rule than for an existing activity because it was felt that on balance there could be a margin of error, and the burden of proof really ought to be on the Government as to why it needs to perform this function in-house.

There has been a good deal of controversy as to whether or not all of the costs applied on the Government side are correct, and there has been much negotiation, both by the General Accounting Office and by the Bureau of the Budget with a number of groups outside as to whether or not these tests are exactly correct.

AMENDED CRITERIA CONSIDERED

We have had it up with our consultant panel of very distinguished accounting people, and we are currently considering some changes in these criteria with the Bureau of the Budget.

We have a meeting scheduled this week, in fact, to review some changes which have been proposed in this regard. But this is a very important area and without some kind of criteria applied uniformly and consistently by the agencies, the Government will not only be going unnecessarily into private enterprises' domain, but will also run the risk of substantially increased costs.

Representative CURTIS. Thank you very much.

Chairman PROXMIER. Are there any other questions? Congressman Mathias?

CONGRESSIONAL ATTITUDES

Representative MATHIAS. Mr. Chairman, if I may comment further on Mr. Curtis' line of thinking, I think we ought to give credit where credit is due. The Comptroller General issued a very full and complete report on the Naval Academy Dairy Farm which confirms my feeling on it. Then Secretary Nitze went forward and took the necessary steps within the Department of the Navy to do what ought be done. I am afraid that the slowdown is not due to either the Comptroller General or to the Department of the Navy, but the root of the problem today will be found in the report of the special subcommittee on the proposed disposal of the U.S. Naval Academy Dairy Farm published by the Committee on Armed Services. So, we ourselves have a little self-discipline to do in the Congress.

Representative CURTIS. Is that the House Armed Services Committee?

Representative MATHIAS. Yes, sir.

Representative CURTIS. Is this where they claim they cannot get rid of any of these things without referring it back to the Armed Services Committee?

Representative MATHIAS. Well, the final conclusion and recommendation was that no disposal proceedings be instituted by the Secretary of the Navy.

Representative CURTIS. I think there is a law, is there not, to the effect that certain dispositions of properties by the military must be referred to the Armed Services Committee of the House and the Senate; am I correct? Does anyone know?

Mr. STAATS. Yes, this is correct. A report must be made to the committee 30 days prior to action being taken, if the estimated value is more than \$50,000. I believe, however, that that may not be the specific problem in this particular case.

Representative MATHIAS. I know the law you are referring to which holds that before property goes to surplus for ordinary surplus disposal the services have a last crack at it, and the committee has a last crack at it.

But the problem here, before you even get to the disposal of the real estate, is the shutting down of the farm, which is a purely executive function, which is—

Representative RUMSFELD. Is the gentleman saying the approval has to be made by the committee or by the House and Senate?

Representative CURTIS. Regrettably the way that law was written it said the committees of the House Armed Services Committee.

Representative RUMSFELD. Is that a violation of the rules of the House?

Representative CURTIS. Not when we go ahead and pass a law. But we run into that in my own Committee on Ways and Means frequently, where I have insisted that it not be the Ways and Means Committee, but that it be the House of Representatives. I know Speaker Rayburn was quite jealous that it be the House and not a committee. You are right in saying there needs to be some self-discipline because some

of these committees in their over-enthusiasm actually write themselves into the law.

NEED FOR FOLLOWUP ON SPECIFICS

Senator PERCY. Mr. Chairman, I would like to commend Congressman Mathias for bringing this case to our attention. It is very easy to deal in broad principles. It is much harder to get down to specifics. It is easy for the Congress to condemn the executive branch of Government, and yet when you follow something through it often ends up right in the lap of the Congress again. If we cannot follow through and see progress, something is wrong with the way we are operating.

Chairman PROXMIRE. I share those sentiments very warmly. I think it is a great service you perform for us.

Congressman MATHIAS. Thank you very much.

SLOPPY INVENTORY MANAGEMENT

Chairman PROXMIRE. There is no group that needs this understanding kind of sympathy from the Federal Government more than the dairy farmers.

Mr. Staats, I want to commend you on a most remarkable statement, well-documented and thorough and specific, and in giving us a great number of factual instances.

Because you are a man who believes in fact and deals so much in facts and does not like to use generalities, I realize that you do not want to characterize the overall inventory management we have in the Defense Department with any adjectives, I suppose, but I cannot come to any conclusion except that it seems incredibly sloppy, a clear dereliction of duty in the management of inventory, a cost to the taxpayers of hundreds of millions of dollars, and maybe even billions and billions of dollars.

FACTS—PREREQUISITE TO INVENTORY MANAGEMENT

I understand that former Secretary Forrestal said we cannot possibly manage inventory if we do not know the facts about it. If you do not know what it is, where it is, how much you have, its condition, and so forth, you cannot manage it. It seems that you have documented very thoroughly the failure on the part of the Defense Department to have that kind of information.

You say: "In general, we have found agency management receptive to our suggestions." This is on the list of specific suggestions you give with reference to civil agency construction.

"Actions have been taken or planned in response to most of our recommendations, which, if effectively implemented, should result in significant improvements."

AGENCY COMPLIANCE TO GAO SUGGESTIONS

Can you give us specific agencies that have responded, the agencies that have not, the extent to which they have not responded and the extent to which they have?

Mr. STAATS. I would like, Mr. Chairman—

Chairman PROXMIRE. I know this is something you may not care to do right now orally, because it would take quite a while to do that.

Mr. STAATS. I think it would.

Chairman PROXMIRE. But if you could document it to some extent at least, it would be helpful.

Mr. STAATS. We have found GSA particularly cooperative on the matters we have brought to their attention. We have found the Corps of Engineers very receptive.

We find, Mr. Chairman, in a great many cases that the External Auditor, if you will, the General Accounting Office, going in is able to develop factors in a way which is persuasive to the top manager where he does not previously have that information available to him, and it may not be dereliction in all cases. It may be the fact that he does not have adequate recording systems available to him. He may not have an adequate internal audit arrangement available to him.

Certainly all of our reports do not carry the implication that there is any malfeasance or misfeasance involved.

Chairman PROXMIRE. I understand that.

Mr. STAATS. It is a very large Government.

Many of these are very complicated issues. I think what we are saying is that the GAO, as an outside organization, is able to develop its facts in such a way that in most cases—not all, but in most cases—we can persuade management we are right, and some corrective action needs to be taken.

We would be very happy to supply for the record a series of illustrations of this type.

(The following material was subsequently filed:)

ILLUSTRATIONS OF CIVIL AGENCY REACTIONS TO GAO REPORTS ON CONSTRUCTION

1. We found that the Federal Aviation Administration had approved the construction of control towers without having analyzed the relative benefits and costs of the tower design, and that as a result, the Administration would incur additional costs of about \$2.3 million in constructing 28 towers of a new design. The Administration agreed with our findings and proposals for corrective action, substituted a lower cost tower design at four locations already scheduled for new towers, and revised its policy and operating procedures in a manner which should, if properly implemented, prevent the recurrence of similar situations.

2. In a review of contracts awarded by the Public Buildings Service, General Services Administration, we found that in 15 out of 28 buildings, the Government had encountered construction difficulties because of foundation design problems and unanticipated soils conditions. We found that the professional engineering staff of the Service did not include specialists in soils mechanics and foundation engineering and concluded, on the basis of our review, that had such specialists been available, certain of the construction difficulties experienced by the Service could have been avoided and the costly effects of others minimized. In response to our proposal, the General Services Administration advised us that the needed in-house soils mechanics and foundation engineering capability would be expanded and certain other corrective measures would be taken.

3. We found that the Bureau of Reclamation and the Bonneville Power Administration, Department of the Interior, had adopted different practices in constructing tower footings for high-voltage transmission lines without fully evaluating alternative methods of construction. We believed that the results of our review, which considered the substantial differences in the costs of footings under the practices of the respective agencies, indicated a need for centralized coordination to provide reasonable assurance that, when improved systems or techniques are developed they will be promptly implemented by all the agencies which can bene-

fit from their use. The Department did not agree with our proposals directed toward achieving the needed coordination. We do not agree with the Department's views on the matter, and intend to pursue the need for coordination through additional review work.

ADEQUACY OF INTERNAL AUDITS

While I am talking on this point, I would like to emphasize something else that we are doing, and that is a series of reports we are making to Congress on the adequacy or inadequacy of internal audit in the agencies. This is where the responsibility basically rests, that is with the agency head. If we can help them strengthen internal audit, it not only helps solve some of our problems, but it also puts the responsibility basically where it belongs, namely with the agency head.

CONGRESSIONAL RESPONSIBILITY

Chairman PROXMIRE. I agree with that. This takes exactly that kind of specific correction, and the highlighting of errors and the need for improvement.

But I just cannot get around the fact that we are human, and unless attention is called to this in a vigorous way and a vehement way by those in Congress who are elected to discharge a public duty, we just know that this big Government of ours is going to continue to make big mistakes at a big cost.

DEPARTMENT OF INTERIOR NOT IN ACCORD WITH GAO

Mr. WEITZEL. Mr. Chairman, for your information, in the meantime we might just observe that of all of the examples that were given in the Comptroller General's statement, the only one where we think the Department is not wholeheartedly in accord with our conclusions is the first one, the Department of Interior, which feels it is a healthy situation to let two of its bureaus, Bonneville Power Administration and the Bureau of Reclamation, find solutions which they feel will meet their own peculiar conditions, and they felt that, perhaps, our report did not go sufficiently into underlying conditions when we made the recommendations that we did as to footings and so forth. We still stand on the conclusions that we made in our report to Congress.

In the second case, that of the Post Office Department, we had recommended that a provision be put into legislation that was pending for long term leasing authority for the Postmaster General. We are informed now that the Post Office Department and GSA standards will be more applicable to post office building construction. So, that has been taken care of administratively.

The other agencies have gone along generally with our recommendations.

INSUFFICIENT RENTALS COLLECTED FOR USE OF GOVERNMENT EQUIPMENT

Chairman PROXMIRE. Very good. That is, as far as the itemized corrections of the Comptroller General's statement are concerned.

Mr. Staats, where you say "although corrective action was promised, the incidence of discrepancies"—this refers to some floor checks and so forth, inventory control—"The incidence of discrepancies rose from 7.5

percent of items tested during late 1964 and early 1965, to 13.5 percent of items tested during the first 9 months of 1966. The approved status of the contractor's system had not changed."

What is the significance of this?

Mr. STAATS. It results in some cases in the Government's not collecting rent for contractors' commercial use of Government-owned equipment. I think the general significance, Mr. Chairman, is that we do not feel that there has been adequate attention given to the problem which had been earlier identified.

INADEQUACIES NOT UNUSUAL

Chairman PROXMIRE. How typical is this? Do you think this is unusual or is this general?

Mr. STAATS. I would not say it is unusual, no.

Chairman PROXMIRE. You also say:

REPORTS OF COMPETITIVE PROCUREMENT

A large percentage of the actions which were classified and reported to higher management levels within the Department of Defense as competitive procurements, in our opinion, were in fact, made without competition.

I think you make a most convincing case that this is without competition. What is the argument, what is the Defense Department's argument here?

Mr. STAATS. Mr. Newman can respond to that.

Mr. NEWMAN. Mr. Chairman, as you know, a copy of this report just went to Defense. They have not had a chance to comment on it and we have not had a chance to discuss it with them.

Chairman PROXMIRE. We can ask Mr. Ignatius when he is up.

I just wondered if you could indicate to us what the merits of their feelings were.

Mr. NEWMAN. Well, I believe, frankly, that it is a case of misinterpretation and also a need for clarification of the existing ASPR's on what is to be reported to the Pentagon in support of the cost reduction program and really what criteria should be used in determining when we have competition. This is one of the problems we are having today, Mr. Chairman.

As you know, under Public Law 87-653 competitive procurement is not under that category, that is, if the contracting officer decides he has competition, he does not need cost data upon which to negotiate. In a majority of these cases an audit by Defense Contract Audit Agency is not requested by the contracting officer.

We are finding in this area that the door is sort of wide open. We have to get better criteria to determine what is competition, especially because, in many cases, contracting officers feel that if two individuals can do the job, this is competition so long as they have a technical, engineering know-how. We feel that *price* competition is of vital importance in any negotiations.

Chairman PROXMIRE. In other words, if all can do the job or three can do the job all at the same price you do not consider it competitive.

Mr. NEWMAN. Well, it may be competitive pricewise, but it is a case of picking the one who has the best record of performance.

Chairman PROXMIRE. Yes, you know, price the same to the last third decimal.

Mr. WEITZEL. Mr. Chairman, as you know, the Armed Services Procurement Act requires awards be made to the bidder whose bid, price and other factors considered, is most advantageous to the Government, so in some cases other factors such as improved performance can come in.

Chairman PROXMIRE. I understand that. It does not always have to go to the lowest bidder.

Mr. WEITZEL. One simple example here: We found a contract was awarded for 244 aircraft valves at a total price of some \$11,000. Requests for proposals had been sent to two firms. Only one proposal was returned accompanied by a letter stating that the two firms solicited had been consolidated.

This proposal was accepted and the contract was awarded to the consolidated company.

The buyer, even though he had prior knowledge of the merger, stated that he considered this to be a competitive award since two sources were solicited. Maybe that is a horrible example, but we feel that the Armed Services Procurement Regulation, as presently drawn, permits a lot of procurements to be reported as competitive which are really not, even though two proposals are sent out.

One company could be out of business, it might not return the proposal, but just so long as the other one responds, the contracting officer can say, "I sent the proposals out to two," and he can report that as competitive.

PURCHASES UNDER \$2,500 REPORTED AS COMPETITIVE

Then, on this point as to the purchases under \$2,500, as the Comptroller General pointed out, 69 percent or \$55 million of the total we reviewed were actually not competitive. But under the present form of the Armed Services Procurement Regulation it can be reported as competitive.

This is why we are suggesting the amendment of the regulations to permit proper classification and greater information to top management.

Chairman PROXMIRE. I can see we have quite a session here, because my time is up.

Congressman CURTIS?

Representative CURTIS. I want to join in the chairman's recommendation to you, M. Staats, and the hard work that the General Accounting Office has been doing in this area for so many years. Also, I want to express the appreciation I personally have for the manner in which you have presented the cases that we have asked you to look into and the general problems over a period of years.

FUNCTION OF JOINT ECONOMIC COMMITTEE

I am anxious to make clear what my concept of the function of the Joint Economic Committee is in this area.

I think Senator Percy expressed it quite well. In our understanding of the fundamentals for broad policy it is important to exam-

ine structure and also how structure is being used, because if the structure is sound but not well used then, of course, we do not want to change the structure, we want to get at the details.

On the other hand, if the structure is not sound, it is important that we review basic policy, such things, of course, as the impact or rather the relationship of the private sector with the governmental sector, as is illustrated in this bulletin A-76 as an indication. (See p. 35.)

But when you get into such things as whether offshore procurement where buy American should exist, it involves problems of balance of payments, cost to the Federal Government. Also involved here is the impact on the private economy itself, which is the basis of our financing any endeavor.

I want it clear that as I view our committee's work, it is to avail itself of the activities of the various legislative committees of the Congress, where they are concerned about the specifics that we are going on over here. We should avail ourselves of their work, and in no sense compete with them.

I know in many of these illustrations you have given us here, this material has been referred to or is being looked at by legislative committees of the Congress.

It would be helpful to me if you would go through your testimony and give to this committee a list of what committees are looking into this matter. If none are, this would be helpful for us to know.

In some instances, I think probably maybe more than one committee is looking into the same thing, and rightly so, because they are looking at it from different angles.

I daresay the Government Operations Committees of both the House and Senate tend to look over these generally. If you would care to respond to that I would appreciate it.

DISTRIBUTION OF GAO REPORTS

Mr. STAATS. I would like to respond in general terms.

First, our general practice is to try to be sure that any committee that, to the best of our knowledge, has any continuing interest or any special interest gets copies of all of our material. We go beyond that and make an effort to sit down with the staffs of those committees and brief them as to our findings and answer questions, and try to relate our reports more directly to that committee's interest.

Speaking personally, I feel that long-term effectiveness of the General Accounting Office can be increased still further as we can relate our work more closely to the work of the committees of Congress.

GAO RELATIONSHIP WITH SUBCOMMITTEE

Now, a second point I would like to make would be that in the area of construction and procurement which has been the concern of this committee particularly, which has been the burden of our statement here today, there is no place in the Congress today that has the same kind of interest and overview of this problem as has been demonstrated by this committee in the past. We are not just trying to pass out bouquets. We feel that this is an area which is terribly important. It is one-third of the total Federal budget, for one thing.

Second, it goes right to the heart of the Government's relationship to the private sector. So that it is important, in our opinion, that there be an overview of this area.

Now, as far as giving you a list here of specific committee actions, I would prefer not to attempt a detailed listing of specific actions by the various committees. Some of the points covered, in today's testimony are new and have not been brought to any other committee's attention before today. Also, we may not be aware of all committee actions because some of them may have been informal. It would not be fair, I believe, to list only formal hearings. Other less formal committee action sometimes is sufficient.

Representative CURTIS. I appreciate your further statement that no other committee is taking this comprehensive view. That is my judgment, too. Yet I find sometimes my colleagues say, "What is the Joint Economic Committee doing in this area?"

I try to point out that we are trying to keep this comprehensive approach and using the specifics, as Senator Percy so wisely observed, to set out what is being done in some of these areas of broad governmental policy to see whether it does need changes. There is nothing like a specific to get us right back to what we are talking about.

REPORT ON FINANCING AGENCY PROGRAM

I would like to refer to a report that you have just issued on various methods of financing agency programs, of May 1967. (See app. VI, p. 317.)

One of the items in this report talks about revolving funds, and if I may read just briefly:

As of June 30, 1966, the Treasury Department showed 117 such funds with cash and fund balances over \$11 billion, investments and securities of over \$2 billion, and budgetary authorizations of about \$23 billion."

APPLICATION OF COMMON ACCOUNTING PRINCIPLES

I want to ask a general question: Did you find common accounting principles in the various funds that you looked into?

Mr. STAATS. I wonder if I might ask Mr. Borth to comment on this question.

Mr. BORTH. I am Daniel Borth. I am Associate Director of the Defense Division.

The answer to your question, Congressman Curtis, is no, we did not, if you are speaking of systems throughout the executive branch.

Representative CURTIS. In other words, you are saying that—

Mr. BORTH. There was quite a variation in application of principles of accounting and reporting.

Representative CURTIS. Quite a variation.

Of course, one thing that has been worrying this committee is that we found two of the services—I think it was the Army and Navy—used the stock fund principle broadly, at least as far as inventory control was concerned, and the Air Force did not. We raised the question, "Well, if it is a good technique for inventory control of certain stocks why wouldn't there be uniformity?"³

I presume then that in looking into some of these revolving funds you did not see a uniformity of philosophy either or did you?

³ Hearings, 1960, p. 175.

Mr. BORTH. We did not evaluate the underlying philosophy of revolving funds, as you may well know. In answer to your question with reference to stock funds in the Air Force, we were unable to discern the very point you are mentioning, mainly, the question as to whether the experiences of the Army and the Navy in the use of stock funds has been fully pursued by the Air Force. In other words, there is a need for common criteria within the Department of Defense.

Representative CURTIS. Thank you very much.

Let me say another thing, and this will bear out one of my points: The Ways and Means Committee is going to start holding hearings on the debt ceiling again, and we are going to go into participation sales certificates.

In your report that I just referred to, you list many of the agencies under programs which generate many of these kinds of capital assets that are not subject to the debt ceiling, although, strangely enough, there are a couple of aberrations. The Ways and Means Committee, however, has not been able to develop this material up to date. So even if we were to develop this kind of material here, it would not be duplicated.

Mr. STAATS. To the best of my knowledge, Congressman Curtis, this is the first time a compilation of this kind has been put together.

Representative CURTIS. Yes.

Mr. STAATS. And I would think it would have interest to the Ways and Means and the Appropriations Committees and other committees as well.

Representative CURTIS. Yes, because I won't have time to get into any of these things in detail. I now want to refer to another report that you have referred to. I refer to the March 1966 report B-140389 on Cost of Sales or Surplus Property and Disposition of Proceeds.⁴ I have been particularly concerned about the fact that this money is not always turned back into the Treasury. Some of it operates as a revolving fund. I refer to the one the military calls the "punkin" fund. I just picked up this colloquialism, and I would say it is quite appropriate. Here is one of the points:

Until fiscal year 1960, the Department of Defense was authorized to use a certain sum derived from receipts of the sales of surplus property. For example, in 1958 it was \$41 million; in 1959, \$49 million.

Then the authorization language was changed on the recommendation of the DoD staff which said that they could do a better job if they were not limited in the use of receipts. They needed flexibility in financing, and on page 56 of the staff report you discuss that.

Now, in 1960 they spent \$78.4 million; in 1961, \$84.6 million; in 1962, \$78.1 million.

In the meantime, the percent of sales costs to gross proceeds went up in 1958, 23 percent; in 1959, 27.5 percent; in 1966, 77.2 percent.

Now, since there have been reports of improper use of the "pumpkin" fund, we asked GAO to make a study and report on that, and that is this report I have just referred to.

I am going to be asking Secretary Ignatius and Admiral Lyle about this thing, but I would like to ask for any comments you would like to make on it.

⁴ Hearings, 1966, p. 273.

DOD TO INSTALL IMPROVED ACCOUNTING SYSTEM

Mr. STAATS. We have a very recent letter, Congressman Curtis, on this point from the Defense Department in which they advise us that they have a target date of July 1 this year for installing an improved accounting system which they believe, at least, will meet our objections, which I believe have been about the same as yours.

Representative CURTIS. Yes. You have not yet received that?

Mr. NEWMAN. No. It is an informal letter.

Representative CURTIS. It is informal?

DEFENSEWIDE AUDIT

Mr. NEWMAN. Congressman Curtis, after the hearings we had and your interest in the "punkin" fund, Secretary Ignatius had an audit—a defensewide audit—made by the DOD auditors, and they finished that up last December. So they have gone into the heart of this, and based on information we have here at the moment they are setting up an improved cost accounting and financial management reporting system, and to me it looks like they are getting on top of the job. We will know the sales, costs, and net results of operations, and what happens to the net receipts.

Representative CURTIS. Yes. Very good. I see my time has expired.

Chairman PROXMIRE. Senator Symington?

Senator SYMINGTON. Thank you, Mr. Chairman.

TECHNICAL DATA FOR PROCUREMENT

Mr. Comptroller General, I was interested in the questions asked by the chairman about procurement by the military. In your statement you say:

Our recent survey indicates that incomplete or inadequate technical data still contributes significantly to the award of noncompetitive procurements.

Later on you say:

COMPETITIVE PROCUREMENT REPORTS

A large percentage of the actions which were classified and reported to higher management levels within the Department of Defense as competitive procurements, in our opinion were, in fact, made without competition. (See p. 9.)

You do not use the word there, "classification," as putting a mark of secret on the document?

Mr. STAATS. No, a matter of definition.

Senator SYMINGTON. Then you say:

In addition, the Armed Services Procurement Regulation permits purchases of \$2,500 and under to be reported as competitive even though many are not. (See p. 9.)

This is a pretty broad criticism of the way these procurement regulations are drawn up, is it not?

INTERPRETATION OF "COMPETITIVE"

Mr. NEWMAN. I would not say, Senator Symington, the way they are drawn up. In some cases they need clarification. But the way they

are being interpreted by the contract officers is what we are talking about. They are sort of stretching a point to report it as competitive.

Mr. STAATS. I think there may be some overzealousness in wanting to report, you might say, what top management wants to hear. That may be an element. That is only surmise on my part. It may be lack of a fair understanding, a very sincere lack of clear understanding, by the contracting officer as to the interpretation of the regulations.

These regulations are pretty voluminous, and there are some cases of fairly heavy turnover of personnel in these procurement offices. This may be a factor, too.

Senator SYMINGTON. Not to be the devil's advocate, but let's think about the problem from both sides of the street. If you take an original order, you have done all the design engineering, all production engineering, all tool-designing engineering, all tool production. In itself, this is a very large percentage of total cost; so you are in a specially good position to make a future quotation on spare parts much better than a newcomer would be on that particular article. I was thinking about that illustration of two companies, first quoting, then merging. But if they were the only ones who had the tools, if you wanted a good price, I do not see where you go except to the people who had done the original work. Is that situation taken into consideration?

PROCUREMENT OF AERONAUTICAL SPARE PARTS

Mr. NEWMAN. It certainly is, sir.

We have cases of aeronautical spare parts where the Navy will go back to the prime on a sole-source basis, and the Air Force will go out on competitive bid basis for the same part. This happened years ago and is still going on, and the part is used for the same engine.

So you have got one service doing one thing and another service doing another for the same identical item.⁵

Senator SYMINGTON. Naturally, if you had overall control—

Mr. NEWMAN. That is what is needed.

Senator SYMINGTON. And proper inspection of the product regardless of the spare parts.

DEFINITION OF "COMPETITION"

Mr. WEITZEL. The problem, Senator Symington, seems to be that the contracting officers themselves are interpreting the Armed Services Procurement Regulation as meaning that competition depends on the number of companies solicited and, as we all know, the company may have moved away or may just not care to respond.

So we just do not feel this is a realistic basis on which to get these reports. When it comes to the under \$2,500 figures they are just lumped in as competitive. We have gone down to the installations and found that, in our opinion, they can easily furnish this additional information, and in this way Secretary McNamara could have a better basis for determining what progress he is making in his campaign to convert to competition where it is feasible and practicable and can be done without injuring the interests of the Government.

⁵ See p. 9, supra.

COMPETITION POSSIBLE ON SMALL PURCHASES

Mr. STAATS. I think what we are really saying are two things: One is that the reporting may be subject to misinterpretation as to the actual extent to which we have competition.

But, secondly, we feel particularly in this under \$2,500 category there may be some opportunities for very substantial savings through competition because of it being in that area that the problem you are pointing out probably would not exist. It would be mostly for smaller type items.

Mr. WEITZEL. In the other example the Comptroller General gave, nearly half the amount of the contract was saved when they canceled the sole source contract with the prime contractor and went down to the source of supply.

VARIANCE IN NAVY AND AIR FORCE METHODS

I recall a report which we made several years ago involving an aircraft bearing, I believe it was, which the Air Force was buying competitively and the Navy would not, and we finally persuaded them to buy it competitively. But they still insisted on a quality assurance, which cost them money, because they just did not trust these people and they said they did not want to trust their pilots' lives to bad bearings. Well, of course, neither the Air Force nor the Comptroller General wanted this kind of a situation.

Senator SYMINGTON. So?

Mr. WEITZEL. So finally the Navy did go to competitive procurement, and I hope none of the planes came down because of it. [Laughter.]

RULES AND THEIR INTERPRETATION

Senator SYMINGTON. Then the criticism if not concerning the clarity of the rules laid down, has to do with the functioning of the various buyers under the rules; is that correct?

Mr. NEWMAN. They are all involved.

One of the biggest problems we have, Senator, as you well know, is people, and we have a constant turnover. The training of people is a problem.

In this whole procurement area, we went into supply, and, gentlemen, these problems are going to be with us as long as we live because the Department of Defense is doing everything it possibly can. There are some areas like the first one mentioned in our statement under "Supply Responsiveness" concerning the Army's need to change its organization. That is a separate problem.⁶

The Air Force does not have this problem; but the Air Force has problems, gentlemen. I mean they have problems in manpower, and they have problems of buying and inventory problems. But they are not as gigantic as those that exist in the Army area.

Senator SYMINGTON. Has that anything to do with centralization or decentralization?

Mr. NEWMAN. Yes, it does. As a matter of fact, I would prefer not to comment on it here. I might say it is the first time we have performed such a broad survey. Personally we are proud of it, because

⁶ See p. 4, *supra*.

I think we got to the heart of some of the problems. However, we will be on these individual problems for years to come until they are solved.

CONSTRUCTION CONTRACT IN -VIETNAM

Senator SYMINGTON. One final series of questions. Thanks to your office, I talked with your people in Thailand. They told me on one group of private contractors—I throw this in to present that the Government does not make all the mistakes—worth \$300 million, a group of private contractors, they, the contractors, had lost \$140 million. That seems to be par for the course. Did anyone yet find out where the \$140 million went?

Mr. STAATS. I do not think we have. We have a report in process that is coming to the Congress in another 10 days or 2 weeks which we are going to outline all of our findings on the construction contract in Vietnam. But Mr. Stovall might want to respond further on this particular point that you are referring to.

Senator SYMINGTON. Incidentally, I was impressed with your men out there. They seemed to know what they were talking about.

Mr. STAATS. This is Mr. Stovall.

Mr. STOVALL. I am Director of the International Division.

We have this work that was being done in Thailand while you were there, being brought together now. We do plan a report on it. I do not know the results of it yet. It is just being put together now. It will be a successor report to our review of the construction in Vietnam because we hope to sort of link the two of them together, particularly in relation to the use of excesses. But we do not have a clear answer to your question.

RÉSUMÉ OF REPORT ON CONSTRUCTION IN VIETNAM

Senator SYMINGTON. Mr. Chairman, would it be in order to ask unanimous consent that a résumé of that report be inserted at this point?

Chairman PROXMIRE. Yes, indeed.

Senator SYMINGTON. Thank you.

(The information requested, subsequently supplied by GAO, follows:)

The report of the United States General Accounting Office on its survey of United States construction activities in the Republic of Vietnam will show that the joint venture contractor, known as RMK-BRJ, which was performing about three-fourths of the total construction, has been unable to maintain control over the hundreds of millions of dollars worth of materials and equipment that have been purchased and shipped to Vietnam for the construction program. The contractor was not prepared to control the receipt, storage, and issue of the steady stream of materials and equipment that began to arrive in Vietnam as a result of the tremendous escalation of the construction program in late 1965 and early 1966.

The report will show that the contractor was unable to cope with the mounting problem of controlling these supplies and equipment which were unidentified, unsegregated, and unprotected from the elements or theft. The magnitude of this problem is illustrated by the fact that at the time of the General Accounting Office survey, the contractor could not account for the whereabouts of approximately \$120 million worth of materials which had been shipped to Vietnam from the United States. These materials were accounted for in the contractor's books as being in transit; however, the contractor's representative having re-

sponsibility for material control acknowledged that much of it had in fact been physically received in Vietnam.

The report will state that the principal reasons contributing to the lack of control were (1) lack of an effective system for material and equipment control, (2) shortage of experienced personnel, (3) lack of adequate staging areas and warehouse facilities, and (4) inadequate security measures to prevent unauthorized appropriation, pilferage and theft.

Chairman PROXMIER. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Comptroller General, I'm impressed with the thoroughness of your report. You are doing a good job. You and your staff have gotten into this in an admirable way, and you point up the way to continue the effort with more zeal and energy as we go forward.

\$77 BILLION ANNUAL PROCUREMENT

I want to talk about some general aspects of the problem because I think few people realize that the Government procurement amounts to \$77 billion worth of goods and services a year, which, as you have indicated, is 10.4 percent of the gross national product. That is a substantial volume of business.

You have divided your audit and review work down to the Civil Division and the Defense Division and the International Division. Have you divided this procurement down into those three divisions, that \$77 billion? Do you have a figure offhand of how much of it is civil and how much—

Mr. STAATS. The breakdown?

Senator JORDAN. How much is "Defense" and how much is "International"?

Mr. STAATS. I do not have it so that I can give you precise figures at the moment. The bulk of it, of course, is in the Defense Department.

Senator JORDAN. Yes.

Mr. STAATS. In fiscal 1966, these figures I have given you on a calendar basis, but the fiscal 1966 figures on defense procurement was about \$48 billion.

Senator JORDAN. Yes.

\$60 BILLION DEFENSE PROCUREMENT IN 1966

Mr. STAATS. And the remainder would be—on a calendar year basis. Mr. Weitzel has just given me the figures for the national defense category which show purchase of goods and services as \$60 billion in 1966.

Senator JORDAN. That defense procurement, of course, is the major portion of the total procurement.

Mr. STAATS. That is right. You understand, of course, in that figure is included military personnel as well as procurement.

Senator JORDAN. Yes; and services. That is in the service department.

Mr. STAATS. Yes, that is correct.

COMPETITIVE AND NONCOMPETITIVE PROCUREMENT

Senator JORDAN. And that portion of materiel which applies—speaking of Defense Department alone—what percent of Govern-

ment procurement of materiel for defense purposes is on a competitive bid basis, what percent was on a negotiated or incentive basis, and what percent is on cost plus?

Mr. NEWMAN. You mean the "advertised fixed price" competitive?

Senator JORDAN. Yes.

Mr. NEWMAN. Very small.

Senator JORDAN. A very small percentage?

Mr. NEWMAN. I would not want to say over 15 percent.

Mr. STAATS. About 45 percent is defined by the Defense Department as being competitive. The figure that I recall is——

Senator JORDAN. But it would not meet the definition you have just supplied.

Mr. STAATS. One of the reasons we have included this point in our review is that we felt that the problem of definition is a fairly important one in terms of understanding what that figure means.

Senator JORDAN. I should say it is. If there is a difference between your interpretation of competitive bidding as being 15 percent and the Department's idea of it being 45 percent, I would say there is a wide difference.

Mr. NEWMAN. The figure I just gave was advertised fixed-price.

Senator JORDAN. That is right.

Mr. NEWMAN. Now, what the Department of Defense calls negotiated contracts, would get up to a good high percentage. In other words, we have only 20 percent in cost reimbursement type and 15 percent in advertising fixed price, the remainder is in other types of negotiated contracts.

PROGRESS IN REDUCING COST REIMBURSEMENT TYPE

Mr. STAATS. This is the area in which the greatest progress has been made in the last 4 or 5 years, in reducing the portion of the contracting which is cost reimbursement type.

Senator JORDAN. Then it has been commendable.

Mr. STAATS. Yes, indeed.

Senator JORDAN. Because testimony in previous years before this committee has indicated the tremendous saving in getting defense contract awards, any kind of purchasing, over into a competitive basis from a cost-plus fixed fee.

AREAS WHERE IMPROVEMENT CAN BE MADE

Mr. STAATS. I might point out at this point, Senator Jordan, that while our testimony here is critical it may be easy to take out of perspective the total problem. As to the progress which has been made in this field, we do not wish to derogate that at all. But our function is to criticize and our function is to point out areas where improvements can be made; and that is, of course, what we feel you are interested in at this particular point in time.

Senator JORDAN. That is right. While this is a critical report, I think it would be well, Mr. Staats, to put in a statement of the progress which has been made in getting this procurement under better management and under better control.

CONTROL OF GOVERNMENT-OWNED PROPERTY

I turn now to a specific item in your report—and there are so many—but I shall confine myself in the brief time I have left to the matter of control over Government-owned property and defense contracts.

This is a problem which has plagued us back through the years, and it seems to me we are making progress slowly—slower here than we have, perhaps, in other areas.

\$11 BILLION CONTRACTOR CONTROLLED GOVERNMENT PROPERTY

You say we now have Government-owned facilities and materiel in the possession of contractors of the approximate value of \$11 billion located in 5,500 plants? This does not include the value of special tooling, special test equipment and military property of the Defense Department, and it does not require contractors to report the value of such property in that position. My question is why not—why don't they?

WHY NO CONTROL OF SPECIAL PROPERTY?

Mr. NEWMAN. They should have control over it and get reports.

Senator JORDAN. They should, but they do not.

Mr. NEWMAN. Well, that is the way the regulations are today.

Senator JORDAN. Yes.

Mr. NEWMAN. I think we covered that in our report sent to the committee.

RESPONSIBILITY?

Senator JORDAN. Yes; but where does the main responsibility lie for inventory control?

Mr. NEWMAN. Well, the first thing, of course, is to get regulations out to the contractors, contracting officers, and the Defense Contract Administration Service. Until the policy is established topside nothing much can be done about it. We have to get the ASPR changed so it will include the accounting system. DOD is now working to get on top of this job. It will cover, we hope, special tooling, special test equipment, and military property.

So, any assets in the hands of contractors will be under good accounting and financial reporting system.

Another thing, more emphasis and attention has to be given in this area to the property administrator. I believe this will come under the Defense Contract Administration Service.

It is a new organization just getting started, but it should have specialists who will keep on top of this area, Senator Jordan. It has been neglected for years and years. We can go back to World War II on this one.

Senator JORDAN. Indeed it has, and it requires a lot of attention and a lot of fact-finding, and perhaps some hard and fast criteria and guidelines set down to bring it into line.

Mr. NEWMAN. But back to your specific question of who is responsible, it has got to be the contractor. When he signs for a piece of equipment it starts at that point. He must be required to maintain an acceptable accounting, adhere to proper standards of accounta-

bility, and make complete, accurate, and current reports to DOD management. Also we have got to see that we get the equipment back.

Senator JORDAN. You say this very definitely states that many contractors do not maintain financial control accounts for Government-owned materials.

Mr. NEWMAN. Yes, sir.

Senator JORDAN. They did not maintain them.

GOVERNMENT EQUIPMENT ON NONDEFENSE WORK

Yet we find that a lot of equipment, Government-owned equipment, in the hands of contractors is being used for nondefense work.

Mr. NEWMAN. Yes, sir.

Senator JORDAN. Even at the time when this very Government-owned equipment is of a critical nature and needed elsewhere for defense work?

Mr. NEWMAN. That is correct, sir.

USE OF 8,000-TON PRESS

Senator JORDAN. For instance, you quote an example of this 8,000 ton press costing \$1.4 million installed in a contractor's plant. 75 percent of the use of the large press was for commercial work, while the defense work was being done by the smaller presses, perhaps, and not being done as well. If there was need for the 8,000 ton press in the first place, there would certainly be a need for it in a critical area of defense work.

LACK OF UNIFORMITY OF NOTES

You also go into the lack of uniformity in rates charged for rentals of Government-owned equipment. I think this whole area needs to be ventilated, needs to be gone into, with a great deal of care to determine what is a proper rental basis, what is a proper reporting basis, what kind of accountability can we assess against this contractor who uses this equipment for nondefense uses, for commercial use, and so on, Mr. Staats.

What are your plans for continued surveillance?

GAO PLANS

Mr. STAATS. We do plan to continue our work in this area. The new report is as Mr. Newman points out. The important thing I would like to emphasize here is the Defense Contract Administration Services organization can, we feel, perform a very important role here in trying to be sure that the services are on top of this and following up with the individual contractor. A contractor does assume responsibility for accountability of these records. Somebody has to be sure that the contractor is performing.

Senator JORDAN. Yes. I should think it would be very important that we get on top of that.

Thank you, Mr. Chairman. I have used my time.

Thank you, Mr. Comptroller General.

REPORTING ON SMALL PURCHASES

Chairman PROXMIRE. You have stated, Mr. Staats:

In addition, the Armed Services Procurement Regulations permits purchases of \$2,500 and under to be reported as competitive, even though many are not.

Then you go on to show that on the basis of your checking that 69 percent of a total of \$80 million in procurement actions were not competitive, were noncompetitive procurements. (See p. 9.)

It would seem to me that this is a regulation the Armed Services certainly ought to change, if, in fact, they are assuming that procurements of less than \$2,500 are competitive, and you say that about 70 percent, better than two-thirds, are not competitive. This is just a matter of deception, they are deceiving themselves, and deceiving the Congress, correct?

Mr. NEWMAN. Mr. Hammond, would you comment on that, please?

Chairman PROXMIRE. Would you identify yourself, please?

Mr. HAMMOND. James Hammond, Associate Director of Procurement.

Chairman PROXMIRE. Fine.

Mr. HAMMOND. The local contracting officials know that these items are purchased noncompetitively, and this information is recorded on local forms. But when the reports are made to Defense there is no provision for reporting these as noncompetitive, and the total is reported as competitive.

Chairman PROXMIRE. I am sure, as you indicate in your answer, nobody is trying deliberately to deceive. It is just a matter of complying with regulations, and the regulations are wrong.

What—would it be difficult, would it be onerous, to specify a competitive and a noncompetitive procurement when the procurements are this small? When they are this small would it be too much paper work?

Mr. HAMMOND. No. They are already identified. And it is just a matter of reporting them as two items instead of one. I think it would be a simple matter to get it corrected.

COMPETITIVE PROCUREMENT OF TIRES AND OTHER ITEMS

Chairman PROXMIRE. Mr. Comptroller General, in your statement you give this automobile tire example, and you point out that it has every element necessary for competitive bidding.

I wonder if you feel that this is an isolated situation which is being overlooked by the Defense Department or a fairly common one? In other words, if they would sit down and go over their procurement and try to classify them, those that meet these criteria that you have here, and those who do not, and then move into competitive bidding or where they met the criteria, do you think they would pick up a number of other procurements?

Mr. STAATS. Our impression is that they could. But as to the purpose of our pointing this up, it is a part of our program to go in and test other areas of this kind to be sure that the agency has thoroughly looked into the possibility of competitive procurement.

Chairman PROXMIRE. But, of course, the difficulty is you have a small staff and you have a whale of a big responsibility. Whereas you

can step in in a tire situation and save a lot of money and get them moving in there unless it is suggested to the agency itself, to assume the responsibility for seeing what else they can pull in, it is going to be an endless job for you.

Mr. STAATS. That is right. We cannot do the whole job. We have to look at these things on a highly selective basis, and we do it sometimes, well, many times, we do it because a problem will come up in another connection. We, in effect, stumble into some of these situations.

But also we deliberately try to go in and test different situations that either involve heavy procurement or lots of dollars, hoping that as a result the agency will, if our report is correct and accepted, extend it to other areas themselves.

ADEQUATE INTERNAL AUDITS

This gets back again to the importance of adequate internal audit in these agencies which many of them do not now have.

I must say that in the General Services Administration, Mr. Knott came over to see me not so long ago on the basis of a report we did, and he is going to develop a strong internal audit in the GSA. In my mind, this gets at the heart of the problem.

Chairman PROXMIRE. Fine.

Mr. WEITZEL. Mr. Chairman, to give credit, I believe, where credit is due, we might point out that in the tire area several years ago we did a survey in which we made recommendations that GSA have more competition. We felt they could lower the prices they paid partly based on findings in the case of some contracts in the Defense Department where they were getting lower prices than the Federal supply schedule prices GSA had. That was aircraft tires.

This particular report that you are just now mentioning happened also to be a GSA report on the Federal supply schedule. But your point is a good one, that it takes a case by case review of these situations to see if things can be bought competitively.

Mr. NEWMAN. When we had our conference with the big tire manufacturers several years ago we had problems in getting the report out, because each one of them wanted a separate conference.

At an overall conference we asked them, "How can the Government buy tires cheaper?" And the spokesman for the group said, "Yes, they could offer them cheaper." That is, commercial tires that are used by the Post Office Department, Department of Agriculture, Department of Defense, and other agencies. The tires could be built during off-seasons, and he said, "We would give them a third under the regular price."

So here we have procurement of commercial tires where, if we got everybody in the Government to combine all their requirements, we could buy them, and the companies said they would store them until needed at a third less than what we were paying. So much for the tire area—I imagine there are other commodities, too.

ARCHITECT-ENGINEER FEES

Chairman PROXMIRE. You have a very constructive analysis, I think, of the architect engineer fees that are paid, and in your statement you say:

However, because the agencies concerned and the professional architectural and engineering societies do not agreed with us that the competitive negotiation provisions of the statute are for application in the procurement of such services, we suggest that the Congress clarify the intent in this regard. (See p. 11.)

Will you draft legislation or indicate legislation of this kind that could be introduced by us or indicate—you do not have to draft it, but indicate what—what do you think we ought to cover so we will be in a position to act on this?

Mr. STAATS. We will be happy to develop that. We have a full report on this, which has been made to the Congress. I think the statutory change required would be very, very small.

Chairman PROXMIRE. Good.

"TRUTH IN NEGOTIATIONS" LAW

Now, I would like to ask you about a series of brilliant articles, that appeared in the Cleveland Plain Dealer, Cleveland, Ohio, by Sanford Watzman. He did a superb job, I think, of highlighting what you have highlighted, reporting it very well.

The "Truth in Negotiations" law and the failure of the Defense Department to pay any attention to it; this is a law that seems to me to be very good. It requires accurate, complete, and current data to be made available by contractors, and their costs, and the Defense Department has been acting as if it is something that they can take or leave, and decided to leave it. I think you have done a very fine job of developing this fact.

Let me ask you this: your study of defense contracts over a 10-year period has turned up some \$130 million in overcharges to the Government, and you have recovered half that sum from the corporations, is that right?

Mr. STAATS. Yes, that is correct.

Chairman PROXMIRE. This results from just minimal spot-checking on your part?

Mr. NEWMAN. Yes, sir.

Chairman PROXMIRE. Can we have a projection of that figure, how much overpricing occurs every year, the total?

Mr. STAATS. I raised the same question myself, Mr. Chairman. I do not know that there is any good way that we can project an accurate figure, and that is the reason we did not actually include such a figure in our report. But you would have to do a lot of extrapolating which may be very difficult to do, but I think it is still enough to indicate that it would be a very substantial amount of money.

DELAY IN ENFORCING

Chairman PROXMIRE. Well now, let me get back to this truth-in-negotiations question. It has been on the books for more than 4 years. What is taking the Defense Department so long? They seem to indicate that it is vague and indefinite. They have trouble applying it, yet they do not come to Congress, they have not for 4 years come to Congress, for any clarification of it.

GAO CONSIDERS LAW CLEAR

Mr. STAATS. We do not believe they need any clarification. This is really a matter of being sure that the law was fully complied with by the contracting officers. The law that you are referring to has been referred to as the "Truth in Negotiations" law.

Chairman PROXMIRE. Right.

Mr. STAATS. Our purpose in undertaking the study was to find out really whether or not it had been carried out in accordance with the intent of Congress.

SERIOUS LACK OF COMPLIANCE

Chairman PROXMIRE. Would you agree there is a serious lack of compliance?

Mr. STAATS. Yes.

Chairman PROXMIRE. And a comprehensive lack of compliance?

242 CASES TESTED BY GAO

Mr. STAATS. Yes. We felt the matter was so important that we were not willing to rest just on a few isolated cases, and that is the reason we took 242 cases of either prime or first-tier subjects.

Chairman PROXMIRE. What were the results of your finding in some of those cases?

Mr. STAATS. In our report which we sent to the Congress, which is dated January 16, it indicated very widespread noncompliance with the law.⁷

Our review was during the period April 1965 to June 1966. Thus, we picked a period when the law had been in effect for 2 years, so there would be adequate time for somebody to issue the regulations.

185 OF 242 CASES AWARDED UNDER LAW

We found 185 of the 242 procurements examined in the first phase were awarded under requirements of the law and procurement regulations for submission of cost or pricing data and certification that the data submitted was accurate, complete, and current.

IN 165 OF THE 185 CASES RECORDS LACKING

However, in 165 of these awards we found that the agency officials and prime contractors had no records identifying the cost or pricing data submitted and certified by offerors in support of significant cost estimates.

NO RECORDS FOR REMAINDER

We also found that of the remaining 57 of the 242 procurements examined, agency and contractor records of the negotiation indicated that cost or pricing data were not obtained apparently because the prices were based on adequate price competition or on an established catalog or market price of commercial items sold in substantial quan-

⁷ See staff study, 1967, p. 273.

titles to the general public. But there was not a record showing the basis for the contracting officer's determination.

20 OF 185 CASES IN FULL COMPLIANCE

Chairman PROXMIRE. So really what you are saying is in these 185 cases only 20 were in compliance with the law.

Mr. STAATS. Full compliance.

Chairman PROXMIRE. About 10 percent compliance, really.

Mr. STAATS. At the time of our review a new form, dated December 1964, had been developed by the Defense Department. However, in most cases we found that the revised form was not being used.

Chairman PROXMIRE. What did they say? Have they given any response to you?

Mr. STAATS. Yes. We include in our report the full response of the Defense Department?

Chairman PROXMIRE. Would this involve any burden, any big serious burden, on their part?

Mr. STAATS. Not in our opinion.

ACCURATE DATA ESSENTIAL

Chairman PROXMIRE. Is it possible for the Defense Department to determine, especially in view of the lack of competition, is it possible for the Defense Department to determine the real assessment on these contracts without having accurate, up-to-date cost data?

Mr. STAATS. It cannot be done.

Chairman PROXMIRE. They cannot do it?

Mr. STAATS. We could not do it. All we could find out was that the negotiation file was not documented to show that necessary data had in fact been made available to the contracting officer.

Chairman PROXMIRE. It seems to me it would be a big temptation—it seems to me most of these contractors are patriotic, honest businessmen, but there is a temptation when the costs are not given to the procuring agency, a terrible temptation, to overcharge.

AUDITING REQUIRES BACK-UP DATA

Mr. WEITZEL. Even if they are given, Mr. Chairman, no one can come along later and find out what costs were given at the negotiating table, and if you do not have something to measure against then you do not know whether the Government has been overcharged as a result of the failure to furnish the information because you do not know whether it was furnished or was not furnished.

In effect, you could walk into this room and it would be filled with file cases and you would not know which things in the file cases were presented to the Government and which were not.

But if they identify them and use the form and give the other information that is necessary, the Defense Contract Audit Agency or the GAO auditors would be able to follow this up and make a comparison.

LAW PROTECTS CONTRACTOR

MR. STAATS. The law is a good law from the standpoint of the contractor as well, because if this information was, in fact, made available to the contracting officer and the information was current, accurate, and complete, then the Government does not have any recourse if it later develops that costs are less than anticipated.

GOVERNMENT HAS RECOURSE IF PRICES MISQUOTED

However, if that information were not made available, and it is determined that his prices quoted were inaccurate, then the Government does have recourse.

MR. WEITZEL. You have such a case as that if the contractor presented information indicating that he was going to pay \$500,000 for a particular component to his assembly that he is furnishing the Government. As a matter of fact, he could have a rather firm bid for \$300,000. This is close to an actual case; it is not an actual case.

In that event, and if the contractor had certified that he had furnished the most accurate, current, and complete information whereas, in fact, he had not, and the Government found on audit that he had not, then the Government could have a basis for a claim because of the contractor's failure.

DOD RESPONSIBILITY

Chairman PROXMIRE. Now this seems to be a clear responsibility of the Defense Department.

MR. NEWMAN. That is right.

Chairman PROXMIRE. Because the contractors haven't even got the forms, is that correct?

MR. NEWMAN. They have forms now.

Chairman PROXMIRE. Form 633, I understand, has not been distributed by the Defense Department.

MR. NEWMAN. At that point in time they had not been distributed. When we were out working on the audit of 242 contracts, the forms had been sent to the warehouse instead of to the contracting officers, so we got them to get them out of the warehouse and send them to the contracting officers.

Chairman PROXMIRE. But you are making a report based on what you found at this time when the reports were in the warehouse.

MR. NEWMAN. That is right.

Chairman PROXMIRE. So a contractor can hardly be held liable for something that he is not given the form on which he is to report.

MR. NEWMAN. That is correct.

DCAA RESPONSIBILITY

To give you another illustration, Mr. Chairman, as you know, we are vitally interested, and it has been discussed here at the hearings, about internal audit. DCAA, which was set up, I think, about 2½ or 3 years ago, is responsible for all the contract auditing.

Senator SYMINGTON. What does that mean?

MR. NEWMAN. Defense Contract Audit Agency.

POSTAUDIT NEEDED TO DETERMINE REFUNDS

We issued an audit report in February 1966 to the Congress criticizing the Department of Defense for DCAA not making the postaudit to determine the amount of refund that should be made.^s

Now, you see that is from December 1962. From the time the legislation was effective to February 1966, Defense had not done anything in this area.

Finally, they got on the bandwagon and made up an audit program and began making postaward audits.

INADEQUATE POSTAUDITING

But even today, for instance, there is not, in our opinion, sufficient numbers of these contracts being postaudited to determine if adjustments should be made in the price.

Chairman PROXMIRE. So today has that form been distributed; is it in use?

Mr. NEWMAN. Yes.

Chairman PROXMIRE. Are they complying with the Truth in Negotiations Act, in your judgment?

Mr. NEWMAN. Yes, insofar as furnishing the Form 633 is concerned.

Chairman PROXMIRE. Are they complying?

Mr. NEWMAN. Yes, they are using that form today.

Chairman PROXMIRE. I understand.

I am told that a rollcall is imminent. I know Congressman Curtis has a number of questions, and I would like to ask him to take the Chair while those of us who have to respond to the rollcall will do so and we will be back.

Representative CURTIS (presiding). Thank you, Mr. Chairman.

GAO REPORTS TO CONGRESS

Following up on this, Mr. Staats, you referred to two reports that you made to the Congress, one on this auditing. To which group in the Congress did you make that report or was it to an individual?

Mr. STAATS. We refer to a report to Congress, Congressman Curtis; a report we send normally to the Speaker and to the President of the Senate.

REPORTS TO COMMITTEES

Representative CURTIS. I see. One that would be made in response to this committee you would address to this committee?

Mr. STAATS. We would also make reports to committees which are at the specific request of the committee.

Representative CURTIS. Of course; but these reports were to the Congress?

Mr. STAATS. That is correct. It was a public report.

Representative CURTIS. Yes.

Mr. STAATS. All reports to the Congress become public reports, whereas a report to the committee may or may not in the discretion of the committee.

^s Staff study, 1967, p. 85.

Representative CURTIS. I was interested in seeing where the responsibility in the Congress might come to rest.

Let me ask you this: I should know, but I do not know. The Truth in Negotiations Act—did that come from our committee or from the Armed Services Committee?

Mr. STAATS. The Armed Services Committee.

Representative CURTIS. Did this report to them, to the Congress—was that referred to the Armed Services Committee, do you know, and did they hold any hearings on it?

Mr. STAATS. There has been no hearing held on it. It was made available to the Armed Services Committees as well as Government Operations and to the Appropriations Committee.

Representative CURTIS. Yes.

GAO AND RENEGOTIATION BOARD

This committee, of course, has been interested in this subject for some time, and I do want to pursue it further, and yet there is another committee on which I serve which has an interest in this in another way, the Ways and Means Committee. Does the Renegotiation Board ask the Government Accounting Office to assist them in any of their work that they do in renegotiation?

Mr. STAATS. Not directly, to the best of my knowledge. Our material is made available to them.

Representative CURTIS. But you have not had any specific request for personnel or assistance in the running down of some particular case they might have?

Mr. STAATS. I am sure we would cooperate with them. We would not feel that it would be appropriate for us to assign personnel to them as an agency of the executive branch.

Representative CURTIS. Even though they requested it? I am, first, trying to find out what the relationship is.

(The GAO subsequently filed the following information for the record:)

STATEMENT ON GAO RELATIONSHIPS WITH RENEGOTIATION BOARD

The following working relationships have evolved to provide assistance to the Renegotiation Board and to our Office in carrying out the respective responsibilities.

Copies of our audit reports to the Congress relating to contractors whose Government business is subject to renegotiation are provided to the Board for use in conducting renegotiation proceedings.

A list of contractors on which audit reports are in process in the General Accounting Office is sent each month to the Board in Washington for its information and use in renegotiation proceedings. If further information as to a specific contractor is desired by the Board, representatives of the General Accounting Office have authority to discuss the examination and the tentative findings; however, draft copies of audit reports are not provided to the Board.

Representatives of the General Accounting Office may discuss with representatives of the Board, information in their files relating to a specific contractor being examined or scheduled for examination by us.

Mr. STAATS. I think it would present some problem of precedent to us to either undertake assignments or assign personnel directly to an executive agency.

Representative CURTIS. Let me ask you the other question: has the Renegotiation Board ever referred to the Congress any problems they have seen develop as a result of their casework?

Mr. STAATS. Not that we are aware of. We could check that to be 100 percent sure.

(The information below was later supplied for the record:)

STATEMENT ON WHETHER PROBLEM AREAS ARE BROUGHT TO THE ATTENTION OF CONGRESS BY THE BOARD

The Board has informed us that, except for matters which have been discussed with the appropriate legislative committees during the consideration of the several extensions of the Renegotiation Act, problem areas have not generally been brought to the attention of the Congress. However, the Board refers to the appropriate procuring department information obtained in its work which it considers to be of interest to the department.

EFFECTIVENESS OF RENEGOTIATION BOARD RE USE OF GOVERNMENT PROPERTY

Representative CURTIS. The record might as well show here that I have been very critical of the Renegotiation Act for years because I felt that it was not serving a good function. If anything, it was providing sort of a crutch that enabled our procurement officers and others to say, "Oh, well, we don't have to worry too much about this. If it is too bad in the pricing, and so forth, the Renegotiation Board will pick it up."

Yet when we examine the activities of the Renegotiation Board I find that they pickup very little, if anything. Actually some of the things they do pickup go the other way and discourage contractors who are doing a good job from bidding on Government work. For this purpose I was seeking whatever information you might have as to whether or not the Renegotiation Board might have picked up some of this use of Government property in the fulfilling of some contract they have with the Government in their negotiating of that particular contract.

Mr. STAATS. We could check this point.

Representative CURTIS. Would you? I would be very interested in knowing whether they have because——

Mr. STAATS. I can see the relevance of your question.

Representative CURTIS. Yes. You see, this would be an immediate thing that the Renegotiation Board ought to look at and they say they do in renegotiating a contract. They will say, "Well, how much equipment was furnished by the Government," and so forth, and in many of these contracts the Government has furnished equipment. But I have never heard them make the point that the records were inadequate so that they did not have the information or anything of that nature.

I would have thought that this Truth in Negotiations bill would have been of tremendous advantage to the Renegotiation Board.

Mr. STAATS. We would be happy to supply a statement on this for the record.

Representative CURTIS. Yes.

(The informatoin referred to follows:)

CONSIDERATION GIVEN BY THE BOARD TO GOVERNMENT PROPERTY IN THE HANDS OF CONTRACTORS

The Renegotiation Board has informed us that—

(1) Contractors on request submit information to the Board showing the total amount of Government plant, equipment, and materials furnished by Government departments;

(2) Generally, the Government-furnished plant and equipment information, as furnished by the contractors, has been accepted by the Board for purposes of renegotiation;

(3) When the Board has occasion to question the information supplied by a contractor, the matter is referred to the appropriate Government department for confirmation.

Representative CURTIS. Now, let me ask another procedural question.

On these cases that are brought out here, it looks as if—in some instances, as Senator Proxmire was bringing out—the contractors themselves have not been furnished the forms, it would be hard to put the onus on them.

Yet, on the other hand, the fact still remains they have been using Government property without adequate payment.

RECOUNPING FROM CONTRACTORS

What procedures do we have for recouping these funds or these amounts from these contractors? Can you comment on that?

What is done with respect to recouping?

Mr. STAATS. I wonder if we could ask Mr. Keller, our General Counsel, to respond to these questions?

Representative CURTIS. Yes, of course.

Mr. KELLER. I think the question, Mr. Curtis, breaks down into two parts. On certifications of cost data as required by Public Law 87-653, if the certificate does not identify the data on which the certification was based you do not have much of a case for a price adjustment because you have lost the identification of basic element you need for the price adjustment. That is, the data on which the Government relied in negotiating the contract.

Representative CURTIS. Let me interrupt for just a minute.

On the basis of at least the cases that the General Accounting Office checked, although they actually used the equipment, although they actually did not fill out the form, once you have that information I would think you could have a recoupment.

Mr. KELLER. That is the other part of your question.

Representative CURTIS. All right.

USE OF GOVERNMENT PROPERTY ON COMMERCIAL WORK

Mr. KELLER. Where a contractor has utilized Government property for commercial work without approval of the Government, I think the Government has a case to recover a reasonable charge for the use of that property. Such a recovery would be pursued by the Government.

Representative CURTIS. Who would pursue them; would the Defense Department pursue them?

Mr. KELLER. It would be up to the contracting agency to seek a payment from the contractor for the use of Government equipment on commercial business.

Representative CURTIS. But is all this property actually assigned out, say, to the Defense Department and then, in turn, assigned to the contractor? GSA could own some of it.

Mr. KELLER. It could be in the hands of GSA or Defense or any of the contracting agencies. I think GSA and Defense would be the two major agencies.

Representative CURTIS. In that instance then the person who would have to move toward the recoupment would be the agency to whom this equipment was assigned, is that correct?

Mr. KELLER. That is correct, sir.

ROLE OF JUSTICE DEPARTMENT

Representative CURTIS. Would the Justice Department ever get into this area to collect claims of this nature? I am not thinking of the civil rather than criminal aspect.

Mr. KELLER. I think they would if it comes to a case where the Government is contemplating court action or is in a position of defending a suit. Short of that, I do not see Justice in the picture.

Representative CURTIS. Many of the defense contracts have renegotiation clauses in them, and this would be another area where some of this could be followed through. It is very difficult for me to understand how the Defense Department could do a very good job of renegotiating if they have not gotten this information back on their reports. Would you comment on that?

Mr. KELLER. It would be certainly difficult for them. I guess if you do not have information maybe your problem is not too difficult. We think they should have the information.

Representative CURTIS. Yes.

NEGOTIATION WITHOUT RECORDS ON GOVERNMENT FURNISHED PROPERTY

I do not know how you could really negotiate a contract with much intelligence if you did not have records of what Government property is owned and might have been used in this.

DEFENSE CONTRACT ADMINISTRATION SERVICE (DCAS)

One other basic comment: This committee has shown considerable interest in the development of the Defense Contract Administration Service. They are a key to this problem. The qualifications of the personnel responsible for following through is important. Secretary McNamara created a service so that there would be an esprit de corps, and improved training of this kind of personnel.

ROLE OF DCAS IN NEGOTIATIONS

Incidentally, in my interrogations on how far we were going, I was looking into what jurisdictions were given to the contracting service officers. I was disappointed to learn that they had nothing to do, ap-

parently, with the renegotiating of contracts. They are apparently simply to continue to take a contract that has been negotiated, follow through for deficiencies, compliance, and so forth, but they were not involved in the original negotiations and, therefore, not involved in the negotiations themselves.

But, inasmuch as you have touched on the problem of turnover of personnel and lack of expertise, would you comment on this specific effort on the part of the Defense Department to create a special service?

GAO REPORT ON DCAS

Mr. STAATS. Perhaps I might respond first, Congressman Curtis, by referring to a report which we just sent to the committee. It was sent to this particular Subcommittee on the development of the Defense Contract Administration Services, and our suggestions with respect to strengthening and improving the work of that service.⁹

Representative CURTIS. Very good.

Mr. STAATS. This is a very recent one. If I could read one paragraph—

Representative CURTIS. Please do.

Mr. STAATS (continuing). Which I believe summarizes better than anything else I could say on the subject:

During our survey we observed a number of areas which we believe warrant further management attention. These areas include (1) military department's retention of plants and contract administration function—

that is the function not having been centralized yet, but we feel it should be centralized—

(2) elimination of delays in the payment of contractors' invoices and loss of cash discounts reported at \$2.3 billion for the year ending November 30, 1966—that is the figure only with respect to those areas that we checked—

and (3) agency efforts to anticipate and minimize delinquencies in contract deliveries, (4) agency technical evaluations of contractors' price proposals, (5) agency efforts to eliminate unneeded quality assurance inspection requirements imposed by procuring activities.

We feel this is a desirable development, we applaud it. We think that these are things that ought to be looked at by the Defense Department in an effort to try to improve on it.

Representative CURTIS. Thank you very much. My time is up.

Chairman PROXMIRE. Unfortunately, that is another vote I have got to go down for. But let me ask a couple of questions.

GAO REPORT ON "TRUTH IN NEGOTIATIONS," FEBRUARY 1967

The Cleveland Plain Dealer series also mentioned a GAO report issued in February.¹⁰ You say in this report that the Defense Department has been derelict in not requiring its contractors to adopt formal business-like cost estimating systems. Apparently the Defense Department's own auditors, not just the GAO, have been urging this same step for some 10 years.

⁹ Comptroller General's Report B-161328, May 8, 1967.

¹⁰ Staff study, 1967, p. 176.

IMPORTANCE OF COST ESTIMATING SYSTEMS

Will you please tell the committee why estimating systems are so important.

Mr. STAATS. Well, this, of course, goes to the heart of the negotiations. Unless the Government has the basis of estimating what the costs are going to be, has the data with which to enter into those negotiations, then it is likely to be kind of one-sided.

Chairman PROXMIRE. This is because, as you have well-documented, such a small percentage of the procurements are competitive. Therefore, you have to rely on cost estimating systems to get a fair price.

Mr. STAATS. That is correct.

Chairman PROXMIRE. How do you account for Mr. McNamara's tardiness in this area?

Mr. STAATS. Well, again, about all I can say on this is there's been considerable progress made in this area, but there is a lot more to be done.

Chairman PROXMIRE. Are you satisfied with their February report, with their answer to your February report? Their response?

Mr. WEITZEL. They certainly have been cooperative in what they said they were going to do. [Laughter.]

Mr. WEITZEL. I am not saying that facetiously. They have to have time, but they did, as I recall, adopt our proposals and said they were going forward with them.

Mr. NEWMAN. That is right.

VOLUME OF BUSINESS REQUIRES A SYSTEM

Mr. WEITZEL. We feel that because there are so relatively few GAO auditors and, Defense Department auditors, although there are 3,600 of the Defense ones, compared to the total volume of procurements, the more you can systematize and get a reliable system in operation in a contractor's own operations, the more dependable that will be and the less independent review work will have to be done after an estimating system is appraised.

Chairman PROXMIRE. This is another very important reason for your "truth in negotiation" compliance.

Mr. NEWMAN. Correct.

Chairman PROXMIRE. Your limited auditors.

NEED FOR FEEDBACK FROM DCAS TO DCAA

Mr. WEITZEL. In that same report we also suggested, as I recall, that the defense contract audit people should make broader reviews of contract pricing proposals. They should have better access in some cases to the contractors' records, and also there should be more feedback from the contract administration people—the contracting officer to the auditor—so that the auditor can see whether his recommendations are used and adopted. As I recall, Mr. Newman, the Defense Department, responded that they were taking steps to put this into effect. The access to records may be a rather difficult one in some cases.

POSTAUDIT SYSTEM

Chairman PROXMIRE. About a year ago you issued a report urging the Defense Department to adopt a postaudit system on defense contracts. That is to check back to see whether the Government had been cheated.

Do you mean to say the Department had no such program of its own until you prodded it into adopting one?

Mr. NEWMAN. That is correct, sir.

Chairman PROXMIRE. No program of this kind?

Mr. WEITZEL. This was a postaudit program as I recall.

Chairman PROXMIRE. Isn't it logical that they should have something like that?

Mr. WEITZEL. To us, yes, sir.

GAO AND DOD DISAGREEMENT ON INTENT OF ACT

Mr. NEWMAN. Yes. You must understand, Mr. Chairman, from the period December 1962 to October 1964 we were having serious discussion with the procurement people in defense.

When the Truth in Negotiations Act came out we interpreted the act differently than they did. Of course, we helped write it. As a result there was quite a bit of discussion in getting out the ASPR's. When the original ASPR's were put out, we didn't agree with them. We kept constantly prodding them to make changes and it wasn't until about October 1964, almost 2 years later, that the ASPR's were put in such shape that we could live with them.

Now, all that was going on up to October 1964.

DCAA POST AWARD AUDITS

Now you must realize that the Defense Contract Audit Agency prior to the time it was set up, was in the three different departments, and they all had different regulations. So the Defense Contract Audit Agency had just been established about a year, when in February 1966 we issued a report telling them they should make postaward audits. Immediately by March 1966 they had an audit program. However, as I understand it from figures that have been submitted to us, they made very few postaward audits up to the end of 1966.

Chairman PROXMIRE. How is it working now?

Mr. NEWMAN. We haven't had a chance to look at it.

Chairman PROXMIRE. At the end of 1966, which is quite recent.

Mr. NEWMAN. Yes, sir.

Chairman PROXMIRE. It hadn't done as much as you would expect.

Mr. NEWMAN. Well, for instance, one DCAA regional office I went into had, I think, 13 postaward audits completed.

Chairman PROXMIRE. What does this mean, put this in perspective.

Mr. NEWMAN. Well, they had made an audit on price proposals of at least a thousand. So there was a very, very small percentage of post-audit. But they are devoting more and more time to it and we are going to keep on their heels.

Chairman PROXMIRE. I hope so, because after all, isn't it true that the amount of money you save in terms of the cost of conducting these

audits is overwhelming? It's what—is it, 10 to 1, 100 to 1, a 1,000 to 1? Anyway it's a tremendous proportionate saving. The best kind of investments the taxpayer can make.

AUDITOR'S ACCESS TO RECORDS

Mr. NEWMAN. Well, if they are utilized properly. We have an internal audit report coming out which will cover the subject, and we feel more and more that they should have the authority that we have in this area.

They are having their access to records problems. It was only yesterday I got a call from our west coast office about it and it is surprising to find out that some contractors refused to let them even look at the records, so they have their problems as well as we have ours in getting these records to make a proper audit.

Mr. WEITZEL. There has been some discussion as to whether a law is needed to give Defense auditors access to the records or whether it can be accomplished administratively, which we feel it could by changing the form of the contract.

Mr. NEWMAN. We recommended that in February 1966, but nothing has been done to date.

Chairman PROXMIRE. Yes. Congressman Curtis will take the chair while I go to the floor to vote.

RECOUPING THROUGH RENEGOTIATION BOARD

Representative CURTIS (presiding). Have you ever used the machinery of the Renegotiation Board? Of course, the essence of this is through the tax laws or recouping some of the price on the ground that in these originally negotiated contracts, where no one really knows what the costs are, there being new weapons or something new, so that they then come back and take a look to see whether to renegotiate the price. Then the Government recoups it through the Internal Revenue Service, in the renegotiation process. I would think that a lot of these kinds of things that you have mentioned would be the basis for starting a case over in the Renegotiation Board.

Mr. STAATS. I really can't answer your question. I suppose it really would have to come from the Renegotiation Board itself. I do know—

Representative CURTIS. I would think a case can start on their initiative or it could start on anyone's initiative. I ought to know this but I don't.

Mr. WEITZEL. Mr. Curtis, one of the problems, I believe, and only one, of course, is that the Renegotiation Board is more concerned with a contractor's total position on his total business with the Government, whereas we, and the Defense Department under the Armed Services Procurement Regulations, are concerned with individual contracts.

Representative CURTIS. Well, there is his total in a sense, but they have to be concerned with the individual contract. In fact, that is the way they develop the data in order to determine whether there is a—

Mr. WEITZEL. They are concerned with the performance and whether it is efficient or whether they have saved all the money that they could have, but it is possible for a contractor to make a million dollars on one contract and lose a million on another, and while I am no expert

on renegotiation, I think then he wouldn't be renegotiated as substantially.

Representative CURTIS. You would be renegotiated. Maybe that is sort of a saving grace that was put in and I think probably legitimately to protect someone. But it doesn't deter the Renegotiation Board from making a determination of what they think is reasonable profit. One of the big arguments I have had with them over the years was with the airframe companies. They said, "well, we should only give them x-percent return because so much of the equipment furnished and capital is Government equipment and Government capital." And I then ask, "why is it that the percent of Government capital in the airframe industry hasn't been reduced over a period of say, 10 years?" And they answer, "well, you can't expect people to put their money into such a risky business." Then I go back to the original point, "well, maybe you aren't giving enough return for people to risk it."

GOVERNMENT FURNISHED EQUIPMENT

Well, whatever it is, I am just bringing that out to demonstrate that they do go into specific contracts in order to get results.

One of the big items that they are constantly looking at—they say they are—is how much capital has been provided by Government in machinery or whatever, and how much has been provided by the contractor himself. So they are very much in the area of our discussion here.

Mr. WEITZEL. They may have some difficulty. I believe the report that we are working on on Government property in contractors' plants will point out that special purpose tooling isn't even included in the accountability by contractors. We think it should be.

Representative CURTIS. Yes.

Mr. WEITZEL. That is the basis of it. It could obviously be used as you were pointing out for the particular purpose for which it was put into the plant.

Then another thing, a contractor's complement, you might say, of Government furnished tooling could be maintained and even increased in value by the replacement of existing Government-owned equipment though they have an ultimate policy, supposedly, of reducing the Government-owned equipment in the plant.

Representative CURTIS. Mr. Comptroller General, you have been very kind to suggest that you would look into some of this. I wonder if you would look somewhat fully into how the renegotiation process fits into what we are talking about here. And also whether or not that might be a tool to be of some assistance.

Mr. STAATS. I think the question is a very relevant one and we would be glad to.

Representative CURTIS. Yes.

USE OF SALES RECEIPTS "BACKDOOR SPENDING"

Now I have another line of questions that relates to your reports on the cost of sales of surplus properties and distribution of proceeds, and on various methods of financing agency programs.

There is a general term used in the House and I guess in the Senate too, about "backdoor spending." I am concerned about how the receipts that are obtained from the disposal of the property, for example, are actually used.

RECEIPTS FROM SALES OF REAL AND RELATED PERSONAL PROPERTY

I pointed out the so-called "punkin" fund that has to do with the Defense Department's use of some of these receipts. But I found out that is also true, apparently, on some of the sales of real and related personal property under the GSA Act. These do not go to Miscellaneous receipts but to the land and water conservation fund, which the Interior Department administers.

Have you looked into that aspect and have you any comments on that?

Mr. STAATS. Well, that one might be regarded in the sense as an earmarked fund—it is a hybrid actually. Part of the receipts that go into the fund are made up by the people who visit the parks. It is the same as a user charge, but part of it also arises from the sale of land.

Representative CURTIS. Yes.

Mr. STAATS. So it is a hybrid type of fund.

Now, those moneys have to be appropriated out of that fund.

Representative CURTIS. Through the regular appropriation process?

Mr. STAATS. Yes.

USE OF RECEIPTS FROM SALE OF SEALSKINS

Representative CURTIS. Then how did this happen? Some of the funds come from the sale of sealskins or the skin processors and yet they used that fund, I think, without appropriation to try to develop a competing source of tanning and curing sealskin pelts. In fact, as I understand it, they used all the receipts so that the State of Alaska did not get its share in it and that was not through an appropriation process.

WIDE DISCREPANCY IN USE OF RECEIPTS

Mr. STAATS. I think you are correct on that one. I think about all that can be said is, it is this kind of an accretion of history of a number of different actions taken by Congress which results in a wide discrepancy in the way in which money goes into these special funds and the way in which it is authorized to be spent, some of it subject to appropriation, some of it not.

Representative CURTIS. This is a good beginning to your report, but I repeat, only a good beginning.¹¹

The administration has recommended further reliance on the user fee technique of gaining funds, and I happen to favor an increased use of this technique—to the extent that it is appropriate. But if we are going to move in this direction. I want to know what these user fees are and how they are going to be spent. If I read your report correctly, we have developed no uniform system of how receipts from user fees

¹¹ See hearings of Subcommittee on Foreign Aid and Expenditures of the Senate, Government Operations Committee, Sept. 23, 1965.

or sale of surplus personal property or real estate can be used. You did say in this one fund it was supposed to be appropriated. But I pointed out a case where it didn't follow the appropriation process.

Would you comment on my observations?

Mr. STAATS. Mr. Keller would like to respond to part of the question.

Mr. KELLER. Mr. Curtis, on the question of the use of receipts from the sale of property, the Federal Property Administrative Services Act authorizes the use of receipts under certain conditions.

The act authorizes the administrator to use receipts for the utilization of excess property and the disposal of surplus property including the expenses of sale, the payment of auctioneers, appraisers, et cetera. Also funds from the sale of property that was originally purchased from funds that are not appropriated funds or are revolving funds, would go back to the funds from which the purchase was made. Funds are authorized to be placed in a special deposit account to take care of any question of refunds that may be due to contractors. Also, funds can be applied against work performed by a contractor, under certain conditions.

The latter may be the sealskin-operation you were talking about, I am not sure of that because I haven't checked into it.

Representative CURTIS. Yes. If you would check into that.

(The following material was subsequently filed relative to the foregoing:)

STATEMENT RELATIVE TO PROTECTION, HARVESTING, AND SALE OF PRIBILOF FUR SEALS

The act of February 26, 1944, as amended, and subsequently repealed and replaced by the Fur Seal Act of 1966 (80 Stat. 1091), declared the Pribilof Islands to be a special reservation for Government purposes and gave the Secretary of the Interior authority to protect and harvest the fur seal herd, to furnish the necessities of life to the native inhabitants of the islands, and to provide for their comfort, maintenance, education, and protection. The act also provides that the proceeds from the sale of sealskins shall be deposited in a special fund in the Treasury (Pribilof Islands fund), and that there is authorized to be appropriated annually, for the purpose of carrying out the provisions of the act, an amount not exceeding the total proceeds of such sales covered into the Treasury during the preceding fiscal year. Beginning with fiscal year 1959, the State of Alaska (72 Stat. 339) has received 70 percent of the net proceeds from the sale of sealskins as determined by the Secretary of the Interior after deducting costs of administering the Pribilof Islands.

Since 1921, fur seals harvested from the Pribilof Islands have been processed and sold by the Fouke Fur Company under successive contracts with the Department of the Interior. We understand that the expenses of processing and marketing the sealskins have been met from the gross proceeds resulting from the sale of the sealskins and the net proceeds have been deposited into the Treasury. This practice appears to be a reasonable interpretation of the laws applicable to the harvesting and sale of fur seals from the Pribilof Islands and has been recognized by the Congress. See for example House Report No. 3052, 81st Congress.

The current contract with the Fouke Fur Company entered into on April 30, 1965, provides that seven-eighths of the sealskins harvested during 1963 through 1967 will be made available to Fouke for processing and sale. Pursuant to a determination by the Secretary of the Interior the remaining one-eighth of the sealskins harvested during 1963 through 1967 are to be retained by the Government for use under experimental contracts with other interested firms.

The initial research and development contract was entered into with the Pierre Laclede Fur Company on August 30, 1965, pursuant to authority contained in the act of February 26, 1944, as amended, and provided for the Government to furnish the contractor about 5,000 sealskins for research and development purposes. The total cost of the contract to the Government was estimated to be \$377,636, including a fixed fee of \$30,000, which was to be financed out of pro-

ceeds for the sale of any sealskins processed by the contractor. In the event, proceeds from sales were insufficient to reimburse the contractor for allowable costs of the contract, the deficiency was to be paid the contractor out of funds appropriated for administration of the Pribilof Islands.

NO FORMALIZED ACCOUNTING ON USE OF RECEIPTS

Representative CURTIS. By the way, and have you all made any recommendations as to how we might formalize the accounting of this?

Mr. STAATS. The answer is that we have not. As I have mentioned earlier, to the best of my knowledge, this is the first time this over-all type of compilation has been put together in this particular form. I think it would be of use to a number of the committees of Congress.

PRESIDENT'S COMMISSION ON BUDGET CONCEPTS

I cannot speak finally for the President's Commission on Budget Concepts, but I would think that it would be almost inevitable that that Commission will address itself to this same issue.

Representative CURTIS. Yes.

You can see in the Ways and Means Committee why we would become involved.

First, we have never developed capital budgets in the Federal Government. I think we badly need them because we get proceeds from the sale of capital assets. We were talking about one today.

Second, we get proceeds from user fees.

Apparently we haven't developed any uniformity about how the receipts from either of those two sources might be used. How do we develop some sort of uniformity in this area?

CATEGORIES OF SITUATIONS RE USE OF RECEIPTS

Mr. STAATS. If I may say so, it seems to me you have three fairly distinct categories of situations.

BUSINESS-TYPE ENTERPRISES

One is the business-type enterprise where the Congress is interested in knowing what the shortfall is between receipts and outgo.

Representative CURTIS. Yes.

Mr. STAATS. I am thinking of power.

Representative CURTIS. TVA, and so forth?

Mr. STAATS. Yes.

REPAYMENTS TO LOAN FUNDS

The second type situation is where you have a loan fund into which repayments are made, and the question of whether those repayments become available for new loans under a revolving loan fund concept.

USER CHARGES

The third is the situation you have been referring to, namely, where you have user charges for people who receive some special service or benefit from the Government and are therefore charged, in effect, a tax, and how that money gets spent. Whether it is earmarked. The gasoline tax for highways is a case in point.

Representative CURTIS. Or stamps.

SALE OF STAMPS

Mr. STAATS. Or postage stamp revenues for use in the postal fund. So you have three fairly distinct categories, and how you treat it depends a little bit on your philosophy with respect to every one of these three.

Representative CURTIS. Yes.

RECEIPTS FROM SALES OF PROPERTY

I think that is true. Yet in this one area of your report where we are talking about the sale of surplus properties, I think it looks like there can be some uniformity.

Then in these other funds—122 of them, which would include revolving funds and other things—there needs to be some rationale, and I think you are recommending that, too.

Mr. STAATS. Right. I think the question we might advantageously look into as a general accounting office would be the question of the sale of physical assets, what becomes of the proceeds on the sale of physical assets.

I think that is a somewhat different problem than the three categories referred to.

Representative CURTIS. Well, I agree, and that is where I originally started my interrogation. But then when I got into this specific case we found they were commingling those funds with user fees and so forth.

Mr. STAATS. Right.

Representative CURTIS. First, we ought not to commingle. Then we get into this thing of the Pribilof Islands and the seals. This is the most unique kind of thing for the Federal Government. Possibly, it isn't as unique as I think it is, but it isn't a user fee, and it isn't a sale of an asset that we procured. It illustrates some of the problems that exist in both the user fee technique and the sale of physical assets.

Well, my time is up, and I will turn it back to the Chairman.

ACCESS TO COMPANY RECORDS

Chairman PROXMIRE. That post audit report also mentions the matter of access to company records for the purpose of comparing actual costs, costs estimated at the time of negotiation. As I understand it, Mr. McNamara is not sure of his authority in this situation, and you recommended that he could assert his authority by way of regulations.

It has been more than a year since your report was issued. How has this problem been resolved?

Mr. STAATS. I don't believe there has been any resolution on it.

Mr. NEWMAN. No.

DOD EXPLORING PROBLEM

Mr. STAATS. Mr. Keller tells me that Defense has a subcommittee that has been exploring this, reviewing it.

Mr. NEWMAN. For a year.

Mr. STAATS. We do not know what the current status is.

Chairman PROXMIRE. In the time it's taken the Defense Department to ponder this point, how much money do you think they have lost in overpricing defense contracts—

Mr. STAATS. I have no way of knowing.

Chairman PROXMIRE. Plenty.

Mr. WEITZEL. Mr. Chairman, one of the complications in this area—

Chairman PROXMIRE. Let me say either he has that authority now or it could be provided by an Act of Congress, is that correct?

Mr. NEWMAN. That is correct.

Mr. WEITZEL. Yes, we think they could do it administratively but during the Holifield hearings on Defense contract audits by the General Accounting Office, I believe a question was raised by the subcommittee as to whether this question was not of such moment that it should be referred to the Congress for action. I think this may be contributing to the delay in resolution of the problem, the fact that the Holifield committee felt as it did. For example, on page 13 of the report on Defense contract audits which was House Report 1344 of the 89th Congress, the subcommittee said, "it would seem that if the Department of Defense is to acquire the access privilege on a sustained or permanent basis, it probably should be a matter of congressional rather than administrative decision." That is all I will read.

Chairman PROXMIRE. Who said that?

Mr. WEITZEL. This was the report of the Military Operations Subcommittee of House Government Operations, back in March, 1966—the Holifield Subcommittee Report.

Mr. NEWMAN. Congressman Chet Holifield's subcommittee.

REVIEW OF NEGOTIATION PROCESS

Chairman PROXMIRE. Every step along the way—here step No. 1, you don't have competitive bidding, you can't have it as completely as we would all like to have it. We all agree on that. We would like to have more. We don't think we have enough. So you would like to have more. So you have to estimate the costs. The second stage or cost estimate has been called delinquent, it certainly has not been adequate.

Then in a third stage or followup the opportunity of the Secretary of Defense or his auditors to actually check the cost records, the post audit, they can't do that. So that it would seem that it puts the Government in a most disadvantageous position, and it would seem to me that if Congress is going to be responsive to taxpayers under these circumstances they certainly ought to provide at least some access to records in the event the Secretary of Defense tells us that in his view he doesn't have that authority now.

Mr. WEITZEL. We feel their auditors certainly should have that access.

Chairman PROXMIRE. Why do you think they should have it?

ACCESS AUTHORITY TO REVIEW CONTRACTOR'S RECORDS

Mr. WEITZEL. We think they should have it if they are going to get at the bottom of these situations. We have it and we exercise it subject to some question on occasion, but what you were saying just makes the

point that was made by Representative Hardy in proposing the amendment to the Armed Services Procurement Act, and the Federal Property Act, which gave the GAO auditors access to contractors' records in cases of negotiated contracts. He said—

Chairman PROXMIRE. You have that Hardy amendment which is in the law?

Mr. WEITZEL. That has been in the law.

Chairman PROXMIRE. You act under that. But do they have any corresponding authority?

Mr. WEITZEL. They do not, but they also have the authority to make a contract as one of the parties to the contract, the other one, of course, being the contractor, and we feel that it is, let's say, consistent with good management to insure that you have such access to records in the case of a negotiated contract so that you will be able to determine whether you had the proper information.

Representative CURTIS. Will the gentleman yield?

On the renegotiation clauses or redetermination clauses that are put in those contracts, that is the essence of them, isn't it, that they have access to this information?

Mr. WEITZEL. A price redetermination clause would have provisions for furnishing cost information on which a redetermination could be based. But, Mr. Hardy said that the contractor would have his lawyers and accountants and he felt that the Government was at least entitled to the benefit of an audit report and we think they are entitled to the benefit of a Defense audit report, but this has been a matter of some discussion as you can see.

DOD HAS ACCESS TO CERTAIN DATA

Mr. KELLER. I would like to clarify one point on the access problem. It is a question of degree or extent of access with the Defense Department. They do have access to the data used in negotiating the contract. We think they should also have access to the cost of performing the contract.

Chairman PROXMIRE. They do have access to what.

Mr. KELLER. The data used by the contractor in negotiating the contract.

Chairman PROXMIRE. And they also ought to have access—

Mr. KELLER. To the cost of performing the contract as well as the data used in negotiating the contract.

Mr. STAATS. Under Public Law 87-653, the Truth in Negotiations law, the contracting officer would have access to any available information at the time the contract is negotiated. What Mr. Keller is referring to then is what actually takes place after the contract is entered into.

Chairman PROXMIRE. Well, the Truth in Negotiations Act isn't enforced or hasn't been, we haven't had any evidence that it is being respected. And absent that we don't have the postaudit either.

"TRUTH IN NEGOTIATIONS" AND POSTAUDIT

Mr. STAATS. We don't really have either effectively, now.

Chairman PROXMIRE. You don't have anything. You don't have either effective now, you say.

PECKING AT THE PROBLEM

Mr. NEWMAN. Mr. Chairman, it is just impossible for the General Accounting office to audit all these contractors. We are pecking at it as best we can.

Chairman PROXMIRE. Right.

Mr. NEWMAN. But there are some 3,600 auditors over in DCAA that should devote considerable of their time to postaudit.

POSTAUDITS FORECLOSED BY DCAA IF "COMPETITION" CLAIMED

The other area under this Truth in Negotiation that the DCAA auditors cannot touch is when the contracting officer decides that he has competition. The only one who gets into that area is the General Accounting Office and this we don't like because we have noticed in statistics that have come through recently that this type of procurement has jumped from \$5 billion to \$10 billion in 1966.

COMPETITIVE PROCUREMENT JUMPED FROM \$5 BILLION TO \$10
BILLION IN 1966

Chairman PROXMIRE. \$5 billion to \$10 billion?

Mr. NEWMAN. In one year, in this area.

Representative CURTIS. They claim were negotiated?

GAO DISAGREES ON DEFINITION OF "COMPETITION"

Mr. NEWMAN. The contracting officer claims it is awarded on the basis of competition but we found that in some cases there was not price competition.

Chairman PROXMIRE. I see.

Mr. NEWMAN. There has got to be definite criteria set up as to what is competition.

Chairman PROXMIRE. They claim competitive negotiation has jumped from \$5 to \$10 billion? That doesn't seem reasonable.

AUDITS REQUESTED BY CONTRACTING OFFICER

Mr. NEWMAN. But there is no audited proposal, you see. The auditors don't get into that proposal unless requested by the contracting officer. We found very few audits made in this area.

COLLABORATION BETWEEN PROCUREMENT OFFICER AND AUDITORS

Chairman PROXMIRE. This brings up another question:

Your report on estimating systems mentioned that Mr. McNamara has so far been unable to get his auditors and procurement officials to get together. Apparently certain information is denied to auditors by their colleagues. As I understand, Mr. McNamara personally addressed himself to that problem 3 years ago in a memorandum. Has he had any success to this day?

Mr. STAATS. You are quoting from the Cleveland *Plain Dealer* article?

Chairman PROXMIRE. Yes.

Mr. STAATS. I can't really say to what extent. I think this is one that might well be addressed to the Defense Department witnesses when they appear here.

Chairman PROXMIRE. We will do that.

Mr. WEITZEL. As you know there has been a procurement policy directive by the Defense Department in January of this year, but that is only recently.

GAO AND INDUSTRY REVIEW ASPR'S

Mr. NEWMAN. Mr. Chairman, as you know, when an ASPR is written over in the Department of Defense, we now have a procedure set up so we review and comment. We are working very closely with DoD. At the same time the ASPR goes to the industry for review and comment. When an ASPR goes to industry giving the auditors more authority—I leave it to your own conclusion.

Chairman PROXMIRE. I can understand.

Mr. NEWMAN. It is one of the big problems.

Chairman PROXMIRE. Mr. Staats, is there anything this committee can do or the Congress can do to achieve better enforcement of the Truth in Negotiations Act?

COMMITTEE SUPPORT WOULD HELP GAO

Mr. STAATS. I think if you agree with our conclusion, a statement on the part of this committee would be most helpful. I think the Cleveland *Plain Dealer* series has been a public service. I think this is a very important report that we have issued. We were frankly a little surprised that it did not receive more attention than it did. But I think that specifically the only suggestion I would have would be your consideration of our findings and if you agree with our position, some support for it.

Chairman PROXMIRE. In your statement, where you refer to the Defense Supply System—does the Secretary of Defense have the authority to correct the situation?

Mr. NEWMAN. Yes.

Chairman PROXMIRE. Your overall observations in general.

Mr. NEWMAN. The Department of Defense is really working on them right now.

NEW REGULATIONS ON STOCK FUND DEFICIENCIES

Chairman PROXMIRE. They are working on them, there is no question? The stock fund—I thought the situation was corrected as a result of earlier reports by the GAO at the request of this committee? If I get it, this fund, stock on hand, is not issued in the Pacific in some instances unless the requisition is—

Mr. NEWMAN. What are you reading from, sir?

Chairman PROXMIRE. Page 20, "Responsiveness of Supply Systems."

Mr. NEWMAN. Of the statement or the report?

Chairman PROXMIRE. Your report.

Mr. NEWMAN. I want to be responsive. I have it now. Stock fund financing.

Chairman PROXMIRE. That is right, and my question is, I thought the situation was corrected as a result of earlier reports of the GAO at the request of this committee.

Mr. NEWMAN. Well, in some cases these were and in other cases they weren't. But I can say now that under the new accounting system and the new regulations coming out for stock funds, I understand from Mr. Anthony, the Comptroller, that the situation we have described won't exist in the future.

Chairman PROXMIRE. The stock on hand is not issued in the Pacific in some instances unless the requisitioner has stock fund obligation authority to pay for the orders—

Mr. NEWMAN. There won't be any stock fund obligation in the future.

Chairman PROXMIRE. They won't have that in the future?

Mr. NEWMAN. In the future, when a GI wants a part he has to make sure he has the right requisition number, that's all.

Chairman PROXMIRE. He was prevented just by accounting obstacles.

Mr. NEWMAN. Accounting variance as well as stock funds.

Chairman PROXMIRE. Even though he needed it for a mission in Vietnam?

Mr. NEWMAN. That is right.

DOD COMPTROLLER SUPPORTS STOCK FUND CONCEPT

Mr. STAATS. Mr. Anthony is a strong supporter of the stock fund concept. They have not been sensitive enough particularly on three points: one is what happens in a period of rapidly increasing demand. The second is what do you do about identifying slow moving items in your inventory so that you clear those out, otherwise you can build up the amount of your stock fund without really serving any useful purpose.

The third, the problem of crowding up against your total ceiling and then you get a new ceiling put on your stock fund and all of a sudden you have a big surge of demand to fill up that stock fund which may result in inadequate use of current inventory some place else or improper buying practices.

TRYING TO REMEDY DANGER POINTS

All three of these are danger points, but he feels that the problem doesn't go to the basic concept of having stock funds, but rather to try to identify these situations and try to remedy them.

Chairman PROXMIRE. Gentlemen, the hour is late, it is 1 o'clock and you have all been very patient. I have some other questions. I am going to ask Mr. Ward to go through them and if he thinks that they should be answered for the record you can provide them for Mr. Staats. (See app. I, p. 270.) Of course, if Congressman Curtis wants to ask further questions at this time he is free to do so.

Representative CURTIS. No, I appreciate their patience, too, and I won't bear on it. I have probably some other questions which I will submit them for the record and will welcome your response.

Mr. STAATS. We appreciate the opportunity, Mr. Chairman.

Chairman PROXMIRE. You have been an excellent witness and certainly given us a great deal of very, very helpful information.

Tomorrow we meet in hearing room 4221, New Senate Office Building, at 10 o'clock. Our first witness will be Assistant Secretary of Defense, Paul Ignatius, followed by Vice Admiral Joseph Lyle, director of the Defense Supply Agency.

The GAO, we hope, will have some representatives in attendance.

(Whereupon, at 1:10 p.m. the subcommittee adjourned, to reconvene at 10 a.m., Tuesday, May 9, 1967.)

ECONOMY IN GOVERNMENT

TUESDAY, MAY 9, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10:05 o'clock a.m., in Room S-407, the Capitol, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire; Representatives Curtis and Rumsfeld.

Also present: John R. Stark, executive director, and Ray Ward, economic consultant.

Chairman PROXMIRE. The Subcommittee on Economy in Government will come to order.

We are pleased to have another excellent and able witness with us this morning, the Assistant Secretary of Defense, Installations and Logistics the Honorable Paul R. Ignatius who will discuss for us a number of topics which I outlined by letter of April 27, 1967. In addition I am sure that other members who will be here shortly will have a number of questions based upon yesterday's testimony by the Comptroller General of the United States. At this point I will include in the record a copy of the letter sent to the Department of Defense.

(Letter referred to follows:)

APRIL 27, 1967.

HON. ROBERT S. McNAMARA,
Secretary of Defense,
Department of Defense, Washington, D.C.

DEAR MR. SECRETARY: This confirms conversations between your staff and the staff of the Subcommittee on Economy in Government of the Joint Economic Committee relative to the Subcommittee's hearings on May 8, 9, 10, and 16. Department of Defense witnesses are scheduled to appear May 9, 1967, 10:00 a.m. (Hearing room to be announced later.)

We will want a progress report on the general Department of Defense Cost Reduction Program and detailed information about the Defense Supply Agency and its component agencies. In this regard, a comparison of conditions in the management of commodity groups, i.e., medical, subsistence, etc., now and before single managers were set up a number of years ago would help to show progress in use of space, turnover of stock, stock losses, use of manpower, etc.

The specific recommendations affecting the Department of Defense in the May 1966 report of the Subcommittee on Procurement and Regulation should also be covered in the testimony.

We are giving emphasis this year on the development of programs designed to identify, analyze, and organize common type activities and projects as steps toward the elimination of unneeded duplication of effort and expense. In this regard, a short review of progress in effectiveness and efficiencies in the operation of common type agencies in addition to the Defense Supply Agency, namely DCA, DIA, MTMS, etc., will be of benefit.

Any other common programs identified, developed, or planned under your Project 81 should also be discussed as we believe that unremitting effort along these lines is required in achieving economy in Government.

We need information also on the DOD program in being or planned respecting the President's memorandum of March 3, 1966, and the implementing BOB Cir-

cular No. A-76 as to procurement of goods and services and on the related program of screening and disposal of nonessential real properties.

As in the past, the DOD witnesses may divide the subject matter to be covered as they may decide.

Please submit 100 copies of prepared statements at least one day before the appearance date, and refer any questions you may have to Mr. Ray Ward, Staff Director of the Subcommittee, phone 173-8169.

Sincerely yours,

WILLIAM PROXMIRE, *Chairman.*

Chairman PROXMIRE. Mr. Secretary, you have an awesome responsibility in regard to the economy of the United States. This subcommittee has often expressed the thought that the scope of military operations for procurement, transportation, storage, communications, and disposal in addition to real and personal property holdings valued at billions of dollars is of vital importance to the economy. In fact, the how, when, where, and by whom in each of these areas affects the national economy and that of States and local communities. A decision to build a facility or eliminate one is important, even critical to many people.

Since the procurement program is, to a great extent, done by negotiation and not by the time-honored advertised competitive bid procedure, it is a subjective matter and hence open to the pressures that may be exerted by numerous forces. So we as the Subcommittee on Economy in Government are interested not only in the scope of your responsibilities but quality of its performance.

I have read your statement carefully and I am sure that you have achieved many economies during the past few years. But I am concerned, as are other members of this committee, at the long list of deficiencies which have been brought to our attention, and brought to our attention very emphatically and with excellent documentation by the Comptroller General just yesterday.

In an operation so large, involving millions of transactions, thousands of installations and facilities, and billions upon billions of dollars, it becomes apparent that long lists of economies and deficiencies are possible at the same time. So what we want to know is this—are we making enough progress?

Since Admiral Lyle, Director of the Defense Supply Agency will also testify today, we will defer questions in order to conserve time until Secretary Ignatius completes his prepared statement.

I understand that Congressman Curtis who has been very diligent in this area will be here shortly. You may introduce your associates and proceed with your statement.

STATEMENT OF HON. PAUL R. IGNATIUS, ASSISTANT SECRETARY OF DEFENSE (INSTALLATIONS AND LOGISTICS), AND VICE ADM. JOSEPH M. LYLE, DIRECTOR, DEFENSE SUPPLY AGENCY; ACCOMPANIED BY PAUL H. RILEY, DEPUTY ASSISTANT SECRETARY OF DEFENSE (SUPPLY AND SERVICES); JOHN M. MALLOY, DEPUTY ASSISTANT SECRETARY OF DEFENSE (PROCUREMENT); MAJ. GEN. JOHN A. GOSHORN, DEPUTY DIRECTOR, CONTRACT ADMINISTRATION, DSA; AND WILFRED J. GARVIN, COMPTROLLER, DSA

Mr. IGNATIUS. On my left is Mr. Paul Riley, my Deputy for Supply and Services, Mr. John Malloy, who is my Deputy for Procurement, and on far right is Vice Admiral Lyle.

Shall I proceed with my statement, Mr. Chairman?

Chairman PROXMIRE. Yes. Handle it any way you want. You may either read the statement in full or abbreviate it as you wish, skip over or highlight it.

Mr. IGNATIUS. Mr. Chairman and members of the Joint Economic Committee, I appreciate the opportunity to appear before your committee once again. I propose to review briefly some of the items of particular interest to the committee, as evidenced by your April 27 letter to Secretary McNamara, and by the recommendations made in the committee's report last year.

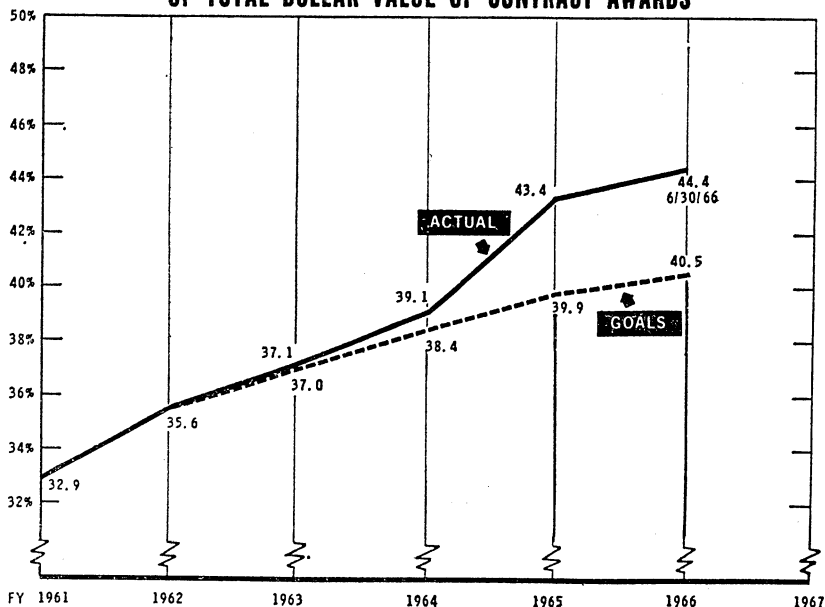
COST REDUCTION PROGRAM

In previous appearances before this committee, Secretary McNamara has described the Department of Defense (DoD) cost reduction program and I am sure that all of you are familiar with it.

When Secretary McNamara first took office, one of his basic objectives was to identify those areas of the Department's logistical operations where good business management could reap readily demonstrable benefits. Twenty-eight areas were selected for emphasis. A 5-year program was established, individual goals were developed, and the results were measured, documented, audited, and reported.

The chart below provides a good example of the way in which management emphasis in a selected area can produce desirable results. The chart shows our trend away from noncompetitive to competitive contracting. During fiscal year 1966, the dollar value of contracts awarded on the basis of price competition amounted to 44.4 percent of the total value of contract awards—up from 32.9 percent in fiscal year 1961. Each year the actual results exceeded the goal we had established.

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



The 5-year program ended June 30, 1966, after having saved \$14.2 billion, or 5 cents out of every dollar appropriated for defense in the 5-year period. The principles of that program are today being applied by every major department or agency in the Federal Government, by at least one State, by most major defense contractors, and by many nondefense contractors. The table below summarizes the cost reductions achieved in the 5-year program.

Department of Defense cost reduction program

[In millions of dollars]

Category	Savings realized in—					
	Fiscal year 1962	Fiscal year 1963	Fiscal year 1964	Fiscal year 1965	Fiscal year 1966	Total
A. Buying only what we need.....	412	860	1,521	2,555	1,665	7,013
B. Buying at the lowest sound price.....	160	237	553	1,150	1,235	3,335
C. Reducing operating costs.....	178	289	757	1,138	1,563	3,925
Total program.....	750	1,386	2,831	4,843	4,463	14,273

The initial 5-year program was a pioneer effort. Its scope, organization, goal-setting processes, measurement techniques, and audit procedures for validating savings distinguished it from previous economy programs.

Now that the goals of the 5-year program have been accomplished, we plan to extend the program by establishing annual goals for savings attributable to new actions taken in each future year.

In terms of overall coverage and organization, the program remains the same. The various reporting elements of the Department will continue to recommend their own goals with my office managing program and the Defense Comptroller auditing it. Savings will be reported in the year in which the decision giving rise to the savings was taken. The annual report will reflect for each action savings realized in the current year and, separately, estimated savings (if any) to be realized in the 2 succeeding years. The base period for measuring progress will always be the year immediately preceding the year in which the savings action is taken.

During the current fiscal year, the Military Services and the Defense Supply Agency (DSA) expect to take actions which will yield savings of \$872 million in fiscal year 1967 and a total of \$1.5 billion over the fiscal year 1967-69 period. The specific goals are as follows:

Anticipated savings, fiscal years 1967, 1968-69

[Dollar amounts in millions]

	Savings from Fiscal Year 1967 actions to be realized in—		
	Fiscal year 1967	Fiscal year 1968-69	Total
Buying only what we need.....	\$534	\$262	\$796
Buying at the lowest sound price.....	104	141	245
Reducing operating costs.....	224	222	446
Military assistance program.....	10	5	15
Total.....	872	630	1,052

In addition to our own program, we have maintained a strong contractor cost reduction program. The savings from the contractor program are separate and distinct from those reported under the Department of Defense program. Eighty-nine companies are now participating in the contractor program and over 200 of their plants or divisions report to us semiannually on their cost reduction accomplishments.

In the 2 years ended June 30, 1966, companies in this program reported cost reductions of \$1.8 billion on their defense sales, exclusive of firm fixed-price contracts. On February 8, Secretary McNamara reported to the President on these industry accomplishments. In his memorandum, he pointed out that these savings benefit the DoD by—

Reducing payments to contractors under cost-reimbursement contracts.

Enabling Defense to share in savings under contracts with incentive-type arrangements.

Providing a lower base of experienced costs for reference in pricing out subsequent contracts.

MAY 1966 COMMITTEE REPORT RECOMMENDATIONS

Since the time of our appearance before this committee last year, we have made progress in improving our supply system and in doing so have given emphasis to the recommendations made by the committee in its report dated May 27, 1966.

PROPERTY ADMINISTRATION

Last year the committee recommended "that the Department of Defense undertake a thorough study to determine the most effective and economical method of obtaining adequate control over Government-owned property in the possession of defense contractors." I am happy to report the following progress.

First, we have worked closely with the GAO during the past year to develop an improved property accounting system, and have provided the GAO with a number of proposals for review and comment.

We are revising the Armed Services Procurement Regulation (ASPR) to provide our property administrators with more definitive guidelines. The new regulation will require closer surveillance of contractors' property control systems and more frequent utilization surveys.

The Defense Industrial Plant Equipment Center has also made progress during the past year. The Center has expanded its program of reconciling Government and contractor property accounts. More mechanized records have been developed to improve responsiveness and more utilization spotchecks are being made.

Another program that will materially assist in improvement has been the recent formation of contract management review teams in the DSA and the military departments. These teams will survey all contract administration functions and will make property administration a special subject for review. This effort will give us a timely field review of the control and economical use of Government property in the hands of contractors.

We are also attempting to improve the overall technical competency of our property administrators. Training programs and position classification standards are being reviewed for adequacy and possible improvement.

The administration of Government property in the hands of contractors is a big task and problems will undoubtedly continue to be encountered. However, I believe that the efforts I outlined will go a long way toward overcoming the difficulties addressed by the committee, and form a basis for further improvements.

UTILIZATION OF PERSONAL PROPERTY INVENTORIES

Inherent in any well-conducted business is the assurance that its assets will be used to the maximum extent. The DoD probably operates the biggest supply business in the world, and insuring the best use of its assets is a monumental task. But much progress has been made.

The record shows that 8 years ago, in fiscal year 1958, the DoD utilized only \$213 million out of \$6.1 billion worth of excess property it generated. Since then, the utilization rate has steadily improved to the point where in fiscal year 1966 we utilized \$1.9 billion out of \$6.4 billion worth of excess property. By the end of fiscal year 1966, our excess stocks had been reduced to \$3.2 billion, an all-time low.

SPECIAL PROGRAM FOR MANAGEMENT OF SHORT-SHELF-LIFE ITEMS

During the past year we have completed actions designed to improve the management and control of short-shelf-life items, a subject of particular interest to this committee. On June 22, 1966, we reached an agreement with the General Services Administration on cross-servicing of shelf-life items. Under the agreement shelf-life items that are potentially excess to DoD components and civil agencies may be transferred without reimbursement. Accordingly, the market is widened and there is greater assurance that items of this type will be consumed before their shelf-life expires.

To implement this agreement, we issued a DoD instruction on November 18, 1966. This instruction is a comprehensive one and covers the many aspects of shelf-life item management, not just the utilization aspect. By November 1, 1967, a date that necessarily coincides with some revisions to our catalog program, we expect to have the new system and its controls installed.

SUPPLY STANDARDIZATION AND INVENTORY ITEM REDUCTION

During the 12-month period ending December 31, 1966, approximately 308,000 additional standardization status codes were recorded in the central Federal catalog system file maintained at the Defense Logistics Services Center. These standardization status codes are assigned to each item of supply after a detailed review of its technical characteristics, application, and functional use has been conducted. The codes indicate whether the item is (1) standard; (2) limited standard; (3) nonstandard. This standardization information receives primary consideration in making future procurement and inventory management decisions.

In regard to the inventory item reduction program, the Military Services and DSA have submitted "withdrawal-of-interest" and cancellation actions for 236,857 Federal stock numbers during the first 8 months of fiscal year 1967.

REAL PROPERTY MANAGEMENT DISPOSAL

The goal of our base utilization program is to insure efficient use of our worldwide system of bases and installations. Continuous review is needed to keep this system in proper balance. Changes in the alignment of our troops and advances in weapon technology have important effects on our installations requirements. Moreover, opportunities are disclosed from the reviews we make to consolidate functions and eliminate unnecessary costs, and to get rid of bases that no longer meet a military requirement.

Since this program began in 1961, a total of 917 separate base closure or reduction actions have been taken. When they are all completed, these actions will result in the release of 1,818,249 acres of excess land, the elimination of 207,000 jobs, and annual recurring operating costs of approximately \$1.5 billion. The elimination of bases no longer required is necessary in order that funds and manpower devoted to defense are not expended on activities which are no longer required.

We regret the dislocations and inconveniences which unavoidably result from these necessary base changes. However, the closure schedules provide for an orderly phase-out of activities, in most instances over periods of several years, in order to minimize the impact on the communities involved, and to provide employees the maximum possible opportunities for relocation. Our Office of Economic Adjustment has assisted 56 communities in 31 States in finding a variety of industrial or public uses for bases we have closed. A job opportunity is guaranteed for every career employee affected by base closure actions. If the new job opportunity requires a move to another location, the Government will pay transportation and moving expenses for the employee and his family. We also arrange for retraining at our expense and continue the employee's salary while he is being retrained.

I am pleased to report that since our guaranteed job opportunity program was initiated, no career employee affected by a base closure or reduction has been separated without having received a valid job offer.

SURPLUS SALES AND USE OF RECEIPTS

You will recall that at the end of July 1965 this committee requested the GAO to make a study of the cost of sales of DoD surplus property and the use of the proceeds, to determine whether any of the proceeds were being used for nonauthorized purposes.

The GAO study concluded that no instances were observed where proceeds from sales of surplus property were diverted for purposes which are contrary to law. However, the report stated that established DoD policies for the reimbursement of disposal expenses and depositing of sale proceeds were not always followed.

The GAO study contained no specific recommendations, although four measures for improving disposal operations were suggested:

(1) strengthening of DSA's supervisory role; (2) implementing a uniform cost accounting system; (3) establishing an improved reporting system; and (4) validating the propriety of disposal expenses through internal audit. With regard to the first suggestion, DSA's role as the property disposal program manager was strengthened by Deputy Secretary of Defense memorandum dated November 27, 1964, subject: "Implementation of Secretary of Defense Project 26 as it Relates to the Management of the Department of Defense Property Disposal Program" and was further strengthened by the December 9, 1965 revision of DSA's basic charter. We believe that sufficient guidance has been provided to enable DSA to manage and administer the disposal program. With regard to the other suggestions, the Defense Comptroller will shortly issue a comprehensive DoD instruction which will establish a uniform cost accounting and reporting system for property disposal operations. The information available to me indicates that we are not utilizing surplus sales proceeds for any purpose other than to meet expenses directly related to disposal operations.

RELiance ON PRIVATE INDUSTRY

The DoD is committed to a basic policy of relying upon private enterprise for the products and services it requires to the maximum extent consistent with effective and efficient accomplishment of our programs. We believe proper application of this policy not only is in the national interest but that it also supports the specific interests and objectives of the DoD. By relying upon commercial sources for products and services, we can free ourselves from day to day responsibilities of managing and operating such activities in order to devote more time to other programs. In many instances we can also avoid the costs of constructing and maintaining facilities and the risks of obsolescence of facilities and equipment.

This basic policy was established on a Government-wide basis by the Bureau of the Budget about 13 years ago and was reaffirmed about a year ago when the Bureau issued its Circular No. A-76. The DoD participated in development of that Circular and we are now proceeding to carry out its provisions. Overall responsibility for implementing the Circular within the DoD was assigned by Secretary McNamara to the Assistant Secretary of Defense (Installations and Logistics), but responsibility for conducting the specific reviews and maintaining the inventories and controls required by the Circular are assigned to the head of each Military Department and Defense Agency. These assignments of responsibility and general procedures for applying them were provided in DoD Directive 4100.15 dated July 9, 1966. More detailed procedures were provided in a comparison instruction. Copies of the directive and the supporting instruction are available for the Committee's use or for inclusion in the record.

Circular No. A-76 provides that:

Each executive agency will complete and maintain an inventory of the commercial and industrial activities which it manages and operates.

Existing Government-operated commercial and industrial activities are to be reviewed once each 3 years to determine whether the products and services involved should continue to be furnished by the Government directly or if commercial sources should be relied upon.

Special reviews and approvals of "new starts" will be made.

The inventory of commercial and industrial-type activities in the DoD is nearly complete. There are 3,343 of these activities in the Army, Air Force and the DSA. The Navy will soon complete its inventory.

A review of all of these activities will be completed within the next 3 years. We now have over 200 studies underway.

COMMON AGENCIES

In your letter of April 27, 1967 to Secretary McNamara, you requested that we discuss the progress and effectiveness of common Defense Agencies and any other common programs planned under Project 81. I will discuss some of the common-type agencies other than the DSA. Admiral Lyle, the Director of DSA, will discuss the progress within that agency. With respect to DSA, I would like to say that it has made significant progress and has performed in a highly efficient manner in providing common-type supply support to the forces in Vietnam.

DEFENSE COMMUNICATIONS AGENCY (DCA)

In arriving at the ultimate goal of a single integrated worldwide communications system, the DCA is progressing in a satisfactory manner. However, much remains to be done in managing the manpower and money associated with the five major switching systems comprising the backbone of the system.

In order to strengthen the management of these large systems, the DCA underwent an internal reorganization in November 1966. This reorganization established under a general officer a number of program management offices to permit management overview of the implementation of the major systems comprising the worldwide communications network. These management offices work directly with their counterparts in the military departments to insure that each of the major programs is properly implemented.

MILITARY SEA TRANSPORTATION SERVICES (MSTS)

The effectiveness of the Navy's MSTS can best be illustrated by its performance in support of our operations in Southeast Asia.

In mid-1965, when the buildup began, 176,000 tons were being shipped each month by sea to South Vietnam. In March 1967, over 796,000 tons of materiel were shipped to South Vietnam. To meet its worldwide needs, greatly increased as a result of Southeast Asia operations, MSTS now controls or operates 560 ships compared to 201 in June 1965.

One indication of MSTS' efficiency is the fact that its shore-based personnel have increased by only 6 percent while the ships sailing under MSTS control have increased almost 300 percent. MSTS is charged with getting the ships in and out of port in the most expeditious manner and handling all phases of liaison, supply, repairs and routing of its own ships as well as the chartered freighters and the 160 ships we have withdrawn from the National Defense Reserve Fleet.

During the past year MSTS instituted a competitive form of procurement for ocean transportation of military cargoes with the berth

line operators. In the past, cargoes were booked to the commercial carriers following conferences with operators' associations at rates established by the operator groups. Under the new system competitively established rates for North Atlantic routes were 14 percent lower than the prior conference rates. Comparable savings have not as yet been achieved for the Pacific routes.

MILITARY TRAFFIC MANAGEMENT AND TERMINAL SERVICE (MTMTS)

MTMTS was created on February 15, 1964, under a DoD charter which states "The purpose and objectives of this assignment with respect to DoD military traffic, land transportation, and common-user ocean terminals are:

To eliminate duplication and overlapping of effort between and among Military Departments, Defense Agencies, and other components of DoD.

To improve the effectiveness and economy of these operations throughout the DoD.

To insure that the approved emergency and wartime requirements of the DoD are met."

MTMTS has eliminated overlapping and duplicating functions by taking the following actions:

It has converted some 15 unilateral or bilateral military ocean terminal organizations to four common-user terminals under MTMTS control.

It has converted 15 military departmental elements at aerial ports of embarkation to seven Military Air Traffic Coordinating Offices under MTMTS control.

It has eliminated five Defense Traffic Management Service Regional Offices and established two MTMTS Area Headquarters for CONUS traffic management and terminal command control.

Economies have resulted from these actions. The MTMTS cargo workload has increased 150 percent since 1965, but the number of people it employs has risen only 12 percent.

MILITARY AIRLIFT COMMAND (MAC)

Since the establishment of the single manager for airlift services, significant improvements have been made in management efficiency and cost effectiveness. MAC has increased airlift effectiveness and fostered the development of an expanded civil reserve air fleet program to provide flexible expansion of augmentation airlift from commercial carriers to meet defense needs. In 1965, MAC flew 120,000 tons of cargo to South Vietnam. In 1966 this tonnage increased 150 percent to 300,000 tons.

During the past year progress has been made toward the goal of providing direct through-plane airlift service from the point of cargo generation in CONUS to the overseas destination. With the introduction of the C-141 aircraft, MAC has been able to initiate direct service to point within South Vietnam from aerial ports on the east coast and in Texas as well as from the normal west coast ports. This new operational pattern has resulted in both improved operational effectiveness and cost savings. These C-141 aircraft operating from east coast

aerial ports to South Vietnam make possible the delivery of a ton of east coast originated priority cargo to Saigon in 38 hours at a cost of approximately \$709. In the past, using C-124 aircraft and west coast aerial ports, this same movement would have required a minimum of 95 hours at a cost of approximately \$1,425.

In addition to the economies realized through introduction of the jet-powered C-141 aircraft and the direct polar routings permitted by such aircraft, significant improvements have been achieved in the cost effectiveness of our commercial airlift augmentation. In fiscal year 1962 the Civil Aeronautics Board's approved minimum rates for roundtrip chartered airlift procured by MAC were \$.029 per passenger mile and \$.1375 per cargo ton-mile. By fiscal year 1967, through the efforts of MAC in reviewing and analyzing actual commercial costs in coordination with the CAB, these rates had been reduced 30 percent for passengers and 34 percent for cargo. These efforts have continued each year, since fiscal year 1962. To appreciate the significance of these efforts, it is necessary only to look at recent history. Based upon the fiscal year 1965 minimum rates, for example, the MAC commercial buy for fiscal year 1966 and fiscal year 1967 would have cost approximately \$150-\$200 million more than the DoD actually was required to pay at the rates established by the Board after coordination with MAC.

At present the Board has not issued its final decision regarding the minimum commercial charter rates for fiscal year 1968. However, based primarily on the MAC analysis of commercial air costs, the Board in March 1967 did propose new minimum rates which would reflect cost reductions of as much as 22 percent below fiscal year 1967 levels. It is important to note that despite these rate reductions, the air carriers have continued to offer increasing numbers of modern turbine powered aircraft to MAC and have provided capability far beyond their contractual commitments during the build-up of forces and operations in Southeast Asia.

PROJECT 81

Your April 27 letter also asked us to review with you any other common-type activities developed under "Project 81."

Project 81 was one of many study projects assigned by the Secretary of Defense to various DoD components early in 1961. It was designed to identify selected "common services" where efficiencies and economies might be realized through consolidation of these services or through other changes in organization and management. The initial identification produced a large list of possible areas, some clearly adaptable to consolidation and others clearly not. The areas that appeared to offer the most promise for savings and increased efficiency were studied in further detail to determine the feasibility of consolidation as well as to identify savings and appropriate management arrangements. Based on the findings of these studies, action was taken to consolidate functions or improve management in order to achieve savings and increased efficiency.

Today, Project 81 is no longer carried on as a separate study project. Each of the Assistant Secretaries of Defense is responsible for recommending changes to the DoD structure to accomplish the objectives

of increased effectiveness and efficiency. The focal point for changes in the management of DoD has been established in the Office of the Assistant Secretary of Defense (Administration). Thus, analyses and studies of various potential areas for consolidation or improved management are a continuous process in DoD and are not linked to a special project.

Major consolidation actions which have been reported to the committee in previous testimony include:

Formation of the DSA in November 1961 with responsibilities for the organization, direction, management, administration and control of the supply and service functions previously fragmented among various DoD agencies.

Establishment of the Defense Contract Audit Agency to audit all DoD contracts, replacing contract audit activities of the separate Military Departments.

Establishment of the MTMTS to consolidate the operations of military traffic, land transportation, and common-user ocean terminals under the Secretary of the Army.

Establishment of a special assistant for strategic mobility in the Office of the Joint Chiefs of Staff to provide the Secretary of Defense with a single point of contact regarding strategic mobility matters.

Establishment of the defense attaché system under which the senior military attaché at our diplomatic posts represents the Department of Defense as a whole, rather than representing only his parent service.

Establishment of an Electronics Compatibility Analysis Center under the management of the Secretary of the Air Force to gain a more efficient operation in our analysis of electromagnetic radiations.

Consolidation of field contract administration offices of the Military Departments under the Defense Supply Agency to unify and improve the administration of our contracts following their award to industry.

Consolidation of all language and information training under the Department of the Army.

Consolidation of advanced sensor interpretation training under the Department of the Air Force.

Consolidation of executive-level computer training under the Department of the Navy.

These actions, plus many minor modifications, typify the progress made in recent years.

The committee asked that we identify similar studies that are now in progress or being planned. At the present time we have several areas under examination to determine if changes should be made in the existing management structure to obtain improved performance. These are:

Audio-visual activities, to eliminate duplication and overlap among the military services.

Expansion of the Defense Communications System (DCS) under the Defense Communications Agency to establish maximum integrity of the DCS under one manager.

Environmental services, i.e., meteorology, astronomy, and oceanography of the Military Departments to insure that these resources are being managed properly and applied equitably among the users.

Food service procedures and practices of the Military Departments to determine if a common ration base, master menu, and research and

development activities can be standardized to effect savings and efficiency.

Procurement of ADPE for command and control from off-the-shelf commercial sources to standardize computers and obtain savings by a single large buy.

In addition to the above items now under examination we have completed a study of DoD management of publications and printing. Actions on the recommendations of this study were deferred at the request of the chairman of the Joint Committee on Printing (JCP) in March 1966, pending the outcome of a JCP survey of the Federal printing program. To date, the JCP study findings have not been made available.

CONCLUSION

Mr. Chairman, we deeply appreciate the counsel we have received from your committee in the past and solicit your continuing advice and support. With me are Mr. Paul H. Riley, my Deputy for Supply and Services, Mr. John M. Malloy, my Deputy for Procurement, Vice Admiral Joseph M. Lyle, Director of the Defense Supply Agency, and other key departmental officials. We are prepared now to respond to questions or comments that you or the members of your committee may wish to direct to our attention.

Chairman PROXMIRE. Thank you very much, Mr. Ignatius. As you know, the report of the Comptroller General and the statement that he made yesterday were critical in some very, very important respects. I would like to start off with what you started off with in your statement.

CONFLICTING STATEMENTS ON COMPETITIVE BIDDING BY GAO AND DOD

You emphasized the increase in competitive bidding as an indication of the more efficient procurement in reducing the cost of procurement. It seems to me that any reading at all of the Comptroller General's statement yesterday would tend to challenge the argument that this competitive bidding is competitive—is really effective competition. I would like to read just one part of what the Comptroller General said yesterday, and then ask for your comments. He said:

Our survey showed that of about \$2 billion worth of aeronautical spare parts bought in fiscal year 1966 by four major purchasing centers, about \$425 million or 21.5 percent was reported to have been purchased competitively. Of this amount \$114 million, or less than 6 percent of the total was accomplished by use of advertising while \$311 million or 16 percent was procured by competitive negotiation wherein the number of firms requested to bid was somewhat limited.

A large percentage of the actions which were classified and reported to higher management levels within the Department of Defense as competitive procurements, in our opinion, were in fact made without competition.

The primary cause for misclassifying procurements as having been awarded on the basis of price competition appears to stem from the criteria in the Armed Services Procurement Regulation. The regulation permits a contract award to be classified as competitively priced, even when only one response is received, as long as two or more proposals were solicited and the accepted proposal meets certain other evaluation tests. (See p. 9, supra.)

Then they went on to point out that you have a situation of procurement of less than \$2,500, which are automatically classed as competitive, whereas their study of a typical amount of \$80 million of pro-

curement actions found that \$55 million or about 70 percent, 69 percent to be precise, were not really competitive at all.

Then he went on to say that:

Our survey tests of \$174 million in procurements classified as noncompetitive showed that about \$103 million or 59 percent was procured noncompetitively because of determinations that technical data were either not adequate or not available.

He makes an illustration of that and concludes, "However, we found that adequate technical data to support a competitive procurement was on hand. Under these circumstances it would seem to me that Congress would be better informed, the public would be better informed, you would have a better understanding of what competitive procurements means, if we were more precise and accurate in our definition of what procurement is. Don't you feel that that is correct?"

Mr. IGNATIUS. Yes, I would like to respond to those comments. First this was a draft report which my office received only last night, Mr. Chairman, and therefore I am not able to comment on the report as such.

Chairman PROXMIRE. I understand, because it was just brought to our attention last night.

Mr. IGNATIUS. Mr. Malloy just learned about it this morning.

Let me, however, speak to these points, because they are important ones that he has raised. First he points out that we may be overstating competition because we may count something as competitive when only one bid is received. I would like to read from the Armed Services Procurement Regulation.

Chairman PROXMIRE. Of course our quarrel is with the regulation.

Mr. IGNATIUS. Sir?

Chairman PROXMIRE. Our quarrel—my quarrel—is with the regulation.

Mr. IGNATIUS. What I would like to do is read it and then attempt to give you my view on it.

Chairman PROXMIRE. All right.

COMPETITIVE BIDDING

Mr. IGNATIUS. Then the committee certainly will want to question me or to judge for itself. What it says is:

"This may include awards"—may include awards—"made following the solicitation of two or more sources for price proposals where only one proposal was received and accepted as the lowest evaluated price."

This has been in effect since 1959 in the Department, and what it is intended to cover, Mr. Chairman, is a situation like this:

Supposing the last time we bought something we solicited three companies, and let's say the low bid for the item was \$5. We went out again, and solicited three companies. We got a bid of \$4.90, only one bid. Now under that circumstance, we had a baseline of a \$5 price that was established when we had three bids.

The procurement was made in a competitive atmosphere, that is to say three companies were solicited. In fact, only one responded, but the price of \$4.90, in this hypothetical example, was slightly less than the last time it had been bought competitively.

The rule was established in 1959 to accommodate situations of that kind, where to a reasonable man in effect a competitive price was achieved even though only one bid in fact was submitted.

Chairman PROXMIRE. No. 1, I think that I would certainly challenge that as competitive, because the \$4.90 figure may or may not be competitive in any real sense, because of efficiencies, because of lower costs, because of all kinds of things that might have developed, that \$4.90 may be way out of the ball park.

It would just seem not only a matter of commonsense but a matter of common understanding that where you do not get actual competition it is not competition, even though you can make assumptions that it has some elements of competition within it. Competition it would seem to me, and I think to the overwhelming majority of people, means that you have two or more people trying to compete for procurement. If you only have one, only one responds, it is not competitive. I understand your viewpoint.

Mr. IGNATIUS. This, as I say, has been consistently followed since 1959.

ASPR TO BE REVIEWED

Chairman PROXMIRE. I hope you will reconsider that regulation.

Mr. IGNATIUS. We will certainly look at it. We will do more than that. We will try to determine whether there is any abuse of this. It is certainly not our intention to overstate. We made a sincere effort to increase the amount of procurement that we have awarded competitively.

Chairman PROXMIRE. You see the point I am making is not just the point that a Senator makes here in criticizing your work. It is a point, as I say, that is documented by the Comptroller General, who has gone into great detail and has experts making this assessment, and when he concludes—when they conclude—and as you know, they are careful in their conclusions, that such a large proportion of this is noncompetitive that you classify as competitive, it seems to me it should shake the notion that you continue with calling this competitive bidding.

Mr. IGNATIUS. Let me say once again that it is a draft report, we have not had a chance to look at, and I am sure the Comptroller General would certainly say, were he here, that often when draft reports are submitted, and the agency, whether it is Defense or any other agency of the Government, has had an opportunity to comment on it, the final reports are often modified in the light of the comments. We accept these reports in a constructive way, Mr. Chairman, and will certainly look at it in that manner, but I did want to state that this is a practice that has been followed for a number of years, and to give the reason why.

PROCUREMENTS OF \$2,500 AND UNDER

Now I would like to turn to the area of procurements of \$2,500 and under, and here I think there is a matter of some importance.

We require in procurements of a dollar amount of \$250 to \$2,500 that three bids be obtained if at all possible, and we don't require that more than three bids be obtained, because of the time involved in getting them. We try to have more streamlined procedures for our small

dollar value purchases to be able to concentrate our effort on the large dollar value purchases.

7,600,000 PROCUREMENTS UNDER \$2,500 IN FISCAL YEAR 1966

To give you some notion of the magnitude of this, Mr. Chairman, in fiscal year 1966 we made 7,600,000 transactions in the category of \$2,500 and under. If we were to establish a reporting system that showed in each of the 7,600,000 cases whether in fact the three bids were received or not, it seems to me that we would be greatly overburdening our reporting system, and without any—

Chairman PROXMIRE. May I just interrupt to say I raised this precise point yesterday with Comptroller Staats, and they responded, the Comptroller General responded that they had no difficulty at all in analyzing this \$80 million in procurement actions as to which were competitive and which were not. They said all they had to do was read and they could tell at once.

7,600,000 PROCUREMENTS EQUALLED 4.6 PERCENT OF DOLLAR VOLUME

Mr. IGNATIUS. The point is—if I can get one more point out that I don't think was mentioned—these 7,600,000 procurement transactions in 1966 amounted to only 4.6 percent of our procurement dollars. In other words, less than 5 percent of our dollars were associated with almost 8 million procurement actions.

Again, the only point I am trying to make, Mr. Chairman, is that I think you have to apply a cost/benefit analysis to reporting. In fact in this area, as in the other area, we have consistently followed this rule since 1959. Therefore, the increases I reported, from 1961 when we went up from 32 percent competitive to 44 percent in fiscal 1966 have the same reporting base. That is to say, we consistently followed this rule.

This is de minimis, in other words; and if we were to establish an elaborate reporting system for almost 8 million transactions that involve less than 5 percent of our dollars, it seems to me that we would be subject to criticism.

Chairman PROXMIRE. I raised that point with the Comptroller General as I say, and his response was that they were able to find it out without any difficulty. Of course they have a very small auditing staff compared to what you have. It would seem to me this again is a regulation that ought to be reexamined. It is true that the procurements of less than \$2,500 are not the biggest or the most substantial part of your procurement. As you say, they are less than 5 percent.

Mr. IGNATIUS. Less than 5 percent; yes, sir.

Chairman PROXMIRE. Nevertheless, this is a distortion. It would seem to me that it would be worthwhile for the Congress and for the public to know what is competitive and what is not. Let me move into another area.

Mr. IGNATIUS. Sir, I don't believe it is a distortion if we followed it consistently in our reporting. I will look at it.

Chairman PROXMIRE. I will say this. It is a consistent distortion. In other words, it was a distortion before and it is still a distortion. It is either competitive or it is not. They say it is not competitive and you

say well, it is too hard to report whether it is competitive or not. They say they were able to get the information without difficulty, and their judgment is it is not more difficult to report.

Mr. IGNATIUS. As I say, we will look into that, but I think we have always got to apply the standard of cost effectiveness to reporting systems, and we will check with them and ask them perhaps to make some kind of estimate of man-hours and costs, if we were to install this kind of a reporting system.

PROCUREMENT OF TIRES

Chairman PROXMIRE. In his report he pointed out that automobile tires—about \$17 million worth of automobile tires and tubes—are purchased annually under negotiated Federal Supply Schedule contracts. This would apparently affect not only your agency but other agencies, too. This isn't a great deal of procurement compared to what you have altogether, but it raises a very significant point in my mind. They found that there is no reason in the world why the purchase of automobile tires shouldn't be competitive. It meets all of the requirements. You have an ample number of suppliers. You have a homogeneous product that you are purchasing.

It is standardized and so forth. And yet until the Comptroller General moved in on this and called attention to it, procurement was made without competition. Under these circumstances it would seem to me that it would be wise not only to correct this situation here, but for the Defense Department and the GSA, which I think was the particular agency that he quoted here, for your agencies to analyze all your procurements, to find out what particular products would fall into this competitive area, and then insist in these areas where you have an ample number of suppliers, a standardized product and so forth, that procurement is by competition.

Mr. IGNATIUS. Mr. Chairman, I certainly agree with the general proposition, and that is in fact what we have done and that is why we have been able to increase so significantly our competitive procurements.

Chairman PROXMIRE. Has this been done?

Mr. IGNATIUS. With respect to tires, GSA buys tires. The only tires we buy are special aircraft tires or special sizes associated with tactical vehicles.

Chairman PROXMIRE. The reason I raised this is we did not have this example with regard to your agency. It may be that you could establish this across the board, but I would feel better if you, the biggest procurement agency in the Government, could tell me now that you have or will make an analysis because GSA apparently has done it, and that is a fine and efficient outfit, an analysis of your procurement to determine the products you procure, where there are a number of suppliers, where it is a standardized product, where it is possible to have competitive procurement, that in fact you insist that the procurement officials purchase competitively.

Mr. IGNATIUS. We have made such analyses many times in the past.

Chairman PROXMIRE. Can you provide the committee with documentation on this?

Mr. IGNATIUS. Yes, sir, we can. This is really in the area of the potential for competition. For example, some of our largest dollars are in areas where there is no potential. The POLARIS missile is an example.

I suppose theoretically it would be possible to have two sources of the POLARIS missile, but it would be so costly to set up the duplicating tooling and incur the learning associated that as a practical matter you can't do it, so that we deal with one company following design competition.

In other areas, for example—let's say a relatively simple radio—it is our policy to buy competitively as soon as we can, and the competitive potential in that area is good. We have made analyses of this kind. We have followed them vigorously, and it is because we have done that that we have been able to increase our competitive procurement since 1961 from 32 percent of our dollars to over 44 percent.

Chairman PROXMIRE. My time is up. I want to get into the next and to me the far most interesting part of it in my next questioning period. Congressman Curtis?

Representative CURTIS. Well, Mr. Chairman, after reading this paper and listening to these answers, it is almost like going back to 1951. When you say the POLARIS missile has to be a single contract, after all the discussions we have had for years about breakout contracts and competition, it just typifies your testimony, Mr. Secretary, which amounts to excuses and the avoiding of the basic issues.

Now, this committee relied upon, as one of the key factors in following what we thought was progress, the definition of competition. There is no question that you understood it just as we understood it, and when you fall back on the way you did it in 1959 as an excuse, well, that is what it amounts to. What you have done is to take a perfectly good product, labeled competitive, which has meaning, and corrupted this meaning—if this testimony that we have received is accurate, and I have every reason to believe that it is.

Now, there are other reasons why you would like to put competitive labels on. If it is noncompetitive, then you come in and hopefully do some auditing on those, and this is a key point.

Also if it is noncompetitive or negotiated, it comes at least under whatever discipline might exist in the Renegotiations Act. I must say that I don't see any point in carrying on the interrogation.

Mr. IGNATIUS. Mr. Curtis, it would be very helpful to me if you could give me the reasons why you have come to that conclusion. You have commended us many times in the past for the efforts we have made, the figures we have reported, which indicate the substantial increase in competition in the last 5 years that has come about as a result of devoted and sincere effort on the part of our military and civilian people. The facts speak for themselves.

DEFINITION OF COMPETITION

Representative CURTIS. The trouble we have here is that we thought we understood definitions, and as I say, you have corrupted your labels. When you come in with this kind of answer in respect to what is com-

petition, and defend it in this fashion, I say it makes almost meaningless the things that I have said in praise, as I frankly have thought that we were moving in this direction.

When I heard the testimony yesterday in regard to the noncompliance with the Truth in Negotiations Act, when I still see, after all my correspondence on getting Government out of business, the military in this instance, engaging in the generalities we have had before without zeroing in on crucial questions like commissaries and so forth, and I don't want to get into a hot subject particularly, because I find that I can't cope with that, but at least I would like to have the list of the inventory that you mention in your statement.

I think the better way for me to proceed is to go over this statement and your answer, and as best I can present the reasons why I have made these statements.

I can't express my disappointment more. This generality that you have given us here, and the evasive answers, after all the work that we have been trying to do in this thing—

MR. IGNATIUS. Mr. Curtis, I must respond because of the admiration I have for the guidance you have given us, and when you say evasive answers, if you will give me an example of that, I will be as forthright as I possibly can. I thought I was being forthright in saying that we have followed rules—

Representative CURTIS. Well, for example, in saying that it only applies to 4.6 percent of your procurement. What has that got to do with the issue?

MR. IGNATIUS. What it has to do with the issue is that we must be very careful, particularly in a hearing associated with economy in Government, that we not spend money beyond the benefit that is attained from it.

Representative CURTIS. Of course that is an understandable principle, but that is not an answer. If what the GAO tells us is true, these small contractors just automatically put it on their own records, whether it was bid or not, and then you give us this answer that it will require a great reporting system. When we come to the detail, this is the kind of thing I regard as an evasive answer. The Federal Government has an annual bill that is approaching \$2 billion in the use of computers, so that we can bring about this kind of reporting by process. You dismiss this matter and say you are following procedures of 1959, and that it only applies to 4.6 percent, which I suspect is about \$2 billion worth of goods.

But the main thing I am concerned about is the coverup or the misuse of the term "competitive bidding" which has become sort of a checkpoint that I have used myself over a period of years, to test out the progress. Now I find, after listening to this, that I am going to have to review in my own mind all that has gone on in the past.

I know you are well aware that the Armed Services Committee has been accusing the Defense Department of rigging figures for years in their claims of benefits. I have defended you on the floor of the House. I was shaken a bit when I made a suggestion that maybe we get some outside people to evaluate your savings. I did not get a very good response in the Defense Department on it. Frankly, it just shakes me to the point where maybe I have to review what I have said in the past about our progress here.

TRUTH IN NEGOTIATIONS ACT

I think probably as shocking a thing as I know was the apparent failure of the Defense Department to implement the Truth in Negotiations Act, and the statement of the General Accounting Office that although they do do post auditing, that the Defense Department says they can't do post auditing, that DoD can't get access to the books.

We interrogated to find out. Well, surely if these are negotiated contracts, and these are independent contracting parties, namely the Government and private contractors, you can put into the contract itself the right to look at books and records and whatever is necessary. Maybe we ought to have a response to that.

Is it the Defense Department's position that they can't have post-audits, that they can't do this kind of auditing of these contracts that GAO has been doing, and come up with some of these points that they have made to us?

Mr. IGNATIUS. We will respond to that. Let me say in regard to competition I will welcome your comments after you have had a chance to review the situation again.

Let me simply say that in 1966, despite the urgency of many of our procurements in support of our operations in Vietnam, the DoD as a whole increased the amount of its price competitive procurement from 43.4 percent in fiscal 1965 to 44.4 percent in fiscal 1966, despite the exigencies of the war. Secondly, if I may say so—

Representative CURTIS. Wait, let me stop you there just a minute.

Mr. IGNATIUS. Yes, sir.

Representative CURTIS. This is true if we can count on the definition of "competitive." That is why I say we go right to the heart of this thing, and now I am finding that I have to review very carefully what the Defense Department has called competitive.

Mr. IGNATIUS. The definition is—

Representative CURTIS. Now on the other thing, the exigencies of the war are there. But one of the points that I have thought was very good that the Defense Department has said was that they were able to handle this war with great efficiencies. Also, you have said that the war is a lesser percentage of the gross national product than any previous one, and so forth.

I recognize the problems that exist when you have a heated-up situation. But let's don't argue both ways. Let's get to the one question I did ask on this proposed auditing. What is the position of the Defense Department? Can you or can't you postaudit? Do you or don't you postaudit?

Mr. IGNATIUS. The question with respect to postaudit differs by type of contractor—whether it is cost reimbursable or whether it is fixed type.

We also postaudit under cost-reimbursable contracts. With regard to fixed-price-type contracts our practice with regard to postaudit has been limited to an audit up to the time of award under fixed-price contracts, and not afterwards. The question of whether it should be extended beyond that in the case of firm fixed-price contracts is now under study in the Defense Department, between the Comptroller's Office and my office, and no decision has been reached as yet.

Representative CURTIS. May I ask what do you have to study this for? Is there any question in your mind of the actual essentiality of postaudit in these cases?

Mr. IGNATIUS. I think the question, Mr. Curtis, has to do with the nature of the firm fixed-price contract. This is the preferred type of contract. It is preferred because it costs the Government the least to administer, and secondly, it provides the greatest incentive to the contractor to reduce costs.

Under this kind of a circumstance, where the contractor bears the risk, if the price is \$1 and his costs are \$1.05, he is still paid only \$1.

If by greater efficiency he is able to bring his cost down, we take the position that he is entitled to the profit he would make as a result of this. If you begin to do too much auditing of costs under a firm fixed-price contract, following award, we believe that you might be damaging the basic intent of the firm fixed-price contract, and in effect converting it to a redeterminable contract, which we have tried to avoid.

ACCOUNTABILITY FOR CONTRACTOR INVENTORY

Representative CURTIS. Well, that is very interesting. One other final point, because my time is up anyway. In our efforts to find the accounting for equipment that is furnished to the contractors, the Defense Department is responsible for a great deal of this. This has been an issue that we have raised continually, and the reports from the GAO indicate almost no system at all. That is what it looks like. Will you comment on that? Do you think that the Defense Department has some system established of accounting for this equipment?

Mr. IGNATIUS. Yes, sir, we do. I pointed out in my statement that this is a difficult area. This last year—

Representative CURTIS. Let's stop there. Why is it so difficult just to have an inventory of what the equipment is? Some of this, of course, is very valuable. Why is that more difficult than some of these other things? Any area is difficult.

REPORTING USE OF EQUIPMENT

Mr. IGNATIUS. Yes. It is not difficult in terms of an inventory. It is difficult in order to maintain an efficient reporting system with regard to the utilization of the equipment by contract.

Representative CURTIS. Well, that is the issue. Why is it difficult to maintain a system of reporting inventory? That is a problem that everybody in business has. What is so difficult about it?

Mr. IGNATIUS. I would say that the number of pieces of equipment involved, the number of contractors involved, and the varying use. Now let me comment on this.

Representative CURTIS. Well, that is what I mean by an evasive answer.

DCAS SURVEYS OF CONTRACTOR'S SYSTEMS

Mr. IGNATIUS. Well, if I could complete my statement, sir. This last year the Defense Department Contract Administration Services surveyed some 4,389 contractors out of the total of some 4,466 that were large enough in terms of the number of pieces of equipment,

Government properties they had, to require a reporting system. This survey—

Representative CURTIS. Let me stop you there. Do you mean that because one company might just have one piece of equipment, therefore you forget it, that your system would say the only ones we are going to talk about are those that have maybe eight or 10 or 100 pieces? Now that is what I mean by saying it is not a system, if you don't include every item.

Mr. IGNATIUS. No—

Representative CURTIS. I don't care whether it is one small company, if it has got a machine that is worth only \$5,000 if you have a system, you should have that included.

TOOLS OF \$1,000 REPORTED TO DIPEC

Mr. IGNATIUS. We do have such a system, and all machine tools of \$1,000 or over must be reported to our centralized management office for this, the Defense Industrial Plant Equipment Center.

Now where large numbers are involved, the system is more complete than it is when smaller ones are. As I was saying, our Contract Administration Agency this last year surveyed about 4,400 in round numbers out of 4,500 of these companies, and they found all but 725 had systems that met the standards, and in the case of the 725, there were some deficiencies.

Since then, and as of March 31 of this year, all but 159 of those 725 have been corrected. We have done a number of other things in this area to improve performance, as I indicated in my prepared statement.

Representative CURTIS. Then this of course is very proper. You are asking time to respond in depth to the reports of the GAO and this would require that you are looking at their reports, which is quite inconsistent with your testimony.

Mr. IGNATIUS. Let me say, Mr. Curtis, we just got the GAO report. It is a draft report. We intend to study it. We have begun that already, and if there are any indications of improper utilization on the part of our contractors, we will stop it.

CONCERN ABOUT ITS SYSTEM

Representative CURTIS. I am concerned about the fact that they make spot checks, Mr. Secretary, to test the system. If these spot checks were done on a random basis, a scientific basis, and that is the way you reported them to us, then we can conclude something about the system. We are not concerned about calling to your attention a specific, whether it is a prior contract, but only as that illustrates the system itself.

What I am saying is that if the GAO report of the sampling of this system is accurate, then there is complete inconsistency between your testimony and that, but I do think you make a very proper point that you haven't had a chance to look at the report.

Our testimony here is probably too early. I would like to have you back after you have had a chance to look at those reports, and get your statements there, and then I will interrogate you on those. I will do a

little homework of my own and report back to you, but I can't avoid making the temporary conclusions I have made.

I am always subject to change after thinking about them, but I frankly have been shocked by the testimony yesterday and the testimony here today which I just regard as generalities. It is like going to a high school or even a grammar school course in management and procurement practices.

We have been in this thing in depth and this committee is accustomed to talking about specifics, not generalities, and I am just left cold by this presentation. I am sorry, Mr. Chairman.

Chairman PROXMIRE. Congressman Rumsfeld?

VIETNAM CONSTRUCTION CONTRACT FOR \$1.2 BILLION

Representative RUMSFELD. Mr. Secretary, is this contract, the construction contract in Vietnam of \$1.2 billion, under your jurisdiction?

Mr. IGNATIUS. Yes, sir; this is the contract with the joint venture of Raymond, Morrison, Knudsen, Brown and Root, and J. A. Jones—

Representative RUMSFELD. The so-called combine.

Mr. IGNATIUS. The specific responsibility is within the Navy—the Navy Facilities Engineering Command.

Representative RUMSFELD. Right. How you describe the contract? It is a unique contract as I understand it?

Mr. IGNATIUS. Yes. There was a civilian contractor—

Representative RUMSFELD. No, the specific words I am thinking of. Is it a cost-plus incentive fee?

Mr. IGNATIUS. Cost-plus award fee.

COST-PLUS AWARD FEE

Representative RUMSFELD. Cost-plus award fee?

Mr. IGNATIUS. Yes, sir. It was initially a cost-plus fixed fee I believe, where the fee did not vary based on performance, but rather was paid as a percentage of the originally estimated cost, and the Navy thought it would be desirable to change this to an award fee, where the amount of fee varied with the quality of performance and instituted that change a couple of years ago.

Representative RUMSFELD. It is my understanding that under the cost-plus-award-fee contract as it now stands, the award fee in fact includes a percentage of cost as a major portion of determining what the award fee will be.

Mr. IGNATIUS. I am not prepared this morning to respond specifically to the details of the award fee. I am sure the Navy could develop that information. We could provide it for the record, should you desire us to, but the basic change—

Representative RUMSFELD. Have you not been involved with this particular contract? It is the biggest one you have, isn't it?

Mr. IGNATIUS. The administration of the contract is assigned to the Navy, formerly the Bureau of Yards and Docks, now the Facilities Engineering Command.

Representative RUMSFELD. Under your jurisdiction.

Mr. IGNATIUS. Under Secretary Bannerman's overall jurisdiction in the Navy Department, under Rear Admiral Husband's immediate

supervision in the Navy's Facilities Engineering Command. It comes under my general area of policy surveillance.

I am familiar, as I indicated, in my response earlier, with the contract, with the fact that the CPFF arrangement was converted to a CPAF arrangement. I know generally the terms of it. In specific detail we would need to get this furnished for the record.

Representative RUMSFELD. What is the Government's policy with respect to contracts that are cost-plus a percent cost?

Mr. IGNATIUS. They are illegal. Cost-plus percentage of cost contracts were used in World War I and were declared illegal.

Representative RUMSFELD. That is my understanding, that they are illegal, and I would like to know from you whether or not cost-plus award fee isn't really a euphemism for cost-plus percentage of cost.

Mr. IGNATIUS. No, sir, it isn't.

Representative RUMSFELD. In what way?

Mr. IGNATIUS. It would be an illegal contract if it were.

Representative RUMSFELD. I have studied the contract, and I must confess I don't pretend to be an expert in it, but there is no question in my mind but that it is a cost-plus contract, and the plus, at least a portion of the plus, is a percentage of cost.

Mr. IGNATIUS. What it is, Mr. Rumsfeld, is an attempt to get a little more incentive into what otherwise would have been a situation without any. The cost-plus fixed fee contract is a legal contract, which we don't like to use, incidentally. One of the things we have done in the last 5 years is to reduce the use of the CPFF contract from 38 percent of our dollars in 1961 to less than 10 percent today. Under certain circumstances it is used as in this construction contract, where the nature of the work and the uncertainties involved precluded a firmer type of contract, this CPFF type of contract was first used. Later on, in order to get some kind of incentive for performance, the Navy converted it from CPFF to CPAF, varying the fee in terms of the performance attained. It is not——

LEGALITY OF VIETNAM CONTRACT

Representative RUMSFELD. Do you have a ruling from somebody saying that this is a legal contract?

Mr. IGNATIUS. Well, this was approved within the Facilities Engineering Command and in the Office of the Assistant Secretary of the Navy, and the legal counsel always participates in decisions of this kind.

Representative RUMSFELD. In my study of this contract I note that the Defense Department has had a great deal of difficulty in performing audits, and has been rather slow on it.

Mr. IGNATIUS. In performing audits on this?

Representative RUMSFELD. On the contract.

Mr. IGNATIUS. The Navy Auditor was involved in this. Subsequently the Defense Contract Audit Agency was.

Representative RUMSFELD. They were doing it from the United States and Japan.

AUDITING THE VIETNAM CONTRACT

Mr. IGNATIUS. Initially, they established an audit Office in California, in the general area of San Francisco, where RMK, this firm, maintains its West Coast headquarters, the United States headquarters for this effort, and where it does its purchasing and other efforts. Subsequently I believe Defense Department auditors, from Mr. Petty's Defense Contract Audit Agency, were sent to Saigon to conduct audits of the contract.

Representative RUMSFELD. I don't see any particular mention of this activity in your statement. In retrospect are you proud of the way that contract has been handled with respect to auditing?

Mr. IGNATIUS. First my statement was responsive to the Chairman's letter of April 27th, in which he outlined the subjects that he wanted me to discuss. I could have discussed to this had he so asked me to do. That is why it is not in my statement.

Secondly, with respect to the performance of the contract, this has been a tremendous effort as I am sure you know. We went into Vietnam at a time when there was only one port able to receive deep draft ships. We made a large-scale deployment in a short period of time. General Westmoreland—

Representative RUMSFELD. I am not talking about the buildup in the contract. Once the contract is signed and you decide what you are going to do, you still ought to know whether or not and, if so, how you are going to audit it.

My study of it is that you were trying to audit it with one or two auditors located many thousands of miles away. It seems to me that as the Secretary in charge of this portion of the Defense Department's responsibilities, that this is clearly not an adequate auditing system, and anyone who has studied it I think has come to exactly the same conclusion.

Mr. IGNATIUS. First, Mr. Rumsfeld, audit is not my responsibility. It is the responsibility of the Comptroller of the Defense Department, who is responsible for auditing activities, and not me. Now, secondly, this contract—

Representative RUMSFELD. Let's stop right there.

Mr. IGNATIUS. Yes.

Representative RUMSFELD. Your title is Assistant Secretary of Defense for Installations and Logistics. Within that category don't you have auditors in the staff? I know you have a Defense Auditing Agency that is somewhat separate, but don't you have auditors?

Mr. IGNATIUS. I am not responsible for auditing activities of the Department of Defense or its components. The Assistant Secretary of Defense—Comptroller is, and his counterparts in the Military Departments, namely the Assistant Secretaries for Financial Management, are responsible for audit rather than the Assistant Secretary for Installations and Logistics. This is in keeping with normal practice.

Representative RUMSFELD. Yes. I was under the impression it was in the administration of the contract that there was an audit responsibility, and that in addition there was the Defense separate audit responsibility. Apparently I am incorrect.

CONTRACT AUDIT AND ADMINISTRATION

Mr. IGNATIUS. No, sir, I don't think you are in that last phrase, because you made a distinction between administration and audit. Administration of the contract, namely post-award after the contract is awarded is, broadly speaking, within the procurement function, the post-award function of contract administration as it is called.

Representative RUMSFELD. That is my information.

AUDIT SEPARATE FROM OPERATION

Mr. IGNATIUS. But audit has always been, in business or in Government, tended to be independent of the operating people, in order that the auditing people can be objective and detached. For that reason, the auditing function is the responsibility of another supervisory channel, and not in the supervisory channel of the operators. In other words, you don't want to audit yourself.

Representative RUMSFELD. Is the construction contract in other countries in Southeast Asia the same kind of a contract?

Mr. IGNATIUS. We have a contract in Thailand with Dillingham, Zachary, and another one in Thailand with Utah, Martin and Day, both under the administration of the Navy's Facilities Engineering Command. I believe, but will need to check the record, that these may also be on the award-fee basis. Those contracts are important, but they are smaller in scope than the RMK contract in Vietnam is, one less than \$100 million and the other around \$160 million.

I will have to check the record to see the amounts. We have augmented them and the current value I would think of those contracts would not aggregate \$300 million.

Representative RUMSFELD. Mr. Secretary, my time is up. I would just want to echo the concern that Mr. Curtis expressed. It may be that your testimony is responsive to the Chairman's letter.

It is not responsive to the questions that are on my mind, and it seems to be a rather superficial and in some ways a little heavy on the adjectives—at least your answers have been, as to what is going on.

When you say the competitive price was achieved in answer to Chairman Proxmire, when you had one firm submitting a response to your request for a proposal, it leads me to the inevitable conclusion that you and the Department of Defense have a very different definition of the word "competitive" than I do.

Mr. IGNATIUS. Yes.

DEFINITION OF COMPETITION

Representative RUMSFELD. And it seems to me when you talk about increasing from 43.4 to 44.4 your competitive proposals, I believe those were the figures, that you might very well be talking about something entirely different than I am talking about, and there is a tendency to—

Mr. IGNATIUS. Mr. Rumsfeld, if you will look at the record when it is available, I did not say what you said I said. I used a hypothetical example in response to the chairman's question, where an award was made in a competitive atmosphere, and the price was competitive, even

though only one bid was received. I did not say that you would automatically have a competitive situation on the submission of one—you said it, and I think if we check the record we will find you said it.

Representative RUMSFELD. I did not say you said that. I said you said the competitive price was achieved, and I wrote it down when you used the hypothetical case saying that \$4.90 was the competitive price that was achieved. And, it is not necessarily the competitive price. It is what you think might be a competitive price, if you had had competitive bidding which in your hypothetical case you did not.

Mr. IGNATIUS. We got one bid, that is true, in that hypothetical case.

Representative RUMSFELD. And you don't have the vaguest idea if that is a competitive bid or if that bid is a competitive price, other than your previous experience.

Mr. IGNATIUS. Previous experience is often useful in evaluating a current situation. That is all I was trying to say. And if it isn't competitive, we shouldn't count it as such.

Representative RUMSFELD. It seems to me that there is a tendency to attempt to bury the committee here in percentages and statistics, without really getting down to the hard facts of defining our terms and seeing what in fact the problem has been.

The GAO report was carefully worded. It was not a wild report. It was very cautiously and carefully drafted—their statement, I mean, to the committee—and the statement to the committee certainly doesn't jibe with the considerably different picture you have painted of your successes and lack of successes.

Now if there are problems in the regulations, if there are problems in the procedures, I think there ought to be enough candor on the part of the Department of Defense to come in, and talk about them and see if we can't point towards improving them, rather than saying how you have made the "analysis repeatedly" and you have "followed them vigorously" and "devoted and sincere efforts" and "the facts speak for themselves." I wrote down those four or five quotes, which don't add to my input, and I am being very sincere.

Mr. IGNATIUS. I know you are, sir, and so am I. I believe we are at some disadvantage with draft GAO reports that we haven't seen, and testimony that preceded us by only a day, to answer specific comments that are made, and without the chance to confer with the people who have made them.

The point that I attempted to make to the chairman is that we always are receptive to GAO reports. We learn from them. The record speaks for itself. We welcome this look from the outside, and we will address these reports in a systematic and objective way, as we always do.

We have not had an opportunity to do that as yet, since we just got them. We will do that, and if they disclose any wrong application of the rules that govern us, we will reassess the rules as the chairman asked me to do. We will be happy to do that. This is part of normal administration of responsibilities.

Representative RUMSFELD. Mr. Curtis estimated that the portion you were talking about—where it might not be advantageous from a cost standpoint, to audit more fully—he estimated it was about \$2 billion—the 4.6 percent. Is that pretty close?

Mr. IGNATIUS. It is a little high. It will vary from year to year obviously. I think in fiscal 1966 the 4.6 percent was under \$2 billion, it was about \$1.7 billion, so he wasn't too far off. But the number of transactions is the thing that I think is significant here, Mr. Rumsfeld. There are almost 8 million purchase transactions involved in that. All I am trying to say is not—

Representative RUMSFELD. You said the de minimis rule applies there.

Mr. IGNATIUS. It might well.

Representative RUMSFELD. For about \$2 billion.

Mr. IGNATIUS. This is presumably why the rule was set as it was in 1959. I checked with the people who set that rule. That was before my time here. That is the reason that was given for doing it in that manner.

Representative RUMSFELD. I have trouble agreeing when you argue that the number of pieces of equipment involved and the number of contractors involved and the quantities involved in this say \$2 billion figure is your excuse that it is, from a cost effectiveness standpoint, not worth the effort.

It is almost like you are saying the Department of Defense is too big to be run, that you are doing too many things, and you can't do it all, and that the only alternative is to break it up in bits again.

Mr. IGNATIUS. That is not what I am saying at all. I don't think that there is any business, or even indeed in running your own house, where you don't give more intensive effort to the more significant dollar amounts than you do to the smaller ones. I don't spend the same time appraising a dollar purchase that I may make in my family, that I do a \$3,000 purchase when, let's say, I am buying a car. You put the emphasis where you have the significant values. Now in small purchase—

Representative RUMSFELD. With a small agency handling \$2 billion, they can handle the money efficiently and effectively and know what they are doing.

Mr. IGNATIUS. Sir, it is not the \$2 billion. It is the 8 million transactions. A small agency couldn't make 8 million transactions. This couldn't be done by a small Agency.

Representative RUMSFELD. My time is up.

Mr. IGNATIUS. The second point is that these are local purchases that tend to be made in the community where we are buying in the market place, where our rule requires that there be only three competitive bids.

Thus, all of these things taken together, on balance, led the people who established this rule in 1959 to say, "We will assume that all of these are competitive procurements and report them as such, even though in some instances they may not be."

Now, if there is any large-scale error in that, I suspect we ought to change it, even though it won't have any real significance on the totals reported, because it is less than 5 percent of our total. But we will look at that and reappraise it.

Representative RUMSFELD. Mr. Chairman, I apologize for taking so long. I do hope we can have these gentlemen back after they have had a chance to study that report.

ADVERTISED PROCUREMENT 15.1 PERCENT OF TOTAL

Chairman PROXMIRE. Yes, I agree.

Now, I would like to proceed in this competitive bidding area. I have here a table the source of which is the Office of Secretary of Defense Military Prime Contract Awards and Subcontract Payments on Commitments, showing that formally advertised procurement constituted 15.1 percent, and the negotiated procurement constituted about 85 percent, 84.9.

NEED FOR SOUND NEGOTIATION

The reason that I am happy that we had this discussion on competitive procurement or formally advertised procurement is it indicates the very great importance in the negotiations of having sound negotiations, on which you have full information, which brings me to the fact we have had on the books the Vinson Law since 1962, which provided for the truth in negotiations, provided that the contract shall specify the accurate, complete, and current costs on which the negotiations are based, and yet I think we had very good documentation that this law is not being enforced by the Department of Defense, and I would like to ask you about it.

STATEMENT OF COMPTROLLER GENERAL

Mr. Staats said this. I refer to the transcript of yesterday. He said first that he conducted a study, because he was so concerned about this, and they thought it was so important that they felt that there may be lack of compliance, so they conducted quite a comprehensive study. I will quote from the transcript (p. 62):

Mr. STAATS. And our purpose in undertaking the study was to find out really whether or not it had been carried out in accordance with the intent of Congress.

Chairman PROXMIRE. Would you agree there is a serious lack of compliance?

Mr. STAATS. Yes.

Chairman PROXMIRE. And a comprehensive lack of compliance?

Mr. STAATS. Yes. We felt the matter was so important that we were not willing to rest just on a few isolated cases, and that is the reason it took 242 cases of either prime or first tier subjects.

Chairman PROXMIRE. What were the results of your finding in some of those cases?

Mr. Staats said in part:

In 165 of these awards we found that the Agency officials and prime contractors had no records identifying the cost of pricing data submitted and certified by offerors in support of significant cost estimates.

We also found that of the remaining 57 of the 242 procurements examined—and there was some compliance with some of them—

of the remaining 57—

which was not compliance and which did not fall in this other category I mentioned, there was not a record certifying that the reason for lack of compliance was because they were based on adequate price competition.

So my conclusion on the basis of this is there was about 10 percent compliance with this law which it seems to me is just vital, if you are

going to have a basis for procurement of this 85 percent of your procurement, which is on a negotiated basis.

Then I asked if this kind of Truth in Negotiations Act would involve a burden on the Department of Defense. My question was:

Would this involve any burden, any big serious burden, on their part?

Mr. STAATS. Not in our opinion.

Chairman PROXMIRE. Is it possible for the Defense Department to determine, especially in view of the lack of competition, is it possible for the Defense Department to determine the real assessment on these contracts without having accurate, up-to-date cost data?

Mr. STAATS. Not on a central basis or a post-audit review. It cannot be done.

Chairman PROXMIRE. They cannot do it?

Mr. STAATS. We could not do it. All we could find out was that the information was not present, that that information had in fact been made available to the contracting officer. (See p. 63.)

Then one other point before I ask you to comment. Mr. Weitzel of the Comptroller General's Office said this:

Even if they are given, Mr. Chairman, no one can come along later and find out what costs were given at the negotiating table, and if you did not have something to measure against then you do not know whether the Government has been overcharged as a result of the failure to furnish the information because you do not know whether it was furnished or was not furnished.

INDICTMENT OF OUR PROCUREMENT PROCESS

This seems to me to be a most serious indictment of our procurement process, and it seems to me that the taxpayers could well expect that we are losing not hundreds of millions but billions of dollars because of the failure of enforcing a law that has been on the books for more than 4 years.

DOD REQUIRED CERTIFICATES BEFORE "TRUTH IN NEGOTIATIONS" ACT

Mr. IGNATIUS. First, Mr. Chairman the Department of Defense by administrative regulation required certificates of this kind before the law was passed.

LAW NOT APPLICABLE TO ALL NEGOTIATED CONTRACTS

Secondly, it does not apply to all negotiated contracts. It applies to those negotiated contracts over \$100,000 where price competition is not present, so I don't believe the 85-percent figure is correct, but it is still a substantial figure. It probably is of the order of 65 percent of our dollars.

Thirdly, we have worked assiduously on this matter.

Chairman PROXMIRE. Just at that point you say it does not apply to all of the areas that are not subject to advertised competitive bidding.

Mr. IGNATIUS. That is correct. It is limited in several ways. It is limited by dollar value, and I believe it is contracts of \$100,000 or over.

Secondly, it is limited to contracts that are noncompetitive, that is to say where competition is not present in the form of —

Chairman PROXMIRE. I don't want to belabor this point, but I think it is important to recognize that where you have competitive negotiations as it is put —

Mr. IGNATIUS. Yes, sir.

Chairman PROXMIRE. This kind of cost data should be extremely important, even though you don't have a sole source.

COST BREAKDOWNS NOT REQUIRED WHERE ADEQUATE COMPETITION
IS DEEMED PRESENT

Mr. IGNATIUS. We do not require cost breakdowns in competitive negotiations where adequate competition is deemed to be present.

Chairman PROXMIRE. Well, I think that just from the questioning this morning and yesterday as indicated that competition isn't adequate enough to provide procurement on the basis of reasonable cost absent cost data. Go ahead.

CONTRACTORS MUST CERTIFY AS TO COST AND PRICING INFORMATION

Mr. IGNATIUS. Then the law require contractors to certify that the cost and pricing information that underlies their proposal is based on data that is current, accurate, and complete. They must so certify.

JUDGMENT FACTOR AS TO ADEQUATE COMPETITION

Now we are obtaining those certificates, and we are complying with the law. There are two questions I think that relate more in the area of judgment and these are, one, where does the law apply, that is to say where does adequate competition exist. If adequate price competition exists, it is not necessary to negotiate from cost breakdowns. So there can be a difference of judgment. The GAO has said in this and other reports and comments to us that they have not seen adequate documentation in the contracting officer's file in situations where he believed the law did not apply.

Now, we need to work on this to make sure that——

Chairman PROXMIRE. But what they are also saying is that in this 65 percent area, where you stipulate that there is no competition, that in that area there obviously is a great deal of failure to abide by the law.

Mr. IGNATIUS. Yes.

Chairman PROXMIRE. And to get the kind of cost data which is essential if procurements are going to be at a reasonable cost.

Mr. IGNATIUS. Yes, sir; that is the second point. I said there were two.

Chairman PROXMIRE. Yes.

JUDGMENT FACTOR AS TO ADEQUATE EVIDENCE ON COSTING IN FILES

Mr. IGNATIUS. The first was where does it apply. The second is where it applies, and we do obtain the certificate which we are required to obtain, do we have adequate evidence in the contracting officer's file that in fact data submitted were current, accurate, and complete? Here there can be a difference of judgment and interpretation.

SPECIAL COMMITTEE WORKING ON PROBLEM

We are working probably harder on this point and have in recent months than any point really in the procurement area. We have as-

signed a special ASPR committee composed of our top people, a blue ribbon committee headed by Col. George Thompson, who is our top-pricing man, working on this.

We had some difficulties at first. We believe that it is improved now. The GAO report that you addressed, Mr. Chairman, did in fact deal with implementation in the early period. I am not trying to condone any failures on our part. I am simply saying that this was in the early period.

We think we have improved it, but we need to continue to work on what constitutes adequate compliance with respect to the documentation—that the data submitted were current, accurate, and complete.

Chairman PROXMIRE. Yes, but it seems that the Defense Department hasn't even gone through the simplest kind of procedure to require compliance.

Mr. IGNATIUS. Yes, sir.

Chairman PROXMIRE. Wait a minute though. The basic form was form 633, I understand.

Mr. IGNATIUS. Yes, sir.

ISSUANCE OF FORM DD 633

Chairman PROXMIRE. Now this was the testimony yesterday. I said:

The cost contractors haven't even got the forms; is that correct?

Mr. NEWMAN. We have forms now.

Chairman PROXMIRE. Form 633, I understand, has not been distributed by the Defense Department.

Mr. NEWMAN. At that point in time they had been distributed, we were out working on the audit of 242 contracts, and the forms had been sent to the warehouse instead of to the contracting officers, so we got them to get them out of the warehouse and send them to the contracting officers. (See p. 64.)

Now this was 3 or 4 years after the law had been passed. Instead of sending these forms which should be filled out if the law is going to be fully complied with, instead of sending those forms out, they were sent to the warehouse and sat in the warehouse as I understand it for 7 to 9 months until the GAO got on top of it and insisted or at least called your attention to it, and then they got some action.

Mr. IGNATIUS. Form DD 633 was our form. I would like Mr. Malloy, if I might, to comment on this, because he is intimately acquainted with this part of it.

Mr. MALLOY. Mr. Chairman, the DD form 633 is a form which can be labeled a cost breakdown form. It is a form which has been used in the Department of Defense going back into 1958 and the 1959 time span. The form that we are now talking about is a revision of our standard form. We put it out in late 1964.

The reason for putting out the revision was to take advantage of the experience that we had had, that we had gained in implementing Public Law 87-653 in the previous 2 years. We found that we had to make improvements in the way we got data, in order to be more precise in our implementation of the law. So we revised that form, and published it and sent it out to the field.

It had been published to the field about 4 or 5 months as I recall, some part of which was taken up in the distribution process getting it out to where the forms are held in stock, when the General Account-

ing Office made an initial review. They found that in many of our offices, not all of them but in many of our offices, they had not yet requisitioned the form and they were using the old form.

As a matter of fact, when the General Accounting Office people found this, they came over to my office, not even bothering to write a report, and reported this to me verbally. We checked it and found there was some substance to the information we had been provided by the General Accounting Office.

Forthwith, within a week or two, we published to all contracting officers within the Department of Defense an instruction over Mr. Ignatius' signature, in which we told people again that they must now stop using the old form, and use the new form.

Now, you could comply with the law using the old form, but the new form made it more precise in terms of what people were supposed to do. That is the story.

Chairman PROXMIRE. Let me make sure I understand the situation. Maybe I shouldn't have gotten off on the form situation. Are you telling this committee this morning that there is now and has been for some time compliance, full compliance with the Truth in Negotiating Act, the contractors are stating their cost accurately, that it is current and that it is complete in virtually all cases?

REQUIREMENTS OF PUBLIC LAW 87-653

Mr. MALLOY. Mr. Chairman, Public Law 87-653 requires three basic actions. It requires that we request the contractor submit cost and pricing data in the areas in which the law applies.

The law also requires that the contractor sign a certificate that that data that has been submitted is current, accurate and complete.

And it further requires that contracts that are subject to the law contain a clause which gives the Government a contractual right for a contract adjustment in the event it is later determined that the data were not in fact current, accurate and complete.

Now as to these three basic provisions of the law, we always have and continue to get cost or pricing data. We have been getting these certificates and we have been including the contract adjustment cost in all of the contracts which in our judgment are subject to the law. There should be no question about our getting cost data in connection with noncompetitive procurements. This is the way we negotiate a non-competitive procurement.

In the normal situation, you will receive a quotation from a contractor with a cost breakdown, because we ask for that information when we send out our requests for proposals to him. We take—

Chairman PROXMIRE. I agree with you that there is no question you should get it. Are you getting it?

Mr. MALLOY. Yes, sir, we are.

Chairman PROXMIRE. You are getting it?

Mr. MALLOY. We are getting cost and pricing data generally.

Chairman PROXMIRE. What is your answer to the charge that there is not compliance, what is your answer to the charge that there is not comprehensive compliance? I am trying to find the words he used, rain, but I did read them in my inquiry of Mr. Ignatius.

Mr. MALLOY. Mr. Chairman, there are two points that the Comptroller General has made. In the first instance, he says that as he looks at the decisions that the contracting officers are taking on a case-by-case basis, that he is unable to find clear documentation in our files as to the reasons why the judgement was made that the law did not apply in a particular case. The Comptroller General is not saying that the law either applied or did not apply in that particular instance, but he could not find the documentation.

Chairman PROXMIRE. That is certainly a serious failure on the part of the Department of Defense, the absence of a justification for the exception; isn't that right?

Mr. MALLOY. Mr. Chairman, our regulations require that there be sufficient documentation.

Chairman PROXMIRE. He couldn't find them.

Mr. MALLOY. There should be, I agree with you, there should be that type of documentation. Now I could not tell whether in the given cases that the Comptroller General looked at, whether all of the facts might not have been able to be verified in other ways. But this is an area in which over the past year or so we have been concentrating in our training programs and insisting that our people do this. There is no question in my mind that this should be done, and for the most part it is being done.

Now the second question comes up not in the case of whether or not we are getting cost data. We are getting the cost data. We are having the cost data audited by our auditors who go in and make an independent check of the contractor's books and give us an independent report, and thereafter there is a negotiation. Whereas in the normal situation, the contractor might well take an optimistic appraisal of the future from his point of view, our people might take a pessimistic approach, and the negotiation process is to arrive at a mutually acceptable price with give and take.

Now in that situation, you are looking at sometimes almost mountains of cost data. The contractor must certify as to the factual base on which the price was negotiated, and there are literally thousands of facts that are potential to be certified to.

RELATING CERTIFICATE TO THE FACTS

The problem comes when the contractor executes a certificate. The problem that we need to overcome, and it is a most difficult problem, Mr. Chairman, is to be sure that that certificate is related to the specific facts. Then you have to pick out which specific facts are material. They are all involved in the transaction, but which are material and how do you identify them.

Now our objective is to identify the major important items, because we as anybody else are interested and vitally concerned that if it subsequently turns out in a postaudit by the General Accounting Office, by our own postaudits, and we now do postaudits, if we find data that is not in fact current, accurate and complete, that we have a contractual basis for a recovery. We work diligently to see that that result comes off. But this is a type of thing, with the amount of data that is involved, that we have some difficulties in being sure that this is done. I suspect that we will always have difficulties in this regard.

STATEMENTS CONTRADICTING COMPTROLLER GENERAL

Chairman PROXMIRE. Let me just say—my time is up again—that you are saying that this is a very difficult law to carry out. The Comptroller General said that he did not think it would constitute a heavy burden. You are saying that there is a substantial compliance or virtually complete compliance. He said there is a serious lack of compliance.

I get the feeling from your answer, Mr. Malloy, that your department feels that there are serious difficulties in this law as it is presently written to comply with it. It seems to me that a law of the Congress that has been on the books for four and a half years, that there is something wrong with it, if it is difficult for the agency which is given the responsibility for enforcing it, that you should have been up here on the Hill long ago indicating what is wrong with it, how it can be improved, how it would be possible to comply with it, if it is unrealistic what it is unrealistic.

At the same time it is hard for me to believe, to make any conclusion except that the position of the Comptroller General is right, and that there should be the accurate, current and complete cost data in every case, and on the basis of his findings, and I must say on the basis of your responses, my feeling is that we aren't getting that, in this enormous amount of procurement which costs tens of billions of dollars a year.

Mr. MALLOY. Mr. Chairman, I—

SUGGESTED CHANGES IN THE LAW?

Chairman PROXMIRE. Do you have any change in the law to suggest—so that you can comply with it?

Mr. MALLOY. I do not at this time have any changes in the law that I would suggest to the Congress. We are working as the Secretary indicated very diligently in defining some of the terms that are used in the law in the way in which they will be given practical effect at the working level.

This is the type of situation that requires training and education and precise regulation writing, and we have made a major change along these lines in 1964.

CHANGE DUE IN REGULATIONS

Now we are taking all of the experience that we have learned in the past 2 years, and we are about to put out another change in our regulations, and adopt a major training program along with it, to be sure that the people at the working level understand clearly what the requirements are.

I must say, Mr. Chairman, that we have been working very cooperatively with the General Accounting Office in this regard.

Chairman PROXMIRE. I know you have, and I don't mean to be critical of your efforts, and so forth.

Mr. MALLOY. They are very helpful to us.

Chairman PROXMIRE. That just is very, very difficult for us to understand here in the Senate and in the House, when we pass a law

and find the Comptroller General, who is our principal adviser in this area, who tells us that there is the lack of compliance, and I can conclude nothing except that it must be costing the taxpayer a whale of a lot of money, and it is shocking.

I realize it is difficult to train people and it is difficult to get people fully cognizant of it, and if there were a failure to comply in 1 or 2 percent of the cases, it is understandable although this would be costly. But when the failure is so comprehensive as indicated in these 242 cases, wherein 57 of the 242 cases there was no reason for waiver of the trust certificate entered into the file "and this constituted a violation of the Defense Department's own regulations", it is very hard to accept.

LAW APPLICABLE TO 18,000 CASES PER YEAR

Mr. MALLOY. Mr. Chairman, we handle considerably in excess of 18,000 procurement situations every year, in which this law applies.

Chairman PROXMIRE. You are not telling me by that answer that the Comptroller General picked a nontypical situation?

Mr. MALLOY. No.

Chairman PROXMIRE. He finds there is this huge percentage of non-compliance, it would seem to me it is fair to conclude that he is being objective and fair in this selection of cases, and that you can apply this generally.

DOD COOPERATES WITH GAO

Mr. IGNATIUS. I think this is an area, Mr. Chairman, if I may make a comment here, where we have been working cooperatively with the Comptroller General. We have a number of efforts underway.

Our aim is to comply fully. If in our judgment after the passage of further time we conclude that despite what we would regard as a sincere and significant effort we can't do it, then we would want to come back to the Congress. I don't think we should do that yet.

I think we need to continue to work within our own department and in consultation and cooperation with the Comptroller General, in large part addressing our effort toward the question of when is compliance in fact clear and evident.

SIMILAR STANDARDS NEEDED

I think it is important that we and the Comptroller General have a similar standard as to what constitutes adequate compliance. There are some areas for judgment here, and it is our aim to comply fully. We need to insure that our standards, which are in our judgment addressed to full compliance, are similar to those of the Comptroller General—to narrow the gap, if there is one.

It is my own assessment in looking at what is going on, that an effort is being made, but that problems still remain. I would like to work on this for a while longer with our own people, and in consultation with the Comptroller General, in particular as I say to bring into focus the question of what constitutes adequate compliance.

Chairman PROXMIRE. And you would agree that it is not simply a matter of argument over standards, that the Comptroller General is

very sincere when he argues, and I think he is probably right when he argues that you simply can't know whether or not the cost is reasonable, whether or not the profit is excessive, unless you have the kind of information which has been lacking in a very large proportion of these cases; is that correct?

Mr. IGNATIUS. It is correct that we need to have adequate support for the costs and prices proposed, and the question I think, Mr. Chairman—

Chairman PROXMIRE. And you don't have that.

Mr. IGNATIUS. No, sir, I don't say that. What I say is that we need to have a common understanding as best we can in a situation of this kind as to what constitutes adequate support and documentation.

Chairman PROXMIRE. You think you have it and he thinks you do not have it; is that correct?

Mr. IGNATIUS. Mr. Malloy, who has been closer to this than I have, feels that we have been complying. I have made the statement that there are judgment areas here. We have been obtaining the certificates. I believe that in that sense we have been complying.

The question I think that has been raised is have we in some instances failed to obtain certificates in circumstances where we should have. This as I understand it can be a matter of documentation.

MAJOR ISSUE WITH GAO

Second, the question of documentation both of decisions and of the support behind them, that lies behind the certificate, is the major point at issue with the GAO.

Chairman PROXMIRE. I want to apologize to Congressman Rumsfeld, but I do want to raise this point. Mr. Staats speaking:

165 of these 242 awards we found the agency officials and prime contractors had no records identifying the cost or pricing data submitted, and certified by offerors in support of significant cost estimates.

If this is true, and I am sure the Comptroller General is honest, I don't know how you can possibly accept the argument that you have adequate cost information.

Mr. MALLOY. Mr. Chairman, that statement by the Comptroller General does not mean that we did not have cost or pricing data. I would almost guarantee, and I haven't seen the specifics, that we had the cost and pricing data.

IDENTIFYING COST DATA WITH CERTIFICATE

Chairman PROXMIRE. You have no means of identifying it.

Mr. MALLOY. What he is talking about is the record of identifying this mass of cost data which we had in great volume supporting the certificate. That is a narrow area in which there is some difficulty.

Chairman PROXMIRE. That is a pretty big area where you have this massive amount of cost and you have no records of identifying it so that you can relate it and so that it can be specific and useful.

Mr. MALLOY. We have a great many records, Mr. Chairman, identifying this data. It becomes a question as we try to pick out of this total the things that are most meaningful, whether we do it in the most precise way. It is not an easy chore, and we are working on it.

Chairman PROXMIRE. He said you have no records identifying the costs or pricing data submitted. He did not say your records may not be adequate or precise enough or satisfactory. He just said no records. Do you reject that?

Mr. MALLOY. Again I don't know the specific case—

Chairman PROXMIRE. This is in most of the cases, 165 out of 242.

Mr. MALLOY. The question that the Comptroller General addresses himself to here, and as I say, we have been discussing these matters with the Comptroller General people, is the problem of documenting the connection between this mass of data which we have and the certificate. It is not a question of whether we are getting the data or not.

Chairman PROXMIRE. I want to come back again. Congressman Rumsfeld?

Representative RUMSFELD. Do you agree that having this cost data isn't really of much value unless you have the records relating to it?

Mr. MALLOY. We have the records, sir.

Representative RUMSFELD. Then the Comptroller General is wrong.

Mr. MALLOY. I am not saying that the Comptroller General is wrong. I am trying to explain the kind of records that we have.

NEGOTIATION PROCEDURE

In a normal procurement of the kind we are discussing here, we will send out to the contractor a letter asking for a quotation and send him the specifications and the requirements of the procurements, and ask him to submit a proposal plus certain kinds of cost or pricing data.

The contractor fills out our forms and submits this data to us. We take all this cost data, make our own preliminary analysis of it, give it to our auditors and send the auditors back out to the contractor's plant, where they check every one of those figures against the contractor's books and records and submit it as an independent audit report. All of these things are in the record so we have plenty of records.

After we get through the negotiation process, in which more data is often supplied, we then have to have the contractor execute the certificate. We are asking him to do that, and we are doing our best to insure that we know precisely what he had certified to. That was the point in developing a new form, the revised DD Form 633, where the instruction on that new form is much more precise than the old form. A proper following of that form, tying the figures to source data, will in our opinion and in the opinion of the Comptroller General be compliance with the law.

Representative RUMSFELD. I think maybe one of the problems I am having is that this hearing is going to show literally dozens of instances where you and the Secretary have said that you are "doing your best" and that "it is a difficult chore" and that you are "working hard at it" and that you are "being diligent." I don't think there is anyone on the committee who is suggesting that you are not "doing your best," or that you are not "working hard at it," or that it is not a "difficult chore."

ADEQUACY OF COMPLIANCE WITH THE LAW IS THE QUESTION

The question is whether you are complying with the law and whether you are doing well enough, and that isn't answered by saying you are

"working hard at it" or that "it is a difficult chore." I hope that when you come back, we can peel through some of those things and try to narrow down specifics as to how good a job is being done. It is for the Congress to decide whether it is good enough or whether it ought to be better.

GOALS SET BY DOD

Now three quick questions. In the Secretary's statement you have your goals charted out, and you have the actual achievement. Without going into really breaking down what this really means, let me ask you on these goals, were those goals set 5 years ago and not revised?

Mr. IGNATIUS. The goals were set initially as I recall, Mr. Rumsfeld, at the outset of the program.

Representative RUMSFELD. You started in 1961?

Mr. IGNATIUS. They moved from about 32 percent, which was the situation at the start of the program, to about 40 percent I think was the long-range goal. But as experience developed, and the Departments were able to exceed the goals that were set, revised goals that were higher were established.

Representative RUMSFELD. Then why doesn't your chart show 40 percent, if that was your original goal?

Mr. IGNATIUS. That was the goal that was set for fiscal 1966 as I recall.

Representative RUMSFELD. My question is are the goals shown on this chart the goals that were set 5 years ago and not revised? Is the answer no?

Mr. IGNATIUS. The answer is that there was an initial goal set, and then it was revised year by year as progress improved. The initial goal was in fact lower than the goal that was finally set. I will need to check the record to be exact.

Representative RUMSFELD. I have trouble believing that you are accurate on that, because your goal, if it was revised year to year depending on what success you had, why did you revise down your rate of improvement between 1965 and 1966? Obviously if you draw a straight line up between 1963 and 1966, you will see it would have gone higher. Instead your goal is revised down. Yet you had tremendous success in here—

Mr. IGNATIUS. Yes, we did. I am glad that you feel we had tremendous success.

Representative RUMSFELD. Now, I mean according to your graph and in relation to your goals as shown. My statement prefacing it was that assuming we are all talking about the same thing when we are talking about competition, goals, and so forth.

Mr. IGNATIUS. Yes.

Representative RUMSFELD. I don't concede that for a moment after our earlier discussion.

Mr. IGNATIUS. Let me check with my predecessor, Mr. Morris, who was responsible for the initial goal setting in 1965, and submit for the record if I may, Mr. Chairman, a statement responsive to Mr. Rumsfeld.

Chairman PROXMIRE. Very well.

(The information referred to follows:)

When the DoD Cost Reduction Program was established in 1962, initial cost reduction area goals were established for a five-year period. For the area entitled,

Shift from Non-Competitive to Competitive Procurement, the initial five-year goal was set at 39.9% of the total dollar value of contract awards. All goals are reviewed and revised annually. The FY 1966 goal was established at 40.5% since it did not appear that we could again achieve the 43.4% competitive rate realized in FY 1965. The fact that 44.4% of our FY 1966 contract awards were let on a price competitive basis, 3.9% in excess of the established goal for FY 1966 and 1% in excess of the FY 1965 rate of competitive awards, is indicative of the continuing attention being given by the Department of Defense to increasing the percentage of procurement dollars spent on a competitive basis.

Representative RUMSFELD. In your "cost reduction program" table, what is the difference between the chart figures and your plans for the future? Specifically in this chart, as shown right here, if you make a decision that is going to result in \$10 million of savings in a given fiscal year, and it will involve savings in the future, do these figures show cumulatively over each year, or is it a one \$10 million saving the first year?

Mr. IGNATIUS. It depends, sir, on the nature of the savings. We have had savings that are one-time and if they are one-time they are shown only in the year in which they were incurred. If they have repetitive or recurring value, the recurring saving is shown, and in the case of the recurring savings as opposed to the one-time, the cumulative value would be included in the figures.

Representative RUMSFELD. So in other words, if you make a decision with respect to handling of a contract that is going to result in some savings, then from now on you call that savings by the Department of Defense?

Mr. IGNATIUS. No, sir, we are not. In this program which was set as a 5-year program, as I addressed in my statement, we did set some long-range goals, and we did take over the 5-year period the recurring value of the savings.

Representative RUMSFELD. I see.

Mr. IGNATIUS. Having completed that, we are now on an annual basis, and don't proceed in the way we did in the 5-year program.

Representative RUMSFELD. Except that your program for the future is going to be on an annual basis, and that the annual report will reflect for each action savings realized in the current year and separately estimated savings to be realized in the 2 succeeding years.

Mr. IGNATIUS. Yes, sir. Our reason for that, Mr. Rumsfeld, is that we will take a decision let's say in fiscal 1967, and if it had savings value in 1967, it will be audited and recorded as such.

If it has recurring value, we have gone on a 3-year cycle here, because we are on a 3-year budget cycle. We are executing one budget, defending a second and planning a third, and our aim here was to complete the 3-year cycle, so that if the savings was recurring in nature, it would have been reflected in a budget, and at that point, no further recurring value is taken. We believe that is a desirable thing to do.

Representative RUMSFELD. It sounds like it makes sense.

In your statement, under "Utilization of Personal Property Inventories," you use the words "excess property and excess stocks." Are they interchangeable in the context of this paragraph, or are they different?

Mr. IGNATIUS. They are meant to be the same, and it is just two words that mean the same thing. Property and stocks in this case are

synonymous, and what we are talking about is our supply system inventories. This would involve real property, and since they are items of supply, the word "stocks" was used. But they are synonymous.

Representative RUMSFELD. Thank you very much.

Chairman PROXMIRE. Thank you.

I would like to pursue this now, Mr. Ignatius, by getting into the third area.

POSTAUDITING CONTRACTS

We talked about competitive bidding, we talked about negotiations. I would now like to ask you to talk about, tell us about postauditing. There was testimony yesterday that the Defense Department had no program for postauditing contracts until the GAO prodded it into accepting one. Why did the Defense Department need such prodding?

Mr. IGNATIUS. This is in the context of Public Law 87-653?

Chairman PROXMIRE. This is in the context of the entire negotiation process.

Mr. IGNATIUS. Well, the question of postaudit I don't think there is any difference between us and the GAO in respect to cost reimbursement type contracts. The question relates to fixed price type contracts.

On cost reimbursable contracts we do postaudits. In the case of fixed price type contracts, we have limited our postaudit to those data that were involved in negotiation of the contract up to the point of award as opposed to after award. The GAO believes that we ought to postaudit in fixed price contracts. We currently—

Chairman PROXMIRE. That is a matter of difference of opinion as to what you ought to postaudit and what you should not. The GAO did persuade you to proceed with the postaudit, which you have now accepted, as I understand it; is that right?

Mr. IGNATIUS. I would like Mr. Malloy to comment. It is my understanding, Mr. Proxmire, and I believe this is correct, that we have this as an issue before us now in the Office of the Secretary of Defense involving the Comptroller, Dr. Anthony, and myself.

We have an issue before us, which the ASPR committee has addressed, namely, should we do the kind of postaudit that the GAO believes should be done. That is an issue before us which has not as yet been resolved. It refers to the postaudit of fixed price contracts only. I am not aware of any differences between us and the GAO in respect to the cost reimbursement type of contract.

Now, Mr. Malloy may want to amplify that.

Chairman PROXMIRE. Go right ahead.

Mr. MALLOY. Mr. Chairman, I believe your question may have been also addressed to the question of the whole concept of a postaudit operation by our own auditors. It is true that there was a GAO report to that point that we received during the past year.

Prior to that time our auditors were doing some postaward auditing, but as I understand it they were not doing it on any systematic large-scale basis. The Defense Contract Audit Agency, as you know, is a relatively new agency, and the demands for the time of the auditors with a stepped up program was such that they were just not doing

this type of audit as much as the General Accounting Office thought they should.

Chairman PROXMIRE. Weren't enough people available to do it?

Mr. MALLOY. Well, I think that they were using their staff for the more current procurement matters rather than for the postaudit review.

Chairman PROXMIRE. Wouldn't it have made sense to expand the staff? Isn't the return immense to the taxpayer? The postauditor, wouldn't he bring in far, far more in relationship to the cost?

Mr. MALLOY. I just don't know how to answer that, Mr. Chairman. There is some potential. What the trade-off is I really don't know. But to get to your point of—

Chairman PROXMIRE. Wouldn't it be rather easy to determine this, based on the auditors that you have?

RETURNS FROM POSTAUDITS

Mr. IGNATIUS. The audit agency believes there would be a good return.

Chairman PROXMIRE. An immense return. The Internal Revenue Service finds in auditing tax returns, that an auditor brings back \$10 for every dollar he costs. Here I estimate it would be many, many times that.

Mr. IGNATIUS. You are correct that in the sense that the Director of the Defense Contract Audit Agency does believe that that would be the case. He has so stated.

Mr. MALLOY. But it is true, Mr. Chairman, that—

Chairman PROXMIRE. But it wasn't done as you say until recently, is that right, Mr. Malloy?

POSTAUDIT PROGRAM INSTITUTED DURING PAST YEAR

Mr. MALLOY. This was a recommendation that we received from the Comptroller General, and the Comptroller of the Department of Defense, Secretary Anthony, considered the General Accounting Office recommendations, felt that it had merit, and instituted the program during the past year.

Chairman PROXMIRE. During the past year. Now even on this new program there was testimony that the Defense Department's new program still contains a large loophole, and that is the access to the contractor's records. That issue apparently hasn't been resolved. The GAO has access to the contractor's records on the basis of the law, but the question of whether or not the Defense Department as I understand it, has access of that kind has not been resolved.

Mr. MALLOY. Mr. Chairman, that particular issue relates to the matter that Secretary Ignatius was talking about earlier. It only relates to the fixed-price area, and it only relates to access to records of the cost of performance of the contract.

We have full access to records on all types of contracts except fixed-price contracts, and we have full access to records even on a post-award basis to all of the data submitted by contractors and used in the negotiation of the contract.

There is a narrow area applying to firm fixed-price contracts in which the General Accounting Office has from the Congress authority to audit the actual costs that were incurred under that fixed-price contract, and we have never done that in the Department of Defense.

Chairman PROXMIRE. How much money is involved per year? How much money would be involved last year in contracts that have this exemption from access to the contractor's records? How many billions of dollars?

Mr. MALLOY. I don't have that. I will try to develop that figure for the record, Mr. Chairman. We know of course the total number of firm fixed-price contracts. We would have to make an estimate of the number of the total that the law applied to. I think we could, and I will certainly try.

(The information referred to follows:)

We do not have the precise number and dollar amount of noncompetitive firm fixed price contracts of \$100,000 or more executed in fiscal year 1966 in which the Department of Defense would have had access to contractors' records under Public Law 87-653—if that had been our policy during that fiscal year. However, from other procurement statistical data we estimate that there were approximately 4,500 such contracts with an estimated value of \$4 billion.

Chairman PROXMIRE. You say that the Comptroller General has a law. Do you feel that you would have to have a law? Couldn't you simply put it in your contract. You have a postaudit?

Mr. MALLOY. We certainly could provide for this contractually, though I should point out that another committee of the Congress last year indicated in one of its reports that at least in the judgment of that committee, the provision of this type of an audit should not be done by contract, and maybe ought to be a matter for the Congress to consider.

But it certainly as a technical matter could be done by contract, and if the results of our current discussions indicate that we are going to proceed on this basis, we will do it by a contract provision.

Chairman PROXMIRE. Certainly we ought to have a proposition in the Defense Department that either you go ahead on the basis of making a contract that you can postaudit, or you can request Congress for a law authorizing you to do so, because meanwhile we are losing billions of dollars. Are we not? These postaudits pick up in general, they are inclined to pick up a substantial amount of difference.

Mr. MALLOY. We might, Mr. Chairman, but I think as Secretary Ignatius said earlier, that we are concerned as we analyze this matter—and we have not made our decision yet—but we are concerned that we preserve the integrity of firm fixed-price contracting, because we think that this has great advantages to the Government.

What we would like to do is to have the best of both worlds, and we are considering various alternatives that might give us the optimum approach to the matter.

BUSINESSLIKE COST ESTIMATING SYSTEMS

Chairman PROXMIRE. There was testimony yesterday that the Defense Department had been dallying for 10 years despite recommendations from its own auditors and from the GAO on the question of whether to require contractors to adopt what was called business-

like cost estimating systems. The reports of your auditors on this subject have been strangled by redtape over the years. How much longer will it take before this issue is resolved?

Mr. MALLOY. Mr. Chairman, the question of cost estimating, formal cost estimating systems was addressed by the Comptroller General in a report to us during the past year. I might say that we have been concerned with estimating systems for years. Essentially we are concerned with the proper estimate, and to the extent that a formalized estimating system can contribute to a good estimate, we think that this is advantageous, and we have always been of that mind.

The Comptroller General has suggested during the past year that we ought to require more formalized estimating systems on the part of contractors.

DOD AND GAO IN GENERAL AGREEMENT

As a matter of fact, we agree with the Comptroller General in this regard, and we are now putting more emphasis on this, and our auditors, who have the primary responsibility of reviewing contractor estimating systems, have adopted a comprehensive system of surveying contractor estimating systems.

We are supporting this effort with our own people, and this is an extension of a program that we have had, but the new dimension that has been added by the Comptroller General is a renewed emphasis on the formalities of estimating systems, and to the extent that we don't get too formal, we will make some good progress here.

Chairman PROXMIRE. Then as I understand it, the new system that you have doesn't meet all the GAO recommendations. In what respects does it fall short?

Mr. MALLOY. I believe that our new system does meet the GAO recommendations. I am not aware that we are at cross purposes with them on this point.

Chairman PROXMIRE. As far as you know it meets all the GAO recommendations, or most?

Mr. MALLOY. Yes, the recommendations that we have made—as a matter of fact, the General Accounting Office, I believe, in their report on estimating systems pointed out one of the things that we did in issuing directions to all of our contracting officers, to tell them to get solidly behind this program that our auditors were launching. So I believe that the General Accounting Office and ourselves are not at odds on this point.

SECRETARY McNAMARA ON "TRUTH IN NEGOTIATIONS"

Chairman PROXMIRE. Mr. Ignatius, 3 years ago Mr. McNamara issued a memorandum signed by him personally as I understand it which said in effect the findings by GAO did not relieve the Defense Department of the responsibility of making such findings on its own issues. In other words, Mr. McNamara made it plain it was the Department's responsibility, not GAO's, to enforce the Truth in Negotiations Act.

He also laid down some ground rules for his auditors and other departmental personnel spelling out their jurisdictions and directing them to cooperate with one another. Why is it that 3 years after Mr. McNamara supposedly settled these issues, the issues are still alive?

Mr. IGNATIUS. I don't know that I can add to what Mr. Malloy has said or what I said earlier with respect to that particular action. We have gone into it in some detail with you. We are working cooperatively with the GAO on it.

There remains some differences which I am hopeful we will be able to resolve in the near future. I certainly agree and subscribe to what the Secretary has said.

We are responsible for the conduct of our assignments here. He has strengthened our own audit functions in many ways, through the establishment of the Defense Contract Audit Agency and other measures, working with the official to whom he looks for audit, the Assistant Secretary of Defense, Comptroller.

LACK OF COMPETITION IN PROCUREMENT REQUIRES POSTAUDIT

Chairman PROXMIRE. What concerns me overall is that, No. 1, we have a very limited amount of advertised competitive bidding. We have, we are still having a limited amount by your definition, less than half of our procurement of any kind of competitive bidding by any stretch of the imagination.

The Congress passed a law, the Truth in Negotiations Act, which in my judgment lacks full compliance or anything like full compliance. The only remaining safeguard is a postaudit, and it seems on the basis of the response we got this morning that there is a very substantial area for improvement here.

So as we look at the overall procurement process, it seems that there is a vast area in which there may very well be a substantial loss to the taxpayer, and a substantial additional expense, and this concerns me a great deal.

DECISION PENDING ON POSTAUDIT OF FIXED-PRICE CONTRACTS

Mr. IGNATIUS. Mr. Chairman, we have it before us, immediately before us, the question of postaudit of fixed-price contracts. We have not as yet reached a decision on it, but we will in the near future.

STAFF LIMITATIONS NOT A QUALITY FACTOR

Chairman PROXMIRE. Do you have any limitations on staff in these areas?

Mr. IGNATIUS. I would say that the answer is yes and no. I suppose that any person in Government or in business or any organized endeavor has some limitations on staff, and I think desirably so.

On the other hand, I don't believe that there is a limitation where we can demonstrate that we can improve the quality of our performance, if we have additional staff.

VALUE ENGINEERING

An example of that would be in the value engineering area, where we are achieving significant savings. The Secretary authorized an additional 265 people in the value engineering area on the basis of a study that demonstrated that these people could save substantially more than the cost of adding them to our rolls, by virtue of the efforts

that they made. That is a specific instance of how we have added staff, and you might say spent a little bit of money with the prospect of saving a lot.

Chairman PROXMIRE. Well, yes. The amount is so fantastic and so far beyond the imagination of any of us, who can say how much \$37 billion is, it isn't really comprehended. It is obviously immense.

Obviously under these circumstances, if we can follow policies that comply with what seems to be a reasonable law, the Truth in Negotiations Act, for example, postauditing and so forth, the saving potential is very, very great.

Mr. Ignatius, I want to thank you very much. You have been most patient. I realize it is not easy to submit to this kind of questioning, and I appreciate your sincerity and your ability in responding, and I want to thank the distinguished gentlemen who are with you, too.

TESTIMONY OF ADMIRAL LYLE

Now we would like to turn to the admiral for his presentation. I want to apologize to you, Admiral Lyle, for having kept you waiting. You are an expert in the areas that we haven't covered very much.

As you know, this subcommittee has a fond, perhaps a paternal interest in DSA, and we are looking forward to hearing your statement. I have had an opportunity to review it. You may proceed.

The hour is late. I apologize for that. I don't know what we can do about it, but if you would abbreviate it I would appreciate it. May I say, Mr. Ignatius, if you would like to leave, you can do so. You have been most patient, as I said. You have been here more than two hours.

Mr. IGNATIUS. I appreciate that. I would like to stay just to hear the proceedings. They are of interest to me.

Admiral LYLE. Mr. Chairman, I welcome this opportunity to report to you on the performance of the Defense Supply Agency, and to describe the progress that we have made in our major programs for improving integrated management of supplies and logistics services.

In my testimony to the committee last year, I stated that we had experienced an extremely large increase in demands for supply and logistics services support of the military forces deployed in Southeast Asia and related troop augmentations in the United States. I went on to state that we had been and were giving primary management attention and first priority in the application of resources to satisfying these requirements. The volume of the services' demands has continued to increase in the current fiscal year and we have continued to apply priority management attention and allocate available resources accordingly.

As an indication of the direct impact of Vietnam operations on our supply operations, a special review of our total shipments from January through June of 1966 revealed that more than 60 percent were destined for the Pacific area with the lion's share of these shipments earmarked for direct support of the forces in Vietnam. The growth in supply workload experienced over the past 2 years, almost all of which is attributable directly or indirectly to the military operations in Southeast Asia, is illustrated by the following comparative figures:

The dollar value of issues of stock fund materiel rose from \$1.9 billion in fiscal year 1965 to \$2.9 billion in fiscal year 1966. On the basis of experience through the first 9 months of this fiscal year, we expect this figure to exceed \$4.0 billion by June 30, and to increase to almost \$4.4 billion during fiscal year 1968.

The value of Stock Fund contracts placed to replenish issues and to build up inventory and on-order levels, which totaled \$1.8 billion in fiscal year 1965, rose to \$4.2 billion in fiscal year 1966. Fiscal year 1967 stock fund obligations, including some mobilization reserve augmentation, will aggregate approximately \$4.5 billion. The stock fund program for fiscal year 1968 contemplates total obligations of \$4.15 billion. The total DSA procurement programs for fiscal years 1967 and 1968, including purchases of bulk petroleum and purchases under the coordinated procurement program, will approximate \$6.2 billion and \$5.8 billion, respectively.

Requisitions received and processed by our supply centers rose from 15.4 million in fiscal year 1965 to 19.4 million in fiscal year 1966. The requisition volume had climbed to 15.3 million by the end of March 1967 and is expected to reach 20 million by the end of this fiscal year. The estimated volume for fiscal year 1968 is 20.7 million.

Total tonnage received and shipped through the eight DSA-operated depots rose from 1.7 million tons in fiscal year 1965 to 3.0 million tons last year. With total tonnage handled at 3.1 million tons through March, we expect the fiscal year 1967 volume to reach 4.0 million tons and 4.4 million tons in fiscal year 1968.

SUPPLY SUPPORT PERFORMANCE

In spite of this increased workload the agency has responded well to the emergency demands placed upon it. I am happy to report a marked improvement in our supply posture in comparison with that of a year ago. I indicated at that time that with an increase in demand of the magnitude we were then experiencing, on a supply system encompassing more than a million and a quarter items, we could expect support problems and some shortages from time to time. We did experience such problems.

Principal among these problems was the trouble we had, almost from the start of the major build-up in forces in Vietnam, in keeping pace with demands for certain clothing and textile items. The highly publicized "jungle" boots and tropical combat uniforms were troublesome because they were newly developed and the limited stocks we had on hand had been originally intended to support small numbers of selected Army troops. Although items in the "clothing bags" issued to recruits were not new and we had ample stocks on hand to meet programed troop input, the initial demand surges stemming from the build-up in forces quickly depleted our on-hand stocks of some items and we had to rely heavily on receipts from production. As a result, issue of the tropical combat boots and uniforms were restricted to troops actually in or directly supporting combat operations, and the Services had to reduce the numbers of certain items issued to recruits. The situation has improved to the point where today the current production of "jungle" boots and tropical combat uniforms exceeds the Vietnam requirements, and some months ago the military services were able to refer to the issue of full "clothing bags" to their recruits.

We have encountered similar though generally less acute problems in other areas. However, except for construction supplies, supply performance in other commodity areas has also returned to satisfactory levels. In the case of construction supplies, we had difficulty, initially, with fortification and construction materiel, because of large orders and lengthy production leadtimes. This situation has improved, and our principal concern now is with repair parts for construction equipment. In the Vietnam environment, construction and other engineering equipment parts wear out at an abnormally high rate. Increased production and expedited delivery to Vietnam are satisfying the current requirements of the deployed forces for these items. In the case of industrial, electronic, and general supplies, current supply performance is at or near pre-Vietnam levels, while performance in the medical and subsistence categories actually exceeds those levels.

The overall "effectiveness" of our supply system is measured by the rate of stock availability. This rate is expressed in terms of percentages of the requisitions for stocked items we are able to fill immediately from stocks on hand. With the first impact of the Vietnam build-up this stock availability percentage fell several points from the highly satisfactory 91 percent we averaged during fiscal year 1965 to 87 percent during fiscal year 1966 to a low point of 83 percent last October. As a result of special efforts to obtain materiel from commercial suppliers, cooperation of the military services in easing nonessential specification requirements and accepting substitute items or basic materials, and the efforts of industry to meet or anticipate specified delivery dates, the trend of our stock availability has turned upward and it currently is ranging from 88 to 90 percent.

Before I depart from the subject of our support of the Southeast Asia operations, I want particularly to comment on two aspects of our procurement program—competitive procurement and procurement from small business.

I am happy to report that in spite of the pressure of high priority requests for support of the combat forces in Vietnam, we have maintained a high rate of competition in the procurements made by our supply centers. As of the end of March, 1967, 92.5 percent of the \$4.8 billion worth of the procurements made during the current fiscal year have been competitive. With regard to this percentage, I might add that we do not have a potential for significant increase because of the continuing high volume procurement of brand name merchandise for commissary resale and off-shore purchases of bulk petroleum, neither of which qualifies as competitive procurement.

In the area of use of small business firms in our procurements, we have been able to achieve a participation rate of 45 percent of our procurements this fiscal year. This is the highest percentage achieved in a comparable period since the Agency became operational in 1962. We are especially pleased with this accomplishment because during this fiscal year we have had substantial increases in demands for such items as standard electron tubes, prefabricated buildings, heavy construction equipment, and certain repair parts and components, all of which have little small business potential. We also have had increased requirements for aviation fuels, especially for tanker loadings, which have outstripped the capacity of small business concerns. Another fac-

tor impinging on our small business performance has been the number of Defense contractors which once were small businesses and which now qualify as large businesses and therefore adversely affect our small business percentage.

CONTRACT ADMINISTRATION SERVICES

Fiscal year 1967 will be the first year of full operations for our Contract Administration Services organization. I mentioned in my statement last year that the Contract Administration Services assignment had felt the impact of expanded requirements from the Southeast Asia build-up. These figures will give an indication of the extent of this impact:

The dollar value of materiel inspected and released for shipment by our Contract Administration Services Regions totaled \$11.7 billion in fiscal year 1966. We expect this figure to rise to \$18.2 billion in the current fiscal year and to hold at or above that level in fiscal year 1968. Funds obligated on prime contracts administered by Defense Contract Administration Services Regions reached \$48.6 billion at the end of March, 1967, as compared to \$40.5 billion at the end of fiscal year 1966.

Since assignment of the Contract Administration Services responsibility we have successfully overcome the usual problems of consolidation within a new organization while taking on a progressively increasing workload in support of the expanded procurement programs of the purchasing activities.

We have designed and installed uniform procedures to capitalize on the best features of the separate systems used by the military departments in the payment of contractors, with a view to achieving an optimum combination of effective control and timely payments. Because of activation problems, including training of personnel and reorientation of contractor personnel in the new procedures, the processing time of invoices for payment initially averaged 16 days. Currently, the average processing time for payment of invoices to contractors has been reduced to 10 days.

We are developing and employing uniform quality assurance methods to replace the widely varying practices previously applied by the military services. Where we find that the quality control system employed by the contractor results in a continuing high quality product, we can reduce the number of inspections and tests during and upon completion of the manufacturing process. Also, when we find that contractor quality control systems consistently satisfy our standards, we can reduce the frequency of periodic system evaluations.

We have consolidated at the Defense Industrial Security Office in Columbus, Ohio, the security clearance function for contractor personnel employed on classified contracts. Security administration of contracts involving classified material is accomplished through our 11 Contract Administration Services regions and—unlike other elements of the contract administration assignment—extends not only to contracts assigned to DSA for administration but also to contractor facilities retained for administration by the military services, and classified contracts awarded by the National Aeronautics and Space Administration and seven other Federal agencies. In addition, our

Contract Administration Services organization is responsible for the safeguard of foreign classified information released to U.S. contractors under security agreements entered into between the United States and the foreign government involved. Since consolidation of the security clearance of contractor facilities function in our Contract Administration Services organization, we have acted to identify and terminate clearance for facilities which have not been engaged in classified production for 18 or more months. As a result, we have reduced the number of cleared facilities from over 22,000 to approximately 15,000. This has improved efficiency of the industrial security program and permitted us to limit expenditure of industrial security resources to those facilities actually engaged in classified work.

We have undertaken a series of steps to mechanize certain contract administration services. Because of the size and complexity of this undertaking we are approaching it in increments. We began with the systems used in mechanized contract administration by the Air Force. However, we recognized that changes in these systems would be required to accommodate the needs of a consolidated contract administration services function.

The first phase in development of an improved system was begun in April 1966 and full implementation is scheduled for July 1967.

The second phase was begun in July 1966 and we are currently engaged in equipment selection. Full implementation of the system will not occur before March 1968.

Mr. Chairman, I am pleased to state to this committee that Defense Contract Administration Services functions are being performed effectively and efficiently, and with savings in costs over the methods used prior to their consolidation. As a result of improved management of contracts in the field through uniform policies and procedures, the initial contract administration mission assignment has been broadened in scope through plant cognizance reassignments and functional transfers. Some of the major plant cognizance reassignments to DSA include General Dynamics' Convair Division, San Diego; Martin-Marietta Corp., Orlando; and Sperry-Utah Co., Salt Lake City.

Other functional transfers include surveillance of safety matters concerning hazardous and dangerous materials and processes formerly performed by all military departments; and contract administration functions related to military construction supply contracts for supplies and equipment produced in contractors' plants formerly performed under Army cognizance.

ITEM MANAGEMENT CODING

Last year I mentioned that we were participating with the military departments, under the direction of the Office of the Secretary of Defense, in a joint review of the application of uniform item management coding criteria to all of the items in the Federal supply classes which have been designated for integrated management. On the basis of application of these criteria, an estimated 457,000 items currently managed by the military departments will be transferred to DSA for integrated management by the end of fiscal year 1968. As of 31 March 1967, a total of 147,600 items had been transferred to DSA.

DSA/GSA ITEM TRANSFERS AND CIVIL AGENCY SUPPORT

Under terms of the Department of Defense/General Services Administration agreement of December, 1964, DSA and GSA have been moving forward in the transfer of supply items in the 52 Federal supply classes which will be managed by GSA for the entire Federal Government. According to present plans, on 1 July 1967 we will complete transfer to GSA of a wide range of items in these classes. This will involve approximately 17,000 items managed on a centralized and decentralized basis. Stocks of these items and any other items transferred in the future, will be inventoried prior to transfer to assure accuracy of records. Other classes and/or individual items will be examined under the terms of the criteria contained in the agreement to identify those which are more economically manageable under central Federal-wide GSA control, without impairing support of essential military programs.

Another feature of the DoD/GSA agreement was the provision that DSA consider support of all Government agencies with electronics, medical, fuel, clothing and textiles, and subsistence supplies whenever definite economic benefits will accrue to the Government and no adverse effect on support of the military services will result.

We have completed evaluation of support to Federal agencies for these five commodity areas. As a result, DSA support of civil agencies in the areas of fuel and electronics has been found advantageous and feasible, and has been approved by the Secretary of Defense and the Administrator of General Services. Fuel support is primarily a procurement function and involves no adverse effect on our military service support. It is planned that it will be phased in over a 10-month period beginning 6 months from completion of coordination with the civil agencies which GSA expects to accomplish by June of this year. Tentative scheduling for electronics support provides for phase-in over a 12-month period beginning July 1, 1968, to assure civil agency support without adverse impact on our present heavy workload in the electronics area.

In the clothing and textile commodity, where there is substantially less commonality, savings are less significant and workload impact greater. In view of our already heavy operational commitments in support of Defense, it is planned to limit extension of DSA support of civil agencies to specific cases clearly justified by cost savings and assurance of no impairment of DSA military support. From time to time, in coordination with GSA, we will review the feasibility of DSA support of all civil agencies for clothing and textiles.

The medical and nonperishable subsistence areas involve a relatively heavy additional workload for us. Moreover, study of these areas does not evidence significant economies under a Government-wide support arrangement. This is due largely to the present lack of substantial commonality in civil agency and DoD items of supply. For these reasons, we have recommended that complete support for all Government agencies not be undertaken at this time. However, in view of the fact that an increase in commonality could, in turn, provide the potential for Government-wide savings, we plan to accomplish a technical review of DoD/civil agency medical and nonperishable sub-

sistence items for the purpose of identifying those areas in which there exists the potential for increased commonality. Following this review, GSA and DSA can again assess the feasibility of DSA assuming overall support responsibility in these areas. In the interim, we plan to continue providing support to civil agencies on a case-by-case basis in those instances where there are definite economic advantages to the Government and where no adverse impact on our military support capability will result.

Meanwhile, through individual interagency agreements, we are providing substantial supply support to Federal agencies of the Government. We are supporting the Coast Guard and NASA with a full range of DSA managed materiel; the Veterans Administration and Public Health Service with selected medical items; the Federal Aviation Agency with a broad range of electronics materiel and with combat type packaged subsistence items; the Maritime Administration with selected items, including fuel and substantial numbers of electronics and clothing and textile items; the Office of Economic Opportunity with clothing and textile and subsistence items; the General Services Administration Transportation and Communications Service with electronics supplies; and, in conjunction with the Army, the Agency for International Development with selected medical items for AID programs in Southeast Asia. An agreement has recently been reached with the Post Office Department to provide selected electronics, general and industrial item support. In addition to these arrangements we currently have under study perishable subsistence support of the Bureau of Indian Affairs school program.

As I stated last year, there are certain benefits from our furnishing Veterans Administration and Public Health Service hospitals with support in perishable subsistence items, with the scope of this support based on local agreements between individual hospitals and our subsistence regions. Since April, 1966 such agreements have been made with 45 hospitals and through mid-April, 1967, we have supplied perishable subsistence worth \$1,139,000 to the hospitals. During the course of developing cross-servicing perishable subsistence arrangements with the Veterans Administration and the Public Health Service, it was agreed that a joint DOD-VA review of item specifications used in hospital feeding programs should be undertaken. This review has been completed and the results are being evaluated by the affected agencies with the goal of optimum standardization of perishable subsistence used under military and civil hospital feeding programs.

CATALOGING

Our efforts to reduce the number of items used in the supply system of the Department of Defense have continued. But in spite of the progress which we have made in several concerted efforts in this direction, the overall number of items listed in the Department of Defense portion of the Federal catalog has increased in the past year.

During fiscal year 1966, we reviewed over 283,000 items. As a result of identification of duplicate or similar items already in the catalog and of actions to standardize such items, we obtained military service concurrence in the elimination of more than 116,000 items. We have

set our sights on eliminating 91,500 items during fiscal year 1967, and by the end of March, 1967 we already had service concurrence in the elimination of nearly 67,000.

We still are convinced that the best way to control the growth of the number of items in the Federal catalog is by preventing items from entering the system initially. One method which we use to do this is a mechanized screening of manufacturers' part numbers or Federal stock numbers proposed for cataloging incident to provisioning a new equipment. During fiscal year 1966 our Defense Logistics Services Center in Battle Creek, Mich., screened nearly 4 million part numbers against master catalog record files. Almost 36 percent of these were found to match items already assigned stock numbers in the DoD portion of the Federal catalog.

Another method and one which holds the greatest promise in terms of effectiveness and efficiency is the Department of Defense item entry control program. We have found that approximately 75 percent of new item growth occurs in only 67 Federal supply classes. We have, therefore, concentrated on a critical technical review of items in these 67 classes to prevent entry of new items when fully acceptable items are already in the system. By the end of this fiscal year we will have 13 Defense technical review activities established at DSA and military department inventory control points to review all proposed items in the 67 high growth classes. The results of total item entry control effort thus far have been most encouraging. As of the end of the first half of this fiscal year, 282,000 proposed new items have been subjected to the scrutiny of item entry control. Forty-two percent of those items were rejected including 33.8 percent outright duplicates and 8.2 percent returned to the originator for correction of various administrative errors in the item identification or other cataloging data.

Despite these concentrated efforts, however, the number of items in the catalog increased during calendar year 1966 by a net 128,377. This is a reversal of the trend of calendar year 1965 and is attributable in part to the introduction of parts for support of new major end items of equipment, and to fewer deletions due to retention of older equipments.

UTILIZATION OF ASSETS

Efforts to increase utilization of long supply and excess stocks within the Department of Defense continue to show progress and I will touch briefly on the results.

Inter- and intra-service utilization of military service releasable assets totaled \$403 million in fiscal year 1966 and \$174 million through the first half of fiscal year 1967. DoD utilization of excess stocks in fiscal year 1966 amounted to \$1.46 billion and \$609 million through the first half of fiscal year 1967. Total DoD utilization of both releasable assets and excesses reached \$783 million by the end of the first half of fiscal year 1967.

We are making some progress in using the facilities of the Defense Logistics Services Center at Battle Creek to centrally screen Federal agency requirements against Department of Defense inventories of releasable assets. On September 28, we signed an agreement with the Federal Aviation Agency which will provide for screening both FAA

requirements against DoD inventories and FAA releasable assets against DoD requirements. Agreement also has been reached with the National Aeronautics and Space Administration for an operational test and evaluation of NASA's full participation in the Defense Logistics Services Center's central mechanized screening of NASA requirements against DoD assets. Needless to say these two agreements have not been in force long enough for their full benefits to be felt, but we are hopeful that economies will be forthcoming which will prove the advantages of the screening process for these two agencies.

In recognition of the potential savings inherent in a central mechanized screening of the Government's releasable assets against requirements prior to initiation of new procurement, we have embodied in the planning of a new Defense integrated data system, to be installed at the Defense Logistics Services Center during the fiscal year 1970-71 time frame, the capability to perform such screening for agencies outside DoD more effectively and efficiently. It should be noted, however, that the real success of centralized mechanized screening depends on more than computer capacity at the Defense Logistics Services Center. It requires civil agency completion of catalogs, mechanization of their supply procedures, and most important of all, the capability to interface with the Defense Logistics Services Center's mechanized system either through the General Services Administration or central control points in the civil agency segment of the Government. Anything short of this will produce second-rate results and the full potential of centralized screening will not be attained.

DSA is administrator of the Department of Defense program to reutilize automatic data processing equipment within the Department and for coordination with the General Services Administration for the exchange of excess automatic data processing equipment between DoD and the other Federal agencies. This program too has shown encouraging improvement during the past year. From July 1, 1964 through March 31, 1967, automatic data processing equipment, both leased and owned, valued at \$204 million had been reutilized through this Department of Defense program, including transfers coordinated with the General Services Administration.

Improved management of Government-owned industrial plant equipment is being approached from three directions:

One, applicable provisions of the Armed Services Procurement Regulation have been given additional emphasis to assure that procuring contracting officers critically examine the contractors' need for industrial plant equipment and provide such equipment only when it is in the best interests of the Government to do so. This requirement is in keeping with the Government's policy that the contractor provide all equipment, except when there is no alternate means of obtaining contract performance and the use of Government-owned industrial plant equipment is less costly.

Two, requests for procurement of industrial plant equipment are screened by the Defense Industrial Plant Equipment Center to determine whether equipment, available for use, can be obtained from industrial nonmilitary sources or from the Defense Industrial Plant Equipment Center's inventory of idle equipment. Only when equipment is found unavailable are certificates issued permitting procurement.

Three, to assure proper utilization of industrial plant equipment by contractors, industrial specialists of our Contract Administration Services organization visit facilities of Defense contractors to assess the use of Government-owned industrial plant equipment loaned to the contractor; to evaluate the development of current and projected use controls by which the contractors can plan more effective use of Government equipment; and to identify items of Government-owned equipment no longer required for Government contract performance so that such equipment can be reported to the Defense Industrial Plant Equipment Center as idle and available for other use.

We are also conducting a one-time equipment inventory reconciliation program. The program will provide adequate and compatible central inventory records of the industrial plant equipment located at contractor facilities under Defense Contract Administration Services' cognizance. This 2-year program envisions a reconciliation of approximately 83,444 industrial plant equipment items in the hands of 1,081 contractors. At the conclusion of the first 3 months of 1967, 18,000 industrial plant equipment items reported to be or found to be in the possession of 248 contractors had been reconciled and records corrected.

Mr. Chairman, this concludes my prepared statement. I shall be happy to respond to your questions.

Chairman PROXMIRE. Admiral, are you familiar with the letter which was written to the Secretary of Defense on May 3, by Director Newman of the General Accounting Office?

Admiral LYLE. Not by those terms.

GAO REPORT INVENTORY CONTROL

Chairman PROXMIRE. I wish to ask you some questions from that particular letter and from the report which he sent, a draft report he sent on May 3, because it does raise some questions as to your responsibility. The question in the first place:

The reliability and usefulness of the inventory record control depot levels of inventories—

that is wholesale inventories—

within the Department of Defense. We found that substantial differences existed between stock record balances and the actual quantities of items in inventories throughout the depot supply system. Depot supply activities in the Department of Defense adjusted inventory records up or down an average of \$2.4 billion annually in fiscal year 1965 and 1966, in order to bring the stock record balance within physical quantities.

He goes on to say:

These imbalances result from inadequate control over documentation affecting the inventory record as well as the overall physical assets. This necessarily has an adverse effect on the total supply mission. These inventory records must be accurate and current and relied upon to use requisitions to be satisfied, and whether procurement actions are necessary.

What is your answer to this?

Admiral LYLE. Mr. Chairman, I have seen the draft of that report. I have not had time to review it in detail. I would say that I generally agree as far as DSA is concerned, with its findings and recommendations. They fairly closely parallel our own resulting from a study which we undertook starting last December.

I would say that the extent of the problem, as far as DSA is concerned, is not as great in actual, practical effect as the dollar value of the arithmetic total of the inventory adjustments cited in the report indicate, and by that I mean this:

We have in the past pursued a practice that when a depot receiving a shipment order from an inventory control point was unable to locate the material, either because the storage location records were inaccurate or because there was a new and recent receipt that had not been placed in its proper location in the storehouse, denied the order, saying, "I don't have the material", our inventory control points enter an inventory adjustment to reduce the stock record balance to zero. This would result in our records showing a loss by inventory of that amount, of whatever the stated balance was. We would then institute, under our regular practice, a special inventory to find the material which we were sure was there, and when we found it, we would pick it up in our records as an inventory gain. So you would have in effect, a loss and a gain and arithmetically you would have double—

Chairman PROXMIRE. Yes, but do you think if that is the only problem this, in general, would be only inclined to wash out because you would make, as you say, a reduction and later on a restoration?

Admiral LYLE. That is true algebraically but arithmetically it results in a very large total of adjustments.

Chairman PROXMIRE. I can see the difference, but the difference he raises here of \$2.4 billion which is how large your inventories are—is it \$40 billion?

Admiral LYLE. He is speaking of adjustments in one direction or the other; this is the point I am getting at.

Mr. IGNATIUS. May I comment on that. On page 38 of the GAO's report, which I did look at, they showed that in the net. The Comptroller General reported a gross adjustment of 2.4, but on page 38 of the draft report the net adjustment is given, and the net adjustment over the 2-year period is \$66 million, or less than 1 percent of the inventory value that he is talking about. So that the net does tend to cancel out as I read this.

Chairman PROXMIRE. From the point of view of the record it is inadequate.

"We believe that the organizational structure of the supply system contributes substantially to the difficulties in control of inventories."

In other words, he feels that there is a weakness and a deficiency here that should be corrected.

Admiral LYLE. There is no question about that. I just wanted to let you know that our situation in DSA is not as bad as the gross figure indicates.

Chairman PROXMIRE. I see.

Admiral LYLE. Now, I am not at all satisfied with our situation, as I previously indicated, and we now have going into effect for fiscal 1968, this next fiscal year, a new approach to our formal inventory system.

INVENTORY DISCREPANCIES

Chairman PROXMIRE. Let me just interrupt one more time, to say that there is such a discrepancy between the services. For instance, the Navy had a percent of gross physical adjustment of 13 percent. The Air Force had 35 percent and the Army about 60 percent.

Now, recognizing that there are substantial differences of course in the kind of inventory they have, it seems to suggest that may well be a serious problem as far as the Army is concerned.

Admiral LYLE. I cannot speak for the Army, sir. I am only speaking for DSA in my remarks.

Chairman PROXMIRE. Perhaps that is Mr. Ignatius's responsibility.

DSA INITIATING CORRECTIVE PROGRAM

Admiral LYLE. But I want to leave you with the feeling that we do respect the report. We are not satisfied with the state of our inventories, and we have a corrective program going into effect soon, which will focus on the items that have had movement.

We have found that this is where errors occur, that they are a function of the movement, the rate of demand, the volume of movement of the item, so we are focusing on the heavy movers in our new inventory process.

Chairman PROXMIRE. Along this line, it seems to me that there is, and I get this impression, Admiral Lyle, from reading your statement, that the important improvements are planned, that they have been in stage for a long time. I am concerned, and the staff of this committee suggested that they feel concerned, but there is a lack of urgency.

It is puzzling to us to understand why it takes so long to inventory a contractor inventory, for instance, when so much is at stake. You always seem to look forward to a situation that it is going to improve and are working on it, but we never seem to solve this problem, you see.

Admiral LYLE. Well, in the case of the contractor inventory, shifting fields entirely as I follow you now, we have an entirely different situation. You have—as I read the Comptroller General's report in this area—a separate report from the one we were just discussing—you have basically three broad areas involved. You have the question of—

SCOPE OF PROBLEMS REQUIRE SWIFTER ACTION

Chairman PROXMIRE. Yes; I did not mean to bring that in as something that requires a detailed explanation. I just meant to bring that up as another example of what seemed to be, and I don't want to be unfair to you, what seemed to be a lack of urgency, a lack of deep concern, a failure to make these improvements promptly, and a feeling that you always had to look off in the future on these things, rather than have them accomplished swiftly.

DCAS A NEW ORGANIZATION

Admiral LYLE. I think not, sir. What I was coming to was the simple point that with reference to the Contract Administration Services' part of the contractor inventory problem, they are a new organization. They only completed their organization and went operational at the end of calendar 1965. They are only a year old, and these large-scale improvement programs are not done overnight. As far as

the DIPEC part of the problem, which is another related part, DIPEC is only about 2 years older than CAS. These developments are not accomplished overnight. It takes a significant amount of time for a new activity just to get born and grow a bit, and to develop its organization and staffing, and its basic procedures, and indoctrinate its people into a common approach to its tasks. We have inherited a diverse group of people, brought up in different systems, so there is some significant amount of effort that goes into the development and training process.

DSA INHERITED ROLES AND PROBLEMS

Chairman PROXMIRE. You are saying you inherited this from the other services?

Admiral LYLE. Yes. Almost everything DSA does now is a consolidation, an amalgamation, an inheritance of roles, functions transferred from the services and consolidated in us.

Chairman PROXMIRE. Let me ask you this: Mr. Newman said that—

In regard to the broader problems relative to inventory control, we are suggesting the Secretary of Defense establish a group made of representatives from the military departments and the Defense Supply Agency whose sole function would be to study this problem in depth—

and try to come up with some answers. Is this being done?

Admiral LYLE. I don't think it has been done formally, but I think—I'm sure—that Mr. Ignatius would regard it as a good idea.

Chairman PROXMIRE. There obviously are areas that do require—

Admiral LYLE. You see we just heard about this Friday—about this particular report, sir, and about that particular recommendation. We have not had time to absorb it, but my reaction is that it is sound and is worth careful attention.

Chairman PROXMIRE. On page 16 of this report, the Accounting Office says this:

During fiscal 1965 and 1966 the DoD supply activities, except those of the Department of the Air Force generally, did not accomplish the regular periodic inventories described by their own directors. The Army, for example, the overall data for the period of February 1965 to June 1966 submitted for the 20 Army depots showed that 55 percent of them took no complete inventories, 45 percent took no sampling inventories, and 25 percent performed no location record audits.

This does seem to be a standard, especially since the other service, the Air Force particularly, was able to do it. Now they have made some criticism of the way the Air Force did it, but at least they accomplished a lot more than the Army did.

Admiral LYLE. I can't speak for the Army, but I am aware that at that time they were undergoing a reorganization of their depot system, and this very well could have had a profound effect.

As far as DSA itself was concerned, we did fairly well in fiscal 1965, and in 1966 we were involved in the Vietnam buildup and this is where we put our priority and our resources, and frankly as a result, we did not do very much on inventorying in fiscal 1966.

NEED FOR ADEQUATE INVENTORIES

Chairman PROXMIRE. The Navy did rather badly, too. It showed 66 percent of the items of Navy supplies of fiscal inventories, 88 per-

cent in 1966, but this compared with a much higher percent, close to 100 percent in the Air Force, and it would just seem that when you don't take these inventories, even on a sampling basis that it is hard, as we indicated before, to meet the supply mission if you don't know what you have in stock, and that often the supply mission would be frustrated.

Admiral LYLE. No doubt about it, sir. It is a fundamental part of your supply operation, and it must be done well.

Chairman PROXMIRE. It was not done well last year but you feel that it is something that is on its way to correction?

Admiral LYLE. I do, sir.

PAINT AND HAND TOOLS

Chairman PROXMIRE. Are you familiar with the indictment by the Comptroller General of the handling of paint and hand tools?

Admiral LYLE. Yes, sir.

Chairman PROXMIRE. What is your response to that perfectly enormous writeoff and loss of at least a portion of the inventories?

Admiral LYLE. Well, again, Mr. Chairman—

Chairman PROXMIRE. Is this typical?

Admiral LYLE. No, I don't think so, and for this reason. We had recently taken over inventory management of items in these two commodity areas from the Service Single Managers. You see, this situation occurred very early in our life, 1962, somewhere along in there, possibly 1963.

We turned over to GSA, I think in January 1963, in the case of paint; and for hand tools maybe a little bit later than that.

Chairman PROXMIRE. Yes. They say "DoD transferred paint inventories of GSA and the Navy during the period of 1963 to 1966, transferred its hand tool inventories to GSA during the period January 1964 to February 1966."

TRANSFER TO GSA AS RECORDED ON BOOKS

Admiral LYLE. Yes. Basically we did not have time, in the interim between transfer of these inventories from the services, from the Service Single Managers, and the transfer to GSA, to assure ourselves of the accuracy of the records, so we transferred the material to GSA at the quantities we had recorded on our books.

NO INVENTORY VERIFICATION MADE

There was no special, mutual inventory verification of assets at the time of the transfer. We have learned from this, and this is why I said in my statement that in future transfers to GSA we will have a special inventory, mutually attested, to be sure that they start out with accurate knowledge of assets.

PAINT WRITEOFFS

Chairman PROXMIRE. The writeoffs are just fantastic here. The initial paint transfer to GSA was about \$8 million worth of stock.

Subsequently there was a transfer of \$6.6 million. The total writeoffs are over \$3 million. As a percentage that is a tremendous writeoff. It would be something in a private corporation that would result in a most serious problem, maybe bankruptcy.

HAND TOOL WRITEOFFS

In hand tools there was a transfer of \$46.7 million initially, followed by an additional transfer of \$4.1 for a total of \$50 million. The writeoff there of \$4.5 million, not as big a percentage, but still very big and more troublesome.

REASONS FOR WRITEOFFS

Admiral LYLE. You see, as I said, Mr. Chairman, this adjustment includes the period prior to DSA's establishment, and goes back to some undetermined time in the past, whenever the last inventory may have been taken in those areas.

It is also affected, particularly in the case of paint, by unsatisfactory material, unfit material which had to be written off.

PROOF OF SOUNDNESS OF DSA IDEA

Chairman PROXMIRE. That is right. All this proves that DSA is a good idea. It shores up the previous situation.

Admiral LYLE. I think that is true, this is our experience, that where you consolidate the management of common services and materials in this way, you do maximize your visibility of the situation and your ability to control it.

Chairman PROXMIRE. Thank you, Admiral Lyle. Once again I want to apologize for having detained you so long before you testified at all, and I want to thank Mr. Ignatius and the other gentlemen for their patience and good humor. As I say, it is not easy to come up and face the kind of questioning which you got this morning, but you handled it well, I thought.

The committee will resume its hearings tomorrow morning here in room 4221 at 10 a.m. with Martin Gainsbrugh, chief economist of the National Industrial Conference Board.

(Whereupon, the committee was adjourned at 12:55 p.m. to reconvene Wednesday, May 10, 1967 at 10 a.m.)

ECONOMY IN GOVERNMENT

WEDNESDAY, MAY 10, 1967

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The Subcommittee on Economy in Government met, pursuant to recess, at 10:10 a.m., in room 4221, New Senate Office Building, Hon. Thomas B. Curtis, ranking minority member of the subcommittee, presiding.

Present: Senators Proxmire and Jordan; and Representative Curtis.

Also present: John R. Stark, executive director, and Ray Ward, economic consultant.

Mr. CURTIS. Inasmuch as Senator Proxmire is engaged in a number of other tasks, he has asked me if I would open the meeting here. The subcommittee will be in order.

We are pleased to have with us today the Honorable Martin R. Gainsbrugh, senior vice president and chief economist of the National Industrial Conference Board. I want to personally say how happy I am to see you here and express my personal appreciation for your being willing to give us the benefit of your wisdom.

Chairman Proxmire's letter to Mr. Gainsbrugh will be included in the record at this point.

(Letter referred to follows:)

APRIL 27, 1967.

Mr. MARTIN R. GAINSBROUGH,
Chief Economist, NICB,
845 Third Avenue,
New York, N.Y.

DEAR MR. GAINSBROUGH: I am pleased that you will be able to testify before the Subcommittee on Economy in Government of the Joint Economic Committee on May 10, 1967, at 10 a.m. (room to be announced later), concerning the Government's business activities in their relation to economy in Government.

It is a subject of high priority inasmuch as the Government's role vis-a-vis the private sector is an initial step toward achieving economy in Government. The scope of the Government's business activities and their impact on the business and the tax structures at Federal, State, and local levels are subjects also of great importance to the Subcommittee.

Your analysis of President Johnson's memorandum of March 3, 1966, and Budget Bureau Circular No. A-76 as effective instruments for dealing with the "Government in Business" problem will also be of value.

Please furnish 100 copies of your prepared statement to Room G-133, New Senate Office Building, Washington, D.C., at least one day before your appearance on May 10th.

Under separate cover we are sending you copies of the 1966 hearings and report of the Subcommittee on Procurement and Regulation. If any additional in-

formation is desired, you may contact Mr. Ray Ward, Staff Director of the Subcommittee, phone 967-8169, Study Room 161, Library of Congress Annex, Washington, D.C.

Sincerely yours,

WILLIAM PROXMIRE, *Chairman.*

During the past 2 days, the Subcommittee on Economy in Government has received testimony from representatives from the General Accounting Office and the Department of Defense on economy measures taken or to be taken in the real and personal property management areas which consume the bulk of the annual budget. Today, however, we want to discuss the subject of the Government's involvement in so-called business-type activities. These are activities which have been started and continued for a variety of reasons—cost; health, as in the case of the dairy we discussed Monday; only source of supply, as a yardstick as in clothing manufacture; quality assurance, as in coffee roasting; too costly or hazardous for private industry, as with the Alaska Railroad; utilities, for many reasons; et cetera, et cetera, over a wide range of activities.

This subject was given consideration by the Bonner committee in 1951-52, which I might say I had the pleasure of serving on; the Harden committee in 1953-54; by the Second Hoover Commission; and more lately by the House and Senate Government Operations Committees.

The Subcommittee on Federal Procurement and Regulation, the predecessor to this subcommittee, has for a number of years urged a stronger program for (a) control of new programs and (b) reduction of old ones.

We were pleased, therefore, when President Johnson gave impetus to the program on March 3, 1966, and the Budget Director issued circular A-76 to the heads of the executive departments and establishments on "Policies for Acquiring Commercial or Industrial Products and Services for Government Use." It seems apparent that a definition of the Government's role vis-a-vis the private sector is an important step in developing a program on economy in government. It is also important for the public to be aware of the scope of this subject and the impact on the Nation's tax structures.

Mr. Gainsbrugh, I think most of us have seen your excellent booklet entitled "Government in Business." We certainly know the distinguished organization of which you have been the guiding light for so many years.

We will be pleased to hear your statement at this time. I would like to have you, before you begin your statement, tell us a little of your background and something about the organization you represent. This is essentially for the record.

TESTIMONY OF MARTIN R. GAINSBROUGH, SENIOR VICE PRESIDENT AND CHIEF ECONOMIST, NATIONAL INDUSTRIAL CONFERENCE BOARD, INC. (NICB), NEW YORK, N.Y.

Mr. GAINSBROUGH. Thank you for an opportunity to at least resort to the soft sell so far as the National Industrial Conference Board is concerned, and put a modest bit in the record so far as my own achievements.

The conference board is the largest private business research agency in the United States. It has recently completed its 50th year of existence, and it marked that anniversary by a world convocation to which I would like to refer in my statement at a later time. The theme of that convocation was "The Future of Capitalism."

The board is a nonprofit institution. It is supported by the sale of its services. It has no endowment. It, by charter, must refrain from lobbying, and my appearances before this committee over the years have been primarily in terms of funneling what information we had to this committee for its potential use, rather than to advocate any particular bit of legislation.

Mr. CURTIS. And may I interrupt by saying that almost invariably we seek you out by invitation, as we have here.

Mr. GAINSBROUGH. I feel honored to be back again with this committee. I believe I have appeared before it almost from the time it was first established.

The NICB is currently financed by around 4,000 business organizations, educational institutions, governmental agencies and labor unions. Its fees range from a minimum of \$350—less than that for educational institutions—and there is a maximum subscription that we will accept from any business organization, so that we don't have to depend too much upon any particular contribution.

The research we do is determined by the research staff alone. No one tells us what areas we shall research. We have complete academic freedom as to the manner in which these materials shall be presented. I believe our work over the years has gained acceptance not only in business circles but is highly regarded by the academician, and by government and is very frequently cited.

So far as my own competency is concerned, I have been with the National Industrial Conference Board as its chief economist for nearly 30 years. I have also been a professor of economics at New York University School of Commerce and Graduate School of Business for about 20 years. I am a past president of the American Statistical Association. I have chaired the Conference of Business Economists, the Society of Business Advisory Professions. I have served as a consultant to the Bureau of Labor Statistics, currently to the Bureau of the Budget, to the Federal Reserve Board and other governmental agencies. I believe I could add a few additional items if I weren't using up my own time.

Representative CURTIS. I know you could. In fact, we will add some ourselves. I appreciate that very much. I wonder if you would proceed then with your statement?

Mr. GAINSBROUGH. Perhaps something is to be gained by reiteration, so this morning I am again presenting in an updated version the materials we have previously collected dealing with the enlarged role of Government in modern day society, with the thought in mind that this committee is just as interested in government in the economy as it is with economy in government.

I might preface my statement by citing for you what occurred at our world convocation, to which I referred earlier. To this convocation we invited the greatest minds in the world, to discuss the future of capitalism, and one series of presentations was concerned with the evolu-

tion of modern-day capitalism, the changes that have come about in the 20th century, particularly in the relationship of government to the economy.

The individual invited to discuss that particular development was Lord Franks, the provost of Oxford. His is one of the most searching of minds in this whole area, and what he proceeded to do at this particular convocation was to trace the evolution of modern-day capitalism, particularly the relationship of government to our society.

His basic thesis was that, when we came into the 20th century, the United States and most of Western Europe was still largely in the laissez-faire state, and that between the entrance into the 20th century and World War II, we moved into the second stage in the evolution of modern-day capitalism, from laissez-faireism to increased governmental regulatory activity.

He referred as illustrative to the various governmental agencies, SEC, and others that were created in this interim period. But the point I want to emphasize is that he then went on from the second stage to the third stage, in which he said we in the United States and virtually every Western industrialized power now finds itself, and that is an increased degree of government intervention in the marketplace.

This was of deep concern to him as it related to the basic structure of capitalism, and the strength that capitalism derives from the rationing process performed by the free market.

It is in a sense against that particular background that I wanted to develop the statement that has been placed before you. Rather than read this rather lengthy statement, I thought what I would like to do, and I would welcome questions as I move along, if you like that form of procedure, was to emphasize some of the empirical data that we have collected, that perhaps highlights these changes in a more significant way than just through broad historical recital.

Representative CURTIS. That will be agreeable, and without objection we will put the full statement in the record, and then proceed as you would like.

(Mr. Gainsbrugh's prepared statement follows:)

PREPARED STATEMENT OF MARTIN R. GAINSBROUGH

THE GOVERNMENT IN THE MARKET ECONOMY

Economic growth, first quarter of 1967 excluded, is perhaps more rapid and pervasive than ever before. Swift as has been the national growth rate and that of private industry, however, both have been outstripped by the public sector. This speed-up in public expenditures and governmental influence in the market place is particularly pronounced in the United States for the period following World War II. So complex is the scope and variety of federal, state, and local activities that time permits only a broad-brush picture of its impact upon the market place.

A. GOVERNMENT AS A PURCHASER OF GOODS AND SERVICES

A significant economic dimension of total governmental activity is its total outlay not only for the purchase of goods and services, but also for interest on its debt and subsidies, transfer payments for veterans, welfare and similar purposes. The combined expenditures of Federal, state and local governments after eliminating duplication that arises in such a total from Federal grant-in-aid, were roughly \$209 billion in 1966. At the turn of the century the corresponding

total was somewhat less than \$2 billion. The peak of public outlays prior to World War II never exceeded \$20 billion. At their postwar trough in 1947 such expenditures were still barely above \$40 billion.

TABLE 1.—*Government as a purchaser of goods and services*

[Dollar amounts in billion]

Year	Total outlays	Purchases of goods and services	Transfer payments	Net interest ²	Total outlays as percent of GNP	Purchases of goods and services as percent of GNP
1903 ¹	\$1.7	\$1.5	\$0.2	\$0.1	7.5	6.6
1929	10.3	8.5	.9	1.0	10.0	8.2
1939	17.5	13.3	2.5	1.7	19.3	14.6
1947	42.4	25.1	13.0	4.2	18.3	10.9
1953	101.2	81.6	14.7	4.8	27.8	22.4
1966	208.8	153.1	44.2	11.5	28.2	20.7

¹ Fiscal year.² Including subsidies less current surplus.

Interest and transfer payments have both contributed to this acceleration in government expenditures. Transfer payments have experienced the sharpest growth, reaching \$44 billion last year as compared with \$2.5 billion prewar.

Economists prefer to use changes in the share of gross national product taken off the market place by government rather than total governmental expenditures as a guide to trends in its economic influence. Interest and welfare payments are by convention excluded from gross national product. Only the public payroll and what is otherwise bought from the private sector for government consumption or investment enter into this frequently cited comparison of governmental growth and national economic growth. The underlying rationale is that such a comparison reveals the changing extent to which existing resources are being channeled into the public sector.

In such comparisons government looms ever larger in terms of its influence in the nation's market place. We entered this century with little more than 5% of all goods and services destined for government use. Under the maximum pressure of World War I this set aside reached 21%.

With peace restored, the proportion declined and by the late '20's such purchases were equivalent to a twelfth of annual output. The enlarged role of government during the Depression helped raise this to nearly a seventh of output in 1939. The lowest postwar set aside in 1947 again found little more than a tenth of national output allocated to the public sector.

With the Korean War the progression upward resumed, the war peak alone requiring close to a quarter of all output. Subsequently our provision of a defense shield for the Western World together with the enlarged scope of state and local activities kept the share of gross national product devoted to government to fully a fifth of annual output throughout the past decade.

The record of government as a purchaser clearly reveals that for two thirds of this most prosperous century with its years of war and peace and of deflation and inflation, government demand has grown more rapidly than the private sector. The trend is unmistakably upward. As one level of government—Federal, state or local—at times declines, the other level expands. Wars bulge the public sector. Peace deflates it. But its market share holds above where it had been prior to war in the familiar ratchet effect. The long run secular trend indicates government absorbing an even larger share of national output, thereby expanding its influence not only as to what shall be produced but also where and by whom.

In similar fashion, government's direct or latent power has steadily risen to determine who shall be employed and where. The actual number of full-time equivalent workers directly employed in the public sector, including those in the Armed Forces, was about 14.6 million in March, 60% of whom worked at the state and local level. This means that of each 100 persons at work, including those in the Armed Forces, 18 were on government payroll.

TABLE 2.—*Direct Government employment*

[Thousands of persons]

	Total	Federal		State	Local
		Civilian	Military ¹		
1929.....	3,320	533	255	2,532	
1939.....	4,329	905	334	3,090	
1947.....	7,057	1,892	1,583	3,582	
1953.....	10,200	2,305	3,555	4,340	
1966.....	13,972	2,565	3,123	2,152	6,132

¹ Estimated.

In addition, estimates are also available of the indirect employment arising from the \$67.9 billion of receipts of the private sector from government purchases in 1965. In combination, the direct and indirect employment arising from government totaled nearly 20 million jobs. Thus 26 out of 100 individuals employed in the United States in 1965 were at work directly or *indirectly* for the government. Two generations ago only 5 out of every 100 employed were public servants. As in the case of the share of national output it purchases so, too, in the case of its impact upon employment direct or indirect—the immediate and potential influence and power of the public sector over the market place has been steadily magnified and gives little, if any, sign of tapering off.

B. GOVERNMENT AS A SUPPLIER OF FREE GOODS AND SERVICES

In much the same way that business looks more frequently toward government for its orders for goods and services, and labor finds itself steadily more dependent upon government for employment, so too, do more and more individuals look to government to provide them with transfer payments and with other free goods and services. Transfer payments are officially defined as income received by individuals from government for other than current contributions to production. Among the beneficiaries of such payments through this redistribution process are the aged, the orphaned, the widowed, the unemployed, the poor and needy, and veterans. Such payments in 1966 represented almost 8% of all personal income received by individuals in that year. In 1929 they accounted for less than 2% of individual income.

TABLE 3.—*Government transfer payments*

	Total (billions)	Transfer pay- ments as per- cent of per- sonal income
1929.....	\$1.5	1.7
1966.....	44.6	7.7

A recent estimate of the Office of Research and Statistics of the Social Security Administration found that social welfare expenditures by all forms of government were in relative terms equivalent to 12% of gross national product in the last fiscal year. They were 2.4% toward the close of the 19th Century, 4.2% not only in the late Twenties but also as recently as the close of World War II. Education and social insurance have experienced the greatest increase since that time. With medicare now extended, more gains faster than national economic growth are apparently in store. About one quarter of this nation's entire bill for health and medical care is already met out of public revenues. These sharply increased outlays reflect health and medical care for veterans and other dependents, the medical bill of the Armed Forces, payments to private practitioners for public assistance cases and for medical and related research.

C. GOVERNMENT AS A REVENUE COLLECTOR

As the share of national output allocated to government rises, so, too, must the share it collects of the nation's income, less its bill for goods and services

purchases is financed out of debt. In 1966, the receipts from all sources including trust funds exceeded \$212 billion. The comparable take was only \$11 billion in 1929 and \$15 billion as late as 1939.

TABLE 4.—*Government revenue*

[Dollar amounts in billions]

	Total	Federal	State and local ¹	Total revenue as percent of GNP
1929.....	\$11.3	\$3.8	\$7.5	11.0
1939.....	15.4	6.7	8.7	17.0
1944.....	51.2	41.0	10.2	24.4
1966.....	212.3	142.5	69.8	28.7

¹ Excluding Federal grants-in-aid.

The extent to which income flows have been affected by taxation since World War II is strikingly evident in the dramatic change in the relation of government receipts to gross national product. What the public sector now collects annually is equivalent to about 29% of annual output—a larger share than the 24% it received at the maximum war effort in 1944. Taxes alone in 1965 were equivalent to 23% of gross national product or 28% of national income, as compared with 21% of gross national product and 25% of national income in 1944.

Federal receipts are presently greater than this nation's total annual output as late as 1941. But the relative gain in recent years is most pronounced in state and local government. Until the early 1950's the receipts of such units were no larger relative to national product than in the late Twenties. Thereafter they rose from 7.5% to about 12% of gross national product in 1965. Including Federal grants-in-aid of over \$10 billion annually, the receipts of state and local government now total over \$88 billion, in 1965, nearly three and a half times the 1950 take. Even so, expenditures have bulged so that state and local debt has in turn, quadrupled since the early 1950's.

By way of highlighting the transformation of market forces, accompanying the growth in government, it is pertinent to note that in the late Twenties and just before World War II, personal consumption expenditures were equivalent to about three fourths of the national output. Today consumers take less than two thirds of annual output off the market place. The comment offered by the U.S. Department of Commerce on this continuing secular decline in the consumer's share of what is produced.¹

"The consumer market throughout the postwar period absorbed around two thirds of total gross national product. This share was lower than that which prevailed in prosperous prewar years, when three fourths of total output flowed through consumer channels.

"This fundamental change reflected the expansion in the role of Government resulting primarily from the heightened requirements of national defense, although an increase in civilian-type services rendered by Government was involved also. This shift to Government in the use of current output was accomplished through a considerable step-up in the rates of taxation. The ratio of disposable personal income to GNP was thereby lowered; and, in turn, there was a corresponding reduction in the ratio of consumption to GNP as individuals in the past decade spent and saved roughly the same proportions of their after-tax incomes as they did in the prewar era."

D. GOVERNMENT AS A PRODUCER AND SELLER

Few, if any, changes in the market structure of this century have been so laden with social, economic and political significance as the movement of government into areas of activity previously reserved for tax-paying enterprise. This has

¹ A possible offset exists in the direct flow to consumers of government-provided goods and services at little or no cost (e.g. national parks, toll-free express highways; higher education at public expense, etc.).

blurred, if not obliterated, such border lines as may earlier have existed between the public and the private sectors. Along with its growth as a source of market demand, employment and transfer payments, the government's share of total domestic tangible wealth (structures, equipment, inventories, land, etc.) has risen from about 7% in 1900 and 9% in 1929 to an estimated 14% in 1966. Alternately, this means that the share held by the private sector dropped from 93% in 1900 to 86% in 1966. The lion's share of public tangible assets is owned by State and local governments. In 1958 this share amounted to \$165 billion compared to \$50 billion held by the Federal government, according to Kendrick's estimates.

TABLE 5.—*Tangible wealth by economic sectors*

	1900	1929	1958	1966
Tangible assets ¹ (billions of current dollars).....	88	423	1,654	2,390
Share held by private sector (percent).....	93	91	87	86
Share held by public sector (percent).....	7	9	13	14
Federal.....	1	1	3	(²)
State and local.....	6	8	10	(²)

¹ Exclusive of gold.

² Not available.

The production of electric energy is the classic illustration of entrance of government into an industry previously privately financed and owned. In 1929 the publicly-owned facilities accounted for only 5% of all electrical power generated for public use. Investor-owned utilities have raised their output from 88 billion kilowatt hours then to more than 881 billion kilowatt hours in 1966. However, government owned electrical energy output continues to outstrip even this high rate of expansion, so that currently nearly 23% of all power is publicly produced against 5% in 1929. Federally-owned facilities have undergone phenomenal growth in the 1929-1966 period. In 1929, for instance, only 300 million kilowatt hours were generated while by 1966, 153 billion kilowatt hours of electricity were produced by Federally owned facilities. The 1966 figure is 510 times the 1929 output compared to a far more modest 25 fold expansion in state and local power output and a comparatively flimsy 10 fold rise in private power production.

TABLE 6.—*Electrical energy production*

	Total production	Percent publicly owned	Publicly owned			Privately owned
			Federal	Municipal	State ¹	
	<i>Millions of kilowatt-hours</i>		<i>Millions of kilowatt-hours</i>	<i>Millions of kilowatt-hours</i>	<i>Millions of kilowatt-hours</i>	<i>Millions of kilowatt-hours</i>
1929.....	92,180	5.1	300	3,916	451	87,510
1950.....	329,141	18.9	40,387	16,101	5,793	266,863
1966.....	1,143,737	23.0	153,021	52,558	57,309	880,480

¹ Includes cooperatives.

In similar fashion, the Rural Electrification Administration's activities grow and assume new dimensions well after fulfillment of its original purpose of electrification of all farms. It, too, has moved into commercial-type ventures aided by the low interest rate at which it can borrow funds from the Federal Government.

In shipbuilding, distribution, particularly through PX operations, construction and printing, are other major sectors where Federal government enterprise competes vigorously with private business. Sales of Government-run commissary and PX operations totaled \$3.2 billion in 1965 placing this government enterprise third in sales of the top ten U.S. retailers, outranked only by Sears, Roebuck and A & P.

Of all the ship construction work performed for the U.S. Navy in 1964, the government accounted for 28% of it.

State and local governments have also enlarged their activities in these fields. Liquor store and utility revenues of state and local governments, for example, totaled \$6 billion in 1965 as against barely \$1 billion in the late Thirties. Both dollar amounts, however, accounted for about 8% of total self-generated revenue in their respective periods.

Alcoholic beverage distribution facilities (state liquor monopolies) are presently operated by 16 state governments—Alabama, Idaho, Iowa, Maine, Michigan, Montana, New Hampshire, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, Washington, West Virginia, Wyoming—and by some counties and small municipalities in a few states.

TABLE 7.—Operating revenue and expenditure of local utilities¹

[In millions of dollars]

Fiscal year	Water supply		Electric power		Transit		Gas supply	
	Revenue	Expenditure	Revenue	Expenditure	Revenue	Expenditure	Revenue	Expenditure
1953.....	939	631	713	453	500	529	295	228
1957.....	1,246	912	965	738	542	552	138	114
1961.....	1,621	1,116	1,450	966	588	636	197	155
1965.....	2,004	1,367	1,833	1,216	776	885	295	228

¹ Expenditure includes interest on utility debt.

Liquor store revenue amounted to \$1.4 billion in fiscal 1965. Retail sales of liquor stores nationwide totaled \$6.3 billion in calendar 1965 so that roughly 20-25% of all liquor store sales are presently channeled into the public sector. This is exclusive of taxes on alcoholic beverages which amounted to \$4.6 billion at all three levels of government in fiscal 1965.

Among the utility enterprises, run in the main by local governments, are water supply, electric power (usually distribution systems), gas supply and transit systems. About 75% of all localities with water systems are operating them under public ownership. Publicly-owned water systems along with electric power and gas supply systems, without paying tons, seem to be self-supporting, at least in the aggregate; that is revenues cover operating costs plus depreciation and interest, but no allowance is made for taxes. This is apparently not the case when it comes to public transit systems, where deficits are the rule rather than the exception.

State-run lotteries are beginning to appear, but the competition here is with underworld private enterprise.

Rather than curtailment of state and local activity in commercial areas, such activity may well increase as tax sources become fewer and more cost pricing comes into effect with regard to utilities.

E. GOVERNMENT AS MONEY LENDER AND GUARANTOR

The structure and internal composition of financial markets, much like the market for commodities and the consist of employment, has been markedly altered by direct government lending but even more by the widespread use of Federal guarantee. Unlike the Congressional ceiling that control Federal debt, there is no statutory limit to Federal guarantee of loans or on the amounts quasi-public agencies can borrow for their operations. Neither the guarantee nor insurance activities are directly reflected in the administrative, cash or national-income budgets. "Comparisons over time are misleading if there is a shift from direct-loan programs, which are included (with net amounts) in the budget, to guarantee programs which are not included."¹

¹ David J. Ott and Attlat F. Ott, "Federal Budget Policy," The Brookings Institution, Washington, 1965, p. 15.

TABLE 8.—*Federal credit programs*

[In billions of dollars]

	Total Federal loans outstanding	Guaranteed and insured loans	Direct loans
1939.....	10.0	2.2	7.8
1953.....	25.9	15.8	10.1
1966 (estimated).....	136.3	98.2	38.1

Government lending entered its take-off state in the Great Depression to fill credit gaps then prevailing and to finance improvements for social reasons. In total, Federal credit programs are now well in excess of \$136 billion as compared with their prewar peak of \$10 billion. Guaranteed loans alone have risen from \$2 billion to roughly \$98 billion over this period! This unparalleled expansion reflects the penetration of Federal direct loans and underwriting into mortgage financing. Nearly a third of all mortgages written since 1949 have been financed or guaranteed by Federal credit agencies. These guarantees have in turn affected the quality as well as the quantity of mortgage credit through down-payment requirements, length of amortization, appraisal procedures and related factors. With the risk of loss through default limited or removed, mortgage loans have tended to move up relative to market or appraisal values.

Interest rates vary widely among public lending agencies, ranging from 2% for direct loans by Rural Electrification Administration to 6% for certain loans of the Veterans Administration.

TABLE 9.—*Mortgage debt outstanding at year end*

[Dollar amounts in billions]

	Total, all holders	Financed or underwritten by Federal credit agencies		Privately financed
		Total	Percent of all mortgages	
1939.....	\$35.5	\$6.8	19.2	\$28.7
1950.....	72.8	24.9	34.2	47.9
1966.....	366.0	99.8	27.3	266.2

F. GOVERNMENT SUBSIDY AND QUASI-SUBSIDY

Government can significantly condition or alter market response through the use of subsidies to supply goods or services at less than cost. It can offer capital to governmental or private enterprises at less than prevailing interest rates in financial markets. State and local governments, through the remission of taxes or other charges can influence plant location. Still another form of subsidy is the provision of government insurance at rates less than in the private sectors.

The intent of subsidy is to achieve a desired social or economic objective by providing a product or service that would otherwise be offered at a higher market-determined price. Federal subsidies have been estimated by the Legislative Reference Service of the Library of Congress to total about \$8 billion annually in recent years. The cumulative outlays for such purposes since 1950 are now about \$85 billion and this sum does not include veterans programs, foreign aid and some of the other major expenditures that might well be embraced in a broader definition of subsidy.

Over half of all subsidy over this period has been extended to agriculture in connection with carrying costs and losses involved in price supports, agricultural surplus disposal abroad and soil-bank acreage restrictions. Business subsidies largely in the form of postal deficits and shipping and aviation subsidies have comprised about a fifth of all Federal subsidies. Subsidies to labor, largely for unemployment trust fund administration, have in turn totaled about \$6.5

billion or more than 7.5% of all subsidies. Other such aid has been directed toward home owners and tenants, private hospital construction and health research facilities. Until very recently stockpiling of strategic materials had been regarded as a subsidy, but the new subsidy figures prepared by the Library of Congress no longer include this item. These stockpiles have of late been employed as an anti-inflationary device, with their actual or threatened release timed to exercise maximum leverage on efforts by private producers to raise prices, as in the case of aluminum or copper.

G. GOVERNMENT AS REGULATOR OF BUSINESS STRUCTURE AND OPERATIONS

Market operations and business structure have been increasingly subjected to both direct and indirect controls by government, especially through the creation of independent agencies endowed with regulatory powers, ranging from the Interstate Commerce Commission established nearly a century ago to the Commission on Civil Rights and NASA. Business decisions must now weigh the net effect on present and prospective profits not only of the formal and informal rulings of the established agencies as the Internal Revenue Service, Securities and Exchange Commission, Federal Trade Commission and Tariff Commission and the National Labor Relations Board to name only a few of the well established agencies, but also the "voluntary" guidelines suggested by various branches of the Executive Office. Much of management's struggle for success, if not survival, has indeed shifted from fratricidal competition within its own industry or with products of other industries serving similar markets to emerging without fatal consequences from government inspection and interrogation, if not intervention through direct or indirect public competition.

One indication of the growth in such governmental activities is the enlarged staff of many of the regulatory agencies over the past decade, even though total civilian Federal employment remained virtually unchanged.¹ Lawyers in government practices for example, numbered nearly 30,000 in 1963, half again as many as in the early 1950's. The corresponding rise in the number in private practice was only about 13%.² The various regulatory agencies increased their employment from 1955 to 1966:

Agency	1955	1966
Interstate Commerce Commission.....	1,822	2,276
Tariff Commission.....	198	262
Securities and Exchange Commission.....	686	1,314
National Labor Relations Board.....	1,150	2,210
Federal Trade Commission.....	584	1,118
Federal Power Commission.....	657	1,072
Federal Communications Commission.....	1,094	1,468

Mr. GAINSBROUGH. Thank you, Mr. Chairman.

On the first page of this statement then is perhaps the best aggregate measure we have of the impact of government upon the marketplace. This is the Government as a purchaser of end products, as purchaser of goods and services. Here we are the beneficiaries of the system of national accounts that has been painfully developed by the economic profession over the past quarter century. No previous generation had bodies of data assembled of this character. It is an excellent way of communication, using the framework of national accounts.

As is clearly evident here, there is ample documentation of the thesis that the Government has intervened more in the marketplace with the passage of time. The total purchases of goods and services by the Government, as can be seen from this table, in the year 1966, amounted to around \$153 billion. This contrasts with barely more

¹ In the Federal administrative budget, expenditures for "regulation of business" in connection with commerce and transportation are shown to be \$38 million in 1955 against \$100 million now. (Stat. Abstract 1966, p. 392.)

² (Statistical Abstract, 1966, p. 158.)

than \$1 billion of purchases of goods and services in the marketplace by Government when it came into the 20th century.

In addition to the purchases of goods and services, there are other ways in which the Government intervenes in the marketplace or affects the economy, in part through transfer payments. Notice the growth there. In part, through interest on its debt.

The total purchases of goods and services and transfer payments and net interest in the year 1966 crossed the \$208 billion mark. No single economic statistic in and of itself contains much meaning. It is when you relate any individual economic statistic to the whole of which it is a part that it takes on meaning, and the whole of which this Government purchases is a part of the gross national product, and so, referring again to the beginning of my prepared statement, we express this in terms of meaningful relatives.

There you see the documentation of the thesis originally advanced. When we came into the 20th century, the Government intervened in the marketplace to the extent of possibly 5 to 71½ percent, the figure for 1903 being 71½ percent. I believe most conservative economists would accept the thesis that 5 to 10 percent intervention would still warrant the label "laissez-faireism."

The comparable figure for 1966 is 28 percent of the GNP, represents the share of aggregate purchases of goods, transfer payments, and net interest. So that this is not misunderstood, included under Government, of course, are not only the Federal but the State and local units as well—this is the aggregate of governmental activity.

Senator JORDAN. Mr. Chairman, may I intervene?

Representative CURTIS. Yes, please do. That is the way you want to proceed?

Mr. GAINSBROUGH. Yes, I would prefer this.

Representative CURTIS. Yes, that is perfectly agreeable.

Senator JORDAN. Perhaps you are going to get to it. Your table shows a constant rising percent the total outlays bear to a percentage of the gross national product, but in the final column, purchases of goods and services as a percentage of gross national product, I notice that the percent for 1966 is less than it was in 1953.

Mr. GAINSBROUGH. Yes. The observation is correct, and I think the primary reason is not a reduction in the influence of government upon the marketplace, but rather the fact that 1953 was the peak of the Korean war, and so we pick up in 1953 the expenditures for Korea. These are then reduced subsequent to the Korean war, and if we were to net out the influence of the Korean war in the opening years of the 1950's, I believe the upward progression would still be evident.

(Mr. Gainsbrugh later supplied the following:)

The percentage referred to declined to 18.6 percent by 1955, then rose to 19.5 percent in 1957, 19.8 percent in 1960, and reached 20.7 percent in 1966.

Mr. GAINSBROUGH. I do not want to make that too doctrinaire a statement. I think there has been far less growth in the Federal sector over the past 10 years than previously, and most of the growth that has come about in the past 10 years has been at the State and local, rather than at the Federal, level. That has been in good part helped

by grants-in-aid to the various States, funneled from the Federal to the local units of government.

Over the long sweep of time, however, the significance of the table I think is as I would emphasize it. The secular trend is upward. And having referred to the impact of war, it is true that when wars come along, as in the case of World War II, the Korean war, and possibly in the case of the Vietnam war, there is a decline in the Federal rate of expenditure following the war, but there is also a ratchet effect. The Federal, State, and local expenditures, relatively, never go back to where they were prior to the war. They start from a somewhat higher figure even after the cutback in war and defense expenditure.

What I have underscored then in the first table is the increased influence of the government directly upon the marketplace. I turn from that to another manifestation of the increased influence of the government on the marketplace, where we shift from its impact in terms of purchases of goods and services to the employment created within government. This is another indicator of the growth of government in the economy, and as can be seen from this table, and we haven't carried this back as far as the previous table; it could be carried back if there were interest, the direct government employment as late as 1929 was about 3 million, 3.3 million to be exact. This could be in turn broken down into the civilian employment, a very low figure for military, a relatively high figure for State and local employment. Contrast that with the nearly 14 million people on governmental payrolls now. Again, so that the story is not distorted, it should be noted that civilian employment at the Federal level was 2.3 million in 1953, 2.6 million in 1966. There has been, to repeat, a relatively modest growth in the Federal sector, both in terms of its influence upon the marketplace and in terms of its direct employment.

The growth is more marked in the case of the State and local units of government, where over the same period of time, from 1953 to 1966, you can see that employment has doubled.

Representative CURTIS. On that, I don't know how much you have gotten on the components, but a good bit of that local increase is in education.

Mr. GAINSBURGH. That is correct, sir.

Representative CURTIS. And I think it serves the purpose if in expenditures, too, we were able to break that out. Do you have any idea of how much of that local increase is educational? I can't recollect myself other than that I have the impression that that is a very large part of that increase.

Mr. GAINSBURGH. I don't have those figures at my command, but what I can do in the record is to insert them and perhaps supply a companion figure for that for education in table I.

Representative CURTIS. Yes.

Mr. GAINSBURGH. So we can see what the figures were, both in terms of expenditures and in terms of employment.

(The information referred to was subsequently supplied by Mr. Gainsbrugh and follows:)

SUPPLEMENTARY TABLE

Total government educational expenditures as percent of total government purchases of goods and services, selected years:		Percent
1938	-----	20.4
1946	-----	13.7
1948	-----	24.5
1953	-----	12.4
1966	-----	21.7
State and local government education expenditures as percent of total expenditures:		
1938	-----	24.9
1946	-----	23.9
1948	-----	25.3
1953	-----	28.5
1965	-----	33.0
State and local educational employment as percent of total employment, selected years:		
1929	-----	45.1
1939	-----	41.8
1947	-----	41.8
1953	-----	43.6
1966	-----	50.6

Mr. GAINSBROUGH. I do know that I believe the last figure I looked at for the education bill of this Nation, public and private, was somewhere around \$40 billion.

(Mr. Gainsbrugh later supplied the following:)

Actually \$39 billion in 1964-65, \$30.4 of which was public.

Representative CURTIS. Yes, and in this area too, I have been impressed with the still relatively small percentage of that expenditure made up by the Federal Government. We hear of the tremendous publicity given to the Federal programs, but it is remarkable to me how small a part still remains. This would not be true, I guess, if we broke out that which is research and development that is tied into education. But the bulk of educational expenses do come from local government and a lot of it is private. I have seen some figures—I think someone at the University of Chicago is developing them—that show how much industry spends on training and retraining. These are rough estimates, but as much as \$14 billion a year was suggested.

Mr. GAINSBROUGH. An amazingly high figure when you see them in the aggregate.

Representative CURTIS. Yes.

Mr. GAINSBROUGH. And this after the completion in many instances of the investment in public education.

Representative CURTIS. That is right, yes. This is a constantly occurring thing. A great deal of adult education is tied into this too, in the colleges and universities.

Mr. GAINSBROUGH. I welcome this emphasis upon the productive character that underlies both the employment and the purchase figure. I am not necessarily reading into this growth in the governmental sector wasteful activity. There are activities carried on in the public sector that have their counterpart in the private sector. This is recognized in national accounting.

In national accounting we do incorporate the expenditures in the public sector as well as in the private sector, in the belief that they are equally constructive.

Representative CURTIS. I should have given the reason so you can comment on that, in our study and the study that you are directing our attention to as the Government directs goods and services, it really doesn't matter whether it is education or something else, because it shows the impact. That is, at least as far as the more narrow band that we are considering when Government gets directly into business itself, the field of education is not one that traditionally we have identified in the before-profit or the totally economic sector of our economy.

Mr. GAINSBURGH. Yes; public education is regarded, I believe, as a warranted form of expenditure by those right of center, although I know in some instances those extremely right of center would wish to see more of this in the private sector.

Representative CURTIS. That is true.

Mr. GAINSBURGH. I did want to offer a comment on the thesis of the productive character of some of these expenditures and employment. At times I will lecture at State universities, and rather than have my compensation come from New York University and appear in the private sector, that compensation for a lecture at the University of Wisconsin or Iowa will appear in the public sector. Yet I am performing exactly the same service in the public sector as in the private sector. This is the underlying rationale.

The steel corporation, for example, has men in uniform and calls them security officers. These expenditures appear under the private sector. If these men were in the garb of municipal police or in the military uniform, the same service might well be performed and appear in the public sector rather than in the private sector.

I can remember at one meeting of the American Economic Association, where I was taken to task for aggregating figures of this sort, and being concerned about the growth of Government. The then president of the American Economic Association turned to me and said one huge sector of expenditure was the military, and was I in any way advocating that the military be moved over to the private sector and compensated there rather than in the public sector?

It was recognized, of course, even by Adam Smith, that some of the expenditures by Government belonged basically in the public sector—the police force, the military.

Representative CURTIS. Let me comment there because it brings home a point I have been trying to get across in the Congress and elsewhere for some time. In the field of education, particularly vocational education, I think the military bill must run around \$2 or \$3 billion a year. Yet, because it has had a uniform put on it, it isn't identified as vocational education. There has been practically no coordination of the military training programs with the Federal vocational education programs, apprenticeship training programs, which is Federal, too, and not with the State and local training programs and educational programs that go on. So following your basic thesis of breaking out these endeavors and looking at them, here is a good one to break out from the military.

In fact, this committee over a period of years has been involved in that very thing and we have used the phrase: "Let's take the uniform off of this activity to see whether it is well performed and better per-

formed in the governmental sector." So just putting a uniform on it and calling it "defense" isn't a complete justification for saying that it is, per se, a governmental responsibility.

Our discussions yesterday with the Defense Department about what they contract out and the techniques they perform, and what they do in-house and what they contract out, is in this area.

Mr. GAINSBROUGH. I have been on the Board of Advisers of the Industrial College of the Armed Forces for nearly a decade, and one of the points I have observed over the years is the extent to which the educational process goes on in the Department of Defense.

In many instances the private sector relies upon the training in the field of space, aeronautics, in the computer field, and will very frequently attract from the defense forces men who have picked up their basic training in these areas, and then employ them very productively in the private sector.

Representative CURTIS. Yes. As a matter of fact, the Department of Labor has conducted some surveys I have seen and maybe you have seen them, too, asking people where they acquired their skill that they are presently engaged in. Those who acquired it in the military is a sufficient enough percentage to show up in these studies. The military in some instances claim, too, that they are being drained of the people they have trained.

I noticed in a newspaper 2 days ago that the Marine Corps is complaining that they have a shortage of pilots because so many of the people they train as pilots go into the civilian sector or work for the airline companies. But then, this works the other way, too.

I have also seen figures, which I think are the most interesting figures of them all, of a comparability ratio between the skills that the military needs and the skills that exist within the society, and with the technological warfare as it is, this comparability ratio has continued to move upward.

Before the Civil War, I think the figure was around 40 percent. It went up around 60 percent in World War II, and it is well over 80 percent now, depending on what sort of estimates you use. I would suggest myself that it probably is closer to 90 percent, thereby indicating the great need for correlating the training that goes on in the Military Establishment with the similar training that goes on in the private sector.

I have interrupted you.

Senator JORDAN. In this connection may I suggest a problem?

Representative CURTIS. Yes.

Senator JORDAN. And ask for advice on it. So many times we have the case of a young man starting out in life who perhaps comes from a broken home, or very reduced circumstances, maybe even abject poverty. He tries to go to school, and he ends up as a school dropout. He is hailed before the draft board and he fails the examination, perhaps, for induction into the armed services.

Then he seeks employment in the labor market. He has two strikes against him: No. 1, he is a school dropout. No. 2, he is a draft reject, and this employer, under our present Minimum Wage Act, must look at him with an eye to see how productive he might be under the circumstances of employment that might be offered to him.

The chances are he has a hard time getting a job. What do we do with this kind of man? What do we do with him? Having been notified by reason of his history that he is a problem, and probably is a likely recruit for the crime, what is our responsibility, both in the public and private sector, to do something about this at the time the signal, the danger flag goes up, and we know that this is the beginning of a problem?

Mr. GAINSBROUGH. This is more widespread than is generally recognized. It is one of the reasons those of us who believe in the inadequacies of the approach to the resolution of the unemployment problem through demand creation alone have stressed. The need to concentrate upon the problem of the individual at the grassroot level, rather than concentrating upon the problem of resolving unemployment through stimulation of demand.

Until we reached about the $4\frac{1}{2}$ - or 4 percent unemployment level, there was indeed something positive gained by stimulation of the economy, both through private and public needs. But when you get to the 4-percent level, more and more of the individuals who are unemployed have the peculiar characteristics that you have cited—untrained, unskilled, lacking individual motivation, needing to be “re-treaded” as it were. And here the emphasis is I believe rightfully shifting from stimulation by the demand route to concentration upon the problems of making these individuals productive members of society.

In the private as well as in the public sector, there is recognition now that more needs to be done to help retrain these individuals. In part, such efforts are held back through the minimum wage law to which you have referred. In part, they are held back by reluctance on the part of various sectors of society, including labor, to accept as wide a resort to apprenticeship as used to prevail.

What is happening in various parts of our society—and I have seen this happen in my hometown, Rochester—is that the private sector, growing aware of this problem, has resorted to special measures, in a sense overcompensation, seeing what can be done to pick up the rejects and give them, through technical training at a vocational school, through bringing them into a new type of classroom, a combination of education and employment. For girls lacking stenographic skills, acquainting them with proper garb for business purposes, office mores, et cetera; and making them more productive members of society in the process.

This is largely the type of activity that I would call investment in the individual, investment in the human resources as distinct from investment in brick and mortar. Its basic characteristic is that it is largely localized effort rather than centralized effort that can help resolve this particular problem. The problem is fairly acute. As you look at the composition of our unemployed now, you will find, for example, that the rate of unemployment of the married male is down to $1\frac{1}{2}$ percent. It used to be 4 or $4\frac{1}{2}$ percent. The quit rate, the voluntary rate of departure from one job to another of a married man is around 2 or $2\frac{1}{2}$ percent, so we have virtually overfull employment of the adult male, of the seasoned worker.

For the young, the 16-, the 17-, the 18-year-old, the particular group you are speaking of, the unemployment rate there is 8 to 10 percent

rather than the 4 percent. For the nonwhite unskilled, the unemployment rate there is 15 to 20 percent, and even this fails to adequately describe the unemployment there. Unless these youngsters are actively seeking employment, under the new definition of unemployment, they will not be counted as unemployed in our own community. There are many on the streets who are not picked up as unemployed, primarily because they are no longer seeking jobs. They have given up the pursuit of seeking legally recognized type of activity. Some of them find employment in pursuits that don't show up in the national income figures.

But under this new definition of unemployment, unless the individual is actively seeking employment, and can specify the types of activities that he is pursuing, in his search of a job, he wouldn't even be picked up in the official figures.

Senator JORDAN. Very few of them voluntarily go back to school. It seems to me like about all there is left for this young fellow is to drift into a life of crime many times to start with, and then from there on.

Mr. GAINSBROUGH. The question basically is how do you motivate that particular individual to accept his responsibility. The community I think is beginning to recognize its responsibility; the private sector is, also. In part, I think this comes back to problems of training within the home, by the church, as well as by the private sector and by the community. We need all of these efforts I believe to transform this human resource into a productive resource under the conditions that you have described.

Senator JORDAN. Thank you, sir.

Representative CURTIS. We will get back to aggregates now.

Mr. GAINSBROUGH. I am delighted that the stress has been upon the productive pursuit in which many of these individuals on public payrolls are engaged, and the constructive activity for which these expenditures are made. But I don't want to leave not fully underscored the fact that this means concentration of power somewhere within the public structure. When we have 18 of every 100 persons on government payroll, there is the growing power within government to determine who shall work and where an individual shall work. When you have over 20 percent of the marketplace determined by government buying, you get some indication of the power that resides somewhere in government as to what shall be bought and where it shall be bought.

Referring to my prepared statement, we look at still another dimension of the government in the economy—and slowly we are working our way toward the area that is of specific interest to this subcommittee—direct competition with business counterparts in the private sector.

All we have done here has been to highlight the extent to which the Government, through the transfer payment mechanism, has become an important source of income for more and more people in our society. Again, there is innate power residing in government as a result of this particular development.

Representative CURTIS. This is essentially social security, isn't it, the bulk of that?

Mr. GAINSBURGH. Yes. In 1966, 47.1 percent of all transfer payments came out of the Federal social security system. Social welfare expenditures by all forms of government were in relative terms equivalent to 12 percent of the gross national product in the last fiscal year. This compared with 2 or 2½ percent when we entered the 20th century.

Representative CURTIS. On that I wonder how accurate our figures are. I have been on the Ways and Means Committee since 1953, dealing with this problem of social security, and most of our welfare programs are in the jurisdiction of Ways and Means. For years, I have sought to get from the Department of Health, Education, and Welfare the expenditures by local governments as opposed to State governments in the area of welfare and health. They haven't had the figures.

What brought it to my attention particularly was that they always had Missouri and Texas listed as spending no money, because those two States do most of the spending of welfare and health at the county and municipal level, and very little at the State government level. But the only statistics that HEW had were State.

Then when you ask them how much do the Community Chest agencies and the nonprofit groups spend in this area, they still haven't got those statistics. So I just wonder, dealing with the problem as a social problem, how good our figures in the 19th century were. The reason our figures today seem to be clear is that we have these big programs in aggregate programs like social security, old-age assistance, aid to dependent children, and aid to the blind. These are all now singled out and amassed at the Federal level. Would you comment on just the statistical abilities that we have?

Mr. GAINSBURGH. Among my other activities I have been on the advisory committee to the Social Security Administration, so I learned a little bit about the problems they have there of collecting data. I would agree that the figures are better at the Federal than at the State and local level.

Representative CURTIS. Yes.

Mr. GAINSBURGH. These figures do not include the private sector's contribution toward philanthropy and charity. The conference board has devoted considerable study to this. The emphasis is all too often upon what has been going on in welfare payments just within the public sector.

Representative CURTIS. Yes.

Mr. GAINSBURGH. Rather than the recognition of what was done early and what continues to be done in the private sector.

Representative CURTIS. Ways and Means is holding hearings in executive session right now on this. We held public hearings early this year. One of the very intriguing things that bears on this point, and I merely mention this to illustrate it, is that the doctors testified before we adopted medicare, that they were by and large undercharging the older people. Incidentally, our nonprofit hospitals and other hospitals said that they were doing the same thing. So medicare went in, and as everyone knows, medical costs went way up and are continuing to go up beyond the projected increase in costs by the Government, in our estimates.

These estimates were on the assumption they were going up, but not as much as they did. An accusation was made that the doctors were now

just in effect gouging. But the social security administrators testified no, that really what was happening was that the doctors and hospitals had been in effect under charging by a recognizable percentage, and that now that Government was paying for it, they were picking it up.

I only mention this to illustrate, of course, some of the difficulties that exist in trying to figure out costs and know what we have been spending in these areas. I don't know how anybody ever could have figured out what the amount of undercharge might have been previous to medicare. Now it is coming out in the open to some degree as to how big an item it was, but it is in the billions.

Mr. GAINSBURGH. One of the virtues of appearing before this committee is the witness gets educated as well as, I hope, the members of the committee, and I am learning a lot this morning again about the limitations surrounding some of the data that we think is fairly reliable.

Representative CURTIS. We don't know anything on it yet. We are in a speculative area over there right now. Well, I am sorry I interrupted you again, but this is very intriguing.

Mr. GAINSBURGH. To complete the score before we look specifically at competition with the private sector, if the Government spends, unless it is going into debt, it has to collect the revenues for those expenditures. The figures for what is collected by Government are another indication of what has been happening within a generation.

The total of government revenues in 1966—Federal, State and local—was \$212 billion. Putting that in meaningful form, that figure is equivalent to 28.7 percent of all the gross national product that is in a sense siphoned off for governmental purposes. Perhaps this is a way of indicating what has happened in a short period of time. The comparable maximum war effort in 1944 was 24 percent of the gross national product, and we are surpassing that.

A fact that I keep constantly before my students, and I think that should be recognized by the consumer, is that our accounts do reveal what has been happening to the Nation's output. As late as 1929, and this is typical of the 1920's and the earlier period, about three-fourths of everything we produce was taken off the marketplace by the consumer.

If you look at our figures today, but before Vietnam, consumers of today take less than two-thirds—around 63 percent—of the output. This is a significant secular change in the American economy.

What I have extracted from one of the official publications is very revealing as to how this is brought about. The consumer market throughout the postwar period, and here I quote from my statement, "absorbed two-thirds of the GNP. This was lower than the share that consumers used to get in prewar years when three-fourths of total output flowed through consumer channels. This fundamental change reflected the expansion in the role of Government resulting"—and I am quoting—"primarily from the heightened requirements of national defense, although an increase in civilian-type services rendered by Government was involved also."

Now the reason for this quote: "This shift to government in the use of current output was accomplished through a considerable step-up in the rates of taxation."

What we did was to lower the ratio of personal income after tax to GNP through taxation. It is no surprise if you lower the ratio of

personal income to GNP, personal income after tax to GNP, that less of the GNP will go to the consumer. In turn, there was a corresponding reduction in the ratio of consumption to GNP as individuals in the past decade spent and saved roughly the same proportion of their after-tax incomes as they did in the prewar era.

And again, so that one possible escape hatch is seen, it may be that consumers are still getting as large a share of the Nation's output as they used to, if you put into the consumer share the goods they are getting for free from Government. The Government, acting as an intermediary, can provide them with recreation, national parks, with toll-free express highways, with higher education at public expense as distinct from private expense.

Still, I think it is significant that the consumer is no longer getting as large a share of the output as previously, and the primary reason is that more of the marketplace output is being taken off by government.

Representative CURTIS. Let me ask a question which shows my ignorance. It is a technical one relating to gross national product. Using GNP and using this ratio of what the consumer gets, what about the increased amount spent in the investment dollar? Does that wash out as we compute GNP?

Mr. GAINSBROUGH. No.

Representative CURTIS. So that wouldn't be a factor?

Mr. GAINSBROUGH. The private investment in plant and equipment will be picked up in the business sector as gross private domestic investment. There are four sectors in the GNP.

Representative CURTIS. Yes.

Mr. GAINSBROUGH. One is the consumer sector, the second one is the business sector, the third is net exports of goods and services, and the last is——

Representative CURTIS. Could this be because we have had a great increase? I think we have had a great increase in investment.

Mr. GAINSBROUGH. Government investment or private investment?

Representative CURTIS. No; private investment. Would private investment be picked up through——

Mr. GAINSBROUGH. Private investment in the late 1920's was 15 percent of the GNP.

Representative CURTIS. Yes.

Mr. GAINSBROUGH. Gross private investment in 1966 is about 16 percent of the GNP.

Representative CURTIS. You have really answered by question then. I wasn't sure whether it would be computed in this. It is computed, but it has been relatively constant.

Mr. GAINSBROUGH. Fairly stable percentage over the time.

Representative CURTIS. Has government investment increased over this period?

Mr. GAINSBROUGH. Markedly. Government purchases of structures and equipment, expressed as a percent of GNP, rose from 4 percent in 1929 to 6.2 percent in 1940, and to 10 percent in 1965. We are coming to a table here showing the growth of wealth in government.

Representative CURTIS. Yes.

Mr. GAINSBROUGH. One of the points that the Subcommittee on Statistics of this Joint Economic Committee might well explore is the

treatment of government in the GNP. All that we are regularly shown is total government purchases of goods and services. It is often assumed that this is all for direct consumption purposes, whereas actually under purchases of goods and services there is investment as well as the purchases of other goods. This in a sense is the double accounting procedure that has been suggested for governmental expenditures. It hasn't been carried over into the national product accounts.

Representative CURTIS. I know I have been arguing for years to get a Federal capital budget which would to some degree do that. Now our Subcommittee on Economic Statistics has been moving into this area of studying physical wealth in society, and we have had some development of it, which is to me a most important thing.

To me the interesting thing, though, even when you get into the studies of government wealth, the Government Operations Committee indicates that of this big budget—\$200 billion—there isn't a very sizable portion that actually goes into physical wealth. Public works, of course, obviously is an item, but I remember roughly computing, and I don't think it is as high as 10 percent.

Mr. GAINSBROUGH. As you know, much depends upon the concept and definition that you are going to carry over to the balance sheet.

Representative CURTIS. That is true.

Mr. GAINSBROUGH. In the case of defense, you could, and I believe John Kendrick, who is assembling these data, will regard investment in ships and planes as part of the capital formation process.

Representative CURTIS. This is a real question, though, isn't it?

Mr. GAINSBROUGH. Well, when you need those assets, they are highly valuable.

Representative CURTIS. I would put them on the books at \$1, but it is true that if you were confronted with replacing a system—

Mr. GAINSBROUGH. That is right.

Representative CURTIS. To defend wealth, then, of course, it has the aspects of this, but what is the DEW line worth? It cost a couple billion dollars, and it is obsolescent, but that is the nature of military capital. You hope it is obsolete, that your research and development has made it obsolete by the time you have got it almost.

Mr. GAINSBROUGH. There are problems involved in the balance sheet as there are problems in the operating statement, but I think one of the points I would underscore in connection with your observation is you want some degree of consistency in definition to be carried over from the operating statement to your balance sheet. And this consistency I think then would suggest that in much the same way that we treat a dollar of expenditure in the GNP as being equivalent to a dollar of expenditure in the private sector—in other words, there is no discounting of the dollar as it relates to a governmental expenditure, in the belief that a dollar spent for employment in the governmental sector is just as productive as in the private sector. So one could very well contend that a dollar spent for a capital item, irrespective of whether it is military or civilian, ought to have the same treatment in the balance sheet as in the operating statement.

Representative CURTIS. In the expenditure but not in the rest, which is increased wealth. Incidentally, this committee has for years followed

the surplus property disposals of the Federal Government, mainly the military, of course. What is that figure now? It runs about \$5 or \$6 billion a year. We only realize maybe—

Mr. GAINSBROUGH. Less than 20 percent?

Representative CURTIS (continuing). A few cents on the dollar. It is below 5 cents, isn't it?

This figure, incidentally, has been as high as \$8 billion a year. This is not to say this is waste. Some of it is and some of it shows the inefficiencies that exist in the system, but more of it is the fact that the military hardware really is expendable. It must be put on the books at practically a dollar.

Mr. GAINSBROUGH. But it is true even in the consumer sector to say nothing of the business sector how little value a good has on resale.

Representative CURTIS. Yes.

Mr. GAINSBROUGH. So that this finds its counterpart in the private sector, in the low value of secondhand furniture or—

Representative CURTIS. Yes; but with the accounting systems we have in the private sector—and I have often observed that the Federal income tax, the greatest benefit is to develop cost accounting in our society, and particularly to distinguish between that which is capital and that which is current. We have in the private sector a pretty sophisticated accounting system where we have not developed the counterparts.

Mr. GAINSBROUGH. I agree. But we are at work on that, and it is comforting to have the support of this Joint Economic Committee in the development of a national balance sheet.

You see, we rely so much upon national accounting as it relates to the operating statement. We have lacked the companion statement. That is the balance sheet.

Representative CURTIS. That is right.

Mr. GAINSBROUGH. No business worth its salt could run without the two financial control statements.

Representative CURTIS. That is right.

Mr. GAINSBROUGH. The balance sheet and the operating statement. You cannot really determine the significance of change in your operating statement unless you have a balance sheet. You could have an economy or a business going into liquidation, and still be showing a strong operating statement, unless you had the connecting link in the terms of the balance sheet. Our interpretation of the operating statement will be far better if we know what is happening so far as assets and liabilities were concerned over in the balance sheet side.

Representative CURTIS. Yes.

Mr. GAINSBROUGH. Referring to my statement, we do come to these estimates that I have been speaking of (see p. 152). Another way of looking at the growth of government is the wealth that has come into the possession of government, and here we are the beneficiaries of the preliminary estimates that John Kendrick has supplied. We have used his figures here of the tangible assets of the United States through the year 1966.

Senator JORDAN. This is both public and private.

Mr. GAINSBROUGH. Both public and private, and then the breakout.

Senator JORDAN. Yes.

Mr. GAINSBURGH. Look first at line 1. Since these figures are so recent you may want to spend a minute or two on them. There has been much concern about the growth of debt in the United States, both public and private. I find some comfort in the fact that we have nearly \$2.5 trillion of tangible assets. These are shown here. This does not include financial assets. These are physical assets. This compares with a total debt of around one and a third trillion dollars. I find—I believe most of us would—considerable gratification in the growth of the American economy in terms of the tangible assets from about \$88 billion, as best Goldsmith could estimate them, to today's \$2.5 trillion.

But along with that notice that the growth has again been pronounced in terms of the possessions of the public sector. These increased to 14 percent in 1966 as compared with 7 or 8 or 9 percent in an earlier generation. So there again is a doubling in the physical assets held by government, most pronounced at the State and local level.

Representative CURTIS. But I have also seen figures, and I cannot recall them, but put these in the Congressional Record, attempting to show balance sheets of net assets.

Mr. GAINSBURGH. Yes.

Representative CURTIS. And in the private sector, in households, the balance sheet is a beauty.

Mr. GAINSBURGH. That is the consumer sector.

Representative CURTIS. The consumer, the individual, the household, and the business balance sheet is a good one. Local government is a good one and that is simple. In other words, their physical holdings, their wealth, continued to increase, net holdings over the debt. The States have done fairly well. But the Federal Government has moved from a zero position in 1900 to a minus eight according to this.

In other words, again this gets back to how good are the statistics. But I have looked over the statistics of the Government Operations Committee on the physical wealth in the United States, and it looks like they are hitting at it. I think their figure, including military, is around \$250 billion, but the debt is \$330 billion.

Mr. GAINSBURGH. I had that in my statement and then took it out because I did not mean to suggest or did not want the overtones that might have emerged from a minus 8 percent net worth position of the Federal Government. I think that figure needs very careful study before it can be accepted.

The balance sheet, you see, is a new device, and we want to look as intensively at what it begins to show as we did at the national income and the GNP figures when the first emerged.

One of the primary reasons why the accounts look as unbalanced as they do at the Federal level is the cost of war. This is picked up at the Federal level, and there is no counterpart at the State and local level. Much of the increase in the Federal debt has been primarily because of the \$200 to \$250 billion debt expansion during World War II alone.

Representative CURTIS. Let me correct my statement for the record. Mr. Ward has shown me the Federal real and personal property inventory report of the U.S. Government covering its properties located in the United States and territories overseas as of June 30, 1966, published by the Committee on Government Operations, U.S. House of Representatives.

The total there is \$244 billion personal property, about \$102 billion real property, so the total figure is \$347 billion, not the \$200 billion that I gave. That is \$347 billion.

This though, again as I recall these, puts in military hardware at the acquisition cost.

Mr. GAINSBURGH. Nearly \$150 billion of that is Department of Defense.

Representative CURTIS. Yes; so this is where the discrepancy could occur.

Mr. GAINSBURGH. Since this is so germane to your subject, I would propose now to stay with my statement in closing.

Few if any changes in the market structure have been so laden with social, economic, and political significance as the movement of government into areas of activity previously reserved for tax-paying enterprise.

What has happened as a result of this is that we have practically obliterated such borderlines as may have existed earlier between the public and the private sector.

I offer some illustrations here, and there are many others. Public production of electric energy provides the classical illustration of entrance of government into an industry almost solely privately financed and owned. In 1929 the publicly owned facilities accounted for only 5 percent of all electrical power generated for public use. Investor owned utilities have raised their output from 88 billion watt hours in 1929 to more than 881 billion kilowatt-hours in 1965. That is an impressive record. This is one of our most pronounced growth industries. Yet Government-owned electrical energy output continues to outstrip even this high rate of expansion, so that currently nearly 23 percent of all power is publicly owned.

Of the total production of electrical energy back in 1929, 5 percent was publicly owned. In 1950, 18.9 percent, and in 1966, 23 percent, and you can see the growth in part at the State level and part at the municipal level, and the tremendous increase at the Federal level.

In similar fashion, the Rural Electrification Administration's activities grow and assume new dimensions, well after fulfillment of its original purpose of electrification of all farms. It too has moved into commercial type ventures aided by low-interest rate at which it can borrow funds from the Federal Government.

The primary purpose in many of these areas is to provide yardstick operations rather than its initial purpose.

Others that we have singled out—shipbuilding, distribution, particularly through PX operations, construction, and printing—are only a small part of what would be a longer list.

These are other major sectors where the Federal Government enterprise competes vigorously with private business. This one you have to see to believe. Sales of Government-run commissary and PX operations totaled, before Vietnam, \$3.2 billion in 1965. This is the third largest retailing activity in the United States. It is outranked only by Sears, Roebuck and A. & P.

Of all the ship construction and maintenance performed for the U.S. Navy in 1964, the public sector performed 28 percent of it.

I wish we had more data on counterpart activities at the State and local level, because I think the figures would be equally sensational.

State and local governments have also enlarged their activities in these business fields. Liquor stores and utility revenues of State and local government, for example, totaled \$6 billion in 1965 against barely \$1 billion in the late thirties. Both dollar amounts account for 8 percent of total self-generated revenue.

Among the utility enterprises, run in the main by local governments, are water supply, electric power, gas supply, and transit systems.

We go on to enumerate some of the problems at this area. State-run lotteries are beginning to appear. The competition here is with under-world private enterprise. Rather than curtailment of State and local activity in commercial areas, such activity may well increase as tax sources at the State and local level become fewer and more cost-pricing come into effect with regard to utilities.

The closing part of my statement is devoted to the emergence of government as a money lender and guarantor under various Federal credit programs.

Representative CURTIS. This subject now, that would not tend to get into the statistics that you have been giving us before, would it, or at least a lot of it would not? Let me put it this way: I have seen figures, you probably have, too, of what the contingent liabilities of the Federal Government are. They run up to around \$1 trillion. Of course this is to a large degree money lender and guarantor.

We in the Ways and Means Committee beginning Monday are going to be getting into this participation activity problem, where we are dealing with actual certificates that the Government's various lending agencies issue. But the immediate question I am asking is whether or not the extent to which the Government has moved as a money lender and a guarantor would show up in these previous statistics given.

Mr. GAINSBROUGH. In none. This is another new development of modern-day capitalism; you have a congressional ceiling that controls the Federal debt.

Representative CURTIS. Yes.

Mr. GAINSBROUGH. But there is no statutory limit to Federal guarantees of loans or the amounts quasi-public Agencies can borrow for their operations. This is a way of coming in the back door if you cannot go through the front. Neither the guarantee nor insurance activities are reflected in any one of our administrative cash and national income budgets.

Representative CURTIS. You have answered the very question I asked.

Mr. GAINSBROUGH. Then I offer a quote from The Brookings Institution:

Comparisons over time are misleading if there is a shift from direct loan programs which are included with net amounts in the budget to guaranteed programs which are not included.

Some bulk very large. Federally guaranteed insured loans amount to nearly \$100 billion in just this one instance.

The closing sections, too, are highly pertinent to these discussions; use of government subsidy is another form of intervention, as is the increased degree of government regulatory activities. The latter is difficult to measure, but the only quantification—and I have been accused of professional bias—I could find would be the employment of lawyers as an indication of regulatory activities.

Lawyers in government practice numbered nearly 30,000 in 1963, half again as many as in the early 1950's, while the corresponding rise of the number in private practice was only around 13 percent.

I have put some indication of the growth of employment in the regulatory commissions, so that you could see the justification for Lord Frank's contention that in the second stage of modern-day capitalism we increased the regulative activities of government.

I think I have pretty well documented the third stage, the increase in direct intervention by government.

In closing my formal statement I would like to make several proposals to you on the basis of the evidence I have already submitted, and I am sorry that this has been written so late that it was not possible to incorporate it in my prepared statement.

The opening evidence I have offered is an indication that government is in business is an ever larger way, even though we could wish for more documentation, and this committee might well insist on it.

As early as 1933 a special committee of the House of Representatives appointed to investigate Government competition with business reported that:

The evidence in general indicates that the operations of the Federal Government in the field of private enterprise have reached a magnitude and diversity which threatens to reduce the private initiative, curtail the opportunities and infringe upon the earning powers of tax-paying undertakings while steadily increasing the levies upon them.

In 1954 the Director of the Budget, Rowland R. Hughes, said—this is a direct quote:

The Federal Government is, among other things, the largest electric power producer in the country, the largest insurer, the largest lender, the largest borrower, the largest landlord, the largest tenant, the largest holder of grazing land, the largest holder of timberland, the largest owner of grain, the largest warehouse of grain, and the largest truck fleet owner. This is a rather amazing list.

That was 1954. I suspect the list would be longer rather than shorter if we had it for 1967.

Extensive researches have been conducted before and since to determine the size and scope of governmental business operation. As the chairman has indicated, valuable data have been amassed by the First and Second Hoover Commission, and I worked on both, on the organization of the executive branch in Government. The Bureau of the Budget has collected data, as have various congressional committees and the National Industrial Conference Board.

Official attempts and numerous unofficial attempts have been made to reduce the number of Government business enterprises since the appearance of the First Hoover Commission report as long ago as 1949.

The need now is for up-to-date, comprehensive research and interpretation of this development by what I propose, a Presidential Commission. This would assess not only the magnitude of today's governmental business operations, but would also explore the following questions:

1. Is Government business activity increasing or diminishing and in what areas are the trends apparent?

2. What was the original purpose for entering into an area previously reserved for private business? Is that purpose now still controlling? This is perhaps the Commission's most important function.

In instance after instance, the original purpose has been subordinated, and a new purpose has been taken over, without necessarily having congressional approval.

The Commission's first task is to determine if Government business activity is increasing or diminishing. Second, to catalog, as it were, the original purposes for each of these invasions into the private sector, and to examine whether the original purposes are still controlling.

3. What is the deeper, longrun significance of the growing entrance of Government into sectors of business previously reserved for the private economy.

4. How should public policy be defined with respect to justifiable governmental business enterprises that are engaged directly in competition with the private sector?

5. What steps are required to see that such a policy is respected, after it is enunciated by the various agencies including the Bureau of the Budget. We have followed with a great deal of interest the laudatory work the Bureau of the Budget has done in exploring some of these areas. The question then comes up about the implementation of its findings, after the circulars of the Bureau of the Budget are distributed to the various governmental agencies.

The dangers of governmental competition with private business can be expressed in many ways. In 1954 the House Governmental Operations Committee warned:

If Government competition with private enterprise were pushed to its logical conclusion, the Government would ultimately destroy its source of income and commit national suicide.

I finally end my statement by saying that experience—and this is a quote from Louis D. Brandeis:

Experience should teach us to be more on our guard to protect liberty when the Government's purposes are beneficent. Men born to freedom are naturally alert to repel invasion of their liberty by evilminded rulers. The greatest dangers of liberty lurk in insidious encroachment by men of zeal and well-meaning.

I have not meant my comments throughout to necessarily indicate a bias against governmental activities. I have tried to underscore that as the Government grows in terms of its activities relative to the private sector, it picks up centralization of authority that may or may not necessarily be good for the longrun interest of the American economy.

Representative CURTIS. I certainly want to thank you, Mr. Gainsbrugh, for a very thought-provoking and thoughtful statement. It has been of tremendous value of this committee, and hopefully our committee hearings which are printed, and our reports, will become subject material for the universities, colleges, and other study groups around the country.

I am tempted to pose another problem that is facing the Ways and Means Committee right now. It is of this broad scope.

It has to do with how we handle the retirement of our people, what sort of a system do we establish. The point I have been making when the HEW Secretary testified, and then others on behalf of the administration's proposal, was that you are only calling our attention to one aspect of the retirement programs of our people; namely, the governmental programs, social security.

As I always understood it, we had a tripartite system when social security was advanced. We still have private savings, and of our people

over 65, well over 80 percent own their own homes free and clear of mortgage, their own consumer durables. There is a substantial retirement that they have provided through their personal savings.

The third area developed a little bit later than social security. In a sense the Government has had something to do with its development. I am referring to private pension plans, because we have special tax laws in respect to them. We have \$90 billion in our private pension plan funds for retiring potentially around 40 million Americans. That is the third thing.

I asked the Government witnesses what about the whole man? What about the person who is actually retired? How much does he get social securitywise, how much from his own savings and how much from other kinds of programs? Well, they had none of this data, and they were not even thinking in these terms.

Then I posed it in another way, and I am a little tedious in explaining this perhaps, but I know of no other way of doing it. When I was over in Europe in December on the Kennedy round, I was talking with European businessmen and others, they were complaining about the fact that they had no real capital markets in Europe like we have. I observed that a great many of our capital markets, where the capital is generated, was institutional through our insurance companies, around \$200 billion, through these pension plans \$90 billion, and other savings that have been pulled together through these kinds of institutions. I said that in Europe the social security program is on a pay as you go basis. They now recognize that the trust fund of about \$22 billion right now is only a contingent fund. That is all it is. They are not counting on earnings from that have to help pay the benefits.

Well, the European systems are not tripartite. They are almost all directed toward the Government programs, and, being pay as you go, do not generate these funds.

So coming back to the Ways and Means Committee forum, I said if you insist on extending social security from a \$6,600 base to \$10,800, you then move into the area of financing retirement through pension plans which are on this funded basis, which generates savings. This figure may be high; Mr. Reuther said it was high. But I still think it is within reason, where around 60 percent of the benefits paid under the private pension plans come from the earnings on those pension plans, whether it is 40, 50, or 60, a sizable part does come—

Mr. GAINSBROUGH. From the private sector.

Representative CURTIS. From the private sector. The public sector, of course, can pay as you go, not creating funds that are to be invested and earned. So the big question in my mind that I have been trying to get an answer to, does it serve as well to put more of the retirement of our people on a pay-as-you-go social security system, or is it more desirable to use the funded approach that the private pension plans have? As I put it bluntly to Mr. Reuther:

In your bargaining table, if you are going to ask that \$599 a year more be paid in the nature of premiums for the retirement of our people, and that is the increase that they will be asking for, under the social security system, or would it be better to get that \$599 into a funded program, the kind of pension plans you set up for the United Auto Workers?

You can only get \$118 more a month through the Government program, and it looks like you can get four times that amount if you put it into the funded approach. I am thinking of the overall picture.

Here is the big area of social endeavor, the retirement of the people of the society. We can finance it completely on a pay-as-you-go basis. You can finance some of it through this kind of saving that we have developed, or you can have any mix.

Mr. GAINSBROUGH. That is quite a problem as you present it. One of the points I think that you might want to consider is what the funding would have to be in the aggregate, if the social security program were either fully or partially funded.

Representative CURTIS. I can give you that figure. It was given to us—

Mr. GAINSBROUGH. It would be a rather amazing figure.

Representative CURTIS. \$350 billion.

Mr. GAINSBROUGH. That is right.

Representative CURTIS. This was the figure Secretary Gardner has given us if we funded social security the way we require private pension plans to be funded.

Mr. GAINSBROUGH. I think when we look at what outlets we might have for \$350 billion of funded social security program we might face a problem similar to Switzerland where they had to seek outlets for the fund outside of Switzerland itself, where you had an overaccumulation of savings from the point of view of the domestic economy.

I have not been able to make up my own mind as to where I would stand or what the economic arguments are pro and con, funding versus pay as you go, as it relates to social security. I am impressed with the tax burden that some future generation is going to have to carry under an expanded social security program, using the same three-legged-stool approach that you mentioned earlier which applies to the cost of this program.

The three-legged arrangement you mentioned earlier was that we want to depend jointly upon the private sector, the public sector, and the individual in terms of amassing a competence for his old age.

The cost of the program as it was originally set forth was to be borne three ways, by the employee, by the employer, and through general Federal funds. It is becoming increasingly apparent that more and more of the cost in the future is going to be borne in the public sector rather than by the employer or the employee. And the cost of a fully rounded social security program in some of the countries that I have looked at, not just the 12 or 15 percent that has been quoted to you, but may run as high as 18 to 20 percent. If all of this is borne out of general tax funds, you can begin to visualize what this may mean in the way of a tax burden at some later period.

Representative CURTIS. I am very much impressed with your concept of creating this broad commission. This is the kind of very broad problem that I would hope that such a commission would put its sights on.

I will yield to Senator Jordan.

INVENTORY OF GOVERNMENT EQUIPMENT

Senator JORDAN. Thank you, Mr. Chairman.

Pursuant to the previous hearings of this committee in prior years, calling attention to the great inventory of Government-owned machinery and tools of all kinds and description used by the private sector

and the lack of an adequate accounting system therefor, this committee recommended that a very careful inventory be made of those items, and that some program be set up for either disposing of them or getting them on a more businesslike rental basis in one way or another.

We also recommended that certain items of short shelf life, such as medical supplies, rather than being allowed to deteriorate to the point they were dumped and wasted from the shelves of the Federal Government, be utilized in other divisions of the public sector, or even in the private sector.

PRESIDENTIAL "GOVERNMENT PROCUREMENT GUIDELINES"

Pursuant to those recommendations, the President last year issued a memorandum to the heads of the departments and agencies entitled "Government Procurement Guidelines," and it directed the Director of the Bureau of the Budget to issue detailed guidelines "for the determination as to when the Government should buy its products and services for its own use under the general policy of reliance upon private enterprise."

BUDGET CIRCULAR A-76

Now, do you feel that the Bureau of the Budget has moved forward with a strong program pursuant to the President's instruction which itself was pursuant to the hearings of this committee, the evidence brought forth?

Mr. GAINSBROUGH. I am delighted the question has been raised. We have worked closely with the Bureau of the Budget over the last year or two. Before the bulletin was issued, we did meet with Mr. Staats and others to discuss some of the major questions that rise in connection with purchase—to hire, to make, or to buy. We have met subsequently with trade associations and with various representatives of industry to see how they view the bulletin, since it has been published. I would bring to your attention four areas of discussion that still remain unsolved.

CIRCULAR A-76 SOMEWHAT WEAKER THAN PREVIOUS STATEMENTS

Good as the circular may have been in alerting the various governmental agencies as to the criteria to be kept in mind and decisions as to whether to make or to buy, one major reservation about the current circular is that it fails to emphasize as much as previous budget bulletins, that the preference should be for purchase from the private sector, unless the reasons heavily favor the Government producing the item itself.

The statement is somewhat weaker than previous statements in terms of underscoring the desirability of purchasing from the private sector.

COST OF MONEY

A second area that is mentioned in Bulletin A-76, but is still much discussed in meetings of industry-Government representatives, is the economic arithmetic to be employed in determination of whether to make or buy. The particular item here that is in controversy is the cost

of money. How shall the cost of money be treated in the private sector-public sector comparisons?

In some of the earlier circulars or instructions there was very little reference to this item at all. In the latest bulletin we have made some progress. But the question still remains as to whether the cost of money shall be determined on the basis of what money costs the private sector or what money costs the Government when it seeks funding. Shall it be the prevailing commercial rate that is entered or shall it be the prevailing governmental rate?

FOREGONE TAXES

No. 3 is far more important perhaps than the other two that I have named. This is the whole area of foregone taxes. How shall taxes be treated in a comparison to cost of production in the public and in the private sector? Is it a meaningful policy of the Bureau of the Budget still to exclude State and local taxes from such determinations?

This exclusion is defended on the basis that it is difficult if not impossible to arrive at an estimate of what the State and local taxes would be.

Within industry groups and certainly among accountants, with whom we have consulted, there is a feeling that such figures can be readily derived, and that there should be a recognition of the inadequacies of cost comparison, because of this exclusion.

DIFFERENTIAL TO EMPLOY

Last, and by no means least, is the question of what differential should exist in final determination as to whether to make or buy. There is a widespread belief again on the part of those in industry that the differential is too narrow, as it currently exists, and winds up in too many instances in favor of Government making rather than buying. This differential in good part comes from the exclusion of State and local taxes and the inadequate treatment of the cost of money.

What is being suggested—and I think it is looked at somewhat receptively by some in the Bureau of the Budget—is that this differential is still too narrow, and recognizing the inadequacies of treatment of State and local taxes in the cost of money, perhaps it might be 15 or 20 percent rather than the present 10 percent.

I am using those figures largely as illustrative, however, rather than as being specific.

AREA FOR COMMISSION STUDY

Senator JORDAN. This is an area that you would anticipate in your suggestion of the proposed new Commission that it might explore.

Mr. GAINSBROUGH. Yes, I think this is another one of the sectors that lends itself now to some better degree of empirical determination.

What we lack throughout all of this is a body of data that you and others can use for final determination. The Bureau of the Budget has moved steadily toward quantification of many of these problems. Circular A-76 is a step in that direction. But, you see, there are many

unresolved problems that remain for determination. I think these can be better resolved within the Presidential Commission I propose, where you have representatives from business, education, Government, and labor, than through debate just among those within Government alone.

Senator JORDAN. How different is the Commission you are suggesting from the two Hoover Commissions with which we are all familiar back in the 1950's or 1940's?

Mr. GAINSBURGH. I think they are basically the same. Wherein they differ, I think, is the emphasis that I am inclined to place upon continuous review. The Commission would review the enabling act, determine why this particular activity was undertaken, decide whether that is still a controlling factor, and then offer some recommendations as to what the legislative branch might do as a result.

I think, too, that it might differ from the two prior Hoover Commissions in that some thought might be given to a scheduled reexamination at recurring intervals, so that it would not be a one-shot operation but might be in a sense a watchdog type of activity.

Senator JORDAN. You suggested a research and updating, and certainly a surveillance would be in order, a continuous surveillance.

Mr. GAINSBURGH. That is right. This is so important an area. From the figures you have seen on the trend of Government activity, and the holdings of wealth, then stop and ponder what future acquisitions and activities may be required under the accelerated technological change that lies ahead.

OBSOLETE ADPE

I served on the President's Commission studying Federal holdings of automatic data equipment, and I think Mr. Staats referred to this too. The Federal Government is the largest purchaser of computer equipment. It perhaps has served a very constructive purpose in the area of research and development of such equipment. But it now holds nearly \$1.5 billion or \$2 billion of obsolete equipment. How does one treat this in Government accounting? What do you do with obsolete inventories? If you insist, as apparently the decision is, to continue to purchase rather than lease, in some of these areas in which there is very rapid technological change, unlike industry where there is a charging off under depreciation of these items, you are left with the difficult question as to how to dispose, within the marketplace, of obsolete equipment, or how to treat obsolete equipment in books of accounting within Government.

PURCHASE VERSUS LEASE OF ADPE

It seems so economical to purchase rather than to lease, since the use you are going to make is so intensive. But one of the items of economic arithmetic that should be looked at in this decision is what is the disinvestment that will go along with purchases as compared with lease.

Senator JORDAN. Many businesses find it more desirable to lease because of that unknown factor of obsolescence which may strike them overnight with the improved design, more sophistication.

Mr. GAINSBURGH. There are arguments both pro and con on the leasing and purchase of computers, but I offer it just as an illustration of the dynamics of change—

Senator JORDAN. Yes.

Mr. GAINSBROUGH (continuing). As they are going to affect Government determinations, whether to buy or to purchase in the open market.

Senator JORDAN. I appreciate your fine statement this morning. It has been very instructive and educational for me, with your good and forthright answers to our questions. Thank you very much.

Representative CURTIS. I think our counsel, Mr. Ward, has a couple of questions he would like to ask, and I would like to have him do so.

Mr. GAINSBROUGH. May I say before he begins that he has been very helpful to us in getting at some of the underlying data relative to Government activities. These are not easy to come by; access to files is far more difficult than it would first appear.

COSTS ON NONGOVERNMENTAL ACTIVITIES

Mr. WARD. I would like to ask you with respect to Circular A-76 in the use of a differential, whether there should be a differential used at all, if the item can be bought competitively?

Mr. GAINSBROUGH. Well, this is what I had in mind when I said that the first point of disaffection with A-76 was their failure to underscore, perhaps as forcefully as others would have, the preference for buying, if at all possible, in the private sector. Buy from the private sector, unless there are compelling arguments, because of hazard, because of inadequacy of supply, because of national security, that move you in the direction of making rather than buying.

I am reluctant to endorse the general rule that if you can get it in a competitive market, there need be no consideration of Government make. There may be a leadership role involved as in the case of a computer that the Government wishes to fulfill through its own make rather than through purchase.

Mr. WARD. We have found that you often get into a lot of expensive bookkeeping and accounting and so on, to prove things that perhaps don't need to be proved at all, where there is a product involved that you can buy competitively.

Then the second question would be, if it can't be bought competitively, wouldn't it be better to place more effort on trying to get market competition rather than the Government itself providing the competition?

Mr. GAINSBROUGH. Again I think I would agree with it as a general rule. There may be exceptions as in the case of national security, or in the case of the leadership role in R. & D., which I don't want to discount too heavily, because there is so much that has come from the leadership role, in space and in the computer area, by Government.

Mr. WARD. Yes.

Mr. GAINSBROUGH. That wouldn't have been forthcoming as readily in the private sector.

Mr. WARD. Thank you. That is all I have.

Representative CURTIS. Thank you again, very much, Mr. Gainsbrugh. We deeply appreciate your appearing before us.

Mr. GAINSBROUGH. As always, I have enjoyed being here.

Representative CURTIS. We also have with us Mr. R. Douglas Marshall, chairman of the board of trustees of the National Association

of Wholesalers. Mr. Marshall, we appreciate your coming before this committee and giving us your views. I understand you have a prepared statement.

STATEMENT OF R. DOUGLAS MARSHALL, CHAIRMAN, BOARD OF TRUSTEES, NATIONAL ASSOCIATION OF WHOLESALERS

Mr. MARSHALL. I do; yes, sir.

Representative CURTIS. Without objection that will go into the record, and if you will proceed however you care to.

(The statement referred to follows:)

PREPARED STATEMENT OF R. DOUGLAS MARSHALL

My name is R. Douglas Marshall. I am President of the R. D. Marshall Co., a wholesale distributing firm of airconditioning and refrigeration supplies in Albany, N.Y. Today, I am appearing before this Subcommittee as the Chairman of the Board of Trustees of the National Association of Wholesalers. The National Association of Wholesalers is composed of 50 national commodity line wholesale associations, which are comprised of 19,000 merchant wholesale firms. We are indeed grateful for the opportunity to present our views on Government procurement policies and practices. Thousands of wholesalers throughout the nation are now servicing countless Government installations with goods and commodities. The industry is indeed concerned with government procurement policies and practices.

The federal Government has a need for a vast quantity of goods and commodities to be used at hundreds of locations, not only in this country, but throughout the world. Our statement here today concerns only those supplies needed in the United States, where there are many sources of commercial supplies. Also, our attention is focused not on the many special products and devices which are peculiar to Government need, but to the commercially available goods and commodities.

The mass movement of goods and commodities from the point of origin, be it field or factory, to the point of need is the function of the wholesale distribution industry. To perform this function it is not only necessary to anticipate the variety of articles which may be required, but to determine when they will be needed, to invest in the purchase of these commodities, and to maintain adequate storage facilities for them. There are many thousands of wholesale establishments located throughout the country to serve the needs of consumers and industry. We serve the needs of many Government installations, states, cities, small businesses and also the largest corporations in the United States. Indeed, for my business in Albany, my largest purchaser is the General Electric Corporation.

This Subcommittee is concerned with economy in Government, and so are we. At this time in the procurement operations of the Federal Government there is a consistent, but false concept that centralized procurement is the most economical method of purchasing for the needs of many scattered installations. The nation's largest corporations, whose profit reports indicate a sharp interest in economy in purchasing have not adopted this principle. Why the difference in concept between the Government and the large corporations?

Basically, we believe the concept of centralized procurement stems from the fact that the officials who direct Government procurement operations are *price* conscious when they should be *cost* conscious. There is a world of difference. Under the present procurement concept, there is a determination to obtain the lowest price, store commodities in a Government operated warehouse and fill the needs of scattered Government installations as these needs arise. The vast costs of centralized storage, warehousing, and inventorying are staggering.

We wholesale distributors are specialists in the business of acquiring, holding, selling and delivering inventory to the point-of-user need. This is our only economic justification for existence. Many people have long predicted the demise of the wholesale distributor—educated people who should know better but who have never studied the facts. In the past five years, for example, the growth in dollar volume of business handled by the nation's merchant wholesale distribu-

tors has grown at a rate of almost 6% per year. This is approximately double the growth rate of our Gross National Product. This is a period in which you will all agree, I'm sure, there has been a tremendous growth in so-called "discount merchandising" of consumer goods.

The reason for this is simple. As we become more sophisticated in our analysis of true total marketing or distribution costs, item by item, large and small businesses are finding that "rapidity of flow of goods" from production line to user is the key to profits in distribution. Mass merchandisers, through the use of electronic data processing equipment are finding that they can afford to "buy direct," warehouse and sell *only those items on which they have constant, steady volume demand*. The vast bulk of the items they handle in their merchandise lines are slow moving, occasional demand items. They cannot afford to buy them direct, warehouse them and hold them for ultimate user demand. They are turning to us wholesale distributors, the experienced inventory-handling specialists, to handle and supply many items for them. The "price" may be slightly higher but the "net cost" is much less and profits are much greater.

In 1963, the Comptroller General of the United States made a study of the centralized procurement operations of several inventory control points in the Department of Defense. In a letter to the Speaker of the House and the President pro tempore of the Senate, dated November 29, 1963, he stated,

"Our review disclosed that inventory control points within the Department of Defense have not given appropriate consideration to commercial availability and the costs of central management and distribution when determining whether an item of supply will be procured directly by using activities or will be obtained through service supply channels. As a result, Department of Defense activities centrally manage hundreds of thousands of low-volume, minor items of supply that are readily available to using activities from commercial sources. We estimate that direct procurement of such items by using activities would reduce supply management costs by about \$50 million a year and supply inventories by about \$275 million."

The Comptroller General's study covered six of about 58 centralized military inventory control points throughout the United States, which manage in excess of 5 million items of supply. The six control points analyzed manage about 1 million of those items of supply, or about 20% of the total DOD supply inventory from the standpoint of number of items handled.

At the six inventory control points studied, the Comptroller General's staff selected about 561,000 minor items of supply for study, consisting primarily of hardware, repair parts, industrial supplies and other low-volume items. With respect to this list of items an examination into the dollar value of issues of these items during a 12-month period ended in 1961 disclosed that about 258,000 items, or 46%, had not been issued at all during the year, and 213,000 items, or an additional 38%, had annual issues ranging in value of from less than \$10 to under \$400.

Rightfully or wrongly, the Comptroller General decided that economies that could be realized through centralized procurement of items averaging \$400 or over of the issue per year were justified. For purposes of making our point, we will agree with him, however, we are sure that many more items, on which issues of much more than \$400 per year are made, can be much more economically purchased locally.

The amazing fact is that 471,538 items out of the 561,000, or 84%, had been issued either *not at all during the year*, or in quantity of value *less than \$400*. The Comptroller General then selected 2,614 of these items, by random systematic sampling methods, for detailed examination. For the total of 2,614 supply items selected for detailed examination, they questioned, either personally or by correspondence, wholesaler-distributors, and manufacturers' outlets to determine whether the items would be readily at local levels.

They considered an item to be readily available if it was in stock locally or could be obtained from the factory or distributor in thirty days—about the same length of time normally experienced by using activities when obtaining items from central inventory control points.

The study revealed that 942 items, or 36%, of the 2,614 items covered in the review were readily available from local commercial sources. 631, or 67%, of those items were either in stock at local outlets or could be obtained in *5 days or less*, many being available for immediate shipment. The remaining 311 items could be obtained from the factory, nationwide factory outlets, or local distributors in *30 days or less*.

The Comptroller General concluded that 32% of the 471,538 low-volume, minor-line items, or 150,300 of those items, should have been decontrolled and procured locally by using activities *at tremendous net savings to the taxpayer.*

His estimate of the average annual cost to centrally manage minor items of supply, weighted according to volume at the respective locations, was about *\$114 per supply item.* His report concluded that, "additional costs attributable to local purchasing activities were exceeded by savings in other functions such as report preparation, requisition preparation, packing and crating and storage." The average additional price of items, actually priced locally by the staff, was 30% more than the prices paid for those same items purchased by central inventory control points. He found, however, that the average annual issue of those items compared was only \$46. Remember, he also found that "per item cost" of central management was \$114, on the average, per item, per year.

Expanding these costs of central supply management and the additional prices that might have been paid for local procurement to the estimated 4.8 million items in DOD inventory, the Comptroller General estimated that a potential exists for the complete elimination of over 553,000 supply items from DOD inventories, and that local procurement of these items, *even at 30% higher prices,* would save the taxpayers an estimated \$50 million a year.

The weighted average inventory value per item of those 553,000 supply items, based on the sample at the six control-point locations, was \$552. The Comptroller General thus estimated that if these 553,000 items were eliminated from the DOD inventory system, a total of \$275 million in Government funds would be freed from investment in needless central Government inventory. The interest on this needless investment, alone, would save the taxpayers another \$8 million a year, computed at the Government's cost of only 3% annual interest.

I would call the Committee's attention, Mr. Chairman, to the fact that the Comptroller General stated that since July 1955, almost 13 years ago, the prescribed policy of the DOD has been that, "the military departments, in peacetime, should place optimum reliance on *local management and procurement of material.*" He charges that "inventory managers have continued to centrally manage commercial items of supply under criteria that *do not give adequate consideration to commercial availability and costs of distribution* of these items from centralized inventories." We could not agree more.

At one of the Army locations investigated, an item was retained in stock if (1) the item is requested three times a year, or once a year for missile components, (2) the item is on an overseas stock list, and (3) the item has a mobilization reserve requirement. The Comptroller General then flatly stated that he found no indication that *commercial availability or distribution cost* influenced these determinations. We submit that on this basis, at \$114 per year average per item inventory carrying costs, there is a built-in automatic *average of \$38 per issue cost*—often for penny items!

At the Navy's Yards and Docks Supply Office (YDSO) the *average annual* issues of minor items managed by YDSO amounted to only \$38 per item during the year of the examination. Items were supposed to qualify for central stockage, according to regulations in effect at YDSO, only if annual issue was \$200 or more. They were considering raising that to 150 units per year or \$1,500 worth of issues per year, according to the report. That would certainly be a step in the right direction.

The report concludes that regulations contain criteria for utilization of commercial sources of supply which are more restrictive than necessary. It then states that from a geographical viewpoint, the disadvantages of supply from a manufacturer or distributor located outside the user's local trade area, compared with a military depot similarly located, are not apparent. We could not agree more, Mr. Chairman. We would hazard the guess, in fact, that such local procurements from local commercial sources would get there much faster *from wholesale-distributors and at less net cost.*

We agree with the Comptroller General, Mr. Chairman, in almost all he has reported as a result of his survey of the DOD inventory and central procurement practices. We are appalled that under the circumstances, we are able to sell the DOD local users as much as we do. It is a tribute to the good judgment of procurement officers at the local level.

We are firmly convinced that the conditions uncovered by the Comptroller General's survey of procurement practices in the DOD, would also be found to be present in the procurement practices of the GSA. We suggest, Mr. Chair-

man, that it would appear that the Congress is going to *have to force changes* in the procurement practices of the Federal departments and agencies by law, IF modern business inventory control and good common sense practices are to be undertaken in the procurement processes of the Government.

Government regulations often set forth laudable objectives, but day-to-day procurement practices continue to require construction of millions of cubic feet of warehouse space, all over the 50 states, for the needless, wasteful storing of hundreds of thousands of items that are *locally available at greatly reduced "net cost" to the Government.*

This is where the Government procurement system breaks down and the Comptroller General goes to great lengths to point this out in his report of November 29, 1963, and in many more of his reports to the Congress. *"Net cost" of an item, delivered to the point of use, should be the controlling factor in determining methods or channels or places of purchase of materials and supplies by the Government.* Delivered price to some Government receiving dock, often 300 to 3,000 miles or more from the point of eventual use and often, as we have seen, one or two or three years or more from the date of demand, is the controlling factor too often used by Government central procurement officers.

"Price" is only one element of cost and very often, as private industry purchasing agents will tell you, very often the least important element of "net cost."

We wholesale distributors know this well, for this is our business. By and large, we manufacture nothing; we buy, hold, sell and deliver the products that are made by others (the repair and replacement parts and equipment, materials and supplies needed by others—needed by the Government). No one knows better than we that there are tremendous costs connected with the performance of the distribution functions.

The reason the small businessman plays such a minor role in supplying the Government is because the entire system of procurement of materials and supplies, repair and replacement parts and equipment by the Government is based on price—one price to all Government departments and agencies is the dream of the Government procurement officer. His invitation to bid is based on the estimated needs of all departments and agencies of the Government for that product, supposedly six months to one year in advance.

To begin with, it is quite obviously impossible to predict what the needs of all departments and agencies of the Government will be for even one year in advance on any one item. This is why the Government has such a large surplus disposal problem. These surplus sales are the result of poor predictions by central procurement officer. The surplus sales are usually at "give-away prices," 10% to 20% of the original "price". The loss on these is not 80% or 90%, Mr. Chairman, but 80% or 90% *plus* the cost of receiving, handling, storing, interest on investment and dozens of other costs.

According to the Comptroller General's Report, as stated earlier, the central procurement price is, on the average, about 30% below the local purchase price, but what is the "cost" delivered to the point of need? Forgetting the cost of checking in and out of warehouses on movement from point to point in the Government central supply system, just remember that the Comptroller General found that the average cost of recording per year was *\$114 per supply item.*

Again, I point out that centralized procurement means obtaining a large volume of goods at a central point, and then warehousing them, breaking bulk, repackaging them into smaller quantities, shipping them, at the time of need, to the point of need. The operation includes moving goods, maintaining inventories, filing requisitions, billing and many other operations. It is in many ways the same operation that goes on in my business and other wholesale businesses.

What does it cost to carry inventory? Before me is a small pamphlet prepared by Dr. Ronald Foster, assistant Professor at the Ohio State University, called "What Does It Cost To Carry Inventory?" Here are some of the factors he lists which comprise the cost of carrying inventory. They are: taxes on land and buildings, insurance, depreciation, maintenance and repair of buildings, utility costs, depreciation on equipment, maintenance and repair on equipment, obsolescence, pilferage, deterioration and other losses on inventory, labor costs on physical handling, labor costs on clerical operation and record keeping, and interest on money invested in buildings, equipment, land and inventory. For the average wholesaler, the cost of carrying inventory is in the neighborhood of 25% per year. Thus, an inventory of \$100,000 costs \$25,000 just to maintain.

When goods and supplies are purchased by the local using agency at the time of need, all of these costs are eliminated. For literally tens of thousands of items, there is no need for the Government to warehouse, for these commodities are readily available from local commercial sources.

Unfortunately, too much of the advice that the Congress receives comes from the officials who believe in centralized procurement as a basic concept. The procurement officials in the hundreds of Federal installations across the nation have a different view. They know that local suppliers can deliver goods and commodities on much shorter notice than they can be delivered from the centralized warehouses operated by the Federal Government. They also know that local vendors can supply a vast volume of product knowledge that is unavailable from the central Government warehouse.

The time has come for Congress to express clearly that economic procurement is required; that efficient procurement does not require an empire and that modern business practices must be brought to the Government's procurement activities.

Mr. MARSHALL. We can shorten it up considerably, Mr. Chairman, if this is agreeable, and still cover the salient points.

Representative CURTIS. Very good.

Mr. MARSHALL. It is getting late. As you have said, my name is R. Douglas Marshall. I am president of the R. D. Marshall Co., a wholesale distributing firm of air conditioning and refrigeration supplies in Albany, N.Y. Today, I am appearing before this subcommittee as the chairman of the board of trustees of the National Association of Wholesalers. The National Association of Wholesalers is composed of 50 national commodity line wholesale associations, which are comprised of 19,000 merchant wholesale firms throughout the country. We are interested in the question of Government procurement, and are certainly happy to be here this morning to talk briefly with you.

This discussion of mine I don't think is quite going from the sublime to the ridiculous, but I would agree that possibly it is from the grand to the precise. I think this is more like it. And I could sum up the rest of my testimony probably in one sentence, by saying that the proverbial old shopper was probably right when he said he could "save you money by getting it for you wholesale."

I think this is the gist of what we are saying here this morning. But wholesalers are mostly small businessmen like myself clear across the country. We sell, we can and we do sell to the government at all levels, National, State, and local, and we save them money.

The question of price versus cost is discussed in my testimony, and this is a most important distinction to make, because the price of an article in Seattle bears little resemblance to its actual cost when it is required in Washington, and the fact that it is here when it is needed is the important thing, not how much it is at some distance away.

Centralized purchasing has been furthered by the government and by government witnesses, and we wish to point out that centralized purchasing is not always the best. To illustrate in my own particular case if I might, Mr. Chairman, our single largest customer in upstate New York is the General Electric Co. We sell more to GE than we do to anybody else.

They buy so much from their plants in Burlington, Vt., Pittsfield, Mass., their main office in Schenectady, their plants in Utica, Johnson City, New York, Glens Falls, and Fort Edward. All of these plants buy from us as separate organizations, no centralized purchasing.

In addition, plants like Pittsfield, Mass., Utica, N.Y., and Schenectady are so large that we deal with, oh, half a dozen or eight different purchasing departments in each of these plants, so that centralized purchasing is not generally followed by many of the large corporations.

Why is this? Well, I think that the large corporations realize that they must be cost conscious instead of price conscious, and there is quite a difference and distinction to be made.

The Comptroller General of the United States made a study in 1963, and I have a copy of the report here. If the committee wishes to obtain copies, they are available through the Comptroller General's Office, and it is a most valuable report.

Representative CURTIS. Would you identify it by title and date, just for the record?

Mr. MARSHALL. All right, sir. "Report to the Congress of the United States, Uneconomical Management of Commercially Available Items, Department of Defense," by the Comptroller General.

Representative CURTIS. It should have a date on the inside there.

Mr. MARSHALL. November 29, 1963.

Representative CURTIS. That identifies it. Thank you.

Mr. MARSHALL. Yes, sir. The number here is B-146828, if this is of any value.¹²

The Comptroller General made a study of the centralized procurement operations of several inventory control points in the Department of Defense, quoting from my prepared statement:

In a letter to the Speaker of the House and the President pro tempore of the Senate, dated November 29, 1963, he stated:

"Our review disclosed that inventory control points within the Department of Defense have not given appropriate consideration to commercial availability and the cost of central management and distribution when determining whether an item of supply will be procured directly by using activities or will be obtained through service supply channels. As a result, Department of Defense activities centrally manage hundreds of thousands of low-volume, minor items of supply that are readily available to using activities from commercial sources. We estimate that direct procurement of such items by using activities would reduce supply management costs by about \$50 million a year and supply inventories by about \$275 million."

I will just summarize what I have here. They chose six out of about 58 central military inventory control points, and these six stock 1 million different supply items out of a total of some 5 million that are stocked by all 58. So they had 1 million supply items in these six storage warehouses.

They examined more than half of them, about 560,000 of the minor items of supply, maintenance and repair, emergencies, things of this kind. These aren't guns or battleships or airplanes. These are bolts and nuts and hardware items and drugs and sundries and the parts and pieces that go into maintenance and repair.

In respect to this list of over 560,000 of these items in stock, they found that 46 percent had not been issued at all during the preceding year, pretty near half of them. They never even sold one. Nobody asked for one, but they had them in stock.

Of the rest, there was an additional 38 percent which had moved somewhere between \$10 and \$400 in value during the year, and this is

¹² Copy in subcommittee files.

84 percent of their inventory of these 560,000 items that had moved half of them not at all, and a third maybe somewhere between \$10 and \$400.

They found out when they analyzed their cost of maintaining these warehouses that for every single one of those items, it costs them \$114, whether they sold one or 1,000,000, it cost them \$114 just in the paper work, in inventory, in putting them in stock, in shipping them. So here is \$114 for every single item, and they don't sell any. This is not from a commercial standpoint very sound. I would go broke very quickly doing this sort of thing.

The Comptroller General has urged the Department of Defense that they consider the possibility of buying locally the commercially available items which comprise the bulk of the inventories in wholesalers across the country. The report concludes, and I am now on page 8 of my testimony, the bottom of page 8, the report concludes that regulations contain criteria for utilization of commercial sources of supply which are more restrictive than necessary. It then states that from a geographical viewpoint, the disadvantages of supply from a manufacturer or distributor located outside the user's local trade area, compared with a military depot similarly located, are not apparent. We could not agree more, Mr. Chairman. We would hazard the guess, in fact, that such local procurements from local commercial sources would get there much faster from wholesaler-distributors and at less net cost.

The emphasis upon price and not upon delivery cost is where the Government breaks down, falls down in this procurement system.

This is where the Government procurement system breaks down and the Comptroller General goes to great lengths to point this out in his report of November 29, 1963, and in many more of his reports to the Congress. "Net cost" of an item, delivered to the point of use, should be the controlling factor in determining methods or channels or places of purchase of materials and supplies by the Government. Delivered price to some Government receiving dock, often 300 to 3,000 miles or more from the point of eventual use and often, as we have seen, 1 or 2 or 3 years or more from the date of demand, is the controlling factor too often used by Government central procurement officers.

"Price" is only one element of cost and very often, as private industry purchasing agents will tell you, very often the least important element of "net cost." That is the price of the item.

We wholesale distributors know this well, for this is our business. By and large, we manufacture nothing; we buy, hold, sell and deliver the products that are made by others—the repair and replacement parts and equipment, materials and supplies needed by others, needed by the Government. No one knows better than we that there are tremendous costs connected with the performance of the distribution functions.

I will close this with this statement: The cost of carrying an inventory has been estimated at from 20 to 25 percent of the cost of the item, and this is something that the Government does not take into consideration when it thinks only of price. When the functions of a wholesaler are considered, and with these functions a Government material warehouse is going to have to assume should be considered in the cost, and it becomes apparent that for commercially available items it is in most

cases cheaper for the Government to buy them locally than to attempt to buy them centrally and stock them in warehouses across the country.

This is the gist then of our testimony. We feel that the time has come for Congress to express clearly that economic procurement is required, that efficient procurement does not require an empire, and that modern business practices must be brought to the Government's procurement activities. Thank you very much.

Chairman PROXMIRE (presiding). Thank you very much. I am sorry and apologize for being so late, and I want to thank the distinguished Congressman from Missouri for his chairing the hearing. I just have a couple of questions. If the gentleman from Missouri would want to go ahead, please do.

Representative CURTIS. Whichever you prefer.

ITEMS IN FEDERAL SUPPLY

Chairman PROXMIRE. Let me ask you this. This is just a technical question first. You said something about there being 5 million items. Where did you get that? Do you mean 5 million separate items?

Mr. MARSHALL. This is in the report from the Comptroller General.

Chairman PROXMIRE. The reason I asked is because yesterday we were told by Mr. Ignatius that it was 3.9 million, and they take great pride that it had gone down.

Mr. MARSHALL. Is that so? In these were some 5 million different items.

STAGNANT INVENTORY

Chairman PROXMIRE. The implication is of a stagnant inventory.

Mr. MARSHALL. Yes.

Chairman PROXMIRE. What was your figure of what percentage has not moved at all?

Mr. MARSHALL. Forty-six percent.

Chairman PROXMIRE. Forty-six percent?

Mr. MARSHALL. Yes, sir.

Chairman PROXMIRE. And 84 percent had moved in such slow volume.

Mr. MARSHALL. Yes, sir.

Chairman PROXMIRE. In terms of dollars.

Mr. MARSHALL. That is right.

Chairman PROXMIRE. That it was negligible.

Mr. MARSHALL. Yes, sir.

Chairman PROXMIRE. That is 84 percent altogether?

Mr. MARSHALL. Yes, sir.

Chairman PROXMIRE. Of course this raises the other question. I am sure that one answer they have is that although this may not have moved in a year, it may move in very, very small volume, that we have to have it in Vietnam to save a life, we have to have an inventory.

Mr. MARSHALL. Yes, sir.

Chairman PROXMIRE. The emergency question, the availability question is very, very important, and if you don't have it in a commercial wholesale location that is available, and you have to have it produced of course it could, because of a nail a shoe is lost.

Mr. MARSHALL. Yes, sir.

Chairman PROXMIRE. And because of that a horse is lost and then a kingdom is lost.

Mr. MARSHALL. Granted. I don't think we can make a hard and fast estimate that everything should be done this way. There are certain military items of such a critical nature—

CRITERIA FOR STORING

Chairman PROXMIRE. What criteria would you suggest we adopt? You make a wonderful point here, but when should the Government stop and when should it not stop?

Mr. MARSHALL. I would say the words "commercially available," this is the key to it. If you can pick up a supply house catalog and say here these things are, these guys have got them in stock all over the country, then it is foolish for us to stock it. It is their job.

Chairman PROXMIRE. This not only requires them to check it as of one point, but to keep rechecking it to make sure it continues to be available.

Mr. MARSHALL. This was done in a survey, and in my testimony there is reference to it. A survey was made. They selected some; a study was made.

They took a total at random by systematic sampling methods for detailed examination. Of the total of 2,614 supply items selected for detailed examination, they questioned, either personally or by correspondence, wholesaler-distributors, and manufacturers' outlets to determine whether the items would be readily available at local levels.

They considered an item to be readily available if it was in stock locally or could be obtained from the factory or distributor in 30 days—about the same length of time normally experienced by using activities when obtaining items from central inventory control points.

The study revealed that 942 items, or 36 percent, of the 2,614 items covered in the review were readily available from local commercial sources. Six hundred thirty-one, or 67 percent, of those items were either in stock at local outlets or could be obtained in 5 days or less, many being available for immediate shipment. The remaining 311 items could be obtained from the factory, nationwide factory outlets, or local distributors in 30 days or less.

Chairman PROXMIRE. And of course some of these items I suppose can be designated as not being necessary in emergency situations. In other words, you know that part of a weapon that is being used currently in combat, that obviously it should be available.

Mr. MARSHALL. Yes, sir.

COST OF WAREHOUSING

Chairman PROXMIRE. If it is an item of clothing perhaps that would not be used in Vietnam, or something else of that kind, obviously you can throw that kind of thing out of the emergency category. Let me just ask one other very brief question. What is warehousing cost in terms of percentage? I have got an estimate here of 10 percent per year of the value of goods.

Mr. MARSHALL. No.

Chairman PROXMIRE. I know it varies a lot.

COST OF WAREHOUSING 25 PERCENT OF VALUE PER YEAR

Mr. MARSHALL. It does vary. I have with me, and I will leave it for the committee, a study made by Professor Foster of Ohio State on this. He says 25 percent.

Chairman PROXMIRE. Warehousing?

Mr. MARSHALL. Warehousing. This is the cost of carrying an item in inventory for a year, 25 percent of its value. You have the cost of the building, you have the investment on the item, you have the cost of putting it away on shelves, you have the cost of taking it off the shelf, shipping it out.

Chairman PROXMIRE. This 10 percent figure was supplied by Sears, Roebuck to this committee some years ago. Maybe they have a different kind of problem.

Mr. MARSHALL. Possibly. I have never seen that figure this low. Ten percent—now Sears, Roebuck is a large retailer with a turnover much faster than the average wholesaler has. They have to. When you think that we have many items in our stock that don't sell for a couple of years, and yet I must have them there because they are emergency items.

Chairman PROXMIRE. Mr. Marshall, from what you tell us the Defense Department can hardly be considered to be a fast-turnover outfit.

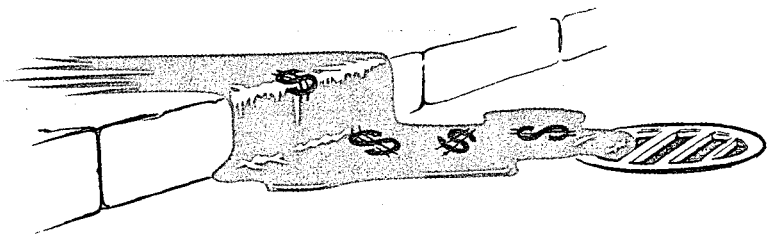
Mr. MARSHALL. Well, this is true, and we are only speaking of those items, the fast turnover of a defense item, this is for them to stock and to buy direct and to warehouse. It is these slower moving items that comprise over 50 percent of the total that move so slowly, that in most cases are locally available, commercially available, that we feel this is where the Government should look to save money.

I would suggest, too, that if a study of this kind is made, that these would be the people to contact, the purchasing people in the local government activities. They know how valuable it is to be able to call a local supplier for something that is needed. I am surprised that the wholesaler sells as much as he does to the Government, in view of the restrictions that have been placed.

Chairman PROXMIRE. Congressman Curtis?

(The study referred to by the witness is reprinted herein:)

WHAT DOES IT COST TO CARRY INVENTORY



by
Ronald S. Foster, Ph.D.
Assistant Professor
The Ohio State University

Prepared for
The National Association of Wholesalers
Washington, D. C.

WHAT DOES IT COST TO CARRY INVENTORY?

IN this age of the "Profit Squeeze," it is becoming increasingly more difficult for management of wholesale-distributor firms to earn a reasonable profit—make an adequate return on invested capital—to compensate them for money invested in their businesses. The key role of inventory management in the profitability of wholesale distribution is too often overlooked. In the average wholesale-distributor business, **INVENTORY is the LARGEST SINGLE ASSET ITEM**, thus tying up a large portion of owner's investment.

Every wholesale-distributor business manager knows the **purchase price** of his inventory—he must also know **what it is worth**, for tax purposes. The question that is **too little understood and too often overlooked** in figuring the cost of operation of a distribution business is **WHAT DOES IT COST TO CARRY INVENTORY?**

Let's look at the total annual cost of carrying inventory as a percentage of the total value of the average inventory. For example, a firm's annual inventory carrying cost would be twenty-five percent (25%) if it cost the company \$50,000 in one year to carry \$200,000 of average inventory in stock. Does this appear high? Low? Unfortunately, not many wholesale-distributors know the answers to these questions. An examination of the literature on the subject reveals that some leading authors have made estimates of the total annual cost of carrying inventory, a summary of the opinions of which are shown in Exhibit #1.

Perhaps the most widely quoted estimate appears in Alford and Bangs' **PRODUCTION HANDBOOK** which sets the total annual carrying cost at twenty-five percent (25%) of the value of the average inventory on hand. The breakdown of the 25% figure is shown in the first column of Exhibit #2. The second column shows the estimate and breakdown of inventory carrying costs by Remington Rand in **INVENTORY CONTROL FOR WHOLESALE-SALERS**. Also shown, in the third column, is the combined estimate of seventeen wholesale-distributors in attendance at the "Third Planning for More Profits Seminar" presented by the National Association of Wholesalers in 1961.

Both the Remington Rand estimate and the combined estimate of the wholesale-distributor executives suggest that the **annual cost of carrying inventory** for an average wholesale-distributor firm amounts to **at least** as much as twenty percent (20%) of the average inventory value. This figure will, of course, vary between wholesale-distributor firms, especially the breakdown of the various cost elements, even though the firms may be distributing the same commodity lines.

The fact that actual carrying costs vary between wholesale-distributor firms, however, strengthens the need for each such firm to **determine its own inventory carrying cost figure**. These costs are **NOT REPORTED** in normal accounting records and must therefore be determined. They are **TOO IMPORTANT TO BE OVERLOOKED**.

Exhibit 1

ESTIMATES OF INVENTORY CARRYING COSTS		
Author	Publication	Estimate of Carrying Costs as a Percent of Inventory Value
L. P. Alford and John R. Bangs (Eds.)	PRODUCTION HANDBOOK (The Ronald Press Company, 1955) p. 397	25%
Dean S. Ammer	MATERIALS MANAGEMENT (Richard D. Irwin, Inc., 1962) p. 137	20-25%
John B. Holbrook	MANAGING THE MATERIALS FUNCTION (American Management Association, 1959) p. 67	24%
John F. Magee	"The Logistics of Distribution" HARVARD BUSINESS REVIEW, July-August 1960, p. 99	20-35%
Benjamin Melnitsky	MANAGEMENT OF INDUSTRIAL INVENTORY (Conover-Mast Publications, Inc., 1951) p. 115	25%
W. Evert Welch	SCIENTIFIC INVENTORY CONTROL (Management Publishing Corporation, 1956) p. 63	25%
Thomson M. Whiting	THE THEORY OF INVENTORY MANAGEMENT (Princeton University Press, 1957) p. 220	25%