

68061731

90th Congress }
2d Session }

JOINT COMMITTEE PRINT

ECONOMY IN GOVERNMENT PROCUREMENT AND PROPERTY MANAGEMENT

REPORT

OF THE

SUBCOMMITTEE ON ECONOMY IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

MAY 21 1968



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APRIL 1968

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

WASHINGTON : 1968

06-84656

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(II)

LETTER OF TRANSMITTAL

APRIL 23, 1968.

To the Members of the Joint Economic Committee:

Transmitted herewith for your consideration and use and for the use of other Members of Congress, the business and academic communities, and other interested parties, is a report entitled "Economy in Government Procurement and Property Management," prepared by the Subcommittee on Economy in Government.

The report is based upon hearings which the subcommittee held in November and December, continuing the work over many years of its predecessor, the Subcommittee on Federal Procurement and Regulation. The present series of hearings have concentrated on the elimination of waste in Government property activities, particularly defense procurement.

The subcommittee has been deeply disturbed over the extensive testimony and reports of the General Accounting Office reflecting loose management, especially in the Department of Defense. The need for corrective measures indicated in the earlier hearings prompted the present followup hearings. These hearings confirm the need for dispatch in implementing changes to obtain economy of operation, protect public property, and render the huge inventories effective for their intended missions.

Again, I express appreciation to Comptroller General Staats and his staff in the GAO for the outstanding work they have done for the Congress and the public by their investigations related to this inquiry. The special studies and reports made for the subcommittee have made important contributions to economy in Government, and can reduce Federal spending by billions of dollars.

WILLIAM PROXMIRE,
Chairman, Joint Economic Committee.

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ECONOMY IN GOVERNMENT PROCUREMENT AND PROPERTY MANAGEMENT

Introduction

Defense procurement has reached the level of \$45 billion. It is the single largest item in the Federal budget. It dwarfs all other programs of the Government, including space, atomic energy, and all grant-in-aid programs combined. And the Congress has shown no lack of generosity toward the Department of Defense to enable it to carry out its various missions, especially procurement. An examination of the total Defense budget will quickly bear this out. There are approximately 40,000 civilian DOD professional procurement officials plus an additional 1,500 military personnel assigned to procurement matters.

Considering the funds and facilities that the Congress has made available to the DOD, there would seem to be no reason why defense procurement cannot be managed efficiently and economically. Unfortunately, this is not the case. This subcommittee has expressed its concern on numerous occasions over deficiencies in the management of Federal procurement programs. The evidence we have received in the most recent round of hearings documents a case of loose and flagrantly negligent management practices in the Defense procurement program.

The DOD apparently refuses to reverse the long-term trend away from competitive bidding and toward noncompetitive negotiated contracts, while only timidly, at best, implementing the Truth in Negotiations Act passed 5 years ago. Its practice of furnishing property to contractors at Government expense without proper scrutiny amounts to a multibillion-dollar-back-door subsidy program never intended by the Congress.

These practices, and many others inimical to the public interest, are documented in the hearings and highlighted in this report. The subcommittee's recommendations are the minimum corrective steps that urgently need to be taken.*

*NOTE.—Representative Martha W. Griffiths states: "While I concur heartily in the recommendations contained in this Report, I am convinced that even the maximum possible utilization of competitive bidding will not cure Defense procurement shortcomings. The deficiencies in Defense procurement and in Government purchasing, generally, will not be cured until the Government recruits, trains, and keeps procurement officers of the superior caliber and integrity that are needed. As long as procurement officers can be overruled, fired, or hired away from the Government we shall continue to have the difficulties that this subcommittee has so often, and so rightly, attacked. The answer, obviously, is better recruitment, better training, better support in terms of authority, and rewards sufficient to induce procurement personnel to remain on the public payroll on a permanent basis. Rules of procedure, such as competitive bidding, are essential. But equally essential is the attainment of a procurement service manned by first-class personnel."

Summary of Recommendations

1. The subcommittee once again urges the greater utilization of competitive bidding to satisfy the requirements of defense procurement, and reversal of the tendency to award contracts by noncompetitive negotiation.¹

2. Legislative action should be taken to insure postaudit rights of the Government under the Truth in Negotiations Act.

3. When audits reveal that defective cost or pricing data have been certified by a contractor, despite the fact that accurate, current, and complete data were available to him, the case should be referred to the Justice Department for appropriate action.

4. The GAO and GSA should take steps to insure that other Federal agencies adopt the provisions of DOD Circular No. 57 as minimum standards for the awarding of negotiated contracts.

5. The Bureau of the Budget should issue a uniform policy for the guidance of Federal agencies and contractors regarding the use of price differentials under the Buy American Act.

6. The inventorying of all Government-owned automatic data processing equipment (ADPE), including equipment furnished to contractors, should be completed as soon as possible and kept current so as to prevent unneeded future purchases.

7. GSA should make it possible for smaller manufacturers of ADPE to furnish part of the Government's requirements. Specifications should not be designed around the products of certain companies which have the effects of eliminating competition and stifling the incentive of smaller manufacturers.

8. The DOD must make a much greater effort to enforce its stated policy that contractors provide their own facilities, equipment, tooling, and materials incident to the performance of Government contracts.

9. The DOD must make a much greater effort to encourage contractors to replace Government-owned equipment when it becomes inefficient or outmoded, and to require economic justification from any contractor requesting replacement of equipment at Government expense.

10. Where costs of production have been reduced as a result of replacement or modernization of equipment at Government expense, appropriate contract adjustments and price reductions should be made.

11. Immediate steps should be taken to collect full payment for past, present, and future use of Government-owned property, and to establish an adequate system of use records.

12. The inventorying of all Government-owned property on loan to contractors should be expedited by all defense agencies. Proper controls should be established for each class of property.

¹ See Rep. Martha W. Griffiths' note, p. 1.

13. A system of uniform rental rates should be established for the use by all contractors on an equitable basis who have been furnished Government-owned property.

14. A thorough review should be made of any misuse or unauthorized use of Government property in the possession of contractors. Penalties should be assessed for unauthorized or improper use of such property.

15. GAO is requested to advise the subcommittee as to collection action taken or planned by DOD resulting from GAO Report B-140389. Action taken regarding these contractors should be extended equally to all similar contractors holding a Government property.

16. GAO is requested to continue to investigate the adequacy of controls over Government property furnished to contractors, including property held under contracts with agencies other than DOD, such as NASA and AEC.

I. Procurement Policies and Practices

COMPETITIVE AND NEGOTIATED PROCUREMENT

The DOD is not doing an adequate job with respect to its major procurement programs. Control over a substantial portion of procurement has been virtually lost as a result of excessive resort to negotiation of defense contracts and insufficient knowledge of cost and pricing data. During the period 1951-67, DOD negotiated 86.1 percent of the net value of its procurement despite the clear congressional intent that procurements be made through formal, written bid procedures, whenever practicable. Only through competitive bidding can we extend to all persons an equal right to compete for Government business, prevent unjust favoritism, collusion and fraud and secure for the Government the benefits which flow from competition. Little or no progress has been made toward the objective of greater use of competitive bidding.

RECOMMENDATION

1. The subcommittee once again urges the greater utilization of competitive bidding to satisfy the requirements of defense procurement, and reversal of the tendency to award contracts by noncompetitive negotiation.²

NONCOMPLIANCE WITH THE TRUTH IN NEGOTIATIONS ACT

The most glaring fact about the Truth in Negotiations Act is that it has still not been fully or even substantially implemented, although 5 years have elapsed since its passage. The Comptroller General testified that there had been full compliance on only about 10 percent of the transactions tested. He further testified, on the basis of minimal spot checking of defense contracts, that over a 10-year period the Government had been overcharged \$130 million as a result of the failure of the DOD to obtain adequate cost and pricing data. Obviously, this figure represents only a fraction of the total overcharge.

The recent DOD regulations contained in Defense Procurement Circular No. 57, concern the Government's right of access to performance records of contractors holding noncompetitive firm-fixed-price contracts. These regulations carry out, in part, an earlier recommendation of this subcommittee that the DOD postaudit contracts coming under the Truth in Negotiations Act. The single purpose of any postaward cost performance audit, under the new regulations, would be to determine whether or not defective cost or pricing data were submitted. Profits may not be looked into. Price adjustments are provided for where audits reveal that certified cost or pricing data were inaccurate, incomplete, or noncurrent.

The new regulations represent important steps toward the full implementation of the Truth in Negotiations Act. However, the post-

² See Rep. Martha W. Griffiths' note, p. 1.

audit rights provided are limited in scope and purpose, and are subject to modification or rescission by future regulations. Since the Government's postaudit rights are contractual in nature, they do not have the binding force of law.

RECOMMENDATIONS

2. Legislative action should be taken to insure postaudit rights of the Government under the Truth in Negotiations Act.

3. When audits reveal that defective cost or pricing data have been certified by a contractor, despite the fact that accurate, current and complete data were available to him, the case should be referred to the Justice Department for appropriate action.

4. The GAO and GSA should take steps to insure that other Federal agencies adopt the provisions of DOD Circular No. 57 as minimum standards for the awarding of negotiated contracts.

THE BUY AMERICAN ACT

The subcommittee has expressed its concern during the past several years over the inconsistent application of the Buy American Act. The act provides that materials for public use shall be purchased from U.S. manufacturers, except where it is determined that their purchase would be inconsistent with the public interest or their cost would be unreasonable. Inconsistency in its application continues.

The problem is that while most agencies utilize a 6-percent differential, and an additional 6 percent to "small business" or suppliers in an area of substantial unemployment, the DOD since 1962 has utilized a 50-percent differential. Thus in the purchase of the same item two agencies of the Federal Government may utilize widely separated differentials. The Bureau of the Budget has conceded that the situation is "a mess," but it has not acted to rectify it. The economic implications of these policies are antagonistic. The 6-percent differential permits greater purchases of foreign goods and thus operates against a favorable balance of payments. The 50-percent differential protects domestic manufacturers but increases costs of procurements and therefore militates against a balanced budget.

From the evidence it appears that the DOD's 50-percent differential raises a protective wall so high that American bidders may be encouraged to take advantage of it. It may also be self-defeating in the long run by pricing the protected items out of foreign markets and thus injuring our balance of payments. Further, the DOD's practice is placing a significant burden on the already extremely high level of defense procurement.

RECOMMENDATION

5. The Bureau of the Budget should issue a uniform policy for the guidance of Federal agencies and contractors regarding the use of price differentials under the Buy American Act.

PROCUREMENT OF AUTOMATIC DATA PROCESSING EQUIPMENT

In the past several years there has been phenomenal growth in the use by the Federal Government of automatic data processing

equipment (ADPE) and systems. The Federal Government now spends about \$3 billion annually for the purchase or lease of ADPE. In 1967 Government-owned ADPE having an acquisition cost of \$80 million was declared excess to the needs of the owning agencies. Despite the enormous costs of ADPE procurement, an adequate inventory of Government holdings, including Government-owned equipment furnished to contractors, has not been developed. Satisfactory levels of centralized control over new acquisitions, and of interagency cooperation, so as to avoid unnecessary duplication and further economy in use of ADPE, have not been achieved.

There is also evidence that Government procurement practices have tended to favor the larger manufacturers of ADPE, thus stifling competition from the smaller companies. Testimony received by the subcommittee indicates that the numerous smaller producers of so-called peripheral equipment might well participate to a larger extent in furnishing the Government's requirements directly.

RECOMMENDATIONS

6. The inventorying of all Government-owned ADPE, including equipment furnished to contractors, should be completed as soon as possible and kept current so as to prevent unneeded future purchases.

7. GSA should make it possible for smaller manufacturers of ADPE to furnish part of the Government's requirements. Specifications should not be designed around the products of certain companies which have the effects of eliminating competition and stifling the incentive of smaller manufacturers.

II. Government-Owned Property Furnished to Contractors

AMOUNT OF GOVERNMENT-OWNED PROPERTY

The executive branch is responsible for the protection and management of public property entrusted to it. Congress defined this responsibility in the Federal Property and Administrative Services Act of 1949, which provides that each executive agency shall maintain adequate *inventory* control and accountability systems for the property under its control to determine which is excess property. The executive branch, and especially the DOD, is not satisfactorily carrying out this responsibility. There is an extensive lack of inventory and management controls over literally billions of dollars of public property.

The extent of the responsibility of the DOD for inventory controls and accountability systems for property in its possession is indicated by the following breakdown (as of June 30, 1967):

Real property.....	\$38, 495, 000, 000
Personal property.....	157, 057, 000, 000
Total.....	195, 552, 000, 000

The total of approximately \$196 billion was up \$12 billion from fiscal year 1966.

Perhaps the most serious problem uncovered in recent years by this subcommittee concerns DOD's policy of furnishing Government-owned property to defense contractors, and practices surrounding the use and replacement of such property. The stated policy of DOD is to require contractors to provide their own facilities, equipment, and materials incident to their contracts. It is also the stated policy of DOD to encourage contractors to replace old, inefficient, Government-owned equipment with modern, more efficient, privately owned equipment.

Yet the amount of Government-owned equipment furnished to contractors has more than doubled since fiscal year 1965. In that year the amount of such property in contractors' hands was valued at \$7.2 billion. One year later, fiscal year 1966, the amount was \$10.9 billion. As of fiscal year 1967, it was estimated at \$14.7 billion. The following table breaks down the types of property held by contractors:

Government Property Held by Contractors (as of June 30, 1967)

[In billions of dollars]

Industrial plant equipment (IPE) mostly metalworking costing over \$1,000.....	\$2. 6
Other plant equipment costing less than \$1,000—furniture, office machines, etc.....	2. 0
Materials, electronic gear, cloth, duck, sub-assemblies, parts, hardware items, etc.....	4. 7
Real property—buildings, plants, etc.....	2. 4
Special tooling and test equipment.....	3. 0
Total.....	14. 7

The evidence received by the subcommittee indicates that the DOD is not adhering sufficiently to its own stated policy with regard to the furnishing of Government-owned property to contractors.

RECOMMENDATION

8. The DOD must make a much greater effort to enforce its stated policy that contractors provide their own facilities, equipment, tooling, and materials incident to the performance of Government contracts.

REPLACEMENT OF GOVERNMENT-OWNED EQUIPMENT

One of the reasons for the sharp increase in the amount of Government-owned property furnished to contractors has been DOD's program for modernization and replacement at Government expense of machine tools furnished to contractors. For the period 1958-63, annual expenditures for this program averaged about \$27.4 million. But for fiscal year 1966, expenditures increased to \$51.5 million, and for fiscal year 1967 expenditures of \$65.8 million were forecast.

According to DOD's policy, when a contractor cannot be encouraged to replace Government-owned equipment, the Government may effect the replacement if it is in the interest of the Government and can be justified on economic grounds. But an investigation by GAO of the tooling modernization program has revealed cases where the contractors were not even asked by DOD to invest in modern tooling. In some cases DOD furnished Government-owned equipment to the contractor without even finding out whether the contractor was in a position to purchase it himself. Contractors have not generally been required to submit statements as to their ability or willingness to purchase equipment for use in performance of defense contracts.

In practice, therefore, there has been a failure of compliance with DOD's policy regarding the replacement of Government-owned equipment. Further, where costs of production have been reduced as a result of the modernization of equipment at Government expense, the savings have not been passed on to the Government in the form of contract adjustments.

RECOMMENDATIONS

9. The DOD must make a much greater effort to encourage contractors to replace Government-owned equipment when it becomes inefficient or outmoded, and to require economic justification from any contractor requesting replacement of equipment at Government expense.

10. Where costs of production have been reduced as a result of replacement or modernization of equipment at Government expense, appropriate contract adjustments and price reductions should be made.

11. Immediate steps should be taken to collect full payment for past, present, and future use of Government-owned property, and to establish an adequate system of use records.

INVENTORY OF GOVERNMENT-OWNED PROPERTY

DOD has failed to establish adequate controls over the inventory of its approximately \$15 billion of property furnished to contractors. Adequate property accounting records are not available in all of the plants. DOD has made an inadequate number of internal audits regarding the effectiveness of property administration at contractor plants.

Although Assistant Secretary Morris testified that the Defense Supply Agency has central knowledge of an inventory of some 400,000 tools valued at \$4.3 billion, more than half of this equipment is in the hands of contractors who maintain the only use records. In other words, the Government knows where this equipment is located, but only the contractors know how it is being utilized.

GAO, in the investigation requested by this subcommittee, found weaknesses in the control of special tooling due to deficient inventory practices, the absence of financial controls, and the absence of a requirement for surveillance by Government property administrators. In some instances, equipment was not even identified as Government property or in the property records. Contractors' accounting systems were found not providing for financial control. In most instances acceptable physical inventories of Government-owned material were not being taken properly.

Obviously, there have been serious departures from good property management practices.

RECOMMENDATION

12. The inventorying of all Government-owned property on loan to contractors should be expedited by all defense agencies. Proper controls should be established for each class of property.

USE OF GOVERNMENT-OWNED PROPERTY

There has often been a failure on the part of contractors to obtain proper authority for the use of Government-owned equipment on private, commercial work. Since 1957, contractors have been required to request prior approval from the Office of Emergency Planning for more than 25 percent non-Government use of Government-owned equipment. This requirement is not being complied with, nor are DOD contracting officers requiring compliance. A spot check has revealed instances in which contractors have used Government equipment for as much as 97 percent of actual production. In one case, an ammunition facility was used during the 9-year period ending September 1966, 80 percent of the time for commercial work.

These practices not only violate Government regulations, they constitute unwarranted subsidies to defense contractors who are thereby enabled to unfairly compete with others who have to purchase their own equipment, and to make excessive profits.

In addition, there is significant lack of uniformity in rental rates actually charged, inequities between contractors, and in some cases, reduced rent payments to the Government. In many instances, the Government is not receiving equitable compensation for the use of its property, especially where it is used without proper authorization.

RECOMMENDATIONS

13. A system of uniform rental rates should be established for the use by all contractors, on an equitable basis, who have been furnished Government-owned property.

14. A thorough review should be made of any misuse or unauthorized use of Government property in the possession of contractors. Penalties should be assessed for unauthorized or improper use of such property.

15. GAO is requested to advise the subcommittee as to collection action taken or planned by DOD resulting from GAO Report B-140389. Action taken regarding these contractors should be extended equally to all similar contractors holding a Government property.

16. GAO is requested to continue to investigate the adequacy of controls over Government property furnished to contractors, including property held under contracts with agencies other than DOD, such as NASA and AEC.

Appendix

LARGEST HOLDERS OF GOVERNMENT-OWNED INDUSTRIAL PRODUCTION EQUIPMENT (IPE)

As of November 30, 1967, it was estimated by the DOD that some 1,900 companies held 209,598 pieces of IPE which cost \$2.6 billion. The following table shows the holdings of the 15 largest holders as of that time:

15 LARGEST COMPANY HOLDINGS OF GOVERNMENT-OWNED IPE AS OF NOV. 30, 1967

Ranking	Name	Number of pieces	Percent of total	Cost	Percent of total
1	General Electric	9,011		\$114,752,148	
2	North American Aviation	8,924	8	105,636,333	9
	Subtotal	17,935		220,388,481	
3	AVCO	6,395		89,633,519	
4	General Motors Corporation	6,014		83,979,781	
5	General Dynamics	7,298	18	79,174,713	18
	Subtotal	37,642		473,176,494	
6	Lockheed	8,359		77,068,029	
7	TRW	3,495		64,706,654	
8	Douglas Air	4,777		57,837,398	
9	ALCOA	457		47,505,011	
10	Aerojet	3,666		46,119,900	
	Subtotal	58,386	28	766,413,486	30
11	LTV	2,964		42,047,137	
12	United Air	2,141		37,115,005	
13	Boeing Co	3,286		36,915,820	
14	Curtis-Wright	2,173		36,661,534	
15	Raytheon	4,329		32,896,692	
	Sub	73,289	35	953,049,674	27
	Total 1,900 (estimated) companies	209,598		2,578,627,370	

Notes

The extent of the contractor holdings of Government-owned IPE costing in excess of \$1,000 per piece is indicated in the above table. The 15 largest holders by "cost" held 37 percent of the total value of \$2.6 billion. This included 73,289 of the total of 209,598 pieces or 35 percent.

It is noted that the GAO investigation revealed that 17 companies held \$195,733,000 in IPE mostly metalworking tools and \$108,251,000 in heavy presses for a total of \$303,984,400 or about 12 percent of the total. Only two of the 17 studied by GAO rank in the first 10 [TRW, Aerojet].

Of interest also is the fact that two companies—General Electric and North American Aviation—hold 17,935 pieces of equipment at \$220,388,481. This is about 8 percent of the equipment and 9 percent of the total value.

While the average cost of the 209,598 pieces of equipment was more than \$12,000, the 457 pieces held by ALCOA averaged more than \$100,000 each. And ARMCO, not listed above, holds two pieces of equipment which cost \$2,120,179.

On the other end of the spectrum, it is estimated that of the 1,900 companies holding IPE in 2,256 plants, about 50 percent hold less than 20 items each.

Such giants of American industry as A.T. & T. and United States Steel have holdings of millions each but were not studied by the GAO nor are they in the "Top 15" in their holdings.

The above refers only to the IPE valued at \$2.6 billion. It does not refer to facilities, materials, tooling and test equipment held by contractors with an estimated value of more than \$12 billion.