

# RESTRICTED

991

PROCUREMENT SERVICE CONCEPTS

12 December 1952

## CONTENTS

	<u>Page</u>
INTRODUCTION--Rear Admiral W. McL. Hague, USN, Commandant, ICAF.....	1
SPEAKER--Mr. R. M. Brophy, Deputy Minister, Canadian Department of Defence Production.....	2
GENERAL DISCUSSION.....	19

Publication No. L53-71

INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

# RESTRICTED

# RESTRICTED

992

Mr. Reginald M. Brophy, Deputy Minister, Department of Defence Production, Dominion of Canada, was born in Montreal, Quebec, Canada, on 6 June 1902. He began his career with the Canadian Marconi Company, Montreal in 1919 and was assistant general sales manager 1924-1926, general sales manager 1926-1934; director station relations, NBC, New York City, 1934-1937; general manager, Canadian Marconi, 1936-1945; president, Canadian Radio Manufacturing Corporation, Limited, Toronto, Ontario, Canada, since 1945; president and chairman of the Board, Rogers Majestic Electronics, Limited, Toronto since 1945; vice-president and director, B.N.A. Holdings, Limited since 1945; director Canadian Overseas Telecommunications Corporation; vice-president and director, Canadian Radio Patents, Limited, Sealair Patents, Limited, Member, Radio Manufacturers Association of Canada (director and past president), Institute Radio Engineers.

RESTRICTED

# RESTRICTED

PROCUREMENT SERVICE CONCEPTS

993

12 December 1952

ADMIRAL HAGUE: Distinguished guests, gentlemen: During my years as a shipbuilder, I had the very good fortune of being associated with one or two very fine, able, shipbuilding organizations. Individuals of those organizations were sparked by a determination to turn out good ships as expeditiously as possible and at a reasonable cost, and they had the knowledge and the art to make good on that determination.

Now, much as I from time to time was inclined to succumb to sinful pride, I always realized that we did not have a corner on brains nor on good ideas. That realization made me avid when I went to other shipyards to inquire into their methods and their means of solving problems that were common to both of us. When you stop to think of it, the more important our undertaking, the more important it is that we examine closely into what the other fellow is doing in the field so that we may improve our own methods.

Now certainly there is no one in this auditorium this morning, having delved into the impact of military expenditures on the national economy and having examined the many complexities of military procurement, who will be inclined to depreciate the importance of military procurement. It happens that our Canadian friends go about this business in quite a different manner from what we do. I am sure also that we, having lived cheek by jowl all these years with our Canadian friends, will not be inclined to depreciate the degree of their intelligence nor to ascribe to them any lack of bright ideas. It is appropriate then for us to examine into the Canadian methods of military procurement.

We are very fortunate in having with us, to give us an insight into this question, Mr. Reginald W. Brophy, Deputy Minister, Canadian Department of Defence Production. You will have noted from the brief biography which you have of Mr. Brophy that he was drafted for public service in Canada after a very long and successful career in the Canadian electronics industry, an industry, I might add, that has demonstrated it can compete in the United States market with our own home-grown industry.

I would like to invite particular attention to Mr. Brophy's service on the NATO Task Force which studied the productive capacity of western Europe. Mr. Brophy brings to us, therefore, not only the authority of his present position, but a long background of intimate knowledge of industry and the productive process.

RESTRICTED

**RESTRICTED**

Mr. Brophy, your presence honors us. It is a great pleasure to me to welcome you to the Industrial College of the Armed Forces.

Gentlemen, Mr. Brophy.

MR. BROPHY: Thank you, Admiral Hague.

Gentlemen: Not so very many years ago, a group of civilian and military officials who met to deal with a common problem would have needed a referee rather than a guest speaker. At one time there was a wide breach between civilians and soldiers. The professional soldier lived and fought in a world apart, where the emphasis was on gallantry and devotion to duty in war and on horses and women in peace. In those days, wars involved a relatively small number of men fighting in out-of-the-way places like the Crimean Peninsula, the Nile Valley, or the veldts of South Africa. In general, military expenditures were small and the budgetary problems now associated with defense preparedness simply did not exist. Soldiers were not accustomed to dealing with politicians, who were regarded as rather devious fellows whose motives were certainly suspect.

This can perhaps be illustrated by the unhappy experience of Earl Kitchener as a British Cabinet Minister. In the midst of the patriotic fervor of 1914, Kitchener was appointed Secretary of State for War and head of the War Office. Kitchener's idea of the way the war should be run was to tell his Cabinet colleagues as little as he possibly could. He disliked the politicians' continual inquiries about military matters and he is supposed to have told someone that it was "repugnant to him to have to reveal military secrets to 23 gentlemen with whom he was barely acquainted."

It may have been episodes such as this which fostered the notion of the "military mind," and which implied that professional soldiers were characterized by lack of political awareness. I should perhaps emphasize, when I am talking about the lack of political astuteness among soldiers, that I am referring to the pre-1914 period. Certainly modern professional soldiers are doing considerably better. One in particular has recently demonstrated his ability in the political field.

I recall a story about Abraham Lincoln on this subject. One of Lincoln's generals wrote him a long and detailed letter in which he explored the political situation at length and offered the President the benefit of his advice. Lincoln was asked what he was going to do about this letter. He mused a moment and then said that it reminded him of a man who undertook to ride a very unruly horse. He saddled it and mounted but the horse began to kick and buck and sashay in a very dangerous way. Finally the horse caught his hind foot in the stirrup and the man said, "Well, if you're going to get on, I'm going to get off."

**RESTRICTED**

# RESTRICTED

995

In the past, professional military people and civilians in government tended to operate in watertight compartments. The nature of modern war has changed all this. In the first place, technological developments have been so rapid and so far-reaching that professional military men today must concentrate a great deal of their attention on scientific and engineering problems. In the second place, the impact of military production on our present-day economies is so heavy that our military departments must necessarily contend with difficult problems of raw material supplies, priorities, allocations, and prices. As a result, the military is necessarily involved in the financial and budgetary problems of the Government. Today, the claims of a modern defense program on manpower, resources, and finances are so large that continuous negotiation with the other claimants is essential if over-all government policy is to be carried out. The interrelationship of military and civilian aspects of defense has led to many difficult problems and this is particularly true in the field of military procurement. These problems can be dealt with effectively only if the professional military men, and the civilian specialists in mobilization planning, work sympathetically together.

When Admiral Hague asked me to come to speak to you, he suggested that I explain the methods of military procurement in Canada and discuss the United States-Canadian relationships in this field. Because military procurement is in the hands of a civilian agency in Canada, it has been necessary to develop a complex system of interdepartmental cooperation between the armed forces and the civilian procurement department. Since our methods are different from yours, I would like to tell you how our system developed and how it works.

The military procurement function was first assigned to a separate civilian agency just before the outbreak of war in 1939, so that it is by no means a traditional policy in Canada. A number of considerations led to the centralization of military procurement in civilian hands.

First of all, it was recognized that some aspects of military purchasing had been unsatisfactory in the First World War. The main problem was lack of coordination in dealing with purchases made on behalf of the Allies. In addition to our own domestic procurement agency, the Belgians, French, and British all had purchasing missions in Canada. These missions acted independently and in a number of cases there was a scramble for scarce supplies. This led to erratic price increases and to a general disorganization of the market. It was obvious that, in any future war, Canada would again be called on to export large quantities of food, raw materials, and munitions. To avoid a repetition of this experience, it seemed that a centralized procurement agency was needed to deal with both our military requirements and anticipated export demands.

RESTRICTED

# RESTRICTED

996

There was a fairly concerted effort in the mid-thirties to centralize all government purchasing, both civilian and military, in one place. It was felt that such unification would lead to economies and increased administrative efficiency. For example, there were probably half a dozen departments buying uniforms of one kind or another and this involved considerable duplication of personnel. On many other items, decentralized purchasing meant that it was not practical to buy in carload lots, with resultant savings in production and transportation costs. When the services were buying separately, there were often significant variations in the prices paid by each of the armed services for what were supposed to be identical items.

By far the most important object of the decision to establish a centralized purchasing agency was to mobilize and allocate the productive capacity of the country in such a way as to meet military requirements in order of their urgency. It was felt that a centralized civilian agency could direct the procurement of military supplies so as to make the maximum use of the productive facilities of the country and at the same time insure that deliveries were made in the proper order of priority. In short, it was visualized that production scheduling on a national scale could be undertaken if necessary.

As you may know, after the First World War there was a widespread revulsion against the idea of profiteering in munitions. This resulted in a good deal of investigation into the problem in a number of countries, which continued into the thirties. In Canada, just before the Second World War, there was considerable criticism of a Canadian contract for the manufacture of Bren guns. As a result, the Government appointed a Royal Commission to investigate the alleged irregularities. While there was no evidence of corruption in any sense, it was found that the contract involved the construction of new facilities which might have been found elsewhere. One of the recommendations of the Royal Commission was that a single civilian agency be created to purchase military requirements. Perhaps it was felt that civilians, with long purchasing experience in industry, would drive harder bargains than the military.

Accordingly, the Defence Purchases, Profits Control and Financing Act was passed in 1939 authorizing the appointment of the Defence Purchasing Board which began operations in July 1939.

By the spring of 1940, it was decided to establish a separate civilian department to handle military procurement. Accordingly, the Department of Munitions and Supply was set up and assigned far-reaching control functions, in addition to the responsibility for all military procurement. The Department operated under special emergency legislation and was given the power to buy, sell, ration, allocate, or fix

# RESTRICTED

# RESTRICTED

997

the prices of essential supplies and to establish priorities if necessary. In brief, this Department was empowered to direct and control war production in any way necessary for the furtherance of the war effort.

The Department of Munitions and Supply handled the procurement, not only for the Canadian Forces, but also for the United Kingdom, the United States, and for other allies to the extent that these countries purchased in Canada. In the early stages, the requirements of other countries in Canada were essentially warlike stores, and were of substantially the same type as the goods being purchased for the Canadian services. However, as the years passed, procurement in Canada by other countries included more and more goods of a civilian type. It was therefore decided that it was not appropriate to apply the special purchasing procedures that had been developed for the procurement of munitions and general service supplies to transactions which normally would have been handled through commercial channels, with prices and contractual conditions determined by commercial considerations.

To meet this situation, a new agency known as the Canadian Export Board was set up in 1944 to handle procurement of civilian type supplies for other governments. Because of the relation of this trade to the ordinary export trade of the country, this agency was established as a part of the Department of Trade and Commerce. In carrying out the operations of the Canadian Export Board, it became apparent that the contractual relations with the purchasers and the suppliers would be materially simplified if the contracting agency were a Crown corporation, capable of contracting in its own name rather than having all transactions direct with the Crown. Accordingly, in May 1946, by an Act of Parliament, the Canadian Commercial Corporation was brought into being and took over the operations of the Canadian Export Board.

While this agency for foreign procurement of civilian type goods was being built up, the direct procurement activities of the Department of Munitions and Supply were decreasing. The war was over, and it was no longer felt appropriate that purchasing should be carried on under the special emergency powers that had been found necessary during the war. By this time the volume of purchasing through Canadian Commercial Corporation for the account of foreign governments had risen to an aggregate greater than the amount of purchasing being done on behalf of the Department of National Defence. A good many of the staff who had been in the Department of Munitions and Supply had by then been transferred to the Canadian Commercial Corporation, and it was apparent that there was no useful purpose to be served by maintaining two procurement agencies.

In February 1947, under appropriate authority, the procurement for the Department of National Defence was taken over by the Minister of

# RESTRICTED

# RESTRICTED

998

Trade and Commerce and arrangements were made for the Minister to utilize the Canadian Commercial Corporation as his agent in purchasing the requirements of the services. It should be noted that, while the Canadian Commercial Corporation acted as a principal in dealings with foreign governments, it acted only as an agent of the Minister in procurement of the requirements of the Canadian services. It performed as the Minister's agent the same general functions for the services as had been performed by the Department of Munitions and Supply: namely, the receipt from the services of details of their requirements, the canvassing of the market to determine the best source of supply, the awarding of the contracts, and the follow-up on deliveries. It did not assume any responsibility for inspection nor did it pay the suppliers, these two functions being the responsibility of the Department of National Defence.

To meet the needs of an expanded defense program after the outbreak of Korea, a separate Department of Defence Production (DDP) was established on 1 April 1951 and the essentials of military procurement developed during the Second World War were carried over into the new department.

Before going into the operations of our civilian procurement system, I would like to touch briefly on our system of government and how government expenditures are handled. Years ago there was some concern that we might be tempted to adopt the form of government of the United States. In fact, when our first grammar schools were established in Ontario in the late eighteenth century their avowed aim was to protect Canadian children from the baneful influence of republican ideas in the United States. In the case of our governmental system, we adapted the English constitutional system to our particular circumstances.

One essential feature of this system is the concentration of legislative and executive power in the Cabinet. In the United States, Cabinet members are appointed by and are responsible to the President. In Canada, on the other hand, members of the Cabinet can only be appointed from among the elected members of Parliament and are responsible to Parliament. A Cabinet Minister, as the head of the operating department, explains and defends the operations of his department in the House of Commons. At certain specified times, any member of the House has the right to direct questions to any Cabinet Minister concerning the work of his Department. In Canada, where the executive is in the legislature and responsible to it, a vote of censure of administrative performance could cause the downfall of the government. I realize that Secretaries of the United States Departments appear before congressional committees to answer questions. Our Ministers also appear before similar parliamentary committees. However, I think a basic difference lies in the fact that United States Secretaries are not directly responsible

RESTRICTED

# RESTRICTED

999

to Congress. Much of our government's routine business is carried out by Orders in Council which correspond to the Executive orders of the President. Orders in Council must, of course, be based on enabling legislation in the same way as Executive orders.

One must appreciate the role of the Cabinet to see how public expenditures are controlled. Initially, of course, Parliament provides certain funds to be spent on public business, including military procurement. This is a jealously guarded right and is one of the basic elements of British constitutional practice. However, the objects of expenditure are approved by Parliament in rather broad categories. The approval of individual commitments is a Cabinet responsibility. This means that there is control over the details of expenditure at a very high level. At the present time, any proposed expenditure on military procurement involving an expenditure of 50,000 dollars or more must be approved by Treasury Board, which is made up of Cabinet Ministers. There is some delegation of authority to commit smaller amounts, but it is quite limited except for competitive contracts under 10,000 dollars.

Let us turn now to the operations of the Department of Defence Production, which is the civilian agency responsible for military procurement. Once a requirement has received internal approval within the Department of National Defence, purchasing action is initiated by raising a requisition or contract demand. Contract demands describe the equipment to be purchased and must bear a certification that a sufficient sum of money has been set aside or encumbered to pay for the purchase. This means that preliminary discussions between the Department of National Defence and the Department of Defence Production are often necessary in order to determine how large the financial encumbrance should be. Once the contract demand has been submitted to the DDP, purchase negotiations can be started with prospective suppliers.

In general, there are six types of contract normally entered into by the Department. The first and most frequently used is the fixed-price contract, awarded on the basis of competitive tenders. Approximately three-quarters of all contracts are awarded on this basis. Unless other considerations prevent it, the lowest tenderer is awarded the contract. Factors which are considered and which may justify departure from this basic principle are delivery dates, satisfaction on previous contracts, the stability of the contractor's financial position, and capacity of the contractor to produce the goods in question. In some cases the lowest tenderer is awarded only a part of the contract, in which case negotiations are then undertaken with the next lowest tenderer with a view of obtaining the balance of the requirement.

RESTRICTED

The second type, the negotiated fixed-price contract, provides for those cases where an item can be obtained from only one source of supply. This situation would occur where spare parts for items already in use are required, where tests on certain types of specialized equipment are to be conducted, where previous experience might have proved one type of patented or technical equipment to be the best, or where only one firm in Canada has facilities for producing the required product. This type of contract is also employed where it is desired to give experience in manufacturing a certain class of military equipment to firms capable of such production, or where tooling up for military production is to be accomplished. There are a good many cases where this procedure has to be followed, but careful scrutiny insures that tenders are called wherever possible.

In both of the foregoing types of contract the price can be fixed in advance. For those contracts where the price cannot be fixed, four other procedures are provided. All four involve determination of the contractor's costs and are subject to audit by the Cost Inspection and Audit Division of the Department of Finance. They are also subject to renegotiation under the Defence Production Act.

The first of these is the ceiling-price contract subject to reduction to cost-plus-a-fixed-percentage, which is employed where benefits of volume production occasioned by military requirements cannot be determined accurately in advance; where, for example, the contract price can be calculated only on the basis of commercial experience and the economies of large-scale production are not known.

The second of this type is the target-price-plus-incentive contract. A target price is set on the basis of such criteria as are available. A valid criterion for an item being produced in Canada for the first time might, for example, be the current laid-down import price. On completion, the contractor is paid his actual costs, and a fee which is calculated as an agreed percentage of the target price plus a bonus if the contractor reduces costs below the target price. This type of contract can only be employed where a target price can be estimated with some accuracy.

A third variation where costs cannot be known in advance is the contract based on costs plus a fixed fee to the contractor. In this case increased costs do not result in increased profits or fees to the contractor.

Finally, there is the contract where costs plus a fixed percentage of costs are awarded to the contractor. This type of contract is avoided wherever possible, but it is inevitable in those cases where a lack of previous experience makes even reasonable approximations of cost impossible.

# RESTRICTED

1001

These are the principal types of contract used, although sometimes two or more types may be combined--for example, a target-price contract may also have a ceiling price.

The Department has developed a series of General Conditions, which are published and which, by reference, are incorporated into all contracts. The main set of conditions, which is applicable to all contracts irrespective of their nature, is known as Form DDP-26 and covers such matters as arrangements for subletting any part of the contract, inspection, acceptance and delivery, warranty, scrap, insurance, security, patent claims and royalties, termination, and other similar matters. In addition to this form, there are special conditions relating to aircraft overhaul, shipbuilding, ship repairs, capital expenditures, firm-price contracts, cost-plus contracts, construction contracts, and various others.

One of these sets of General Conditions which is of particular interest is the one known as Costing Memorandum DDP-31. This memorandum sets out the classifications of expense that will be recognized by the Department as properly constituting an element of cost. It has, of course, particular reference to any contract based on cost plus some fixed or percentage profit. It could also relate to a negotiated-price contract in which the Department might have agreed to a fixed price, on the understanding that it was based on costs computed on the basis of Costing Memorandum DDP-31 plus a given rate of profit. The memorandum specifies a number of expenditures which may not be included as costs. The two exclusions which are perhaps most noteworthy are interest on borrowed money and selling expenses. The reason for excluding these two items is so that the Department will not be placed in the position of expressing an opinion as to the proper or reasonable amount of such expenses. Interest on borrowed money is clearly an expense of doing business, but the Department could not get comparability in its treatment of various contractors if, in the case of a company largely financed by borrowings, its costs were increased by interest, while the competitor, who might be financed entirely from its own capital, would have no such element of cost. What the Department is really saying is that the profit, to which it agrees, is the reward that it is prepared to pay for the provision of all the capital facilities, including working capital, necessary to carry out the contract.

In the case of advertising, the Department seeks to avoid the very difficult and contentious questions regarding the proper amount of advertising and selling expenses to be incurred by business concerns. It does not deny nor confirm the need for such expenses as part of a company's general overhead, but simply says that it will establish a rate of profit out of which the contractor, in his wisdom, may expend such amounts as he sees fit on advertising and selling expenses.

RESTRICTED

# RESTRICTED

1002

Where the Department is successful in obtaining tenders from a number of suppliers, it is generally assumed that the margin of profit of the successful contractor need not be a matter of special investigation, since competitive factors should insure that the best value is being obtained from the taxpayer's dollar. In all cases where it is necessary for the Department to examine costs and profit margins, the general yardstick which is followed is a profit rate of between 5 and 10 percent of cost. The actual rate varies, depending upon the nature of the industry, the size of the contract, and the type of the contract. These rates, as I have pointed out, are not net profit to the contractor, because of disallowed expenses, but even without regard to disallowed expenses they are lower than the rates of profit being earned by manufacturing concerns on general commercial work, as evidenced by statistics published by the Taxation Division of our Department of National Revenue.

There is one type of procurement activity which deserves special mention. The Defence Production Act set up a revolving fund to finance the purchase of materials and components needed in defense production; the stockpiling of strategic materials and the provision of working capital advances in certain special circumstances. While the fund has been used to buy such strategic materials as tin and quartz for indefinite retention, its most important use has been in the purchase of components for resale to prime defense contractors. This has been done in the case of fabrics for uniforms, where the cloth has been supplied to the garment manufacturer. The revolving fund has also been used in our naval program where yards located across Canada are building the same type of vessel, and such items as propulsion machinery for escort vessels are bought in one lot and sold to the different yards as required. By eliminating duplication of orders on similar items of this kind, it is possible to obtain improvements in price, deliveries, and specifications.

As an offshoot of its procurement function, the Department of Defence Production is responsible for the provision of capital assistance to defense contractors. The Department, wherever possible, urges the manufacturer to provide, out of his own funds, equipment that is necessary for the defense production program. Nevertheless, it has been found necessary, in certain instances, to provide capital assistance in order to establish facilities which, though essential to the defense program, have little or no civilian application. Assets acquired through capital assistance are placed at the disposal of applicants by formal contract, but title vests in the Crown.

The major portion of the current capital assistance program is devoted to the acquisition of machine tools. Capital assistance is not granted to purchase cutting tools, hand tools, jigs, fixtures, dies,

RESTRICTED

# RESTRICTED

1003

patterns, molds, or gages. The machine tools, which are the property of the government, can be allocated and reallocated to industry in order to meet the varying requirements of the defense program. With the termination of the current defense program, these tools will be maintained as an important element of our industrial preparedness.

Even if a contractor were financially capable of buying specialized equipment necessary for defense contracts, he might well be unwilling to do so unless assured of a requirement for the machinery for a period sufficient to allow him to recover his initial cash outlay in full through normal depreciation. Since the cost of necessary machine tools required for defense production must eventually be paid for by the Crown, it is considered preferable under these circumstances to pay for the equipment under capital assistance rather than through production contracts, as the Crown thus retains title to and control over the assets.

A rental agreement is negotiated with prime and/or subcontractors who install Crown-owned facilities as an integral part of general plant layout, and who use such facilities for commercial as well as defense work. Rental for nondefense work is 1 percent per month on the total value of capital assistance granted, or such percentage thereof as may be appropriate.

There is one type of contract that I might mention and that is one for the development of equipment for the armed services. In Canada I understand we handle these development contracts on a basis different from yours. When a firm receives such a contract, it is paid for the development and the government gets the know-how, which is made available to any firm in Canada when we go out to tender on the item in question. To compensate the company for the know-how, we usually allow a 10 percent profit on these contracts. We find that this system works out reasonably well as the companies which take these development contracts find that, as a result of working on the development, they are in a somewhat better position to bid on future orders.

Another point that may be of interest to you is the fact that within the Department of Defence Production we have a group which carries out what amounts to an internal audit of all contracts awarded by the Department. This group, known as the Contracts Authorization Division, operates independently on our purchasing and negotiating officers. They review contracts to satisfy themselves that the established procedures of the Department have been complied with and that the terms of the contracts are in line with departmental policy. We consider this a most important function both in the coordination of our purchasing and procurement on an over-all basis and in providing an internal check on individual transactions.

# RESTRICTED

**RESTRICTED**

This might be an appropriate time to tell you a little about the organization of the Department. On the chart which you have you will see that the Department has three main branches: the Production Branch--responsible for the major program that require specialized production; the General Purchasing Branch--concerned mainly with those things that can be purchased off the shelf; and a Materials Branch--concerned with critical materials needed to carry out the defense program. The latter, whose activities are mainly of a regulatory nature, is much smaller than it was a few months ago. We had set up a pulp and paper division within the Materials Branch, not because newsprint and wood pulp were in short supply in Canada, but to carry out the recommendations of the International Materials Conference. When I.M.C. disbanded its pulp and paper committee as a result of improved supplies, we discontinued our division. As the supply situation improved generally and in line with the government's policy of keeping controls to a minimum, we have been able to do away with our Chemicals and Explosives Division and reduce our staff in other divisions of the Materials Branch.

The other branches shown on the chart are of an administrative or service nature. The Administration Branch, under the Secretary of the Department carries out the usual administrative functions and also issues invitations to tender and receives bids for all contracts handled on a tender basis. The Financial Adviser's Branch, in addition to developing financial policy within the Department, includes the Contracts Authorization Division which I mentioned earlier.

I would also like to draw attention to one of the divisions under the Production Branch. This is Defence Construction Limited, a Crown company which handles defense construction projects such as barracks, radar stations, and the repair and maintenance of military buildings. The handling of construction for the Department of National Defence through one agency has helped to coordinate this program and fit it into the civilian program, which has been particularly heavy over the past few years due to Canada's record level of investment. Among other Crown companies associated with the Department are the Canadian Commercial Corporation, which as you know handles U. S. Government contracts placed in Canada as well as those of other governments, and Canadian Arsenals Limited which plays an important role as one of our major prime contractors in the gun and ammunition programs.

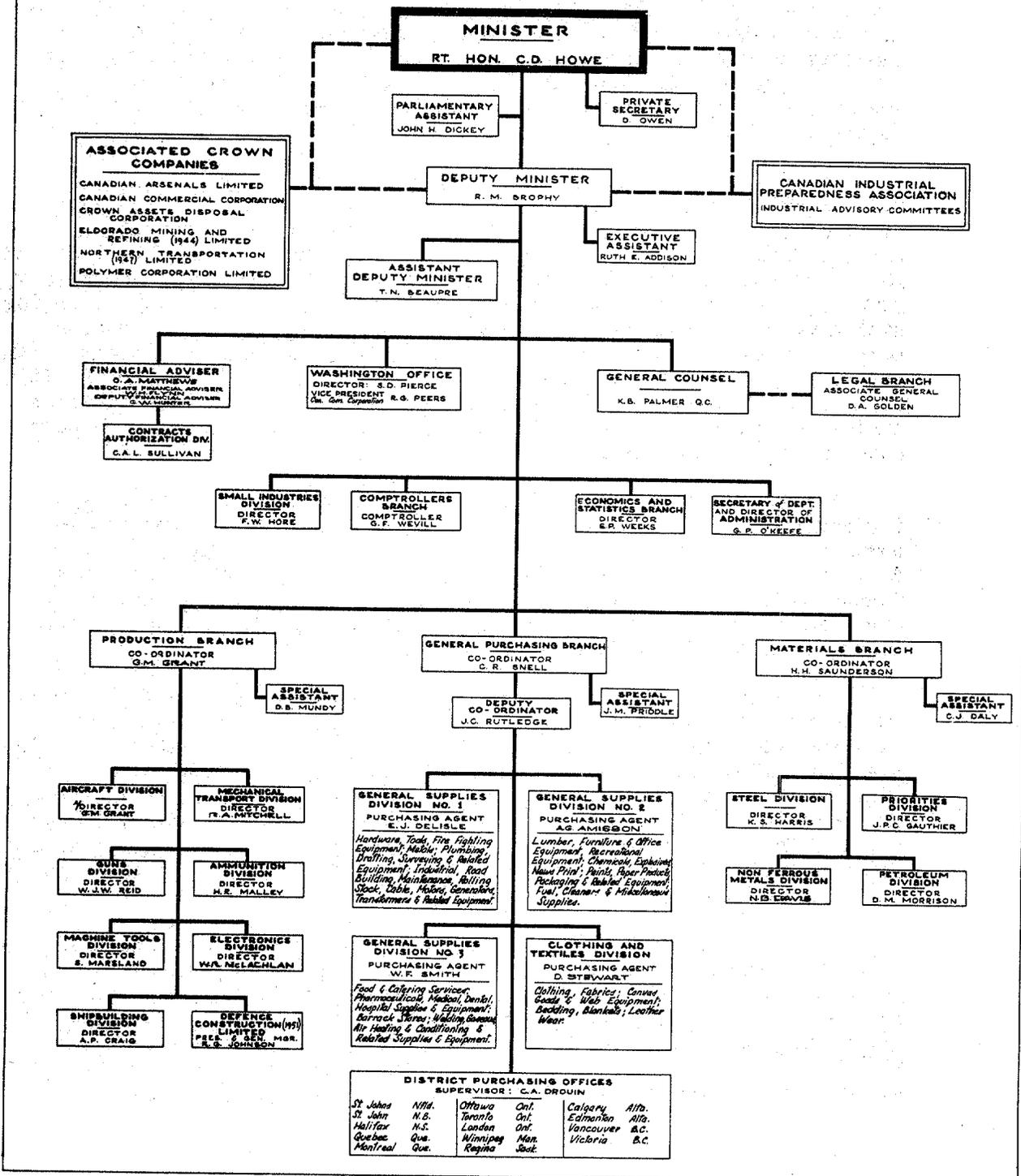
This, briefly, is the organization of the Department.

When the procurement function was first turned over to a civilian agency, I need hardly tell you that the armed services were afraid that something very bad had happened to them. They were fearful that the new agency might undertake to police or screen their requirements and to tell them what they could and could not have. They were reassured on this point and it was agreed that the purchasing agency would not

**RESTRICTED**

# DEPARTMENT OF DEFENCE PRODUCTION 1005

ORGANIZATION AS AT OCTOBER 1, 1952



# RESTRICTED

1006

exercise any review function. I can perhaps best illustrate this by telling you of an incident in the House of Commons last year. At question time, Mr. Howe, the Minister of Defence Production, was asked if his department screened DND requirements and he replied that, if the services asked for a gold-plated piano, his department would buy it for them, but if they asked for a nickel-plated one, the department would question the request, as nickel was in short supply and under control.

At first, the civilians were handicapped by their unfamiliarity with military requirements and its attendant jargon, which is pretty formidable to an outsider. Unless he happened to be an expert, it was difficult for a civilian purchasing agent who got a contract demand for a "ferro-resonant flip flop" to know what he should go out and buy. However, we have got around this problem to a large extent by seconding military personnel from the three services to assist our purchasing people in dealing with highly technical and complicated equipment. (In case some of you are wondering what a ferro-resonant flip flop is, it is a small can one inch by one inch by a quarter inch, which contains miniature condensers and coils and which permits the making of binary counter in an electronic circuit.)

A related problem continues to arise in connection with orders for equipment which is subject to modification before a contract is completed. In a technical field, the manufacturer often prefers to deal with the user in resolving problems of specifications and performance. In many cases, this is essential but it is important that any direct dealings between the manufacturers and the armed services do not lead to contractual difficulties.

Problems are encountered also in long-range procurement planning. It is often difficult to obtain good forecasts of future military requirements. This means that it is hard to assess the extent to which new facilities are needed for particular items. One might claim that this problem would be aggravated by the existence of a separate agency responsible for military procurement and production. I am not at all sure of this. I am satisfied that the difficulties of forward planning cannot be alleviated simply by uniting the two functions in one department of government.

I think one of the big advantages of the system is the centralization of procurement activity that is possible. It also eliminates a good deal of the conflict that arises when separate services are competing with each other for production facilities to carry on their individual contracts. Under our system, DDP decides where contracts will be placed and can insure that the best possible use is being made of defense production facilities on an over-all basis.

RESTRICTED

# RESTRICTED

1007

It will be obvious to you that our procurement methods place a high premium on the cooperation of military and civilian personnel. Such cooperation is clearly fostered by mutual understanding and trust. When everyone does his job efficiently, the basic reasons for friction disappear.

The same general considerations apply to international as well as to interdepartmental relationships. The relations of the United States and Canada in the field of war production and military procurement since the early days of the Second World War are an outstanding example of international cooperation. I would like to outline briefly the historical background and then go on to some of the current problems of reciprocal procurement.

On 5 July 1940 two long cables were sent by the British Government: one to New York and the other to Ottawa, asking for a list of army ground equipment to replace the disastrous losses at Dunkirk. A few days later there were meetings in Ottawa and New York in which the two cables were combined and studies were started to see which country could fill the British needs in the shortest time. This was really the beginning of the cooperative ventures of the United States, the United Kingdom, and Canada in the field of military production.

The Fall of France was also the signal for a greatly intensified production effort in Canada. There were large and urgent needs from the United States for machine tools, trainer planes, components of all sorts, as well as guns, rifles, and ammunition. By the winter of 1940-1941, financial trouble developed. Our United States dollar balances had dwindled to a dangerously low level and you will remember that in this period any belligerent country had to pay cash for the purchase of munitions or related goods in the United States.

The reason for our shortage of United States dollars was quite simple. Normally, we could exchange sterling arising out of our trade with the United Kingdom and Europe for United States dollars, but the British suspended the convertibility of sterling early in the war with the result that we were accumulating sterling balances in London and depleting our scarce supplies of United States dollars by large capital purchases. Since there was some risk that the whole Canadian production program would be impaired, it was essential to find some way of alleviating our exchange problem.

The question was discussed by President Roosevelt and Prime Minister King in a meeting at Hyde Park in April 1941. They issued a statement of policy known as the Hyde Park Declaration which said, among other things, and I quote, "in mobilizing the resources of this continent each

# RESTRICTED

# RESTRICTED

1008

country should provide the other with the defence articles which it is best able to produce, and, above all, produce quickly, and that production programmes should be co-ordinated to this end."

As a result a Crown company, War Supplies Limited, was set up under the Minister of Munitions and Supply about the middle of May 1941 to handle orders for munitions to be manufactured in Canada for the United States.

Problems were encountered initially as a result of the Buy American Act but, late in 1941, the provisions of this act were suspended for all purchases made through War Supplies Limited. Moreover, all purchases made through this company entered the United States free of duty.

The procedures which developed out of the Hyde Park Declaration contributed in a very important way to the solution of the Canadian-United States dollar problem. However, other problems had arisen in the coordination of production programs and it was agreed to appoint what came to be known as the Joint War Production Committee, to explore methods of increasing the joint war output of the two countries. President Franklin Roosevelt wrote to Mr. Milo Perkins, then head of the Board of Economic Warfare, asking him to be the chairman of the United States section, and commented: "I see no reason why each country should produce all of the articles necessary for its defence if certain articles can be secured more efficiently and expeditiously from the other country."

I cannot at this time recount the detailed arrangements which were made to implement the general policy of cooperation. However, I would like to quote some remarks made in 1945 by Mr. Sydney Pierce, who is present today as Canadian Minister to the United States and who knows a good deal about this subject. He said, "The official pronouncements, the committees, and the practical achievements do not adequately represent the degree of cooperation achieved. The intangibles have been equally important but more difficult to set out. There has been the open exchange of confidences between the Americans and the Canadians, the warm welcome, the freedom from formality, the plain speaking, and the all-prevailing friendship."

With the increase in international tensions following World War II, which came to head with the outbreak in Korea, we faced again the need for using our joint resources and facilities in a way that would make the best contribution to our common objectives. We established a counterpart of the committee we had used so effectively in World War II and called it the Joint Industrial Mobilization Planning Committee. One of its most important achievements was the sponsoring of a statement of principles for economic cooperation which the two governments accepted

RESTRICTED

# RESTRICTED

1009

by an exchange of notes on 26 October 1950. This document became the expression of policy for cooperation between our two countries. It continued and brought up to date the principles and practices which had been established during World War II. But there were some highly important differences between the conditions under which our two countries now operated and the conditions under which we had previously worked so closely.

In the first place, we were not in all-out war; we were dealing with the preparations for war, with the cold war, and with limited hostilities. The requirements of the military were not so great as during the last war. This time, a smaller portion of the economy was given over to war production. Everything was done, not only to insure the immediate output of arms but to build up an industrial potential on which we could draw if it became necessary to mobilize fully. Another important difference was the result of a major change in Canadian policy, which was to change over to United States-type equipment so that our armed forces and yours might fight together using the same equipment and the same supply lines. Large requirements against United States production developed rapidly and Canadian production facilities were required to manufacture to United States designs and specifications.

It was now possible for the principles of cooperation to be translated into practical application to a far greater degree than before. The results, even in a relatively short period of time, have been important and indicate a healthy trend. Canadian aircraft facilities are manufacturing F-86 fighter aircraft for the Canadian Air Force, for the USAF for use in Korea, and for NATO countries. The manufacture of F-86 aircraft in Canada has an added flavor of cooperation between our two countries, as Canadian materials and Canadian-built equipment are being used together with GFAE equipment produced in United States plants. Another example of joint cooperation is the project known as "Operation Pinetree" which is utilizing both United States and Canadian facilities to construct an early warning radar system across the northern part of the continent.

The objectives of a directive of the United States Department of Defense, dated 27 November 1951, entitled "Joint Industrial Military Cooperation with Canada" are being realized. Canadian and United States military production is working toward common objectives, obstacles are being removed to the implementation of the principles under which we operate, channels for the exchange of information are being developed and used, secondary sources of supply in both countries are being established. The whole coordination effort is contributing to dispersal on a continent-wide basis. The problems are certainly not all solved but the action which has been taken indicates that we are on the right track.

RESTRICTED

# RESTRICTED

1010

It might be useful to mention one of the important arrangements in the field of procurement between our two countries. Following discussions, the United States Secretary of Defense on 5 May 1950 directed the three military departments and the Munitions Board to develop a program for the purchase of military equipment in Canada within the range of 15 million to 25 million dollars for fiscal year 1951. Later, on 29 June 1951, the target for United States procurement in Canada was raised to 100 million dollars for fiscal year 1951 and on 28 December 1951 the objective went to 300 million dollars for fiscal year 1952. These targets have been effectively met and the resultant contracts and orders have provided a major stimulus to Canadian production in military hard goods.

It is significant that the most recent directive of 11 September 1952, on the reciprocal procurement program does not set a specific dollar target for fiscal year 1953 but states "in view of the present rate of procurement for the fiscal year 1953 it has been agreed between the staffs of the Department of Defense and the Canadian Department of Defence Production that no directive need be issued establishing a specific target for fiscal year 1953." Thus, we are implementing the accepted policy that military procurement should be undertaken where it makes the most sense.

Concurrent with the development of the reciprocal procurement program, efforts were made on your part to lessen the restrictive effects of the Buy American Act. Here again, the evidence of wise policy is clear. The situation as it now stands is that, to all intents and purposes, the Buy American Act has been waived insofar as Canada is concerned by both the USAF and the Army.

In view of the numerous historical precedents for close cooperation between Canada and the United States in the field of war and defense production, there is really no serious concern over policy. There are still a number of procedural and administrative issues in this field to be resolved. Most of these arise from the necessity of conforming to the Armed Services Procurement Regulations which are primarily designed to deal with domestic procurement and are therefore not entirely suitable for transactions with another government.

A number of problems relating to contracts with the United States Armed Services were resolved in a letter agreement reached in February 1952. This agreement provides for profit limitations; free inspection and audit services; the refund of Canadian customs duties, sales and excise taxes; and prescribes methods of dealing with exchange fluctuations, administrative costs, government-owned facilities, and similar matters.

# RESTRICTED

RESTRICTED

1011

One outstanding problem is the variation in provisions of the contracts with the different services. A good deal of work has been done to arrive at a common form of contract. The matter is still under consideration.

When I started out, I said that not so many years ago there was little in common between soldiers and civilians. They lived and worked apart in a spirit of mutual distrust. With the growth of understanding of common problems, there has developed a spirit of tolerance and cooperation. This has also occurred in the relations between our two countries and I would like to pay special tribute to the excellent cooperation we have received from everyone on this side of the border in working out satisfactory procedures and in clearing up any difficulties we have encountered. I hope that you feel the same way about us and I can assure you that we, in the Canadian Department of Defence Production, will do everything we can to insure that this cooperative spirit continues in all our working relations. Thank you.

Gentlemen, I have had a chance to talk to you for an hour and I suppose it is now your turn to have a go at us.

I am fortunate in having with me here today some of the men from our Washington office: Mr. Sidney Pierce who is Canadian Minister to the United States and director of our Washington office; Mr. Roy Peers, Vice-president of Canadian Commercial Corporation; Mr. John Douglas and Mr. Norman Chappell. Aside from the fact that misery likes company when you have to do a job like this, they will be able to answer the questions better than I, so as you see, I have brought them here in self-protection.

QUESTION: Does the General Purchasing Branch of the Department of Defence Production buy off-the-shelf items for other departments of the Canadian Government, for the civilian activities of the Canadian Government? If not, are there cogent reasons why the purchasing for civilian agencies should not be so linked with the purchases for military agencies?

MR. BROPHY: The answer to that is that the General Purchasing Branch purchases off-the-shelf items for the armed services and, if requested, for the Civil Defence group of the Department of National Health and Welfare. The terms of reference of the Department cover only defense supplies and projects.

QUESTION: Sir, I understand from this chart on your Industrial Defence Board that the same activities were carried on under the Department of Commerce--is that what you call it? Has the Department of Defense Production taken over those activities?

RESTRICTED

# RESTRICTED

1012

MR. BROPHY: Mr. Pierce, can you take that?

MR. PIERCE: I am ready to pass this back to Mr. Chappell. A board was created with a civilian and departmental membership. It was created as an advisory panel to the Minister of Trade and Commerce, and I think that as the international tensions increased and we got closer to mobilization, the functions of the Board were taken over by the Department of Defence Production. Is that right?

MR. CHAPPELL: That's right.

QUESTION: At what point do the three armed services present their individual requirements to Defence Production? In other words, if the Army has some particular interest in a tank of a certain type, is that automatically referred to Defence Production or must it defend its particular activity against, maybe, some other activity which has an overriding consideration?

MR. BROPHY: Are you ready to deal with that, Norman?

MR. CHAPPELL: I think Mr. Brophy partially touched on this in his speech when he referred to the statement by Defence Production Minister Howe regarding a gold-plated or nickel-plated piano. The function of DDP is to procure for the services and not to be critical of the armed services. Those problems must be rationalized within the services themselves. Remember that the financial encumbrance in the requisitions to purchase is a financial encumbrance against the budget of the Department of National Defence. They pay for the procurement. Therefore, the services have to rationalize their individual requirements within the Department of National Defence. Is that the answer you want?

MR. BROPHY: As the three services are within the Department of National Defence, it is from that Department and not from the individual service that the request to procure a particular piece of equipment is passed on to our Department.

QUESTION: I see, that is different from a regular board.

QUESTION: With respect to research and development, is my understanding correct that the duties of your Department here are purely for the purchase activities, the purely contractual activities and that the research and development people as such are part of the Department of Defence and you people are merely their purchasing agent?

MR. BROPHY: Yes. The position, I think, is about this way. There is a Defence Research Board and there also is some development work

# RESTRICTED

# RESTRICTED

1013

carried on by the services, but any request for development or a development contract to be placed with a contractor flows through the Department of Defence Production. In other words, the DDP does all the contractual work with the contractor. The development and research liaison flows between the services and the Defence Research Board.

QUESTION: Do you know whether research and development as such, then, that is to say up to the point of actually doing some of it, is still in the Department of Defence purely a military responsibility?

MR. BROPHY: Just say that again, will you please?

QUESTION: Well, research and development is bought with two kinds of people, the technical people and the contracting people. I understand you furnish the contracting people?

MR. BROPHY: That's right.

QUESTION: To what department do the technical people belong? Do they belong to the Department of Defence or do they belong to a civilian department also?

MR. PIERCE: Perhaps the questioner has in mind something like our Defence Research Board which is an agency headed by a civilian, Dr. Solandt.

MR. BROPHY: Yes, Dr. Solandt heads the Defence Research Board.

MR. PIERCE: Dr. Solandt, head of the Defence Research Board, has equal status with the military chiefs on the Joint Chiefs of Staff committee.

QUESTION: He belongs to the Department of Defence, I take it?

MR. BROPHY: Yes, he is part of the Department of National Defence.

MR. PIERCE: And has equal status.

QUESTION: Undoubtedly by this time the Board and yourself must have made some studies of our system compared to yours. Will you please make some comments as to the advantages and disadvantages of your system of procurement as compared to ours?

MR. BROPHY: I think probably the only answer I could give to that would be to leave copies of the speech I just made. I think that does draw comparisons. Frankly, I don't think either one of them is perfect. I think that is what we are all striving for, but I think I would like to leave that question just about in that position.

# RESTRICTED

# RESTRICTED

1014

QUESTION: Mr. Brophy, how would you coordinate requirements for civilian production with military production, assuming the military asked for more than the country can produce at the present time?

MR. BROPHY: That would be coordinated in DDP, in Defence Production, in consultation with other Departments, particularly Trade and Commerce. It could mean a reduction in civilian production.

QUESTION: Who would claim for civilians. Who would, say, compute civilian requirements?

MR. BROPHY: I think probably we would compute the military requirements and what was left over would be for civilians.

MR. PIERCE: I think that is the answer these boys would like to get, but I think clearly it is, as you say, your responsibility to decide issues of that kind. Maybe this is part of the answer: A good deal of it can be done through the direction of raw materials which is in the hands of the DDP. That is particularly significant, I think, because you not only place contracts for the services but this is the Department, and Mr. Brophy is the man under the Minister who decides what amount of nickel shall flow and the plants it shall flow to. So you have control at the source which often obviates the necessity for decision within an individual plant.

CAPTAIN HAYES: As you noticed from Mr. Brophy's biography, he knows considerable about the electronics field and also international procurement. So, if you have any questions on that, he will have the answers.

QUESTION: Mr. Brophy, I can see how this system would work very well on a nice clean-cut procurement or development item, but how does it work with an item just being invented, through the phase where invention and design have to be negotiated back and forth between the inventors and the production people? Don't you run into quite a few stalls on that?

MR. BROPHY: Yes, we do.

QUESTION: Don't you think the additional link in the chain, the introduction of your people between the technical man and the producer, is a hindrance rather than a help?

MR. BROPHY: I think we have to remember there that the basic concept of DDP is that it handles purchasing and contractual relationships. It is not going to concern itself with whether or not the thing

# RESTRICTED

# RESTRICTED

1015

has three tubes or four tubes unless it gets to the point where you can't get production going. Then we will get in and do what we can to solve the problem.

QUESTION: Are you in a position to knock the heads of the design people together? Are you qualified to do that?

MR. BROPHY: The best head-knocking procedure, if it became a real bottleneck--which it could very readily--would be from our Minister to the Minister of National Defence. There are your two controls. In other words, the Defence Production Minister who has been asked to procure this item, says, "I want this produced and I want it produced fast." The Minister of National Defence, on the other hand, may want it to go on in development for a long time.

QUESTION: My question has to do with the procedure of purchasing. Suppose the United States Air Force or a United States commercial company wanted to buy an electronics gadget from a Canadian company and the facilities of this company were already overtaxed for defense production, would our Air Force or our industrial company have to go through your organization or could we go directly to the Canadian electronics manufacturer and leave a contract with him even at the expense of interfering with your defense production?

MR. BROPHY: That is a contract flowing from the United States to Canada for production. Mr. Pierce.

MR. PIERCE: There are two ways of handling that. Mr. Chappell will tell you about priorities and the means for obtaining them. Mr. Peers will mention the placing of contracts. Could I suggest that division?

MR. CHAPPELL: Perhaps Mr. Peers, Vice-president of Canadian Commercial Corporation, would answer that.

MR. PEERS: It is not mandatory that the services deal with our organization in Washington, the Canadian Commercial Corporation, but the advantages of dealing through this corporation are very obvious because, first of all, you don't have to go looking for a facility in Canada because our corporation is a branch of the Department of Defence Production. Under the agreement of 14 February to which Mr. Brophy referred, in dealing through our corporation, the Canadian Government assumes all responsibility, contractual--including financial and inspection. So in fact any contract to this manufacturer in Canada or all manufacturers, comes under the Canadian Industrial Mobilization scheme, and would fit in with our contracts on the same priority basis that Canadian contracts have.

RESTRICTED

**RESTRICTED**

QUESTION: Suppose Westinghouse of the United States has a contract from our Government and its representatives in turn want to sublet part of that contract to one of your Canadian companies, would they go directly or come to you?

MR. PEERS: They would go directly. They have the privilege of going directly.

MR. PIERCE: There is the system of priority and allocation.

MR. CHAPPELL: This is current and operating today and has for some time. Under the Priority and Allocation System, the military program of the United States receives preferential treatment by the use of the preferential A,B,C, and E symbols and allied ratings. By joint negotiation that same treatment is extended to the Canadian military production program. In other words, our impact against the United States for the Canadian military production program is protected prioritywise and materialwise on the same basis as the United States military production program. That is the quid. The pro of it is this: It goes back to a basic document between the two countries, which is an arrangement for the participation of Canada in the United States system. The document is the National Production Authority Regulation 3, as amended. The latest amendment was August 20. It is covered in about one sentence. If I may, I would like to read it--"Any person located in the United States who places an order with a Canadian supplier for Canadian materials and who requires assistance to obtain delivery of such materials may apply through the Canadian Division of the National Production Authority to the Canadian Defence Production Department, Ottawa, Canada, for the required assistance." Materials imply any raw materials, manufactured commodities, or components.

It is true we do not have in Canada the same type of formal system as you have in the United States, but I think it is fair to say that our guiding principle is that defense comes off the top as the cream and they will be looked after first, and United States defense orders would be accorded the same treatment as our own defense orders.

QUESTION: Can you tell me what degree of standardization you have achieved in the last 11 or 12 years since this office really began operation, in the cataloging or standardization of items as between the services?

MR. CHAPPELL: I don't think I am competent to answer it except in the most general way. There are two concepts of standardization. You have mentioned one in your speech, sir, the decision to standardize on United States type equipment as a general policy. This question refers to standardization within the services. That basically is a question for rationalization within the services themselves.

**RESTRICTED**

# RESTRICTED

1017

However, DDP has something to do with it. When a requirement requisition comes to DDP, and we are looking at it from the point of view of placing the order, we can, through interdepartmental arrangements, point out that the Air Force shows a requirement for, say, boots of a certain specification and the Army shows a requirement for boots of another specification, and that in the light of the position of facilities to make these boots, it may be desirable for them to reconsider the specification of their boot requirements.

MR. PIERCE: I think there has been a good deal done--to give a specific answer--in the case of uniforms. I think that led to the standard specification for cloth because our Department had to buy and stock it. I think there was a lot of interdepartmental discussion for six months that led to the standardization of cloth. A great deal has been done just through operations of that kind, in my opinion.

MR. BROPHY: Fundamentally, the standardization is between the services themselves. There is a committee from the three services which is studying that. Can you add anything on this question?

MR. PIERCE: No, I think not, except that over a period of years there has been a great deal accomplished in various fields with regard to items that might come under general purchasing.

MR. BROPHY: I don't think that is a very clear answer, but I think it is probably the best that is going at the moment.

CAPTAIN HAYES: Thank you very much, Mr. Brophy, for this one-hour, highly concentrated course in procurement. I can't speak for the Commandant, but for all the rest of us, thank you very much.

(6 Mar 1953--350)S/rrb.

# RESTRICTED

1018

*Shades*