



CURRENT ASPECTS OF PROCUREMENT
IN THE DEPARTMENT OF THE ARMY

Honorable Courtney Johnson

NOTICE

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Reviewed by: Colonel Thomas C. Keech, USAF

Date: 4 February 1960

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GENERAL MUNDY: Those of you who have had any experience with military procurement know that it is a complex subject and often a very frustrating one. In fact, I have heard it said that anyone who gets himself associated with military procurement can expect the assorted sensations and reactions of a man making love to an elephant.

This implies three things, of course. In the first place, it's no fun; in the second place, you are liable to get stomped on in the process; and lastly, you've got to wait nine years to get the results.

But, seriously, procurement is a complex and an involved subject. The College is greatly indebted to the Department of the Army, and particularly to the Office of the Assistant Secretary of the Army for Logistics, at least, for the three years that I have been here. The Honorable Frank Higgins and a panel of experts have come over each year and have put on a really fine program for us.

The new Assistant Secretary of the Army, the Honorable Courtney Johnson, is continuing this program much to our thanks.

Mr. Secretary, the class has already been given your biography. It is a real pleasure to welcome you here.

Gentlemen, it is a pleasure to present to you the Honorable Courtney Johnson, the Assistant Secretary of the Army for Logistics.

SECRETARY JOHNSON: Good morning, Gentlemen. General Mundy, General Houseman, Members of the Staff and Faculty, and the Students of this Class, and Guests: This is a great pleasure. What General Mundy didn't tell you is that I have appeared here before, but in an entirely different capacity, coming in from industry to lecture or to give an address, or whatever you might call it. I think the last time I did that, out of 2 or 3 times, was 10 years ago, so I now find I am on a regular schedule--I appear once every 10 years.

Since this is a part of our logistics assignment, I think I might say a word to start with about logistics. Last fall I was over in England, and a very good friend of mine, Leonard Short, and I were traveling together. He is an Englishman, a highly educated Englishman. In the course of our conversation, he said, "You know, I am very much puzzled about this word, "logistics," that you use. I would assume that it is connected with logic." I said, "Leonard, you don't have to assume that at all."

Actually, I define logistics as the assignment to arm, equip, and supply the Army, or the Navy or the Air Force, but I have a better definition than that. It came from Lt. General Sink, who is the Commanding General of the 18th Airborne Corps, the Strac. General Sink has a novel way of expressing himself. Many of you probably know him. He uses this way whenever he wants to emphasize something. Last spring I was in Chicago with him, and we were talking to a group of Ordnance officers, ^{from} all over the world, and General Sink was making the point that it was very important

that they carry out their duties because it was on them that the Airborne Corps depended for the arms and supplies that made them effective. And he said, "You know, a soldier that ain't got no gun ain't doin' so good." Gentlemen, that is the best definition of logistics that I know, and procurement is a part of logistics.

Our plan this morning will not include any type of a formal address from me. I would like to tell you what we propose to do. We have divided this subject of procurement into eight sections. To introduce each section we will ask a prepared question; we will ask it of ourselves. I want to assure you that on these prepared questions we have been coached in advance. That will serve in each case to introduce the subject. Then we would like to have questions from the audience on that subject.

I will try to keep to the time schedule. We have divided it and will try to make it hold so that we can get through when we are expected to.

At the start I would like to introduce each member of the panel, and, after I have introduced each member, I would like him to come up and take his place at the table.

We first have Brigadier General Stephen R. Hanmer. General Hanmer, after graduating from the Military Academy, took a Master of Science degree at Cornell University. He is a graduate of the Engineering School of the Armed Forces Staff College and of the Industrial College of the Armed Forces. He is one of the graduates of this organization. He has had many positions of great responsibility--District Engineer, Assistant to the Chief of Engineers

for war Planning, assignment to the Department of Army, General Staff, and to the Supreme Headquarters, Allied Powers in Europe; and at present he is Deputy Chief of Engineers for Military Operations. General Hanmer.

Next I would like to introduce Colonel William H. Gurnee, Jr. Colonel Gurnee is a graduate of the Military Academy. He has an M. A. from the Graduate School of Business Administration at Harvard University. He has attended the Industrial College of the Armed Forces and a number of other of the service schools which I won't detail. He has held various important positions in the Quartermaster Corps. He served on the staff of the Under Secretary of the Army as Chief of the Purchasing Section, several years ago, and subsequently became Chief of the Procurement Division of the Office of the Assistant Secretary of the Army for Logistics, my office, several years ago. At the present time he has returned to my office as Executive Officer for the office. Colonel Gurnee.

Next I'd like to introduce Mr. Albert C. Lazure. Mr. Lazure graduated from the University of New Hampshire and took a law degree from Georgetown. He served in the Armed Forces and rose to the rank of Lieutenant Colonel in the Ordnance Corps during World War II. He has had experience in the teaching profession, in legal and auditive activities in the General Accounting Office, and in a great deal of contracting claims work. At the present time Mr. Lazure holds the important position of General Counsel of the Ordnance Corps, and, of course, in this position is deeply involved in all procurement activities in that Corps. He subsequently has risen to the rank of Colonel

in the United States Army Reserve Corps. Mr. Lazure.

Finally, I'd like to introduce Lieutenant Colonel Jack C. Knox, who graduated from Texas A and M College in 1938. He has attended the Command and General Staff College and the Armed Forces Staff College. His duties have included field artillery assignments and various positions in the Transportation Corps. He was recently in the Office of the Deputy Chief of Staff for Logistics, Department of the Army, and since May he has served as my military assistant in the Office of the Assistant Secretary of the Army for Logistics. Colonel Knox will pose the questions for us.

I want to mention before proceeding further, gentlemen, that I am very glad that I find in the ~~audience~~ Lieutenant Colonel Clarence Davis, who, until quite recently, in fact until he came over here, was Director of the Requirements and Planning Division in my office. I am delighted, knowing him as well as I do, that he can be here in this class this morning.

I am going to ask Colonel Knox to pose the first question.

COLONEL KNOX: The first general subject is Methods of Army Procurement. The question under that is: For definition purposes, what do you mean by "advertised bidding" and "negotiated procurement," and under what conditions are each used?

SECRETARY JOHNSON: I think I'll start off on that myself. Advertised bidding is bidding on which you have all the specifications and can describe thoroughly all factors in regard to procurement so that they can be responded to in writing and in a sealed bid. In this case the determining factor, providing

the bid is responsive to the invitation, is the price. When the bids are opened, the bidder with the low price gets the bid, as I say, if it is responsive to all the factors in the invitation.

Negotiated procurement is procurement where an invitation for a proposal is received either from a sole source or from multiple sources, and, after the proposals have been made, there is further discussion in regard to those proposals between the contracting officer and the firms that are bidding. This is done in the cases where specifications cannot be complete and/or where the discussion as to facilities, capabilities, experience, personell that are offered for the particular function, and other factors that come up must be discussed, since they will be different for the different companies.

This is a very short definition. There is one thing about negotiated procurement that I want to mention, which is that there is a very material difference between sole-source negotiation and competitive negotiation. I hope that your questions will bring out that difference.

I would like to have chart one, please. (Chart I)

This is a very simple chart, simply to show you what the relationship is between negotiated procurement--the number of actions in dollar value-- and formal advertising. As you see, in negotiated, we have 2,100,000 actions and in formal advertising we have 100,000. In dollar value, negotiated procurement is \$4.1 billion, and formal advertising is \$1.3 billion.

With that very brief background, we will be glad to have your questions with regard to this part of the program, if someone would like to start it off.

QUESTION: Mr. Secretary, are there any ground rules? Will you always use negotiation in overseas contracts and in other instances where you have to use formal advertising here in the United States?

SECRETARY JOHNSON: No, sir, there are no such ground rules. I might say that we use negotiated bidding as little as we can, in spite of the fact that you see up here a tremendous predominance of negotiated bidding. One reason for the very large number of transactions of negotiated bidding is that bids for such items as subsistence, food, or clothing and textiles have to be negotiated. In other words, it is what you might call in the case of food spot buying. There is no way that you can send out a formal bid and get the answer in time to catch the market, you might say. So that there is an enormous number of those.

Another reason is that a tremendous number of the transactions are at posts, camps, and stations, and are small transactions--purchases from the hardware store, or from local business, and so forth. Those are to take care of the immediate needs of maintenance and otherwise, and those are negotiated bids. To go through the whole process of formal advertising for these procurements, which fall below \$2500, probably would cost more, to go through the process of formal action, than it does on the average to buy what you are trying to get. So you get this very large number of transactions.

There is no difference in that respect between Europe and the United States that I know of. Do you know of any difference, Bill?

COLONEL GURNEE: No, with the exception that we do a great deal of negotiation overseas because of the peculiar laws, that are peculiar to the country in which we are doing our negotiation. I don't believe that in any country overseas you find that you can enter into formal advertised contracts of a large nature, simply because you have to observe the laws of the land. In many cases you have peculiarities on patents, and all the rest of it. As a result you will find that other than commercial, off-the-shelf type items, overseas we are predominantly negotiating, for that reason.

I might add to what you said, Mr. Secretary. One of the large items of negotiation in this country is the small purchase. Last year small purchases accounted for 89 percent of all the actions, and yet they accounted for only 5 percent of the dollar value.

QUESTION: Sir, are any of your advertised bidding contracts subject to renegotiation laws?

SECRETARY JOHNSON: No, I think the answer to that is no. Try that, Al.

MR. LAZURE: I would say that they all are, because the renegotiation laws are not renegotiation by contract. A renegotiated contract was entire defense business. To that extent, defense business would be in the form of both advertised and negotiated contracts. Renegotiation, to make it short, it not contract. It is defense business.

SECRETARY JOHNSON: Al, would that be true on, for instance,

advertised contracts for a specific item, on which there is no bidder who has other types of business? Would they be renegotiated?

MR. LAZURE: If the contract fell over the statutory amount called for as renegotiation.

SECRETARY JOHNSON: I see. It's a question of size.

QUESTION: Sir, is your target for a high percent of procurement by formal advertising more because of requirements of law or because of good business practice?

SECRETARY JOHNSON: I'll answer the last phrase that you used, first. As far as I know, in a lifetime in business, I have never seen advertised procurements in the automotive industry. There isn't any such thing. There is a request for quotations, but they are always subject to negotiation after the price is sent in. The very formal method of the advertised procurement is a government device.

Now, it's desirable to Congress, and it's desirable to the Army and the Navy and the Air Force, also, where it is possible, to do it. ^{It's} /a much simpler process, as far as the contracting officer is concerned, than negotiated procurement. We like to do it wherever we possibly can.

GENERAL HAMNER: Could I volunteer something?

SECRETARY JOHNSON: Certainly.

GENERAL HAMNER: The Secretary held a little bait in his opening statement. No one has picked it up. Maybe I can get in a plug for one of his most sacred principles, here. There is a widespread and popular

minunderstanding in some parts of Congress and the public that a formal advertised bid gets competition and a negotiation doesn't get competition. There is nothing further from the truth. For example, in the hearings of a subcommittee of the Armed Services Committee last year in the appropriations hearings, this question was posed: Here are some statistics that are given, that about 85 percent of contracts are listed as negotiated with a sole source. What part of that 85 percent involved competition? Well, it took a hell of a lot of examining of statistics to come out with an answer. When they got to the bottom, they found that, out of a majority of negotiated actions of all three services, about 89 percent of these so-called negotiated-with-one-source Air Force contracts flowed from or followed directly on the heels of a competitive situation. In the Navy it was 70 percent and in the Army it was 93 percent.

So I stress, and I believe the Secretary will second this, as he always does when the occasion arises, that you don't be misled in thinking that advertised formal contracting is the only competitive situation. A great majority of negotiated contracts have good competition.

SECRETARY JOHNSON: I would go further than that and say that your competitive negotiation is a very much more severe form of competition than the competition under an advertised bid, because, in a competitive negotiation, each company had to come back and justify its price by an examination of its costs, and it has to justify its position as a company, the personnel who are going to work on the contract, its past experience,

its facilities, its equipment, and everything that has to do with the bid. It is most thoroughly examined. General speaking, the bidders on negotiated procurement change their bids during negotiation, downward, of course. Finally, the bidder who gets it generally gets it at a considerably lower price than he originally bid.

That is the type of purchasing that goes on in industry, and it is a very severe form of competition. I'd be glad to have any questions on this subject, because I think it is vital to our whole procurement position.

QUESTION: Sir, These negotiated proceedings that you are talking about seem to vary from service to service. You mean you take the low competitive proposal and negotiate with that man, and only that man? Or do you do what I think in the industry is called "shop," where you conduct simultaneous negotiations with 2 or 3 people?

SECRETARY JOHNSON: I am very glad you asked that question. I can't answer as to policies with respect to the other services, but I know what our policy is, and I feel very strongly about it. If you start on a negotiated procurement, you are under obligation to negotiate with everybody who makes a proposal. Even if your negotiation consists of asking them if they want to change their proposal, that's negotiation, if their proposal is very high. Nevertheless, they should have the opportunity to negotiate. This is announced as a negotiated procurement. If they put in a proposal and are simply passed by and no one negotiates with them, they have a very real cause for complaint. And I might say they generally make the complaint, too.

On the other hand, they may have no opportunity--they may be clear out of the ball park--but they must have the chance to enter into a negotiation.

GENERAL HOUSEMAN: I ordinarily don't ask questions, but I wondered if we get the distinction between the lowest bidder and the lowest responsible bidder. Does that word, "responsible," ever enter into it? Or, in fact, do you give every man who enters a bid the illusion that he is being considered, even though he is nothing but a man who has collected 2 or 3 people and is operating under a loss making hats, or something?

SECRETARY JOHNSON: General Houseman, I think you've got two terms here. You said: Is he responsible? There is also the question: Is he responsive? In other words, does he, in his proposal, to be responsive, answer all of the requirements of the invitation for a proposal? Responsibility is a different thing. Certainly he must be responsible. There is a very severe obligation on the contracting officer that he get a bidder who is responsible, financially, in experience, equipment, facilities, management, and every other way. That is certainly one of the most important factors in a negotiated procurement. It is a factor also in the advertised procurement. But in the negotiation you have a chance to investigate more thoroughly the responsibility of the company.

QUESTION: Sir, what are the present Department of the Army ground rules, or regulations, if you call them such, regarding the procurement of preferred makes--in other words, from a manufacturer, to continue fleet buying or something of this sort, in negotiations?

SECRETARY JOHNSON: Let me briefly try that, and then I am going to pass the buck. In my opinion, to use your terminology, we do not place business on the basis of preferred makes. We may place business because there is only one place that we can get the item that we want. That occasionally happens, and that's where we get a sole-source, negotiated procurement. We avoid that wherever we possibly can. We are devoted to the idea that we must have competition. For the contracting officer, for instance, to look over the field and say, "I prefer this company and this product; we will therefore place the business there," we do not do that. In fact, we guard against it most carefully.

Have you anything to add to that, Bill?

COLONEL GURNEE: In the commercial type of item we do have a program that will lead toward that. That is in the standardization program, where we will limit negotiation to 2 or 3 producers who are capable of making the item that we want. This has tended to eliminate a great number of various types of makes and models in the system while concentrating on 2 or 3. This is a very dynamic program.

Probably General Hamner will want to talk more about it, because the Corps of Engineers in the Army is the one that is predominant in this field.

GENERAL HAMNER: I'll be glad to pick up the ball right there, Colonel Gurnee. Since the question stems from an engineer, I can see his concern in this subject. Quickly and briefly, this ability is a tremendous tool to reduce the logistic complications, especially pertaining to engineer services,

where, perforce, having great dependence on commercial types of construction equipment, if we don't watch it, we can have such a great number, say, of tractors, graders, or generators, not only in this country but all over the world, that the spare parts and maintenance support become almost intolerable.

Therefore, this procurement standardization, which I believe pertains more to Engineers than to almost any other tech service, fundamentally enables us to settle on two or more makes or models of particular types of equipment, and then, for a reasonable period thereafter, to limit our procurement to those two types.

We are particularly indebted to the broad shoulders and courageous attitude of Mr. Johnson--and I say that right here before him--because that brings a great deal of pressure from those who are not so preferred at the time to get back in on the procurement. But it is successful. Industry is beginning to accept it. And it does have tremendous value to us in the Engineers to have 2 or 3 makes and models so that, specifically, for example, we can have in the Pacific Area one make of tractor and in the European Area another make of tractor, and then concentrate our spare parts and maintenance support on those.

SECRETARY JOHNSON: I might pick it up there. You would say, and perhaps some of you are saying: Well, if you want to standardize, why don't you standardize on one, and really standardize? We have the difficulty, gentlemen, that we must, in our opinion, preserve competition. So this very formalized procedure that we have is to do two things: One, to

standardize as far as possible, and the other is to preserve competition. As long as we have at least two possible sources, we have competition, and in most cases these sources are standardized as two. The rule is that a source must have at least 15 percent of their product in the inventory before we will standardize on it. We have had many cases in recent years where the same source keeps getting the business, and, as long as nobody else has at least 15 percent, it's an industrywide procurement. The minute one gets 15 percent, then we standardize on those two. In some cases the inventories are such that we have as many as three, and I think that in one case we had as many as four that we standardized.

As we have said, this is almost all engineer equipment, because it is commercial-type equipment. If you have a military design of equipment, then obviously you standardize, because you all buy it all of that design, no matter who makes it. But, when you are buying commercial-type equipment, then you have to use this other device to maintain both standardization, ~~and competition~~ to the greatest extent possible, and competition.

GENERAL HAMNER: Incidentally, Mr. Secretary, there is a paper on its way to your desk right now to standardize on 45 K. W., quarter-cycle, precise power generators which are very vital to modern missile systems. We are asking the Secretary to approve that so we can hold to two major firms, two sources of these generators, which are almost vital to the success of any missile system.

SECRETARY JOHNSON: I think you can see that, providing all conditions

are met, that naturally that will be approved. I think you can see, gentlemen, that we are going to get a reaction, because there are probably several other companies that think that they can make that type of product and they want to compete on it. We have to say no, and this goes into all the aspects that you can imagine. Generally these cases, if they are argued, go to the Congress and to GAO, the Defense Department, and everybody else. You have to stand like a rock or they will tear you down. Nobody has torn us down yet. I hope they are not successful.

COLONEL GURNEE: I might add one thing on the military item. We do have a policy that states that the developer, the R&D contractor, normally will get the first production run. This might be considered, in the context of the question, as preferred. It is not regarded as such, because, after that first production run, we assume that we will have drawings and specifications that will permit competition to a military spec.

MR. LAZURE: Could I add one allied aspect of this, Mr. Secretary? Also, often there is a requirement by contracting officers for a preferential light on their part. Usually that is where there is no design disclosure package in the form of plans, specifications, and all that. There may be procurement of that type under the ground rules which Army, Navy, and Air Force have, provided the request for proposals puts in our requirement with respect to that item so as to give other competitors an opportunity to provide the particular item. That, of course, leads to many problems, because the determination as to our requirement is an evaluation determination, and does not

necessarily mean a Chinese copy, but it must have performance and other characteristics required for the particular item.

So we have, in addition to the standardization problem, the problem of the requirement by a contracting officer where there is no good design disclosure package. GAO has recognized that by their requirement for ^{its} use in that type of procurement.

SECRETARY JOHNSON: I'd like to go back a moment to the point that Colonel Gurnee brought up. I'll use an illustration. We are buying from the Food Machinery and Chemical Corporation, M-113 personnel carriers. They developed this item and they are in the process of producing the first run of it. The second run is going out for competitive procurement and there are, I think, about 15 companies that have expressed an interest in it. They will be given the opportunity, on competitive negotiation, to make their proposals on this item. This is an illustration of giving the first run to the people who have developed it. It's a great time-saver and it produces the production package that you need in order to go out on competitive procurement. I might say that the developer doesn't like this process the second time around. He regrets that we have to go out on competitive procurement.

QUESTION: Has the Army adopted the so-called two-step procurement method?

SECRETARY JOHNSON: I don't believe that I am familiar with the term.

STUDENT: At least in the Air Force it is first, going out for performance

and specifications, getting proposals in, and negotiating with the various bidders to get them up to technical capacity; then, on the second round, going out on strictly an advertised bid.

MR. LAZURE: I might answer that, Mr. Secretary. As a result of the hearings of the Hebert Subcommittee of the Armed Services two years ago, the Air Force volunteered for the three services to utilize this so-called two-step approach. That is an approach, as you say, where the contractors first come in and, in response to request for proposals, they come in on the technical side and ask questions and negotiate technically. Then the second phase is the price phase, where they come in to get their price. That resulted, I might say, from cases which Army, Navy, and Air Force had where there seemed to be a reaction by contractors that one step, without explaining in detail with each contractor certain technical requirements, particularly where the design disclosure package was not 100 percent complete, was inadequate negotiation. As a result of the Air Force's volunteering it, they are doing most of the work in that regard. We do a little bit of it but not very much. The thing was to go on for roughly two years, at which time the Air Force was to report on their general reactions to it. We have not had that report as yet.

SECRETARY JOHNSON: It has merit. I think, in many competitive negotiations, you get practically the same result anyway. That is, everyone has had a chance to discuss the procurement, and then they can present new prices. They don't formally come in with a sealed bit. That's the only difference. They simply present a new price.

QUESTION: I'd like to know what process you went through to determine that the two generator manufacturing companies were the two fair-haired boys in that type of procurement. What had to be done, or what could be done by some other company in order to get into this closed corporation?

GENERAL HAMNER: I don't like the term "closed corporation" because it is by no means closed. It is closed for the period, to get the obvious advantage that I discussed earlier. The specific answer to your question is that in our system, or about to be in our system, concerning procurement, those two firms will constitute more than 15 percent of our assets each. Therefore, under the basic theory and the law that allows it, we are entitled so to do.

SECRETARY JOHNSON: The reason for the selection also--it is a competitive selection originally; the way they got into the position to do this was through competition, and their product has proved satisfactory in this case, a very specialized product--is there is only one other company, I remember, that claims it can do a similar job.

GENERAL HAMNER: Incidentally, many of the others that we have had on competitive formal bids are struggling and having a great deal of difficulty in producing an acceptable generator in this highly complicated field--precise power with close regulation.

STUDENT: Could I amplify my question a bit? Do you have some type of board or committee that has a subjective meeting to determine which of these contractors do build acceptable products and which ones should be

allowed to compete for this particular generator? Is that correct?

GENERAL HAMNER: Almost. As to the board, the board consists of the Chief of Engineers, me, as his Deputy, the Chief of Supply, and everybody interested. This is a vital decision, and it is not left to any specific small group. But, fundamentally, we have 4 or 5 contractors now delivering as a result of competitive bids, and these two particular ones happen to come out with more than 15 percent of our assets, and, fortunately, those are darn good generators.

SECRETARY JOHNSON: I might add something here. The final decision on this is in my office. It is presented by the Engineers for a decision as to whether or not we will standardize on these two, with a complete background.

QUESTION: When you bought these quarter-cycle generators, did you coordinate with the Navy? The Navy was buying those, too, several years ago.

SECRETARY Johnson: I doubt it very much. Possibly you can say.

GENERAL HAMNER: I can't answer that specifically. These are very heavy density items, specifically for the missile systems. I would say, without being able to verify it, I am sure our people are in contact with the Navy, because we do desire, among the three services, to have a maximum of standardization also.

COLONEL GURNEE: May I expand a little on that, General. Actually, when this leaves the Engineers, it goes before another board within the

Department of the Army, which includes CONARC, the users, and everybody else, and at that time we go to the Air Force and to the Navy and get their sign-off on the basis that their mobilization requirements can be met by the two we are standardizing on. We have complete coordination with the other two services before the Secretary is asked to limit the negotiations. Then that limited negotiation is good for only a period of two years. So it can be reviewed at any time for additional requirements from the Navy or the Air Force. But, specifically, yes, the board meets on it.

SECRETARY JOHNSON: We made one change in this quite recently, on the theory that, in this case, every dog is entitled to two bites. In other words, if you have two contractors and one has 15 percent and the other one has, we'll say for this example, 85 percent, and there is another procurement, and the 85-percenter gets that procurement, that may throw the first one down to 10 percent. Well, if you interpret this exactly, he would go out. We have decided that, where a man has qualified, he will have one more opportunity to bid, even though he falls below 15 percent. Then if he still goes down, he's out.

I have to cut this off, gentlemen, because our time on this subject is up. Our next subject is Types of Contracts.

Will you read the question, Colonel Knox?

COLONEL KNOX: The question is: What are the various types of contracts used by the Army, and to what extent is each used, and why?

SECRETARY JOHNSON: I'd like to start on this one. There are two

ways of answering that question. One is the types of contracts as to what they are supposed to accomplish, and the other is the technical contract itself. The first part concerns your supply contracts, your R&D contracts, your construction contracts, and your service contracts; and I think there are one or two others. That is a contract for a specific purpose. As to the contracts themselves, there is a variation of the kinds of contract forms that can be used, contracting principles that can be used.

I am going to ask Mr. Lazure to expound on that.

MR. LAZURE: First, starting out with the law, I might say that the law, that is 10 U. S. C. 2306, provides that any kind of contract may be used except the cost plus percentage of cost contract, where the interest of the Government requires forms and kind. So, starting with the law, we go into what you might call fixed price contracts. Fixed price contracts have their variations. There are fixed price contracts with escalation clauses, and there are fixed price contracts with price redetermination clauses. Then you go into the time and material forms of contracting, where you use engineering labor hours or some other factor. That is in essence a form of cost contract. Then you have cost contracts, and they break down into various types, too--cost plus a fixed fee, which is allowed under law; cost plus a percentage of cost, which is not allowed under law; a straight cost, where we use facility contracts and do not pay a fee, and then cost plus incentive fee costs. Then you have facility contracts, where you have in essence a form of cost contract, or a provision of a straight supply contract, where you reimburse the contractor for facilities. You have lay-away

contracts, for storage, maintenance, and service agreements. You have letter contracts, which are in essence a modified, simplified form of a contract to expedite work. You have indefinite-delivery contracts, which are broken down into so-called, call, and so-called, indefinite supply, contracts or open-end contracts. And they are in essence a form of fixed-price contract. You have personal service contracts, which are specially authorized by law for particular situations, where you need personal services in the form of consultants and experts. You have leases and license arrangements.

I think that in general covers it. As the Secretary said, you may use these forms for different purposes. For research and development you would use the cost form, generally. For construction contracts--a cost form, generally. For big facility contracts--a cost form, generally. For the IFB procurement--a fixed price form--invitation for bidding, or advertised form.

So that you have from the various forms different procedures under which you would use them. They are set forth generally in regulations.

SECRETARY JOHNSON: May we have chart No. 2? (Chart 2.) This is a very good picture of this. Here are your types of contracts that Mr. Lazure has just described. You can see there are quite a few procedures that can be followed.

Any questions on this subject?

QUESTION: Sir, I notice that you have the incentive fee contract. I

notice also that you have had very little experience with it. Is that because it is a new type? What experience have you had with it?

SECRETARY JOHNSON: We have used any incentive type of contract in a very limited way in the Army, much less than the Air Force has used it, and I think less than the Navy has used it. I don't know whether we are right or not. I think our procurements in many respects are somewhat different than those of either of the other services. Colonel Gurnee?

COLONEL GURNEE: We have attempted to get the same result through our price redetermination type contract. You notice that they were rather extensive in the Army. The incentive type contract requires that you are able to pretty well estimate what your cost is going to be. Your target cost has got to be pretty well fixed or you have opportunities for tremendous profits going one way or the other, or tremendous costs, because, if the contractor is able to cut away below the target price under the incentive formula, he accrues additional profits, because, of course, the cost is reduced. We feel that a price redetermination type contract, where you run through part of the contract and then take a look at what your costs actually are, and then figure the progressive cost from then on, is probably a more accurate way and also provides the same incentive to the contractor, because, after that point he can accrue savings to himself.

SECRETARY JOHNSON: I think the point that Colonel Gurnee has made is that the factor that alarms us in the incentive type contract is setting the target. Obviously, if you set your target and inadvertently set it high, the

contractor can beat the target. In other words, he can do it in a way that he should have done anyway, and you are simply paying him a bonus for doing what he ought to do. I had some experience with this in labor relations at one time with a company. We had an incentive type of labor relations. It was largely piecework or gang work. We set targets and then they got extra for doing more work than they had contracted for. Well, the upshot of it was, it wasn't long before the target was high enough so that they were sure to make the bonus; they didn't have to do anything extra. It was a very serious situation for that company, because they found themselves, over a period of years, paying the highest labor cost in the whole industry. It was due to this incentive plan which failed to work because they couldn't hold the target down to where it ought to be.

QUESTION: Sir, I noticed in your diagram that you had a cost-sharing type of contract. I know this type of contract is used in the procurement of items overseas under our Military Assistance Program. I wonder if you would comment on that, particularly with regard to the offshore procurement.

SECRETARY JOHNSON: I am going to ask Mr. Lazure to comment on that.

MR. LAZURE: Cost sharing is in essence a procedure which is much like an incentive. We don't use it very often in the Army. I was rather surprised to see it up there because it is not a common use form of contract procedure. Cost sharing is also utilized in areas where we want the contractor to put investment in at his own risk, in addition to our sharing part of the cost.

So it's used in those two ways. I might say there is very limited of both. First, it is awfully hard to work out. Sometimes you'll have contractors come in and say, "We will participate and incur part of the initial research and development costs on a particular item, provided you will bear the rest of the cost." They try to interest us in doing that. The way you get into difficulties is trying to insure what part of that cost sharing will resolve to the benefit of the Government in terms of proprietary rights and other things generated under it. Actually it is a form of cost contracting not very commonly used.

SECRETARY JOHNSON: I think of one specific instance where a company came in. It was on the development of a gas turbine engine. They said it would cost about \$5 million to develop this and they would charge us \$2.5 million if we accepted their proposal. They said they would stand the remainder, and if it went over \$5 million they would stand everything above that. Of course they had an interest in this, because the gas turbine would have commercial application also. So we were sharing to that extent. It would be called cost sharing.

Our time is up on this subject, gentlemen.

Colonel Knox, will you read the next question?

COLONEL KNOX: The next subject is Procurement Organization and Procedure. The first question is: What is the general Army organization for procurement?

SECRETARY JOHNSON: I think I'll start on this. In the first place, the

procurement authority stems from Congress. It comes from Congress to the Secretary of the Army—or the Secretary of the Navy or of the Air Force. Everything that is done is done through the Secretary of the service, as you all know, by delegation to the Secretary. The policy as it regards procurement is delegated by the Secretary of the Army, in our case, to the Assistant Secretary, Logistics, for policy. The operations are delegated to the Army staff, and in particular the Deputy Chief of Staff for Logistics, in our case. So that the Deputy Chief of Staff for Logistics looks to the Assistant Secretary of the Army for his policy guidance and control, and has command of and relays that policy to the technical services. Then the procurement is in the technical services in the Army, and, of course, is delegated to the Chief of the technical service, who in turn delegates it down, finally, to the contracting officers. The contracting officer is the responsible man with authority on procurement. I don't think that we should ever forget that it is the contracting officer who has, by delegation, the authority and the responsibility for procurement. He has it legally, and he has it by delegation.

Now, the operation of the contracting officer is something that I think you will be interested in. I am going to ask General Hamner to go into more detail on that.

GENERAL HAMNER: Of course I am sure that most of you are now familiar, or soon will be, with the general evaluation of a bid in the normal sense of unit price, the transportation costs, the discounts, the escalation, and all of those pertinent aspects. But the Secretary would like to have me

stress today that the most important aspect of a successful negotiation is the marshalling of a team of experts under the contracting officer, highly skilled advisers and technicians, who handle this with and for him. Your contractor, of course, will marshal in the field a very qualified team of his own experts who are completely in the know of all aspects of the company's side of the proposal. Depending on the complexity, scope, and number of dollars involved in any particular negotiation, the government team may vary from a minimum of negotiators, price analysts, a legal counsel, a commodity engineer, and, of course, the contracting officer, to more than 20 different principal areas of attention. This would be, for example, in a really complicated procurement for an entire production plant or for a weapon system.

I want to reel these off so that they will impinge on your consciousness of how many different areas are really involved. As needed, they call upon labor advisers, wage and salary boards, small business advisers, production experts, traffic engineers, safety engineers, security engineers, security experts, patent and insurance advisers, tax experts, auditors, accountants. They make use of the Army Audit Agency to the maximum extent necessary, seek the advice of inspectors and investigators and property disposal experts. They use public information officers to see that you have smooth, prompt, and adequate coverage of public relations. And then you come to the preaward survey and award boards, climaxing your negotiations.

The negotiator must be the quarterback and the coordinator of this team of experts. He must funnel information to them. He must evaluate the problems they run onto. And he must avail himself of all their skills with a great deal of imagination and emission.

This type of technical assistance may not be required in all the fields that I have enumerated, but in all negotiations some of this talent is utilized to reach our ultimate objective of obtaining the best possible price for the Government, yet equitable to the contractor.

SECRETARY JOHNSON: Thank you, General Hamner. There is a third part to this question as we have set it up, and that is: What control is exercised within the Army over contract awards?

I would like to show Chart 3. (Chart 3.)

I think I can say, gentlemen, to begin with, that in fact the control of awards lies in the Office of the Assistant Secretary. In other words, the Assistant Secretary could say, "Every contract has to come to my office for approval before it is awarded." Obviously, he does not do that. The level at which the award is approved--the award that has been worked out with the contractor--is illustrated on this chart. As you can see here, I'll just go through Ordnance. The head of the procurement agency is delegated by the chief of the technical services up to \$1 million; the office of the chief of the technical services up to \$4 million; the Office of the Deputy Chief of Staff for Logistics over \$4 million and up to \$7 million. Anything over \$7 million is in the Office of the Assistant Secretary of the Army.

Approval has to be made in my office in those cases. You will notice it is different for the different technical services. The reason for that is that we want to get a sampling. Ordnance is by far the largest in dollar volume of business. If we made the same scale for the other technical services, when we got over to the Chemical Corps we would never see a Chemical Corps contract in my office or in the Deputy Chief of Staff for Logistics office. We want to see a sampling of them to be sure the whole procurement policy and the procurement methods are being followed. We want to watch that as closely as possible.

Let's have Chart 4. (Chart 4)

In addition to that there are exceptions. That is what we indicate on this chart. On guided missiles and rocket spare parts, everything comes to my office; aircraft maintenance service in excess of \$1 million; medical care contracts in excess of \$10 million; and Military Interdepartment Procurement Requests to other services in excess of \$2 million; and, finally, and this is a very important one, gentlemen, procurements which may be controversial or sensitive, or which involve a major policy decision. There are procurements of very limited size, sometimes, that are extremely controversial, perhaps Congressionally, or perhaps in an industry, and we bring those up to my office before they are approved.

Any questions on this subject? This subject is Procurement Organization and Procedure.

QUESTION: Sir, could you please comment on the responsibility of an

overseas commander in the procurement organization for procurement overseas?

SECRETARY JOHNSON: I think I will ask Colonel Gurnee to answer that.

COLONEL GURNEE: I'll try. It is my belief that the overseas commander has the same responsibility for procurement as the head of any other major procuring activity. Most of the major commands overseas are designated as major procuring activities. As such the commander is in the same position as the chief of a technical service, commander of a continental U. S. Army, and so forth. As such, as the chief of a major procurement activity, he has full responsibility for procurement within that command. Have you a more specific point that you want to raise?

STUDENT: No.

SECRETARY JOHNSON: I am going to see whether I am right on this. I'll try it out, anyway. I think by Army regulation, the procurement that can be undertaken by an overseas commander is limited. Is that right, Al?

MR. LAZURE: Yes.

SECRETARY JOHNSON: That's what I thought. They can't just buy everything. There are only certain things that they can buy overseas. Otherwise they retain the procurement responsibility in the CONUS.

QUESTION: Sir, does either the OSD or the Bureau of the Budget get into the act as far as review authority on any individual contract goes?

SECRETARY JOHNSON: Yes, occasionally. For instance, there may

be a Congressional inquiry as to procurement, which may come to us through the Office of the Secretary of Defense. There may be a policy involved. We had a very serious case recently on a proposed procurement, where the Office of the Secretary of Defense said that we hadn't figured our requirements correctly, that we were planning on a procurement larger than we needed. In that respect they get into it quite frequently, in other words, as to whether or not our requirements are what they ought to be. The requirements guidance, which comes from the Joint Chiefs of Staff, and from the Secretary of Defense, is not always absolutely clear. Sometimes it is very difficult to tell just what they mean. So, unless we can get it clarified, we make our own interpretation, and then we have an argument as to whether our interpretation is correct or whether somebody else's is. I see Colonel Davis smiling back there. He was mixed up in this for several years on this very subject.

Does that come close to answering your question?

STUDENT: Yes, sir.

SECRETARY JOHNSON: They do not in any way control the procurement itself. The responsibility is the contracting officer's responsibility.

MR. LAZURE: A good illustration, Mr. Secretary, would be our Nike Zeus, where Congress itself has appropriated sufficient money for the research and development phase, and they have appropriated \$360 million for the production phase.

SECRETARY JOHNSON: A hundred thirty-seven million.

MR. LAZURE: They have appropriated \$137 million for the production phase for the current year. In that case Congress itself has seen fit to control the production, so that you can buy only so much production with your money. In that kind of case the Bureau of the Budget and the Department of Defense would get into the procurement to analyze it. I noticed with some interest that General Cutler has said that he feels we should go further in the production phase in this regard for the air defense command.

This is the type of case where you have implications going from the Hill to the White House to the Department of Defense to the Army.

SECRETARY JOHNSON. That \$137 million, after being appropriated, has to be apportioned by the Bureau of the Budget, and the apportionment request has to be approved by the Defense Department--in fact the Secretary of Defense. So they have a control over procurement in that respect. Once the project is approved and the money is apportioned to the service, then nobody can control that procurement. They may criticize it, but they don't control it.

QUESTION: In some of our high priority projects we have found it necessary, or at least desirable, to make some amendments in these levels and in the procedures. Has any consideration been given to further streamlining of the procedures, generally, for possibly greater use of post audit?

SECRETARY JOHNSON: I might be able to answer that, but I don't quite understand the question. What part of the procedure are you referring to?

STUDENT: Specifically, the Army Ordnance Missile Command. There was the Jupiter and the Redstone, and it was desired to give more authority to the operator in the field, and possibly amend some of the procedures.

SECRETARY JOHNSON: It went far beyond an amendment of the procedures. This was an entirely new procedure. In this particular instance General Medaris was given a very exceptional and unusual authority in regard to the Jupiter, the Redstone, and the Zeus, and the Pershing missiles, in which he did not follow the usual chain of command. Authority was passed on to him in advance and he exercised it subject to only monthly review of what he had done.

Would you like to have any further comment on that?

STUDENT: Have we learned anything from that experience that might be expanded, at least in part, to our other procurement?

SECRETARY JOHNSON: In my opinion we have learned one thing; that, when you depart from the channels of command and authority that are usually set up, you lose something. We have set up in all the services the channel of command and the channel of authority, and each step in that channel of command and authority has a function to perform. The men in that particular step are trained men who have great experience, and who perform that function well. Now, if you bypass those various steps, you definitely lose something, in my opinion. You may gain speed, and, under an emergency, that may be a very desirable thing, but you do lose a great deal of the application of the

knowledge that comes from each phase of the channel of command and the channel of authority dealing with this question.

I have worked for the Government quite a little bit, and your first reaction when you work for government is that there are too many decisions that have to be made. Always remember, gentlemen, we are dealing with public money and the national interest, and we can't afford to make mistakes. We do make them, sometimes, but we make a great many less mistakes if we follow the channel of authority and the channel of command that are set up, because each has a function to perform and each performs it.

Does this come anywhere near to answering your question?

STUDENT: Yes, sir. Thank you.

SECRETARY JOHNSON: Of course you can expedite it. A dictator can expedite operations very rapidly. All he says is: "Do it." Then everybody gets busy doing it. The trouble is that the dictator starts making mistakes eventually, sometimes rather rapidly. Finally, he makes so many mistakes that it is goodbye, dictator. That's the inevitable result of too much authority placed in the hands of one person, I think. I am giving you just a philosophical opinion.

QUESTION: I believe when you started out you said that the Congress prescribes to some extent the organization of procurement by statute.

SECRETARY JOHNSON: No, excuse me. I said that the authority for procurement is by an act of Congress. That's what I should have said.

STUDENT: Maybe my question isn't appropriate, then. I was going to

ask why they feel they must do this? And, second: Does this cause you any problem? Do you feel it is appropriate?

SECRETARY JOHNSON: I don't see how they could do it any other way. The Congress has to appropriate the money, and Congress then specifies as to how and by whom this money shall be spent. They can't just appropriate the money and toss it up for grabs. They appropriate the money and say to the Secretary of the Army, "You have been given this much money to spend. The final authority for spending this money is in your hands." Then the Secretary of the Army delegates, as I described before. The contracting officer is set up as the final authority on making the contract.

STUDENT: You don't think they would do it any differently if it weren't prescribed that way by Congress?

SECRETARY JOHNSON: Without formalizing it, I think it is the normal procedure in industry. The Board of Directors, after all, appropriates the money, to use a similar term. The President delegates the purchasing to the purchasing agent, or the vice president in charge of purchases. The purchasing agent is the final authority on purchase. His name is signed to the contract. Nevertheless, for approval of contracts, he may go more informally than we do in the services, to the President or to the Executive Vice President, on important contracts, as we have detailed here the important ones, and say, "I propose to do it this way. This is my decision. Have you any objections or have you any advice?" I think it's a normal

procedure. We simply formalize it more than they do in industry.

STUDENT: But you are limited by law on what you may delegate.

SECRETARY JOHNSON: No. Are we, Bill?

COLONEL GURNEE: In some respects. I was going to say that we in the Army think that the act which prescribes the procurement exercise throughout the Army and the other services is a good act. We have no basic quarrel with it at all. Where it gets specific is in such things as negotiation authority. It does say in the act, for instance, that you cannot delegate the authority to negotiate certain types of contracts below the Assistant Secretary level. This is one case--the D and F's. We could quarrel, possibly, in some detail with that. The law says that you can negotiate small purchases which are under \$2500. We feel that under today's conditions that should be \$10,000. This is small.

The Congress has not really prescribed the organization for procurement within the services, except to say that, under certain circumstances, authority will remain only in the secretariat and will not be delegated. But those are few.

SECRETARY JOHNSON: Well, the D and F's are determination and findings. In any negotiated procurement there are 17 exceptions to advertised procurement, and you all know them--I am sure you do. You have all read them and examined them. Before any one of those exceptions can be applied, the Secretary of the Army or an Assistant Secretary of the Army--and unless he is out of town that would be the Assistant Secretary for Logistics in the Army--

or the Under Secretary, of course, must sign that determination and findings and say, "I determine and find that this should be a negotiated procurement, for the following reasons:". That cannot be delegated, and the negotiation can't take place until that D and F is signed. This is true of all the services, not just the Army.

QUESTION: I noticed in your list of exceptions to the obligation authority there, that the first one was a \$200,000 one for missile parts. It seems that, with the considerable feel that we are trying to get on missiles, that exceptionally low authority has to go all the way up to the Secretary, so it must have some special meaning. I wonder what that is.

SECRETARY JOHNSON: This is not a regulation by anyone else. It is just a regulation in my office. This happens to be the way we run it in the Army. Let's put it this way. We know less about missile parts and how many are needed and about the whole operation of providing necessary parts to support missile systems. We know less about that than about anything else; obviously; it's a new type of thing. We wanted to keep our finger on it to the extent of finding out what is going on. In other words, we didn't want to run into a situation where we were buying \$5 million worth of parts today and \$10 million tomorrow and \$20 million the next day--and I assure you that these figures are not exaggerated--without knowing what the process was that determined the number of parts that were to be bought, who passed on it, and what the experience was. We wanted to know at least as much as we could about it. That's the only reason for this.

The time will come, perhaps in the near future, when we will raise that, and we might raise that from \$200,000 to \$500,000. But the determination of when or if we do that is in my office; not anywhere else. This isn't an Army regulation.

MR. LAZURE: I might add in that regard that sometimes, a number of these things go up to the Secretary together. For example, this missile repair parts procurement would go up with other factors of procurement. So they are streamlined within Army at Dep Log and at Secretary levels.

SECRETARY JOHNSON: I might say that's one of the things that this special authority that was given to General Medaris bypasses. This regulation is not imposed for those four missiles systems that I mentioned.

QUESTION: This question has to do with the authority of the contracting officer. You mentioned earlier that on an advertised bid, for instance, he was required to take the lowest bid provided the bidder was responsive. Now, recognizing that there are different degrees of responsiveness, and also responsibility, as the General pointed out, and a minimum of responsiveness might be acceptable, suppose you have a situation where a bidder underestimates the cost of this in the opinion of the contracting officer, which would lead it eventually to renegotiation at a higher cost. Does he have authority to reject that lowest bid and accept a higher bid?

SECRETARY JOHNSON: I'll answer this quickly. As you see, I am willing to do that even though I am sometimes contradicted by my experts. I would say no. He is obligated to take the lowest bid if it is from a responsible

and a responsive bidder. Now, if subsequently the bidder raises the question that he made a mistake, that is referred to the General Accounting Office for decision as to whether or not he will be required to deliver on the price that he bid or whether he will be allowed to correct the mistake.

STUDENT: I was thinking of a situation where the contracting officer initially looks at it and says he can't possibly do it for that. We have run into situations like that in the Navy. Then what do you do under those circumstances?

MR. LAZURE: In that regard, if I may inject, Mr. Secretary, there is the so-called theory of constructive notes that is recognized in procurement law. Where a contracting officer has a bid or a proposal which is so low that he, as you say, recognizes that the man can't possibly do it, he should then go back and ask for a verification of the bid or proposal. He may have to go back a couple of times. We've had the situation where we have gone back twice and the fellow says, "I could still do it for that." Then he comes in and yells that he couldn't because he hasn't estimated engineering on machinery or something. But there is this theory of constructive notes, and the contracting officer is responsible in a case of that type to ask for this verification.

COLONEL GURNEE: Then the next step is he files a mistake-in-bid notice to the Comptroller General, and we go to the Comptroller General and he usually says, "If there has been a notice to the contractor and everybody has been cleared, and he has been asked to verify and point out," and the Comptroller General usually will not allow it. On the other hand, if we

have been negligible and let that thing slide through without verifying it when it should have been put on notice, normally then the Comptroller General will allow the claim for a mistake in bid and will go ahead and compensate him for it.

SECRETARY JOHNSON: There is a great risk in this. If the contracting officer used his judgment as to whether a man couldn't make it for what he said he could make it for--because it is really astonishing in many of these procurements, competitive procurements, what prices are achieved--and he does make the product and he makes it at a profit, and all his competitors have said he can't do it and of course his costs are too high, and that sort of thing, nevertheless he takes it at that price and he operates successfully, it depends on the degree. If he's got a bid that wouldn't cover the material cost, then he knows he's right. But, once you begin getting above material and direct labor, you don't know what he can do. He may have rationalized out his overhead, or most of his overhead, because he has it covered somewhere else, or he may have rationalized out most of his G and A. That's his business. He may take a 1 percent profit instead of 10 percent. That's his business. The contracting officer is not in a position, unless it's kind of an extreme case that you are talking about, to make that decision. He might be throwing out something that was very much to the advantage of the Government.

Gentlemen, it's 10:20 and this calls for the coffee break.

SECRETARY JOHNSON: Gentlemen, I want to make a correction in a statement that I made. I said the D and F's for all 17 exceptions have to come to my office. Actually, all 17 exceptions do not require D and F's signed by the Assistant Secretary. They are selected ones. Colonel Gurnee called my attention to that. I supposed that they all did, because the number that comes up there makes it seem that way.

Going through this process of being questioned, which is an interesting process, when you are sitting on this end of it, reminds me of something that happened up in New York, that I'll tell you about very briefly. I have one minute, I think. This was at the American Ordnance Association meeting in New York. During the business sessions three Generals, in the morning, from the Air Force, the Navy, and the Army gave talks on what was needed in the way of materiel for each of the services. Our representative was General Sink, whom I mentioned to you before. Everything went fine. They had a question period and were just about to adjourn when someone in the audience posed a final question, and he posed it at General Sink. He said, "General Sink, can you tell me how much unification has taken place in the Pentagon between the services since the new Unification Act and the new setup for the Defense Department has been achieved?" General Sink said, "No, I don't think I can tell you that. But the Assistant Secretary of the Army is sitting down in the front row. I think he can tell you that." So I had to answer it.

Actually, the answer was not difficult about my own end of the business,

because, in the logistics materiel, or material, whichever you want to call it, we have an enormous amount of unification. Seventy-five percent of the money that is spent for goods and services by the three services is spent by one service in favor of all three—75 percent of the money. So that we have 75 percent unification. The part that isn't unified is the part that is very specialized--for instance, submarines, or supersonic bombers, or tanks for the Army, and that's unified to a certain extent because we also buy tanks for the Marine Corps--and except for those very specialized military items, there is an enormous amount of unification which comes from single managerships and single procurement.

This isn't the subject for this meeting, but it's true, nevertheless. So I was able to answer that.

Gentlemen, the next question is on Small Business, and I am going to ask Colonel Knox to read the question.

COLONEL KNOX: How does small business fare in the Department of the Army contract awards?

SECRETARY JOHNSON: I want to make one comment on this, although I am going to ask Colonel Gurnee to answer this question specifically. The percentage of the Army's prime contracts placed with small business is the largest in the three services. My comment is this: I think that the Army has a better opportunity in buying subsistence, and ^{on} many of the smaller items that the Army buys, to a much greater extent than the other services, the Army has a better opportunity to deal with small business on

prime contracts than perhaps the other two services do.

With that very brief remark to start with, I'd like to have Colonel Gurnee develop this subject, which is a very important one.

COLONEL GURNEE: Several years ago the Army tried to develop a method of portraying to Congress the activity of small business as far as Army prime contracts were concerned. It is a very difficult thing to present, because the Congress and the general public keep looking at the percentage figure only, and keep saying, "Why isn't it larger?" For instance in 1958 we had awarded 35 percent of our total prime contracts in the Army to small business, and in 1959 33 percent. This is a hard figure to analyze and to defend. We attempted to develop a series of statistics and figures to indicate where our problem lay.

I'd like to show you some charts which we used. I'd like Chart #5 first. (Chart #5)

What we did was to analyze the total Army procurement as we saw it in its various components. We came to the conclusion that basically we had about five different businesses within the Army. These are the figures for fiscal 1959. We had about \$5.4 billion in supply contracts.

The first business which we actually analyzed was our textile, clothing, and equipment, for which we are the Single Manager, buying for all three services. We found that we spent some \$300 million, total; and 71 percent of that went direct to small business. Therefore we came to the conclusion that we have no problem here. This was competitive procurement primarily

by formal advertising. Small business was getting certainly its fair share. So we can pretty well forget this problem.

Construction was the next business that the Army was in. Here, out of almost a billion dollars, 57 percent went directly to small business on prime contracts. Again this is probably not an area that we should worry too much about.

The next one was subsistence, again, a single manager responsibility of the Army. This was \$614 million. Here 63 percent went direct to small business. Again we felt this was an area where we were doing extremely well in and probably could afford not to emphasize too much.

Here are supplies and services. These are primarily housekeeping efforts--utilities and all the other things that come into maintaining a going activity. This was \$809 million, and 46 percent went to small business.

This comprises about half of our total procurement.

May I have the next overlay, please? This shows the remaining half of it, or what we call major items--about \$2.6 billion. Here you will notice that there was only 9 percent/went direct to small business. Obviously, then, this is the area that we have to be concerned with in making sure that our Small Business Program is as dynamic and good as it can be. Breaking this down, then, we found that about \$1.3 billion went for such things as missiles and major, big hardware items. Obviously this is an area in which a firm with less than 500 people cannot take on a contract. So we can pretty well forget this. Then we had 385 in our tactical vehicle and

commercial vehicle area. This again is an area of procurement in which we could not expect a small business firm to take on a prime contract. Both of these areas are, of course, subject to tremendous small business subcontracting.

This left \$900 million in an area that we felt was available for small business and which we want to take another look at. May I have the next overlay?

This is the breakdown of this \$917 million. As you can see, actually small business got 16 percent of this \$917 million. Then we found that in 68 percent of it small business did compete. They were offered an opportunity to bid and they were not the low bidders. We found another 14 percent that small business did not even bid on, even though the opportunity was there for them. Then there ^{are} negligible amounts where small business was the low bidder but was not given the contract because they were either not responsible or not responsive.

We felt that these last two areas are the areas in which small businesses should make their most energetic approach. We feel that the program having been developed to this point, it is now in the hands of small business. We have gone around the country with this type of information, and have told small business, "This is where you now must compete. This is where you must sharpen your pencil. The Army can do ^{no} more than to afford you the opportunity to compete on these items. It is up to you to carry it from here."

We have had rather substantial success with this type of approach, both

with Congress and with industry, in trying to show the Army's approach to giving small business an opportunity to secure their fair share.

Let me have the last chart, please. This summarizes what our fiscal 1959 shows. Small business actually got \$1.7 billion, or 33 percent of the dollars awarded in all Army new procurement activities in 1959. A rather interesting thing is, while this is 2 percent lower than last year, the actions remain exactly the same.

That's all I have, sir, on this.

SECRETARY JOHNSON: Thank you, Bill. Colonel Gurnee already mentioned this, but, to set the background, I want to point out that we are talking only about prime contracts, contracts directly between the Government and a company. The question of subcontracts is one that Congress has carefully avoided. They don't want us to show them how many subcontracts small business gets, and that is a difficult thing to show, what percentage of this money is spent when contracts are taken by large business and then are subcontracted to small business. That is not included in this presentation. Whereas we show that 33 percent of the money in the Army goes to prime contracts to small business, my guess would be that that would be up around 55 or 60 percent of the money if you actually could find out, and if anybody would pay any attention, the amount of money that then goes to small business through subcontracts from large business.

I wanted you to know that that is not in this calculation.

Now, do we have questions?

QUESTION: Sir, has there been any consideration given to developing a new criterion to determine what is small business? We have at the present time an arbitrary 500-employees requirement. In the clothing and textile or the subsistence business, 500 people might be one of the large units in the industry. On the other hand, in the automotive industry, the fifth or sixth largest producer may have from 2,000 to 10,000 employees. Could you address yourself to that?

SECRETARY JOHNSON: Well, I think I can say rather superficially that an effort has been made to work this out by industries over a period of many years, unsuccessfully. It's a very difficult thing. If you take the watch industry, big business in the watch industry may employ only 1,000 people, where big business in the automotive industry may employ 150,000. It is almost impossible to determine it by industries. There has been a recent change in respect to some types of contracts which are judged on the basis of the amount of business done per year. I think this is in the construction field. Isn't it, Al?

MR. LAZURE: It is in all fields. The Small Business Administration has a definition now that realizes the 500 rule, but it also provides that the business is not certified by the Small Business Administration as small business. In other words, they have the right to say that a group not dominant in a particular field is small business. So, in certain businesses you can have 5,000 people and be small business. And, by the same token you can be big business in certain fields and have less than 500. So that there is this rule

of dominancy in your field that would come into play here, too.

COLONEL GURNEE: I'd like to add one thing to this. To the contracting officer, the worst thing that could happen would be for SBA to come out and, by number of employees, define every conceivable industry. This would drive the contracting officer absolutely out of his mind, if he isn't that way already. The problem is that you have many companies that are in several industries. They have 500 for one, 250 for another, and 3,000 for another. You'd never be able to get this thing straightened out. We have consistently held, I think, in the Army that, while this is a responsibility of SBA, we haven't really had much trouble living with 500 as a definition. It's as handy as hell, and the day we start changing this we get into real details. We are going to be in a lot of trouble.

QUESTION: Sir, how does this proportion of military procurement that is given to small business compare with the proportion of total business that small business represents--if I make this clear?

SECRETARY JOHNSON: I don't think our calculations are based on that. You can get a pretty good idea from those charts you just saw. These columns on the right, I think, were universally military procurement items, large military equipment.

STUDENT: No, sir. I mean, in the civilian business world, small businesses represent some fraction of the total business. How does that compare?

SECRETARY JOHNSON: I don't know. Does anyone know?

MR. LAZURE: I don't think there is any such correlation. It would be awfully hard to arrive at.

SECRETARY JOHNSON: Small business is a measurement that is set up only in government.

QUESTION: Mr. Secretary, I am surprised that there is no mention of set-asides. Is that no longer a problem? What is the current status?

SECRETARY JOHNSON: I was hoping that would come up. It is a very difficult problem. We can set aside either 100 percent or a part of a procurement directed to small business where we feel that it is proper and where it is recommended by the Small Business Administration. I am going to pass this on and let Colonel Gurnee take it from there.

COLONEL GURNEE: We are still very much with the problem of set-asides. We have tried within the Army to adopt a program of unilateral set-asides, of ourselves determining from procurement history where it is perfectly proper to make a small business set-aside without being urged to do so by SBA. This is a problem that the Army, I think, led in initially, because of the type of things we buy. As long as we are buying off-the-shelf items--to a large extent, for instance over \$2 billion worth, which is pretty much--we can pretty well enter into a set-aside program without any difficulty. Where the history has shown clearly that there is adequate competition, and that the competition is among small business men, we have no concern whatsoever about making a set-aside. In fact we have urged our people to make it unilaterally on their own.

Where we get into difficulty is where there is a limited number of people who are willing to compete for an item, simply because the last procurement on an open competition went to small business. Where there are only 2 or 3 firms bidding, we are still very much concerned about the fact that we are shutting off competition if we go to a set-aside. This is where we run into our trouble with the Small Business Administration. We like to maintain the competitive picture.

SECRETARY JOHNSON: I would like to add one thing, and this is really the difficult part. We still have the obligation of buying to the best advantage of the Government. We still have that. We also have a clause in the Procurement Act which says that none of the appropriated money shall be used for the relief of economic distress. Thank goodness we have that. It gives us a good foundation. Consequently we have another policy that we have established in the Army. Where we have 100 percent set-asides for any particular item, at intervals we throw this wide open to the industry to test the market, to see whether small business is taking advantage of that situation and is not giving us as good prices as if we included large business. If we find they are not, we put the procurements across the board instead of setting aside. This causes great arguments with the Small Business Administration. Nevertheless, the fundamental here is that we are still obligated to get procurement to the best advantage of the Government. We can't dodge that responsibility.

COLONEL GURNEE: Sir, we do have handouts of these charts I showed.

They are available, gentlemen, if you wish them after the session.

MR. MUNCY: You will find them in your boxes when you get back, gentlemen.

SECRETARY JOHNSON: Colonel Knox, will you read the next question?

COLONEL KNOX: The next subject is Domestic Versus Foreign Procurement. The question is: How does the problem of foreign competition affect military procurement?

SECRETARY JOHNSON: I am going to attempt this myself, gentlemen. I think fundamentally here we are talking about the Buy American Act, with which most of you ought to be familiar, and I think you are. The Buy American Act in effect states that, where there is a foreign bid which is 6 percent or less lower than the American bids--in other words, the foreign bidder is penalized 6 percent--if it is within that field the American bidder takes the bid. There is a variation in this, in that, if the American bidder is an area of labor surplus, that rises to 12 percent. In addition, of course, you have to evaluate the duty on foreign bids, and of course the transportation.

Now, there is an exception to that. If there is a determination that the ~~foreign~~ acceptance of the foreign bid would be against the national interest or national defense, if there is that determination, the foreign bid can be turned down on that basis. This is a matter that has been fought out ever since I have been over there, and probably will be for a long time in the future, although we have a pretty firm stand now.

Most of this question has come up recently, in the last 2 or 3 years, in relation to large power units, such as generators, transformers, and

hydraulic turbines for the Engineer Corps programs, and the foreign bidders are almost universally lower than the American bidders. Sometimes they are not responsive. If they are not responsive, then we turn down the bid on that basis. But the variation between the foreign bid and the American bid is really spectacular.

We had one recently on generators, or transformers--I have forgotten which--where the American Kneeland Company of Austria was the low foreign bidder, and the lowest American bidder was 62 percent higher than that bid--62 percent higher. And of course they got the business.

Determination has to be made as to whether that is against the national interest or the national defense. Unfortunately, it has to be made in my office, subject to recommendations coming up from the Engineer Corps, of course.

That is the way foreign bidding affects our procurement. I don't know whether this is going to get further into supply contracts. We have an area in which we cannot accept foreign bidding and it is in the Procurement Act. It is the Verry Amendment. We cannot accept foreign bids on certain classifications. I don't know what they are. Do you?

MR. LAZURE: Textiles and foodstuffs.

SECRETARY JOHNSON: Those are the two main items.

MR. LAZURE: And cartridge-bag silks.

SECRETARY JOHNSON: Cartridge-bag silk was a special one. Of course they immediately changed the cartridge bag to nylon, so we don't

buy cartridge-bag silk any more.

I'd be glad to have questions on this. It's a very interesting subject.

GENERAL HOUSEMAN: I don't quite understand. Do you mean to tell me that there is no food procured by the armed services overseas now?

COLONEL GURNEE: The Verry Act says that you will not buy food overseas for use in this country.

SECRETARY JOHNSON: In the commissary.

QUESTION: How do you handle the case where a company is a U. S. company with an overseas subsidiary, where they might manufacture all or part, specifically the hard part, where they manufacture certain components overseas and ship them to this country and assemble them here?

SECRETARY JOHNSON: The only thing that gives that company an advantage is that there is no question about supporting the product after it has been purchased. We made a ruling that these companies in heavy industries that are bidding from abroad must have on the North American Continent the ability to support the product--generators or transformers or turbines, or whatever it may be. So that a company that is established here and has a subsidiary abroad has an advantage. They can get the low labor rates abroad for components, or even for the whole product, and ship it in, and bid on that basis. It doesn't apply to the capital ownership of the company, if that's what you mean. It's simply the location of the company.

QUESTION: Many people in this country are quite concerned about the rapid depletion of our gold reserves. I wonder if this would be a factor in

the national interest to be considered.

SECRETARY JOHNSON: I think it might be a factor in the national interest, but it isn't a factor that the military services can handle. This question of whether we should build a wall to prevent products from coming in here at lower prices because there is a lower labor rate abroad--that's part of the reason for the lower prices--is a matter which is, of course, of great concern to the whole country; but it is not a concern of the military services.

These various associations and companies come in to argue with me about whether we should do this or not. I say, "We simply operate on what the Buy American Act says." It doesn't say that we are to exclude foreign products because the labor rate abroad is lower. It deals with this in the term of prices. We have to abide by that.

I think the question you bring up is a very serious question, but it isn't one that we should handle in the military services. It's an economic question and, to a large extent, it's a State Department question, as to whether we can do all selling and no buying, or whether we must do some buying as well as some selling.

QUESTION: Sir, do you have any figures as to what percentage of Army procurement money is spent in the overseas market?

SECRETARY JOHNSON: You mean spent from this country in the overseas market? I have no figures, but I will take a guess that it is a very minute percent. The reason I say that is because I have insisted that, where

a foreign bid is the low bid, the question shall be referred to my office before the bid is awarded, if it is going to be awarded abroad. Now, if it is excluded because of non-responsiveness, it doesn't come to my office. That's simply because this is such a very, let's say, ticklish subject.

I don't know what the answer to that is. Of course, we spend a great deal of money abroad for goods and services for our armies abroad. We buy lots of food abroad; we buy services abroad; we hire foreign personnel; and so forth. Have you a figure, Bill?

COLONEL GURNEE: Six hundred twenty-four million last year was procured overseas.

SECRETARY JOHNSON: For use on the Continent?

COLONEL GURNEE: It doesn't say.

SECRETARY JOHNSON: I think most of that would be for use overseas.

COLONEL GURNEE: I would feel sure it would be for use overseas. Six hundred twenty-four million represents the amount of purchases outside of the United States.

SECRETARY JOHNSON: That's out of a total figure of \$5.4 billion.

COLONEL GURNEE: I would agree with you that most of that is for use overseas.

SECRETARY JOHNSON: This may spread further. For instance, we are right now buying military trucks in Japan. We are buying them for equipping our allies in the Far East, for very obvious reasons, that they can be supported out of Japan from Japanese factories, instead of standing

on our necks for the rest of our lives. They are good trucks; they are copies of our trucks. In some respects they are even better, because their 2-1/2-ton trucks are Dieselized and give a better fuel economy.

It is interesting to note, however, that between the cost of those trucks to us in Japan and the cost of those trucks bought in this country and delivered in Japan, on some of them the price is 50 percent, and I think the average is about a 40 percent reduction in cost to the United States by doing that.

How far this is going to go, on foreign people bidding in this country for our military procurement, I don't know. I can see nothing to prevent their doing it in the law if they want to do it. We have one exception that I'll mention, and that is Canada. We have a government-to-government arrangement with Canada, where, for military items that are for the defense of the North American Continent, or for the common use of our military forces, the Buy American Act is abrogated and the evaluation of duty is abrogated. In other words, we have put Canadian contractors on exactly the same basis as American contractors by this agreement. We have what we call a Production Sharing Committee set up in the military services which deals with a similar committee in Canada. We meet once a quarter. Then there is a working group that works all the time on this. So that we are trying to get more business into the Canadian firms, very deliberately. You might ask: Why? Because we are using an awful lot of Canada for our military operations, particularly the Air Force is, with the various warning lines and the various installations for missiles, and so forth, in Canada.

Canada says: "Well, if you are going to use our homeland for these purposes, we ought to make more military items, which will give us more employment." This has been worked out on a government-to-government basis. That is an exception to anything that I have said before.

QUESTION: Mr. Secretary, this question has to do with the decision-making process when you decide whether to buy something overseas or in the United States. We had a speaker here last week from the Department of Commerce who said that our foreign trade in the overall picture as far as foreign trade is concerned hasn't changed very much; that our favorable balance of trade is remaining about the same. So, when you look at an individual item, it shouldn't be too important. Also, he made the statement that the trade mix changes all the time, so that in the commercial world we can make some things cheaper this year, and in 10 years maybe somebody will underbid us on them. So that the trade mix is changing all the time.

When you decide whether you should buy American or not, what process do you go through? Whom do you talk to?

SECRETARY JOHNSON: I can tell you exactly in relation to the items that come to me, which so far are the items of large power production, which I have mentioned. They come up through the Engineer Corps, because all the construction is done by the Engineer Corps. The ruling is this: If I decide that it is not against the interest of the U. S., our national interest or our national defense, then that's as far as it goes. We buy it if the bid is low.

I could talk for 10 or 15 minutes on whether or not that is a correct

decision . I fought this out two years ago. The correspondence is this deep (indicating) on the basis that I shouldn't make that decision, because I am deciding for the Navy, the Air Force, the Atomic Energy Commission, the Interior Department, and everyone else. I don't think I should. They said, "Nevertheless you've got to do it." All right.

Now, if I should decide that it is against the national interest or the national defense, that then goes to the Defense Department, who refer it to OCDM, who then decide whether that is correct or not.

That is the decision-making process as far as the things that we handle go. We did have a case about a year ago, where it was decided--I wasn't in this office at that time--that it was against the national interest. That went up to OCDM and they approved that decision. The country, the press, the industry, the State Department, and everybody else practically jumped through the ceiling. I never saw so much uproar about anything. OCDM in a subsequent operation reversed their ruling. So we have no limitations now.

I think we'll have to go on to the next question, gentlemen. Colonel Knox, will you read the next question.

COLONEL KNOX: The next subject is Congressional Procurement Interest. The question is: What is the Army position relative to the recent Congressional interest in military procurement? This relates primarily to the conflict-of-interest problem and the question of weapon systems contracts.

SECRETARY JOHNSON: I would like to start this one, and maybe we'll

all get in it before we get through. In the first place, it really divides itself into two parts. I will take the question of weapon system contracting first. I am not absolutely certain that I know everything there is to know about what weapon system contracting is as it relates to the other services, or even my own, as far as that is concerned. But I think we have a difference of philosophy, here, and have had, in that the Army does not turn over the responsibility and the control of a weapon system to anybody. We may make a contract with a contractor to produce a weapon system, true, but we retain the right of decision on anything that comes up in regard to that contract. We retain that through the particular technical services which is making the procurement.

I believe there have been some cases in the other services where the decisions in regard to many important things--all the important things--that have to do with the weapon system were made by the contractor who was appointed for that purpose, and the control did not remain in the technical service.

I can't go deeper in that because I don't know enough about it, except I do know what we do. We retain the control in the Army. That's one part of this.

The next part relates to a conflict of interest, which relates largely to people, and, while it has been a subject of great Congressional interest, as you know, I am inclined to think we are going to get some benefit out of it. There are some evidences of it. The conflict of interest pertains to the fact that a man who has worked on one side of the fence, from the military

standpoint, should not, upon resignation, go with a company and then use his knowledge and talents to try to get business for that company. That, of course, reflects on his integrity—the idea that he shouldn't do this. I think it is absolutely wrong in the first place. It also deprives the literally thousands of military officers who retire and have to go on working at something of a very large opportunity to enter into work that they are most familiar with, and I don't think it should. That has been called conflict of interest.

But out of this, after a very great investigation, as far as I know, they haven't been able to uncover a single case where the facts bear out that allegation. What I am hoping will come out of it is a change in the present law which will abrogate the present ruling against dual employment and dual compensation. I think you will cure about 90 percent, 95 percent, or maybe 99 percent of the idea of the conflict of interest if they will do that. In other words, so many of the retired military personnel would be glad to work for the Government if they weren't penalized for doing so.

If we can get dual compensation and dual employment laws off the books, I think this is practically going to solve itself.

That's enough for me to talk about. I would be glad to have questions, gentlemen, on this subject.

QUESTION: Mr. Secretary, we have had speakers from industry and also from the Department of Defense discuss this subject of weapon systems procurement. From both sides we have heard that one of the major objections

industry has to the defense contract is that there is always someone looking over their shoulder telling them what to do. It is their contention, at least one speaker so stated, that they could do a better job and a cheaper job if they were allowed to do the job the way they wanted to do it, rather than have someone always making changes. This has also been said by some members of the Defense Department. Would you care to comment on that?

SECRETARY JOHNSON: I'll be very glad to. In the first place, I don't believe their allegations that they would do it better and do it cheaper, particularly the latter. They'd do it more expensively. That's just human nature. If nobody is looking over your shoulder and you can dip money out of the pot any time you want to, the human nature is that you dip it out. Somebody has got to be looking over your shoulder. That's our feeling, that we've got to control this. This is public money; you've got to control it. As far as their doing it better is concerned, that depends on what basis you start on this thing. I am firmly convinced that the responsibility of the military departments in regard to a product is quite different than the responsibility for a commercial product.

A commercial product, if you put it out and it doesn't work, or if there are some repairs that have to be made, or if you run into bugs, and so forth, costs the company some money, and that's just too bad. The objective for a military product is to have it perfect. That's the objective. We never quite get there, but we get as near that as we can, because the consequences of

poor military products are quite different than the consequences of poor commercial products. We've got to make the necessary changes and do the things that come up that will make the product better, easier to maintain, have longer life, and be more reliable. We've got to do those things. That's a military obligation.

If you turn that over to a commercial outfit and say, "You go ahead; you make this thing," they haven't got that obligation. We've got to retain that obligation.

Have I answered your question?

STUDENT: Yes, sir, you have.

SECRETARY JOHNSON: Have I answered it right?

STUDENT: That's a matter of opinion, sir.

QUESTION: More along the same line, sir--it has been contended from the platform here that you never reach this degree of perfection that you indicated, as you also recognize, and that, in trying to reach the top, say, 15 percent of perfection, we have prolonged the production to the point where a lot of these weapons never get into our arsenals. Aren't we better off if we don't strive for so much perfection and let the company take the original idea, and run with the ball, and produce us something that isn't perfect but yet is something that we can use to a degree? This is the idea, I think, that the Colonel had.

SECRETARY JOHNSON: I agree with you that this process does lengthen out the so-called lead time. I wish somebody could really define lead time sometime. It does lengthen it out. And it is a question of judgment as to

the degree that you should do this. I know that the perfect is the enemy of the good. That's an old saying. I think it was used by a lot of people, but notably, General Patton. He said that, that the perfect was the enemy of the good.

Whether you should try to get up to 100 percent perfect, which is probably impossible, or 99, or 95, or 90, or 85 is a matter of judgment by the people who are going to be responsible for the performance of that military item. I'll give you an example. We have been striving to get multi-fuel engines that will burn anything, from molasses to high octane gasoline, multi-fuel compression ignition engines. The first specification was that they must start on gasoline at 65 below zero--or that was one of the requirements. Well, my contention is that the vehicle itself won't start, no matter what you do with the engine, at 65 below zero. Now, we could have gone on striving to start the things on gasoline at 65 below zero for the next 10 years and would probably never have achieved it. We have since relaxed that to an extent. I think now--I am not quite sure--it's about 20 below zero. We can do that. Then you can get starting at lower temperatures either with additives or with kits.

It would have been silly to try to get 100 percent at 65 below zero. It is not silly to try to get 100 percent at 25 below zero. This is a matter of judgment and a matter of military necessity.

I don't know whether I am answering this right, or to your desires. Am I answering your question properly?

STUDENT: I am satisfied, sir.

SECRETARY JOHNSON: Well, I think I haven't satisfied you on one thing, and that is your contention that maybe it would be better to do it faster and not have it quite so good. I can't subscribe to that. I think we can do it faster and still be just as good. I think part of this long time is administrative processes, which are too long, rather than the fact that we are striving for finer products. I think there is large room for improvement in the whole administrative process as it goes through the various layers of authority. That I believe. In other words, we can make our decisions faster. I think we chew them over too much. We ought to be able to make a decision pretty quick after the necessity for the decision arises. That would expedite things enormously.

The other thing that people who argue this way don't take into consideration is that a very large percentage of this delay is fiscal. It isn't either what I have just said, the administrative system, or the necessity for getting fine products. A lot of the delay is that the money is not there when we need it to continue the process. We stretch it out, or we stop it and start again. That part of the process does delay us abnormally and unreasonably.

QUESTION: Sir, with respect to weapon system contracting, one of the big problems in controlling a contract is the control of the make or buy structure--that is, what parts will be made in the plant by the contractor and what parts will be contracted out? How does the Army control the make or buy part of the contract for the production of an item?

SECRETARY JOHNSON: There is a new regulation on this. Al, can you cite it?

MR. LAZURE: Yes. The Congress has been greatly interested, particularly the committee which is just coming out with a report on January 10, the House Armed Services Committee. They have gone into a great deal of detail on this make or buy policy. I think each service does it about the same way, and not too well, perhaps, at this point in time, because we have not as yet gone into our subcontractor structure, particularly on big contracts, to control it to the degree that is now called for in our book--which is quite new, I might add. Make or buy policy, or subcontractor provisioning, is controlled to a great extent within the major weapon system prime contracts.

In the Army we do not pull out quickly the fresh contract we have in that area. We define in the contract the scope of the work by description and sketches. We then set areas of responsibility, technical supervision, and concept control in the Government. Then we set up support task assignments for policy guidance control structure, driving equipment, wiring system, and weapon system, so that we can easily give it to the Martin people or do it ourselves. Then we set up certain technical supervision and concept control retention on the part of both the prime contractors and the major subcontractors; the right of the Government in GFP for certain types of products; the requirement of the subcontractor to conform to our research and development concepts and layout; the right of approval of a contractor's prime contract with subs,

and any personnel changes; the right from him to furnish certain time schedules; the right on the part of the Government to approve the selection of major subcontractors; liaison between him and his people, particularly the major subsystem contractor; the facility clearance actions that are required from both the prime and sub; the detailed layout by program phase and personnel build-up from the R&D to the production phase; the funding requirement that the Secretary mentioned and the phasing in of it within the appropriation year; provision for break-out and multiple sources in the subcontractor structure; the right of the Government to furnish to its own or other services certain types of arsenal support and assistance, such as in propulsion guidance and things of that type by our own in-arsenal group.

You see in that way, within the contract provisions in a contract we attempt to correlate the total weapon system. It isn't easy.

SECRETARY JOHNSON: I think this illustrates one point that is very important in these complicated contracts, and that is that any controversial points be decided in advance and put in the contract. That is also true on famous Section 15 on what shall be included as cost. There are many gray areas there that should be decided in advance and put into the contract. This is the way we are going to do it. Then there is no question about it. They do it that way or they are not in conformity with the contract.

QUESTION: What proportion of your contractors have to be lawyers to handle this kind of deal?

SECRETARY JOHNSON: The contractors have to have a very good and

elaborate legal organization to handle these contracts. There's no question about that. So does the Government. When these things get down on paper, that's the way they are going to be interpreted, and that's the way you are going to pay. You've got to have very competent legal advice in advance. These things can run up to a half-billion or a billion dollars, these contracts such as we were talking about here, with the greatest of ease.

QUESTION: This is a related question on decision-making. I am really impressed at how many factors have to be taken into consideration by a contracting officer. What are the ground rules for closing off negotiation when you are working with 10 or 15 contractors and all of these things have been set?

SECRETARY JOHNSON: Well, now, you've got into a sticky one. I know what I wish the ground rules were, and that is that at some point in the negotiation we could say that on such and such a date we close out the negotiations and that's it. In fact we do say that in effect. But the General Accounting Office says we can't close them out that way, that any contractor has a right to alter his proposal up till the time the actual signature is put on the contract. We tell the contractors we are going to be through on the 15 of February and they can make any changes they want until then, and generally that works out all right. But legally we can't stick to it, because, if somebody comes in on the 17th of February and says, "I want to change my proposal," and the contract is not yet signed, we've got to accept the change. This is not a satisfactory answer, and it isn't a satisfactory situation. But

that's it.

Gentlemen, we have now the period until the end of this session for general questions on any of the procurement subjects that we may have discussed, or, in fact, on any that we haven't discussed.

QUESTION: Mr. Secretary, I think one of the things that everything we do in procurement is set up to insure is a better product for lower cost. In this area I guess one of the most controversial subjects is the cost type contract versus the fixed price contract. In the area of cost incentive types versus fixed price redetermination--that is, the Army system versus the Air Force system--I would like you to explain how this incentive thing would work best--say, one type versus the other--what the benefits are of one versus the other.

SECRETARY JOHNSON: I don't think I can answer your question. I am going to investigate it with the panel here in a minute. I am allergic to incentive contracts for the reason that was mentioned earlier in this session. That is, the trouble with an incentive contract is setting the target. If you make a mistake in that the contractor will enjoy profits that he doesn't deserve. We were talking coming back from coffee about some contract away back, years and years ago, made by the Signal Corps, in which they bought a plane, and their requirement was that the plane should fly a thousand feet high--you can imagine how many years ago this was. The bonus/^{was}for every foot over a thousand, you see. Nobody knew whether the contractor knew that he could make one that would fly 2,000 feet when the contract was made. If he could,

he was going to get a bonus for an extra thousand feet that he had in the bag. That's why I am allergic, generally speaking, to incentive contracts. The question as to whether we should have cost type contracts, particularly cost plus a fixed fee, is generally a question of whether you can do it any other way or not. I think on most of these very complicated weapon systems, where you have not had any experience when you started it, or very little, there is no other way to do it. On most of the research and development contracts there is no other way to do it. You don't know exactly what you are going to get into after you get started. And it requires a cost plus a fixed fee contract in my opinion, with very careful supervision by the service involved, by the contracting officer and all the help he can get. I don't see any other way to do it.

But I can't make a comparison between that and the incentive type contract. Can you make any comparison, General Hamner, or Al?

GENERAL HAMNER: I can comment first on the construction field. I am a little more familiar with that and actually with some of the supply. That raises some very interesting questions. Basically a CPMF construction contract might on the surface appear to be a darn fine way of doing business today, let's say in some of this missile construction. We have a multiplicity of change-overs, and the installation is changing while you are building it. On the other hand, I have talked in detail with General Wilson, who handles this game, and asked, "Just why do you avoid those in present-day contracts?" He gave me several reasons which you might be interested in. One is that

there is a generally bad odor around CPFF which stems from the 100 percent audit, the difficulty with some contracting officers' controlling of CPFF. So it has a bad name in itself. That's not necessarily enough to put it aside, but the next idea is that it's too darn easy to change. In other words, the using service can almost at will change the thing, and therefore, never get it built, or run the cost up. Another aspect is that, even with the best contractor, he does not handle his operations as economically as he would if he were using his own dollars and his own forces. That was dramatically illustrated in the North African base construction. I won't go into detail there, but, when that CPFF was finally closed out, the contractor immediately cut down huge stocks of parts supplies and material to practically nothing, planned ahead a little bit, used expedited methods by air shipment, and what not, and reduced the cost of that lot because he was dealing with his own dollars.

So I would say this: that, in spite of the fact that there are many changes in a rapidly moving game like missile base construction, we still use an advertised type of contract and run the risk of change-order to stay away from a CPFF in the construction field.

SECRETARY JOHNSON: Part of that bad odor comes from the fact that as far back as World War I the contracts were cost plus a percentage of cost. Of course, that, obviously, was a very bad thing, because, the higher your cost was, the more profit you made. And that just put a lot of these things through the ceiling. Many people don't distinguish between that

and a cost plus fixed fee. Let me add one other thing. As far as the Army is concerned, we are striving very hard in these missile contracts and others where we are on a cost plus fixed fee basis, and as soon as we can get components that are set and we have all the specifications, drawings, and the whole production package, we are breaking out those components. In other words, we are taking them away from the prime contractor and are going out on a fixed price competition to have them as government-furnished products or equipment. This is a slow process. In the long run it is going to correct the situation quite materially and we avoid a multiplication of profits. In other words, the prime doesn't get a profit on the subcontractor's profit.

QUESTION: All these problems with the cost plus a fixed fee type contract certainly obtain on a fixed price redeterminable type contract during that portion of the contract prior to the redetermination, so that, by the time you do redetermine you are really redetermining based on a cost to the contractor up to that time. Any efficiency improvements or innovations that the contractor might make after the redetermination will certainly result, then, in higher profit to the contractor, and he gets it all, rather than the Government's sharing with him in this excess profit, if you want to call it that, as the Government would be doing under an incentive type contract.

SECRETARY JOHNSON: Let me correct your statement in just one respect. That redetermination is based on an audited cost, not just what

the contractor says his cost is. That's very important.

STUDENT: Yes, sir, that's true. But also on a cost plus fixed fee type contract I presume the costs are audited.

SECRETARY JOHNSON: Yes, they are. I am going to ask Mr. Lazure to tell me either I am right or wrong on this. You can have a price redetermination which is backward and forward or forward only. Is that right, Al? In other words, you can have by contractual arrangement a price redetermination which will determine the price on the product that you have received, as well as on the product you are going to receive, after an audit. So, depending upon the accuracy of the audit, and general speaking it would be quite accurate, a correction for the first part of the contract can be made also.

STUDENT: In other words, you are saying that, after the product is completed, the costs are redetermined.

SECRETARY JOHNSON: That could be, or you can have an arrangement where 30 percent or 50 percent is audited, on the previous cost, and you can have an arrangement where you go back and correct the price on what has been received, as well as setting the price for the future. Or you can have an arrangement that up to that point the price on what has been received will remain in effect; you will not go backwards but will correct the price for only the remainder of the contract. Am I saying this right, Al?

MR. LAZURE: Let me say that the incentive form is a good form under certain circumstances: One, if you have your cost target and ceiling realistic

enough so that the contractor isn't windfalling on it. If you can do that on the cost type incentive contract, it's a good form, because the contractor shares in his efficiencies, and all that. Then you have a second form of incentive, which is performance incentive. If he can perform within a certain time and within certain qualities, you give him a bonus for that. Then you have a time incentive. If he can perform faster than what would be normal, then you give him an incentive for that.

Air Force has tried contracts with all three of these incentives within them. Any one of them is a tough contract, because, you first have to determine a good target and a good ceiling. There are tremendous problems in this area. I had a case yesterday where Navy was being clobbered by the General Accounting Office because their target was not realistic and the contractor windfalled \$500,000 in cost. They attempted to lick that by putting in delay time. In essence that becomes then almost a form D price redetermination type.

Let's leave that for a minute and go into price redetermination contracts. This is another good form. There you set your initial prices with a proviso in the contract that you will redetermine the price either at a percentage point or at the end of the contract. You can tailor-make these to do anything you want. One advantage of them is that they are not subject to the type of audit that ASPA 15 calls for, for cost contracts. Cost principles in ASPA 15 are guide lines for price redetermination, but they are not sacrosanct.

The other type of contract is the cost contract, and that again is a good form.

There you get 100 percent audit. You have your maybe cost, your yes cost, and your no cost, all defined in your regulation. Each one of them for a particular situation might be a good thing. I will say this: At the end of World War II the British would use the incentive type, but they called it the cost-minus type. As you minused your cost you shared in the fee. They have given it up. They say it doesn't work. Our experience has been that, of the types that we have, we can give incentive in the price redetermination form, by upping fee as the contractor reduces cost during this period that we set for the percentage. This is not to say that any one of them is good or bad, but, depending on the situation, they are good or bad.

I will say this: Congress currently is looking with a rather jaundiced eye at the incentive types in the Navy and the Air Force. Army is a little luckier, using the price redetermination type, and has not had the type of criticism that the other two have had. Whether we are a little bit in advance of the other services, I don't know. Perhaps we are a little luckier.

QUESTION: Mr. Secretary, could you give us an idea of the degree and perhaps the manner in which the apportionment proceedings invade your contract decision-making authority and responsibility?

SECRETARY JOHNSON: This is something like General Sink's question, I might say. The process is that the Army composes its budget, after a great amount of work, and then gets the Defense Department approval of the budget, and at the same time gets , or almost coincidentally gets, a BOB approval of the budget. It is presented by the President to the Congress,

and Congress makes the appropriation. That, as you know, does not mean that we get the money, because the appropriation is then turned over to the Bureau of the Budget, and they apportion it. In order to get the money to us they must make a specific apportionment. To get that apportionment, we have to present a request for apportionment to the Defense Department. The Defense Department then either approves or disapproves that request. There is a no-position there, too, that can be taken. If they do approve the request, it goes to the Bureau of the Budget, who may, then, apportion the total amount of the request, or a portion of it. And, of course, the whole process goes on from the minute the appropriation is made until the end of the fiscal year. You are continually struggling to get an apportionment of the money that has been appropriated. In my short experience here, I don't think I know of any case where we have got it all. They always hold back some of it.

In effect this means that there are on the way up a review of the budget by the Defense Department and by the Bureau of the Budget and by Congress, and on the way down there is a review by the Bureau of the Budget and by the Defense Department, or by the Defense Department and the Bureau of the Budget, before we get the money. That's five reviews.

I said a while ago that I thought that, as long as we are dealing with the public money and the public interest, so-called red tape is a good thing. But I think maybe five times is a little too many reviews. Maybe we ought to get that down to about three, and then we'd be doing enough. Five times is very, very difficult, and this is one of the time-consuming elements.

Until that apportionment arrives in the hands of the Army, we can't go out to start a procurement. We don't. We don't want to get in the position where we have gotten industry to spend a lot of money to make their proposals, figure out a procurement, and come in with their proposals, and then find out that we haven't got the money to do it with. So, until we get the money, we don't start. This delays things terribly.

I don't know whether I have answered your question. Have I?

STUDENT: Yes, sir.

QUESTION: Mr. Secretary, I'd like to go back to foreign versus domestic procurement for a moment. My question has two parts, sir. One: Does the Army seek to place procurement overseas in order to save money? Second: If our budget is going to be continued to be decreased every year and prices are continually going up on equipment, are we justified, and will you, if you don't already do this, seek to procure where you can save the Army money, and get the most for it?

SECRETARY JOHNSON: I would like to answer that question affirmatively, the last one, but I don't think I can, because the whole process of our Government is involved in that. To answer your question, ^{if} the foreign companies in the fields that I have mentioned express a wish to bid, I can't say we seek them, but we don't reject them. We are not seeking the procurement of major military items abroad, except in Canada, and except for our purchase of trucks in Japan. We didn't originally seek that purchase in Japan because of the price advantage. In fact, we didn't know there was such a

price advantage until the Japanese companies got to competing with each other. We sought that in order to get the support off our neck. We wanted the parts that had to be supplied in the future to come out of Japan. This eventually might mean, or we hope it will mean, that the companies buying those from Japan will pay Japan for them instead of our paying for them, to put it very simply, and also to take a lot of complication out of our supply system.

Now we find that we have a big advantage. And you might say, yes, we are seeking to buy goods in Japan, that is, trucks, because now we know what we can do. We haven't sought to buy trucks in Europe. I don't know what would happen if a European company came in and said, "We want to bid on this order for 2-1/2 ton trucks." Frankly, I don't know. I know we'd have an awful lot of head-scratching. We are letting them do it on some products. Why shouldn't we let them do it on these?

This is a very unsatisfactory answer. I realize it, but I don't know a satisfactory answer. At the moment, I don't see what would prevent a good foreign producer from saying, "We want to bid on this, that, or the other thing," and bidding on it. And, if he is within the limits of the Buy American Act, he should get the business. Perhaps we could say, "Well, you can't make the delivery that we want," or "You can't support the product after we have procured it."

Have you any ideas on this, General Hamner, or Al, either one of you?

MR. LAZURE: I can say this: The Buy American Act itself starts out

with the policy that we will buy within the United States all goods that can be substantially manufactured or produced in the United States. By "substantially" they mean 50 percent or better. You then have the exceptions in the law which say that there are certain things that are recognized, almost automatically, as not being available here. So there is a list that has been prepared of things you can buy foreign. Then there are three exceptions that the Secretary may exercise: One, the so-called nonavailability exception, under which he may delegate to the Chiefs of the technical services the right to say that a particular item, say, a machine tool, is not available in this country, and be allowed to purchase it overseas. Second, there is this national interest that the Secretary mentioned. Where the national interest requires a foreign purchase, he makes such a decision, as in the Canadian purchases, and then we can purchase from Canada. Then there is a price-unreasonable area that is now set by a 6 percent value. If the price of a foreign product is 6 percent lower than the American price, and includes duties, and all that, you may purchase that.

if
However, /national interest and price-unreasonable come in together, you may have a requirement go out through to OCDM for final determination.

Finally, there are some ground rules in the Appropriation Act on foods and textiles saying to buy them here. Then there is the rule on Soviet purchases. Even in the availability area, there are certain Soviet purchases which have to go to the Secretary--over \$2500.

Finally you get to the offshore purchases. Offshore you can buy for

offshore needs, within the indigenous areas.

I think in essence that sums up the method under this Buy American. We start with the assumption that purchase will be in this country if the item can be manufactured and produced here.

STUDENT: Even if we can go out and save a tremendous amount of money, we do not seek to buy elsewhere?

MR. LAZURE: That's right.

GENERAL HOUSEMAN: Will you clarify for me what you mean by "this country?" Do you include Hawaii and Alaska?

SECRETARY JOHNSON: Oh, yes. Don't let the Senators from there even hear you ask that.

MR. MUNCY: Mr. Secretary, we are all indebted to you personally this morning, for taking nearly four hours of your time to discuss Army procurement policy and problems with us in a very down-to-earth manner. We are also indebted to your experts on the panel--General Hamner, Colonel Gurnee, Mr. Lazure, and Colonel Knox. If you will pardon it, we are very pleased to see that two of your experts on the panel are graduates of this College. Thank you, gentlemen.