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REPORT TO THE CONGRESS

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Coordinated Consideration Needed Of Buy-National Procurement Program Policies B-162222

Office of Management and Budget

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BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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DEC. 9, 1971

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-162222

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on coordinated consideration needed of buy-national procurement program policies by the Office of Management and Budget.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Secretaries of State, the Treasury, the Interior, Defense, and Commerce; the Joint Economic Committee; the Commission on Government Procurement; the Council of Economic Advisers; and the General Services Administration.

Elmer B. Staats
Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

COORDINATED CONSIDERATION NEEDED OF BUY-NATIONAL PROCUREMENT PROGRAM POLICIES
Office of Management and Budget B-162222

DIGEST

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WHY THE REVIEW WAS MADE

In calendar year 1970 the Nation's balance-of-payments deficit on the official settlement basis exceeded $10 billion. The U.S. Government is pursuing several courses of action designed to alleviate the factors contributing to the unfavorable balance.

This General Accounting Office (GAO) report discusses one course of action--Federal procurement policies under the Buy American Act and the Balance-of-Payments Program, jointly referred to in this report as the buy-national procurement program. This program regulates Federal procurement in situations where suppliers offering domestic products and services are competing with suppliers offering foreign products and services.

FINDINGS AND CONCLUSIONS

Policies and procedures implementing the buy-national procurement program generally permit Federal agencies to pay up to 50 percent more for domestic products over comparable foreign products, to protect domestic interests and to improve the U.S. balance-of-payments position. (See p. 5.)

Need for reports on balance-of-payment benefits

Although the buy-national procurement program has been in existence for a number of years, information has not been accumulated to evaluate the effects of the program on the balance of payments or to determine what it has cost to obtain balance-of-payments benefits. (See pp. 12 and 28.)

GAO questions whether it is in the national interest to pay premiums of millions of dollars annually to retain procurement dollars in the United States, without some form of reporting system to determine whether balance-of-payments benefits are being achieved. (See p. 27.)

A case involving several civil agency procurements and a single Department of Defense (DOD) procurement showed that additional costs had been incurred without balance-of-payments benefits because of different procurement policies under the buy-national program. (See pp. 12 to 15.)

DOD saved an estimated $12.8 million in balance of payments by buying domestic sandbags at a premium of $7.7 million, 60 percent more than the estimated cost of foreign procurement. At the same

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time civil agencies purchased foreign-made products at a cost of $12.9 million.

The civil procurements offset the balance-of-payments benefits achieved by DOD.

With a more coordinated buy-national procurement program, other alternatives would have been available to the executive branch. Coordination might have resulted in:

--Domestic procurements by civil agencies and foreign procurement by DOD. (The same balance-of-payments benfit would have accrued at a savings of $4 million.)

--Domestic procurements by civil agencies in addition to DOD's domestic procurement. (An additional balance-of-payments benefit would have accrued at a premium of $3.7 million which was well within the guidelines established.)

--Limited resources might have been reallocated to other Federal programs aimed at expanding exports which reportedly are more cost effective in obtaining balance-of-payments benefits.

Value of foreign and domestic components not considered

Federal agencies are not required to determine the value of foreign and domestic components in end products and whether the additional cost that may be paid for a domestic end product will result in an appropriate benefit to the U.S. balance-of-payments position. (See p. 16.)

Federal agencies should consider the value of American and foreign components in the end product, to guarantee that premium prices are paid only when demonstrable balance-of-payments benefits will result. (See pp. 28 and 29.)

DOD approved an Air Force procurement from a domestic firm for $2.3 million more than the price offered by a foreign supplier. Due to the foreign components in the product, however, only $1.4 million in balance-of-payments benefits were achieved. (See p. 17.)

Using a guideline that a $2 advantage in the U.S. balance-of-payments position is necessary for each $1 in additional cost, a premium price of only $700,000 was justified. DOD was aware of the effect of the foreign componency on the balance-of-payments benefits but did not have enough time to readvertise the procurement to obtain componency data from bidders. (See pp. 17 and 18.)

Complexities call for high-level coordination

The buy-national program is complex. Its complexity is further compounded by the program's effect on major domestic and international program policies, such as the level of Federal spending, efforts to curb inflation, protection of domestic industry and employment, and U.S. foreign economic and trade objectives, including negotiations aimed at gaining access to foreign government procurements. (See pp. 22 to 27.)

GAO recognizes that most of these considerations are not subject to precise measurement--that subjective judgments by management might well outweigh the basic buy-national determinants of cost versus benefits. Decisions must consider that changes in any program may result in divergent effects on other programs. (See pp. 29 and 30.)

RECOMMENDATIONS OR SUGGESTIONS

GAO recommends that the Director, Office of Management and Budget:

--initiate a reporting system to assist in evaluating the effectiveness of buy-national procurement program policies in terms of balance-of-payments benefits and additional costs incurred and

--determine the feasibility of requiring that componency information be obtained and considered on procurements that involve buy-national program policies. (See p. 33.)

The creation by President Nixon of a new, high-level Council on International Economic Policy early in this year recognizes the need for coordinating economic and trade policies with overall national objectives.

GAO recommends also that the Director, Office of Management and Budget, in his role as the overseer of executive agency programs and policies, assess the indicated costs and benefits under the buy-national procurement program against the

--potential adverse impact of buy-national policies on other U.S. foreign economic and trade objectives formulated by the Council on International Economic Policy and

--potential for greater benefits in assisting the domestic economy and the U.S. balance-of-payments position by reallocating budgetary resources to other programs which reportedly are more cost effective and consistent with traditional U.S. efforts toward freer and fairer world trade. (See p. 33.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

Of the 10 agencies whose comments were requested, only DOD disagreed with GAO's proposal for a reporting system. DOD stated that the 50-percent premium for domestic procurement discouraged foreign bids and that therefore only estimates were available. GAO believes, however, that estimates would be useful in evaluating the efficacy of buy-national policies. (See p. 30.)

The Office of Management and Budget generally agreed with the proposal and is currently studying the feasibility of a reporting system. GAO was informed by an official of the Office of Management and Budget that it would be the logical organization to carry out or to coordinate an assessment of the program and other alternatives with information provided by other agencies. A high priority should be assigned to developing such a system. (See p. 31.)

Of 10 agencies commenting on a draft of this report, only DOD and the Office of Management and Budget did not agree with the objective of obtaining and evaluating componency information. The remaining agencies, although basically agreeing with GAO's position, expressed concern that undeterminable amounts of administrative costs might be incurred before the benefits to be realized were known. (See p. 31.)

GAO agrees that the feasibility of adopting a more stringent componency policy should be fully evaluated before it is adopted. (See p. 31.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

This report, showing the need for coordinated consideration of buy-national procurement policies, is being sent to the Congress because of the effect that the buy-national procurement policies have on a variety of important domestic and international program policies.

Contents

ABBREVIATIONS

AID	Agency for International Development
DOD	Department of Defense
GAO	General Accounting Office

DEFINITIONS AS USED IN THIS REPORT

Benefits	elimination or prevention of an outflow of U.S. dollars
Costs	budgetary outlays for products or services
Coordination	establishment of policy by one agency based upon overview of all issues, facts, and alternatives regarding a Government-wide program.

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

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CHAPTER 1

INTRODUCTION

The Buy American Act and the Balance-of-Payments Program, which favor the purchase of domestic products over foreign products, are referred to collectively in this report as the buy-national procurement program. This program applies, in part, to Government purchases in which suppliers offering domestic products are competing with suppliers offering foreign products.

The buy-national policies provide for adding a specified percentage to the bid amount of a supplier offering a foreign product or service when it is competing with a bid from a supplier offering a domestic product or service. These policies are intended to provide domestic employment, protect American business from foreign competition, provide for a defense mobilization base, protect national security interests, balance the effect of buy-at-home restrictions of other nations, and improve the U.S. balance-of-payments position. A discussion of the policies and procedures implemented under the Balance-of-Payments Program and the Buy American Act is presented below.

BALANCE-OF-PAYMENTS PROGRAM

Foreign confidence in the dollar is believed to depend on the U.S. balance-of-payments position and the strength of the U.S. economy. Since the U.S. dollar is the international trade and reserve currency, an adequate supply of gold is deemed necessary to maintain confidence in the value of the dollar.[1] To protect the U.S. supply of gold from being depleted, it is desirable for the United States to maintain a favorable balance of payments--inflow of foreign exchange greater than outflow of U.S. dollars.

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[1]Foreign confidence in the monetary strength was tied also to the ability of the United States to redeem foreign-held dollars for gold. The redemption of dollars for gold, however, was temporarily suspended by the President on August 15, 1971.

The rapid expansion of foreign economies and their increased export of goods to the United States since the mid-1950's have contributed to an unfavorable balance-of-payments position. For these and other reasons, the Government has taken various measures to improve its balance-of-payments position. U.S. balance-of-payments and Federal procurement statistics for the period 1960 through 1970 are provided as appendix I.

The Department of Defense, because of its substantial overseas expenses, plays an important role in seeking improvements in the balance-of-payments position through a variety of special measures. One of the measures authorized the payment of higher prices for domestic products for use abroad and was adopted in line with Presidential directives.

To give preference to domestic products, DOD established a 50-percent domestic-preference rate, which permitted the procurement of domestic goods and services for use abroad at a price up to 50 percent above bids submitted for foreign goods and services.[1] DOD's position is that although the 50-percent domestic-preference rate has reduced DOD expenditures abroad, it does not play a major role in curbing U.S. balance-of-payments outflows. DOD advised us that there were numerous limitations which restricted DOD's procurement from foreign sources, including national security set-asides for small business and statutory requirements for ship construction. DOD, however, was unable to provide us with actual statistics on foreign procurement and their effect on the balance of payments.

In an effort to further improve the U.S. balance-of-payments position, the Office of Management and Budget recommended that all Federal agencies follow the DOD practice of buying domestic goods and services for use abroad at prices up to 50 percent above bids submitted for foreign goods and services. The 50-percent criterion was administratively established by the executive branch. All Federal agencies, except the Agency for International Development

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[1]When approved by the Secretary of Defense or his designee, the preference rate of 50 percent can be exceeded.

(AID), have adopted this procurement policy regarding Federal procurement for use abroad.

Insofar as AID is concerned, until 1959 the foreign aid program allowed free-world procurement (certain countries excluded) with loans provided by AID. In 1959, in response to a Presidential directive regarding steps to be taken to improve the U.S. balance-of-payments position, AID adopted a policy of tied procurement. The tied-procurement policy requires that AID-financed procurements be made from specified countries, which include the United States and certain developing countries. The AID policy restricts the value of components from nonspecified countries in an end-item to a specified percentage of the sales price of the product. On direct procurements for AID, only 10 percent of the sales price of the product may consist of components provided by nonspecified countries but, on procurements made by other countries with AID loans, the rate is 50 percent. The 1961 Foreign Assistance Act made the AID tied-procurement policy a statutory requirement.

BUY AMERICAN ACT

The Buy American Act (41 U.S.C. 10a-d) of March 3, 1933, as amended, provides that, in the procurement of goods and supplies, Federal agencies acquire domestic products unless (1) they are for use outside the United States, (2) they are not available in sufficient quantities and of satisfactory quality, (3) the head of the procuring agency determines that their purchase would be inconsistent with the public interest, or (4) the head of the procuring agency determines their cost to be unreasonable.

Executive Order No. 10582, issued in December 1954, prescribes uniform policies for making certain determinations required by the Buy American Act. The Executive order defines a domestic product as an end product consisting of domestic components which exceed 50 percent of the cost of all the components included in the end product. The policies provide also that an unreasonable domestic price be determined as one exceeding the delivered cost of foreign products (including duty) by 6 percent.[1] The Executive order provides exceptions to 6-percent rule by permitting agency heads to apply higher rates when they determine that such is not unreasonable or is not inconsistent with the public interest.

In August 1962 DOD initiated a review to consider the effect of the 6-percent rule on the balance of payments. The purpose of the DOD review was to consider the merits of procuring a greater amount of domestic, rather than foreign, products for use in the United States, in view of the balance-of-payments benefits and the impact on Federal spending. Subsequently DOD adopted a 50-percent domestic-preference rate in accordance with the exception provision

[1] As an alternative to the 6-percent rule, the Executive order provides that an unreasonable domestic price be determined as one exceeding the offered price of materials of foreign origin, exclusive of duty, and all costs incurred after arrival in the United States by 10 percent. Furthermore, on the basis of the Executive order, administrative policies have allowed the use of an additional 6 percent when domestic procurement involves small business and areas of substantial unemployment.

of Executive Order No. 10582 which permits agency heads to apply higher rates when they determine that such are in the public interest.

DOD's adoption of the 50-percent rates under the Buy American Act, which is limited to the procurement of goods and supplies for use in the United States, made the DOD policy consistent with its Balance-of-Payments Program. This program involves goods and services used outside the United States and also provides for a 50-percent preference rate for domestic products. DOD formally adopted the use of the 50-percent domestic-preference rate under the Buy American Act in the March 1964 revision to the Armed Services Procurement Regulation. Under the regulation DOD is permitted to use the 6-percent rate (which includes duty) used by the civil agencies or the 50-percent rate (which does not include duty), whichever gives the greater preference to domestic products.[1]

DOD's adoption of the 50-percent rate resulted in nonuniform rates' being used by DOD and the civil agencies under the Buy American Act. In 1963 the Cabinet Committee on Balance of Payments agreed with the nonuniform policies because it believed that an increase in the civil agencies' rate could damage forthcoming trade negotiations, whereas the abandonment of DOD's rate could imply complacency regarding balance of payments.

At the time of our review, the percentages to be added to bids of suppliers who would offer foreign goods were as follows:

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[1]Duty is a tax levied by the U.S. Government on certain imported goods. The amount of duty varies with the goods and could be significant. Therefore the 6-percent provision, plus duty, in certain cases could offer greater preference for domestic products than application of the 50-percent premium.

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	Percentage added to bids of suppliers who offer foreign products: Defense agencies	Civil agencies (note a)
For use in the United States	50[b]	6
For use outside the United States	50	50

[a]Except AID.

[b]Defense agencies are permitted to use a 6-percent rate, including duty, or the 50-percent rate, excluding duty, whichever gives the greater preference to the domestic products.

SCOPE OF REVIEW

Our review was directed toward an evaluation of the policies and procedures used by Federal agencies in implementing the Buy American Act and the U.S. Balance-of-Payments Program. We have not attempted to evaluate other procurement policies, such as the Berry amendment, which favor the purchase of domestically produced products with public funds. As a part of our evaluation, we attempted to determine the rationale underlying the various domestic-preference price rates currently being used and the relationship between budgetary costs and balance-of-payments benefits resulting from procurements made under buy-national policies. We examined background documentation, relevant studies made by Federal agencies, interagency correspondence, congressional testimony, and procurement regulations. We examined also into selected procurement transactions of various Federal agencies.

In addition, we interviewed officials of various Federal agencies both at the headquarters level in the Washington, D.C., metropolitan area and at selected regional offices in the eastern part of the United States. The principal Federal agencies involved in our review were as follows:

Washington, D.C., metropolitan area:
- Office of Management and Budget
- General Services Administration (Federal Supply Service)
- Defense Supply Agency
- Department of Defense
- Department of Commerce
- Department of the Interior (Bureau of Reclamation)

Regional offices:
- Defense Industrial Supply Center, Philadelphia, Pennsylvania
- Defense Personnel Support Center, Philadelphia, Pennsylvania
- Aeronautical Systems Division, Air Force Systems Command, Dayton, Ohio
- Tennessee Valley Authority, Chattanooga, Tennessee
- Veterans Administration, Hines, Illinois

CHAPTER 2

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NEED FOR METHOD OF EVALUATING

EFFECTIVENESS OF BUY-NATIONAL PROCUREMENT POLICIES

To manage any program effectively, management must have some method for objectively evaluating program results. Without such a method management cannot adequately direct program activities to ensure that the program objectives are being accomplished.

Although the buy-national procurement program has been in existence for a number of years, a valid system of assessing results for use as a basis for planning and redirecting activities has not been developed. Thus Federal managers are without any valid means for determining what has been achieved as a result of the policies and procedures of the buy-national procurement program. They do not even know how much Federal procurement is affected by this program.

Federal procurement in fiscal year 1970 exceeded $47 billion. The total Federal procurement for fiscal years 1960 through 1970 is provided as appendix I. The extent, however, to which buy-national procurement program considerations were involved in this procurement was not documented. Responsible officials familiar with this program have estimated that, at the most, $1 billion annually in Federal procurement involves buy-national program considerations, but no one has accurate information on the actual amount.

If the estimate of $1 billion is reasonably accurate, it is a small percentage of total procurement but nonetheless a significant amount of money. Despite the substantial amount of money that appears to be involved, we found that Federal managers did not know, nor could they determine, either the extent to which existing procurement policies and procedures were resulting in balance-of-payments benefits or the extent to which additional costs were being incurred because of the absence of a reporting system.

Since we could not find any source of information on the amount of purchases made under either the Balance-of-Payments Program or the Buy American Act, we were unable to make any assessment of how much extra was spent each year to secure balance-of-payments benefits or how much in the way of balance-of-payments benefits was obtained for these additional costs. From a limited sample of procurements made, however, we were able to illustrate the inconsistent effects that the existing buy-national policies and procedures had had on the balance of payments and on Federal spending. GAO recognizes that the examples used in this section are somewhat dated. This was due to the absence of a reporting system and we were unable to find examples of more recent procurements at the locations visited.

In one such case the Deputy Secretary of Defense approved a justification for procurement of domestic sandbags at an estimated price of $20.5 million, although similar foreign sandbags could have been purchased at a price estimated by DOD at $12.8 million. The procurement justification cited balance of payments as the basis for the procurement of a domestic product. DOD authorized the purchase of domestic sandbags[1] at an additional cost of $7.7 million, about 60 percent more than the estimated cost of foreign sandbags,[2] to achieve a balance-of-payments benefit of $12.8 million. In this example we assumed that, if foreign bids were requested and received, they would come from responsible sources and their bids would approximate the DOD estimate.

Our test of civil agencies' procurements showed that similar balance-of-payments benefits available to them at considerably less cost had not been obtained. Civil agencies, for example, purchased foreign products at a cost of $12.9 million for use in the United States, even though

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[1] Subsequent to the award of this contract, the Congress approved legislation prohibiting foreign procurement of synthetic fabric similar to the fabric use for these sandbags.

[2] In this example we assumed that the foreign product would not contain any domestic component and that the domestic product would not contain any foreign component. This information was not available during our review.

similar products could have been purchased from domestic suppliers at a cost of $16.6 million. This was done because civil agencies' premium payments generally are restricted to 6 percent for domestic products for use in the United States. The purchase prices, additional costs, and balance-of-payments benefits involved in these defense and civil procurements are summarized in the following schedule.

	DOD	Civil agencies
	(millions)	
Price of domestic products	$20.5	$16.6
Price of foreign products	12.8	12.9
Premium price paid for domestic products	7.7	-
Savings by purchasing foreign products	-	3.7
Balance-of-payments benefits	12.8	-
Balance of payments lost	-	12.8[a]

[a]When information was available, we adjusted the balance-of-payments benefits obtainable to recognize the effect of domestic costs in foreign products and foreign costs in domestic products.

The above illustration covers Federal procurements totaling about $33.4 million ($12.9 million for foreign products by civil agencies plus an estimated $20.5 million for domestic products by DOD).

The net effect of the actual procurements was that the balance-of-payments benefits achieved by DOD's using the 50-percent criterion were offset by the civil agencies' procurements of foreign products using the 6-percent criterion. The extent to which similar comparable situations may have occurred is not known due to the absence of a reporting system, but we are of the opinion that such situations probably occur regularly under existing ground rules. The extent to which this type of information, if accumulated, might affect existing policies under the buy-national procurement program also is not known. Nevertheless we believe that information of this type would assist materially in evaluating the effectiveness of buy-national procurement policies in terms of balance-of-payments benefits and additional costs incurred.

This case demonstrates the need for coordinated consideration of the buy-national procurement program policies. For example, if a coordinated 40-percent policy had been established, the above procurements would have been reversed ($16.6 million would have been spent for domestic products in civil agencies and an estimated $12.8 million for foreign products in defense agencies) and the same balance-of payments impact would have been achieved at a cost savings of about $4 million.

Another possible benefit from a more coordinated procurement policy would have been that, in addition to the DOD domestic procurement, civil agencies would have procured domestic products at a cost of $16.6 million for an added cost of $3.7 million or about 28.7 percent more than the actual foreign procurements. This would have benefited the nation's balance-of-payments by an additional $12.8 million. The procurement would have been well within the guidelines established by the Cabinet Committee on Balance-of-Payments which permit the payment of an additional dollar in cost for each $2 advantage in balance-of-payments benefits.

In addition, the above example raises the issue of whether there is more than a question of consistent application of coordinated premium rates in achieving the cost and benefit objectives of the buy-national procurement program. For example, there are other Federal programs aimed at expanding exports which reportedly are more cost effective and might have resulted in obtaining greater balance-of-payments benefits than the $25.7 million for the $11.4 million in additional costs.

We recognize that there are a variety of major domestic and international program considerations directly affected by the buy-national procurement program. These considerations, which are more fully discussed in chapter 4, are not subject to precise measurement but should be considered by the executive branch in a coordinated assessment of the buy-national procurement program.

CHAPTER 3

NEED TO DETERMINE FEASIBILITY

OF REQUIRING AN EVALUATION OF COMPONENCY

Procurement regulations do not require Federal agencies to determine the value of foreign and domestic components in end products and whether the additional cost for a domestic end product, considering the value of both foreign and domestic components, will result in an appropriate balance-of-payments benefit. Therefore premium prices may be paid by the Government for domestic end products without obtaining an appropriate balance-of-payments benefit. We believe that a determination should be made of the feasibility of requiring Federal agencies to evaluate componency contained in end products and of requiring appropriate balance-of-payments benefits when premium prices are paid for domestic products.

GUIDANCE DOES NOT PROVIDE FOR AN EFFECTIVE EVALUATION OF COMPONENCY

It has been a long-standing policy for procurement offices to evaluate bid prices to obtain balance-of-payments benefits. This policy coincides with the efforts of the Federal Government to improve the U.S. balance-of-payments position. Procurement regulations require bidders on Federal supply contracts to certify that they are offering either a domestic or a foreign product. A product is considered foreign if the cost of the foreign materials included in the product constitutes 50 percent or more of the total cost of the material. If a foreign product is offered, the procurement office is permitted to buy a domestic product at a higher price.

Neither the Federal procurement regulations nor the Armed Services Procurement Regulation requires procurement offices to obtain the cost of foreign and domestic materials in end products. Furthermore, no procurement regulations provide a standard of what an appropriate balance-of-ments benefit is. In 1964, however, the Cabinet Committee on Balance of Payments interpreted that at least a $2 advantage in the balance-of-payments position of the United States was considered necessary for each $1 in additional cost resulting from the acceptance of a higher domestic bid.

In a prior GAO report (B-152980, January 1966), we stated that the Department of the Air Force, at the direction of DOD, had awarded a contract to a domestic firm for a communications system at a price $2.3 million higher than the price offered by a foreign firm. The contract was awarded to the domestic firm for balance-of-payments benefits. The contract award was made under defense policies that did not require the bidders' estimated costs of domestic and foreign components to be obtained and taken into account in evaluating the merits of the alternative bids. If the Air Force had been required to obtain information on the value of the foreign components, it would have been able to determine the actual balance-of-payments benefits and to make an informed decision regarding the desirability of paying a premium price for a domestic product.

An evaluation of the foreign components in the bids would have revealed that the additional price of $2.3 million for the domestic product would have achieved only a $1.4 million benefit in balance of payments. Information on the bid prices and the value of the foreign components is presented in the following table.

	Bid price	Foreign component cost
	(millions)	
Domestic firm	$9.5	$3.2
Foreign firm	7.2	4.6
Difference in cost	$2.3	-
Difference in foreign component cost	-	$1.4

Applying the interpretation of the Cabinet Committee on Balance of Payments that at least a $2 advantage in the balance-of-payments position of the United States was considered necessary for each $1 in additional cost resulting from acceptance of a higher domestic bid, the $1.4 million benefit in balance of payments would have justified only a $700,000 premium rather than the $2.3 million paid.

DOD advised us that it recognized that the bid by the domestic firm involved some foreign components, that the bid by the foreign firm involved some domestic components, and that the real balance-of-payments savings would be less than $7.2 million. DOD claims, however, that time did not permit a readvertisement of the procurement to elicit this type of data from the bidders. Irrespective of the basis that DOD may have used to award the contract to the domestic firm, this example clearly demonstrates the additional costs that can be incurred without obtaining an appropriate balance-of-payments benefit.

In response to the prior GAO report, DOD stated that a revised evaluation technique had been adopted to give more appropriate recognition to the costs of foreign components included in domestic bids. DOD also expressed the belief that the revised evaluation technique should be applied in only those unusual cases in which accurate data on foreign and domestic components would be reasonably available and in which the size of the procurement transaction would warrant the extra administrative work involved. DOD procurement regulations subsequently were revised to provide that information on the value of components be obtained from the domestic bidder on procurements in excess of $250,000 when it was anticipated that the low domestic bid would involve relatively substantial foreign expenditures or that the low foreign bid will involve relatively substantial domestic expenditures.

GAO examined into the implementation of DOD's revised procurement procedure and found that criteria had not been established for determining when the revised procedure should be used. A request for use of the revised procedure must be approved by the head of the agency or his designee in advance of solicitation of bids, to permit the solicitation to describe the evaluation procedure that will be used. It appears that use of the revised procedure is dependent upon the judgment and experience of procuring officials and their willingness to submit the necessary request. Therefore the obtaining of componency information is inhibited; this seemed to be the case since we could not locate bid solicitations which called for componency information at locations visited.

PROCUREMENT PRACTICES OF FEDERAL CIVIL AGENCIES COULD BENEFIT BALANCE-OF-PAYMENTS PROGRAM

During our review we found that the civil agencies of the Federal Government could contribute to a greater extent to the Balance-of-Payments Program by determining the costs of foreign components included in bid prices. For example, the Bureau of Reclamation, Department of the Interior, received six bids in 1968 for the construction of the second section of the Fort Thompson-Grand Island 345-kilovolt transmission line of the Missouri River Basin Project. The two lowest bidders were domestic firms which offered domestic products. As shown below, company X's bid of $6,067,578 involved foreign components totaling $1,737,062 and company Y's bid of $6,245,221 involved foreign components totaling $230,267.

	Bid price	Foreign component cost
Company Y	$6,245,221	$ 230,267
Company X	6,067,578	1,737,062
Difference in cost	$ 177,643	-
Difference in foreign components cost	-	$1,506,795

The policy and procedure of the Bureau of Reclamation require that componency information be included in the evaluation of bids to determine whether to classify bids as domestic or foreign. Componency information is obtained by the Bureau on all contracts over $250,000 when a potential application of the Buy American Act's provisions exists. Under Bureau procedures, however, the Balance-of-Payments Program is not a consideration. Bureau officials advised us that necessary componency information was obtained without undue administrative burden. Under the Bureau's internal procurement regulations, consideration was given to the value of the foreign components in each bid, and, in this case, 6 percent was added to the total value of each bidder's foreign components in evaluating the bids. The evaluation disclosed that

Company X was the low bidder after the 6-percent differential was added to the cost of the foreign components, and a contract was awarded on May 3, 1968.

On the basis of the above information, payment of a higher price would have produced a substantial balance-of-payments benefit and would have exceeded the criterion that at least a $2 advantage in balance of payments should be obtained for each $1 in additional cost. In this case the payment of an additional price of $177,643 would have resulted in a balance-of-payments benefit of $1,506,795, or, for each $1 additional cost, a balance-of-payments benefit of $8.50 would have been obtained.

AID PROCUREMENT POLICIES

AID is exempt from certain provisions of the Buy American Act. As discussed in chapter 1, however, AID has established certain procurement policies intended to benefit the U.S. balance-of-payments position. AID's procurement policies require that componency information be obtained and evaluated on all AID-funded procurements. It appears to us that the AID method of componency evaluation may be a simpler method and may be more easily administered than the componency rules adopted under the Buy American Act.

In 1959 AID adopted a tied-procurement policy which basically requires that direct procurement for AID, or procurement by other countries with AID loans, be restricted primarily to the United States and to certain less developed countries. After adoption of this policy, AID was faced with the problem of componency. AID initially considered the Buy American Act's componency policy as established by Executive order and found it to be too complex.

The policy adopted by Executive order under the Buy American Act and under the Armed Services Procurement Regulation requires comparison of the cost of the foreign components with the cost of all components in the end-item. The cost includes transportation; overhead and profit; and, in the case of foreign components, duty. AID officials informed us that the AID policy required merely that a determination be made that the cost of components from nonspecified countries was less than a certain percentage of the sales prices. On direct procurement for AID, components from nonspecified countries are limited to 10 percent of the sales prices, and, on procurements by other countries with AID loans, the cost of components from nonspecified countries is restricted to 50 percent.

AID officials informed us also that AID required all bidders to certify the cost of components from nonspecified countries included in their end products. Also, prior to shipment, the contractors are required to specify the imported components from unauthorized source countries contained in the end products. AID relies on the bidder's certificates and spot-check verifications. Under the AID policy bidders are subject to criminal penalties for false certifications. AID officials claim that obtaining the componency information has not been difficult.

CHAPTER 4

PROGRAM COMPLEXITIES

The issues involved in the buy-national procurement program are extremely complex. Numerous valid arguments have been advanced by leading businessmen, economists, legislators, and top officials of the executive branch in support of, in opposition to, and for modification of, buy-national procurement policies. The complexity of the program is further compounded by a variety of other major domestic and international program policies directly affected by the policies under the buy-national program. Furthermore many of these programs are so interrelated that a policy change in one program may have divergent effects on other important programs. Some of the principal policy considerations affected by the buy-national program policies are discussed below.

FEDERAL SPENDING

Since the policy under the buy-national program is to grant preference to domestic products in Federal procurement, in certain instances the Government pays higher prices for its purchases than the private purchaser pays. Therefore the buy-national program policy is contrary to one of the general principles of Federal procurement, that all Government contracts for property and services should be awarded to the lowest responsible bidder. Over the years various attempts have been made to estimate the additional cost of operating the Government as a result of the application of the buy-national procurement program. Such estimates, however, are extremely difficult to make, since complete and precise data is not available.

In hearings before the Subcommittee on International Exchange and Payments of the Joint Economic Committee in January 1969, DOD estimated that the additional budgetary cost associated with its balance-of-payments procurement program in fiscal year 1968 was about $100 million. It should be noted that the estimate was subject to rough calculation and was no more than an educated guess. Furthermore it is impossible to state exactly what percentage of

Federal procurement is affected by the buy-national program, since there is no way of knowing what foreign bids would be received if there were no program.

INFLATIONARY PRESSURES

Another consideration involving the buy-national program is whether inflationary pressures are accentuated to the extent that we fail to take advantage of the leveling influence of lower cost foreign goods. Several Federal agencies have noted that the discipline of foreign competition is a valuable tool in promoting the adjustment of the U.S. economy toward a more efficient distribution of economic resources.

For example, the Tennessee Valley Authority experienced lower domestic prices as a result of foreign competition in the procurement of steam-turbine generators. After foreign competition was introduced, the domestic price, based on the cost per kilowatt, was reduced nearly 50 percent. The Atomic Energy Commission noted that, prior to 1957, it was buying gallium from a single domestic source at a cost of $2.50 to $3.50 a gram. By 1960, subsequent to the introduction of foreign competition, the domestic price had decreased to $1.04 a gram.

By protecting the higher prices of domestic suppliers in Federal procurement, the Government may be contributing to general pressures for higher prices. If the domestic preference on Government contracts were increased, U.S. bidders that generally bid low and receive awards could successfully submit higher bids which would contribute to inflationary forces.

PROTECTION OF DOMESTIC INDUSTRY AND EMPLOYMENT

One of the primary objectives of the buy-national program is to protect domestic industry from foreign competition. Although there is no doubt that the program can aid domestic industry and can stimulate domestic employment, the relationship between the program and employment is not a simple one. The program is rather inflexible in that it provides support when the Government is purchasing but fails to provide support when the Government either is not purchasing or is not purchasing from those domestic industries or areas in need of support. Moreover, in some cases, protection of one industry may lead to boycott of another by foreign customers in retaliation.

FOREIGN ECONOMIC POLICY

The buy-national program has a direct effect on the foreign economic policy since it affects the ability of foreign producers to compete in selling to the Federal Government. Therefore the Government's actions on procurements under the buy-national procurement program, in which foreign bids are lower than domestic bids, can have a significant impact on U.S. foreign relations. According to documentation made available to us by the Office of Management and Budget, these transactions have been followed closely by foreign governments and industry for clues they may offer to future U.S. foreign economic policy.

Since the 6-percent differential was established by Executive order, there have been few foreign complaints as long as the differential has been followed. After DOD adopted its 50-percent differential, however, Common Market countries and the United Kingdom expressed concern, in a series of protests to the State Department, over the rejection of low foreign bids.

The Federal Republic of Germany noted its multimillion-dollar trade deficit with the United States and stated the belief that it had contributed significantly toward alleviating the U.S. balance-of-payments deficit by the prepayment of debts and by trade liberalization. The Federal Republic stated also that it was becoming embarrassingly difficult to explain the Buy American Act's restrictions on the sale of German goods in the U.S. market.

In another instance the Japanese Government canceled an order for coal from West Virginia after the United States Government rejected a Japanese steel bid by applying the 50-percent domestic differential.

In 1966 representatives of various countries belonging to the Organization for Economic Cooperation and Development met to mutually eliminate all discriminatory procurement actions against products of other members. The United States could not agree, and the other nations threatened to retaliate. The Common Market countries proceeded to work out their own agreement, and, when the agreement was offered as a model for action and was declined by the U.S. Government, the United States was criticized severely again.

During recent international discussions and negotiations involving tariffs and trade, foreign representatives expressed their countries' concern over the buy-national procurement program policies. The importance of the buy-national program to some countries is evidenced by the fact that some countries consider the buy-national program as an element of the U.S. foreign economic policy.

FOREIGN TRADE

The U.S. foreign trade policy is to expand international trade on a multilateral basis by reciprocal reductions of all types of trade restrictions. The buy-national program, however, is one of the barriers to freer world trade in that it favors the procurement of domestic products over foreign products, even though the price of the foreign product may be significantly lower.

Federal agencies noted in studies of the U.S. foreign procurement policies that procurement restrictions on foreign goods seriously undermined U.S. leadership in world trade. The U.S. Government has been in the inconsistent position of discriminating against foreign goods in its own purchasing activities while urging an expansion and liberalization of international trade on a nondiscriminatory basis.

In the November 1969 Presidential message on world-trade policies, President Nixon stated that the policy of freer world trade was in our national interest. The President stated also that the need to restore our trade surplus heightened the need for further movement toward freer trade and required us to persuade other nations to lower barriers which deny us fair access to their markets. The President stated further that the time had come for a serious and sustained effort to reduce nontariff barriers to trade and that their elimination was vital to our efforts to increase U.S. exports.

In the President's Second Annual Review of United States Foreign Policy, dated February 25, 1971, and in the Presidential address on economic policy, dated August 15, 1971, the policies of freer world trade and reciprocal reductions of trade barriers were restated.

BALANCE OF PAYMENTS

One of the prime concerns of the Federal Government is the present unfavorable U.S. balance-of-payments position. The buy-national procurement program is one of a variety of measures taken by the Federal Government to improve the U.S. balance-of-payments position. According to officials of several agencies, only a small fraction of total Federal procurement is actually subject to buy-national preferences. Statistical information on procurement and balance-of-payments savings under the buy-national program, however, was not available.

The buy-national program has been vigorously debated by Federal agencies. Several agencies have opposed the use of the program for balance-of-payments purposes because of the relatively small savings that are outweighed by additional budgetary costs, because of the damage inflicted on the posture of U.S. commercial policy internationally, and because of the disruptive effects on normal competitive forces and bidding procedures within the United States.

Other agencies have favored continuation of the program because any reversal of the current policy would be interpreted as a weakening of our determination to improve our balance-of-payments position. In addition, these agencies felt that there was a need for consistency in procurement policies for use inside and outside the United States and that the program provided a basis for leverage in international negotiations on Federal procurement practices.

OTHER CONSIDERATIONS

In addition to the policy considerations discussed above, other domestic and international policy consideration are affected by the buy-national procurement program. These other considerations include Federal revenues (income tax and import duties), stimulus of foreign competition to the efficiency of domestic manufacturers and to technological advances and quality improvements, access to needed raw materials, and mutual security and national security programs.

The complexity of the various domestic and international programs has resulted in a need for high-level coordination. President Nixon has recently established a new, high-level Council on International Economic Policy in recognition of the need for coordinating economic and trade policies with overall national objectives.

CHAPTER 5

CONCLUSIONS, AGENCY COMMENTS AND GAO EVALUATION, AND RECOMMENDATIONS

CONCLUSIONS

During our review we observed that, although the buy-national procurement program had been in existence for a number of years, information was not being accumulated to evaluate the effects of the program on balance of payments or to determine what it cost to obtain balance-of-payments benefits.

We believe that it is not in the national interest to pay premiums of millions of dollars annually to retain procurement dollars in the United States, without some form of reporting system to determine whether balance-of-payments benefits are being achieved.

We observed also that Federal agencies were not required to determine the value of foreign and domestic components in end products and whether the additional cost that might be paid for a domestic product would result in an appropriate benefit to the U.S. balance-of-payments position.

We believe that requiring contracting officers to obtain and evaluate componency in the light of the Buy American Act and balance-of-payments considerations is a realistic objective.

There appears to be no merit in rejecting low bids on foreign products for balance of payments which are otherwise acceptable, unless it reasonably can be shown that there is a balance-of-payments advantage to the United States sufficient to warrant the additional price paid through acceptance of a higher domestic bid. Therefore it seems reasonable that, when Federal agencies are willing to pay a higher price to domestic suppliers to achieve a balance-of-payments benefit, special efforts should be taken to ensure that higher prices are paid only when there are demonstrable balance-of-payments advantages.

To obtain such assurance, we believe that information regarding the value of domestic and foreign components included in the end products being offered should be obtained and considered in evaluating bids. This practice would enable the procuring agency to determine the actual balance-of-payments benefits of alternative bids and would make possible an informed decision regarding the payment of a higher price.

Although we believe that the principle of obtaining and evaluating componency is sound, appropriate data to evaluate the feasibility of such a program is not available. Since agencies are not required to accumulate statistical data under the buy-national procurement program, they have not accumulated information on componency. It seems to us that the initial step will be to evaluate the feasibility of such a program by determining the magnitude of the componency problem.

If information indicates that componency is a significant consideration under the buy-national procurement program, a determination will be necessary as to whether the additional burden involved in administering such a program will be worth the benefits. In this regard consideration should be given to the AID policy of evaluating componency, a simpler method than the policy established by Executive order under the Buy American Act.

We recognize that the buy-national program is complex and that its complexity is further compounded by the program's effects on major domestic and international program policies, such as the level of Federal spending, efforts to curb inflation, protection of domestic industry and employment, and U.S. foreign economic and trade objectives, including negotiations aimed at gaining greater access to foreign government procurements.

We recognize also that most of these considerations are not subject to precise measurement and that subjective judgments by management may well outweigh the basic buy-national determinants of cost versus benefits. Decisions therefore must consider the changes in any program which may result in divergent effects on other programs. Decisions should consider also the potential for greater benefits in assisting domestic industry and the U.S. balance-of-payments position by reallocation of budgetary resources to other existing programs which reportedly are most cost effective.

AGENCY COMMENTS AND GAO EVALUATION

In our draft report we suggested that the Director, Office of Management and Budget, develop a reporting system that would provide pertinent information to assist in the evaluation of the effectiveness of buy-national procurement policies in terms of balance-of-payments benefits and additional costs incurred. Copies of our draft report were sent to 10 agencies.[1] Only DOD disagreed with our suggestion. DOD stated that, since its 50-percent premium differential discouraged foreign bids, pertinent data did not exist to be reported; therefore, a reporting system would be useless. Their reply stated, in part, that:

> "With respect to procurement for use overseas, it should be noted that, in general, DOD purchases of U.S. items are normally made when the estimated cost of U.S. supplies and services, including transportation, does not exceed the estimated cost of foreign supplies and services by more than 50 percent. In these case, [sic] actual foreign bids also are not received."

DOD recognized that its data relating to these programs was not precise but that sufficient data had been available to permit the necessary evaluation and policy decisions to merit continuation of DOD's present balance-of-payments policies.

We believe that the data presently used by DOD could be included in a reporting system and could be evaluated with

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[1]The agencies which received and commented on our draft report were the Departments of Commerce, Defense, the Interior, State, and the Treasury; the Council of Economic Advisers; the General Services Administration; the Office of Management and Budget; the Office of the Special Representative for Trade Negotiations; and the Tennessee Valley Authority.

data from all Government agencies. This should enable management to make informed decisions on the buy-national procurement policies on a Government-wide basis. Even though DOD data would be estimated, it would be preferable to no information as is now the case.

In commenting on the establishment of a reporting system, the Office of Management and Budget stated that:

> "We agree that more information would be desirable and, in fact, are currently studying the feasibility of a reporting system. The precise design of a system is not yet clear, however, given the problems of determining specifically what it should measure; what level of detail is appropriate; whether it should provide for routine or exception reporting; whether certain kinds of data are even available; etc."

In our draft we suggested also that Federal procurement officials obtain componency information and evaluate the foreign and domestic components contained in end-items as a part of their review and evaluation process on all procurements in excess of $250,000.

Of the 10 agencies that commented on this suggestion, only DOD and the Office of Management and Budget did not agree with the objective of obtaining and evaluating componency. Although reservations similar to those expressed by DOD and the Office of Management and Budget were cited by several of the other agencies, these agencies basically agreed with our position.

The agencies were concerned primarily with the feasibility of incurring an undeterminable amount of additional administrative costs to obtain and evaluate componency information and to monitor contractor performance, without knowing the benefits that could be realized. We agree with the agencies' concerns and believe that the feasibility of adopting a more stringent componency policy should be fully evaluated.

DOD expressed concern that the existing uniform Government-wide policy established by the Buy American Act and by Executive order, which has given notice to the business community of the world of U.S. policy, should not be changed on a transaction-by-transaction basis. We believe that any change that is appropriate to meet the objectives of the United States should be made, whether it requires changes to existing legislation or to policies implemented under that legislation.

RECOMMENDATIONS

We recommend that the Director, Office of Management and Budget

--initiate a reporting system to assist in evaluating the effectiveness of buy-national procurement program policies in terms of balance-of-payments benefits and additional cost incurred and

--determine the feasibility of requiring that componency information be obtained and considered on procurements that involve buy-national program policies.

The creation by President Nixon of a new, high-level Council on International Economic Policy early this year recognizes the need for coordinating economic and trade policies with overall national objectives. We recommend also that the Director, Office of Management and Budget, in his role as the overseer of executive agency programs and policies, assess the indicated cost and benefits under buy-national procurement program against other alternatives.

The indicated cost and benefits under buy-national procurement program should be assessed against the potential adverse impact of buy-national policies on other U.S. foreign economic and trade objectives formulated by the Council on International Economic Policy. The indicated benefits should be assessed also against the potential for greater benefits in assisting the domestic economy and the U.S. balance-of-payments position by reallocating budgetary resources to other programs which reportedly are more cost effective and consistent with traditional U.S. efforts toward freer and fairer world trade. We were informed by an official of the Office of Management and Budget that it would be the logical organization to carry out or to coordinate an assessment of the program and other alternatives with information provided by other agencies.

U.S. BALANCE OF PAYMENTS AND

FEDERAL GOVERNMENT PROCUREMENT STATISTICS

FOR THE PERIOD 1960 THROUGH 1970

Calendar year	Balance of payments: Liquidity balance	Balance of payments: Official settlement balance	Fiscal year	Federal Government procurement (billions)
	(billions)			
1960	-$3.9	$-3.4	1960	$25.7
1961	-2.4	-1.3	1961	27.8
1962	-2.2	-2.7	1962	32.6
1963	-2.7	-2.0	1963	34.1
1964	-2.8	-1.6	1964	35.0
1965	-1.3	-1.3	1965	34.9
1966	-1.4	.3	1966	46.0
1967	-3.5	-3.4	1967	52.1
1968	.2	1.6	1968	51.1
1969	-7.0	2.7	1969	54.2
1970	-4.7	-10.7	1970	47.5

APPENDIX II

PRINCIPAL OFFICIALS

RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES

DISCUSSED IN THIS REPORT

	Tenure of office From		Tenure of office To	
OFFICE OF MANAGEMENT AND BUDGET (Bureau of the Budget prior to July 1970)				
DIRECTOR:				
George P. Shultz	July	1970	Present	
Robert P. Mayo	Jan.	1969	June	1970
Charles J. Zwick	Jan.	1968	Jan.	1969
Charles L. Schultze	Jan.	1966	Jan.	1968
OFFICE OF THE SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS				
SPECIAL REPRESENTATIVE FOR TRADE NEGOTIATIONS:				
Carl J. Gilbert	Aug.	1969	Present	
William M. Roth	Feb.	1967	Jan.	1969
Christian A. Herter	Jan.	1966	Dec.	1966
DEPARTMENT OF STATE				
SECRETARY OF STATE:				
William P. Rogers	Jan.	1969	Present	
Dean Rusk	Jan.	1966	Jan.	1969
DEPARTMENT OF THE TREASURY				
SECRETARY OF THE TREASURY:				
John B. Connally	Feb.	1971	Present	
David M. Kennedy	Jan.	1969	Feb.	1971
Joseph W. Barr	Dec.	1968	Jan.	1969
Henry H. Fowler	Jan.	1966	Dec.	1968