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FEDERAL PROCUREMENT POLICY: IS THE FEDERAL GOVERNMENT FAILING CERTAIN INDUSTRIAL SECTORS?

HEARING

BEFORE THE

SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT & GOVERNMENT PROGRAMS

OF THE

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TUESDAY, JULY 22, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT,AND
GOVERNMENT PROGRAMS,
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Subcommittee met, pursuant to call, at 10:12 a.m. in Room 2360, Rayburn House Office Building, Hon. Todd Akin [Chairman of the Subcommittee] presiding.

Present: Representatives Akin, Bradley, Udall and Manzullo.

Chairman AKIN. I call the hearing to order. We are going to try and proceed expeditiously. We have two different panels, and I have an opening statement, so I figure I will get started with the opening statement and move things along. I believe the Minority Member is going to be here in just a matter of a minute or two.

This is a hearing on the federal procurement policy, and the question is is the U.S. Government failing certain industrial sectors. Speaking at a technology conference last week in California, former Secretary of State Dr. Henry Kissinger expressed his belief that our nation needs to address the increasing outsourcing of economic activity from the United States to other countries.

Kissinger went on to assert: "If outsourcing continues to strip the U.S. of its industrial base and the act of getting out or developing its own technology, then we require a careful thought on national policy." It is concerns like these that bring us here today.

There appears to be a growing trend of federal procurements going overseas. We are seeing an increase in number of federal solicitations, one by companies based outside of the United States. I am not speaking of solicitations for items that are rare or exclusive to a particular country of origin, but rather items that we are able to produce here at home.

For example, the Transportation Security Agency recently awarded a contract for the purpose of 9,600 firearms to be used by U.S. airline pilots to a German arms manufacturer. While I am not a gun expert, I do know that some of the finest firearms in the world are manufactured in the United States. Springfield Armory, one of the oldest and finest firearms manufacturers in the world, is less than 300 miles from my home in St. Louis.

While I am not privy to the details of the purchase, I would question the need to entertain foreign bids for a product of high quality

and outstanding reputation that is manufactured right here in the United States.

The federal government is our nation's single biggest consumer, and there are times when it is necessary for this government to procure products and services from foreign sources. However, the Congress, as a representative voice of the American people, has set forth certain policies that mandate the purchase of products and services from American small businesses and industry. The question is whether or not these policies are being pursued.

With us today we have a representative sampling of American small business and industry. In addition, I have invited the Department of Defense and the Department of Treasury representing federal procurement to join us as we examine this question. I have also invited the White House Office of Management and Budget to join us. Unfortunately, despite our best efforts to accommodate their schedule, OMB representatives were unable to attend.

The OMB sets forth procurement policy for all federal agencies and departments, and it is important we examine whether or not OMB is establishing the best possible policies in this regard. I look forward to the testimony of our industry and government witnesses in regard to this question as well.

I know all the witnesses have prepared written statements for the record. They will be entered into the record without objection. In their opening statements to this Committee, however, I would ask the witnesses to summarize their written testimony and provide only the highlights of that written testimony in light of our limited time this morning.

Thank you all for attending. I will just take a check whether we are ready to proceed. I think it would be appropriate maybe to have the Minority Member make a statement when he arrives. Would that be acceptable? Okay. Let us go ahead and do that.

In the use of time then, I would like to introduce our first panel. Let us see. Okay. Panel 1, Department of Defense, and that would be Ms. Dierdre Lee, and you are the director of the Defense Procurement and Acquisition Policy. Is that correct?

Ms. LEE. Yes, sir.

Chairman AKIN. Okay. I really appreciate your coming this morning, and we would appreciate to hear. I think one of the things that happens is sometimes at these Committee hearings we get so wrapped up in a lot of the details, and everybody has their statement and everything. Maybe we forget that the whole point of why we are here is just to take a look at a question or a problem.

The question is I think there is really a tension between two things. Your overall Department of Defense is given a job to defend our nation, and they are given a limited amount of money to do that, so they are trying to figure out how to get the most bang for the buck. That is sort of their overall, common sense marching orders.

At the same time we are saying we do want to try to protect our manufacturing base, which is not the primary job of the Department of Defense, and so there is kind of a tension as to if I can get black berets made in China, and I do not mean to pick on something that particularly maybe solicits a lot of opinion, but if you can get them at 10 cents versus $10 you think well, I can save a

lot of money and buy some more tanks or whatever it happens to be.

That is the tension. I think that is what we want to look at today. If you would just give us your perspective on that, Dierdre, and thank you so much for coming this morning.

STATEMENT OF DIERDRE LEE, DIRECTOR, DEFENSE PROCUREMENT AND ACQUISITION POLICY, DEPARTMENT OF DEFENSE

Ms. LEE. Yes, sir. Mr. Chairman, Members of the Subcommittee, good morning. I am Dierdre Lee, Director of Defense Procurement and Acquisition Policy. I am here today to discuss the efforts of the Department of Defense to assist small businesses with unique technologies to participate in DOD procurement opportunities. I will also discuss the Department's procurement policy, especially as it pertains to the use of small business and foreign suppliers.

Small business is a vital part of the defense base, and we remain committed to insuring their viability by offering DOD programs that support small business development and sustainability. Eighty-two percent of the Department of Defense prime contractors are small businesses, which demonstrates the importance of small business to this Department.

Small business prime contractors performing on DOD contracts increased to 33,936 in fiscal year 2002, compared to just over 24,000 in 2001. DOD accounted for an unprecedented $59 billion in small business in fiscal year 2002. DOD dollars going to small disadvantaged businesses, women-owned small businesses, service disabled and veteran-owned small businesses and HUBZones increased at the prime and subcontract level in fiscal year 2002 and achieved record highs.

My written testimony provides numerous examples of programs within the Department that facilitate opportunities for small business. Among them are the COSI program, which is designed to introduce commercial technology projects into legacy systems, thereby reducing ops costs and support costs. It is basically now Mr. Hunter's challenge program.

Title III of the Defense Production Act. The Title III program provides incentives to establish or expand production capability for items critical to the national defense when companies are unwilling or unable to make such investments on their own.

The foreign cooperative test program is another way DOD assists small businesses to become DOD participants. The program taps into mature foreign technologies and after successful testing of these technologies forges partnerships with U.S. suppliers through marketing and production license. Though not reserved exclusively for small businesses, small businesses have successfully competed, won and performed on advanced concept technology demonstration programs.

Programs designed to demonstrate the military utility of new technologies while giving more fighters hands-on experience to develop concepts for operational deployment. The Department spends approximately $25 million each year on its mentor protege program where large businesses furnish technical and business assistance to

small businesses so that they can develop as DOD prime contractors or subcontractors.

The Department also issues biannual solicitations for both the small business innovation research program and the small business technology transfer program. These programs fund over $800 million each year in early stage R&D projects at small technology companies, projects that serve the DOD need and have commercial applications. It is through programs such as these that the DOD helps niche companies and taps into cutting edge technology critical to DOD.

Of course, DOD's procurement policy is extremely important with regard to small business and the industrial base. The over arching federal procurement policy is to provide a fair opportunity for all interested and qualified companies to compete for government requirements.

As I said previously, small business is a critical component of the defense industrial base. Under our procurement policies, there is a requirement for procurements to be set aside or reserved exclusively for small businesses. Only small businesses that have a place of business located in the United States can compete for these requirements.

Now let me turn briefly to international sourcing. As you are aware, the Buy America Act provides a framework for government procurement of domestic and foreign products. With limited exceptions, the BAA restricts the purchase of supplies and construction materials that are not domestic. When DOD receives an offer of a product that does not meet the BAA definition of a domestic end product it is considered a foreign product, and an evaluation premium of 50 percent is applied to the offeror of the foreign product unless the BAA has been waived under some exceptions permitted by law.

Trade agreements result in waiving the BAA for some foreign sources and construction materials from certain countries. The Agreement on Government Procurement, the Trade Agreements Act and NAFTA all impact how we handle our foreign procurements. DOD has also waived BAA for countries for which we have a reciprocal memorandum of understanding. These memorandums promote standardization and interoperability of defense equipment with our allies and friendly governments.

Under the exceptions to the BAA, trade agreements and MOUs, foreign firms may compete for DOD contracts. To the extent we provide foreign firms opportunity to sell in the U.S., we retain the leverage to insist on reciprocity for U.S. firms, including small businesses seeking opportunities to export.

Our exports have exceeded our imports in the defense industry, and currently the balance of trade is significantly in the U.S. favor. Defense sales by U.S. companies are two and a half to three times our exports.

Mr. Chairman, as you know, Defense is a complicated business. We need and want maximum participation by our U.S. small businesses.

Chairman AKIN. Dierdre, are you wrapping up now?

Ms. LEE. Yes, sir. The Department is fully committed to fostering the use of small business opportunity as prime contractors, subcontractors and vendors.

[Ms. Lee's statement may be found in the appendix.]

Chairman AKIN. Thank you very much. I appreciate your testimony. You raise some interesting questions, too.

My good friend, Mr. Udall, is here. Just for the record, would you like to have your comments submitted, or would you like to make a statement?

Mr. UDALL. Let me just say, Mr. Chairman, first let me thank you for doing this hearing. I think it is very important. I would like to put my statement into the record. I apologize to the witnesses for being late.

Let me just say that small business getting a bigger share of the federal procurement pie is very important to me in my district in New Mexico and I know to this Subcommittee. We have the Chairman of the full Committee here, and he at various times I think in the full Committee has expressed an interest in this, so I hope that we can continue to work on that.

With that, I yield back to you and look forward to hearing from the next witness.

Chairman AKIN. Thank you very much, Tom, and I think next we will go to our second witness here. That is Jody Falvey, Department of the Treasury, and you are the Director of the Office of Small Business Development.

Ms. FALVEY. Yes, sir.

Chairman AKIN. We would appreciate hearing your thoughts on the subject as well. Proceed.

STATEMENT OF JODY FALVEY, DIRECTOR, OFFICE OF SMALL BUSINESS DEVELOPMENT, DEPARTMENT OF THE TREASURY

Ms. FALVEY. Chairman Akin and Members of the Subcommittee, I am pleased to appear before you today to discuss the Treasury Department's small business procurement program.

Treasury's Office of Small Business Development supports the Small Business Act by stating in our business standard operating procedures that it is the policy of the Treasury Department to provide maximum practicable opportunities in our acquisitions to small business, whether it be small disadvantaged business, women-owned small businesses, veteran-owned small business and service disabled veteran-owned or HUBZone small business concerns.

The OSBD assists, counsels and advises small businesses on all types of procurements for contracting with Treasury. Additionally, the OSBD works closely with each Treasury bureau to implement the Department's small business procurement assistance program. Each bureau has an appointed small business specialist located within the procurement office to coordinate that program.

Treasury focuses its efforts in four major areas. That is information dissemination, whether it be via the internet or hard copy publications, our outreach programs, training or our mentor protege program. Additionally, the OSBD, in conjunction with the bureaus, works closely with the SBA to establish our procurement goals on a fiscal year basis. The accomplishments are provided from the

Federal Procurement Data System to the SBA, which prepares a report for Congress and the President.

Treasury has a rigorous small business outreach program, and for several years we have hosted monthly, no cost, vendor outreach sessions. VOS we call them. We have hosted 12 events thus far for fiscal 2003, and these events are prearranged 15 minute appointments between small business owners and representatives from Treasury's bureaus or Treasury's prime contractors and their representatives. On a four point adjective scale of good, fair, poor or excellent, 99.8 percent of all small business participants rated the sessions as good or excellent.

Treasury is taking the following actions on an ongoing basis to maximize the small business opportunities to market their business to Treasury. In outreach, we host special events, whether they are several disabled veteran-owned small business events during November in recognition of Veterans Day or a women-owned small business event in March in honor of Women's History Month.

We meet periodically with trade associations to discuss and exchange information on success stories or ideas, et cetera. We continue to promote the participation in Treasury's mentor protege program. We continue to promote the participation in Treasury's subcontracting program by making subcontracting plans part of the evaluation criteria on major projects.

We actively seek the various small business categories through the GSA federal supply schedules by looking at the GSA website and the Federal Procurement Data System internal database. We promote the use of all available databases for market research and inclusion or consideration.

During the fourth quarter FY 2002, the Federal Procurement Data Center revealed that even though Treasury was ranked number 10 in the dollars spent government wide, our percentage of dollars spent reflects the commitment to small business. Treasury ranks number one in the percentage for SDB or women-owned small business goals with a 12.22 percent and 6.12 percent respectively.

We are number two in 8(a) and veteran-owned and service disabled veteran-owned small business goals at 6.44 and .94 and .40 respectively. We did exceed our government wide small business goal with 27.66 percent. We are ranked number five for the HUBZone goal at 1.21 percent, but we feel strongly that over time our outreach program and the strategy for HUBZone or service disabled veteran-owned small businesses will provide more opportunities and subsequent contracts and subcontracts.

We attribute our small business success to a number of critical factors. These include senior management support, commitment, a team approach, outreach, information dissemination, training and our mentor protege program. We recognize that we are a part of a larger network that makes up the small business community, and our illustration of the teamwork is having SBA's PCR located in residence at the Treasury office. The PCR's office is located adjacent to our office. By organizational design, this arrangement promotes the teamwork and a genuine partnership, which promotes a successful program.

This concludes may prepared remarks, and I would be pleased to answer any questions you have.

[Ms. Falvey's statement may be found in the appendix.]

Chairman AKIN. Thank you very much for your testimony.

I think procedure-wise we can go to some questions. One, this just to try and keep the schedule going of where we are going this morning with the hearing.

Dierdre, my understanding is you had some other appointments and things. After this panel is done, you need to move along. Was that my understanding?

Ms. LEE. Yes, sir.

Chairman AKIN. Jody, what is your status? I think there were a few people from the business community here that might have some questions, but it might involve your staying an extra 20 or 30 minutes. Is that doable, or did you have something you had to get to right away?

Ms. FALVEY. Yes, sir.

Chairman AKIN. Is that workable? Okay. Thank you. I think perhaps some of our other witnesses might be, and sometimes it is helpful to go back and forth and say well, here is how we see it, et cetera, et cetera.

Okay. I guess I get the shot at the first question here. I guess the first thing, Dierdre, is you really gave an impressive set of numbers. You said basically we have improved the number of these small business types of purchasing arrangements basically by a factor of 50 percent more than we had the year before or like a one-third increase or something. Does that just reflect the increase in Defense spending?

Ms. LEE. Yes, sir. Those are Department of Defense's statistics.

Chairman AKIN. Right. But we spent a lot more money in Defense, did we not, in 2001–2002? I mean, have we not——.

Ms. LEE. Yes. The base has increased.

Chairman AKIN. Yes. So also the number of small business contracts has increased, but is one just a reflection of the other, or percentage-wise are we actually doing better in terms of numbers given the size of the base? Do you see what I am saying?

Ms. LEE. Given the size of the base, the percentages have increased as well.

Chairman AKIN. Okay.

Ms. LEE. We still have more to do.

Chairman AKIN. Thank you very much. I guess I am being called to go vote somewhere, so we are going to turn the meeting over to someone else for the time being.

Who wants to chair it? Mr. Bradley, do you want to take the chair? Thank you.

Mr. BRADLEY. [Presiding] Questions of the panel by Mr. Udall?

Mr. UDALL. Dierdre, my understanding is that the Department of Defense has a five percent women-owned business goal. Is that correct?

Ms. LEE. Yes, sir.

Mr. UDALL. And you are really only at two percent now?

Ms. LEE. In 2002, it is 4.1.

Mr. UDALL. In 2002, it is 4.1. In 2001, I guess it was two percent?

Ms. LEE. Three percent. In 2000, 2.6.

Mr. UDALL. Okay. The number we have on 2002 is 2.67. That is from the Federal Procurement Data System.

Ms. LEE. These are our numbers, and there is an explanation for the numbers which gets very specific on the base. What we do take out is work that, for example, goes to JWAD or that is not available for small business, so we do adjust the baseline.

Mr. UDALL. So tell me what the difference is in the numbers here, your numbers and the difference.

Ms. LEE. Our number would be based by any contract being performed overseas, FMSLs and any contract that is we say not available, for example, that goes to the handicapped or the disabled and is, therefore, not available for a small business.

Mr. UDALL. My understanding is these numbers I just gave you from 2001, these are the official federal government numbers.

Ms. LEE. Those are from the Federal Procurement Data System.

Mr. UDALL. Yes.

Ms. LEE. Correct.

Mr. UDALL. Yes. In 2001, you had two percent, and in 2002 you had 2.67. Can you tell me why you are having such a hard time at achieving the five percent goal?

Ms. LEE. On women?

Mr. UDALL. Yes.

Ms. LEE. Yes, sir. Government wide, we have no set aside program for women. What we do is we have a goal, which is great, but we then put it out, and women have to compete and win, and they do in an increasing number, but we do not have the ability, the authority government wide at the Department of Defense or any of the other government agencies that I am aware of, to do what we call a women-owned business set aside where you would set the work aside for only women.

There is legislation. There is work going on with SBA, and we are waiting for their policy to tell us a possible optional set aside provision, but we do not at this time have that regulation.

Mr. UDALL. We had a piece of legislation that dealt with women-owned businesses and trying to move their ability in the workplace on federal procurement. Do you think that would be helpful to do something along that line to move these numbers up?

If you notice a tone of frustration, in New Mexico, which is a poor state, we are having dramatic, dramatic increases in women-owned businesses, minority-owned businesses. The growth is superlative, so I do not understand why you are not able to do it here at the federal level in the Department of Defense.

Ms. LEE. Sir, I am not familiar with your programs and your set aside programs specifically in the states. Some states do have set aside programs.

As I said, we do not have that for women. We do have the authority to set aside for 8(a) or for HUBZones. The Department of Defense does not have the authority to even do SDB set asides because we reach our goal every five years, and, therefore, we cannot use that set aside provision. We do not have set asides for women, service disabled vets, another large category of other interested constituencies.

My opinion is, and I have concern and I know I have spent a lot of time with Mr. Manzullo on this. Right now our small business procedures are very complicated. What I would like to do is see us simplify them. Women are competing. They are winning. They are doing a good job. Having additional set asides will further complicate the system.

Mr. UDALL. So you are saying that the complications are in part the women-owned businesses making it through your process, and you would like to simplify that process?

Ms. LEE. Yes, sir. I would like to simplify that process for everyone.

Mr. UDALL. How soon are you going to do that?

Ms. LEE. We are working together on that, everything from additional certifications, additional limitations, specific requirements of content of the material of the product they provide, specific certifications. All those kind of things one by one we are trying to simplify the government procurement process.

Mr. UDALL. Thank you for your responses.

Mr. BRADLEY. Thank you, Mr. Udall.

The Chair now recognizes Mr. Manzullo.

Mr. MANZULLO. Thank you. I just have a couple of questions.

Dierdre, first of all, I would like to meet with you ASAP on some simplifications because we are in the process of marking up the Small Business Administration reauthorization bill and always value immensely your input.

Ms. LEE. Thank you.

Mr. MANZULLO. The second question is on page 9 of your testimony, it is the first full paragraph. Do you have that there?

Ms. LEE. Yes, I do.

Mr. MANZULLO. Where it says "Foreign firms..." Do you see that?

Ms. LEE. Yes.

Mr. MANZULLO. "Foreign firms may also participate as subs in DOD procurements. It is DOD's goal to acquire the product, service or technology that would best support our military forces and protect our national defense. Therefore, in general it is DOD policy not to interfere with the prime contractor for selection of its subs because prime contractors have overall responsibility for producing and delivering the contracted items." The last sentence: "It is also the prime contractor's responsibility to insure that the products being delivered meet the requirements of the Buy America Act."

What oversight do you do and what documents do you require of the primes and the subs to show compliance with the Buy America Act?

Ms. LEE. Certainly that depends on the product or the service. We do have Defense Contract Management Agency, and most people are familiar with them, actually in the plant, physically in the plant of many of our large contractors. They in fact would review not only that contractor's procurement system, but their sourcing, their subcontracting procedures, and so they would do an in-plant review on those activities.

Mr. MANZULLO. But is that done on every contract?

Ms. LEE. Not on every contract because we do not have people in plant at every plant. It would depend on the size and the criticality of the program and how we have deployed our DCMA folks.

Mr. MANZULLO. Okay, because that is obviously where we are having a serious—in fact, we are going to have a hearing probably why the Department of Transportation TSC awarded a contract to a German firm on the 9,600 guns.

Dierdre, what we have here is we have a destruction of the American manufacturing base. Let me get very specific. Northrop Grumman is a sub of Lockheed Martin on the joint strike force fighter, and they are still bound by the Buy America Act.

Northrop Grumman said that Ingersoll Milling in Rockford could not make the quality machine necessary to do precision drilling for holes on the F–35. They were unaware of the fact that the prime contractor, Lockheed Martin, had a separate contract with Ingersoll Milling in Rockford for virtually the same machine for a different application on the F–35.

Northrop Grumman instead awarded the contract to a Spanish firm that is not a member of the consortium to build the F–35, which helped bankrupt Ingersoll Milling. Ingersoll Milling is one of only two companies—was one of only two companies—that make sophisticated machines to wrap stealth material on wings for military aircraft that accommodate a six axis head. They are gone now. They were almost sold to the Chinese firm.

What I see in your testimony, I know you have a big job in there. The hearings that we held with Suzanne Patrick three weeks ago indicate the Pentagon has no policy to keep an inventory of critical industries. That is compounded by the fact that there is no oversight as to the awarding of these contracts by the prime and the subs in order to keep those critical industries stabilized.

I guess maybe it is more of a statement than a question on it, but it goes to we are going to be having hearings throughout the end of this year and next year bringing in every single department in the United States to find out how they are complying with the Buy America Act because based upon the information we have the Pentagon is not going to say because of lack of oversight and because of mentality that it is cheaper to buy things overseas so, therefore, why buy American.

My question to you, and it is something that we can discuss later, but you might want to put it in writing, is how can you protect critical defense industries when you have no oversight as to the awarding of the contracts before they are awarded, which could result in a critical industry going under such as what happened with Ingersoll?

You could take a stab at it now, but if you want to put it in writing? Okay.

Ms. LEE. I would be happy to answer that in writing, but I will also say, as I know Ms. Patrick covered with you, we do have a system to monitor our industrial base. She does in fact, and we prepare to the Congress and submit reports on not only what activities we have done internationally, but also how we monitor our industrial base, specific studies, things that we look at and identify critical areas.

As my testimony also states, on things that are critical or security minded we also in many cases restrict them to domestic preference as well, so we do have a monitoring generally of the system.

Perhaps in that particular case not every single manufacturer, but as the industrial base capability as a whole we do look at.

Mr. MANZULLO. Okay. I want to dispute with you on that because I also brought up the fact of Nashville Manufacturing in Tiffin, Ohio, is the last manufacturer of cold-forming machines. They went under. Without a manufacturer of cold-forming machines, you have nobody to manufacture machines that make bullets.

I do not see evidence of that inventory. My understanding of the testimony from Suzanne Patrick was that there is no inventory. I asked her that question. Nobody keeps a list of critical industries. In other words, you can go back and see who is left in the cold-forming business, who is left in the business of making machines for the application of stealth technology material.

If you would like to take a stab at that in writing that is fine.

Ms. LEE. Okay.

Mr. MANZULLO. More importantly at least for now is as we are doing that SBA bill and the reauthorization, if you could take today or maybe tomorrow and talk to Mr. Eskel and give us some hints that you think could expedite and make easier the small business set asides that perhaps might find itself into the Small Business reauthorization.

Ms. LEE. I would be happy to.

Mr. MANZULLO. Thank you. Appreciate that.

Mr. BRADLEY. Thank you very much. I just have a couple of quick questions.

In your testimony, Ms. Lee, you referenced the Title III loan program. Could you tell the Committee when was the last time and to what extent your department actually gave out those Title III loans and to whom?

Ms. LEE. Sir, I do not have the specific information. I would be happy to get it for the record. What I tried to do was illustrate a couple of areas where small business had excelled in that particular program, but I would be happy to get you the amounts and the dates of the last awards.

Mr. BRADLEY. And my second question. Do you believe that small business in this country would benefit from a greater requirement to purchase more American made goods? This is a general thematic question, but just to get your reaction on that.

Ms. LEE. Buy American certainly is one of those things that sounds good to all of us. I submit to you all there is probably not anyone in this room wearing total U.S. made products at this moment.

We live in a global economy, and I am concerned that we go to the extent where we make 100 percent U.S. domestic product and in that process actually harm our small businesses. We have had experiences where small businesses are global too, the total source of their raw materials. If we put on them additional tracking information or require them to produce on U.S. made machine tools—we now know the U.S. machine tool manufacturers do not have 100 percent U.S. made machine tools.

If we put these requirements on them, I am very concerned about the capital that they would have to expend and the reporting that they would have to have just to participate in defense procurement, thereby complicating it further.

Mr. BRADLEY. Thank you very much for your answers.

Seeing no further questions, I will dismiss the panel and call the second panel

[Panel excused.]

Mr. MANZULLO. My understanding, Ms. Falvey, is you are going to be sitting with the second panel so that we can ask you questions. Is that correct?

Ms. FALVEY. Yes, sir.

Mr. MANZULLO. Thank you.

Mr. BRADLEY. Good morning, everyone, and thank you again, Ms. Falvey, for staying with this panel.

With us this morning we have Dr. Sivananthan, who is the president of EPIR, Ltd. The second member testifying this morning is Mr. Bill Jones, who is the chair of Cummins-Allison Corporation; Alan Tonelson, a research fellow from USBIC; and, lastly, John Palatiello, who is the president of MAPPS.

Before I recognize Dr. Sivananthan, I would just say that Congressman Akin, who normally would chair this panel, has been called away for a markup in the Science Committee, and he has asked me to pinch hit for him.

Dr. Sivananthan?

STATEMENT OF DR. SIVALINGAM SIVANANTHAN, PRESIDENT, EPIR TECHNOLOGY

Mr. SIVANANTHAN. Mr. Chairman and Members of the Committee, my name is Siva Sivananthan. I would like to begin by thanking you for the opportunity to testify at this hearing.

I am the president of a small business, EPIR Technology, located in Bolingbrook, Illinois, and am also the distinguished professor and director of the microphysics lab at the University of Illinois at Chicago. I helped pioneer the synthesis of now dominant high-end infrared detecting and night vision semiconductor material, mercury cadmium telluride, which we will refer to as MCT. MCT is used to build detector arrays that can image objects under conditions having literally no visible illumination and through obscurance such as fog and dust.

Our armed forces are indisputably the strongest in the world. One of the principal advantages that we enjoy is that we own the night. Today, I hope to show you that this superiority is threatened by our increasing dependence on foreign sources, especially for infrared materials and substrates.

Our high-end night-fighting capability is based on the use of MCT infrared detectors. The future of this technology will depend on MCT material made by molecular beam epitaxy, which I will refer to as MBE. The concerns that I have and I will describe are not because of the lack of funding, but rather lack of focused funding.

Indeed, our government has provided substantial funding over the past decades to several large domestic companies specializing in infrared detection technology. We have their products to thank for our current supremacy. However, only a very small level of funding has gone to small businesses, universities and defense laboratories working in this field.

Universities, which are frequently the breeding ground for the fundamental understanding and advancement of the science and technology, the manpower of industry and the ideas that build small business have especially suffered from the lack of consistent funding. Small business, a major source for new ideas and products with enhanced capability and reduced cost, have suffered the most.

The funding disparity has led to the U.S. MCT MBE research and development base shrinking to one small business and one university. Their demise has contributed to a decrease in the number of large companies which need suppliers, research and manpower.

I believe that this has led to an increased reliance on foreign manufacturers and to a significant lack of innovation, almost to a halt, to improve quality and reduce their prices. It is not in the economic interest of the large companies to manufacture all components. Outsourcing to foreign suppliers has led to the situation that today there is not a single supplier for the substrate for MBE or MCT devices in the United States. Moreover, there are no domestic sources of MBE reactors. Everyone must buy substrate from Japan and put that in a reactor made in France.

In addition, we find ourselves in a situation that we need to go also to find trained scientists. Meanwhile, foreign governments and organizations have been playing catch up. Very recently they have made heavy research and development investments to close the technology gap in MCT. China, India and France are a few.

The eroding U.S. industrial base's lack of innovation developed by small business and universities, combined with growing foreign efforts, are clearly a recipe for the loss of our supremacy and increased reliance on foreign suppliers.

I think we could still solve this problem soon if we provide long-term funding to the small businesses and forming consortiums based on small business, universities, a research lab and night vision lab and preserve long-term funding to the universities.

The funding level reallocation may involve $5 million to $10 million, but the payoff is large, saving brave soldiers. It will allow us to see a longer instance and detect and identify before others can detect us. Reducing the cost will allow us to provide the high-end night-vision technology to our special forces because the price is going to come down.

Your hearing is an important step in that process. Thank you for inviting me, and I am ready for your questions. Thank you.

[Dr. Sivananthan's statement may be found in the appendix.]

Mr. BRADLEY. Thank you very much.

I would now recognize Mr. William Jones, chairman of Cummins-Allison Corporation.

STATEMENT OF WILLIAM JONES, CHAIRMAN, CUMMINS-ALLISON CORPORATION

Mr. JONES. Good morning. My name is William Jones, and I serve as chairman of Cummins-Allison Corporation. Cummins-Allison is a privately held manufacturing company based in the Chicago area.

In addition to my responsibilities with Cummins, I was recently elected the chairman of the United States Business and Industrial Council. Cummins is also a corporate member of the National Asso-

ciation of Manufacturers, and I sit on a number of NAM committees.

The key product line manufactured by Cummins today is equipment to scan, sort, denominate and authenticate U.S. currency, as well as other currencies of the world. To illustrate the sophistication of counterfeit notes that Cummins can identify, I would provide you with two samples. One of the notes is real. One is counterfeit.

Twenty years ago, five U.S. manufacturing firms accounted for 90 percent of all U.S. requirements relative to the processing of currency. This included equipment utilized at the Federal Reserve down to small desktop machines used at commercial banks, vendors and others. This very vibrant U.S. industry also exported significant amounts of equipment around the world.

Today, all but one of these U.S. manufacturers has been eliminated. During this same time frame, all of the European and Japanese firms have survived and increased their market presence in the United States to about 70 percent. U.S. manufacturers, which now is solely Cummins, is down to 30 percent. Furthermore, the large majority of U.S. export business has been lost.

Most of the U.S. manufacturing facilities and U.S. based R&D has been discontinued and shuttered during these last 20 years. This is because there has not been a level playing field. Foreign governments consider the handling of currency a national security issue and, therefore, favor their domestic industry.

Our foreign competitors have used this to their advantage to develop a full product line and dominate various market niches. This has enabled them to dump products in the United States at prices well below their total cost. This drove the U.S. industry out of business.

In contrast to the national security concerns of foreign governments, the United States government does not appear to have a coordinated strategy for sustaining the domestic industry to handle the integrity of U.S. currency. For example, during the last three years, various congressmen and senators have written to the Treasury policy people on behalf of Cummins. The Treasury responds that they are not concerned about the state of our industry.

Another irony is what I learned when I was on vacation last week. In preparation for the hearing, I understand the Treasury contacted our foreign competitors to help prepare the presentation before Congress. We, Cummins, would have been delighted to discuss the issues with the Treasury had they contacted us directly. As a result, assumptions about the domestic industry may or may not be correct.

An example of foreign governments favoring their domestic industry is the position of the Japanese Government. The Japanese Central Bank is required by law to purchase Japanese products from Japanese controlled industry. Consequently, the European and American manufacturers have zero market share in Japan.

Europe is another case in point. The European Central Bank began to meet with the European manufacturers approximately five years before the euro was ever released. A number of these European manufacturers were also given contracts to print and

produce the euro currency, giving them the ability to influence the design of this new currency.

Cummins attempted to gain entry to this exclusive club, and the Bureau of Engraving and Printing attempted to help us, but on numerous occasions we were denied access. As a result of Cummins' exclusion from these meetings, we obtained absolutely no business for handling the new euro. Absolutely none. Therefore, we lost hundreds of millions of dollars in business. China is a similar story.

A U.S. domestic industry is imperative to the integrity of the U.S. currency. To illustrate, in the early 1990s the lowest cost currency scanner able to authenticate currency sold for $25,000. After Cummins spent five years and many millions of dollars, we introduced a new technology scanner that sold for $2,500. This lower cost technology enables banks to move currency scanning to the front line in their branches where deposits are accepted and, therefore, they are more readily able to identify the customer that submits counterfeits.

There is no question that an enemy will attempt to counterfeit currency. Al-Qaeda, in combination with a rogue government, could easily proffer excellent counterfeit U.S. currency, and I think the samples illustrate this. The use of our equipment by banks overseas gives these banks assurances that they can accept U.S. currency and quickly identify counterfeits at a low cost.

Without Cummins as a domestic producer, this low-cost technology would never have been produced. In fact, numerous foreign banks have told us very bluntly that they would not continue to accept large U.S. currency deposits at their foreign locations if the Cummins machine were not available to identify the sophisticated counterfeits.

Furthermore, we are in the process of developing more sophisticated technology for the next generation that would enable the Fed and commercial banks to more easily track the flow of currency, especially as it changes hands between parties that are adversarial to the United States.

Without government intervention to level the playing field, the U.S. domestic industry will never offer a full product line and may choose to withdraw completely from this market. I am confident that if the U.S. Government intervenes, Cummins would not only survive, but, more important, other American manufacturers would enter back into this industry.

While there are problems with various government agencies, I do want to say that the Bureau of Engraving and Printing does an outstanding job within their limited area of responsibility and has been most supportive of the domestic industry.

I would like to thank the Congress for their inquiry.

[Mr. Jones' statement may be found in the appendix.]

Mr. BRADLEY. Thank you very much. We are all curious as to which of these notes is the real one. The way I identified it, it would appear that someone has folded this one in his pocket.

Mr. JONES. The one with the Federal Reserve Bank B2 is the counterfeit.

Mr. BRADLEY. B2. The folded one is the counterfeit. Fooled me.

Mr. JONES. That was caught on one of our low-cost machines overseas. The problem is the banks overseas, they get a deposit of

$15,000 or $20,000. They have to have a quick and rapid way. Imagine going through that and trying to find it. They tell us it is extremely effective in finding these very sophisticated counterfeits.

Mr. BRADLEY. Your example is wonderful.

Mr. JONES. A picture is worth a thousand words, Congressman.

Mr. BRADLEY. Unless you are in a congressional hearing, so you are exempted.

Questions, Mr. Udall?

Mr. UDALL. Are we finished with the panel?

Mr. BRADLEY. I am very sorry.

Mr. UDALL. I will hold off until we finish.

Mr. BRADLEY. I got so lost in the counterfeiting.

Mr. UDALL. It was his comment about prosecuting. I think that rattled you, Mr. Bradley.

Mr. BRADLEY. Mr. Tonelson, please?

STATEMENT OF ALAN TONELSON, RESEARCH FELLOW, EDUCATIONAL FOUNDATION, U.S. BUSINESS AND INDUSTRY COUNCIL

Mr. TONELSON. Thank you very much, and good morning, Congressman Bradley, Congressman Udall and Congressman Manzullo. I would like to thank you on behalf of the U.S. Business and Industry Council and its Educational Foundation for the opportunity to testify this morning. I am Alan Tonelson. I am a Research Fellow at USBIC's Educational Foundation.

Our subject today is of great concern to the member companies of our council, which themselves are predominantly small and medium sized manufacturers. Since 1933, the Council has championed the cause of strengthening the domestic technology and manufacturing bases, and we are very gratified by the Subcommittee's focus on this critical issue.

It is also an extremely timely issue as the U.S. manufacturing sector as a whole, including small and large companies, is experiencing a downturn of historic proportions. I underline that word historic. It is also critical to understand that much of the blame for these problems lies with a series of ill-conceived and failed trade policies that our government has been following now for several decades.

Now, there is no question that improving federal procurement practices is terribly important, but it is no substitute for a top to bottom overhaul of again these decades of failed trade policies, including NAFTA, including joining the World Trade Organization on highly disadvantageous terms and granting permanent normal trade relations to a thoroughly protectionist China.

The main effect, at least for the purposes of this hearing, of these trade and globalization policies has been to encourage many U.S. multinational companies to migrate overseas, to transfer production overseas and in fact to supply the U.S. markets from overseas. When the multinationals migrate overseas, they take much of their supply chain with them, and that is where small and medium sized companies get whacked. That has been a major effect of these failed trade policies.

In fact, some of the most urgent changes needed in federal procurement policy are probably inconsistent with our World Trade

Organization obligations. In this vein, it is critical for Congress and the Administration to recognize that the World Trade Organization is not a quasi-judicial body in which all parties can be reasonably assured of a fair hearing before a quintessential political body in which a strongly protectionist majority seeks and usually secures major advantages over open market countries like the U.S.

It is vitally important for U.S. policymakers to stand up for U.S. economic interests more effectively, even when the World Trade Organization's protectionist majority does not like it, and this includes negotiating real and monitored and verifiable agreements to open foreign procurement markets rather than accepting empty promises.

My testimony identifies various ways to tighten up our own federal procurement laws to provide more opportunities for highly competitive, fair trading American companies, but first I would like to call the Subcommittee's attention to three important points.

First, we need to know more about the impact of federal procurement policies on small companies and particularly as they belong to the subcontracting and the supply chains of large companies. Anecdotes are obviously informative, but they are not enough. Government wide reporting requirements on foreign procurement levels are an essential first step.

Second, Congress has to be very careful about granting waiver authority. Flexibility is needed; there is no question about that, but it must not turn into a license to basically penalize fair trading U.S. companies. I am particularly worried at this point about the tendency of this Administration to show signs anyway of lapsing into some Cold War style trade policies, sacrificing concrete, tangible American economic interests for often dubious diplomatic objectives.

Third, U.S. content provisions must be carefully monitored as well. Manufacturing must be defined with great precision or the stated purpose of various Buy America laws and regulations will be subverted by screwdriver assembly operations that add little value to the U.S. economy.

Many of these ideas are included in the specific recommendations at the end of my statement, but one feature of some of the other ideas deserves special consideration. Enterprises from countries that are persistent violators of U.S. and international trade laws should not be rewarded by federal procurement policy.

These predatory trading companies should be identified and barred from federal contracting until they have established a long and credible record of good behavior, and certification of such good behavior cannot be left to the Office of the U.S. Trade Representative, which demonstrably lacks the inclination to ruffle feathers among our trading partners. After all, its highest priority is negotiating new trade agreements with these same trading partners, whether they are enforceable and verifiable or not.

In addition, a broad drag net should be thrown out here. Including the innocent with those guilty of predatory trade practices would go a long way toward creating powerful constituencies in problematic foreign countries for abolishing those procedures and actually opening foreign markets. These are hardball tactics, but in trade diplomacy that is often the best way to get things done. The

great, deepening crisis in our manufacturing sector means that business as usual is no longer acceptable.

I thank you very much for your attention and welcome the opportunity to answer any questions you might pose.

[Mr. Tonelson's statement may be found in the appendix.]

Mr. BRADLEY. Thank you very much, Mr. Tonelson.

Now we will recognize John Palatiello, who is the last panelist.

STATEMENT OF JOHN PALATIELLO, EXECUTIVE DIRECTOR, MANAGEMENT ASSOCIATION FOR PRIVATE PHOTOGRAMMETRIC SURVEYORS (MAPPS)

Mr. PALATIELLO. Thank you, Mr. Chairman, Members of the Subcommittee. I am John Palatiello. I am executive director of MAPPS, a national association of more than 170 companies engaged in mapping and related geographic information services. A great many of our member firms are small businesses under the SBA size standard.

Our members make maps from aerial photographs and satellite images. They are used for everything from facilities planning to highway engineering, from doing truck routing and bus routing to property tax assessment. Our geographic information system databases are even used by our first responders and E–911 response.

We are very concerned about the trend towards production work in the mapping and geographic information fields going to foreign competitors. I would like to highlight a few of the points in my testimony and some of the concerns that we have.

We very strongly favored NAFTA because in the pre-NAFTA days trade in aerial photography particular with Canada was a one-way street. Canadian firms could do business in the United States, but there were barriers that prohibited U.S. firms from doing work in Canada.

Under NAFTA, the situation has only gotten worse. It is definitely a one-way street, particularly with regard to government procurement. Canadian firms are using the advantage of the exchange rate between the U.S. and Canadian dollars to underbid U.S. companies.

There are programs in the Department of Agriculture where a majority of the work for aerial photography for crop monitoring and forecasting is now done by Canadian operators because the U.S. firms simply cannot be competitive with regard to the exchange rate between our two currencies. Furthermore, there are barriers erected by the Canadian Government that preclude U.S. companies from doing work in Canada, so it is quite a one-way street for us.

The Buy America Act has been mentioned earlier in the hearing. That applies to products and not services by and large, so there is no protection for those of us in service professions and service industries under the Buy America Act.

One of the things that is being done in federal procurement that I think is working to the disadvantage of small business and domestic service firms is a loophole that has been discovered in the Service Contract Act. The Service Contract Act, and I do not mean to be controversial here, but the best way to describe it is it is the Davis-Bacon Act for services.

The Davis-Bacon Act says you pay prevailing wages on construction contracts. The Service Contract Act says you will pay the prevailing wage rate on service contracts. What is happening is the law applies to services, and I will quote from the law, "the principal purpose of which is to furnish services in the United States."

Well, if Company A is going to perform in the United States, it is subject to the Act. If Company B is going to send the work offshore either themselves as an offshore provider or through a subcontractor, they are not subject to the Act. Therefore, they can do work and pay wages of 10 cents on a dollar, and in fact that is exactly what is going on today.

There is a double whammy that we are very concerned about, and that is Federal Prison Industries. Federal Prison Industries is expanding into services, and one of the areas they look for is well, we will go into services that are going offshore. That way we are not adversely affecting U.S. companies and U.S. workers.

Well, as soon as they identify a service that is going offshore, Prison Industries jumps in, so we get subjected with the double whammy of low-cost labor competition from foreign offshore vendors, as well as low-cost, low-wage compensation from Prison Industries. We do not feel that that is a very tenable situation to be in.

Our concern is that historically once an activity goes offshore, when you have domestic capability and it goes offshore it is very, very rare that it is ever repatriated. It very rarely ever comes back home, and we are deeply concerned.

I mentioned before some of the things that mapping and aerial photography and satellite imagery is used for, the applications of the work that our members do. We are talking about the critical infrastructure of the United States. We were concerned about this issue before September 11. We are far more concerned now.

The maps, the drawings, the blueprints of America's critical infrastructure is now going offshore where there is no knowledge as to what the motives or backgrounds or objectives of the people who have access to that data might have with regard to the United States.

What can we do? First of all, we would urge the Committee, and this has been mentioned previously by other witnesses, to focus more attention on subcontracts. There is very little data available from federal agencies. There is very little oversight on the part of federal agencies with regard to subcontracting.

We always talk about the number and percentage of federal dollars that go in prime contracts to small business, but I think there is a whole other arena out there that we ought to pay greater attention to with regard to a database and tracking and monitoring what is happening with regard to subcontract work.

The same thing is true with regard to grants. The federal government spends a lot of money to state government, and then if state government turns around and contracts federal procurement does not apply so you do not have Buy America, you do not necessarily have Service Contract Act requirements. A lot of the protections that this Committee has built into federal procurement goes by the wayside when the dollars go to the states.

Just anecdotically, let me close with an example of something that we are working with the Committee staff. National Oceanic and Atmospheric Administration did a contract for navigational charting. One of the firms that was awarded the contract not only was found later to be a large business that won the contract under a set aside, and NOAA has not thrown them out of the procurement, but that firm is also a front, and that work is going offshore. Again, it is a double whammy to the domestic small business.

Thank you for inviting me. I would be glad to answer any questions. I appreciate the Committee's attention to this important issue.

[Mr. Palatiello's may be found in the appendix.]

Mr. BRADLEY. Thank you very much, all members of the panel. I will first recognize Mr. Udall for questions.

Mr. UDALL. Thank you, Mr. Chairman.

Jody, I would like to ask about the HUBZone program at the Department of the Treasury. Apparently you had an increase in your procurement budget from $249 [sic] billion in 2001 to over $3 billion in 2002. My question goes to the number of contracts, HUBZone contracts that you had.

Treasury had 233 contracts with HUBZone companies in 2001. In 2002, Treasury had 199 contracts. Can you tell this Committee why there was a decrease in the number of contracts with HUBZone companies?

Ms. FALVEY. No, sir. I do not have the specifics to the contracts that were awarded to the HUBZone during the year you are mentioning, fiscal year 2002, but I would be happy to provide that information.

Mr. UDALL. Thank you. I would very much appreciate that.

Mr. Tonelson, I wanted to ask you about this trade policy issue that you brought up. Specifically you mentioned that we need to open foreign procurement markets and that that would be a way where we could grow business here.

Can you tell us? I mean, are these markets closed now? What should we do to open them? Should we include provisions in all of our trade legislation that comes through? This week or very soon we are going to deal with the Singapore and Chile trade agreements. Should we have specific agreements in those that require them to open up these procurement markets of their governments?

Mr. TONELSON. The main reason that I mentioned the need for trade agreements that effectively open foreign procurement markets is that many of the waivers and exemptions to Buy America legislation as in fact was mentioned by Ms. Lee on the first panel result from trade agreements in which reciprocity has been promised.

We open up our U.S. Government procuring market to this or that foreign country that we signed this or that trade agreement with, and they in turn open up their markets to U.S. producers. There is very little evidence that indicates that true reciprocity has been achieved.

The one study of this that I am aware of focused on the Tokyo Round agreement of the GATT, which was signed at the very end—well, right around 1980. Great promises were made by U.S. trade officials at that time that liberalization of foreign government pro-

curement was going to result in a tremendous increase in U.S. exports. It never, ever happened. In fact, there was a GAO report published a few years later that showed absolutely nothing had happened. The increases in U.S. exports to those markets were infinitesimal.

It is not only a matter of including clearly worded provisions in these trade agreements. It is a matter of actually monitoring the trade agreements and enforcing them. This is one of many areas in which U.S. trade policy has fallen far short, and the main reason is it is more fun to negotiate new trade agreements—you get better media, there are more photo ops—than in the hard, day-to-day work of monitoring and enforcing and eventually ruffling feathers if you find that promises are not being kept, and we have to take enforcement concerns much more seriously.

Mr. UDALL. Are we putting the resources into monitoring and enforcement we should, or are they backing off?

Mr. TONELSON. I read an item last week—I have not researched it as thoroughly as I need to yet—that the request for monitoring resources has gone up, but if you look at the U.S. Trade Representative's annual report on foreign trade barriers you see just how widespread, how numerous they are.

It is very difficult to think that either USTR or the U.S. International Trade Commission or the Commerce Department's International Trade Administration and, after all, those two latter agencies have primary responsibility for carrying out and enforcing U.S. trade laws. It is very difficult to understand how these relatively small bureaucracies can possibly cope with a world in which I would submit that violation of world trade laws like antidumping, like intellectual property theft, like subsidization, has become a way of doing business. They have become the norm, not the exception.

Mr. BRADLEY. Mr. Jones, did you wish to add something briefly?

Mr. JONES. Yes, a specific example around his question. In our industry, for example, even after ascension into the WTO, China retains a 40 percent tariff and excise taxes on our product line. They explained to us it is because it is a national security issue. They want to develop their own industry.

The Chinese Government also intervened on a tender we were offering for 10,000 machines to the commercial banks in China. We went to the USTR, and they said this is unfair treatment, but, getting back to what Alan said, they say we have limited resources, and while it is inequitable it is not a task we can take on right now.

That is unfortunate, but that is what happens. We are a $100 million a year business. We compete with companies that are $1 billion in sales. It is very difficult for our government to advocate. They can take care of the Boeings and Motorolas of the world, but when you get into the mid-size manufacturers, and we are probably 40 percent of total production. There is an inability, at least in our experience. Well-intentioned civil servants, but they just cannot take it on. They do not have the resources.

Mr. BRADLEY. Mr. Manzullo?

Mr. MANZULLO. Thank you.

Ms. Falvey, I do not know if you would be the right person from Treasury that would be able to answer the question, but if not I am sure you would tell us that and help us to get further information.

I am very much distressed over the fact that with regard to the validating or verification of currency that the Europeans and that the Chinese consider this to be a matter of national security and, therefore, exempt from the international trade agreements, and yet the U.S. Treasury invites foreign competitors to the United States to compete with the few manufacturers that are left.

I guess my question to you, if you could answer it, would be do you consider the verification of U.S. currency to be an issue of national security? If you are not the right person, just tell us, but take a stab at it if you want.

Ms. FALVEY. As far as national security, I am not the right person to answer that question.

Mr. MANZULLO. Sure. I understand. Who would that person be?

Ms. FALVEY. I could defer to Mr. Tom Ferguson, the director of the Bureau of Engraving and Printing, that is here today.

Mr. MANZULLO. Is he present in the room?

Ms. FALVEY. Yes, he is.

Mr. MANZULLO. Is he here? Where is he? Mr. Chairman, would you mind if he came up and answered that question?

Mr. BRADLEY. No. Please.

Mr. MANZULLO. Maybe somebody can get an extra chair in there. There we are.

Mr. FERGUSON. I do not know if I want to be that permanent up here.

Mr. MANZULLO. If you could give your name and position for the record?

Mr. FERGUSON. It is Tom Ferguson. I am the director of the Bureau of Engraving and Printing.

Mr. MANZULLO. Okay. Would you want to take a stab at that answer?

Mr. FERGUSON. Yes, sir. We consider the security and authentication of U.S. currency a national security issue. There are several classified security systems embedded in United States currency. Those systems are in fact U.S. manufactured. The detectors that are used to verify those things at the Federal Reserve Systems are in fact U.S. manufactured.

The equipment that those are mounted on are manufactured in the United States by a foreign parent company, but the security systems themselves that are used to authenticate currency at the government level are U.S. manufactured by a U.S. firm.

Mr. MANZULLO. What about in banks?

Mr. FERGUSON. That is a commercial activity that we allow the banks to buy from whomever they want to. It is not something that the government dictates. It does not require that.

Mr. MANZULLO. So you do not consider it a matter of national security that banks in the United States have the equipment in order to——.

Mr. FERGUSON. We and the Secret Service do not officially endorse any machine authentication systems.

We provide a number of security devices that are in the currency for people to use. We provide training for commercial banks. They make an independent business decision on what type of equipment to use. That is something that the government——.

Mr. MANZULLO. Do you invite foreign competitors?

Mr. FERGUSON. Do we invite foreign competitors?

Mr. MANZULLO. At Treasury when you are looking at new equipment. Are you just talking about equipment that is used in Washington?

Mr. FERGUSON. This would be used throughout the country at all Federal Reserve banks, 37 banks and branches.

Mr. MANZULLO. And you are saying that is 100 percent manufactured at all 37?

Mr. FERGUSON. No. What I said, sir, is that the security systems that are in the currency, the classified, high-level authentication systems that are embedded in the currency, and the detectors that are used to detect that at the Federal Reserve banks are U.S.

Mr. MANZULLO. Mr. Jones, do you have a rejoinder to that? If you could pull a mike close?

Mr. JONES. I have slightly different information from the engineers that used to work for the U.S. manufacturer that made machines for the central banks, and that was REI, followed by CSI.

These engineers told me that what happened to meet the Buy America clause when they went to the GND, the German machines—if you are not familiar with those, they sell them around the world to central banks, and from what I know, and I can say this emphatically, their research and development in the development of their products and their technologies are done in Europe.

What they did is it is a little bit like making wine in France and bringing it over here and putting it in a bottle and putting a label on it and saying it is made in the United States. I do not think that is the case.

Let me finish, Tom.

It is true that the Federal Reserve does contract for separate sensors that they put on this machine that the German manufacturer would not have knowledge of. One of them, for instance, is Kodak. I understand one of those divisions was also recently sold to a European manufacturer, so I do not know who has control of the knowledge of that now.

Clearly, a large majority of the content of that machine is foreign produced, and the engineering involved in developing a transport, whatever sensors you put on it, is now controlled by the Europeans.

A long time ago, back in the 1960s, the German Government made a decision. The United States and the British were printing currency for the Germans, as well as providing the equipment to process it. They decided on a national security basis that that was not a good thing, so they gave GND a contract to print half of the deutsche marks.

I can tell you that if the United States Government enabled me to print half of the U.S. dollars, I could be a player in the central banks of the world, but I would never enter that market under the current circumstances because there is no way for me to compete.

Mr. MANZULLO. Let us get a rejoinder from Mr. Ferguson.

Mr. FERGUSON. Yes. Just as I said, all the detectors, the security systems, are U.S.

Mr. MANZULLO. What does that mean? If this is the machine, this represents the machine——

Mr. FERGUSON. Yes, sir.

Mr. MANZULLO [continuing]. That is in the 37 banks across the country, how much of this machine is manufactured in the United States?

Mr. FERGUSON. You would have to ask the Federal Reserve. They are the ones that buy it.

Mr. MANZULLO. Okay.

Mr. FERGUSON. The part that I am involved with is we purchase and design and install and put into the currency authentication systems.

Mr. MANZULLO. Do you mean a code?

Mr. FERGUSON. Codes, inks, materials, a variety of different things that are there so when they go through those machines there are detectors that are installed that will verify that it is in fact an authentic note.

Mr. MANZULLO. That is where your expertise is——

Mr. FERGUSON. Yes, sir.

Mr. MANZULLO [continuing]. Developing the code?

Mr. FERGUSON. My expertise is in producing that currency note to make it as secure as possible.

Mr. MANZULLO. Okay. Then in terms of testing that, the machines that will verify what is in that code.

Mr. FERGUSON. Right.

Mr. MANZULLO. Those machines are made where?

Mr. FERGUSON. The detectors that will verify that code are made in the United States.

Mr. MANZULLO. One hundred percent?

Mr. FERGUSON. Yes. Well, to the best of my knowledge, yes. I cannot get into some of the diodes.

Mr. MANZULLO. Mr. Jones, you are disagreeing on that?

Mr. JONES. I disagree with that. I have a disadvantage, and the Treasury does not really speak to us about these issues, though we have asked for meetings on numerous occasions.

From the information I have from people that were in the United States, particularly U.S. engineers, they would disagree with that.

Mr. MANZULLO. All right. What question is it that you want to pose to Treasury that you want them to answer in writing?

Mr. JONES. Well, some of these issues are delicate and sensitive, first of all. Second, I see representatives of foreign competitors here in the room.

Mr. MANZULLO. That is all right, because I understand Treasury called them as soon as they got the call from our office so that they would be alerted of this hearing.

Mr. JONES. It is a sensitive issue.

Mr. MANZULLO. Of course it is sensitive. What question do you want to have Treasury answer in a letter as to the source of these?

Mr. JONES. If they have any policy to monitor—it is just like with Defense—the critical core industries in the United States that might help with the national security interest of currency.

There are different levels. There is what the Federal Reserve requires, but there is also what is used at the first line. As I told you earlier, we developed some very low-cost, very effective technology to find currency.

Mr. MANZULLO. My question here is, Mr. Ferguson, you helped develop codes so that——.

Mr. JONES. One question I might have is are they interested in trying to develop a level playing field so that the U.S. industry——.

Mr. MANZULLO. No. I understand that. My question here is who is making these machines, and why are all the foreign competitors in this room? That is the gut level. The reason you are here is the fact that you are a domestic industry being——.

Mr. JONES. I am the only one left.

Mr. MANZULLO. You are the only one left in the United States.

Mr. JONES. You could have a hearing on Treasury issues, and I would be the only one on the panel.

Mr. MANZULLO. If I may indulge, what contract is it that you got bumped by Treasury? Did they bump you?

Mr. JONES. I did not get bumped by Treasury. We do not make a product in that category——

Mr. MANZULLO. Okay.

Mr. JONES [continuing]. Because we recognize if we entered it we would not be successful. Think about it.

Mr. MANZULLO. Then what is the other category, the one that you sell to the banks?

Mr. JONES. Sell to banks.

Mr. MANZULLO. So there is no domestic manufacturer? Is that what you are telling me?

Mr. JONES. Not at the level of central banks. Not anymore.

Mr. MANZULLO. What is the level that you are talking about, Mr. Ferguson? Somehow there is a disconnect going on here.

Mr. FERGUSON. The machines I am talking about are simply for the government. To the best of my knowledge, we have never had a bid for any product that we manufacture from Mr. Jones.

Mr. MANZULLO. Okay. This would be the machines that are used here in Washington?

Mr. JONES. In the Federal Reserve banks.

Mr. MANZULLO. The 37 Federal Reserve banks?

Mr. JONES. The commercial banks clear their currency through the Federal Reserve.

Mr. MANZULLO. Correct.

Mr. JONES. When they clear it, they get rid of old currency that is soiled and no longer——.

Mr. MANZULLO. Who has the machines, the individual banks or the Federal Reserve?

Mr. JONES. The Federal Reserve banks.

Mr. MANZULLO. Okay.

Mr. JONES. That is the highest level. Large commercial banks have currency processing machines as well.

For instance, we entered that market two years ago, and the European manufacturers immediately reduced their prices in North America only by 50 percent. I have pricing studies to support that.

Mr. MANZULLO. Okay. Mr. Jones, what I am interested in finding out here is that you are saying that there are unresolved or unanswered questions from Treasury, and I am giving the opportunity to—let me put it this way.

Mr. JONES. Yes, I do have a question for Treasury. Given the inequitable and unlevel playing field at the central bank level, is Treasury interested in looking at the procurement process and changes that may be needed to encourage U.S. manufacturers to bid?

In 2001, we wrote to the Federal Reserve and declined to bid, explaining to them about the problems in the industry.

Mr. MANZULLO. But he is not here representing the Federal Reserve.

Mr. JONES. No, he is not, but——

Mr. MANZULLO. Okay.

Mr. JONES [continuing]. That is the machine he is talking about.

Mr. MANZULLO. Is that correct, Mr. Ferguson?

Mr. FERGUSON. I am talking specifically about the portion of the machine that authenticates currency, not the machine itself.

Mr. MANZULLO. That portion of the machine that authenticates the currency?

Mr. FERGUSON. Yes.

Mr. MANZULLO. But the machine could be foreign made?

Mr. FERGUSON. Yes, it could be.

Mr. MANZULLO. So does that mean that the technology on authentication is given to a foreign country?

Mr. FERGUSON. No. It is a black box system, sir.

Mr. MANZULLO. Explain that.

Mr. FERGUSON. It is a detector that an input goes in and output comes out, but the mechanism itself is embedded in the detector, and it is not available to anyone without destroying it.

Mr. MANZULLO. Let me ask you a question. If we submit to you a list of questions that will be more intelligible than the questions I am asking you now, would you be willing to answer those?

Mr. FERGUSON. Yes, sir. Hopefully, the answers will be more intelligible than what I have given you so far.

Mr. MANZULLO. I appreciate that.

Thank you, Mr. Chairman.

Mr. BRADLEY. Thank you, Mr. Manzullo.

I have no questions at this point, and we have been called for a vote. Mr. Manzullo, is it your intention to resume this hearing with further questions afterwards?

Mr. MANZULLO. I have no further questions. We can just adjourn.

Mr. BRADLEY. Then in that case this hearing is adjourned. Thank you.

[Whereupon, at 11:37 a.m. the Subcommittee was adjourned.]

OPENING STATEMENT
22 JULY 2003

SUBCOMMITTEE CHAIRMAN W. TODD AKIN
SUBCOMMITTEE ON WORKFORCE, EMPOWERMENT & GOVERNMENT PROGRAMS

"Hearing on the Defense Industrial Base"

Speaking at a technology conference last week in California, former Secretary of State, Dr. Henry Kissinger, expressed his belief that our nation needs to address the "increasing outsourcing of economic activity from the United States to other countries." Kissinger went on to assert, "If outsourcing continues to strip the U.S. of its industrial base and the act of getting out (or developing) its own technology, then we require a careful thought on national policy." It is concerns like these that bring us here today.

There appears to be a growing trend of federal procurements going overseas. We are seeing an increasing number of federal solicitations won by companies based outside of the United States. I am not speaking of solicitations for items that are rare or exclusive to

a particular country or region, but rather items that we are able to produce here at home.

For example, the Transportation Security Agency recently awarded a contract for the purchase of 9,600 firearms, to be used by U.S. airline pilots, to a German arms manufacturer. While I am not a gun expert, I do know that some of the finest firearms in the world are manufactured in the United States. Springfield Armory, one of the oldest and finest firearms manufacturers in the world, is less than 300 miles from my home in St. Louis. While I am not privy to the details of the purchase, I would question the need to entertain foreign bids for a product of high quality and reputation manufactured right here in the United States.

The federal government is our nation's single biggest consumer and there are times when it is necessary for this government to procure products and services from foreign sources. However, the Congress, as the representative voice of the American people, has set forth certain policies that mandate the purchase of products and services from American small business and industry. The question is whether or not those policies are being pursued.

With us today we have a representative sampling of American small business and industry. In addition, I have invited the Department of Defense and the Department of Treasury, representing federal procurement, to join us as we examine this question. I had also invited the White House Office of Management and Budget to join us; unfortunately despite our best efforts to accommodate their schedule, OMB was unable to attend. The OMB sets forth procurement policy for all federal agencies and departments and I feel it is important we examine whether or not OMB is establishing the best possible policies in this regard. I look forward to the testimony of our industry and government witnesses in regards to this question as well.

I know all the witnesses have prepared written statements for the record. They will all be entered into the record without objection. In their opening statements to this committee, however, I would ask the witnesses to summarize their written testimony and provide only the highlights of that written testimony in light of our limited time this morning.

TESTIMONY OF THE

DIRECTOR, DEFENSE PROCUREMENT & ACQUISITION POLICY

OFFICE OF THE UNDER SECRETARY OF DEFENSE FOR
ACQUISITION, TECHNOLOGY & LOGISTICS

BEFORE THE HOUSE OF REPRESENTATIVES

COMMITTEE ON SMALL BUSINESS

SUBCOMMITTEE ON
WORKFORCE, EMPOWERMENT AND GOVERNMENT PROGRAMS

JULY 22, 2003

TESTIMONY OF THE
DIRECTOR, DEFENSE PROCUREMENT & ACQUISITION POLICY
OFFICE OF THE UNDER SECRETARY OF DEFENSE FOR
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WORKFORCE, EMPOWERMENT AND GOVERNMENT PROGRAMS
JULY 22, 2003

Mr. Chairman and Members of the Committee:

Good morning. I am Deidre Lee, Director, Defense Procurement and Acquisition Policy, in the Office of the Under Secretary of Defense for Acquisition, Technology & Logistics. I am here today to discuss the efforts of the Department of Defense (DoD) to assist small businesses with unique technologies to participate in DoD procurement opportunities. I will also discuss the Department's procurement policy, especially as it pertains to the use of small businesses and foreign suppliers.

First, I'd like to share some good news stories about the successes of some of our small businesses under the Commercial Operations & Support Savings Initiative (COSSI) and Title III of the Defense Production Act programs. The Title III program provides incentives to establish or expand production capacity for items critical to the national defense when companies are unwilling or unable to make such investments on their own. One of the initiatives was to strengthen the supplier base in the Microwave Power Tube (MPT) industry by selectively targeting supply chain problems associated with critical materials and components that are required by the power tube original equipment manufacturers (OEM). There were a number of different small businesses that were affected by this initiative. Union City Filament, Hackensack, NJ, and H. Cross Company were able to increase the quality of the raw material processing due to the funding they received under this initiative. Efforts at Spectra-Mat, Monterey/Santa Cruz, CA,

focused on improving infrastructure, specifically as it related to the MPT industry and generically, as it pertained to other business opportunities. The president of the company noted that Title III assisted the company in "moving beyond what we could do on our own." Title III program contacts identified other government programs where Spectra-Mat can offer technology that would benefit DoD and provide Spectra-Mat with additional business opportunities. Another company assisted under the MPT initiative was Semicon, Lexington, KY, which produces rare earth magnets that are vital to DoD. These magnets are an integral part of MPTs that are used in over 272 fielded weapons systems such as the E-3 AWACS, F-15, F-18, Aegis Ships, and Patriot Missile Batteries, to name a few. The results of this initiative included continually improving quality rates exceeding 90 percent; on-time delivery rates of 85 percent or better; declining scrap dollars as a percentage of sales and 30 percent reduction in employee training time. The company is now more productive and more competitive.

The Movement Tracking System (MTS) provides the capability to identify position, track progress, and communicate with the operators of tactical wheeled vehicles through the use of positioning and commercial communication satellites. COMTECH Mobile Datacom, Germantown, MD, was awarded a COSSI agreement to develop the system. The system was of significant value to commanders in Operation Iraqi Freedom in tracking movement and location of friendly forces (Blue Force Tracking), and providing unlimited range communication capabilities. MTS was also instrumental in preventing a convoy ambush, used to pinpoint the location for a medical evacuation, and used to report the location of a minefield. The use of this concept and technology has expanded to meet other Department of Defense requirements, such as Blue Force Tracking, the Global Personnel Recovery System, and is an integral part of the Army's Future Combat Systems.

The Foreign Cooperative Test (FCT) Program is another way DoD assists small businesses to become DoD participants. The program taps into mature foreign technologies and after successful testing of these technologies, often forges partnerships with US suppliers through marketing and production licenses. Following successful testing of a United Kingdom (UK) firm's anti-riot grenade, New England Ordnance, Guild, NH, entered into a partnership with the UK company and now produces those grenades for the US. These grenades are used by the US Army Military Police on patrol in Bosnia, Kosovo, and Iraq. Another FCT project was the Automatic Chemical Agent Detector Alarm (ADADA) and its power supply. After successful testing, ETG, Towson, MD, teamed with a UK firm on this product. ETG produces and supports delivery of the ACADA and power supplies to all the Services. Today these chemical agent detectors stand guard in Iraq and around the Pentagon. There are numerous other examples of how COSSI, Title III and FCT programs have assisted small business to develop and become key DoD suppliers.

We believe small business is a vital part of DoD's defense base and we remain committed to ensuring their viability by offering DoD programs that support their development and sustainability.

Of course, DoD's procurement policy is extremely important with regard to small business and the industrial base. The overarching Federal procurement policy is to provide a fair opportunity for all interested and qualified companies to compete for government requirements. As I said previously, small business is a critical component of the Defense industrial base. Under our procurement policies, there is a requirement for procurements to be set-aside or reserved exclusively for small businesses, if market research indicates that there is a reasonable expectation

that offers will be received from two or more small businesses that are competitive in terms of market prices, quality and delivery. Only small businesses that have a place of business located in the United States and make a significant contribution to the U.S. economy can compete for these requirements. Additionally, there are authorities that provide for sole source awards to 8(a) or Historically Underutilized Business Zone (HUBZone) small businesses up to thresholds of $5 million for manufacturing (or $3 million for other acquisitions).

Eighty-two percent of all DoD prime contractors are small businesses, which demonstrates how important the small business world is to this Department. Further, small business prime contractors performing on DoD contracts increased to 33,936 in FY 2002 compared to 24,130 small business prime contractors in FY 2001.

DoD accounted for an unprecedented $59 billion to small business firms in FY 2002, with $33 billion of this going to small business prime contractors and $26 billion to small business subcontractors[1]. Additionally, DoD dollars going to small disadvantaged businesses, woman-owned small businesses, service-disabled veteran owned small businesses, and in HUBZones increased both at the prime and subcontract level in FY 2002 and achieved record highs. These are significant accomplishments since many of DoD's large dollar procurements are for major defense systems which require the resources of large business prime contractors.

The Department is fully committed to fostering the use of the small business community as prime contractors, subcontractors and vendors to the maximum extent practicable.
There are several programs within the Department that are intended to facilitate opportunities for small business. I mentioned the Title III and FCT programs earlier. Additionally, the Department spends approximately $25 million each year on its mentor-protégé program where large businesses

[1] This represents 21.2 percent of prime contract award dollars and 34.1 percent of subcontracts.

furnish technical and business assistance to small businesses so that they can develop as DoD prime contractors or subcontractors. The Department also issues bi-annual solicitations for both the Small Business Innovation Research Program and the Small Business Technology Transfer Program. These programs fund over $800 million each year in early-stage R&D projects at small technology companies -- projects that serve a DoD need and have commercial applications. It is through programs such as these that DoD helps small niche companies and taps into cutting edge technology, critical to the DoD.

Though not reserved exclusively for small business, small businesses have successfully competed, won and performed on several Advanced Concept Technology Demonstration (ACTD) programs. A single ACTD, the Joint Advanced Health and Usage Monitoring System (JAHUMS) benefited four small businesses. The JAHUMS ACTD demonstrated advanced health and usage monitoring technologies on military helicopters. QualTech Systems, Inc., Wethersfield, CT, is the provider of the Knowledge-Based Maintenance Support System. Technologies developed by QualTech under the JAHMUS ACTD are being applied to other product lines including both commercial and military applications, e.g. S-92 and AH-64 helicopter maintenance systems. AMTEC Corp., Huntsville, AL, is the provider of the Advanced Diagnostic Technology using Neural Networks. These advanced diagnostic techniques have potential application for early detection of mechanical failures in machinery systems, such as aircraft transmissions. System Excelerator, Inc., Orlando, Florida, provider of wireless/satellite communications, also participated in this ACTD. Technologies developed by System Excelerator are being applied to other military applications, such as the Navy Aircraft Instrumented Test Stand Facility at Naval Air Weapons Center – Carderock Division, Patuxent River, MD. Another wireless/satellite participant was Outer Link Corp., Concord, MA. The technologies developed by this firm are

being applied to other commercial and military aircraft, such as the Customs Service aircraft in the Homeland Security role.

These programs offer a means for early demonstration of critical technology that provides key components to, or may result in, new defense acquisition programs. As evidenced by the examples cited, small businesses play a key role in these technology demonstrations.

As you are aware, the Buy American Act (BAA) provides the framework for government procurement of foreign products. With limited exceptions, the BAA restricts the purchase of supplies and construction materials that are not domestic, in effect, providing a preference for domestic products. A domestic end product is defined as a product mined, produced or manufactured in the U.S., if the cost of its components, mined, produced, or manufactured in the U.S. exceeds 50 percent of the cost of all its components. When DoD receives an offer of a product that does not meet the BAA definition of a domestic end product, it is considered a foreign offer and an evaluation premium of 50 percent is applied to the offer of the foreign product, unless the BAA has been waived under any of exceptions permitted by law.

Trade agreements result in waiving the applicability of the BAA for some foreign supplies and construction materials from certain " foreign" countries. The Agreement on Government Procurement (GPA) implemented by the Trade Agreements Act (TAA), as well as the North American Free Trade Agreement (NAFTA) and some other international agreements, specifies procurement procedures designed to ensure fairness for all participants. When the restrictions of the BAA are waived under these agreements, offers of eligible products receive equal consideration with domestic offers. The TAA applies to an acquisition for supplies or services if the estimated value of the acquisition in $169,000 or more, and applies to an acquisition for construction if the estimated value of the acquisition is $6,481,000 or more. Under NAFTA, the

acquisition threshold is $25,000 or more for Canada and $56,190, for Mexico. NAFTA applies to construction materials if the estimated value of the construction contract is $7,304,733 or more.

DoD purchases of arms, ammunition, or war materials, or purchases indispensable for national security or for national defense purposes, including all services purchased in support of military forces located overseas, are exempt from trade agreement coverage. DoD's coverage is limited to dual use and commercial products. Since US suppliers are extremely competitive in open international procurement markets, the US has a strong interest in maintaining the integrity of the AGP and other rules-based international trading agreements.

Beyond the various trade agreement waivers of the BAA, DoD has also waived the BAA for 21 countries with which we have established Reciprocal Memoranda of Understanding (MOU). These countries are referred to as "qualifying countries". The goal of the MOUs is to promote standardization and interoperability of defense equipment with our allies and friendly governments. The MOUs are based on the national security considerations and the policies set forth in 10 U.S.C. 2457. The MOUs are intended to ensure reciprocity, transparency and integrity without unfair discrimination in procurements of defense equipment. In this instance, the Secretary of Defense determined that it would not be in the public interest to apply the BAA to procurements from these countries, a list of which is found in the Defense supplement to the Federal Acquisition Regulation – (DFARS 225.872).

Against the background information provided on the BAA, exceptions to the BAA, trade agreements, and MOUs, it should be noted that foreign firms may generally compete for DoD contracts. We do restrict procurement of some critical items in order to maintain domestic sources in periods of national emergency and to protect our technological and industrial base. For instance, DoD has restricted certain forging items, i.e. ship propulsion shafts, periscope tubes and

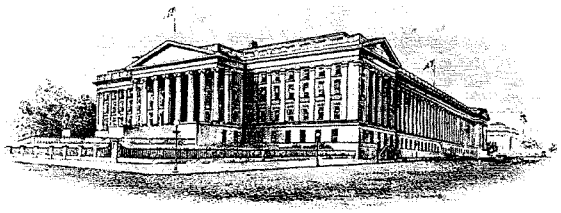
ring forgings for bull gears, whether as end items or components, to the domestic base. We have also restricted Polyacrylonitrile (PAN) carbon fiber to domestic sources. DoD is phasing out that restriction over a five year period ending May 31, 2005. We sometimes restrict procurements to domestic sources for security related matters. To the extent we treat foreign firms fairly in their efforts to sell in the U.S., we retain the leverage to insist on reciprocity for U.S. firms seeking export opportunities. Our exports, of course, mean jobs for American workers. Currently, the balance of defense trade is significantly in the U.S. favor. Foreign Military Sales (FMS) for FYs 2001 and 2000 were $13.3 billion and $12.1 billion, respectively. (FY2002 has not been finalized.) Defense sales by U.S. companies have averaged 2.5 to 3 times defense imports over the past 5 years. These figures basically understate sales because they do not take into consideration DoD's dual use and commercial items that do not require export licenses.

Foreign firms may also participate as subcontractors in DoD procurements. It is DoD's goal to acquire the product, service, or technology that will best support our military forces and protect our national defense. Therefore, in general, it is DoD policy not to interfere with a prime contractor's selection of its subcontractors because prime contractors have the overall responsibility for producing and delivering the contracted items. It is also the prime contractor's responsibility to ensure that the products being delivered meet the requirements of the Buy American Act.

In some of our larger dollar major weapon system efforts, the Department partners with other countries to develop a common system given shrinking defense dollars and the globalization of defense industries. Programs such as the Joint Strike Fighter, Evolved NATO Sea Sparrow Missile, Rolling Air Frame Missile, Medium Extended Air Defense System (MEADS) Development, Multifunctional Information, to name a few, are cost shared with our allies. This

maximizes the use of DoD funds and promotes standardization and interoperability, the importance of which has been demonstrated in recent wartime operations. Further, the Department believes that cooperation and industry- to- industry teaming arrangements can reduce the need for offsets, which is certainly a goal shared with other federal agencies and our industry partners. The Joint Strike Fighter is a model of international cooperation and teaming.

I would like to reaffirm the DoD commitment to small business. I am available to answer your questions.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

EMBARGOED FOR RELEASE **Contact:** **Treasury Public Affairs**
July 22, 2003 10:00AM **202-622-2960**

Treasury Department's Federal Procurement Process

Prepared Statement of Jody Falvey
Acting Director, Office of Small Business Development
Department of the Treasury
Before the
House Small Business Subcommittee
On Workforce, Empowerment and Government Programs

Introduction

Chairman Akin and Members of the Committee, I am pleased to appear before you today to discuss the Treasury Department's small business procurement program.

Background

Treasury's Office of Small Business Development (OSBD) supports the Small Business Act by stating in our small business standard operating procedures that it is the policy of the Treasury Department to provide maximum practicable opportunities in our acquisitions to small business, small disadvantaged business, women-owned small business, veteran-owned small business, service-disabled veteran-owned small business and HUBZone small business concerns.

The OSBD assists, counsels, and advises small businesses of all types on procedures for contracting with Treasury. Additionally, the OSBD works closely with each Treasury bureau to implement the Department's small business procurement assistance program. Each bureau has appointed a Small Business Specialist, located within the procurement office, to coordinate the program.

The OSBD focuses its efforts in four major areas:

- Information Dissemination – Internet and Hard Copy Publications
- Outreach

- Training
- Mentor-Protégé Program

Additionally, the OSBD, in conjunction with the bureaus, works closely with the Small Business Administration (SBA) to establish small business procurement goals on a fiscal year basis. The accomplishments are provided from the Federal Procurement Data Center to the SBA which prepares a report for Congress and the President.

Outreach Program

Treasury has a rigorous small business outreach program. For several years we have hosted monthly, no cost, Vendor Outreach Sessions, VOS as we call them. We have hosted 12 VOS events thus far in Fiscal Year 2003 (FY 03). These events feature pre-arranged 15 minute appointments for small business owners and representatives in a central location with Treasury representatives or Treasury large business prime contractor representatives. The following FY 03 listing provides a summary of these sessions:

Date	Activity	Location or Notes
October 15, 2002	Monthly Vendor Outreach Session	Oxon Hill, MD
November 15, 2002	Large Business Prime Contractor and Subcontracting Opportunities Vendor Outreach Session	Oxon Hill, MD
November 12, 2002	Service Disabled and Veteran Owned Small Business Vendor Outreach Session (in honor of the Veterans Day Holiday)	Oxon Hill, MD
December 16, 2002	Information Technology Program Manager Vendor Outreach Session	Oxon Hill, MD
January 21, 2003	Monthly Vendor Outreach Session	Oxon Hill, MD
January 29, 2003	Texas Vendor Outreach Session (note: out of town vendor outreach sessions are planned for areas in which Treasury has a procurement presence)	Fort Worth, TX
February 18, 2003	Monthly Vendor Outreach Session	Oxon Hill, MD
March 17, 2003	Women-Owned Small Business Vendor Outreach Session (in honor of Women's History Month)	Oxon Hill, MD
May 30, 2003	Large Business Prime Contractor and Subcontracting Opportunities Vendor Outreach Session	Oxon Hill, MD
May 16, 2003	Monthly Vendor Outreach Session	Oxon Hill, MD
June 16, 2003	Information Technology Program Manager Vendor Outreach Session	Oxon Hill, MD
July 18, 2003	Monthly Vendor Outreach Session	Oxon Hill, MD

On a four point adjective scale of excellent, good, fair, and poor, 99.8% of all small business participants rated the sessions as excellent or good.

Additionally, in our role as the chair of the OSDBU Directors Interagency Council outreach committee, Treasury took the lead for the fifth year in a row on the 13th Annual OSDBU Directors Procurement Conference which was held on April 23, 2003 at the Show Place Arena in Upper Marlboro, MD. This event featured over 300 exhibits, four seminars, and one-on-one counseling sessions modeled after the Treasury vendor outreach session. At one seminar, Treasury presented our service disabled veteran owned small business strategy. The day drew approximately 2,500 participants resulting in record-breaking attendance, and similar efforts are underway for April, 2003.

Further, in FY 03, we participated in approximately 15 other conferences such as SBA's annual conference in May and Minority Enterprise Development Week in September. Again, we have similar plans for FY 04.

In accordance with the Small Business Act, the statutory small business goals are as follows:

- 23 percent of prime contracts for small businesses;
- 5 percent of prime and subcontracts for small disadvantaged businesses (SDB);
- 5 percent of prime and subcontracts for women-owned small businesses (WOSB);
- 3 percent of prime contracts for HUBZone small businesses (HUBZSB)
- 3 percent of prime and subcontracts for service-disabled veteran-owned small businesses (SDVOSB).

In addition to the statutory goals, goals are also established for each agency in the following categories:

- 8(a) prime contracts
- small business subcontracts
- HUBZone small business subcontracts

Although veteran owned small business (VOSB) concerns are included in the policy statement, there is no statutory goal for VOSBs. However, agencies are required to collect data on VOSB procurement participation and large businesses must submit a VOSB goal in small business subcontracting plans.

Therefore, based on these considerations, Treasury is taking the following actions on an ongoing basis to maximize the small businesses' opportunity to market their companies to Treasury:

- Outreach – host special event sessions, such as a SDVOSB/VOSB event each November (in honor of the Veterans Day Holiday); and WOSB event in March in honor of Women's History Month.
- Meet periodically with trade associations, such as the Association for Service Disabled Veterans, the National Indian Business Association, and the Asian American Business Roundtable, to exchange information, ideas, success stories, etc.

- Continue to promote participation in Treasury's Mentor-Protégé program
- Continue to promote participation in Treasury's subcontracting program by making the subcontracting plan part of the evaluation criteria on major projects
- Actively seek small business, SDB, 8(a), WOSB, HUBZB, SDVOSB/VOSB from GSA's Federal Supply Schedule (by examining the category on the GSA website and Federal Procurement Data System internal database)
- Promote the use of all available databases for market research and inclusion/consideration
- Expand Treasury's waiver synopsis for small business set-asides (PIM #02-03; procurements for services over $25,000 up to $100,000) by soliciting 5 firms to include, if available, at least: 1 SDB; 1 WOSB; 1 HUBZSB; and 1 SDVOSB.

We continue to strive to meet and exceed the statutory goals for the various small business categories. A review of data from the Federal Procurement Data Center through the 4th Quarter of FY 03 reveals that even though Treasury ranked #10 in dollars spent government-wide, our percentage of dollars spent reflects our commitment to small business. Treasury ranks #1 in percentage for SDB and WOSB goals at 12.22% and 6.12% respectively, and #2 in 8(a), VOSB, and SDVOSB goals at 6.44%, .94%, and .40%. We exceeded the government-wide small business goal, and accomplished 27.66%, which put us at #7. Treasury ranked #5 for the HUBZB goal with 1.21%. We strongly believe, that over time, our outreach programs and strategy for HUBZone small businesses will provide more opportunities and subsequent federal contracts and subcontracts.

Recent Awards

Treasury was presented with two prestigious awards from the U.S. Small Business Administration on May 9 and 10, 2002: the Frances Perkins Vanguard Award and the Gold Star Award.

The Frances Perkins Vanguard Award recognizes those federal buying activities, federal procurement officials, and companies that have excelled in their utilization of women-owned small businesses. The Gold Star Award recognizes federal personnel within a small business office who carry out aggressive goals and strategic initiatives that help ensure a role for small businesses in the Federal marketplace. In conjunction with the Gold Star Award, Treasury was awarded an Agency Goaling Award of Excellence.

Reasons for Treasury's Success

We attribute our small business success to a number of critical factors. These include: senior management support, commitment, a team approach, outreach, information dissemination, training, mentor-protégé/subcontracting efforts, and recognizing that we are part of a larger network that makes up the small business community (senior management, small businesses, large business prime contractors, Small Business Administration, Treasury procurement/program/small business staff, other federal agency small business offices, and small business trade associations). One illustration of this concept regards the placement of the SBA's Procurement Center Representative (PCR) assigned to Treasury. Treasury's OSBD provides

office space for the SBA PCR, and the PCR's office is adjacent to the OSBD Director's office. By organizational design, this arrangement promotes teamwork and a genuine partnership that promotes a successful program.

Closing

This concludes my prepared remarks. I would be pleased to answer any questions you might have.

House Committee on Small Business
Congress of the United States

"Strengthening small niche businesses for retention of infrared materials technology within US: Removing foreign dependency"

July 22, 2003

Prepared Remarks of Dr. Siva Sivananthan, President, EPIR Technologies, Bolingbrook, IL

Mr. Chairman and members of the Committee, my name is Siva Sivananthan. I would like to begin by thanking you for the opportunity to testify at this hearing. I am president of the small business EPIR Technologies, Inc. located in Bolingbrook, IL and am also Distinguished Professor and Director of the Microphysics Laboratory, at the University of Illinois at Chicago. I helped pioneer the synthesis of the now-dominant high-end infrared detecting/night vision semiconductor material, mercury cadmium telluride (MCT). Under certain conditions sensors made in MCT material detect infrared radiation that is invisible to the unaided human eye. MCT is used to build detector arrays which can image objects under conditions having little or no visible illumination.

Background

The vast superiority of the American military has been instrumental in pursuing our global war against terrorism. As seen in Iraq in 1991, in Afghanistan in 2002 and again in Iraq in 2003, the United States has demonstrated its ability to fight and win wars against its opponents with troops that are relatively few in number but that are matchless in their training and, as importantly, in the tools which they are given. One of the principal advantages that Americans enjoy over their opponents is that we "own the night": our troops and airmen are able to see, identify and track targets in nighttime, in low to zero visibility weather conditions, and through obscurants such as fog and dust, with an accuracy and range that no other nation can match. Our training and our tactics are based in no small part on this night / poor visibility superiority. But I am here to report that we may not own the night in the future.

The Dangers of Relying on Foreign MCT Manufacturers

Our high-end night-fighting capability is based on the use of MCT infrared detectors, which are built using MCT material structures grown on substrates using molecular beam epitaxy (MBE) crystalline growth techniques. You might be shocked to learn that today, there is not a single supplier of substrates for MBE-grown MCT devices in the United States. Funding decisions by our government have resulted in increased, and now total, reliance on foreign suppliers for these high-end infrared materials, making us hostage to the current political and business climates of foreign countries beyond our control. These foreign governments and businesses either are or may become indifferent to, or even hostile to, the security of the American people.

What is worse, the effect of these funding decisions has been to facilitate the transfer of this vital technology and products to our adversaries. We still have time to reverse these trends and to become totally self reliant in the production of critical components for infrared technology. But without quick corrective action, this essential part of US military supremacy will be lost. Below I go into more detail about this national security problem and propose possible solutions.

The State of the Domestic MCT Industry

Our government has provided substantial funds over the past decades to several large domestic companies specializing in infrared detection technology based on MCT. We have their products to thank for our current supremacy. However, only a very small fraction of the funding has gone to small businesses. I believe that this has led to an increased reliance on foreign manufacturers and to a significant lack of innovation to improve quality and reduce the cost of products.

As an example, let us consider an infrared imager, which is rather similar to an ordinary video camera. It consists of a large number of individual components that must be assembled together. The individual components themselves often require significant effort and expertise in order to make them from raw materials. It is not in the economic interest of large companies that manufacture such imagers to produce each and every component in-house. Rather, as they have done in other, non-defense areas, the large companies outsource the required materials and components. The choice of the supplier is primarily governed by price. Foreign suppliers are typically in a position to offer the best price because of international economic disparities. While it is true that there are government regulations stipulating domestic content, the companies supplying the final products have been known to take advantage of loopholes such as charging foreign components to overhead. The practice of outsourcing MCT substrate manufacturing has resulted in there being no US suppliers. The only supplier available today is in Japan.

Additionally, the lack of government funding to small businesses undermines the confidence of US-based large corporations regarding the viability of a sustained supply of infrared materials from domestic small businesses. This results in US small businesses losing infrared market share, for which the largest customer is the US government. Moreover, US small businesses cannot sell their products elsewhere due to government export restrictions. As a result, the domestic infrared technology industrial base is shrinking down to a handful of large companies and even fewer small businesses, while research and development is down to a single university.

Increasing World MCT Demand and Development

The above mentioned facts become even more important when we take a closer look at the world market and consumption of infrared products. The defense infrared market is expected to grow significantly over the next several years. The infrared materials and detector arrays markets and infrared systems markets are expected to reach $651 million and $3.6 billion, respectively, by 2007. These figures do not include the potential market to be created by the surge of homeland security requirements. Currently, the US consumes 58.3% of the military infrared material and detector products, followed by Europe (23.2%) and Asia (7.1%). The coincidence of growth, on the one hand, of infrared materials and production in other countries with the drastic reduction, on the other, in the number of US producers makes this issue a serious concern to our national defense.

For example, since 1988 the number of US universities engaged in infrared materials and detectors research in particular MCT has declined from over eight to only one. The number of small US businesses active in the infrared material field is now down to three. There now survive only four US infrared component houses.

While the US infrared infrastructure has been permitted to decay, foreign governments and organizations, noting the present superiority in US infrared technology, have been playing "catch-up." Very recently, they have made heavy research and development investments to close the technology gap in MCT. China, India, Israel, France, Germany and the UK are especially active. They also have growing markets outside the US. The eroding US industrial base, the lack of innovations developed by domestic small businesses and universities combined with growing foreign efforts are clearly a recipe for the loss of US supremacy and an increasing reliance on foreign suppliers.

MCT Technology Export to Foreign Countries

A side effect of reliance on foreign suppliers is the export of our sensitive technology. Those innovations developed in the US but transferred to foreign suppliers for production give foreign nations full access to our technology. For example, the Microphysics Laboratory at the University of Illinois at Chicago was the first to develop methods to grow MCT by MBE. Due to the absence of a domestic manufacturer of appropriate molecular beam epitaxy equipment, the design modifications for MCT were given to a French company, Riber, for the fabrication of suitable equipment. Riber is currently selling molecular beam epitaxy equipment containing those designs to China.

In this way, the materials fabrication processes along with the fabrication tools are being transferred to foreign companies. The transfer of high-end infrared technology to our adversaries must be curbed by encouraging small businesses to build the capability to supply materials and detectors to the system manufacturers, thereby replacing foreign suppliers with domestic merchant suppliers.

State of US Academic Research in the MCT Field

Universities are frequently the breeding grounds for the fundamental understanding of science and technology, the manpower for industry and the ideas that build small businesses. I am sorry to say that here too, the government's investments have not been adequate to maintain and continue research in the MCT area. There is now only one university, the University of Illinois at Chicago, currently performing significant research on molecular beam epitaxy grown MCT. However, its federal funding is so irregular that the laboratory periodically finds itself in a near shut-down condition, only to have to go through a costly and time consuming rebuilding of its research staff when research contracts become available again. This on-again, off-again funding results in both a waste of our valuable funds and a slowdown in the advancement of the technology. Long-term funding is clearly needed to develop innovations (such as multi-color imaging) that will maintain our technological superiority over other nations.

Solutions

The problem of foreign dependence can be countered, and US dominance in the infrared arena maintained, by several initiatives:

1. Increase funding to US-based small companies for <u>infrared materials and components</u> directly to one or more small businesses with the required expertise. Alternatively, DoD may require that the large companies producing the end products internally produce any

components that they are currently purchasing from abroad. Current US automotive practice in supplier outsourcing shows that relying on small, specialized domestic MCT suppliers is the more viable approach. Approximately 45% of the cost of a vehicle goes to component suppliers independent of the car manufacturers. The component suppliers perform their own engineering and have leveraged economies-of-scale to reduce the cost per part. The car manufacturers instead focus on optimization of their manufacturing and assembly operations. The automobile industry's model would clearly be effective in the infrared industry. Therefore, the most viable option is to provide funding for the appropriate small businesses.

2. Encourage infrared-based large corporations to work collaboratively with small businesses to improve products and increase US core competencies in infrared technology.
3. Increase funding to the Army Research Laboratory and the Night Vision and Electronic Sensors Directorate engaged in infrared materials and detectors R&D so they can better lead the direction of, and provide guidance in the development of, this technology.
4. Require the DoD, through the US Army (the government leader in MCT basic and applied research), to establish an infrared focused technology alliance or consortium that creates a synergy of a focused group comprised of selected small and large businesses, universities, national laboratories and other entities to ensure infrared technology development, technology transition and retention of knowledge and competency within the US in the infrared technology. Ideally, about 75% of the funding of this consortium should be awarded to small businesses and universities, while about 25% should be retained by a manager to direct and focus the conducted research.
5. Preserve the long-term funding to the universities involved in the MCT R&D to ensure training and personnel for the future infrared tech-base.

It is in the interest of the US to preserve the long-term viability of its advances in MCT through focused investments through SBIR and other government funding mechanisms to domestic small businesses and universities performing leading edge research. The infrared focused technology alliance proposed above in (5) could be modeled after the Collaborative Technology Alliance originally championed by the Army Research Laboratory under a Federated Laboratory concept for a sustained long-term R&D environment for a cluster of universities, industries and government laboratories to jointly work and exchange ideas. This model is very successful and offers a long-term funding mechanism. However, the infrared focused technology alliance should be specific to the R&D of DOD specific infrared systems, where more focused support is provided for materials research, components and read-out electronics development.

The requested funding level is approximately $5 to $10 million/year for the first few years to kick-start the process. Over the long term, it will produce enormous payoffs to the US by: (i) saving the lives of the brave warriors we send in harm's way; ii) maintaining and enhancing the supremacy of US infrared technology over its adversaries, iii) immunizing US high-end infrared detector supply from adverse economic and political developments in foreign countries, and (iv) reducing future government costs for procuring infrared equipment.

Your hearing is an important step in this process. Thank you very much for your attention, and I'd be happy to answer any questions.

Essential U.S. Industry
For the Security of the U.S. Currency
Executive Summary
Testimony of William Jones, July 22, 2003 before the Sub-Committee on Workforce, Empowerment and Government Programs, the Committee on Small Business.

My name is William Jones and I serve as Chairman of Cummins-Allison Corporation which is a privately held manufacturing company based in the Chicago area. Our company was founded in 1887 by the Cummins and the Allison families, who were prominent leaders in the industrialization of the United States. As a matter of fact, one of the Cummins brothers, Albert, served as the Governor of Iowa from 1902 to 1908 and subsequently was a United States Senator for approximately 18 years, from 1908 to 1926. The Allison family of Indianapolis was instrumental in founding Allison Engineering, and today, you are probably familiar with Allison transmission and other Allison automotive related products and components.

A key product line manufactured by Cummins today is equipment to scan, sort, denominate, and authenticate U.S. currency as well as other currencies of the world.

Twenty years ago, five U.S. manufacturers provided approximately ninety percent of the domestic requirements for technology adapted to automatically sort, denominate, and authenticate U.S. coins and currency. United States manufacturers dominated many sectors of the industry worldwide, ranging from the manufacture of large sophisticated equipment for use by Central Banks down to the desktop equipment used in branches of commercial banks. Furthermore, U.S. industry printed and produced bank notes for use by many foreign countries around the world. These domestic industries enabled the United States to maintain the critical technology to support the integrity of the United States dollar. Today, all but one of these U.S. manufacturers have been eliminated.

The negative impact of any loss of confidence in the U.S. dollar would be an unrecoverable blow to the standard of living of American citizens. The existence of a United States industry for supplying equipment capable of handling and authenticating U.S. currency is critical to maintaining the world-renowned integrity of our currency, and consequently is vital to the national security and life as we know it. However, this once dominant U.S. industry has been systematically eroded and now is in grave danger of complete extinction due to apathetic government policy and ineffective trade regulations that have silently stood by as foreign competitors, assisted by their local governments, have whittled the U.S. industry down to a sole company. Unless prompt decisive action is taken, the United States is headed inevitably toward 100% reliance on foreign technology to process U.S. currency -- tantamount to relying on adversaries of war for the manufacture of weapons and military aircraft.

History has clearly established that a prime target for any broad-based assault on a nation is the stability and integrity of the underlying system of currency. Flooding a nation with fraudulent currency is a well-understood, though perhaps unconventional, modern-day weapon.

The Europeans remember well the attempts by the Nazi Government to counterfeit British Pounds during the Second World War. In modern times a new type of enemy such as Al-Quaida is capable in conjunction with a rogue government of developing and printing excellent counterfeit U.S. currency. The threat is real and should not be underestimated.

The ability to reliably distinguish counterfeits and automatically track the flow of all currency at low cost is the linchpin to repelling this type of attack. To not only foster the foreign development of these types of technology tools, but to knowingly move toward a condition of absolute dependence and reliance upon them, is unwise.

The threat of counterfeit currency is not the only concern. The United States currently enjoys the economic luxury of providing the world's premier reserve currency. However, this preeminent status is constantly threatened and at risk to currencies emerging around the world, perhaps never more so than in the dawn of the forthcoming Euro currency -- the Euro represents the collaborative efforts of numerous foreign governments and private currency printers who are also, in many cases, the manufacturers of equipment for processing and authenticating the currency. The various economic and technical advantages afforded to these European manufacturers by virtue of their alter ego relationship with the foreign currency printing industry clearly will drive the Euro forward at an accelerated rate in its competition with the U.S. dollar.

Most countries around the world today recognize that the design and technology contained in their respective currencies is a matter of national security and many governments provide advanced, detailed disclosures of new features to their local manufacturers of currency handling equipment to the exclusion of foreign manufacturers. Only well after the design is finalized and local manufacturers have designed around the new technology is a new currency disclosed to foreign manufacturers -- even then the disclosure typically is limited to only the information which can gleaned independently. Further intensifying the problem is the fact that many of the foreign manufacturers that participate in advance disclosures of the foreign currency features are also printers of the currency, contributed to the design of the currency configuration, and are able to develop and patent technology for handling the currency years before U.S. competitors have a chance to compete.

An excellent illustration of the close cooperation between foreign governments and their manufacturers was the introduction of the Euro. Five years prior to the release of the new Euro, the European Central Bank established a committee and invited the domestic European industry to participate. This committee designed the new Euro. Our European competitors were permitted to participate on this committee. When Cummins-Allison, an American manufacturer, learned about the existence of this committee, we specifically asked to be included and contacted the appropriate authorities at the European Central Bank. Furthermore, the United Sates Bureau of Engraving and Printing wrote a letter of recommendation to the European Central Bank suggesting the Cummins should be included in the deliberations. We received correspondence for the European Central Bank declining our request. This correspondence is attached as Exhibit One to my testimony.

In a like manner, the Government of China has declared that currency is a national security issue. Therefore, even after entry into the WTO, tariffs of 38% to 40% continue to be assessed by the Chinese government upon Cummins products exported from the USA into China. A recent tender issued by commercial banks in China for 10,000 machines was lucrative and promising to Cummins. However, the Chinese Government stepped in and informed the commercial banks that the bank could not source these machines from a foreign supplier, and particularly could not source from Cummins-Allison in the United States.

The Chinese Government, however, does recognize that Cummins is the world leader relative to technology for processing currency at high speeds and low costs. I cite a specific article written in the Chinese equivalent of the Wall Street Journal. (attached as Exhibit II) I quote, "for example the U.S. Cummins Corporation produces a complete product line..... This equipment can be used at the counter or in the vault..... This is probably the most technically advanced money processing equipment that exist today." The article goes on to say, "we (China) should learn the merits from the importing money processing equipment and overcoming their drawbacks shall be our winning factor. We will move forward in full speed and enrich ourselves with technology and productivity hoping one day we can replace imports (that being Cummins) and then begin exporting money processing equipment bearing a Chinese brand name." Compounding the problem, Cummins has no practical means to protect our patents or intellectual property rights in China because our own U.S. government failed to negotiate adequate protection of such rights as a condition of China's entry into the W.T.O. So China's industry can, and does, copy Cummins technology with impunity.

United States banks, government, and other industry routinely purchase money-handling equipment from manufacturers based in countries that do not admit competing products manufactured in the U.S, or admit U.S products only after imposing exorbitant tariffs and taxes. Admission of imports from markets where U.S. manufacturers are frozen out is the chief reason that the number of U.S. companies competing in this market has been emaciated and may ultimately be the reason the U.S. becomes 100% reliant on foreign technology to process its own currency. Compounding these problems is the fact that currency-handling equipment currently is being dumped in the United States. Competitors have openly acknowledged this fact and boldly act accordingly.

It is important to retain a domestic United States industry. Cummins primary focus is upon the development of equipment to process U.S. currency at a low cost. Foreign suppliers concentrate on their own foreign currency and take the United States currency as a secondary thought.

For example, in 1990 the lowest cost tabletop currency scanner available sold for more than $25,000 in the United States. Therefore it was cost prohibitive for most banks to utilize sophisticated currency, scanning and authentication equipment in their U.S. branch locations. By the mid 1990s, after spending 5 years and millions of R&D dollars, Cummins developed a radical new technology that enabled banks to purchase currency scanners and authenticators at a price of $2,500 per unit. This was less than 10% of the cost of prior generation technology. This has been a huge success and has enabled banks to install sophisticated equipment to process currency at branch locations throughout the United States. The pay back to the banks was less

than one year, so we are told, on this equipment. This was due to the enhanced productivity for processing currency, as well as the ability to find significantly more USD counterfeits at the point of entry into the banking system.

In the next generation of equipment, should we survive, Cummins is developing technologies that will enable banks and the United States Government to improve currency evaluation and surveillance. This new technology will enhance the ability to identify the source of counterfeiting as well as the flow of currency through the hands of terrorists and other adversarial organizations.

Unfortunately, the current political and legal framework imposed upon U.S. manufacturers prevents the type of investments going forward that would permit taking current domestic technology into new products and expanded product offerings, such that U.S. purchasers would have a choice of more than one supplier, or the option of selecting a domestic supplier at all levels of equipment. Ultimately, this restriction on U.S. capacity will eliminate all U.S. production, and the United States will be forced to purchase all of its currency security technology from foreign suppliers. The resulting dissemination of U.S. security technology to foreign manufacturers and consequential reliance on others for U.S. currency technology will place the premier status of the U.S. currency at grave risk.

Testimony of Alan Tonelson
Research Fellow
U.S. Business and Industry Council Educational Foundation
before the
Subcommittee on Workforce, Empowerment and Government Programs
Committee on Small Business
U.S. House of Representatives
July 22, 2003

Good morning, Chairman Akin, Congressman Udall, and Members of the Subcommittee. On behalf of the U.S. Business and Industry Council and its research and educational arm, the U.S. Business and Industry Council Educational Foundation, thank you for the opportunity to testify today on how government procurement policies can more effectively strengthen small niche businesses and support America's competitiveness in the technologies they represent.

This subject is of great concern to the roughly 1,000 member companies of the U.S. Business and Industry Council, which themselves are predominantly small and medium-sized manufacturers. Since 1933, the Council has championed the cause of strengthening the domestic technology and manufacturing bases, and we are very gratified by the Subcommittee's focus on this critical issue.

This hearing, moreover, could not be more timely, as small and medium-sized manufacturers and their larger counterparts remain stuck in a downturn that is reaching historic proportions. There can be no doubt that much of this distress – which threatens our national security; our future productivity, innovative capacity, and prosperity; and future as a healthy, middle-class-based society and democracy – stems from ill-conceived trade and globalization policies. By in effect encouraging many U.S. multinational companies to supply the U.S. market from abroad, by failing to combat predatory foreign trade practices, and by inadequately opening foreign markets to domestic producers, these trade and globalization policies have left most domestic manufacturers with an excruciatingly difficult challenge – struggling to defend their own market while remaining unable to penetrate overseas markets. Their competitors, of course, too often enjoy the benefits of selling to the U.S. market from protected sanctuary home markets.

Without a thoroughgoing transformation of these trade and globalization policies, the domestic manufacturing and technology base will continue to deteriorate. This erosion has occurred under both Democratic and Republican presidents alike. It is not a problem of politics, but of perception – mainly, an inability of Executive Branch officials to identify and support American economic interests.

Changes in government procurement policies can significantly benefit hard-pressed small domestic producers. But the Subcommittee – and the rest of the government – must understand that much more needs to be done. Moreover, some of the most important changes needed in government procurement policies may be inconsistent with America's obligations under current

international trade regimes.

The changes that the U.S. Business and Industry Council believe are necessary as initial steps fall into three categories:

a tightening of the Buy American Act that governs most federal procurement;

a similar tightening of federal technology sharing programs;

much better monitoring and enforcement of international trade agreements covering government procurement practices.

Broadly speaking, the Buy American Act of 1933 as amended by purely U.S. law and by the terms of subsequent international trade agreements requires federal entities to buy U.S.-made goods and services unless compelling economic, political, or national security considerations argue otherwise. The Act is already a powerful tool for providing opportunities for small producers, as the federal government is by far the largest single contractor in the United States, and the U.S. economy is by far the world's largest single national economy.

Unfortunately, the Buy American Act and related programs contain several major loopholes that can undermine their effectiveness. Several amendments and internationally imposed changes have produced the same results. For example, federal officials have broad discretion to waive the Act's provisions. They are free to purchase foreign products or services regardless of price of quality if they themselves believe that such purchases would serve "the public interest." and if domestic products are "unreasonably" priced. Both grounds for waivers are vague at best, and therefore easily subject to abuse.

During the Cold War, American producers were victimized repeatedly by U.S. government policies that sacrificed concrete domestic economic interests for dubious or intangible diplomatic goals. Disturbingly, signs of this impulse have reappeared in U.S. trade policy since 9-11.

At the same time, the specification or precise acceptable price ranges for procured goods and services, as contained in the Buy American provisions for U.S. airport projects and FAA grants, for example, serve the purpose of telling foreign companies exactly how much they need to under-sell their domestic competitors in order to win contracts. In short, these specifications are an invitation to dump and an instruction manual on how to do so.

This problem is especially serious given the ubiquity of foreign dumping into the U.S. market and the ubiquity of foreign government subsidies that make so much of this dumping possible. Foreign competitors that are essentially paid by their governments to win market share will always have a major advantage over domestic U.S. companies – which receive relatively few subsidies. And this advantage will have nothing to do with market forces or free trade.

Today's Buy American laws also lack significant reporting provisions. Indeed, my recent research has turned up such provisions generally in small federal programs like the National Science Foundation and American Indian health care programs.[1] Without high-quality, up to date data on Washington's procurement activities, Congress and the President will experience great difficulties in crafting wise policies.

Nor do any of the government's Buy American provisions appear to feature any independent review processes. In-house complaint and investigative procedures are sometimes available, but inevitably raise conflict-of-interest concerns. U.S. companies believing that decision-makers have ignored or manipulated waiver criteria have the option of litigation. But law suits of course can be expensive and time-consuming – and thus rarely will be used by small and medium-sized companies.

A separate problem with today's Buy American laws and regulations entails substantive amendments – some coming solely at the initiative of the U.S. government and domestic interests, and more resulting from the need for these laws and regulations to conform with U.S. international trade obligations.

For example, in 1994, Congress permitted the purchase of foreign goods if the contract value is less than $2,500. Senator Russ Feingold has asked the General Accounting Office to study this loophole and its effect on American business. We share his concern that this exemption might be depriving domestic manufacturers of significant revenues, and the impact is probably heaviest on small and medium-sized companies.

In 1979, the United States and nearly 30 other countries concluded a Government Procurement Agreement. This agreement was greatly expanded in 1996 under the auspices of the World Trade Organization. Both agreements have denied Buy American coverages to broad classes of goods. So did the 1993 Memorandum of Understanding on Government Procurement signed with the European Community (now European Union). The North American Free Trade Agreement, and U.S. trade policies toward certain Caribbean Basin countries, and toward certain countries on the United Nations' list of the world's poorest countries contain similar provisions.

Most of these changes to Buy American laws have been part of a larger effort to liberalize government procurement practices around the world, and generate more opportunities on net for U.S. producers. The record shows, however, that the promise of more open government procurement markets has not been met, and U.S. export bonanzas have not materialized.

The federal government also influences the relative competitiveness of U.S. and foreign firms

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[1] The Defense Department's foreign procurement is subject to reporting requirements, but at the subcommittee staff's request, I will not deal with defense-related issues in this testimony. However, it is important to note that many domestic manufacturers and national security experts consider the Defense Department's reports to be completely inadequate.

through various technology sharing programs designed to help commercialized the fruits of taxpayer-funded research and development. For decades, federally funded programs achieved great successes in numerous areas of basic research. But applied research, aimed at advances that can directly generate higher growth, profits, and incomes, has always been a much lower federal priority, with three important exceptions – medicine (focusing on public health of course but of tremendous import to the pharmaceutical industry) , agriculture, and defense (where spin-offs have helped midwife many major American technology industries). In the mid-1980s, Washington began to place greater emphasis on commercializing federal research advances.

The institutions created to further these goals include the Federal Laboratory Consortium for Technology Transfer and the NASA Commercial Technology Network. Yet although the institutions are chartered explicitly to strengthen the American economy, there do not appear to be equally explicit bars or limits to foreign participation in these programs. For example, the NASA network's Small Business Innovation Research and Small Business Technology Transfer programs require that participants merely be "a small business...independently owned and operated in the United States by U.S. citizens or permanent resident aliens." These programs often stipulate that the business generated by such government-discovered technologies remain in the United States, but our research so far indicates that monitoring and enforcement are threadbare, and that most of these requirements sunset quickly.

In an increasingly globalized world economy, it is entirely possible that foreign participation in such programs can contribute on net to purely American objectives. Thus, there is ample room for legitimate debate about when and how such foreign participation should be permitted. Unfortunately, this debate has never taken place at senior levels of the U.S. government. Instead, inadequately monitored bureaucrats pursuing short-term programmatic or budgetary objectives have often made decisions on foreign participation in a piecemeal way, seemingly oblivious to larger, longer-term strategic and political questions. Consequently, it is all to likely that many benefits of these U.S. taxpayer-funded programs have leaked abroad – to the direct competitors of U.S. manufacturers.

Finally, U.S. government procurement policies have let down small domestic producers by failing to respond adequately to various foreign predatory practices that provide major benefits to these firms' foreign competitors. It is imperative for this committee to recognize that monitoring and enforcing U.S. trade agreements aimed at reducing or abolishing these practices has long been a major weakness of U.S. trade policy. Monitoring and enforcement has never been a high priority of U.S. trade diplomacy, paling in drama and glamor to negotiating and signing new agreements.

Moreover, the broad U.S. strategy for responding to these predatory practices is fatally flawed. U.S. trade negotiators tend to believe that foreign governments and societies share their legalistic values – in particular, their devotion to black-letter law, and to transparent, accountable governing institutions. Therefore, their negotiating objectives consistently have focused on abolishing or weakening offensive foreign trade rules and regulations.

What Washington never realizes is that most foreign government economic and trade policies – even in genuinely democratic countries – are run by powerful, unaccountable bureaucrats enjoying great power to make policy informally, and behind closed doors. Specific rules and regulations matter far less than the protectionist impulses lying behind them. Therefore, agreements outlawing certain forms of protectionism usually result in the protectionist impulse taking an new form – sometimes a cosmetically changed rule or regulation, sometimes a practice that is even more difficult to identify, much less respond to.

Unless U.S. trade negotiators insist on quantifiable, genuinely verifiable results in trade agreements – i.e., significant increases in U.S. exports or decreases in unfairly trade imports – their record of futility will continue.

The U.S. Business and Industry Council hopes that this Subcommittee and the Congress as a whole will seriously consider these recommendations for improving federal procurement's ability to help small manufacturers:

All federal agencies should be subjected to reporting requirements on their levels of foreign purchases.

The monitoring and review of procurement decisions should be made for all federal agencies by independent authorities that would be empowered to respond quickly and forcefully to allegations of improper waivers.

The waiver language of the Buy American Act must be tightened. In particular, the U.S. content provisions must be expanded to the component and possibly the sub-component level. In order to prevent "screwdriver" assembly operations from enjoying "Made in America" treatment and subverting the intent of the statute. Moreover, the concept of the "public interest" requires much greater specificity, to prevent abuse of this waiver criterion. Congress should also seek to limit sharply the Executive Branch's use of diplomatic justifications for waiving Buy American provisions. Only genuinely important – indeed, vital – national security interests should be considered grounds for foreign policy-related waivers. In general, the scope of Executive Branch discretion must be greatly narrowed.

Goods from countries designated as consistent violators of trade agreements should be immediately barred from receiving waivers to Buy American provisions until they have established a lengthy record of law-abiding behavior. The determination of consistent violators, moreover, cannot be left to the U.S. Trade Representative's office, which has an overriding , historically demonstrated interest in reaching trade agreements for their own sake, and therefore maintaining smooth relations with our major trading partners. Given the Constitution's designation of Congress as the lead federal authority in making trade policy, this function should be returned to Capitol Hill.

Goods from countries that routinely provide official subsidies for production and/or for

export should be barred from receiving Buy American waivers until they have established a lengthy record of refraining from subsidization. As subsidies are by their nature fungible, restricting the waiver ban to export subsidies will be grossly insufficient. Moreover, since the phenomenon of foreign government subsidization of traded goods is so widespread and yet so poorly understood, Congress should authorize a GAO or government commission study of this issue, with the express aim of establishing the extent of this practice. Designation of these countries should not be left to the office of the U.S. Trade Representative. Instead, the Congress should make this decision, based on information provided by the Commerce Department's International Trade Administration.

Goods from countries with long, continuing records of intellectual property theft should be barred from receiving any waivers as well, until they have established long records of law-abiding behavior. Congress should have the authority to identify these countries, based on information from the U.S. Trade Representative's office and other relevant government agencies.

The policies and behavior of these problematic countries must be monitored continuously to prevent them from quickly reverting to protectionism.

The breadth of these measures barring waivers for goods from agreement-violating countries is critical. If "innocent" foreign companies are affected by the new restrictions along with the "guilty," the result is likely to be the creation of lobbies in those countries that will push effectively for elimination of predatory practices.

Congress should act promptly to eliminate the Buy American waiver for government purchases under $2,500 if the GAO report requested by Sen. Feingold discovers that it has significantly and adversely affected domestic manufacturers.

Congress should authorize a GAO or federal commission to study the issue of foreign participation in federal technology sharing programs. Decision-makers simply have too little knowledge of this practice, its effects to date, and its likeliest long-term consequences to make sound decisions on the subject.

Congress should require the President to re-activate the National Commission on the Use of Offsets in Defense Trade, created by the Defense Offsets Disclosure Act of 1999. The Bush administration has allowed five vacancies on the Commission to remain unfilled since the change of administrations in 2001. As a result, the Commission has issued only an interim report, and has not met since December, 2000. A final report – which the 1999 law required by October, 2001 – could shed much light on how offsets routinely demanded by foreign purchasers of U.S. defense goods have affected the small, predominantly civilian companies contained in defense domestic supplier chains. Since offsets often require percentages of the content of defense systems to be made overseas, small suppliers clearly bear much of the economic costs of these agreements.

On behalf of the U.S. Business and Industry Council, I would like to thank the Committee for its time, and I would be pleased to respond to your questions.

Testimony of John M. Palatiello
Executive Director
Management Association for Private Photogrammetric Surveyors (MAPPS)
Before the
House Committee on Small Business
Subcommittee on Workforce, Empowerment and Government Programs
Hearing on Foreign Competition in Government Procurement
July 22, 2003

Mr. Chairman, members of the Subcommittee, I am John Palatiello, Executive Director of MAPPS, a national association of more than 170 private firms engaged in mapping and related geographic information services and products. Our members include firms of all sizes, including a great many that are within the SBA size standard for a small business.

The mapping community is deeply concerned about production work going to foreign competitors. Send drafting, data conversion, scanning, digitizing, and other work related to mapping to subcontractors outside the United States is, in our view, dangerous to our domestic market, as well as a threat to our homeland security.

Before September 11, there was discussion in the mapping community about the practice of sending certain work offshore for subcontractor performance. That discussion focused on whether this was a good business practice and whether this was an ethical activity.

Like many other aspects of American life, things changed on September 11, 2001. In his State of the Union address in January, 2002, President Bush said, *"Our discoveries in Afghanistan confirmed our worst fears ... We have found diagrams of American nuclear power plants and public water facilities, detailed instructions for making chemical weapons, surveillance maps of American cities, and thorough descriptions of landmarks in America and throughout the world. What we have found in Afghanistan confirms that, far from ending there, our war against terror is only beginning."*

Access to mapping data and other work products of the geographic information community can be used for nefarious and destructive purposes if in the wrong hands. Since the September 11 attacks, there has been increased concern about this issue.

For example, after September 11, a number of Federal agencies revised public web sites and removed maps, drawings and other data about our critical infrastructure. For example, the U.S. Department of Transportation's web site on the National Pipeline Mapping System, which provided location data on interstate gas and petroleum transmission lines, was shut down.

While these may have been prudent and necessary steps, they could in some respects be tantamount to shutting the barn door after the horse has left.

There are instances in which U.S. firms send conversion work, mapping and other geographic information work offshore, to India, Pakistan, China, the Philippines, and other countries with lower labor costs. This practice raises issues regarding access to data about the location of power plants, buildings, pipelines, water supply systems, underground utilities and other critical infrastructure by individuals in foreign countries who have not been through any degree of security clearance and where control of access to data simply does not exist.

There are a number of practices resulting in work leaving the United States that deserve the attention of the Subcommittee.

A number of our members are deeply concerned about enforcement of the North American Free Trade Agreement (NAFTA) with regard to services. A number of my member firm principals report being significantly being under priced by Canadian firms, due to the exchange rate between the U.S. and Canadian dollars. A significant portion of contract awards in an aerial photography contract program of the U.S. Department of Agriculture is going to Canadian firms, due to their ability to under-price U.S. firms. Although NAFTA requires transparency between U.S. and Canadian firms in services, few U.S. firms that have been able to penetrate the Canadian market, and virtually no U.S. firms have successfully won Canadian government contracts. We are concerned that NAFTA has become a one-way street.

While the Federal "Buy America Act" (40 USC 10a) generally does not apply to services, for a Federal Government contractor to send work offshore could be illegal and potentially dangerous. The only reason a firm would send work offshore would be to take advantage of lower labor costs. If a firm were to send Federal contract work offshore, take advantage of the lower labor costs, fail to pay the prevailing wage required by the contract, and pocket the difference, it could be in violation of contract clauses and subject the firm to fraud, and its personnel to criminal penalties, as well as possible Federal contracting debarment. We would urge the Committee's investigation of the legality of this practice.

Federal A/E contracts and subcontracts are subject to the prevailing wage requirements of the Service Contract Act of 1965 ("SCA"). Many state and local governments have similar prevailing wage laws. Some would quickly assume that with regard to Federal contracts, this practice could not be taking place, due to the requirement that the prevailing wage be paid to prime and sub - contractors' workers pursuant to the SCA (41 U.S.C. 351 et seq. and 29 CFR 4.101 et. seq.)

However, it has come to our attention that there is a loophole in the SCA and its regulations that not only permits this practice, but indeed may provide an incentive. The Act and its regulations apply only to contracts performed in the United States. Thus if Firm A is submits a proposal to a Federal agency and it performs the work domestically, it is subject to SCA wages. If Firm B submits a proposal, and performs the work through an offshore subcontractor, it is exempt from SCA. The specific exemption for work performed outside the United States is in 29 CFR 4.112.

As noted above, we believe an investigation into the enforcement of the law is in order. The law and regulations apply the statute to contracts where "the principal purpose of which is to furnish services in the United States." If a government agency contracting officer provides Service Contract wage rates to competing firms or the successful offeror, is it not reasonable to conclude that the principal purpose of that contract is to furnish services in the United States?

This loophole clearly undermines the intent of the law. It also disadvantages workers in firms that propose to perform domestically. And it puts those firms at a competitive disadvantage. We believe this practice is occurring on Federal contracts with increasing frequency, and there is no action by Federal agencies to investigate or enforce this practice. Moreover, this scenario is being played out on State and local government contracts using Federal funds, where Federal regulation, oversight and enforcement is nonexistent.

Given the nature of our economy when the SCA was enacted, it is apparent that Congress did not anticipate offshore subcontracting. This is a loophole Congress did not consider, which should be closed. A number of States have laws regarding prevailing wages on state service contracts. At least four state legislatures, Connecticut, New Jersey, Maryland and Washington State are considering legislative proposals to prohibit offshore subcontracting. We respectfully urge the Committee to investigate this loophole in the SCA and assist in a regulatory or legislative solution.

MAPPS is also concerned about work going offshore because of the predatory nature of Federal Prison Industries (FPI). As the Small Business Committee knows from its hearing held last November, FPI is rapidly moving into the services sector of our economy. Prison industries are looking to enter the commercial market for services, claiming a 1930s ban on interstate commerce for prison made products does not apply to services. FPI is targeting for domestic prison labor performance those commercial services that are going offshore. FPI's own documents show it is "broadening its prime contractor role ... in the areas of ... digitization of maps for GIS applications, digitization of engineering and facilities management drawings (am/fm), scanning and digitizing, CALS conversions." Thus, MAPPS is concerned that the trend toward offshore performance of architecture, engineering and mapping activities will result in a double-whammy for U.S. small business mapping firms – low wage competition from off-shore sources as well as from prison industries.

The recent trend toward offshore subcontracting is particularly troubling to small mapping firms. They are not as able as large firms to set up offshore subsidiaries or to negotiate teaming agreements with firms outside the United States.

Our greatest concern, is the fact that when one looks at what has happened in the manufacturing sector, one realizes that once an activity goes offshore, it does not come back home. We are concerned about the long term impact offshore subcontracting will have on the mapping profession and the U.S. economy.

We generally support free trade policies. We are generally resistant to government intrusion in the business affairs of our profession and our members business practices. It should be noted that for obvious anti-trust reasons, private firms or trade associations cannot enforce ethical policies that in any way limit sending work offshore. While only government action can affect this activity, we urge caution by Congress and regulatory agencies. We appreciate the Committee's careful attention to this important matter and commend you, Mr. Chairman, for holding this important hearing and inviting us to share our views.

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