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Report to the Chairman, Subcommittee on Military Readiness, Committee on National Security, House of Representatives

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DEFENSE TRANSPORTATION

Status of U.S. Transportation Command Savings Initiatives

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The Honorable Herbert H. Bateman
Chairman, Subcommittee on
Military Readiness
Committee on National Security
House of Representatives

Dear Mr. Chairman:

In February 1996, we reported that customers using defense transportation services provided through the U. S. Transportation Command (USTRANSCOM) and two of its component commands—the Army's Military Traffic Management Command (MTMC) and the Navy's Military Sealift Command (MSC)—pay relatively high overhead costs.[1] Our report noted that fragmented traffic management processes, a modally oriented organizational structure, and mobilization costs are major factors driving higher transportation costs. As such, we recommended that the Secretary of Defense should ensure that defense transportation reengineering efforts simultaneously address process and organizational structure improvements.

In response to our report, the Department of Defense (DOD) stated that USTRANSCOM would implement a wide range of organizational and process improvements to reduce overhead and improve efficiency. In a December 1996 report to Congress, USTRANSCOM identified over $500 million in savings it attributed to such improvements. In March 1997, USTRANSCOM reported that savings had increased to almost $780 million and that the savings achieved from fiscal year 1993 through fiscal year 1999 will be passed on to peacetime customers in the form of incremental reductions to rates it charges for transportation through the rest of the decade.

As requested, we reviewed the extent that the savings are, or are projected to be, reflected in the form of lower charges to defense customers. Specifically, this report focuses on the (1) extent to which USTRANSCOM expects to achieve long-term savings in its operating and infrastructure costs and (2) changes regarding transportation rates and customer charges. As agreed with your office, because we are continuing to review issues related to streamlining and reengineering the defense transportation system, we are not making any recommendations in this report.

[1]Defense Transportation: Streamlining of the U.S. Transportation Command Is Needed (GAO/NSIAD-96-60, Feb. 22, 1996).

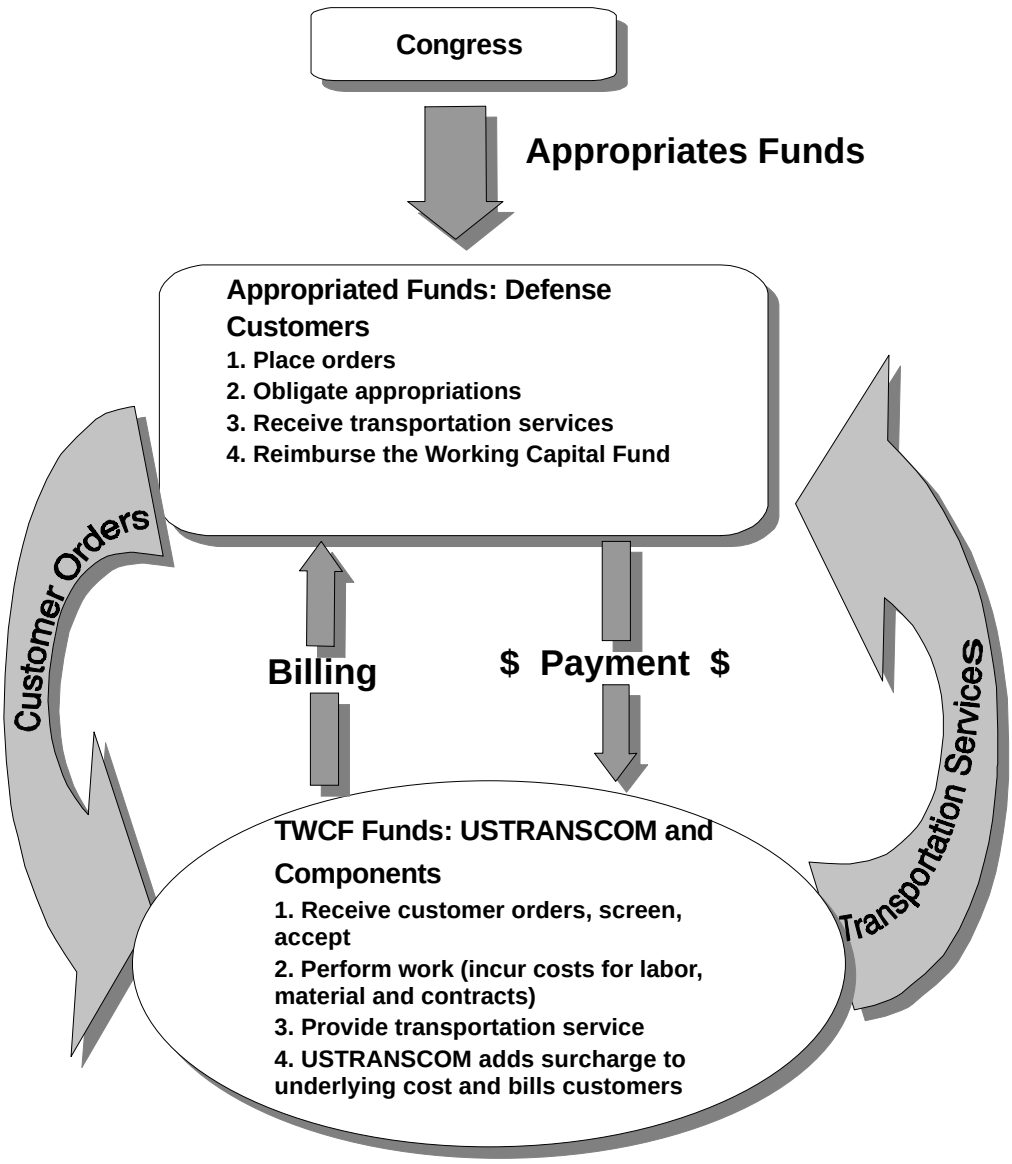
Background

The mission of USTRANSCOM, which is DOD's single manager of all defense transportation services, is to provide global air, land, and sea transportation to meet national security needs, both in time of peace and time of war. USTRANSCOM executes its mission through three component commands: (1) MTMC for land transportation and port operations (2) MSC for sea transport, and (3) the Air Force's Air Mobility Command (AMC) for air transport. Within this report, defense transportation refers to common-user transportation, defined by DOD as transportation and transportation services provided on a common basis for two or more DOD agencies.

USTRANSCOM's responsibilities include financial management of all defense transportation. USTRANSCOM and its component commands operate under the Working Capital Fund system of financial management. Its budget, which includes the component commands, is submitted within the Air Force's Working Capital Fund budget, separated and identified therein as the Transportation Working Capital Fund (TWCF). Under the TWCF concept, DOD customers place orders with the component commands, which then contract for the services and/or provide the services using their own resources. In turn, the component commands charge customers for their services. Customers predominantly use funds from their operations and maintenance appropriations to reimburse component commands, which use these reimbursements to pay their suppliers and to fund their operating costs. (See fig. 1.)

USTRANSCOM's operating costs were approximately $4.0 billion in fiscal year 1997, and in fiscal year 1998, its budget submission estimate is $4.2 billion. In fiscal year 1997, AMC accounted for about 60 percent of total TWCF operating costs, MSC was about 30 percent, and MTMC was about 10 percent. The congressional defense committees have raised concerns regarding USTRANSCOM's infrastructure. Therefore, the fiscal year 1996 appropriation included a reduction of $52 million and the fiscal year 1997 appropriation included a reduction of $100 million due to these high infrastructure costs. The committees believed immediate action was necessary to consolidate and streamline transportation operations in a manner that reduced the amount of transportation overhead passed on to customers without adversely affecting mobilization capability.

Figure 1: TWCF Process



Note: For purposes of this report, the USTRANSCOM surcharge is defined as the difference between what USTRANSCOM pays commercial carriers for basic underlying transportation services and what it charges its customers, illustrating the costs customers pay for USTRANSCOM and component commands' operating expenses.

Source: GAO.

Consistent with working capital fund policy, component commands charge for services using rates that must cover costs USTRANSCOM and its component commands incur for the commercial services plus their other direct, indirect, and overhead costs. Each component command must develop a budget and determine how much to charge its customers for each service. MSC is responsible for negotiating the cargo rates and terms of carriage with the ocean carriers and paying carrier invoices. MTMC is responsible for booking service for individual shipments, preparing shipment documentation, clearing customs, and supporting MSC's payment processes. AMC is responsible for booking cargo shipments and passenger moves, billing customers, and providing airlift.

Multiple factors affect the ability to reduce rates charged to customers, including inflation, the way the rates are calculated, declining workload, and customer satisfaction. In addition, due to the budget process, there is a lag time of up to 18 months between when rates are first estimated and when they are effective. While most rates are supposed to recover actual cost of the operations, some rates do not. For example, the customer rates AMC charges for airlift are supposed to cover only those operating and maintenance costs directly related to providing the airlift service. However, training and readiness, which are not always directly related to providing airlift services and are AMC primary missions, make up much of AMC's operating costs. In accordance with a DOD directive, the Air Force pays or subsidizes[2] the costs of training and readiness, which are in addition to the portion of costs AMC recovers from its customers through the rates it charges for services directly related to providing airlift. This payment, generally referred to as the Air Force subsidy, was about $420 million in fiscal year 1997 and USTRANSCOM estimates it will be about $514 million in fiscal year 1998. Reducing costs that are covered by the subsidy would not reduce customer rates, rather, it would reduce the amount of the Air Force subsidy.

Another factor impacting the ability to reduce rates charged to customers is declining workload. According to the Under Secretary of Defense (Comptroller), DOD has been unable to reduce infrastructure costs as fast as customer budgets have been reduced. Faced with a finite amount of funds, customers are consequently paying higher prices for needed goods and services while overall demand for work is decreasing.

[2]Using funds from its direct appropriations for operations and maintenance, the Air Force makes a yearly payment to TWCF to finance the amount not recovered through charges to its customers. USTRANSCOM refers to the subsidy as the Airlift Readiness Account in its budget submissions. The subsidy process allows any losses to be, in effect, reimbursed through appropriated funds.

Customer satisfaction is another element that impacts the ability to reduce transportation costs. The less satisfied a customer is with the quality, timeliness, or cost of the service, the more likely they will seek alternate transportation resources outside the defense transportation system. For example, in USTRANSCOM's fiscal year 1998 TWCF budget submission, AMC notes that it has been losing peacetime airlift customers to the commercial sector because the commercial sector provides a better service. Similarly, because the military exchanges and commissaries were concerned over high costs of ocean transportation, they received legislative authority to obtain transportation services outside MTMC and MSC in fiscal year 1996. In a May 17, 1997, policy memorandum, DOD stated that this authority may only be exercised to the extent that the military exchanges and commissaries can demonstrate that it would be more cost-effective to DOD to do so, and readiness would not negatively be impacted. The determination of the overall cost-effectiveness and impact on readiness would be made by the Under Secretary of Defense (Acquisition and Technology) in conjunction with the Under Secretary of Defense (Comptroller), the Under Secretary of Defense (Personnel and Readiness), and the Commander in Chief, USTRANSCOM. According to USTRANSCOM officials, this authority has not been exercised.

Results in Brief

The U.S. Transportation Command and its components have sought to reduce costs and improve operating efficiencies in the defense transportation system, while at the same time preserving its readiness capabilities and effectiveness. We recognize that reducing transportation charges to defense customers is complicated by multiple factors that impact the ability of the Command to affect transportation charges. The lag time, for example, between reducing operating costs and realizing reductions in customer charges means that the impact of some of the Command's savings initiatives has yet to occur. At this time, however, it appears that the savings initiatives identified by the Command will not yield as great a result as initially reported. Consequently, the reported savings are not likely to have a significant impact on lowering infrastructure and long-term operating costs, which is key to reducing customer charges. Further, available data indicate that many costs the Command charges its customers are rising at a rate greater than inflation[3] and that surcharges may remain high, even when underlying transportation charges have declined.

[3]For the purposes of this report, "inflation" represents the price growth factor shown for budget purposes by the component commands.

Specifically, only about $260 million of the $780 million reported savings represents reductions to infrastructure and long-term operating costs—savings that could more readily result in lower charges over time to defense customers for transportation services.[4] The impact of some of these savings is yet to be realized. A small portion of the reported savings ($120 million) actually involves improved revenue collections rather than efforts to reduce long-term operating costs. However, most of the reported savings, over $400 million, would not reduce long-term operating costs because the reported savings either (1) were offset by related increases to operating costs, (2) reduce requirements for appropriated funds but do not directly affect customer transportation rates, or (3) will not materialize. The reported savings that are to occur between fiscal years 1993 and 1999 represent less than 3 percent of the Command's $27 billion working capital fund operating costs during that time period. Thus, the extent to which total operating costs might be affected raises questions about the ability of these savings to substantively reduce customer transportation charges.

Further, customer rates have been increasing and the Command projects increases to continue through the end of the decade. The increases are at or above the rate of inflation and some common user rates show increases well above inflation. In addition, the Command's surcharge, which is the amount the Command charges customers over and above the underlying transportation costs, continues to be substantially higher than the amount component commands (primarily MTMC and MSC) pay commercial carriers. Finally, there where instances where surcharges were increasing significantly even when underlying transportation costs had declined.

Our Analysis of USTRANSCOM Reported Savings and Effect on Reducing Infrastructure and Operating Costs

USTRANSCOM and the component commands have taken action to improve customer service, reduce costs, and improve operational efficiency. In March 1997, USTRANSCOM reported that nearly a $780-million savings occurring during the fiscal years 1993 through 1999 time period are expected to incrementally reduce customers' rate charges for transportation through the rest of the decade. Specifically, USTRANSCOM reported that its budget submissions between fiscal years 1993 and 1999 reflect over $500 million in savings resulting from productivity and cost avoidance initiatives, over $200 million in cost reductions due to fewer flying hours, and over $70 million in streamlining-related savings. According to USTRANSCOM, about 65 percent of the reported savings has

[4]Although many of the reported savings were not well documented, we assumed, for purposes of this analysis, that the savings were fully realized. The extent to which the savings were not well documented is discussed in greater detail in the Scope and Methodology section of this report.

been achieved and about 35 percent are projected to occur through fiscal year 1999.

Table 1 shows the savings USTRANSCOM reports by component command.

Table 1: Savings Reported by Component Command

Dollars in millions

	Reported savings by fiscal year							
Component command	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**Total**
AMC	0.0	$210.2	$37.4	$142.6	$31.1	$70.2	$50.3	$541.8
MSC	0.0	43.2	51.5	20.6	24.8	24.1	9.2	173.4
MTMC	0.0	3.1	1.9	0.0	15.9	18.2	22.9	62.0
USTRANSCOM-Headquarters	0.0	0.0	0.0	0.0	0.0	1.4	0.0	1.4
Total	**0.0**	**$256.5**	**$90.8**	**$163.2**	**$71.8**	**$113.9**	**$82.4**	**$778.6**

The total savings reported by USTRANSCOM represent about 3 percent of the $27 billion in TWCF costs that it has incurred or expects to incur during the 6-year period covered by the savings.

To the extent that these savings are expected to be realized, we found that most of the reported savings, over $400 million, would not reduce long-term operating costs, and that only a relatively small portion of the savings, about $260 million, was apt to result in reductions to transportation rates for users of the defense transportation system. Another $120 million actually involved improved revenue collections rather than efforts to reduce long-term operating costs.

Table 2 summarizes our categorization of the reported savings.

Table 2: Analysis of Savings Reported by USTRANSCOM

Dollars in millions

Amount		Summary of our categorization of reported savings		
$258	(33%)	Savings that should affect rates		
		$149	(19%)	Savings that could affect rates affecting all USTRANSCOM customers
		$109	(14%)	Affects rates charged to single-service customers
$120	(15%)	Savings involves increasing revenues not reducing long-term operating costs		
$401	(52%)	Savings not likely to affect rates over the long term		
		$209	(27%)	Offset by related cost increases
		$114	(15%)	Reduces need for appropriated funds but does not affect customer rates
		$78	(10%)	Will not materialize
$779	**(100%)**	**Total**		

It should also be noted that for purposes of our analysis, we assumed that the cost reductions would be fully realized. However, in doing our analysis we found that many of the reported cost reductions were not well-documented and some will not materialize. The extent to which the savings are not well-documented is discussed in greater detail in the Scope and Methodology section of this report.

Some Reported Savings Reduce Infrastructure and Long-Term Operating Costs

About $149 million, or 19 percent, in reported savings result from USTRANSCOM initiatives to reduce infrastructure and operating costs. These efforts are a step in the right direction and should have a positive impact by lowering costs that are passed on to common user customers. Table 3 shows a breakdown of the savings resulting from initiatives to reduce infrastructure and operating costs by command.

Table 3: Infrastructure and Operating Savings by Command

Dollars in millions

Command	Amount
AMC	$ 58
MSC	28
MTMC	62
USTRANSCOM Headquarters	1
Total	**$149**

Some actions that the commands have taken, or are taking to reduce infrastructure and long-term operating costs and to achieve these savings follow.

- AMC has reduced the number of civilian personnel employed, improved operations by combining previously separated air traffic management functions into one Tanker Airlift Control Center, and implemented better airlift loading processes.
- MSC is in the process of reinvention, assessing its key business lines and establishing an organization that it believes will better meet the needs of its diverse customers. Its reinvention plans include a reduction in size and a relocation of its two largest area commands from Bayonne, New Jersey, and Oakland, California, to Norfolk, Virginia, and Pearl Harbor, Hawaii, respectively.
- MTMC is consolidating its Eastern and Western Area Command headquarters into one headquarters. In taking this action, MTMC is not only complying with the decision of the 1995 Base Closure and Realignment Commission to relocate its Eastern and Western Area Commands, but also is consolidating the two area command headquarters into a single MTMC Continental U.S. Command headquarters at Fort Eustis, Virginia.
- MTMC has closed or is planning to close port facilities at Baltimore, Maryland; Compton, California; New Orleans, Louisiana; Iskenderun, Turkey; and Lisbon, Portugal. The closure of its Bremerhaven, Germany, facility is under study. Other downsizing actions have been taken or are planned at Oakland, California; Bayonne, New Jersey; the Azores; Greece; Germany; and Panama. In addition, USTRANSCOM directed the establishment of the Joint Traffic Management Office at MTMC. This office combines cargo and passenger missions and consolidates separate MTMC and MSC traffic management staff.
- USTRANSCOM reduced the number of headquarters personnel in the Joint Transportation Corporate Information Management Center. The Center's primary objective is to improve the efficiency and effectiveness of defense transportation information systems.

Some Reported Savings Affect Primarily a Single Customer

Reported savings of $109 million would reduce costs to programs that serve basically single customers and should reduce rates charged to them. About $44 million of the savings was achieved by changing maintenance procedures, shore support, and operating status, for example, in the Fast Sealift Ship program. The Fast Sealift Ship program consists of eight high-speed, roll-on/roll-off ships that are kept in reserve for surge capability and is funded almost entirely by one customer, the Navy. Another $33 million of the savings was achieved by changing delivery methods, numbers of ships employed for delivery of fuels, and types of ships employed, for example, in the sealift Tankership program. This program uses government and chartered ships to deliver petroleum around the world and is funded almost entirely by the Defense Logistics Agency's Defense Fuel Supply Center. An additional $9 million was attributed to renegotiation of contracts for ships in the Maritime Prepositioning Ships program. This program consists of 13 prepositioned ships loaded with tanks, ammunition, fuel, and other materials for operations involving the U.S. Marine Corps and is funded by, and primarily benefits, the Navy through the Navy Working Capital Fund. Finally, $23 million of the savings was attributed to savings initiatives in the three programs mentioned above, but MSC did not provide data on the exact amount attributed to each specific program.

Some Reported Savings Would Increase Revenues Not Reduce Long-Term Operating Costs

Reported savings of $120 million is actually revenue increased by charging customers for services not billed to them in prior years. One example is an ongoing initiative to locate missing manifests and to charge customers for transportation services not previously billed, resulting in $55 million in additional revenue. Another is the inclusion of new charges to customers for unused space, resulting in an additional $65 million in revenue through fiscal year 1999. By collecting for services not previously billed and charging for unused space, USTRANSCOM will not have to raise rates or increase the amount of the Air Force subsidy in order to cover the losses it may have incurred because those costs had not been previously passed on to customers. At the same time, total customer charges for the same services may actually increase because customers will now pay for costs not previously billed to them. According to DOD, the process of charging customers for unused space should provide an incentive to the customer to reduce or eliminate some airlift requirements, which could also result in some cost savings.

Large Portion of Reported Savings Offset by Related Cost Increases

In two instances, we found that reported savings of $209 million were more than offset by directly related cost increases. AMC reported a total savings of nearly $173 million as a result of reduced flying hours and MSC reported over $36 million in savings from renegotiated container agreements. However, neither of these initiatives considered related cost increases. AMC, for example, attributed the $173 million savings primarily to the retirement of aging C-141 aircraft and a transfer of some C-141 training hours to flight simulators. However, AMC is replacing the C-141 with new C-17 airlift aircraft, and C-5 flying hour costs have been increasing. The reported flying hour cost savings do not reflect increased C-17 and C-5 flying hour costs. Since AMC's estimate includes only reductions for three of the years between fiscal years 1993 and 1999, we recalculated the total C-141 flying hour costs, which actually decreased by $420 million during that period. However, the combined C-17 and C-5 cost increases were over $500 million during the same period, which more than offsets the cost decreases that USTRANSCOM projects will occur in the C-141 program.

MSC's reported savings showed that costs related to container rate agreements would be decreased by $36 million, mostly for fiscal years 1994 and 1995. This is an accurate statement; however, the statement does not give a complete analysis of rate changes through fiscal year 1999. For example, the same container agreements were renegotiated in fiscal year 1996. As a result, in many cases, rates in fiscal years 1997 and 1998 are higher. For example, the negotiated rate for moving a 40-foot dry cargo container from the Military Ocean Terminal, Oakland, California, to Seoul, Korea, dropped about 20 percent from June 1993 to June 1994 but increased by 40 percent in December 1996. The impact of the higher renegotiated rates was not considered in the savings calculation.

Some Reported Savings Reduce Need for Appropriated Funds but Do Not Affect Customer Rates

Reported savings of $114 million would reduce the subsidy the Air Force pays to TWCF but would not affect rates. As previously discussed, the purpose of the Air Force's yearly subsidy to TWCF is to cover readiness and training costs that are not recovered by the rates AMC charges customers for services directly related to providing transportation services, such as airlift.[5] AMC officials told us that the Air Force subsidy to TWCF, in effect, reimbursed the AMC portion of TWCF for the costs attributed to the closure of Norton Air Force Base ($55 million) and for the transfer of C-130

[5]This subsidy may not provide an incentive to decrease customer rates because any losses can be, in effect, reimbursed through appropriated funds. Working capital funds are supposed to provide an incentive to control costs and maximize efficiency. The rates charged for services should cover the expenses incurred for the commercial services plus all other direct, indirect, and overhead expenses.

fixed-costs ($42 million). As a result, savings achieved by eliminating those costs would reduce the Air Force subsidy but would not lower customer rates. An additional $17 million in savings relate to costs that were reimbursed through the subsidy. This amount is calculated using the percentage of operating costs that were reimbursed by the Air Force subsidy between fiscal years 1994 and 1999 from approximately 10 to 44 percent of all AMC TWCF costs during that period. Thus, a total of $114 million reduces appropriated funds but not TWCF costs.

Some Reported Savings Will Not Materialize

According to AMC representatives, about $78 million in reported savings for AMC will not occur. Although AMC reported $23 million in savings was achieved in fiscal year 1996 by reducing the number of regularly scheduled C-5 and C-141 overhauls at depots, those reductions never materialized. Representatives of AMC told us that the Air Force decided it would be unsafe to decrease maintenance on those aircraft because of their age. The remaining savings—about $55 million in fiscal years 1998 and 1999—is associated with performing an intermediate level of maintenance for C-5 aircraft engines located at Dover Air Force Base being performed at the base instead of the depot level. However, these savings will not materialize because, according to AMC representatives, intermediate-level maintenance for Dover C-5 engines has never been done at the depot level.

Many Transportation Rates Continue to Increase

USTRANSCOM reported that the savings discussed previously will be passed on to peacetime customers in the form of lower rates for transportation through the rest of the decade. Therefore, to determine the extent that the savings are, or are projected to be, reflected in the form of lower rates to common user customers, we examined the trends in customer rates as reported by USTRANSCOM in its budget submissions. We also examined surcharges in two common user transportation areas to determine whether the difference we previously reported between underlying transportation costs and USTRANSCOM surcharges continues to occur. We found that USTRANSCOM and the component commands project increases in most common user transportation rates at or above the rate of inflation through fiscal year 1999, indicating that total customers' charges are continuing to increase as well.

While in total, the TWCF budget submission includes unit cost projections, workload assumptions, and rate changes for 10 separate transportation areas, 6 of the areas are for common user transportation. These common user areas provide more than 50 percent of USTRANSCOM's revenue and

include airlift channels for both passengers and cargo, special assignment airlift and joint exercise missions, sealift cargo for both breakbulk and containerized cargo, and port operations. The remaining four transportation areas are primarily single customer oriented programs and include MSC's Fast Sealift, Tankership and Afloat Prepositioning Programs, and the Trained Crews Program, which serves the Air Force almost exclusively. USTRANSCOM projects that rates for the Fast Sealift Ships and Tankership programs will be below the projected rate of inflation. Those lower rates will affect rates for a few select customers but will have little effect, if any, on what most common user customers pay for defense transportation. See appendix I for figures showing rate changes as compared to inflation during the fiscal years 1995 through 1999 time period for each of the 10 transportation areas.

Of the six common user transportation areas, half are projected to substantially increase above the rate of inflation and half will remain generally level with inflation during fiscal years 1995 through 1999. Specifically, USTRANSCOM projects rates for the combined area of special assignment and joint exercise airlift missions to increase 20 percent over the rate of inflation during that time period. According to USTRANSCOM officials, this increase is not due to price growth but rather to a DOD policy change that passes more of the operations costs to special assignment and exercise airlift users. Furthermore, according to the same officials, the rationale behind the policy decision was that, unlike channel cargo and passenger areas, special assignment mission and exercise services are often military-unique services that do not require a billing rate that approximates private industry.

USTRANSCOM projects breakbulk and container cargo rates to increase about 40 percent during the same period.[6] On the other hand, it projects that rates for both passenger and airlift channels during the same time period will remain about even with inflation because these rates are set at a commercially competitive level and any costs not recovered by rates in these areas are reimbursed through the Air Force subsidy. Even though USTRANSCOM projects the port operations rate to remain about even with inflation during this period, reflecting cost decreases affecting common user customers, those decreases are more than offset by increases noted for sealift cargo.

[6]Any customer moving cargo via surface transportation (land and sea) is billed the appropriate MSC sealift cargo rate (breakbulk or container), plus the applicable MTMC port handling or seavan handling rate.

As mentioned previously, various factors contribute to rate changes. Moreover, within each transportation rate area there are many rate categories and rates within categories. Separate categories often apply to specific types of service provided, types of cargo, and location. For example, the MTMC port handling rate area has separate rate categories for export and import cargo and within those categories are rates for each of 14 types of cargo and 6 locations. Thus, the actual change for any given category or any individual rate may vary significantly from the composite rate change.

In addition, since rates are based on actual costs and are first estimated up to 18 months in advance of their effective date, some lag time will occur before the rates are changed to reflect actual cost changes. As previously mentioned, $258 million of reported savings are likely to impact customer rates. Of that amount, about $80 million of savings were actually achieved between fiscal year 1993 and 1995. Thus, the impact of those savings should be reflected in rates for fiscal years 1996, 1997, and 1998. The balance, about $180 million of the $258 million in savings, would not likely affect rates until fiscal year 1999 or beyond.

Transportation composite rate changes in the February 1998 President's Budget submission show significant reductions in some rate areas, differing from the 1999 rate estimates in the February 1997 President's Budget submission and depicted in our rate trend analysis, which we submitted to DOD for comment on March 3, 1998. Although data was not available for us to review the 1999 composite rate changes released after our draft report, we are hopeful that these changes indicate that USTRANSCOM may be successful in reducing charges to its customers in fiscal year 1999 and beyond.

USTRANSCOM Surcharges Continue to Be High

In our February 1996 report, we examined charges to customers in two of the common user transportation areas: MSC cargo/container and MTMC port handling. We have updated those examples to identify changes in underlying (contractor) transportation costs and surcharges being passed on to USTRANSCOM customers. We acknowledge that some potential reductions in rates associated with expected savings are yet to occur. At the same time, the savings that will likely reduce rates in future years represents only a small portion of total USTRANSCOM operating costs. These savings represent less than 1 percent of USTRANSCOM's estimate of $27 billion in total TWCF operating costs for fiscal years 1993 through 1999.

Accordingly, this raises significant questions about the ability of these savings to substantively reduce charges.

The updated examples identify changes in customer charges for the same service in fiscal year 1995 and in fiscal year 1997. The examples also show the costs USTRANSCOM incurred in contracting for commercial transportation, with remaining costs representing USTRANSCOM surcharges. The previous amounts charged customers were from 24 to 201 percent higher than the basic contractor transportation costs and the updated examples show that customers are now charged from 56 to 200 percent higher.[7] In two examples, the actual contractor charges showed a decrease between fiscal year 1995 and 1997, indicating that USTRANSCOM negotiated more favorable container agreements. However, at the same time, the USTRANSCOM surcharge showed an increase between the two fiscal years in both examples. Table 4 cites changes in rates for four of these shipments. All 15 examples using updated data are shown in appendix II.

Table 4: Examples Comparing Contractor Charges With Cost to Customers

A. Port-to-Port Example (no local drayage[a] at origin destination)			
Example A From: U.S. East Coast (any port in range) To: Europe (any port in range)			
Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,552.88	Contractor charges	$1,664.98
USTRANSCOM surcharge	1,739.60	USTRANSCOM surcharge	3,322.82
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	112 percent	Percent cost exceeds contractor charges:	200 percent

[a]Drayage is any required truck or rail transportation within the port area or commercial zone to or from the ship.

[7]The percentage difference increased in 9 of the 15 examples and decreased in 6 examples.

B. Port Area-to-Port Area Example (local drayage at origin and destination)

Example B
From: Military Ocean Terminal, Bayonne, N.J.
To: Bremerhaven, Germany

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,712.18	Contractor charges	$1,863.81
USTRANSCOM surcharge	1,580.30	USTRANSCOM surcharge	3,123.99
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	92 percent	Percent cost exceeds contractor charges:	168 percent

C. Port Area-to-Inland Point Example (local drayage at origin and line-haul transportation at destination)

Example C
From: Norfolk (Zone 2), Va.
To: Giessen, Germany

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$2,361.18	Contractor charges	$2,001.87
USTRANSCOM surcharge	931.30	USTRANSCOM surcharge	2,985.93
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	39 percent	Percent cost exceeds contractor charges:	149 percent

D. Inland Point-to-Inland Point Example (line-haul transportation at origin and destination)

Example D
From: Atlanta/Forest Park, Ga.
To: Kaiserslautern, Germany

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$2,650.87	Contractor charges	$2,240.23
USTRANSCOM surcharge	641.61	USTRANSCOM surcharge	2,747.57
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	24 percent	Percent cost exceeds contractor charges:	123 percent

The extent that TWCF rates, including the USTRANSCOM surcharge, can be reduced is directly related to the extent that long-term operating costs can be reduced. Although nearly $80 million in TWCF savings were reported as occurring by fiscal year 1995, about $180 million in savings expected in fiscal year 1996 through fiscal year 1999 may have a future impact on rates. Nevertheless, the USTRANSCOM surcharge continues to remain relatively

high in the two fiscal years—1995 and 1997—we examined. Using MTMC data, we verified that these examples were representative using MTMC data by comparing the costs and charges of the same examples at the rates (fiscal year 1995) used in our February 1996 report with the more current rates (fiscal year 1997).

To obtain additional information regarding the examples and to ensure all relevant factors were considered in our calculations, we presented the examples to MTMC, MSC, and USTRANSCOM in July 1997. USTRANSCOM responded that the examples ". . . describe the optimal situation of shipping port-to-port cargo," and ". . . focused on shipping rates of the lowest cost carrier for ocean transportation only—not all the applicable charges." We believe our examples demonstrate a variety of shipping points, give consideration to other than the lowest-cost carrier, and include all applicable charges.

Only 5 of the 15 examples describe a port-to-port situation, and those examples, according to MTMC traffic data, indicate that they are illustrative of a significant number of containers handled in the defense transportation system. The other 10 examples represent port area-to-port area, port area-to-inland point, inland point-to-port, and inland point-to-inland point-type shipments. Each type encompasses large numbers of containers moving in the defense transportation system.

Our examples include what MTMC charged its customers for shipment booking, cargo manifesting, customs clearance, and shipment receipt. MTMC could not provide us with any additional costs for any other services it may have provided. However, in many cases, defense customers perform their own shipment booking and have their own documentation and would not require MTMC to provide any additional services.

As stated in our February 1996 report, the total USTRANSCOM surcharge for each shipment in our analysis was substantially higher than DOD's carrier costs even though the charges for an individual component command may not always be higher than what the component command pays the carriers. Our examples highlight the USTRANSCOM surcharge, that is the difference between what USTRANSCOM pays commercial carriers for basic underlying transportation services and what it charges its customers, illustrating the costs customers pay for USTRANSCOM and component command operating costs.

We continue to believe the USTRANSCOM surcharge as shown in our examples is excessively high. We did not attempt to determine what USTRANSCOM surcharge would be reasonable; we have reported, however, the surcharges passed on to customers in other defense business areas were generally much lower. For example, the Defense Logistics Agency's surcharge for hardware items in fiscal year 1996 averaged about 39 percent, which covered the cost of the hardware item, plus supply center and distribution expenses, inflation, and material-related expenses such as inventory losses. The Agency also lowered the surcharge for medical supplies from 21.7 percent to 7.9 percent using best management practices.[8]

Conclusions

USTRANSCOM has taken some positive steps attempting to reduce transportation rates that may be passed on to customers in the form of lower charges for transportation. However, overall only about one third of the reported savings would directly reduce long-term operating costs, which could affect transportation charges to defense customers. Even if all the reported savings directly affected long-term operating costs, the $780 million in savings represents only about 3 percent of $27 billion in estimated TWCF operating costs during the same period. Furthermore, the USTRANSCOM surcharge continues to remain high in the 2 fiscal years—1995 and 1997—we examined, most transportation rates have increased since fiscal year 1995, and USTRANSCOM projects that transportation rates will continue to increase through fiscal year 1999. Further measures to reduce long-term operating costs, such as additional infrastructure reductions, will likely be required to reduce customer charges. Otherwise, peacetime customers will likely continue to pay prices for some defense transportation services that are often two to three times higher than the cost USTRANSCOM pays for the underlying transportation service. Because we are continuing to review the overall issues related to streamlining and reengineering the defense transportation system, we are not making any recommendations at this time.

Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD expressed concern with our conclusions because they believe our report minimizes the efficacy of overall savings to DOD and the taxpayer. Specifically, DOD disagreed with (1) our categorization of its reported savings, (2) the examples we used to show the impact of rate changes and our use of the term surcharge, and

[8]Defense Inventory Management: Expanding Use of Best Practices for Hardware Items Can Reduce Logistics Costs (GAO/NSIAD-98-47, Jan. 20, 1998).

(3) the starting year of our rate trend analysis. Our evaluation of these points is discussed below.

We noted that USTRANSCOM and component command actions to improve customer service, reduce costs, and improve operational efficiency are positive steps. We recognize that, as USTRANSCOM points out, some of the reported savings will, or have, reduced subsidies that customers pay, offset rate increases, and improved revenue collection efforts. As stated in our report, however, these savings will not directly impact customer rates because they do not reduce infrastructure and long-term operating costs. Even if all the reported savings directly affected long-term operating costs, the total dollar savings represent a very small portion of estimated TWCF operating costs during the time period in which the command expects the savings to occur. Further, only about one-third of the reported savings would result in reductions to transportation rates. As our categorization shows, nearly two-thirds of the reported savings would not reduce long-term operating and infrastructure costs and are not likely to affect rates over the long term. Consequently, we remain concerned that transportation charges to its military customers are unnecessarily high.

DOD also stated that the examples in our draft report comparing TWCF to USTRANSCOM-negotiated commercial transportation costs do not portray the results of efforts to reduce costs and increase operating efficiency. As stated in our draft report, the examples are representative of what USTRANSCOM actually pays for commercial transportation compared with what it actually bills its customers. The examples are also representative of actual shipments in fiscal years 1995 and 1997 and payments for commercial carrier contracts USTRANSCOM was reimbursed at actual point-to-point billing rates. Since we were advised by MTMC that contract negotiations for fiscal year 1999 commercial carrier contract prices are still being negotiated and that reimbursement point-to-point rates will not be finalized and published until about August 1998, we used actual available data. Using projected or estimated prices and rates, based on composite rate changes, would be speculative and the results would be subject to change. Our analysis is based on the most current actual data available. As our work continues, we will assess new cost data as it becomes available.

DOD also questioned our use of the term “surcharge”, which we defined as the difference between what USTRANSCOM pays commercial carriers for basic underlying transportation and what it charges its customers. DOD was concerned that we were indicating that the services provided for the

surcharge are of little or no value. This was not our intent. We used the term surcharge and the amounts represented by it in each of our examples to show the differences between underlying commercial transportation charges, and the total amounts billed. We recognize, as DOD pointed out, that the amount shown as surcharge is for contract negotiation and administration, cargo booking, customs clearance, cargo receipt, automated in-transit visibility systems, port management, and surge and readiness programs. We have modified this report to clarify that point.

Finally, DOD stated that fiscal year 1994 transportation composite rate changes should be included in our rate trend analysis as opposed to using fiscal year 1995. We acknowledge that had we used fiscal year 1994 as the baseline there would be less of an upward trend in some rates. However, we chose fiscal year 1995 because it was the first year that reflected USTRANSCOM-managed transportation rates. DOD stated that using fiscal year 1994 was more appropriate because that was the first year USTRANSCOM submitted rate changes for approval by the DOD Comptroller and was the first time a unique budget was developed for USTRANSCOM. However, Command officials told us that it was not until fiscal year 1995 that USTRANSCOM developed customer rates for defense transportation. Accordingly, we chose fiscal year 1995 as the baseline for our rate trend analysis. Also, 1995 rates were the basis for the examples comparing contractor charges with customer charges as we reported in February 1996. We agree that, due to the cyclical nature of rates, the selection of any particular fiscal year as a baseline would likely change the rate trend. In addition, it is important to note that comparing one's rate with another and determining the reasons for the shift in rates is difficult because of the various factors that comprise the rate changes.

DOD also provided several technical comments, which we incorporated into the text of our report as appropriate. DOD's comments are reprinted in appendix III.

Scope and Methodology

To determine the extent to which USTRANSCOM expects to achieve long-term savings in its operating and infrastructure costs, we assessed the savings it reported to Congress in December 1996, including subsequent testimony that reported $780 million, cumulatively, in savings initiatives. We met with officials and obtained briefings and documents from USTRANSCOM on the reported savings initiatives, as well as supplemental information from the component commands—AMC, MSC, and MTMC. We also analyzed available data on reported productivity savings/cost avoidance initiatives

and streamlining initiatives and assessed fiscal year 1993 through fiscal year 1999 TWCF budget estimates and submissions. We attempted to trace the savings to the affected budget accounts with the supporting documents and to validate the amount of the savings and their applicability to reducing transportation charges to defense customers. In most cases, USTRANSCOM or the component commands reconstructed information to show how they best recalled having calculated the amount of savings reported. However, supporting documentation was generally insufficient to track and validate the savings to source and budget documents. Also, because DOD's accounting systems, like all accounting systems, are oriented to tracking expenses and disbursements, not savings, we could not validate or track savings reported to specific budget lines. According to USTRANSCOM officials, most of the reported savings were not traceable to corresponding reductions in specific budget lines because budget adjustments include several factors such as workload, pricing, program changes, and other adjustments that make it difficult to track discreet savings by budget line items. Additionally, USTRANSCOM officials said that many of these initiatives cross several line items. Nevertheless, since it was the only data available, we used the information USTRANSCOM and the component commands reconstructed as the basis for assessing whether the reported savings are likely to result in lower rates for defense customers.

To assess changes in transportation rates and customer charges, we met with officials at USTRANSCOM, AMC, MSC, and MTMC; reviewed budget documents and other supporting documentation; estimated the extent that rates paid by defense transportation customers have changed and are likely to change; and recalculated the examples of customer charges used in our February 1996 report.

We assessed the extent defense transportation rates changed between 1995 and 1999 by first obtaining approved rate changes shown in the fiscal years 1998 through 1999 TWCF budget submissions. For each rate category, we started with a base of 100 for fiscal year 1995, then made adjustments to that amount for each fiscal year with approved rate changes. We compared these changes in approved rates to the annual changes in the price index used to measure inflation, where we also used fiscal year 1995 as the base of 100. We used the same inflation factor shown for budget purposes by the component commands as our measure of inflation to compare the approved rate changes against. For fiscal years 1995 through 1999, the average yearly inflation is 2.56 percent for AMC, 2.48 percent for MSC, and 2.36 percent for MTMC.

The changes in each rate category by fiscal year in appendix I use a baseline year of fiscal year 1995. Rates for fiscal year 1995 represent the first year in which USTRANSCOM established rates on behalf of its component commands. The fiscal year 1995 rates are also comparable to the baseline we used for comparisons of the shipment examples noted in appendix II. Specifically, rates for fiscal year 1995 were formulated by the component commands around January 1993, submitted by USTRANSCOM to the Assistant Secretary of Defense (Comptroller) in a budget document dated October 1993, approved by the Assistant Secretary of Defense (Comptroller) in a program budget decision in December 1993, and published in the President's "Budget Estimates" support materials in February 1994.

It is important to note that comparing one year's rate with another and determining the reasons for the shift in rates is difficult because of the various factors that comprise the rate changes. For example, reasons for changes in the rates include changes in customers' workloads, contractor prices, policy, and congressional directives to include, or not include prior years' operating results, costs to maintain mobilization capability, military pay, and movement of programs into or out of TWCF.

We also assessed changes in customer rates and charges for the examples cited in our February 1996 report by first obtaining the most current MTMC and MSC rates data available (using fiscal year 1997 published rates). We then recalculated our examples and compared the results with those developed in our 1996 report. We provided the recalculations to USTRANSCOM and its component commands to solicit their review and comment and addressed their concerns in this report.

The examples used in table 4 and appendix II are based on charges for typical DOD shipments, each consisting of general (dry) cargo, 47 measurement tons each, transported in commercial carrier 40-foot containers, at rates for the low-cost carrier on each route. The examples reflect charges MSC and MTMC bill their customers for the costs they incur for negotiating rates with commercial carriers used to move DOD shipments, for contracting with the underlying carrier and paying its charges, and for the administrative expenses incurred to document the shipments and handle booking, manifesting, receiving and clearing customs. In every case, all applicable drayage and/or line-haul trucking costs to and from a ship's side were included in our cost calculations. Cost comparisons are based on using the low-cost carrier because MSC advises us that it uses the low-cost carrier in most instances. However, we also

examined the costs of other than low-cost carriers and in each example found the higher cost carrier was not significantly more expensive.

The examples show a comparison of contractor charges with the costs to USTRANSCOM's defense customers for containerized dry cargo shipments. Each example shows two points in time: (1) the first point is described in our February 1996 report and is based on fiscal year 1995 USTRANSCOM-negotiated prices and charges and (2) the second point is calculated based on fiscal year 1997 USTRANSCOM-negotiated prices and charges. We did not use projected prices and charges because the purpose of the analysis was to show what USTRANSCOM actually paid for contracted services and what it actually charged its defense customers for the service.

We conducted our work between July 1997 and March 1998 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Secretaries of Defense, the Army, the Navy, and the Air Force; the Commander in Chief, U.S. Transportation Command; the Director, Office of Management and Budget; and other interested congressional committees. Copies will also be made available to others upon request.

Please contact me on (202) 512-8412 if you or your staff have any questions concerning this report. Major contributors to this report are listed in appendix IV.

Sincerely yours,

David R. Warren, Director
Defense Management Issues

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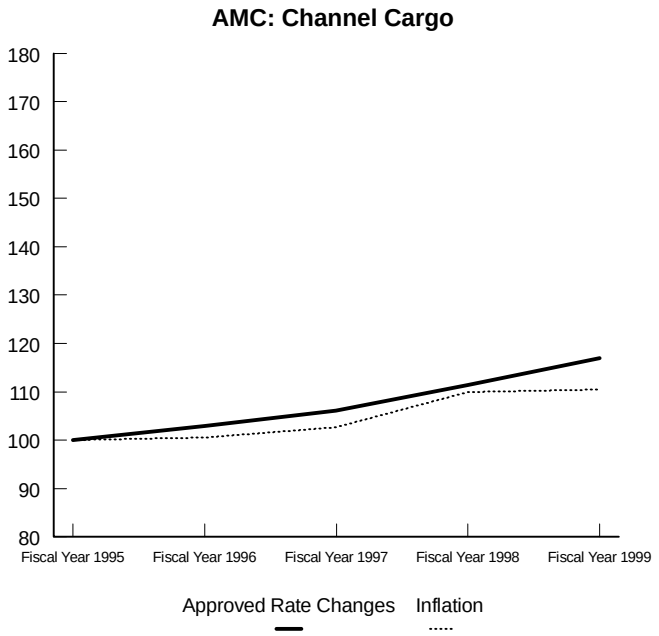
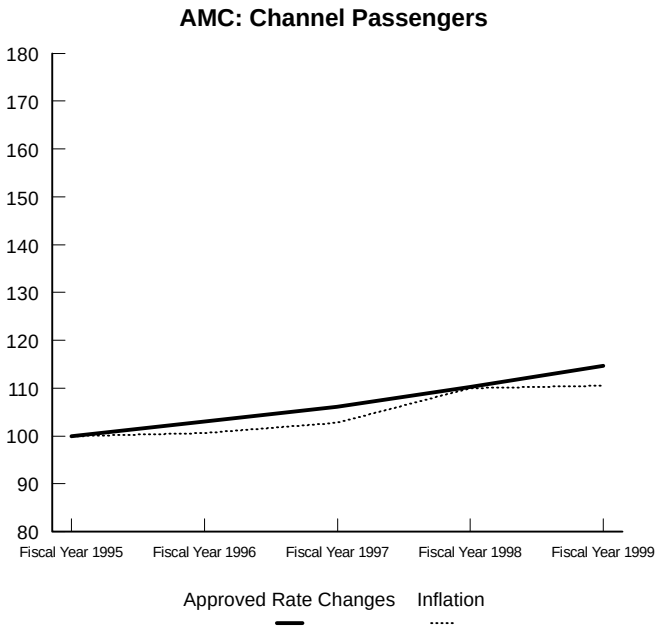
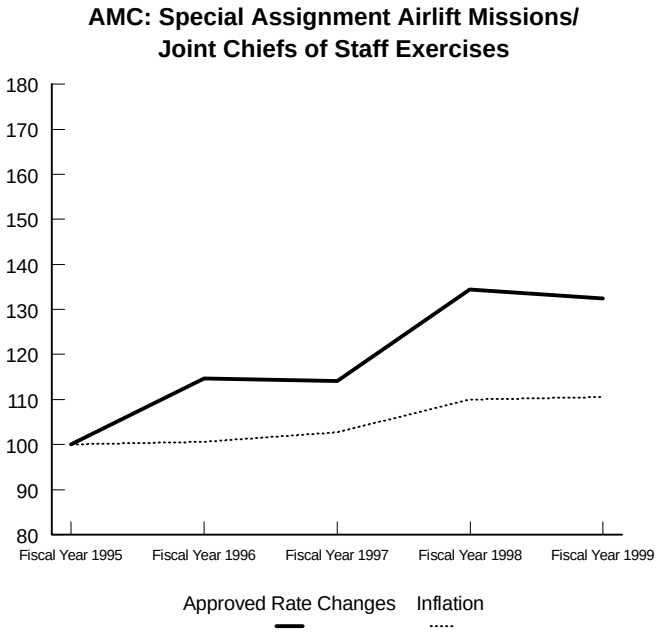
Abbreviations

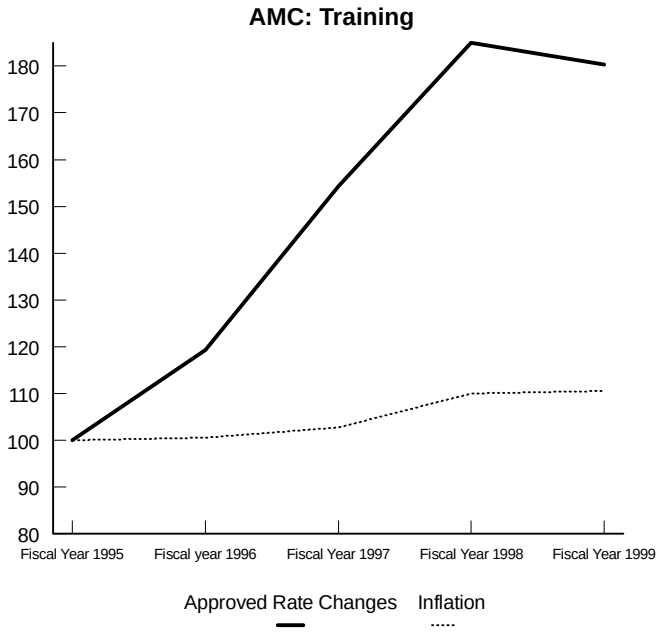
AMC	Air Mobility Command
DOD	Department of Defense
MSC	Military Sealift Command
MTMC	Military Traffic Management Command
TWCF	Transportation Working Capital Fund
USTRANSCOM	U.S. Transportation Command

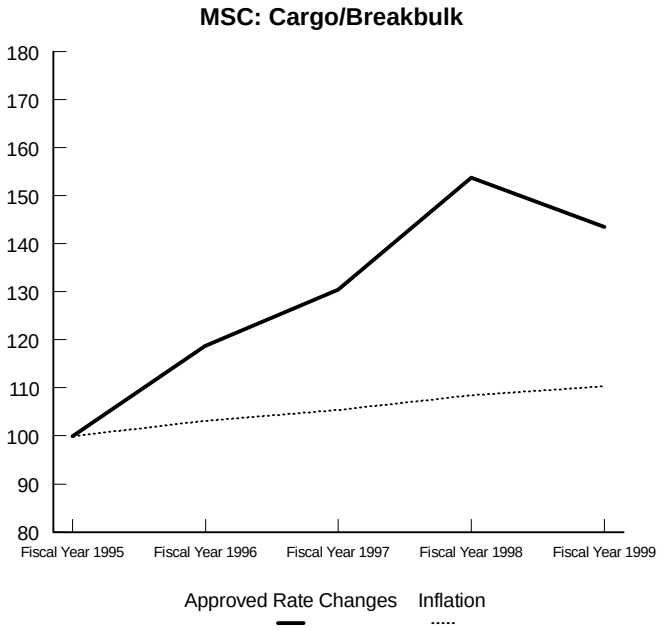
Changes in Rate Categories by Fiscal Year Compared to Inflation

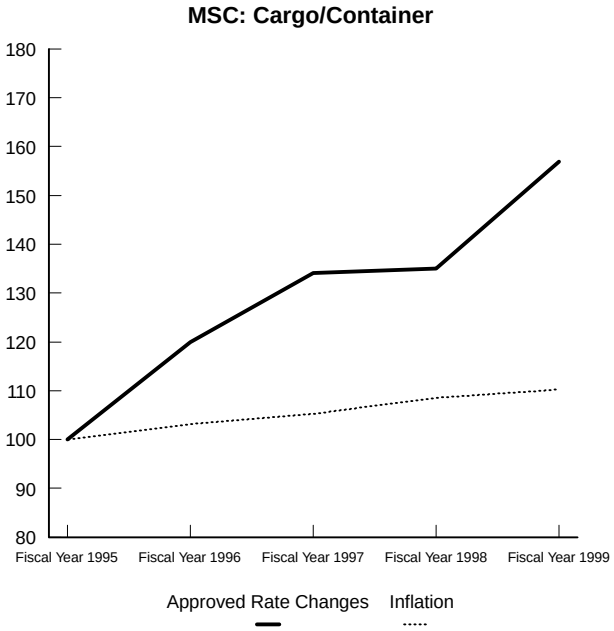


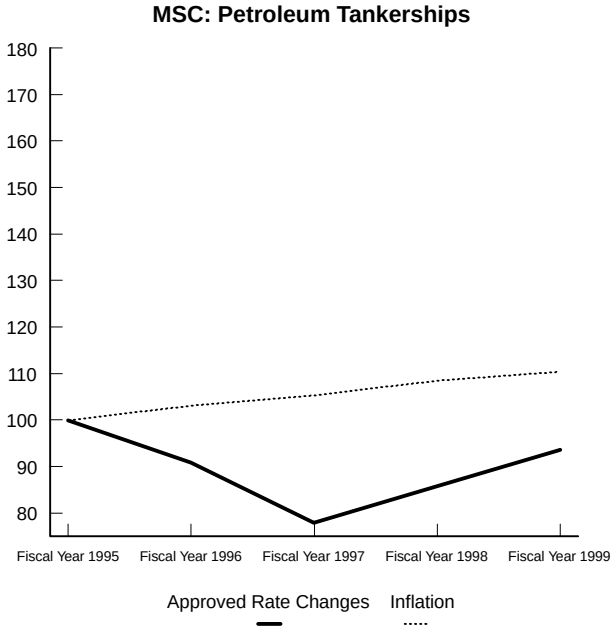


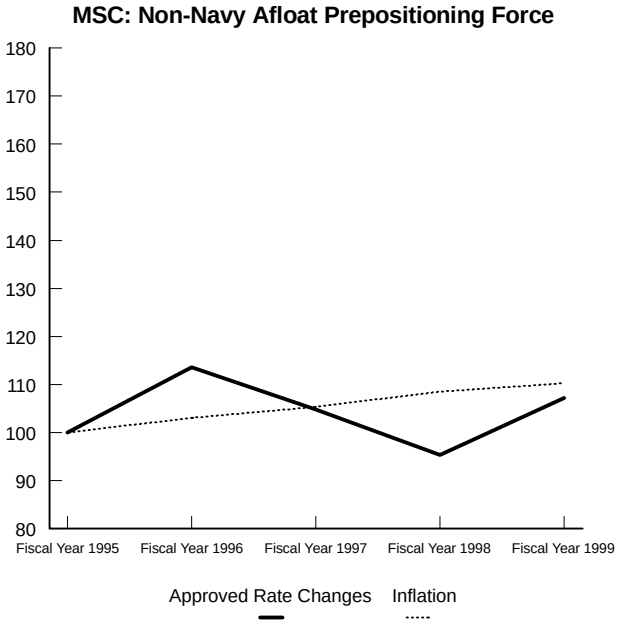


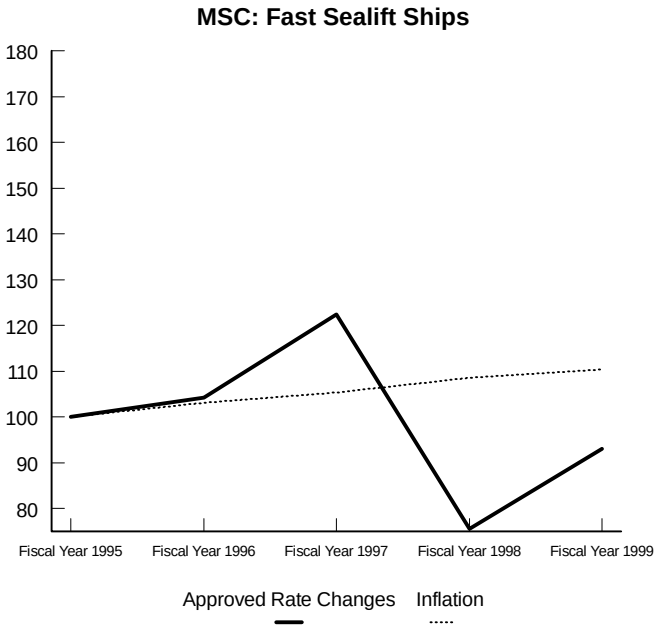


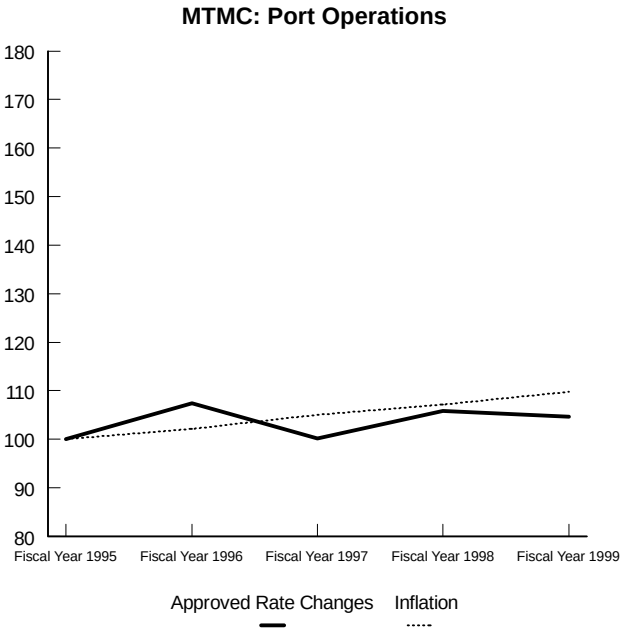

MSC: Cargo/Breakbulk
180
170
160
150
140
130
120
110
100
90
80
Fiscal Year 1995
Fiscal Year 1996
Fiscal Year 1997
Fiscal Year 1998
Fiscal Year 1999
Approved Rate Changes
Inflation


MSC: Cargo/Container
180
170
160
150
140
130
120
110
100
90
80
Fiscal Year 1995
Fiscal Year 1996
Fiscal Year 1997
Fiscal Year 1998
Fiscal Year 1999
Approved Rate Changes
Inflation


MSC: Petroleum Tankerships
180
170
160
150
140
130
120
110
100
90
80
Fiscal Year 1995
Fiscal Year 1996
Fiscal Year 1997
Fiscal Year 1998
Fiscal Year 1999
Approved Rate Changes
Inflation


MSC: Non-Navy Afloat Prepositioning Force
180
170
160
150
140
130
120
110
100
90
80
Fiscal Year 1995
Fiscal Year 1996
Fiscal Year 1997
Fiscal Year 1998
Fiscal Year 1999
Approved Rate Changes
Inflation


MSC: Fast Sealift Ships
180
170
160
150
140
130
120
110
100
90
80
Fiscal Year 1995
Fiscal Year 1996
Fiscal Year 1997
Fiscal Year 1998
Fiscal Year 1999
Approved Rate Changes
Inflation


MTMC: Port Operations
180
170
160
150
140
130
120
110
100
90
80
Fiscal Year 1995
Fiscal Year 1996
Fiscal Year 1997
Fiscal Year 1998
Fiscal Year 1999
Approved Rate Changes
Inflation

Examples Comparing Contractor Charges With Cost to Customers

A. Port-to-Port Shipment Cost Comparisons (no local drayage at origin or destination)			
Example A.1 From: U.S. East Coast (any port in range) To: Europe (any port in range)			
Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,552.88	Contractor charges	$1,664.98
USTRANSCOM surcharge	1,739.60	USTRANSCOM surcharge	3,322.81
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	112 percent	Percent cost exceeds contractor charges:	200 percent
Example A.2 From: U.S. Gulf Coast (any port in range) To: Europe (any port in range)			
Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,552.88	Contractor charges	$1,664.98
USTRANSCOM surcharge	2,064.10	USTRANSCOM surcharge	3,225.47
Cost to customer	**$3,616.10**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	133 percent	Percent cost exceeds contractor charges:	194 percent
Example A.3 From: U.S. West Coast (any port in range) To: Korea (any port in range)			
Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,280.89	Contractor charges	$1,815.00
USTRANSCOM surcharge	2,534.18	USTRANSCOM surcharge	2,214.05
Cost to customer	**$3,815.07**	Cost to customer	**$4,029.05**
Percent cost exceeds contractor charges:	**198** percent	Percent cost exceeds contractor charges:	**122** percent
Example A.4 From: U.S. West Coast (any port in rage) To: Japan (any port in range)			
Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,280.89	Contractor charges	$1,794.00
USTRANSCOM surcharge	2,528.28	USTRANSCOM surcharge	2,202.60
Cost to customer	**$3,809.17**	Cost to customer	**$3,996.60**
Percent cost exceeds contractor charges:	197 percent	Percent cost exceeds contractor charges:	123 percent

(continued)

Example A.5
From: U.S. West Coast (any port in range)
To: Okinawa (any port in range)

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$2,204.29	Contractor charges	$2,215.00
USTRANSCOM surcharge	1,607.88	USTRANSCOM surcharge	2,020.55
Cost to customer	**$3,632.17**	Cost to customer	**$4,235.55**
Percent cost exceeds contractor charges:	79 percent	Percent cost exceeds contractor charges:	91 percent

B. Port Area-to-Port Area Shipment Cost Comparisons (local drayage at origin and destination)

Example B.1
From: Military Ocean Terminal, Bayonne, N.J.
To: Bremerhaven, Germany

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,712.18	Contractor charges	$1,863.81
USTRANSCOM surcharge	1,580.30	USTRANSCOM surcharge	3,123.99
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	92 percent	Percent cost exceeds contractor charges:	168 percent

Example B.2
From: Military Ocean Terminal, Bay Area, Oakland, Calif.
To: Pusan, Korea

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,267.32	Contractor charges	$2,004.00
USTRANSCOM surcharge	2,547.75	USTRANSCOM surcharge	2,054.55
Cost to customer	**$3,815.07**	Cost to customer	**$4,058.55**
Percent cost exceeds contractor charges:	201 percent	Percent cost exceeds contractor charges:	103 percent

C. Port Area-to-Inland Point Shipment Cost Comparisons (local drayage at origin and line-haul transportation at destination)

Example C.1
From: Military Ocean Terminal, Bayonne, N.J.
To: Mannheim, Germany

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$2,142.88	Contractor charges	$2,294.51
USTRANSCOM surcharge	1,149.60	USTRANSCOM surcharge	2,693.29
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	54 percent	Percent cost exceeds contractor charges:	117 percent

Example C.2
From: Norfolk (Zone 2), Va.
To: Giessen, Germany

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$2,361.18	Contractor charges	$2,001.87
USTRANSCOM surcharge	931.30	USTRANSCOM surcharge	2,985.93
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	39 percent	Percent cost exceeds contractor charges:	149 percent

Example C.3
From: Military Ocean Terminal, Bay Area, Oakland, Calif.
To: Yokosuka (Yokohama-Zone 2), Japan

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,607.16	Contractor charges	$2,315.00
USTRANSCOM surcharge	2,202.01	USTRANSCOM surcharge	1,681.60
Cost to customer	**$3,809.17**	Cost to customer	**$3,996.60**
Percent cost exceeds contractor charges:	137 percent	Percent cost exceeds contractor charges:	73 percent

D. Inland Point-to-Port Shipment Cost Comparisons (line-haul transportation at origin and no drayage at destination)

Example D.1
From: Barstow, Calif.
To: Naha, Okinawa

Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$2,136.39	Contractor charges	$2,559.00
USTRANSCOM surcharge	1,495.78 U	STRANSCOM surcharge	1,676.55
Cost to customer	**$3,632.17**	Cost to customer	**$4,235.55**
Percent cost exceeds contractor charges:	70 percent	Percent cost exceeds contractor charges:	66 percent

E. Inland Point-to-Inland Point Shipment Cost Comparisons (line-haul transportation at origin and destination)			
Example E.1 From: Mechanicsburg, Pa. To: Frankfurt, Germany			
Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$2,380.65	Contractor charges	$2,508.09
USTRANSCOM surcharge	911.83	USTRANSCOM surcharge	2,479.71
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	38 percent	Percent cost exceeds contractor charges:	99 percent
Example E.2 From: Atlanta/Forest Park, Ga. To: Kaiserslautern, Germany			
Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$2,650.87	Contractor charges	$2,240.23
USTRANSCOM surcharge	641.61	USTRANSCOM surcharge	2,747.57
Cost to customer	**$3,292.48**	Cost to customer	**$4,987.80**
Percent cost exceeds contractor charges:	24 percent	Percent cost exceeds contractor charges:	123 percent
Example E.3 From: Defense (Texarkana), Tex. To: Mannheim, Germany			
Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$2,644.38	Contractor charges	$2,721.67
USTRANSCOM surcharge	972.60	USTRANSCOM surcharge	2,168.78
Cost to customer	**$3,616.98**	Cost to customer	**$4,890.45**
Percent cost exceeds contractor charges:	37 percent	Percent cost exceeds contractor charges:	80 percent
Example E.4 From: Lyoth, Calif. To: Seoul, Korea			
Fiscal Year 1995		**Fiscal Year 1997**	
Contractor charges	$1,721.03	Contractor charges	$2,277.00
USTRANSCOM surcharge	2,094.04	USTRANSCOM surcharge	1,452.05
Cost to customer	**$3,815.07**	Cost to customer	**$4,029.05**
Percent cost exceeds contractor charges:	122 percent	Percent cost exceeds contractor charges:	56 percent

Comments From the Department of Defense

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

07 APR 1998

ACQUISITION AND TECHNOLOGY

Mr. David R. Warren
Defense Management Issues
National Security and International
Affairs Division
U. S. General Accounting Office
Washington, DC 20548

Dear Mr. Warren:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DEFENSE TRANSPORTATION: Status of U.S. Transportation Command Savings Initiatives," dated March 3, 1998 (GAO Code 709245/OSD Case 1556). The draft report does not contain any findings or recommendations. However, the DoD has concerns with the conclusions presented in the draft report.

The draft report recognizes that the U.S. Transportation Command (USTRANSCOM) has taken positive steps to reduce transportation costs and improve operating efficiencies. However, the report minimizes the efficacy of a substantial portion of the USTRANSCOM reported savings. In addition, the analysis in the draft report is based on USTRANSCOM rate data which, due to the Working Capital Fund rate development and budgeting process, was not substantially impacted by actions taken by USTRANSCOM and the DoD to reduce transportation costs and improve operating efficiencies. Finally, the draft report uses FY 95 data as its baseline for comparison and analysis rather than FY 94 data. The rates in FY 95 were set to refund gains made in prior years; this resulted in an artificially low baseline. Using FY 94 data as the baseline, the trend indicates most rate changes are below the rate of inflation. FY 94 was the first year USTRANSCOM submitted rate changes to the DoD Comptroller, and FY 94 data should be used as the baseline.

The detailed DoD comments addressing the report are provided in enclosure 1. Enclosure 2 contains suggested technical changes. The DoD appreciates the opportunity to comment on the GAO draft report.

Sincerely,

Roy R. Willis
Acting Deputy Under Secretary
of Defense (Logistics)

Enclosures

GENERAL ACCOUNTING OFFICE (GAO) DRAFT REPORT - DATED MARCH 3, 1998 (GAO CODE 709245) NSIAD/AIMD-98-99

"DEFENSE TRANSPORTATION: STATUS OF U.S. TRANSPORTATION COMMAND SAVINGS INITIATIVES"

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ISSUES

1. **Categorization of USTRANSCOM Savings.** The customers of USTRANSCOM are the Military Services and other DoD agencies. Any savings to the Transportation Working Capital Fund (TWCF) are savings to these customers, whether in the stabilized rate structure or outside of that structure (as in direct reimbursements or as part of the Airlift Readiness Account (ARA)). The draft report implies that savings which affect single customer rates, reduce the ARA, or affect revenue rather than cost are not as important as the savings which result in rate reductions to common user outputs of the TWCF. The draft report states that of $780 million in reported savings, only $260 million, or 33%, would result in reductions to transportation rates. In fact, of the remaining $520 million in reported savings, $114 million, or 15%, will reduce subsidies that customers pay to USTRANSCOM, and $209 million, or 27%, while offset by other cost increases, will prevent rate increases from being higher. Another $120 million, or 15% involves improved revenue collection which also affects rates. Overall, 90% of the projected savings impact rates or appropriated account subsidies.

   All savings identified by USTRANSCOM in the TWCF budget resulting from efforts to reduce costs and increase efficiencies are savings to the overall DoD and to the taxpayer. The $209 million in savings that were offset by other cost increases, such as higher fuel and aircraft depot maintenance charges, are savings because they represent fewer dollars spent for the same transportation. The $114 million in savings that reduce appropriated costs but do not impact rates, must still be considered valid savings to long-term operating costs. Because airlift rates are set to be commercially competitive, cost reductions do not have a large impact on rates. The $120 million in savings from improved revenue collection reduces potential operating losses that could increase rates. In each of these cases, the USTRANSCOM customer realizes true cost saving, whether the rate goes down or not.

2. **The examples comparing TWCF to USTRANSCOM negotiated commercial transportation costs do not portray the results of efforts to reduce costs and increase operating efficiency.** The analysis in the draft report is based on USTRANSCOM rate data which, due to the Working Capital Fund rate development and budgeting process, was not substantially impacted by actions taken by USTRANSCOM and the DoD to reduce transportation costs and improve operating efficiencies. While FY 99 TWCF point-to-point rates are not yet set and commercial sealift rates have not yet been negotiated, approved FY 99 composite TWCF rates indicate the favorable impact of the efforts to reduce transportation costs and improve operating efficiencies on the FY

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99 TWCF billing rates. The comparison rate examples used reflect past history and do not report the good news and positive direction in the currently approved FY 99 composite rates. Figure 1, using FY99 composite rate data and projected commercial costs rather than the FY 97 data used in the draft report, indicates rates will decrease as a result of the actions to reduce transportation costs and improve operating efficiencies.. In addition, the term "surcharge" in the draft report is defined as the amount charged "over and above" commercial contract costs. This definition indicates that little or no value is added. In fact, the surcharges include the costs for contract negotiation and administration, which enable customers to benefit for the cited negotiated rates, cargo booking, customs clearance, cargo receipt, automated in-transit visibility systems, port management, and surge and readiness programs.

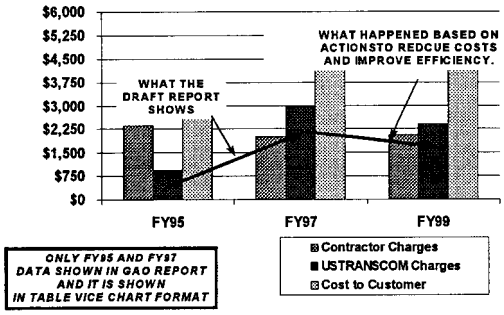

Figure 1

3. **<u>FY 94 rate changes should be included in the Rate Trend Analysis</u>.** The draft report cites increases to TWCF rates at or above the rate of inflation using several examples from FY 95 to FY 99. FY 94 was the first year USTRANSCOM submitted rate changes to the DoD Comptroller for approval. However, FY 95 data is used as the baseline for the "Transportation Rate Trend" analysis in the draft report rather than FY 95 data. The cyclical nature of rates and the selection of the FY 95 baseline skews the trend in rates during this period. As Figure 2 demonstrates, FY 94 data significantly changes the outcome of the GAO rate trend analysis. The typical 18-month lag time between setting rates and their implementation often means rates are adjusted upward to compensate for a year when rates are too low, and downward for years when rates are too high. The rates in FY 95 were set to refund gains made in prior years; this resulted in an artificially low baseline. Any comparisons are skewed as a result. Selecting an FY 94 baseline changes any inflation evaluation of TWCF rates. Using a FY 94 baseline, most TWCF rate changes at MSC

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and MTMC are below the rate of inflation.

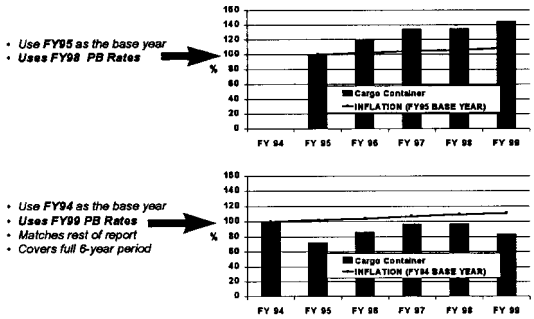

Figure 2

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