

Statement of

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Good afternoon Chairman Wilson, Ranking Member Davis and distinguished Members of the Personnel Subcommittee,

My name is Tom Gordy and I am President of the Armed Forces Marketing Council (AFMC). Thank you for the invitation to offer comments regarding the military resale services and the financial benefits they provide to support the quality of life of our service members and their families.

When the resale hearing was held last June, the commissaries and exchanges were performing very well as demonstrated by increases in sales, earnings and dividends to morale, welfare and recreation programs. Customer satisfaction was high as was associate satisfaction.

The resale systems were planning and implementing programs and initiatives to meet the changing needs and dynamics of the military community, such as the deployment of e-commerce and mobile-commerce applications. And, most importantly, they continued to offer 20 to 30 percent average savings to military families on a market basket of products.

Today, the commissaries and exchanges continue to deliver a world-class non-pay compensation benefit to military families. While there have been strong headwinds in the form of furloughs, diminishing budgets as a result of sequestration and continuing resolutions, as well as the government shutdown, the leaders and associates of the resale systems are to be commended for the great work they have done despite the fiscal challenges they have faced.

During the hearing last year, in my testimony I wrote, "in these challenging budgetary times, we are grateful that, to date, military resale continues to be viewed by

leaders both in Congress and in the Department of Defense to be a vital quality of life benefit to our military families. The support to resale has been nothing short of remarkable, particularly in light of proposals that would seek to significantly alter and/or reduce other benefits cherished by our military families.”

I wish I could offer those same comments this year, but unfortunately, the current budgetary environment has resulted in military resale becoming a target for significant cuts that would jeopardize the viability of the resale systems and the direct and indirect benefits they provide to military families.

Appropriated Fund Support

In the past year, due to budgetary constraints imposed by budget cuts, sequestration, continuing resolutions, and the government shutdown, military resale, particularly the commissaries, has become a target like every other line item in DoD’s budget.

DeCA Appropriation

As you are aware, DeCA’s overhead costs are supported through a \$1.4 billion appropriation. In February, the Department of Defense issued a Resource Management Directive RF-7296, which directed the Undersecretary of Defense (Personnel & Readiness) in consultation with DeCA, DoD Comptroller and OSD’s Capability Assessment and Program Evaluation (CAPE) group to conduct an independent study that would identify DeCA cost reductions of 33%.

There were two parts to the RMD. The first called for cost reductions of five percent. The second part called for additional reductions of 28% that would focus DeCA's operations substantially or entirely on military personnel stationed overseas, or they could propose alternate options to achieve the 28% savings.

Cuts as described in the RMD, Part II, would undermine the value benefit for military families in the following ways:

- Closing or substantially reducing the number of CONUS commissaries would lead to higher prices and loss of benefit in both the remaining remote and overseas stores. DeCA negotiates lower prices for products based on the current volume. Closing CONUS stores would reduce volume by up to 70%. This will lead to significant price increases due to the loss of economies of scale, and manufacturers will no longer be able to provide promotions and coupons that further enhance the savings benefit.
- Closing the majority of CONUS stores would eliminate the benefit for millions of families, breaking a commitment that has been made to every service member. 90% of active duty families shopped the commissary last year, benefiting from the lower prices they offer. The loss of these savings would be akin to a pay cut and would undermine financial and personal readiness of military personnel.
- The 5% surcharge placed on goods purchased in the commissaries funds construction and maintenance of commissary facilities. Annually, that equates to nearly \$300 million of investment on the part of military families into their own benefit. If CONUS stores are closed, there would be a loss of 70% of the surcharge. OCONUS and remote CONUS stores do not generate enough

surcharge revenues to pay for their own maintenance and rely on surplus surcharge revenues generated by CONUS stores, particularly those on larger bases and those located in metropolitan areas like Ft. Belvoir. Closing CONUS stores would leave a deficit in the maintenance accounts for remaining stores, which would lead to operational challenges going forward.

- Because of the 5% surcharge, military patrons have contributed over \$6 billion to fund the construction and maintenance of commissaries world-wide. Closing CONUS commissaries would essentially rob military families of the benefit they built.

We understand some options have been put forward that would keep stores from closing. While we applaud the creative efforts to meet the cuts called for by the RMD without closing stores, most will result in a diminished benefit for military patrons through higher prices and additional surcharges. Such proposals include:

- Elimination of second destination transportation funding and increasing prices by 2 to 3 percent on all products world-wide to fund overseas shipping.
- Development of the enhanced commissary model, which would allow the commissary to sell products, such as wine, beer and health and beauty items at a profit to offset the cost of operations. This would be in conflict with the exchanges whose lost sales would result in lower dividends to fund quality of life programs.
- Increasing the surcharge from 5% up to 10%.

Essentially each one of these proposals will shift the cost of providing for military families from the taxpayer to the families themselves, to the tune of \$450 million per year.

We question why cuts of this magnitude are necessary when you consider the following:

- DeCA continues to meet its mission in an efficient manner while earning clean audit opinions every year for the past 11 years.
- Next to healthcare, the commissary benefit is the most cherished of benefits to service members and their families. Last year, 98 million customer transactions took place in the commissaries - an increase of 1.6 million from 2011 and the second highest number in DeCA's history - demonstrating that the commissary benefit is very relevant to today's military families in CONUS and OCONUS.
- DeCA's 2012 customer satisfaction index is 81, as measured independently by the American Customer Satisfaction Index Survey. The industry average is 76 and only one grocer surpassed DeCA in 2012.
- The commissaries save DoD nearly \$180 million by off-setting cost of living adjustments and reducing overseas shipping costs by approximately \$40 million. They support retention as well, which reduces recruitment and training costs.
- As stated above, 90% of active duty personnel stated they shopped the commissary last year, demonstrating that this benefit is utilized by and supports the active force.
- Last year, DeCA provided approximately \$2.7 billion in savings benefit to families at a cost of \$1.4 billion, nearly 2-to-1 return on investment. If you consider, ancillary benefits to the Department of Defense by off-setting costs elsewhere in the budget, the ROI is much higher.

- Over 60% of DeCA employees are military affiliated - Guard, Reserve, dependents and veterans - helping to support major Department and White House initiatives, while providing jobs that are transferable for military spouses.

Through previous efficiency efforts, DeCA's budget, in real dollars, has remained flat for over a decade, at a time when other benefits, and the DoD budget in general, have experienced double- to triple-digit growth. Because of DeCA's steadfast long term efficiency efforts, it is in a situation where there is very little room for additional cuts.

DeCA and its past efficiency efforts should be held up as an example to encourage efficiencies within other agencies; a failure to reward these efforts may send an unintended message to other agencies to not implement efficiencies or reduce costs until required to do so.

We were encouraged to hear over the summer that the Department may consider a reduction in the cuts from 28% to something lower. However, in recent weeks, we understand that the Joint Staff has asked DeCA to look at cutting its budget by 33 to 66%.

We understand that this recent look is driven by budget cuts caused by the sequester and ongoing continuing resolutions, problems that only Congress can fix. If the commissaries are to remain viable and deliver a non-pay compensation benefit to military families, Congress must act to avert the cuts and relieve the pressure on DoD to achieve a budget number that adequately funds the Department and meet its national security goals.

Overseas Shipping Costs

The other area of concern for budget cuts is overseas shipping of products to commissaries and exchanges. Known as Second Destination Transportation or Service Wide Transportation (SDT/SWT), this funding ensures that quality, American-made products are available to service members and their families serving overseas at a price equivalent to those in CONUS. In other words, it ensures military families are not penalized for serving overseas by higher prices and inferior products. A white paper is enclosed as Exhibit I, which further explains SDT/SWT and the impact of the loss of that funding would have on military families, the services and American producers.

In recent weeks there have been discussions about cuts or elimination to not only DeCA's overseas shipping funds, but also for AAFES'. While these cuts may provide immediate relief to the bottom line of the services who fund SDT/SWT, there will be offsetting increased costs elsewhere in the budget, not to mention the adverse impact it would have on military families.

I would note, however, that the exchanges and DeCA, through the Cooperative Efforts Board, have found efficiencies to reduce shipping costs through partnering together and coordinating shipments to common destinations around the world. We applaud these efforts and look forward to continued reduced costs through efficiencies going forward. However, the discussion that SDT/SWT should be eliminated insinuates that military families essentially should be taxed in order to offset the costs of overseas shipping.

As current law requires appropriated funds to be used to pay for SDT/SWT, we hope that no changes to that law would be forthcoming in order to protect the resale benefit for families overseas.

Legislative & Regulatory Issues

While the major challenges facing military resale are budgetary in nature, there are a few legislative and regulatory issues that we believe could have an adverse effect on the benefit and the families they serve.

Sustainability & Local Procurement Provision

The Armed Forces Marketing Council greatly appreciates the interest of the Members of the Subcommittee in the military resale benefit as was demonstrated in the H.R. 1960, *National Defense Authorization Act for Fiscal Year 2014*.

As the bill continues its hopeful progress towards passage, the Council would like to offer comment on Section 632, entitled *Purchase of Sustainable Products, Local Food Products, and Recyclable Materials for Resale in Commissary and Exchange Store Systems*. While a noble effort, the requirements imposed under Section 632 would have adverse consequences on commissaries, the exchanges and the families they support.

We are very concerned that if the provision becomes law, it would impose significant costs on the resale systems and lead to higher prices on the patron due to the increased operational costs as well as limited supply of required products, effectively reducing the value and savings of the benefit for military families.

Supporting sustainable practices is an important endeavor; however, it should be noted that there is no certification for sustainable products. This provision would burden the Department of Defense through the Defense Commissary Agency and military exchange systems, with the role of defining, identifying and certifying sustainable products.

The burden of establishing a program for identifying sustainable products would require numerous hours of inspecting and certifying producers to ensure their production means meet the program's definition of sustainability.

The role of the commissaries and exchanges is to offer military families a non-pay compensation benefit by offering significant savings on name-brand products that military families desire. The products on the shelf are there because the patrons have voted with their purchasing dollars. It is the free market at work where demand has driven the supply. As patrons have become more health- and environmentally-conscious, the product lines have followed.

It should be noted that military resale already procures products and services from the local economy where there is a demand, and where such local procurement makes economic sense to service members and the resale organizations. In general, products sold in the military stores are sourced from within the competitive market that delivers the best value and greatest savings benefit for military families.

History has shown that mandates that interfere with market forces drive up costs that are eventually borne by service members and restrict consumer choice. As an example, a prior congressionally-mandated initiative to require local procurement of

alcohol beverages on Guam, and not from the competitive market, resulted in 20% to 40% price increases to the military community. Congress overturned that mandate.

Additionally, military resale already has robust programs focused on sustainability - they range from construction, to energy conservation, as well as the sale of environmentally-friendly products within the store.

Sec. 632 would impose another costly layer of bureaucracy to formalize and validate what essentially is already being done to meet consumer demand when and where it makes economic sense.

At a time when the DoD is already struggling to fund current programs within its limited budget, and DeCA is being asked to cut its budget by 33%, this initiative would add an additional unfunded expense and burden to an already challenging situation.

Lastly, while Sec. 632 proposes to impose purchasing requirements on the resale systems, it effectively imposes a purchasing requirement on military families, whose product choices will become limited, resulting in families paying higher prices on qualifying products. Military families are already being asked to give up pay and benefits in the name of deficit reduction. Sec. 632 would further erode the benefit package for service members by reducing the savings in the commissaries and exchanges.

Bangladesh Fire & Safety Accord

In response to disasters at garment factories in Bangladesh, Members of Congress have drafted language requiring the military exchanges to sign on to the

Accord on Fire and Building Safety in Bangladesh, which is purposed to ensure safe working conditions for Bangladesh's garment workers.

On the surface, this is a good measure. However, the devil is in the details. The Accord would require signers to pay up to \$500,000 per factory to update safety measures, but there is no accountability for the money. Additionally, the accord would expose signers to liability by making retailers responsible for the safety of the factories.

It should be noted that, while this accord is signed by garment brands and retailers mostly located in the European Union, most American companies have withheld signing the accord because of the liability exposure and lack of oversight.

There is an alternative to the Accord formed by American companies that is making great progress and meeting goals ahead of the Accord. The Alliance for Bangladesh Worker Safety is the North American alternative that is legally binding and will provide up to \$100 million for worker safety in Bangladesh.

The Armed Forces Marketing Council would encourage the Committee to review the alternatives and consult with DoD and the exchanges on the best alternative for all concerned.

Armed Services Exchange Regulations

To ensure military exchanges remain relevant to the military patron, we encourage DoD and the Committee to overhaul the Armed Services Exchange Regulations, or ASER.

Current ASER are out of date and, in some instances, no longer apply due to changes in the market place. For instance, the ASER limit cars that can be sold to

vehicles that have 75% of their parts made in the USA and/or Canada. Today, only 17 vehicles meet those requirements while over 90 American-brand (Ford, GM, Chrysler) vehicles, including the iconic Ford Mustang, would be prohibited under ASER except that they are American-badged vehicles. However, top-selling foreign-badged cars such as the Toyota Camry meet or exceed the 75% requirement, but are prohibited. Because ASER have not been updated to reflect changes in the auto industry, every year that goes by, patron choice becomes more and more limited.

Therefore, we hope that over the next year the DoD would submit for to the Committee for review and approval an updated version of ASER that reflects today's retail environment and the products available.

Concessionaire Operations

Recently, the Armed Forces Marketing Council was made aware of an exchange concessionaire selling named brand groceries on a military base. This unprecedented move is concerning in that it is a private retailer competing on a military base against the commissaries. Historically, the Council has taken a position against resale agencies taking actions viewed as detrimental to other resale systems.

We encourage the committee and DoD to look into this development to determine the impact on the commissaries and exchanges.

Conclusion

Chairman Wilson, I wish I could say the future of military resale is bright. But with shrinking budgets and the increased demands for efficiencies beyond those that

have already been achieved, the future of this important non-pay compensation benefit lies in your hands and hands of the rest of Congress.

Military resale leaders at DeCA and the exchange systems and the employees they oversee are doing their best everyday to deliver a world-class benefit to our military families. I want to be clear that, in the view of the Armed Forces Marketing Council, military resale is not broken - it is not a problem that needs to be fixed.

In fact, they do their part, working with industry, to become more efficient so they may lower costs and find ways to continue providing significant savings to military families. It is the nature of their business that they do so.

But what is being asked of them to cut goes beyond efficiencies to a real degradation and/or elimination of the benefit for military patrons, particularly those in CONUS.

The loss of the benefit in CONUS will lead to a loss of benefit to patrons overseas. Some view the commissaries and exchanges as isolated stores scattered around the world at each base. But each store is interdependent on the others to provide economies of scale, lower prices, and funds for recapitalization and maintenance. If there is a breakdown in that interdependence, smaller, remote and OCONUS stores will have a very difficult time surviving. And it is in those locations where the benefit is needed the most.

While we are sympathetic to the plight of the Department of Defense and the budgetary challenges it faces, we are also aware and sympathetic to the fact that reductions in taxpayer dollars will get passed on to the military families in the form of

higher prices and lower quality, or complete loss of benefit. In other words, it would be taxing military families for the delivery of their own benefit or breaking faith with them.

Some have stated that this benefit is no longer relevant. I would point them to what happened on October 1st in the commissaries. On that day, the commissaries were opened in order to sell as much perishable products as possible before the stores closed as part of the government shutdown.

On that day, there was a run on the commissaries. Families flocked to the stores as if a major blizzard or hurricane were coming, emptying shelves of almost all products.

If this benefit did not matter to families, including those in metropolitan areas, then that would not have happened. But military families rely on this benefit as part of their compensation and they took advantage of their benefit before it closed indefinitely.

In our view, military families have sacrificed enough over the past 12 years. Asking them to sacrifice more, or to insinuate or allege to them that without them sacrificing their benefits that their service member will not be adequately equipped or trained, is in our view abhorrent. But that is the message being put forth.

Mr. Chairman, we are confident that this subcommittee, under your leadership, will continue to stand firm to protect this important benefit for our military families. Thank you for the opportunity to share our thoughts today and I look forward to your questions.

EXHIBIT I

SERVICE WIDE TRANSPORTATION /SECOND DESTINATION TRANSPORTATION

By law, appropriations are required to fund second destination transportation costs for shipping goods overseas. This requirement recognizes Congress's intent to keep faith with service members and their families wherever they are located, ensuring equity for all service members. It also ensures service members and their families stationed overseas are afforded a comparable selection of goods and prices to their U.S. counterparts.

- U.S. goods provided through on-base venues reduce service member reliance on local overseas economies thereby reducing exposure to force protection risks.
- U.S. goods through on-base venues are needed when there are no shopping alternatives outside the gate for our service members as in Guantanamo Bay, Cuba and Djibouti, Africa.
- U.S. goods, inspected by the FDA, ensure service member's health and safety vice reliance on less-regulated and potentially unsafe products in certain overseas communities.
- SDT/SWT support ensures that exchanges support our troops in contingency areas without cost being a primary motive.

A loss of SWT/SDT, to be substituted with non-appropriated funding (NAF), will have an immediate and adverse impact to overseas service members, to include higher prices for all service members. It will drive costs in other areas of the government, such as military postal system. It will affect U.S. businesses and U.S. jobs.

- NAF business rules will sway towards the most efficient sourcing of products and likely result in rationalizing of overseas products assortments. It will force review and decisions about local overseas product sourcing to keep costs down and likely reduce the breadth of assortment, and therefore choices to service members.
- Service members in overseas areas with reduced choices will utilize military postal system, at government cost, to overcome any loss in products/choices they need and desire, essentially substituting SDT support with other O&MN funds - this is less efficient than leveraging the economies of scale that military resale provides through its distribution channels.
- Military Exchanges operate using best business practices and focus on internal efficiencies as a matter of course. There is little room to garner significant efficiencies to mitigate impacts from increased NAF expenses taking on the burden of any significant SWT/SDT loss. The SWT/SDT support is an input in a business model that drives three outputs - customer savings, MWR support, and customer shopping experience/choices. A reduction in this input creates an imbalance requiring a change in one or all of the three outputs reducing today's exchange benefit and, depending on magnitude, risk future viability of military resale.
- Reductions in the U.S. products shipped overseas will have an immediate impact on the U.S. suppliers and affect U.S. jobs. Roughly a third of resale sales are generated outside the continental United States, equating to approximately \$6 billion in American-made products.
- Most SWT/SDT dollars are transferred to US TRANSCOM to fund overseas shipping, supporting its lift capabilities. A robust program of military resale overseas shipping supports the military transportation system during peacetime ensuring viability of the industrial base and military readiness during war time.