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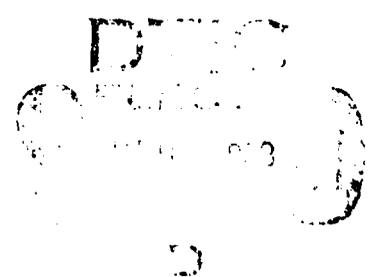
REPORT BY THE
Comptroller General
 OF THE UNITED STATES

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**Unresolved Issues Concerning
 The Disposal Of Stockpile Silver**

The fiscal year 1982 Defense Appropriation Act suspended the weekly auctions of stockpile silver pending (1) a redetermination that the silver to be disposed of is excess to stockpile requirements and (2) congressional approval of any proposed disposal method. In the interim, comments by the Federal Emergency Management Agency and the Department of Defense on a January 11, 1982, GAO report raise new issues that GAO believes must be addressed and resolved in reevaluating the need for the stockpile silver and in exploring alternative disposal methods. Unresolved issues include

- lack of consideration of defense-related monetary uses of silver;
- inadequacies in the decision-making data base relating to legislatively mandated supply factors;
- lack of consideration of the estimated cost of alternative sources of silver and the impact of proposed disposal methods on foreign relations; and
- the viability of various alternative disposal methods, such as bullion coins and convertible bonds backed by silver.



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

B-205617

The Honorable James A. McClure
Chairman, Committee on Energy
and Natural Resources
United States Senate

The Honorable Charles E. Bennett
Chairman, Subcommittee on Seapower
and Strategic and Critical Materials
Committee on Armed Services
House of Representatives

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On January 11, 1982, we issued a report to you entitled "National Defense-Related Silver Needs Should Be Reevaluated and Alternative Disposal Methods Explored" (EMD-82-24). (See app. I.) In the interest of the timely release of the report, your offices directed that we not obtain official agency comments on our findings and corresponding recommendations.

In April 7 and May 19, 1982, letters responding to that report, the Federal Emergency Management Agency (FEMA) and the Department of Defense (DOD), respectively, took exception to some of our findings and recommendations. (The agencies' letters, together with our detailed evaluation of their positions and concerns, are included as apps. II and III.) In no instance did FEMA's or DOD's comments warrant revising our findings, conclusions, and recommendations. Their comments did, however, raise new issues that we believe must be addressed and resolved in reevaluating the need for the stockpile silver and in exploring alternative disposal methods. This report addresses our perspective and concerns about these issues.

BACKGROUND

To prevent a dangerous and costly dependence on foreign supply sources during national emergencies, the United States maintains a National Defense Stockpile of 61 family groups and individual materials. In 1976 and again in 1980, FEMA determined that the supply of silver from domestic production and reliable imports exceeded the estimated quantity required to sustain the United States for a period of not less than 3 years in the

event of a national emergency. Therefore, FEMA concluded that the 139.5 million troy ounces 1/ of silver in the stockpile were not needed to meet national defense requirements and set the goal at zero.

The Omnibus Budget Reconciliation Act of 1981, Public Law 97-35, authorized the disposal of 105.1 million troy ounces, or about 75 percent, of the stockpile silver in fiscal years 1982-84. However, the fiscal year 1982 Defense Appropriation Act, Public Law 97-114, suspended the disposal pending (1) a July 1, 1982, redetermination by the President that the silver to be disposed of is excess to stockpile requirements and (2) congressional approval of any proposed disposal method. In making the redetermination, the President is required to consider certain factors, including the findings and recommendations in our January 11, 1982, report.

The administration established a Federal task force, the Interagency Silver Commodity Committee, to address the legislative requirements. The committee will ultimately make recommendations to the Cabinet Council on Natural Resources and the Environment. Both FEMA and DOD are members of the committee.

On June 29, 1982, the Secretary of the Interior as Chairman pro tem of the cabinet council informed the Congress that the redetermination had been postponed for several reasons. The administration is currently preparing a report to the Congress as required by Public Law 97-114. (See p. 24.) 2/ The report is tentatively scheduled to be released during the spring of 1983.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to (1) evaluate FEMA's and DOD's positions and concerns to determine whether they warranted revising any of the findings, conclusions, and recommendations in our January 11, 1982, report and (2) identify new issues that we believe must be addressed and resolved in reevaluating the need for the stockpile silver and in exploring alternative disposal methods. Our scope and methodology were limited primarily to comparing FEMA's and DOD's comments with the information included in our previous report and identifying and evaluating legislative and executive actions that have occurred. We also interviewed a number of Federal officials and representatives of the domestic mining industry. Our review was performed in accordance with generally accepted government audit standards.

1/A measure of weight equal to 31.103 grams.

2/All page references are to the appendixes.

ALL DEFENSE-RELATED SILVER
USES SHOULD BE CONSIDERED
IN DETERMINING THE STOCKPILE
SILVER GOAL

In our January 11, 1982, report, we stated that not all defense-related uses of silver during past national emergencies are reflected in FEMA's estimated demand. For example, the United States provided almost 411 million troy ounces of silver to allied and friendly countries during World War II under the lend-lease program. We also addressed the potential need for silver as a medium of payment to foreign troops and workers in areas of the world where there may be little confidence in paper currency in times of uncertainty. If the 105.1 million troy ounces of silver authorized for disposal are sold, only 34.4 million troy ounces will remain in the stockpile. Coupled with the 39 million troy ounces currently in the U.S. Treasury for coinage, the remaining stockpile silver may preclude these uses of silver during future national emergencies.

In its April 7, 1982, response, FEMA stated that silver provided to allied and friendly countries during World War II and as a potential medium of payment to foreign troops and workers had not been considered critical in determining the stockpile silver goal. (See p. 12.) FEMA continued that the addition of such low-priority "monetary needs" to offset silver surpluses creates risks that the stockpile will have its metals composition frozen. Thus, we will not have the proper stockpile composition to support the basic mobilization effort required for our self-protection. (See p. 6.)

FEMA concluded that "...funds from the sale of silver will go a long way toward reducing the shortfalls of much higher priority materials [which] would reduce the national defense risks that the Congress mandated the National Defense Stockpile to insure against much more effectively than would a 'wage reserve' for our allies." (See pp. 6 to 7.) In its comments on a draft of this report (see p. 24), Interior stated that FEMA does not advocate the sale of materials within stockpile inventory goals but that defense-related monetary needs are over and above those determined by the established planning methodology.

The fiscal year 1982 Defense Appropriation Act specifically mandates that the President consider defense-related monetary requirements, including historical monetary uses of silver as a medium of payment to foreign workers and troops during times of national emergency, in determining that the silver to be disposed of is excess to stockpile requirements. Such requirements recognize that silver is used not only as a commercial and industrial commodity but also as a precious metal during

national emergencies. However, the modeling methodology FEMA employed in determining stockpile goals does not recognize these uses.

Consistent with our earlier report, we believe that legislatively mandated defense-related monetary uses of silver should be included in FFMA's estimated demand. Exclusion of any of these uses in establishing the stockpile silver goal should be fully disclosed and justified in the President's report to the Congress.

PROBLEMS ASSOCIATED WITH CONSIDERING
LEGISLATIVELY MANDATED SUPPLY FACTORS
MUST BE OVERCOME

The fiscal year 1982 Defense Appropriation Act also requires that the supply-related findings and recommendations in our January 11, 1982, report be considered in redetermining the need for the stockpile silver. Our report recommended that five factors be considered in estimating silver supply: (1) reduced expansion in existing mines during wartime; (2) decreasing domestic smelting capacity; (3) the cost of silver from recycling, domestic stocks, and foreign suppliers; (4) the impact that selling the silver at auction may have on relations between the United States and its major foreign suppliers; and (5) long-term uncertainties relating to projected U.S. dependency on foreign silver sources and the possibility that a silver stockpile goal could be reestablished at some future date.

Of the five supply factors we recommended, FFMA agreed to consider only decreasing domestic smelting capacity. FFMA stated that there are "problems" with including our remaining four supply factors in calculating stockpile goals. We have reviewed FFMA's concerns and found that consideration of two of the supply factors--reduced mine expansion and the potential long-term impact of the disposal--will require expanding the decisionmaking data base. The other two supply factors--the cost of silver from recycling, domestic stocks, and foreign suppliers and the impact that selling the silver at auction may have on foreign relations--may require revisions to FEMA's established planning methodology. However, these "problems" do not preclude considering the legislatively mandated supply factors in redetermining the need for the stockpile silver

Two supply-related issues will
require expanding the decision-
making data base

Adequate consideration of two supply factors will require developing additional data. First, the Department of the

Interior commodity specialist responsible for calculating FEMA's silver supply estimate informed us that his data is currently incomplete and out of date. Information on individual existing and potential mines as well as smelters and refineries will not be available until the end of fiscal year 1984. Further, we found that the availability of such mobilization factors as adequate skilled labor, transportation, water, energy, equipment, and facilities needed to increase production during a national emergency had not been adequately considered. 1/

Our January 11, 1982, report noted the uncertainty surrounding the potential long-term impact of the disposal. To consider projected increased U.S. dependency on foreign sources of silver and the possibility that a silver stockpile goal could be reestablished at some future date will require developing a data base on which to make assumptions concerning the future budgetary impact of projected silver supply and demand imbalances. Such data has not, to our knowledge, been developed.

We believe that a thorough reevaluation of the need for the stockpile silver warrants expansion of the decisionmaking data base. Further, consideration of legislatively mandated supply factors based on incomplete data should be appropriately qualified in the President's report to the Congress.

Monetary considerations do not
equate to using the stockpile
for economic or budgetary purposes

The Strategic and Critical Materials Stock Piling Revision Act of 1979, Public Law 96-41, states that "the purpose of the stockpile is to serve the interest of national defense only and is not to be used for economic or budgetary purposes." Both FEMA and DOD expressed concern that our January 11, 1982, report gave high priority to economic and budgetary rather than national defense considerations. Releasing stockpile materials to dampen sharp increases in price during peacetime and using funds from the sale of stockpile materials to balance the Federal budget are examples of using the stockpile for economic and budgetary purposes, respectively. We are opposed

1/U.S. General Accounting Office, "Consideration of the Need for Minerals Mobilization Planning Within the Department of the Interior," EMD-81-89, June 8, 1981.

to either of these practices and have, in fact, issued a report 1/ stating that the existing stockpile legislation precludes implementation of the administration's plans to give priority to budgetary considerations over national defense-related needs.

Stockpile goals represent the estimated material requirements for the first 3 years of a national emergency, above those expected to be available from domestic production and reliable imports. Our report, in addition to stating that FEMA's domestic mining and processing estimates appear higher than what can actually be produced, stated that silver from other sources, such as recycling, domestic stocks, and foreign suppliers, may cost more per troy ounce (discounted to present value in constant dollars) than the revenues to be realized from the sale of the stockpile silver. Since the availability of silver from recycling, domestic stocks, and foreign suppliers is partially contingent on price, we believe that considering their cost does not equate to using the stockpile for economic and budgetary purposes and is not inconsistent with the legislatively mandated national defense limitation. Our position is supported by the Omnibus Budget Reconciliation Act of 1981, Public Law 97-35, which requires the President to consider the domestic supply of silver for each of the next 10 years as a function of price in his redetermination that the silver to be disposed of is excess to stockpile requirements.

FEMA contended that one of the reasons stockpiling is done during peacetime is to avoid the "gouging" that often occurs in a national emergency. (See p. 15.) This rationale coincides with our finding that the price of both foreign and domestic sources of silver could escalate very rapidly during a national emergency. Therefore, we believe that the estimated cost of silver from recycling, domestic stocks, and foreign suppliers during a national emergency should be considered in determining the stockpile silver goal.

The disposal's impact on foreign relations should be considered

The reliability of the United States' major foreign suppliers is an important factor in the goal-setting process. One of the primary reasons for setting a zero stockpile silver goal is the reliability of our foreign suppliers--Canada, Mexico, and Peru.

1/U.S. General Accounting Office, "Implementation of National Defense Stockpile Plans Would Require Amending Existing Legislation," GAO/EMD-82-111, July 16, 1982.

FEMA's goal-setting process does not, however, consider the degree to which the perceived adverse impact of the silver disposal may weaken economic and political bonds between the United States and its major foreign silver suppliers. FEMA's 1978 reliability assessment, on which the zero stockpile silver goal is based, does not include the potential implications of the auction disposal method on foreign relations. Since all three of the U.S. major foreign suppliers have protested the sale of stockpile silver at auction, we believe that the international implications of any proposed disposal method should be considered.

QUESTIONS CONCERNING ALTERNATIVE
DISPOSAL METHODS MUST BE RESOLVED

The fiscal year 1982 Defense Appropriation Act requires that the President report to the Senate and House Committees on Armed Services on alternative methods to dispose of any silver found to be in excess of stockpile requirements, including his recommended disposal method. No further disposal action can be taken, however, prior to congressional approval.

Before the disposal was suspended, weekly auctions were being held at which up to 1.25 million troy ounces of silver were offered for sale by sealed bid. The minimum bid accepted was for eight 1,000-troy-ounce ingots. While this disposal method is expedient and complies with legislatively mandated competitive procedures, it does not meet other congressional goals to (1) minimize or eliminate any short-term market price disruption because, all else remaining the same or constant, a sale will depress the short-term price of silver relative to what it would have been and (2) assure that the disposal is for domestic consumption because the ingots can displace other silver bullion held domestically which can then be shipped out of the country, or the ingots can be reprocessed and readily exported thereafter.

Because selling the silver at auction had not met all the goals of the Congress, our January 11, 1982, report explored disposal alternatives including coinage programs, small silver bars, transferring or selling the silver to the U.S. Treasury, and leaving the silver in the National Defense Stockpile. While all the alternatives appeared to have both advantages and drawbacks,

a bullion coinage program appeared to be an attractive alternative that should be considered. Effectively implemented, a coinage program may (1) minimize or eliminate any short-term market price disruption by developing new demand to offset the increased supply, (2) better assure that the disposal is for domestic consumption by making the silver more attractive, affordable, and accessible to first-time investors from a wide range of American income groups, and (3) increase Federal revenues to acquire other strategic and critical materials over selling the silver at auction. However, problems associated with past coinage programs that reduced public demand must be overcome. Therefore, we asked the Congress to consider requiring that the Secretary of the Treasury conduct an appropriate study of the probability of developing a strategy to effectively market bullion coins.

FEMA and DOD suggested another alternative--silver backed convertible bonds. (See pp. 9 and 22.) Under this alternative, the U.S. Treasury would issue bonds convertible into silver or cash, at the purchasers' option, upon maturity. According to FEMA, this alternative would yield immediate stockpile revenue while giving the Federal Government use of the stockpile silver until the bonds mature.

We did not explore the feasibility of convertible bonds backed by silver. We must note, however, that if the redetermination is that the silver to be disposed of is excess to stockpile requirements, its availability would be a moot issue. Conversely, if the redetermination concludes that the stockpile silver is needed for national defense, it cannot be disposed of. Therefore, we believe that the Interagency Silver Commodity Committee should carefully weigh the benefits and costs associated with such bonds against bullion coins and other alternatives to disposing of the stockpile silver.

RECOMMENDATIONS TO THE
SECRETARY OF THE INTERIOR

We recommend that the Secretary of the Interior, as Chairman pro tem of the Cabinet Council on Natural Resources and the Environment, require the Interagency Silver Commodity Committee in its report to the Congress to

- make clear the demand factors considered in redetermining the need for the stockpile silver and provide justification for excluding any of the defense-related monetary uses required by the fiscal year 1982 Defense Appropriation Act;
- appropriately qualify those legislatively mandated supply factors that are based on incomplete data;

--consider, as required by law, (1) the estimated cost of silver from recycling, domestic stocks, and foreign suppliers during a national emergency and (2) the impact that any proposed disposal method may have on relations between the United States and its major foreign suppliers; and

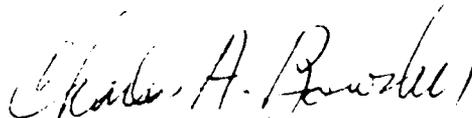
--provide a benefit-cost analysis of the various alternatives to disposing of the stockpile silver, including bullion coins and convertible bonds backed by silver, in support of a recommended disposal method.

AGENCY COMMENTS

We provided a draft of this report to the Secretary of the Interior, as Chairman pro tem of the President's Cabinet Council on Natural Resources and the Environment, for review and comment. In its November 15, 1982, response (see app. IV), Interior agreed to consider our recommendations in the President's report to the Congress which is currently being prepared. Interior believed, however, that it is premature to discuss the President's report until there is agreement within the administration on its contents.

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We are sending copies of this report to the appropriate congressional committees to assist them in evaluating the President's redetermination that the silver to be disposed of is excess to stockpile requirements and alternative disposal methods. We are also sending copies to the Director of FEMA, the Secretary of Defense, the Secretary of the Interior as Chairman pro tem of the President's Cabinet Council on Natural Resources and the Environment, and other interested officials and will make additional copies available upon request.



Comptroller General
of the United States

D I G E S T

To prevent a dangerous and costly dependence on foreign supply sources during national emergencies, the United States maintains a National Defense Stockpile of materials to avoid military setbacks and economic damage in wartime.

In 1976 and again in 1980, the Federal Emergency Management Agency determined that the supply of silver from domestic production and reliable imports exceeded the estimated quantity required to sustain the United States for a period of not less than 3 years in the event of a national emergency. Therefore, the Agency concluded that the 139.5 million troy ounces of silver in the stockpile were not needed for national defense.

The Omnibus Budget Reconciliation Act of 1981, Public Law 97-35, authorized the disposal of 105.1 million troy ounces or about 75 percent of the stockpile silver in fiscal years 1982 through 1984. However, the fiscal year 1982 Defense Appropriations Act, signed by the President on December 29, 1981, suspends the disposal pending a July 1, 1982, redetermination that the silver to be disposed of is excess to stockpile requirements and congressional approval of any proposed disposal.

In July 1981, the Chairmen of the Senate Committee on Energy and Natural Resources and the Subcommittee on Seapower and Strategic and Critical Materials, House Committee on Armed Services, asked GAO to evaluate the impending disposal of silver from an overall availability perspective and report the results to their Committees by the end of 1981. (See app. I and II.) Both expressed concern that the broad implications of the sale had not been adequately considered and subsequently asked GAO to address all aspects of the sale, including changes which have occurred since the sale was last justified and alternatives to disposing of any excess silver. The fiscal year 1982 Defense Appropriations Act includes a specific requirement that GAO's findings and recommendations be considered in the July 1982 redetermination referred to above.

FACTORS USED TO ESTABLISH A ZERO
SILVER STOCKPILE GOAL HAVE CHANGED

Stockpile goals were last published in 1980 based on 1978 supply and demand data. Several factors used to establish stockpile goals for all strategic and critical materials, including a zero silver goal, have changed. These changes have

- increased projected defense-related demand for silver during national emergencies (see p. 9), and
- reduced the availability of silver from existing domestic mines and processors. (See p. 12.)

Moreover, silver from other sources, including recycling and foreign suppliers, may cost more (in constant dollars discounted to present value) during wartime than the revenues to be realized from the sale of the stockpile silver. This could lead to a costly and dangerous dependence. (See pp. 12 and 16.)

Further, all three of the United States' major foreign suppliers, while generally considered reliable, have protested the disposal. Even though a sale's impact will be limited to the short-term, Canada, Mexico, and Peru have expressed their concerns through diplomatic channels, alleging that a sale will depress the market price, resulting in decreased employment and foreign exchange earnings. However, the effect, if any, of their concerns on the future availability of foreign supplies during wartime is unclear. (See p. 14.) In redetermining if the silver to be disposed of is excess to stockpile requirements, projected increased U.S. dependency on foreign silver sources and the possibility that a silver stockpile goal could be reestablished in the future should be considered. (See p. 17.)

CONGRESSIONAL GOALS HAVE NOT BEEN MET

To comply with the enabling legislation, the General Services Administration held weekly auctions where up to 1.25 million troy ounces of silver were offered for sale by sealed bid. The minimum bid accepted was for eight

1,000 troy ounce ingots. While this disposal method is expedient and complies with legislatively mandated competitive procedures, it has not met other congressional goals to

- minimize or eliminate any short-term market price disruption because all else remaining the same or constant, a sale will depress the short-term price of silver relative to what it would have been (see p. 18), and
- assure that the disposal is for domestic consumption because the ingots can displace other silver bullion held domestically which can then be shipped out of the country or the ingots can be reprocessed and readily exported thereafter. (See p. 20.)

The General Services Administration rejected all bids at its fifth and sixth weekly auctions because they were all below market price and subsequently received a congressional waiver from the domestic consumption requirement. An unrestricted silver sale was held on December 16, 1981, but again all bids were rejected.

Moreover, the disposal may not maximize revenues to acquire other strategic and critical materials currently below stockpile goal levels. The disposal is ill-timed, occurring when the price of silver is already depressed. (See p. 21.)

A BULLION COINAGE PROGRAM APPEARS TO BE A VIABLE DISPOSAL ALTERNATIVE

Because selling the silver at auction has not met all the goals of the Congress, GAO explored disposal alternatives including coinage programs, small silver bars, transferring or selling the silver to the U.S. Treasury, and leaving the silver in the National Defense Stockpile. While all alternatives appeared to have advantages and drawbacks (see p. 23), a bullion coinage program appeared to be an attractive alternative that should be considered. Effectively implemented, a coinage program may

- minimize or eliminate any short-term market price disruption by developing new demand to offset the increased supply (see p. 25),
- better assure that the disposal is for domestic consumption by making the silver

more attractive, affordable, and accessible to first-time investors from a wide range of American income groups (see p. 26), and

--increase Federal revenues to acquire other strategic and critical materials over selling the silver at auction in a depressed silver market. (See p. 26.)

The success of a coinage program is contingent, however, on public demand. Problems such as limiting the market to coin collectors, limiting the number of coins per customer, and complex and time consuming ordering procedures have dampened public demand for past coins. Therefore, an effective marketing strategy that includes an economical, readily accessible, and simplified channel of distribution must be developed to overcome problems associated with past U.S. coinage programs. (See p. 32.) The implications of (1) placing a face value on the coins (see p. 26) and (2) making them legal tender (see p. 34) must also be thoroughly studied.

RECOMMENDATION TO THE DIRECTOR OF THE
FEDERAL EMERGENCY MANAGEMENT AGENCY

Since the Federal Emergency Management Agency will have lead responsibility in advising the President with respect to the redetermination required by the fiscal year 1982 Defense Appropriations Act, GAO recommends that the Director of the Federal Emergency Management Agency, in evaluating various factors and information, specifically consider (1) the most recent war scenario hypothesized in terms of participants, war fronts, type of military action, and warning time, (2) defense-related uses of silver during past national emergencies, (3) reduced expansion from existing mines during wartime, (4) decreasing domestic smelting capacity, (5) the cost of silver from recycling, domestic stocks, and foreign suppliers, (6) the impact that selling the silver at auction may have on relations between the United States and its major foreign suppliers, and (7) long-term uncertainties relating to projected increased U.S. dependency on foreign silver sources and the possibility that a silver stockpile goal could be reestablished at some future date. (See p. 38.)

MATTERS FOR THE CONSIDERATION
OF THE CONGRESS

GAO's work indicates that a bullion coinage program is possibly an attractive alternative method for disposing of the stockpile silver. In considering such a program, further study is required regarding the probability of developing an effective marketing strategy which would develop new demand and participation by first-time investors from a wide range of income groups. Pertinent factors to be considered include the implications of placing a face value on the coins and making them legal tender. To have such information available at the same time as the July 1982 redetermination required by the fiscal year 1982 Defense Appropriations Act, the Congress should consider requiring that the Secretary of the Treasury conduct the appropriate study and provide the results to them by July 1, 1982. (See p. 38.)

AGENCY COMMENTS

In the interest of the timely release of this report, the requestors' offices directed that GAO not obtain official agency comments. Views of agency officials were obtained, and are presented in the text of the report where appropriate. Their remarks do not, however, represent the official positions of their agencies.



Federal Emergency Management Agency

Washington, D.C. 20472

APR 7 1982

Honorable Mark O. Hatfield
Chairman, Committee on Appropriations
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

This is in response to the report by the General Accounting Office (GAO) entitled "National Defense - Related Silver Needs Should Be Reevaluated And Alternative Disposal Methods Explored," dated January 11, 1982. The report was made available to the Federal Emergency Management Agency on January 25, 1982. My remarks are focused on the seven recommendations offered on page 38 for redetermining the stockpile goal for silver. In addition, I would like to offer the following three substantive comments:

1. Page 9. Defense-Related Demand for Silver At the bottom of this page there appears a reference to section 2 of the Strategic and Critical Materials Stock Piling Act, that the stockpile should "...preclude, when possible, a dangerous and costly dependence by the United States upon foreign sources for supplies of such materials in times of national emergency." (Emphasis added.) Part (a) of that same section states that strategic and critical materials are required "...to supply the military, industrial and essential civilian needs of the United States for national defense." GAO stated that the needs of allies and friendly nations should be considered in projecting requirements. They also explored the potential need for silver as a medium of payment to foreign troops and workers in areas of the world where there may be little confidence in paper currency in times of uncertainty.

We note that U.S. wage payments to our allies have historically been interpreted by the Federal Emergency Management Agency (FEMA) and all predecessor National Defense Stockpile agencies to be excluded due to their foreign nature. In addition, monetary and foreign wage payments are not included within the definition of expenditures for the defense, essential civilian, or basic industrial tiers which the stockpile was designed to insure. FEMA will consider GAO's opinions on this point. If Congress were interested in paying the wages of foreign troops in wartime, a better means might be to have the Treasury Department buy our excess stockpile silver and establish a special fund for this purpose.

In terms of national defense priorities, however, addition of such low priority "monetary needs" to offset silver stockpile surpluses creates risks that our stockpile will have its metals composition frozen. Then we will not have the proper stockpile composition to support the basic mobilization effort required for our self-protection. Funds from the sale of silver will go a long way toward reducing the shortfalls of much

higher priority materials. Such materials purchases would reduce the national defense risks that Congress mandated the National Defense Stockpile to insure against much more effectively than would a "wage reserve" for our allies.

(GAO's response: While there are materials currently below stockpile goal levels, we believe it important to call to the attention of the Congress the fact that not all defense-related uses of silver during past national emergencies are reflected in FEMA's estimated demand. Further, the fiscal year 1982 Defense Appropriation Act specifically mandates that the President consider monetary requirements, including historical monetary uses of silver as a medium of payment to foreign workers and troops during times of national emergency, in determining that the silver to be disposed of is excess to stockpile requirements.

FEMA has agreed to consider our opinions on this point, but is concerned that the addition of "monetary needs," which they consider to be low priority, creates risks that the stockpile's metals composition will be frozen. We agree that the funds from the silver sale could be used to reduce current deficits of other stockpile materials. However, this should be done with full recognition of the fact that the silver is being disposed of because its defense-related uses are considered by FEMA to be of lower priority than uses for other stockpile materials and not because the silver may not be needed for national defense. Therefore, the stockpile silver disposal may establish a precedent for disposing of a lower priority material to reduce, in FEMA's words, "the shortfalls of much higher priority materials.")

2. Chapter 3. Discussion of the effect of silver sales on the market. There is an assertion that because, other things equal, a sale will depress price relative to what it would have been, undue disruption of the market has been encountered. Price is an ultimate indicator of the strength of the market, and the commodities' records of General Services Administration (GSA) will show many instances of sales occurring when prices were rising. GSA pulls back its offerings when prices are falling or when prices are "soft". For that reason, among others, a weekly auction is a very good vehicle for keeping a constant test on the market. If the criteria suggested by GAO were adopted, no excess material would ever be sold since all sales reduce prices in a theoretical "other things equal" sense in which pressure on price rather than actual price movements would represent the disruption standard.

On page 20, the report cites (out of context) a provision of section 6 of the Act requiring purchasers of silver to use the material for domestic consumption. The proper and complete citation actually is section 6(b): "To the maximum extent feasible ... (3) disposal of such materials shall be made for domestic consumption." An international fungible commodity such as silver is impossible to control to insure

that all sales enter only domestic consumption channels, especially if indirect foreign displacement effects are considered. A categorical sales constraint in terms of domestic consumption only would reduce the stockpile sales price and be impossible to enforce. There are no tags on the silver bars but GAO notes prohibition of even indirect silver exports not physically involving stockpile silver would be required. Even with a coinage program of the unprecedented scale suggested by GAO in Chapter 4, the coins can be shipped out of the country. Silver export and trade controls would be needed to guarantee domestic consumption of any silver stockpile disposal. Presently, we operate under a free trade policy in silver.

The appropriate congressional subcommittees were aware of GSA's domestic and international marketing plans. The plan itself has been tested over the years by GSA acting as sales agent for the Treasury in matters involving nonstockpile silver.

(GAO's response: In our report, we state that the weekly auctions had not met congressional goals to (1) minimize or eliminate any short-term market price disruption or (2) assure that the disposal is for domestic consumption. We conclude, however, that (1) any impact on domestic producers and consumers will be limited to the short-term and will not affect future investment decisions or significantly influence long-term operations and (2) domestic consumption cannot be assured under any disposal alternative.

We found that given the complexities of the silver market, the stockpile sale's impact on price is not completely clear. However, all else remaining the same or constant, a sale will depress the short-term price of silver relative to what it would have been. We did not, nor would we ever, suggest that an "all else remaining constant" criterion be adopted to measure whether the sale of a stockpile material is causing an "undue disruption of the usual markets of producers, processors, and consumers." Quite the contrary, we point out that "regardless of any short-term benefits or disadvantages, the quantity of silver to be disposed of is too small to have any long-term effects on the industry."

FEMA also appears to have misinterpreted our domestic consumption finding. FEMA's response merely reiterates and reinforces our conclusions that (1) the domestic consumption requirement cannot be assured under any disposal alternative, and a bullion coinage program could only better assure that the disposal is made for domestic consumption and (2) the domestic consumption requirement may be counterproductive to maximizing revenues.

In commenting on the viability of the GSA weekly auctions, FEMA does, however, inaccurately state that "GSA pulls back its offerings when prices are falling or when prices are 'soft'." We found that the disposal of the stockpile silver was ill-timed, occurring near the bottom of a commodity-wide market

cycle. The price of silver was already depressed, and the disposal served to lower it further. GSA officials informed us that they prefer to establish and maintain a presence in a given market over the course of a disposal and do not pull back offerings when prices are falling or "soft." They used the ongoing tungsten disposal as an example.)

3. Chapter 4. Alternative Methods of Disposal. Coinage demand to offset disposal of stockpile supplies is the only viable nonmarket disposal method discussed in this chapter. However, there are others. For example, stockpile silver could be used to permit the Treasury to issue bonds convertible into silver or cash at the purchasers option upon maturity. Treasury purchase of stockpile silver at the bond conversion price would yield immediate stockpile revenue, while at the same time reducing Treasury interest costs and giving the government use of the silver stockpile for the maturity of the Treasury bonds.

GAO's major conclusion is that numismatic coinage demand has the strongest merit. Historically, coinage demand is more limited, particularly, if the silver coins are not legal tender. FEMA can support any nonmarket means of disposal which is 1) legal, 2) timely, and 3) does not sacrifice revenue proceeds accruing to the Stockpile Transactions Fund from such disposals.

The report notes some of the disadvantages of coins as legal tender vis-a-vis coordination with Federal Reserve monetary policies involving coinage circulation. The Treasury, particularly the Mint, would have difficulty with any additional coinage program of this magnitude which reverses the silver demonetization policies of the 1960's. Substantial fixed costs "up front", necessitated by such a coinage program, make the program irreversible and far more inflexible than does the current GSA sales program.

As a financial precondition to a major Treasury coinage program, the Treasury must get sufficient appropriations to buy stockpile silver; and FEMA must obtain congressional authority to dispose of it. One can see budgetary delays of several years in getting such activities coordinated. The numismatic coin option shares the irreversible fixed cost disadvantage with the legal coin minting option, but the budgetary lags are less significant. On the other hand, large coinage demands are not guaranteed for numismatic coins with a large governmental markup. Once silver prices increase by the government's margin above silver costs, Gresham's law will cause the coins to be melted back into commercial bullion stocks.

While coinage options have merit, further delays in procuring needed stockpile materials place the Nation's defense in jeopardy. The sale of silver provides an important financing mechanism to obtain these needed acquisitions. FEMA's concern is that these defense acquisitions will be delayed or deferred by placing additional constraints on their sales financing mechanism. Such nonlegislative constraints include GAO disposal goals as distributing small lots of silver to American families or raising the unprovable possibility of future stockpile silver purchases at higher

prices (all wartime material prices would be higher, of course -- but at least silver will be domestically available).

(GAO's response: Our analysis of alternative methods to dispose of the stockpile silver was not meant to be all-inclusive. It did, however, include small silver bars, transferring or selling the silver to the U.S. Treasury, and leaving the silver in the National Defense Stockpile in addition to coinage programs.

Other alternatives are available. For example, FEMA and DOD suggest silver-backed convertible bonds.

We did not explore the feasibility of convertible bonds backed by silver. We were, at the time, working on the premise that if a determination is made that the silver to be disposed of is excess to stockpile requirements, its availability would be a moot issue. A determination to dispose of the silver simply because its defense-related uses are lower priority than other stockpile materials' uses would significantly change this premise and alternative disposal methods aimed at retaining the silver for as long as feasible should be explored, including convertible bonds.

FEMA's concerns relating to a bullion coinage program center on (1) doubt whether sufficient demand exists to dispose of the silver through coinage, (2) the Bureau of the Mint's capacity to issue 100 million silver bullion coins over a 3 to 4 year period, (3) reversal of the silver demonetization policies of the 1960's, (4) the fixed costs necessitated by such a coinage program which may make it irreversible and inflexible, (5) budgetary delays associated with acquiring the silver and obtaining congressional authorization, and (6) future meltdowns when the value of the coins' bullion content exceeds the premium paid by investors.

All of FEMA's concerns were identified and addressed in our report. We identified problems associated with past coinage programs which must be overcome to stimulate demand. We then identified a marketing strategy directed toward developing new demand and participation by investors of modest financial means. This strategy was the basis of June 10, 1982, testimony before the Senate Committee on Banking, Housing, and Urban Affairs. At that hearing, the Treasurer of the United States proposed a similar strategy to market coins to commemorate the 1984 Olympic Games.

We found that the number of silver bullion coins to be issued is insignificant compared to the quantity

of coins struck by the Mint in any given year. We also found that the Mint has the capacity to issue 100 million silver bullion coins over a 3 to 4 year period in addition to the Olympic and George Washington commemorative coins.

The Eisenhower silver dollars and the Olympic and George Washington coins are commemoratives which do not reverse U.S. silver demonetization policies. Other bullion coins could also be issued without affecting monetary policies.

We also noted that although up to 150 million Eisenhower silver dollars were authorized to be minted in December 1970, only about 21 million or 14 percent were minted before the program was halted in 1974. This shows that a coinage program does not incur fixed costs that make it irreversible and inflexible, as FEMA contends.

We stated that the minting costs should be paid for out of the National Defense Stockpile Transaction Fund. While this would require congressional legislation, it could minimize budgetary delays associated with acquiring the silver and obtaining congressional approval. A bill, S. 2598, to dispose of the stockpile silver through the issuance of silver coins, was introduced on May 27, 1982. The bill requires that the costs incurred by the Secretary of the Treasury in minting, distributing, promoting, and marketing the coins be credited to the Mint appropriations fund from the proceeds of the sales of the coins.

Finally, we noted that the silver would not become an immediate source of supply to the market. Even if the coins are eventually melted down, potential adverse price impacts would be minimized by spreading out the increase in market supply.

FEMA concludes that while coinage options have merit, further delays in procuring needed stockpile materials place the Nation's defense in jeopardy because acquisitions will be delayed or deferred by placing additional nonlegislative constraints on their sales financing mechanism. Such a statement is extremely misleading in light of the fact that moneys for acquisitions of stockpile materials cannot be obligated or disbursed unless first requested by the administration and appropriated by the Congress. It also fails to recognize the dismal failure of GSA's weekly auctions to dispose of the silver.

Defense acquisitions may not be delayed or deferred by a coinage program. As of March 31, 1982, the Transaction Fund contained \$182 million in un-

appropriated cash receipts. The administration's fiscal year 1983 budget request includes \$120 million for stockpile acquisitions, with another \$120 million projected for fiscal year 1984. Thus, moneys in the Transaction Fund are already adequate for all planned fiscal year 1983 acquisitions and about half of projected fiscal year 1984 acquisitions. Revenues from a coinage program should then be available for future fiscal years' acquisitions.

Further, if timely revenue maximization is a consideration, GSA's weekly auctions appeared ineffective. Only about 2 million troy ounces of the 10 million troy ounces offered were sold before the weekly auctions were suspended.)

I will now address the seven GAO report recommendations; and for ease of reference, they are set out below:

"... that the Director of the Federal Emergency Management Agency, in evaluating various factors and information, specifically consider:"

1. the most recent war scenario hypothesized in terms of participants, war fronts, type of military action, and warning time,
2. defense-related uses of silver during past national emergencies,
3. reduced expansion from existing mines during wartime,
4. decreasing domestic smelting capacity,
5. the cost of silver from recycling, domestic stocks, and foreign suppliers,
6. the impact that selling the silver at auction may have on relations between the United States and its major foreign suppliers, and
7. long-term uncertainties relating to projected increased U.S. dependency on foreign silver sources and the possibility that a silver stockpile goal could be reestablished at some future date.

Stockpile goals are determined on the basis of policy guidance approved by the President. We are totally in agreement with GAO's Recommendations 1 and 4, and in fact they are regularly considered in silver goal-setting procedures. The Fiscal Year 1982 Defense Appropriation Act mandates that Recommendation 2 be added to this list of determinants. Accordingly, this Agency will consider defense-related uses of silver during past national emergencies in redetermining the forthcoming stockpile goal for silver. Such uses, including monetary and foreign uses heretofore not considered critical, will be evaluated for feasibility of inclusion in wartime requirements. However, FEMA's models presently recognize that the technology and the surplus silver supply of WW II no longer exist, and that the patterns of silver use during the next emergency will not replicate those of WW II or even Vietnam.

(GAO's response: FEMA agrees with us that two factors--the most recent war scenario and decreasing domestic smelting capacity--should be considered. They also agree to consider a third factor--defense-related uses of silver during past national emergencies--but note that stockpiling silver for allied and friendly nations defense-related needs and payment to foreign troops and workers in areas of the world where there may be little confidence in paper currency in times of uncertainty have not, heretofore, been considered critical.)

We agree with FEMA that the patterns of silver use during the next national emergency will not replicate those of World War II or the Vietnam conflict. FEMA's wartime projections, which exclude allied and friendly nations' defense-related needs and payments to foreign troops and workers, exceed annual demand in both World War II and the Vietnam conflict. FEMA projects an average annual consumption of 172.3 million troy ounces for the first 3 years of a conventional war, versus average annual consumption of 103.5 million troy ounces in World War II and 138.9 million troy ounces during the Vietnam conflict. Further, FEMA's wartime projections will increase since the scope of the war scenario has increased. In the interim, FEMA notes that the surplus silver supply of World War II no longer exists to help mitigate the impact of this increased demand.)

Recommendations 5 and 6, as well as a possible reversal of stockpile buying and selling in Recommendation 7, are considered as part of the Interagency Annual Materials Plan Steering Committee powers. Considerations occur within the context of disposal plans and subsequent GSA execution of disposal plans within domestic and foreign market constraints. There are problems, however, with the inclusion of Recommendations 3, 5, 6 and 7 with respect to the calculation of stockpile goals. These problems are discussed below:

Recommendation 3: Reduced expansion from existing mines during wartime.

The silver industry should not be assigned a high war priority just because silver production dropped in WW II. The 1940's silver glut no longer exists. Reduced silver wartime expansion planning factors may not be appropriate now and certainly should not be incorporated just to increase silver goals. The emergency in WW II was access to copper -- silver was used as a substitute for copper. Silver mines were closed and the workers diverted to copper mining. Copper is now accessible. Up-to-date planning factors regarding wartime expansion of output by industry are utilized in all reviews of stockpile goals. These factors include recent silver losses of domestic mine, smelter, and refining capability. Our conservative war growth assumptions vary from assumptions of only peacetime levels of production of silver supply assigned to the Defense Tier up to full capacity output for supplies assigned to the Basic Industrial Tier.

Silver also is an important by-product of nonferrous smelting operations.

In 1981, less than half of primary production came from silver mines. To the extent that the output of those industries is accelerated in wartime, the output of silver will increase automatically.

Actual and planned mine and refinery closings, as well as feasible wartime production reopenings, are taken into account in the determination of available wartime supplies. Only achievable levels of output are assumed with adequate allowance for wartime conversion lags and downtime maintenance and repair. In this connection, the "primary (mine)" category shown on page 11 of the report actually represents primary refining of silver in the United States. This stage of production is a somewhat larger and later stage of production. The "mine" notation was added by the General Accounting Office. Although silver ore derived from domestic mines is the largest component of refinery production, new scrap, imported ore and inventory drawdown are other important components. To avoid double counting, however, imported ore data is removed from refinery production. In wartime as much as one-half of scrap reprocessing in the U.S. may occur in primary silver refineries.

(GAO's response: FEMA's statements on the past inter-relationship between silver and copper and the differentiation between ore refined from domestic mines versus new scrap and inventory drawdowns are not germane to the issue of reduced expansion from existing mines during wartime. FEMA's estimate for primary refined silver, whether from domestic silver mines, as a byproduct of copper, or from new scrap and inventory drawdowns (which are analogous to recently mined domestic ore since they have not been consumed and recycled) appears much higher than what can actually be produced.

The reason the estimate appears high is that industry officials we contacted stated that their existing mines, which produce over 85 percent of U.S. primary silver, are operating at close to capacity. Since at least 3 to 5 years lead time is required to bring on a new mine, production could be increased only slightly during the first 3 years of a national emergency.

Another concern is that there is little data to support FEMA's supply estimates. The Department of the Interior commodity specialist responsible for calculating FEMA's silver supply estimate informed us that his data is currently incomplete and out of date. Individual existing and potential mine, smelter, and refinery information will not be available until the end of fiscal year 1984. Further, we found that the availability of such mobilization factors as adequate skilled labor, transportation, water, energy, equipment, and facilities needed to increase production during a national emergency had

not been adequately considered. 1/)

Recommendation 5: The cost of silver from recycling, domestic stocks, and foreign suppliers.

The National Defense Stockpile cannot be utilized for economic or budgetary purposes, (section 3(b)(1) of the Act). Within those constraints, the costs of acquisitions as well as the potential market impact of sales are given heavy scrutiny both in the AMP Process and at the marketing level by GSA. One of the reasons we try to stockpile in peacetime is to avoid the "gouging" that often occurs in wartime. The cost of silver like other materials cost in wartime, may well be higher from all sources during a national emergency. An ample supply in the economy in these periods will help mitigate such a tendency.

(GAO's response: As stated in our report, we agree with FEMA that "the purpose of the stockpile is to serve the interest of national defense only and is not to be used for economic or budgetary purposes." However, considering the cost of silver from recycling, domestic stocks, and foreign suppliers does not, in our opinion, equate to using the stockpile for "economic or budgetary purposes." Using the stockpile for economic purposes would include releases of materials due to sharp increases in price during peacetime. Using it for budgetary purposes would include exceeding the legislatively mandated \$500 million limitation on the balance in the National Defense Stockpile Transaction Fund.

We believe that if "one of the reasons we try to stockpile in peacetime is to avoid the 'gouging' that often occurs in wartime," as FEMA contends, then FEMA should consider the cost of silver from recycling, domestic stocks, and foreign suppliers as well.)

Recommendation 6: The impact that selling the silver at auction may have on relations between the United States and its major foreign suppliers.

FEMA gives very strong attention to the effects of acquisition and disposal activities on its foreign suppliers. The reliability of foreign sources of supply is an important factor in the goal-setting process. The potential impact of an action on silver or any other material is reviewed by the subcommittee, and the AMP Steering Committee. GSA further coordinates its activities with the Department of State and foreign representatives before it takes final action in the market.

1/U.S. General Accounting Office, "Consideration of the Need for Minerals Mobilization Planning Within the Department of the Interior," EMD-81-89, June 8, 1981.

(GAO's response: As FEMA correctly points out, the reliability of the United States' major foreign suppliers is an important factor in the goal-setting process. One of the primary reasons for a zero stockpile silver goal is the reliability of our foreign suppliers--Canada, Mexico, and Peru.

Our concern, however, stems from the degree to which the perceived adverse impact of the silver disposal may weaken economic and political bonds between the United States and its major foreign silver suppliers. FEMA's 1978 reliability assessment, on which the zero stockpile silver goal is based, does not consider the potential implications of the auction disposal method on international relations. Since all three of the major foreign suppliers have protested the sale of stockpile silver at auction, we believe that the international implications of the auction disposal method should be considered.)

Recommendation 7: Long-term uncertainties relating to projected increased U.S. dependency on foreign silver sources and the possibility that a silver stockpile goal could be reestablished at some future date.

FEMA carries out goal sensitivity analysis with alternate scenarios to delimit ranges of uncertainty. Of course long-term uncertainties exist for all strategic and critical materials, and it is true the U.S. is becoming more dependent on foreign sources of supply for all materials. If there exists a foreseeable possibility that goals will increase in the near future, sales can be halted so that GSA will not be forced to quickly rebuy materials now being sold as excess. This does not mean, however, that excess materials should be retained for the present to meet a potential need in an indefinite future period. Such action would be particularly costly, since many stockpile inventories currently are well below stockpile goals. National security is better served by selling current excesses to help fill current deficits.

(GAO's response: We agree with FEMA that excess materials should not be retained to meet a potential need in an indefinite future period and that national security is better served by selling current excesses to help fill current deficits. Our report points out that uncertainty surrounds the potential long-term impact of the disposal. However, we believe that projected silver supply and demand imbalances together with changes in the war scenario and/or the reliability of foreign suppliers should be considered and provided to the Congress in determining if the silver to be disposed of is excess to stockpile requirements.)

The current silver goal is being reviewed in the light of all relevant national security factors. This review will be completed by the July 1, 1982, date stipulated by the Fiscal Year 1982 Defense Appropriation Act.

(GAO's response: On June 29, 1982, the Secretary of the Interior informed the Congress that the redetermination has been indefinitely postponed. He continued that "there will be no contemplated sale of silver any time within the near future from that stockpile.")

It is regrettable that this report was first submitted to us in final form. In past years we had been afforded the opportunity to comment on a draft version of reports such as these, and frequently we were able to clarify many issues and points before the formal report was issued. I believe this was as much to GAO's advantage as to ours. For example, we believe that Recommendations 1 and 4 could have been eliminated through the review process. Similarly, the demand-supply materials balance table on page 11 contains misleading data on GAO caption titles as well as analysis which could have been greatly improved by consultation with FEMA materials' experts prior to publication. I hope we will have an opportunity in the future to interact with investigators before they compile their final comments and recommendations.

(GAO's response: We appreciate FEMA's concern that our report accurately reflect the issues and points of contention. Our general policy is to give appropriate agencies an opportunity to provide official comments on a draft report with the comments and our responses included in the final report. However, official agency comments were not obtained because the congressional requestors' offices deemed a delay in issuing the report unacceptable since weekly auctions were being held where up to 1.25 million troy ounces of silver were being offered for sale. We did, however, obtain the views of agency officials which were presented in the text of the report where appropriate.

We have carefully evaluated FEMA's comments. In no instance did their comments warrant revising our findings, conclusions, and recommendations. Further, while agency concurrence with our findings tends to support their validity, it is not accepted as justification for dropping a significant point, including related recommendations. Therefore, recommendations 1 and 4 would not have been eliminated just because FEMA agrees with us.)

Sincerely,

SIGNED

John R. Brinkerhoff
Acting Associate Director
National Preparedness Programs

cc: Honorable David Stockman
Honorable Charles A. Bowsher ✓



RESEARCH AND
ENGINEERING

THE UNDER SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

19 MAY 1982

19 MAY 21 P 3: 56

Honorable Charles A. Bowsher
Comptroller General of the United States
Washington, D.C. 20548

Dear Mr. Bowsher:

This is in response to your final report dated January 11, 1982, "National Defense-Related Silver Needs Should Be Reevaluated and Alternative Disposal Methods Explored" EMD-82-24 (OSD Case #5880). We strongly disagree with many of the conclusions in your report. We regret that the report addressees did not desire official agency comments before the report was released. The following comments are provided.

(GAO's response: As stated previously, official agency comments were not obtained because the congressional requestors' offices deemed a delay in issuing the report unacceptable. (See p. 17.))

Chapter 2, pages 9, 10 - We disagree with GAO over the fundamental use of the National Defense Stockpile. The 1979 Stock Piling Act states that the purpose of the stockpile is to serve the interest of national defense only; it is not to be used for economic or budgetary purposes. Yet, this report suggests that peacetime and/or historic requirements be considered in determining if silver is excess to stockpile requirements.

(GAO's response: As stated previously (see p. 15), we agree that the stockpile should not be used for economic or budgetary purposes. Therefore, our report addresses only the defense-related demand requirements of (1) the increased scope of the war scenario which has correspondingly increased projected silver requirements and (2) silver provided to allied and friendly countries during World War II and to foreign troops and workers in times of uncertainty which are not reflected in FEMA's estimated demand.)

Page 9, paragraph 4 - GAO proposes that FEMA consider the use of silver in lend-lease programs to allied and friendly countries. However, the Act precludes stockpiling of commodities for other countries.

(GAO's response: In a November 24, 1980, report entitled "Actions Needed to Improve the Viability of the Strategic and Critical Materials Stockpile" (C-EMD-81-1), we reported that present Department of Defense policy does not call for the United States to singlehandedly counter all conventional military threats. Instead, reliance is placed on our allies, who are doing little to assure adequate supplies of raw materials during national emergencies. While this does not necessarily imply that the United States should stockpile materials for its allies, we concluded that their deficiencies could lead to some difficult options for the United States, including imposing more severe austerity measures on U.S. civilians than presently planned, in order to free materials for U.S. and allied consumption.)

Pages 10, 11 - GAO states that there are uncertainties relating to silver supplies and costs. On page 16, paragraph 5, the report refutes many of these arguments by stating that domestic sources of silver provide a buffer against cartel-type actions. We believe these domestic sources can also provide a buffer against the absence of silver in the stockpile. In addition, the report states that there are substitutes for silver in many applications and that about 20 percent of silver used domestically is for non-essential uses which could voluntarily be curtailed during an emergency.

(GAO's response: We agree with DOD that other domestic sources of silver as well as voluntary conservation in the form of reduced consumption provide a buffer and should be considered by FEMA in establishing the stockpile silver goal. However, as stated in our report, the amount of unreported silver held in private stocks is very speculative. Further, this and other domestic sources of silver may be unavailable during national emergencies and, if available, could cost considerably more per troy ounce, even discounted to present value, than the revenue realized from the sale of the stockpile silver. Therefore, the existence of other domestic sources of silver does not necessarily preclude the need for a silver stockpile.

DOD's comments also fail to point out that voluntary civilian conservation may not be entirely possible without some adverse consequences. In a war, some civilian requirements must be supported. FEMA officials informed us that meeting civilian requirements is important because industries do not produce just defense or civilian products. A single factory can produce products in both categories, and severe economic disruptions can occur when industries providing indirect inputs to critical defense and nondefense production are not adequately supported.)

Page 12, paragraph 5 - Concerning costs, FEMA can take the price of silver into consideration, but the important fact is that the silver is available domestically, although possibly at a higher price.

(GAO's response: We agree that availability of silver or mitigating alternatives, such as conservation and substitution, should be of higher priority in establishing stockpile goals than price. However, as stated above, we found that other domestic sources of silver may be unavailable during national emergencies. Further, it is our opinion (see p. 15) that considering the cost of silver from recycling, domestic stocks, and foreign suppliers does not equate to using the stockpile for "economic or budgetary purposes" and that FEMA should consider such factors in determining the stockpile silver goal.)

Page 14, paragraph 2 - There is a difference in definition of foreign suppliers. DoD considers Canada and Mexico "assured" suppliers during times of national emergency because there are no vulnerable supply lines between the U.S. and these two countries.

Overall, the supply situation for silver is secure. While the costs may possibly be higher, there is an adequate supply of silver available in the event of a national emergency.

It seems preferable to sell silver now from the stockpile and use the revenue to buy commodities for which there are no reliable suppliers or that might be unavailable at any price during a national emergency.

(GAO's response: We concur with DOD that there are no vulnerable supply lines from Canada and Mexico to the United States. However, in a June 3, 1982, report, 1/ we state that other strategic factors such as (1) the political and economic stability of major foreign suppliers; (2) concentration of production and/or processing capacity in one or several foreign countries; and (3) political, military, and economic ties with the United States must be considered in estimating the probability of a supply disruption or sharp price increase and its expected duration.

Limiting the probability of a supply disruption to geographic proximity alone is overly simplistic. It fails to take into consideration the political and economic stability of our major foreign suppliers and their domestic requirements during national emergencies. As such, the degree to which the perceived adverse impact of the silver disposal may weaken economic and political bonds between the

1/U.S. General Accounting Office, "Actions Needed to Promote a Stable Supply of Strategic and Critical Minerals and Materials," GAO/EMD-82-69, June 3, 1982.

United States and its major foreign silver suppliers as well as other definitive criteria, such as their growing attitude towards self-reliance and nationalization policies, must be considered. These factors could conceivably affect the availability of foreign supplies during periods of national emergency.

DOD believes that it is preferable to sell the stockpile silver now and "use the revenue to buy commodities for which there are no reliable suppliers or that might be unavailable at any price during a national emergency." As stated above, however, some domestic sources of silver may be unavailable, and the availability of silver from Canada and Mexico may not be assured.)

Chapter 3, page 18, discusses congressional goals which have not been met. Only one of these "goals" is mandated by law; the requirement that to the maximum extent feasible, disposal of stockpile materials be for domestic consumption. This mandate has been followed by FEMA and GSA in most cases. However, GSA cannot assure that the silver remains in domestic hands. The report itself states that experts say this requirement cannot be assured under any disposal alternative. Even the bullion coinage program which GAO recommends cannot guarantee that the silver coins will remain in the U.S.

(GAO's response: As does FEMA (see p.8), DOD appears to have misinterpreted our domestic consumption finding. DOD's response merely reiterates and reinforces our conclusions that (1) the domestic consumption requirement cannot be assured under any disposal alternative and (2) a bullion coinage program could only better assure that the disposal is made for domestic consumption.)

Page 22, paragraphs 1 and 2 - The report itself states how one congressional goal can counteract fulfilling another. For example, the goal requiring that silver be used for domestic consumption may be counterproductive to the goal of maximizing revenues by excluding certain markets, such as the Commodity Exchange, Inc.

(GAO's response: Again, DOD's response merely reiterates and reinforces our conclusion that the legislative mandate requiring that the silver be used for domestic consumption was counterproductive to maximizing revenues.)

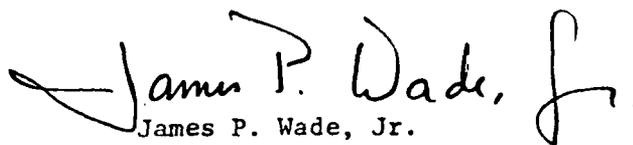
In Chapter 4, alternative methods for disposal of stockpile silver are discussed. The report appears to have overstated the case for the bullion coinage program and understated the case for other alternatives. We have no objection to a coinage program in lieu of silver auctions. However, the report would have been more useful if other alternatives - such as the Treasury selling convertible bonds backed by silver - had been more fully explored.

(GAO's response: As stated previously (see p. 10), our analysis of alternative disposal methods was not meant to be all-inclusive and other alternatives are available. We did not explore the feasibility of convertible bonds backed by silver because we were working on the premise that if a determination is made that the silver to be disposed of is excess to stockpile requirements, its availability would be a moot issue. A determination to dispose of the silver simply because its defense-related uses are lower priority than other stockpile materials' uses would significantly change this premise, and alternative disposal methods aimed at retaining the silver for as long as feasible should be explored, including convertible bonds.)

We believe that stockpile transactions should be limited to the intent of the Stock Piling Act, i.e., to support national security requirements. The report appears to place a higher priority on economic rather than national security considerations.

(GAO's response: Our report states that defense-related demand for silver has increased and that this demand may not be met by domestic sources of silver and reliable imports. We also found that the disposal may not maximize revenues to acquire other strategic and critical materials. These issues, as well as the overall thrust of our report, relate primarily to national defense, not economic considerations.)

Sincerely,



James P. Wade, Jr.

Acting



United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

November 15, 1982

Mr. J. Dexter Peach
Director
Resources, Community and Economic
Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Peach:

We have reviewed your draft report, "Unresolved Issues Concerning the Disposal of Stockpile Silver," and have concluded that rather than write a detailed reply it would better serve our mutual understanding of the issues to first meet informally and discuss them. This would be especially helpful in regard to GAO's line-by-line rebuttal of DOD's and FEMA's responses that followed GAO's report of January 11, 1982. The four recommendations in the present report will be considered in the report under preparation to be sent to Congress as required by P.L. 97-114. We trust that you agree that it is premature to discuss the report to be sent to Congress until there is agreement within the Administration on its content and findings.

We want to comment briefly on GAO's first recommendation, to "clarify for the Congress whether or not silver is being disposed of because its defense-related uses are considered to be of lower priority than uses for other stockpile materials, thus establishing a precedent for disposing of lower priority materials to reduce, in FEMA's words, 'the shortfalls of higher priority materials.'"

This recommendation apparently refers to FEMA's Item 1 comment in its April 7, 1982, response to GAO's earlier report that is appended to the present report. Understandably, while FEMA in stockpile planning sets acquisition priorities among commodities short of goal, which is good planning, it does not advocate the sale of commodities in inventory and within goal to acquire something of higher priority. It is unwarranted to presume otherwise on the rather shaky grounds that FEMA used the phrase "low priority" in reference to possible "monetary needs" of silver over and above those determined by the established planning criteria for defense, essential civilian, and basic industrial tiers.

Even if it should be determined to keep some stockpile silver for monetary uses during an emergency, GAO presumes too much in making the sweeping statement that somehow this may establish a precedent to manipulate inventories in the stockpile on some priority basis.

We intend to address the other three recommendations as Congress intended in the President's report to Congress.

Sincerely,



Daniel N. Miller, Jr.
Assistant Secretary
for Energy and Minerals

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DTI