RENEGOTIATION ACT EXTENSION

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-FOURTH CONGRESS

FIRST SESSION

ON

H. R. 4904

AN ACT TO EXTEND THE RENEGOTIATION ACT OF 1951 FOR 2 YEARS

JUNE 7 AND 8, 1955

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RENEGOTIATION ACT EXTENSION

TUESDAY, JUNE 7, 1955

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to call, at 10:10 a. m., in room 312, Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

Present: Senators Byrd, Frear, Millikin, Martin, Williams, Flanders, Malone, Carlson, and Bennett.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The meeting will come to order.

The committee is now considering H. R. 4904, the extension of the Renegotiation Act of 1951. The bill will be made a part of the record at this point. Also, I submit for the record a copy of the President's message of March 7, 1955, and reports from the Bureau of the Budget and Department of the Air Force, recommending a 2-year extension of the Renegotiation Act of 1951, as proposed in the House-passed bill under consideration at this time.

(The bill, the President's message and the departmental reports follow:)

[H. R. 4904, 84th Cong., 1st sess.]

AN ACT To extend the Renegotiation Act of 1951 for two years

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subsection (a) of section 102 of the Renegotiation Act of 1951 (50 U. S. C., App., sec. 1212 (a)) is hereby amended by striking out "December 31, 1954" and inserting in lieu thereof "December 31, 1956".

SEC. 2. (a) Subsection (d) of section 102 of the Renegotiation Act of 1951 (50 U. S. C., App., sec. 1212 (d)) is hereby amended by inserting after "title" each place it appears "or would be subject to this title except for the provisions of section 106".

(b) The amendments made by subsection (a) shall apply to contracts with the Departments and subcontracts only to the extent of the amounts received or accrued by a contractor or subcontractor after December 31, 1953.

Passed the House of Representatives April 28, 1955.

Attest: RALPH R. ROBERTS,
Clerk.

[H. Doc. No. 101, 84th Cong., 1st sess.]

EXTENSION OF THE RENEGOTIATION ACT OF 1951, AS AMENDED

MESSAGE FROM THE PRESIDENT OF THE UNITED STATES RECOMMENDING EXTENSION OF THE RENEGOTIATION ACT OF 1951, AS AMENDED

To the Congress of the United States:

I recommend extension of the Renegotiation Act of 1951, as amended, to make its provisions applicable for an additional period of 2 years. I make this recommendation because I believe the welfare of the country requires it.

In spite of major improvements, which we have achieved in our contracting and price redetermination operations, there nevertheless remains an area in which only renegotiations can be effective to assure that the United States gets what it needs for defense at fair prices. In addition, I believe that the entire period of defense expansion and rebuilding which the United States has undertaken since the beginning of the Korean hostilities should be considered as a whole insofar as renegotiation treatment is concerned.

Continuation of the renegotiation authority is necessary for several reasons. Because of the complex nature of modern military equipment, the lack of experience in producing it, and the frequent necessity for alterations during the life of a contract, it is impossible for the Government to determine, when the procurement contract is made, what constitutes a fair price and for the supplier to forecast accurately his costs. Moreover, because of limited sources of supply in many cases, there are situations in which the Government is unable to obtain the price benefits that accrue from normal competition.

Furthermore, in the interest of broadening and strengthening the mobilization base, we have encouraged the extensive use of subcontracting. Because the United States has no direct contractual relations with the subcontractors, the only protection against unreasonable prices by them is through the process of renegotiation.

All these factors become particularly important when it is recognized that expenditures by the Government during the next 2 calendar years will include paying the bills for the completion of the expansion of the Air Force to 137 wings. The next 2 years also will see an introduction into the Air Force program of the latest type of supersonic aircraft. New types of equipment also are being ordered for the Army and Navy and Marine Corps.

As a nation, we recognize that so long as defense expenditures represent more than half of the national budget, we must do everything in our power to see to it that the miximum return is received for each dollar spent. On the other hand, we must also be careful not to interfere unwisely in the traditional commercial relationship between the Government and its suppliers. In extending the Renegotiation Act last year, the Congress instituted new statutory exemptions. These have lessened the burden imposed on industry by renegotiation and, more important, have concentrated renegotiation in the areas where it is most needed.

I strongly urge that the Congress take action as promptly as possible so that both Government and business will know that this important adjunct to speedy and effective defense contracting will remain available, at least until December 31, 1956.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE, *March 4, 1955.*

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D. C., June 6, 1955.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance, United States Senate,
Senate Office Building, Washington, D. C.

MY DEAR MR. CHAIRMAN: This will acknowledge your request of May 3, 1955, for the views of the Bureau of the Budget with respect to H. R. 4904, a bill to extend the Renegotiation Act of 1951 for 2 years.

Section 1 of the proposed legislation would extend the Renegotiation Act of 1951 for 2 years and thereby carry out the recommendation made by the President in his special message of March 4, 1955.

Section 2 of the bill would suspend the profit limitations of the Vinson-Trammel Act and the Merchant Marine Act for receipts and accruals after December 31, 1953, under contracts exempted from renegotiation by section 106 of the Renegotiation Act. Since the proposed suspension of profit limitations would expire with the Renegotiation Act, it would appear to produce the anomaly of exempting from both statutory profit limitations and renegotiation during the emergency period contracts which would be subject to statutory profit limitations during normal times. If there is adequate justification for the proposed suspension of statutory profit limitations, it would be more satisfactorily accomplished through appropriate amendments to the Vinson-Trammel Act and the Merchant Marine Act under which the suspension would be permanent.

Subject to the above comments, the enactment of H. R. 4904 would be in accord with the program of the President.

Sincerely yours,

HAROLD PEARSON,
Assistant Director.

DEPARTMENT OF THE AIR FORCE,
OFFICE OF THE SECRETARY,
Washington, June 7, 1955.

Hon. HARRY FLOOD BYRD,
Chairman, Committee on Finance,
United States Senate.

DEAR MR. CHAIRMAN: Reference is made to your request to the Department of Defense for a report on H. R. 4904, a bill to extend the Renegotiation Act of 1951 for 2 years. The Department of the Air Force has been assigned the responsibility for expressing the views of the Department of Defense.

H. R. 4904 initially provided for an extension of the Renegotiation Act of 1951, as amended, from December 31, 1954, to December 31, 1956. This bill was amended by the Committee on Ways and Means and subsequently was passed by the House of Representatives on April 28, 1955, so as to provide that the profit limitations under the Vinson-Trammel Act and the Merchant Marine Act shall not apply to any contract or subcontract if any of the receipts or accruals therefrom are subject to the Renegotiation Act of 1951 or would be subject thereto except for the provisions of section 106 of the latter act. This amendment is made effective with respect to amounts received or accrued by contractors or subcontractors after December 31, 1953. Under a recent Treasury Department ruling, items exempt from renegotiation under section 106 of the Renegotiation Act were still subject to the profit limitations of the Vinson-Trammel Act and the Merchant Marine Act.

The Department of Defense interposes no objection to the enactment of H. R. 4904, as amended and passed by the House of Representatives. The Department of Defense relies on the close scrutiny by the Renegotiation Board of contracts considered for exemption under section 106 of the Renegotiation Act of 1951 so as to protect the interest of the Government from excessive prices.

The Department of Defense strongly urges an extension of the Renegotiation Act of 1951 at least until December 31, 1956, for the reasons outlined in the report to your committee dated March 18, 1955, on S. 1017, a bill to extend the Renegotiation Act of 1951.

It is impossible to determine the fiscal effect of H. R. 4904, as amended and passed by the House of Representatives. It is a generally accepted fact, however, that during periods of relatively high military spending the presence of a renegotiation statute assists in negotiating lower prices than would otherwise be true. This is particularly true where there is a lack of effective competition.

This report has been coordinated within the Department of Defense in accordance with procedures prescribed by the Secretary of Defense.

The Bureau of the Budget advises that this report is in accordance with the program of the President.

Sincerely yours,

H. E. TALBOTT.

The CHAIRMAN. The first witness this morning is the Secretary of the Air Force, Mr. Talbott. We are very happy to have you with us. You may proceed in your own way.

Secretary TALBOTT. Mr. Chairman and member of the committee, I have two statements. One is prepared by the Army and one is prepared by the Navy. The one prepared by Secretary Stevens is to be entered into the record, and also a statement by Secretary Thomas, which is likewise to be placed in the record.

The CHAIRMAN. They will be placed in the record at this point.

(The prepared statements of Secretary of the Army Robert T.

Stevens and Secretary of the Navy Charles S. Thomas, are as follows:)

STATEMENT OF SECRETARY OF THE ARMY ROBERT T. STEVENS

I appreciate this opportunity, on behalf of the Department of the Army, to appear before your committee in support of H. R. 4904, 84th Congress.

The Department of the Army strongly supports the extension of the Renegotiation Act of 1951, as amended, until December 31, 1956, as set forth in H. R. 4904. Continuation of this renegotiation authority is necessary for several reasons, as has been indicated in previous testimony by representatives of the Department of Defense. The following statements are intended to be supplementary thereto.

The Department of the Army subscribes to the declaration of policy as expressed by the Congress to the effect that sound execution of the national defense program requires the elimination of excessive profits from contracts made with the United States and from related subcontracts. It is the opinion of the Department of the Army that the same reasons which existed for the passage of the original act still exist, particularly in view of the large military appropriations and the vast sums of money which have been and will be obligated for the procurement of defense materiel and equipment.

Situations will continue to exist where the Government will be precluded from obtaining the benefits accruing from extensive competition, generally resulting from limited sources of supply or proprietary situations. Under such circumstances close pricing to the extent desired cannot be obtained and such situations are conducive to the payment of excessive profits to contractors.

This act has had a salutary effect upon contract pricing. Contractors recognize that statutory renegotiation tends eventually to eliminate high profits from their earnings on Government contracts and, therefore, are more willing to negotiate closer prices at the inception of the contract. In addition, when contractors know that their Government business may be renegotiated they are more willing to consider the competitive aspects of negotiation and take a lesser profit in order to maintain contract relations with the Government. In those situations where the Government must purchase limited source or proprietary items, items available from only one source, from contractors at prices often established arbitrarily by the contractor, renegotiation is the best means available through which the Government can recapture excessive profits.

The present world situation is such that the Army may well be entering into contracts for considerable amounts of supplies during the next several fiscal years. There will be situations in which it will be impossible for the contracting officer to forecast or anticipate with any degree of accuracy what constitutes a fair price to the contractor or what the contractor's costs and profits will be under the contract. The continuing development of new and highly complicated items, particularly in the electronics and guided missile fields, at an accelerated pace further complicates the problem of close pricing. Close pricing is not possible unless there is previous production experience and adequate knowledge of the problems which will be encountered in performing a contract. The absence of this experience and knowledge make it necessary for the Department of the Army to have available all methods possible to assure that the maximum value is received for each dollar spent for defense purposes.

One of the reasons Congress extended the Renegotiation Act in the past year was because of the vast sums of money which have been appropriated for the procurement of needed defense material, equipment, and related purposes. This trend is continuing. As the committee members know, funds obligated in any particular fiscal year are not necessarily disbursed during that year—thus profits will accrue to contractors and subcontractors during the succeeding year or years even though the funds involved may have been appropriated and obligated at earlier dates. Extension of the Renegotiation Act is one method of assuring that the Government will be adequately protected against the payment of prices which may be excessive in connection with the national defense program.

Since failure to extend the act beyond its present terminal date of December 31, 1954, will mean that receipts and accruals attributable to performance after that date will not be subject to renegotiation, the Department of the Army strongly urges that the act be extended for 2 years as provided by H. R. 4904.

STATEMENT BY THE HONORABLE CHARLES B. THOMAS

Mr. Chairman and members of the committee, Secretary Fogler and I are here today to place the Department of the Navy alongside the Air Force and the Army in supporting the passage of H. R. 4904, a bill to extend the Renegotiation Act of 1951 for 2 years.

The renegotiation of defense contracts is, I believe, as necessary today as it was during World War II and the Korean war. The military departments are continuing to procure large volumes of complicated machinery, equipments, and weapons. In the Navy we are procuring guided missiles, nuclear submarines, faster and more complicated carrier and sea planes, and various types of new prototype ships. Our research and development programs are just beginning to produce a variety of new devices. Obviously, our contractors lack experience in producing the new equipment which results from such research. Under these conditions of constant improvement and development, the Government and the contractor find it difficult, at the time the contract is awarded, to determine what constitutes a fair price. In the procurement of many of these complicated equipments, the price advantages that come from full and free competition cannot be secured because of the small number of suppliers able to make such equipment. Frequently, as we seek to prevent unreasonable contractor profits under these conditions, the best safeguard of the taxpayer's interest is renegotiation.

Furthermore, through our active small-business program and the promotion of a broad mobilization base, the Navy has encouraged substantial subcontracting. The Navy does no renegotiating directly with subcontractors, but the renegotiation board does and thereby offers the Navy, and the taxpayer, protection against unreasonable subcontractor prices.

The areas in which the renegotiation of Navy business is principally concentrated are airframes and jet engines, ships and major components, ordnance, ammunition, and electronics.

Although renegotiation is the only method yet developed whereby we can guarantee ourselves against excessive profits by producers of new or novel military equipment, the renegotiation process does involve one danger which should be guarded against. This danger stems from the fact that unless great care is exercised, the efficient low-cost producer may be allowed a lower profit than the producer which has a larger set of costs. This obviously should be guarded against.

The Department of Defense clearly needs to be able to offer profit incentives to efficiency. I hope that all concerned can keep this factor in mind, so that renegotiation can take into account the efficiency displayed, the risks undertaken, the special problems met and solved, and the accomplishment actually achieved. Those charged with the duties of renegotiation are fair and beneficial when they evaluate each contractor's situation and make certain that the efficient and the productive obtain due consideration.

I believe the Renegotiation Act should remain on the statute books as long as great world unrest continues, and the purchases of the United States Government represent such a large portion of the Nation's economy. Its retention until December 1956, as proposed by H. R. 4904, seems completely justified. I heartily support the bill passed by the House of Representatives, and now before your committee.

The CHAIRMAN. You may proceed.

STATEMENT OF HON. HAROLD E. TALBOTT, SECRETARY OF THE AIR FORCE, ACCOMPANIED BY ROGER LEWIS, ASSISTANT SECRETARY FOR MATERIEL, AND MAX GOLDEN, DEPUTY FOR PROCUREMENT AND PRODUCTION

Secretary TALBOTT. Mr. Chairman and members of the committee, I have been designated as the Department of Defense representative on H. R. 4904. I appreciate this opportunity to appear before you in support of the enactment of that bill.

The Department of Defense strongly recommends extension of the Renegotiation Act of 1951, as amended, so as to make its provisions applicable for an additional period of at least 2 years. The same

reasons which existed for the passage of the original act, and the extension thereof, continue to exist.

Both this committee and the House Committee on Ways and Means, in their reports last year on H. R. 6287, amending and extending the Renegotiation Act of 1951 to cover receipts and accruals by defense contractors through December 31, 1954, stated that they considered extension of the act necessary because of the continuing tension in international affairs. These reports appropriately pointed out that substantial expenditures would be made during calendar year 1954 and that, absent renegotiation coverage for such year, the Government would not be adequately protected against the payment of excessive prices in the execution of the national-defense program.

Department of Defense expenditures subject to renegotiation during fiscal year 1954 were approximately $20 billion. In fiscal year 1955 the forecast of expenditures subject to renegotiation is approximately $17½ billion.

Expenditures for fiscal year 1956 and fiscal year 1957 subject to renegotiation will be of comparable magnitude. It seems clear that this sustained high rate of spending over the next 2 years, as compared to any so-called peacetime period, is a compelling factor in favor of extension.

Significantly, expenditures of the Government during the next 2 calendar years will include moneys for the completion of the expansion, including modernization, of the Air Force to 137 wings. It is logical that the entire period of expansion since the beginning of the Korean hostilities should be considered as a whole insofar as renegotiation treatment is concerned.

Additionally, the next 2 years also will see an introduction into the Air Force program of the latest types of supersonic aircraft. New types of equipment also are being ordered for the Army, Navy, and Marine Corps.

While we have achieved major improvements in our pricing policies and contracting techniques, there nevertheless remains an area in which only renegotiation can be effective to assure that the United States gets what it needs for defense without paying excessive profits.

In the changing technology of the defense effort new equipment becomes more complex and past production and cost experience is not necessarily satisfactory for forecasting and avoiding unconscionable profit.

The problem is further complicated by the numerous changes and improvements which are necessarily introduced into production to achieve better performance, safety in flight, and producibility. Under such circumstances price redetermination and other pricing techniques cannot be considered a complete solution. Other factors also preclude close pricing to the extent desired. These arise principally in situations where the Government is unable to obtain the benefits accruing from extensive competition because of limited sources or proprietary situations.

Experience has proved that statutory renegotiation is an effective method of insuring against excessive profits, particularly where volume is abnormal. It has a salutary effect in contract pricing and has proved particularly effective in the subcontracting areas where maintenance of controls to prevent excessive profits is extremely difficult. In consideration of the very large percentage of dollars in-

volved in subcontracting, renegotiation is particularly desirable and necessary.

Although we are at peace, we recognize that the country is in a state of semimobilization and that, so long as defense expenditures continue at the present rate, we must do everything in our power to see to it that the maximum return is received for each dollar spent.

Extension of the Renegotiation Act of 1951 is an important step in achieving this objective. The Department of Defense strongly recommends a 2-year extension of the Renegotiation Act, first, because the need therefor, as indicated above, will continue for at least 2 years; and, second, annual extension of the act in the past resulted in gaps in the applicability of statutory renegotiation, with resultant confusion in both to Government and industry.

We interpose no objection to the enactment of H. R. 4904 as amended and passed by the House of Representatives. We feel that we can rely on the close scrutiny by the Renegotiation Board of contracts considered for exemption under section 106 of the Renegotiation Act of 1951 so as to protect the interest of the Government from excessive prices.

In conclusion I wish to point out to the committee that the President in his message to the Congress on March 7, 1955, strongly urged an extension of the Renegotiation Act of 1951 at least until December 31, 1956.

The CHAIRMAN. Thank you very much, Mr. Secretary.

I gather from your statement that you do not think that the time has come when we can rely upon competitive bidding to serve the best interests of the Government?

Secretary TALBOTT. No, sir.

The CHAIRMAN. Do you have competitive bidding on those supersonic plane contracts?

Secretary TALBOTT. No. We cannot specify competitive bidding in those contracts.

The CHAIRMAN. Only certain airplane companies are making them?

Secretary TALBOTT. The company that develops the prototype, or develops the design, and they are very expensive in development, are the people best equipped to go ahead with that project.

I think we have even gone too far in a lot of our competitive work where we know beforehand where the business should be placed on account of the facilities and their technical ability, that a lot of these contracts should be negotiated.

I am satisfied that we can save time and money on that basis.

The CHAIRMAN. Are there types of planes, of a standard type, that you let on competitive bidding, that is really competitive?

Secretary TALBOTT. As an example, our B–47 is being made by three contractors. We might be able to come in now on an extension if we had an extension and ask them to bid on it.

The CHAIRMAN. Are there other types of planes?

Secretary TALBOTT. There are no types that are being made by more than one contractor.

The CHAIRMAN. Only one contractor?

Secretary TALBOTT. You do not want to duplicate your tooling and your expense. After a contractor has once built a certain number it is much cheaper for him to go ahead than to try to bring in a new contractor.

The CHAIRMAN. What companies are making the supersonic planes?

Secretary TALBOTT. There are a good many of them—North American, Douglas, Lockheed, Convair, and McDonnell—five of those at the moment.

Republic is also working on the development of a supersonic plane.

The CHAIRMAN. Each one makes a different type?

Secretary TALBOTT. Each one is different and usually for different purposes, sir.

The CHAIRMAN. So really there is no competitive bidding—it is not possible under these conditions?

Secretary TALBOTT. I do not see how it can be.

The CHAIRMAN. Are there any questions?

Senator MARTIN. No.

Senator WILLIAMS. Mr. Secretary, do you use the principle of competitive bidding whenever you can in cases where it is possible?

Secretary TALBOTT. Oh, certainly.

Senator WILLIAMS. I was reminded about last year of a situation wherein awarding contracts for ships you took it away from a lower bidder and assigned it somewhere at a cost of about $6 million or $8 million higher.

How do you work that in your renegotiation principle? That was in the Boston Shipyard and the Bath Iron Works.

Secretary TALBOTT. I am not conversant with that. I would rather have one of the Navy men answer that question, or Mr. Roberts, maybe, the head of the Renegotiation Board.

Senator WILLIAMS. As a matter of principle, how would you feel about that, where competitive bids were sought and received, and then wered not recognized, that the contract was transferred, as you suggested a moment ago?

Secretary TALBOTT. I can think of circumstances that would warrant that change.

Senator WILLIAMS. That is the point I am making—do you take into consideration the surplus labor in an area and assign the contract to that area, even though it is at a higher cost?

Secretary TALBOTT. Under certain circumstances I would say, "Yes."

Senator WILLIAMS. Do you recommend that?

Secretary TALBOTT. Yes.

Senator WILLIAMS. That completely nullifies your principle of competitive bidding.

Secretary TALBOTT. No; that is a very extraordinary circumstance. In other words, I think that also in competitive bidding you have to be absolutely assured that the bidder can perform.

Senator WILLIAMS. In this instance that I mentioned apparently the Government had no such fears because later, to alleviate criticism, they did assign a contract to the same company in the same project. The only thing they lost was about $6 million or $8 million in searching around.

Secretary TALBOTT. I am really not competent to answer that. I am not conversant with that problem.

If you have any of those thoughts with reference to the Air Force, I would be delighted specifically to go into it.

Senator WILLIAMS. You do not endorse any such principle then in assigning a contract in the Air Force?

Secretary TALBOTT. There are certain circumstances in which I would give it to a higher bidder than the lower bidder. It depends upon the competency and the engineering ability, the facilities, and things of that kind.

Senator WILLIAMS. To help us better to understand it, could you outline a specific circumstance, such as that, so that we can understand it?

Secretary TALBOTT. Sure, I could. Supposing that XYZ company on Long Island, N. Y., went into competition on a fighter. They have 300,000 feet. We think they ought to have 1 million feet. They say, "We can do it in 300,000 feet."

Suppose they have 45 engineers. We know those engineers and do not think they are competent, and ought to have 100 engineers. I would not give the contract to them.

Senator WILLIAMS. I think that maybe I understand that. Alphabets did always confuse me.

Would you reduce it to a specific case in which you have done that?

Secretary TALBOTT. No, sir.

Senator WILLIAMS. You have never done it?

Secretary TALBOTT. I do not know, but I cannot give you a specific case.

Senator WILLIAMS. You do not know of any case in which it has happened?

Secretary TALBOTT. I happen not to know of any. Perhaps Mr. Lewis, my Assistant Secretary in Charge of Materiel, does. I do not think that we do.

Mr. LEWIS. You are dealing with a case where we have had competitive bids and then have chosen?

Senator WILLIAMS. A higher contractor. I am just wondering how that could be applied or worked in with the renegotiation principle. If you have a specific case, I would like to hear it.

Mr. LEWIS. In the Air Force our work is divided into generally two broad categories.

By far the largest in terms of dollars expended is for aircraft systems, airplane engines, and so forth. And all of those are negotiated contracts.

The way we handle the competition is normally in the early design stages. We get design proposals. We evaluate them and then get started with the firm.

Of course, after we have the investment in the design, the reorders have to follow the design. You cannot open up a new source and a new design team for that purpose.

The other category is in the supply field where we buy hardware and building supplies and maintenance supplies and even large pieces of equipment, like electric motors that are standard products made by commercial firms for commercial purposes. In those areas we follow the advertising procedure in every case that we can. In those cases we award to the low bidder.

Senator WILLIAMS. You do follow that?

Mr. LEWIS. I cannot answer your specific question. I do not have at my fingertips any specific case where in the advertised area, or even in the negotiated area, we placed business with a firm at other than the low price.

Senator WILLIAMS. That is the point. Thank you.

The CHAIRMAN. What do you mean by "negotiated"?

Mr. LEWIS. Mr. Chairman, we mean that the producing field in which this product is made does not have in it the elements that permit competitive bidding. In other words, it is a single source affair.

The CHAIRMAN. You said just a moment ago that you cannot recall any instance that you awarded it to the highest bidder in the negotiated area.

Mr. LEWIS. I meant to say the competitive area. I am sorry. I meant to say competitive.

The CHAIRMAN. I would like to say, Mr. Secretary, that I share the apprehension of Senator Williams that we are getting away a little too much from competitive bidding. That is the basis of our free-enterprise system, as you know.

Secretary TALBOTT. I feel that we have gone too far in some instances. Let us take an example of an aircraft company. Suppose Douglas came in, into competitive bidding. They are low. We give it to them.

The first thing you know, you have him all loaded up, and you have no competition at all, because they are loaded. I think that we know who has got the competence to build certain types of planes.

The CHAIRMAN. You do not mean that any one company has a monopoly on competence, do you?

Secretary TALBOTT. Let us take an example. McDonnell Aircraft in St. Louis, an excellent group on single-seaters, on fighters, on two-seaters, but they have no experience on the bombers or transports.

North American is one of our best companies in the country and does nothing except concentrate on fighters.

Take multiengine bombers, you think of Boeing, and then you think of Douglas, and then you think of Lockheed. There are certain of these companies that have developed a proficiency with respect to a certain type plane.

The CHAIRMAN. I can well understand the situation on the new types of planes, new inventions. It is very difficult to get competitive bids. Perhaps it is more specialized in the airplane field than in anything else. But otherwise I think that we ought to let our contracts, so far as we can, in a manner to safeguard the Government properly by competition.

Secretary TALBOTT. I agree with you where you can do it.

The CHAIRMAN. After all, that is the way that we built up this country, by competing with each other.

Secretary TALBOTT. Sir, we have to develop a prototype. A lot of drawings must be made before we know what it is. We do not want to do that. We want the contractors to do that.

The CHAIRMAN. I concede that point. It seems to me that you should be cautious not to use the negotiated contract when you can have a real competition.

Secretary TALBOTT. I am sure that we do.

The CHAIRMAN. If one firm starts building the B–47, or any other type, I would dislike to think no other firm qualified to build it can get a contract for that particular type of plane.

Secretary TALBOTT. Let me tell you that it would cost "X" millions—I do not know how many millions to retool a second source on any of those groups.

When we have second sources then you are in a different position.

The CHAIRMAN. If you give no hope to other companies, they are going to make no effort to equip themselves; it would be useless. And Boeing will get the entire B–47.

Secretary TALBOTT. The B–52.

The CHAIRMAN. It just seems to me that, if you can, you ought to build up competitive conditions.

Secretary TALBOTT. You cannot afford to retool for the B–52.

The CHAIRMAN. That may be true of one plane. I am talking generally. I think we are going a little too much toward disregarding competitive bidding. If you give the business to one company, no other company has any hope of entering that particular field for that particular plane; is that not correct?

Secretary TALBOTT. Yes; for that one plane. Each of our top contractors are built up with the type of thing that they can best produce.

The CHAIRMAN. You have got it, however, without competition between the companies, have you not?

Secretary TALBOTT. We have what?

The CHAIRMAN. You do it without competition between the companies?

Secretary TALBOTT. We do have competition between the companies.

The CHAIRMAN. You do not have competition if you assign one plane to one manufacturer exclusively, do you?

Secretary TALBOTT. I think that we know how they are performing, how their performance goes, and their cost per pound of airframe.

The CHAIRMAN. That is not building up competition. You may know that.

Secretary TALBOTT. I think it is.

The CHAIRMAN. I see the necessity of renegotiation under certain conditions, but after all, that is not the policy on which we are supposed to run business in the United States. I do not mean the Government, but I mean private business.

It is a pretty severe thing to negotiate a contract, and make it subject to changes and renegotiation later if you can protect the interests of the Government by a real competitive bidding.

Secretary TALBOTT. I do not think that you can get it that way. I think it would delay us a year on many of these models if we started to try to develop that plan.

The CHAIRMAN. I am not talking about that. I realize that the new models, perhaps, have to start off on that basis, but somewhere along the line another manufacturer making a model, such as the B–52, should have an opportunity to make a bid somewhere.

Secretary TALBOTT. If he made a bid he could not touch the price, because we have already paid for the tooling at another spot. And you cannot tool it twice.

The CHAIRMAN. We are going to make airplanes for the next 50 or 100 years.

Secretary TALBOTT. We are going to change, too.

The CHAIRMAN. Are we going to give a monopoly to one company forever on certain types?

Secretary TALBOTT. Certainly not. We have not, either.

The CHAIRMAN. You just admitted that you did.

Secrtary TALBOTT. Oh, no. In their types.

I think that North American, sir, should stay in the fighter type. And that is where they have been most proficient. I think it would be entirely stupid for us to say to North American, "Now, turn your drawings on the F–100 to some other company and let them compete with you in bids."

They cannot compete, because one company has already all of its tooling and is in production.

The CHAIRMAN. Are you working toward competitive bidding in the far future or near future—any future at all?

Secretary TALBOTT. Not on our new models as we bring them out.

The CHAIRMAN. What about the standard models?

Secretary TALBOTT. They do not stay standard long enough.

The CHAIRMAN. Some day they will, will they not?

Secretary TALBOTT. No, sir; not in my time, or yours.

The CHAIRMAN. On what other things do you have competitive bidding—is there anything in the Air Force that is standard?

Secretary TALBOTT. A great many purchases are standard.

The CHAIRMAN. Do you have competitive bids on those?

Secretary TALBOTT. Yes.

Mr. LEWIS. Yes.

Secretary TALBOTT. Every place we can, we do have competitive bidding.

The CHAIRMAN. What percentage of your expenditure is on a competitive basis, and what is on a negotiated basis?

Secretary TALBOTT. That would be a blind guess. Practically all of our construction, public works and everything of that kind, is all competitive bidding. All of our supplies are competitive bidding.

It is our new developments and aircraft construction that is not.

I would guess that it was about 50–50.

Mr. LEWIS. I would think that the negotiated ran higher, because the value of those contracts is much higher.

Secretary TALBOTT. It might be 60–40.

The CHAIRMAN. What are your total expenditures?

Mr. LEWIS. Well, the Department of Defense or ours?

The CHAIRMAN. The Air Force.

Mr. LEWIS. I would say around 8 or 9 or 10.

Secretary TALBOTT. About 9 billion.

The CHAIRMAN. Nine billion. You mean the expenditures are 9 billion?

Secretary TALBOTT. Yes.

The CHAIRMAN. How much of that is negotiated and how much otherwise?

Secretary TALBOTT. I would say 8 billion of the 9 was negotiated.

The CHAIRMAN. They say here that it is 20 billion—you said that in your statement. It is 20 billion subject to renegotiation. That is a little over one-half of your total expenditures.

Mr. GOLDEN. Yes.

The CHAIRMAN. I hope, Mr. Secretary, that we will work toward that. I am not opposing anything that is necessary for the protection of the Government in abnormal conditions, but I hope that we will work toward competitive bidding, so far as we are able to do it.

They have done it in the Navy pretty well. You will recall that on a new airplane carrier, the plant at Newport News in my State made a bid of seventeen or eighteen million dollars less than another bidder.

Secretary TALBOTT. We are delighted to do that. I think you will find that the Navy has exactly the same problem that we have on the development of new aircraft.

The CHAIRMAN. I am not speaking especially about that. It seems to me that your mind and mine do not entirely agree as to the necessity of working toward a competitive basis.

Secretary TALBOTT. I disagree, because I think that we do think along the same lines. I am very anxious to do it every place we can.

The CHAIRMAN. Your testimony rather impressed me that you were more in favor of negotiation and thought that the other was hopeless to begin with.

Secretary TALBOTT. We do not enjoy negotiated bids, because everybody feels that we are showing favoritism.

The CHAIRMAN. You have competitive bidding where you think you can?

Secretary TALBOTT. Every place we can.

Senator WILLIAMS. Mr. Talbott, when you renegotiate these contracts—we will assume that company X has negotiated a contract in the beginning—and then when it is renegotiated under this Renegotiation Act, do you take into consideration the loss that this company might be sustaining on another contract in which they made a competitive bid?

Mr. LEWIS. Yes.

Secretary TALBOTT. Yes.

Mr. LEWIS. On a year's basis.

Secretary TALBOTT. A year's profit.

Senator WILLIAMS. Where they have a negotiated contract with the Air Force in which they have a surplus or excess profits, we will say in your opinion, in that negotiation, if they also have a competitive contract with some other agency of the Government in which they are losing money, you do take that into consideration in your renegotiation?

Secretary TALBOTT. That is specified in the bill, as I understand it.

Senator WILLIAMS. Does that give an unfair advantage to the same company which is making the competitive-bid article, in that they can be a little reckless, if they know that in one of your negotiated contracts they have a surplus or excess profit of eight or ten million dollars, we will say, which they know will be taken away from them in the negotiations, or, the renegotiation, that they could use that and underbid some competitive bidder on a product which is being competitively bid, because they can offset it and end up and take all of the contracts? Is that not possible?

Secretary TALBOTT. I cannot quite visualize any contractor wanting to do a thing of that kind.

Senator WILLIAMS. For instance, if he has under this negotiated contract the thought that he knows that he is going to have to return to the Government under the renegotiation $10 million, we will say, excess profits, he can afford very readily to cut off $5 million on another contract which is a competitive bid below the normal bidding, knowing that he has a safety margin of a guaranteed profit on both contracts, in that he can reduce his renegotiation from ten to five. Would that not be possible?

Secretary TALBOTT. I do not know that.

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Mr. ROBERTS. It is theoretically possible.

Senator WILLIAMS. Do you not think somebody has thought of that in industry?

Mr. ROBERTS. I do. I think they have thought about it a long time ago.

Senator WILLIAMS. Do you not think it has been used?

Mr. ROBERTS. It has been used. We are constantly trying to detect those things. We are on the alert to them all of the time.

Senator WILLIAMS. Does that work to the disadvantage of the smaller contracts put out on competitive bids, in that the man who is in the field of getting these larger renegotiable contracts is almost practically eliminated from the competitive-bidding projects?

Secretary TALBOTT. No, because they come in in different fields, sir.

Senator WILLIAMS. That does not make any difference in the renegotiation, as I understand it?

Secretary TALBOTT. But you said that they are too small to get into it, to negotiate contracts.

Senator WILLIAMS. We will assume that they have renegotiable contracts with the Air Force and maybe a bid that comes up with the Navy or a completely nonrelated bid, but through a subsidiary company they can enter into that bid below any of the competing forces, because they have got a safety margin of 10 million or 20 million that they will have to pay back to the Government anyway.

Secretary TALBOTT. I do not know of that.

Mr. ROBERTS. We keep a constant contact with the military departments. Whenever we detect anything like that, we bring it to their attention immediately.

I personally have not been able to detect such a case. Theoretically, it is possible.

Senator WILLIAMS. Is there anything in the law that you could do about it if you find a case?

Mr. ROBERTS. The Renegotiation Act requires us to weigh all of the facts and factors going into that operation in each year. That would be a very material fact, I would think.

Senator WILLIAMS. Thank you. I was wondering if it could be used as a material factor, or would you have to give credit to the loss being sustained in a nonrelated contract?

Mr. ROBERTS. We would have to give the right of offset, as provided by the law, but the judgment factors enter into the situation as to the amount of profits that they could keep as reasonable under the circumstances.

Senator WILLIAMS. To the extent that we have these large amounts of renegotiable contracts floating around, you are continuing to penalize the competitive features of our contract in that it is almost impossible for a competitive bidder, I mean, a man bidding on just a specific project under competitive bidding to compete with somebody who has a renegotiable contract in which he has these excess profits accumulated.

Mr. ROBERTS. Again, I say that it is theoretically possible, but American industry is not that large.

These companies do business in related fields. That would apply particularly if some company looked at the other fellow's pasture and

said, "That is very green; let us get into it," by the device that you have outlined.

Senator WILLIAMS. Do you not think that under our competitive system, under which this country has grown, it has grown by men looking in the other man's pasture from a competitive standpoint and seeing what they can do?

Mr. ROBERTS. Indeed, I do.

Senator WILLIAMS. And do you not think they have thought of that long ago?

Mr. ROBERTS. I am sure that they have a long time ago, as I said before.

Senator WILLIAMS. You agree with me that it does handicap strictly competitive bids of the man who is working on nothing but a competitive-bid basis?

Mr. ROBERTS. It could.

Secretary TALBOTT. It could, but I do not think it does.

Mr. GOLDEN. If you assume and accept that the negotiated contract is going to result in a large profit, what you say might happen, can happen, whether you have renegotiation or not. In other words, if he knows he is going to make this huge profit and if he does not have to give it back, he may be willing to underbid.

I might say this——

Senator WILLIAMS. It would and would not, perhaps, had it not been on the renegotiable basis, but on a competitive bid. Maybe there would not have been such a large profit to start with, but if there had been, it would have been the human element that he could pay his tax and keep half of it—might not want to pass it out, but knowing that 100 percent of this renegotiable profit is going back to the Government, he can feel very free to use any portion of it to reduce his bid on a competitive bid below what company Y is bidding, knowing that the loss does not mean anything to him. If he loses $5 million here, he returns $5 million less to the Government and takes a profit on both contracts.

The CHAIRMAN. What profit do you estimate on the investment when you negotiate a contract—how much profit is allowed?

Secretary TALBOTT. Over the entire business last year there was a profit in the aircraft industry of 3.8 percent of the gross business. On that basis, it was 27 percent profit on their invested capital.

It is on that invested capital that your renegotiations are based almost more than anything else. Is that not correct?

The CHAIRMAN. In other words, you allow a company to make 27 percent on the invested capital?

Secretary TALBOTT. That is the result of their operations before renegotiation.

The CHAIRMAN. How do you apportion the work, then? They have other work, of course, with other purchasers, I imagine, most of these companies. Is it very difficult to apportion that?

Secretary TALBOTT. We know exactly what each specific company has done in the way of return on their invested capital. That is taken into consideration by your Reorganization Board in their renegotiations.

The CHAIRMAN. Is that not a pretty substantial profit, 27 percent?

Secretary TALBOTT. Yes, sir; I think it is too high.

The CHAIRMAN. Is not the depreciated value of the property—or how are those assets arrived at?

Secretary TALBOTT. It is the same value that they put in all of these various things. We have the scale of the various companies. Automobiles are down in the lower twenties, 23 percent or somewhere there. You have various companies.

The CHAIRMAN. What is it based on?

Secretary TALBOTT. On the balance sheet.

The CHAIRMAN. If a plant builds a building, then is that based on the depreciated value of the building?

Secretary TALBOTT. Certainly. That is the way it is in the balance sheet. If he has written it down to $1 for the plant, it is based on $1.

The CHAIRMAN. It is my personal opinion that the Government if possible, to have competitive bidding, that it would be much more advantageous to the Government than by these negotiated contracts.

Secretary TALBOTT. I think that that would slow down the aircraft development by 2 or 3 years, if we had to have competitive bidding.

The CHAIRMAN. After all, we ought to do it in a businesslike way, if we can.

What disturbs me constantly on these negotiated contracts, when in some instances. maybe not in these particular things you are talking about—but in some instances it could be left to competitive bids. We have many industries in this country that want to bid on these things. When they bid, that is the way you get your low price. But you guarantee them 27 percent.

Secretary TALBOTT. I agree, but there is no other way to develop this.

The CHAIRMAN. They cannot lose on it. They have 27 percent profit. If they bid on a contract, sometimes they lose. They run the risk of losing. That is the free private enterprise system; 27 percent seems to me to be a pretty liberal profit on the invested capital.

Secretary TALBOTT. It is too high. That is the need for renegotiation. It would not be that after renegotiation.

The CHAIRMAN. I understood you to say that was the basis that you made your renegotiation on, the 27-percent profit.

Secretary TALBOTT. No.

Mr. ROBERTS. No. The Secretary, Mr. Chairman, pointed out that that was the record of the aircraft industry.

Secretary TALBOTT. Last year.

The CHAIRMAN. After you renegotiate a company, what profit do you allow them on the invested capital?

Mr. ROBERTS. Renegotiation operates on each company each year on all of the facts surrounding the performance. The return on its investment is merely one of the factors. The company may have made a great contribution. They may have been splendid operators, extremely efficient. In renegotiation all of those things must be considered and a rounded judgment arrived at.

Senator WILLIAMS. After you have considered all of those things and arrived at a sound judgment, what is the figure? [Laughter.]

The CHAIRMAN. We have got to get down to some figure somewhere along the line.

Secretary TALBOTT. It would be different with every company.

The CHAIRMAN. What is the average profit that the companies make for a Government contract?

Senator WILLIAMS. Let us take the companies and go down the line and let us see.

The CHAIRMAN. Let us take the average.

Mr. ROBERTS. We have not progressed in renegotiation with the aircraft companies through this period of extremely high production to the point where we could say that we have an average, either on sales or on invested capital.

The CHAIRMAN. Have you any approximate idea?

Mr. ROBERTS. Yes, my own personal views are that where a company engages in this difficult task of building highly technical weapons, and if they have done a good job, have made a contribution to the art, that they can have as high as 50 percent return on their investment before taxes. That is my personal view. The Board, of course, is composed of five people, and any judgment is a group judgment.

The CHAIRMAN. Then you have different bases?

Mr. ROBERTS. Yes, sir; very different, Mr. Chairman.

The CHAIRMAN. In this particular instance, assuming they paid 52 percent taxes, that would be around 25 percent?

Mr. ROBERTS. That is right. I tried carefully, Mr. Chairman, to condition my answer on somebody who had done an outstanding job. I am talking about the upper limit of the range.

The CHAIRMAN. What is the lower range? What range do you have between these different companies?

Mr. ROBERTS. I would think 20 percent before taxes, in some instances, inadequate.

Senator WILLIAMS. In arriving at that figure, do you take into consideration their profits or loss in private contracts? For instance, the company is also producing airplanes for commercial airlines. Assuming that they have not been making very much in that line, maybe they lost a little money, we will say, in the private operation; is that taken into consideration as a factor in determining their earning capacity, or do you just consider only their earnings on war contracts, Government contracts?

Mr. ROBERTS. The law requires us to deal only with the Government business. We do not wish to interfere with the free enterprise system.

If the man engages in the production of commercial airplanes, he is entitled to keep whatever he can make. If it turns out, as you say, to be a loss, we do not feel that is our business.

Secretary TALBOTT. We have certain companies——

The CHAIRMAN. One minute. You cannot have a loss on a Government contract.

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. You give them in some instances 25 percent and in other instances 10 percent. How can they have a loss?

Mr. ROBERTS. They have to make the profit before the Renegotiation Board looks at it. Some companies do not make profits.

The CHAIRMAN. You have a price that is fixed, you have a beginning price, is that it?

Secretary TALBOTT. Yes.

Mr. ROBERTS. Yes.

The CHAIRMAN. You always hold them to that beginning price?

Mr. ROBERTS. No, indeed.

The CHAIRMAN. How can they have a loss then?

Mr. ROBERTS. Some companies negotiating with the Government may have become ambitious and said that, "We can build this for a certain amount of money."

As they got into the production of it, they found that they could not carry out their operations in a smooth, effective way. They had stops and starts, and the cost exceeded the price of the contract. Therefore, they have a loss.

Senator WILLIAMS. Do you not renegotiate that upward to take care of that?

Mr. ROBERTS. We do not. The law does not provide for that.

Senator WILLIAMS. And you never renegotiate a contract upward?

Mr. ROBERTS. No.

The CHAIRMAN. How many, to your knowledge, have lost money on airplane contracts?

Mr. ROBERTS. It would be very difficult for me to say.

The CHAIRMAN. Has anyone, has any airplane contractor ever lost money?

Mr. ROBERTS. Now we are speaking of the airplane companies. I know of no airplane company that has made an overall loss. Some on individual contracts have a loss, Mr. Chairman.

Senator WILLIAMS. Do you ever cancel a contract in which there is a substantial loss, and then renegotiate another contract?

Mr. ROBERTS. That would be a negotiation with the military department.

Senator WILLIAMS. Does the military department ever do that—to save a company taking a loss, we will assume through world conditions prices have advanced—it would not be profitable for the company to carry out the contract—do you ever effect the cancellation and make another contract?

Mr. LEWIS. I do not know of any case like that. We do write contracts that have redetermination provisions in them where we agree at a certain date in the contract that we will together examine costs and reset the cost base, but that is provided for when the contract is originally written.

If we write a contract with somebody, we expect them to perform the contract.

Senator WILLIAMS. You called attention to one last week which was in military procurement where copper was 36 cents a pound, and a canceled 31-cent contract, and then turned it around and purchased it at 36 cents again. The cancellation, according to Mr. Flemming, perhaps, was a mistake. Have you made any other mistakes?

Mr. GOLDEN. This was not a military procurement.

Secretary TALBOTT. That was not ours.

Senator WILLIAMS. That was stockpiling.

Mr. GOLDEN. And not our responsibility.

Senator WILLIAMS. It has not happened in your agency then?

Mr. GOLDEN. No.

Mr. LEWIS. No.

Secretary TALBOTT. No.

Mr. LEWIS. We will be the last ones to say that mistakes do not get into the Air Force. I do not know of any, however.

The CHAIRMAN. As a matter of fact, everybody knows these negotiated contracts will be subject to renegotiation. Those who let the contracts, certainly do not use the same diligence in trying to get a

low price at the beginning as they would if it was on a competitive basis, because the Government may be protected by the renegotiation. Is that not right?

Mr. LEWIS. I do not agree with that, that this is the effect on the people doing the contracting.

The CHAIRMAN. Why not?

Mr. LEWIS. I think they are always trying to write good contracts. I think they would consider it a reflection on their capacity as contracting officers.

The CHAIRMAN. Unless you can get competitive bids, how do you know whether it is a good contract?

Mr. LEWIS. We know a great deal about what the things ought to cost. We hold companies to a good standard of cost.

Senator WILLIAMS. What percentage of the contracts would be on cost-plus?

Mr. LEWIS. I would rather dig that figure out and give it to you.

Generally speaking, the more unknowns we have to deal with in a contract, for example, in the development stages, we lean toward the cost-plus-a-fixed-fee type of contract. Where we can, we try to get fixed-price contracts. Where there is a middle ground, where we get fixed-price contracts that are redeterminable.

Senator WILLIAMS. The bulk of your contracts would be cost-plus?

Mr. LEWIS. No; I would say the bulk of them would be fixed-price redeterminable.

Secretary TALBOTT. Let me give you an example, if I may. We at the present time want a long-range, high-speed, supersonic interceptor. Nobody makes it. There are no drawings for it.

We can give you the specifications, the speed, and the range, the armament that we want it to carry, and so forth.

Nobody can give you a contract on building that. We have to have a prototype made. So we go to 3 or 4 companies and we say to them, we want you to answer a certain number of questions. How many engineers? How much floor space? What are your facilities to do this job?

We pick out one. We may pick on two to build a prototype. And then we go ahead and contract for it. But the minute you build a prototype, you have begun your tooling. You are all equipped to do it.

I would much rather have competitive bidding. We all would, but I do not know how to get it on the big bulk of our aircraft.

The tooling on the B–52 is tremendous. To start a new source would mean a minimum of $150 million and probably $250 million. How can any competitors come in to bid on an extra 50 or 100 B–52's? The tooling cost and development cost of this present-day supersonic aircraft is perfectly astounding. We do not like it.

Every place where we think we can get competitive bidding we are getting it. Is that not correct?

Mr. GOLDEN. Correct.

Mr. LEWIS. It is a procurement regulation in the Air Force and in the Defense Department that the first test that a potential contract has to meet is whether it can be put out on a competitive advertised bid or not. That is a requirement.

Senator FLANDERS. Since we have heard these figures that seem rather large about the company which does a good job in development, perhaps being entitled to 100 percent return on its capital investment before taxes, that sounds pretty good.

Secretary TALBOTT. We did not say 100 percent.
Mr. LEWIS. No one said that.
Mr. ROBERTS. Fifty percent, sir.
Senator FLANDERS. I got the idea 100 percent in my mind somewhere. But let us compromise on 50 percent before taxes. That means something around 24 percent or thereabouts after.
Can you give a general idea as to what that might amount to on profit on the sales?
Secretary TALBOTT. I can give you an example of that. Supposing you have a highly skilled engineering group to develop some electronic equipment. I can conceive of their having a return of 300 or 400 percent on their investment.
Senator FLANDERS. The investment is not great for that type of goods, for producing electronic equipment.
Secretary TALBOTT. The development and engineering may constitute a very small investment, but they have a lot of men on that job and high-class talent. The physicist, the mathematicians that are required these days to develop that.
So their capital investment may be very small, yet if you did not give them a proper return they would not be making anything.
Senator FLANDERS. That was the point that I was really inquiring about, as to whether in the case of that sort the investment, that is, the return on the investment might look very high and the return on sales very moderate.
Secretary TALBOTT. Those things can vary both ways. You are right.
Senator FLANDERS. Depending on the situation. But one would expect, for instance, on electronic equipment the capital invested need not be large, but the salaries paid, the staff engaged, would be very, very expensive, so that the return on the investment in that case is not a fair measure of the return of the company.
Secretary TALBOTT. We have all kinds of criteria that enters into it. Undoubtedly the 27 percent that I gave the chairman a few minutes ago is the average return. In many of those instances it is a very high return on capital investment and in those instances it may be perfectly proper.
Senator FLANDERS. Can you give a similar estimate as to the profit on sales in that same area?
Secretary TALBOTT. 3.8.
Senator FLANDERS. 3.8 on the sales?
Secretary TALBOTT. Yes.
Senator FLANDERS. That gives an entirely different aspect to the thing.
Secretary TALBOTT. This is an average figure; it may be too high in some cases.
Senator FLANDERS. At least, however, it is worth looking at both sides of that.
Secretary TALBOTT. Sure.
Senator FLANDERS. Both capital and the return on sales.
Secretary TALBOTT. Yes.
Senator FLANDERS. Also, looking at the fundamental conditions you have just mentioned which have to be taken into account which would give normally a high return on capital to an electronics

outfit and a lower return on capital where the capital investment was primary, rather than the organization required.

I would like to make this inquiry. Where you can place orders in normal competitive bid basis, do you see any need for renegotiation?

Secretary TALBOTT. Probably not, although I am advised there are complications involved, both for industry and Government, in attempting to exempt advertised contracts.

Senator FLANDERS. Are there any cases in your experience in which such business has been placed where renegotiation has come into the picture?

Secretary TALBOTT. I do not know of that.

Senator FLANDERS. What does the law say?

Mr. ROBERTS. The law says that all contracts and subcontracts thereunder that are specified—that is the military contracts—shall be renegotiated. It does not say that "advertised bid contracts" are exempt, which I believe is your question.

Senator FLANDERS. That is my question.

Mr. ROBERTS. Yes, sir.

Senator FLANDERS. It would seem to me that is worth considering as to whether advertised bids under normal conditions, whether they should or should not be exempt.

Mr. ROBERTS. May I make an observation there?

This committee when it extended the Renegotiation Act in 1954 passed what was called the standard commercial article exemption.

The operation of that exemption goes part way in the direction that you are now looking. It goes a long way, I would say.

Senator FLANDERS. The question I am raising before you, and also before the committee, is to whether we might not go all the way on normal competitive bidding.

Secretary TALBOTT. It would be fairly difficult to specify what "normal competitive bidding" is.

This morning we had an instance where it is competitive bidding, but not quite. I would not call it normal. I think that we get into an area that is pretty difficult.

Senator FLANDERS. I am raising the question anyway. I might be helped if I could get some idea as to where the no-man's land is between "normal" and "abnormal" competitive bidding.

Mr. LEWIS. I think this, do you mean by "competitive bidding" advertised?

Senator FLANDERS. Advertised bidding.

Mr. LEWIS. That is one thing. And competitive bidding where you may have competition but negotiation. You did not intend to include that.

Secretary TALBOTT. There are very many instances.

Mr. LEWIS. That is probably not a bad thing, but the problem is, I believe, being satisfactorily taken care of in a different manner through present exemptions in the law.

Secetary TALBOTT. In many instances we invite certain companies to bid whom we know have the competence, or we think have the competence. And other companies will come in and bid.

We say, "No, in our judgment you have not the competence."

I would be perfectly willing to consider an amendment saying that "normal competitive bidding" is not subject to renegotiation.

Mr. LEWIS. Where it is advertised.

Secretary TALBOTT. Yes, where it is advertised.

Senator FLANDERS. That is all. Thank you.

Senator FREAR. Mr. Secretary, would you recommend for a "standard commercial article" the supplier to a prime negotiated contractor to be exempt from renegotiation?

Secetary TALBOTT. A negotiated contract?

Senator FREAR. A person holding a negotiated contract has as one of its suppliers the manufacturer of, I think as you call them, a standard commercial article. Would you recommend that that part of the contract not be subject to renegotiation?

Secretary TALBOTT. I see no objection to it under the present law.

Senator FREAR. That is, if the person who held the negotiated contract procured the standard commercial article through advertised bidding himself as the prime contractor or as the holder of the contract?

Mr. LEWIS. I think the case that the Senator refers to is the case of the supplier of a standard commercial product.

The act provides that, unless the Renegotiation Board sees some reason to include those in the renegotiation operation they are excluded if the established procedures are followed.

I think, to answer your question, Senator Frear, in broad terms, this would be our feeling: As long as we were operating under normal conditions, where competitive conditions existed in that industry, we would not feel that that was any of our business, but we have all been through two wars recently where we saw everything mobilized for the war effort, and we saw these commercial people become, in fact, almost completely military suppliers.

We would think in those circumstances we ought to have the right to look at those contracts.

Senator FREAR. I think that answers the question. That is the only question I have.

Senator MALONE. Mr. Secretary, I think from the questions asked you by the committee they all realize you have a difficult job.

What is your trouble with this equipment now? Is your trouble that you do not know enough about it yourself to make complete specifications to furnish to the contractor?

Secretary TALBOTT. We do not want to carry the engineering talent, the draftsmen, the facilities to do our designing. That is what it would amount to. We would have to do the writeup of the specifications, and if we did that, then we would probably want to develop the products ourselves in our own laboratories, which throws an entirely different concept on the procurement of new products.

Senator MALONE. There has been in certain circles considerable criticism of your Department on the proposition that you do try to tell an executive what you want in the airplane, instead of telling them the performance you want.

Secretary TALBOTT. I agree with you. I think the criticism was proper.

Senator MALONE. Then what you are trying to do is to get away from the detailed specifications and design and simply give the airplane maker, or the contractor, the overall performance, the detailed performance that you expect?

Secretary TALBOTT. That is right.

Senator MALONE. That throws a little different perspective on this thing, Mr. Chairman.

If you are bidding on performance, then it depends a good deal on the company as to their research and their development of an airplane to perform as necessity requires without regard to the amount of material or the kind of material or the kind of engine.

How far do you go in your specifications?

Secretary TALBOTT. We would like to give 2 or 3 of our big manufacturers a specification that we want on a plane. We want so much load, so much range.

Senator MALONE. Are you talking about specifications or performance?

Secrtary TALBOTT. That is performance. I am talking about range, speed, altitude—all of the various things that have come in, and to have three competitors come in and give us what they think they can do and submit a design.

Senator MALONE. Let us separate the specifications from the performance.

Now, specifications in the contractor's mind, or in an engineering mind means detailed drawings of some kind.

What you do then is to tell them the performance you want—let them design the plane subject then to your approval, or do you just ask for the finished product?

Secretary TALBOTT. Yes, either way. How are you going to make a contract with those fellows on that? They will not give you a lump-sum contract—nobody will, except on a basis that is so protective that they will put in a factor of safety of 50 percent, or something of that kind.

Senator MALONE. I want to make this clear for the record, if this is true, that you do not try to design a plane. What you try to do—what you submit to these people is performance that you want in detail.

Secretary TALBOTT. That is our program.

Mr. LEWIS. That is right.

Secretary TALBOTT. That is the program.

Mr. LEWIS. Our nomenclature is a little loose on this. We refer to what I think you have in mind as a performance specification. In other words, it is what the machine or the piece of equipment has to do in performing its military objective. That is different from the detailed design which says that you shall use such-and-such material.

Senator MALONE. Normally, the blueprint referred to as specifications is out for the moment—out of this discussion.

What you would say to Lockheed and to Douglas, to the others that you think might be qualified bidders—and whether you think so or not—if they prove to be qualified bidders, you would say, "We want a 700-mile speed at a certain altitude. We want a certain maneuverability and a certain range for fuel to carry a certain load and displacement."

Is that getting close to it?

Mr. LEWIS. That is generally correct.

Secretary TALBOTT. That is all right.

Senator MALONE. That is about all you tell them, is it?

Secretary TALBOTT. That would be enough, yes. Then let them come in with their drawings, their sketch, and tell us what they can do on that performance.

Senator MALONE. You keep abreast of all of this, so you know already pretty much who is likely to be able to come in with a performance satisfactory?

Secretary TALBOTT. That is right.

Mr. LEWIS. In that circumstance, normally we would invite the people who had competence in that field. In one area it might be three companies. In another field it might be 2 or 4 companies. Wherever we feel there is the general competence to do that kind of a job.

Then we get from them the detailed proposal showing how they would go about doing it.

Senator MALONE. You have several general types of planes. I am in a field in which I am not entirely familiar. So you can help me with the record. You have bombers, long-range, heavy bombers?

Secretary TALBOTT. We have three types of bombers—light, medium, and heavy.

Senator MALONE. Then you have your fighters?

Secretary TALBOTT. Right.

Senator MALONE. Do you have different types?

Secretary TALBOTT. Yes, we have interceptors.

Senator MALONE. I will come to the interceptor. And the fighter. and what else?

Secretary TALBOTT. The fighter-bomber.

Senator MALONE. A combination?

Secretary TALBOTT. And the all-weather fighter.

Senator MALONE. When you determine what the types are—of course, the plane maker already knows—then you try to go into the field and invite the companies to bid, at least those that you know are experienced in this field.

I come back again to the fact that you do specify performance in writing what I call "specifications" or blueprints for this.

Secretary TALBOTT. That is right.

Senator MALONE. If that is the case, Mr. Chairman, it would be a little bit difficult to get a real competitive bid unless you asked for the bids. One might furnish the performance, but you might like the type that one furnished better than another.

Secretary TALBOTT. Let me tell you, Senator Malone, when these three men come in, they do not give us any price—they do not guarantee a price at all. We could not get any of those men to give us a set price that would be acceptable to us for a prototype or for 6 or 10. None of them would do that.

Senator MALONE. Because they are all reaching into the future?

Secretary TALBOTT. They are all reaching into the future.

One of our problems is the time that it takes to develop this thing from the drawing board through to the assembly line. On a bomber it takes us from 8 to 10 years. On a fighter—we have not had any of these fighters, or interceptors, or single engine or two-place planes—very quickly—5 years is as little as we have ever had them.

Senator MALONE. What is the time element from the time you begin to ask for a certain performance until it would come off the drawing

board? The design can go on the drafting board, say. What is the time element until the design can go on the drafting board?

Secretary TALBOTT. The design can go on the drafting board—start in as soon as we tell them to go ahead.

Senator MALONE. By the time it comes off the drafting board, then the time you give them the specifications, they start the design and are ready to start construction, what is that time?

Secretary TALBOT. They will start construction of a prototype within a few months, perhaps, and bring the construction along as they have finished their detailed drawings. In other words, they may know very quickly what size the fuselage is to be—what the wing span is to be—and what engine they will use, a few things of that kind.

Senator MALONE. One of the reasons then that it would be impossible to give you a definite price because they themselves do not know exactly at the time you let the contract what it will cost them until the design is complete, the specifications are written?

Secreary TALBOTT. I do not believe they can get it within 50 percent. I would rather not give the figures in open session.

Senator MALONE. I do not ask for them.

Secretary TALBOTT. I say that I would rather not. I would like to have you know what these development figures are, and then you could see a little bit better what our problems are.

Senator MALONE. Let me ask you this question then. Suppose they make 50 percent before taxes. Ordinarily you know about what these airplane makers are doing, about the brackets they are in. If you make a 50 percent profit before taxes, and with the prices that these fellows are generally in on this type of work—what does that mean that they would be keeping, without any renegotiation?

Secretary TALBOTT. In actual practice, these manufacturers, where they realize that they have over-priced, have made rebates to us voluntarily.

Senator MALONE. That is on account of knowing that they are coming in for renegotiation, is it not?

Secretary TALBOTT. You would not get that if you did not have the renegotiation.

Senator MALONE. I was coming to that. You show that $331 million has been recovered through renegotiation and $133 million voluntarily.

The way you let the specifications and the job in itself encourages the higher figure to start with?

Secretary TALBOTT. No, I do not think so.

Senator MALONE. Even if it is necessary, it would encourage a high simply because they themselves would not know.

Secretary TALBOTT. So long as they know their costs are covered there is no great worry on their part.

Senator MALONE. That would be the next question. Is there very much difference in the way you are letting these contracts under cost-plus contracts?

Secretary TALBOTT. Very little from that standpoint.

Senator MALONE. Of course, none of us like a cost-plus contract. For many, many years the argument, has been bandied back and forth, but no cost-plus contract is let on anything nowadays, at least by government municipalities or States, what you already know you want and can write detailed specifications for.

Secretary TALBOTT. We want to buy on advertised competitive bidding everything that we can write specifications for.

Senator FLANDERS. Will you yield?

Senator MALONE. Yes.

Senator FLANDERS. It seems to me that we should always specify when we say cost-plus, whether we mean our cost-plus be percentage of cost or whether we mean a cost-plus affixed fee. There is a great difference between those.

Senator MALONE. When you do not say fixed fee you mean cost-plus.

Secretary TALBOTT. Everything we have is a fixed fee, not percentage of cost.

Senator MALONE. I have not talked about fixed fee. I meant the other. There is no difference, as a matter of fact, when you analyze this thing and under your renegotiation, because the renegotiator will have to know all of these figures.

You are in a business, as I understand, from all of this questioning here, and I have tried to keep abreast of it as much as I could, that what you are really looking for is a better design all the time. Maybe you will let a bomber now and get a certain type of bomber. The next one you let may be less expensive, a later bomber, less materials, because materials are developing all of the time.

So when you have this type of bidding you are likely to get a different design every time you let a contract for the same performance, if it is 2 or 3 years apart, are you not?

Secretary TALBOTT. We would not be getting the same performance 2 or 3 years apart.

Senator MALONE. I just say that so that it would be comparable for the same performance. You are likely to get a different bid?

Secretary TALBOTT. Yes.

Senator MALONE. What you are hoping for is a better performance all of the time, and you can only get that by turning the contractor loose, so that he knows he will be rewarded by the bid, if we can come up with something, a lighter plane, less material, greater speed, greater range, is that true?

Secretary TALBOTT. Yes.

Senator MALONE. In this renegotiation—it interests me greatly because I used to be in the contracting business in a small way—and a contractor knows his business he does not stay in it—do you have a crew of personnel who know how to check the necessary labor and the useless labor that might be carried on the payroll just to make it look good and make it cost more?

Mr. ROBERTS. We have certified public accountants in our regional boards. We base our findings on audited statements where they are available.

Senator MALONE. Do you have anybody that visits them that understands the business?

Mr. ROBERTS. We have people that understand the business.

Senator MALONE. That can go down into the factory, into the shops, to see whether there are men that are not necessary?

Secretary TALBOTT. During the period of construction we have Air Force men in all of these factories. We are constantly watching their costs.

Senator MALONE. Do you have Air Force men who know construction, who know machinists and what they are doing? During World

War II, there is no question in my mind—I was with the Senate Military Affairs Committee—that they carried hundreds and even thousands of men on the payroll that were not necessary.

Senator FLANDERS. May I ask you to yield again?

Senator MALONE. Yes.

Senator FLANDERS. This comes again back to the question of cost plus as against cost plus a fixed fee. When you are working on a cost plus fixed fee there is not the slightest reason for padding the costs.

Senator MALONE. Let me interrupt there to say that this has nothing to do with my questioning whatsoever. What I was asking, if they have anyone in the negotiator's office who understands what is necessary in a plant and whether hundreds of men are being carried that are unnecessary—and whether they go into this cost. The accountant does not know anything about that. All he knows is that which he gets a profit on.

Mr. ROBERTS. I would like to develop that a little bit, if I may.

In the large airplane makers and large component suppliers, the military services have stationed their production people, production experts, cost experts, and the Renegotiation Board is supplied in each case with a written report on the performance of that contractor. That report covers, among other thing, where they have developed the information and facts about wasteful practices.

Senator MALONE. Personnel or anything?

Mr. ROBERTS. Yes, sir.

Senator MALONE. I knew of cases during World War II where contractors—where certain firms with their contract labor—they had to send into certain fields abroad, paid as high as $15, $20 an hour. It looks impossible. It was there. Do you know about that?

Mr. ROBERTS. No, sir; I never ran into that.

Senator MALONE. They contracted them to go to Asia or some other place. Millions of dollars were made on that kind of a deal. Everybody was so busy they did not have time to do anything about it.

Senator FLANDERS. Will you excuse me again? Millions of dollars would not have been made if that had been a cost-plus-fixed-fee.

Senator MALONE. I disagree with you again because of the fact that if you recognize the cost of the labor, they got a percentage or they get a profit on the additional labor and on the additional cost.

Senator FLANDERS. Not on a cost-plus-fixed-fee contract.

Senator MALONE. I do not see how you argue this. I do not want to take the time of the committees simply because it is a cost if you pay it. The only way you can stop is to stop it at the source. That is what I am trying to get at.

Secretary TALBOTT. That is our responsibility. And we do it.

Senator MALONE. I wanted to find out if you had the personnel to do it. You think you have?

Secretary TALBOTT. Yes, sir.

Senator MALONE. I do not want to prolong this questioning. If you make your 50 percent, and you had no renegotiation board, with the brackets that these airplane makers are customarily in, which is fairly high, I think, what would that 50-percent profit result in after taxes?

Mr. ROBERTS. In the years between 1951 and——

Senator MALONE. Ordinarily, I know it is a general question.

Mr. ROBERTS. Where the excess-profits tax was in effect you could have tax rates running up as high as the 80 percent on the top portion of your earnings.

Senator MALONE. It would go higher than that; 90 percent.

Mr. ROBERTS. Very high, anyway. Since the expiration of the excess-profits tax, the overall effective rate, I believe, is 52 percent. Therefore, they would make roughly one-half of the earnings before taxes.

Senator MALONE. If it was 50 percent you would get about 23?

Mr. ROBERTS. Yes.

Senator MALONE. If it was 40 percent you would get less than one-half of it.

Mr. ROBERTS. Yes.

Senator MALONE. That is all.

Senator CARLSON. All I wish to say is that I rather share the views of the chairman of this committee. I think great progress has been made in entering into renegotiated contracts over the years through experience.

I sincerely hope that every effort will be made to buy as much of this material on competitive bids as possible.

It was my privilege to be a member of the Ways and Means Committee of the House several years ago. We had complaints from all over the Nation from contractors about the renegotiation of contracts. We had some rather extended hearings. Some of them demonstrated that it was not only unpleasant but poorly handled. Experience has demonstrated that you have learned a lot and you are doing a good job.

When it comes to buying new types of aircraft, I would just like to say this: I was at the factory when they rolled the first B–29 off the line, out in Kansas. I saw the B–47 tooled up. I see them now tooling up the B–52.

So, frankly, I do not see how you could do that on a competitive-bid basis. And I would not ask you to.

Again, I go back to the chairman's views, and I hope that we will do as much competitive bidding as possible. That is all, Mr. Chairman.

Senator BENNETT. I have no questions relating directly, but this discussion has turned a great deal this morning on the question of negotiated versus competitive bidding. We understand now, I think, the situation in the aircraft industry.

I just have this curiosity. Has there been any new supplier come into the aircraft industry? Has anybody been able to develop the kind of competence you talk about under this system and become acceptable for negotiated bids, or does this system limit us to the suppliers who were effectively operating at the beginning of World War II?

Secretary TALBOTT. I think that the Air Force and our strengtih can be no stronger than our industries. We have got to have our Air Force backed up by a strong industry, full of competence and properly financed.

We have had difficulty and we will have more difficulty when we reach the 137-wing goal to maintain the organizations that we have got.

I think there have been a few of the smaller companies developed, but there is nobody in the class with these top contractors that we have spoken of. And we can name 10 or 15 of our top airframe manufacturers. We have at the present time four top engine producers. And they are backed up with second sources in the automotive industry.

We do not need in peacetime as much facility as we have.

So I do not like to see new, big sources of supply developed.

When it comes down to your smaller sections, such as your subcontractors, your electronic fellows, I would love to see more of those men brought into the thing, because we develop more engineers and more competence.

Senator BENNETT. So far as the manufacturers of airframes and the basic aircraft itself are concerned, we have pretty well limited it to the same group with which we began at the beginning of World War II?

Secretary TALBOTT. That is correct. And we have even cut down on the number in engine manufacturing.

Senator BENNETT. That may be necessary under the circumstances, but I was going to say unwholesome—that may not be a fair word, but it is one of the situations that is not too healthy with respect to the future because in spite of the fact that you can hire hundreds of engineers, in the end companies like men tend to become rigid in their thinking and their approaches. I think it is the pattern of basic American industries that is often the newcomer, with the new idea, who starts out in the face of statements by all of organized industry that the program he proposes is impossible and unreasonable and never should be considered, that makes the fundamental changes and advances.

That is one of the things that bothers me about this situation that you tend to become rigid in relation to the number and the relationship with suppliers.

Secretary TALBOTT. I am inclined to agree with you, but some of these fellows go up and some go down. When you go over the present industry that we have, we have terrific competence and we have more diversification than there is in any other country in the world—much more.

Senator BENNETT. Has there been much of a period of mergers and consolidations?

Secretary TALBOTT. No, sir. I have discouraged that since I have been in office.

Senator BENNETT. These people then are essentially the same separate groups with which we began?

Secretary TALBOTT. Yes, sir.

Senator BENNETT. I have no other questions, Mr. Chairman.

Senator MARTIN. I want to take just a moment to say this: I think this discussion this morning has been one of the most worthwhile discussions I have listened to in a long time.

The thing, Mr. Chairman, that I have been worried about is that there is not any question it was the free competitive-enterprise economy of America that won World War II. The thing that is worrying me is whether or not we are not destroying competition.

The thing that really causes competition in America is the fact that a young man in the factory may invent something and he gets the benefit of that invention. Probably he spent long hours, working at nights when other men in the factory were enjoying rest.

I see your position where we cannot do all of this on the free competitive-enterprise plan. You have got to have renegotiation and factors of that kind, but the thing that worries me is this, there has been great consolidation of industry in America which has put the little fellow clear out of business.

New ideas in America come from the little fellow.

The thing that worries me is whether or not we are going to be in a position, say that world war III comes 20 years from now—whether or not then we are going to be in the same position we were in in World War II.

Secretary TALBOTT. I like your philosophy. And it is my philosophy, so I like it.

We have placed additional business with new companies who were not really given much aircraft work. Pretty nearly all accessory development. We are doing that and doing it constantly, trying to develop new sources.

When a new problem comes up that is a difficult problem in electronics, you think of the American Telephone & Telegraph or you think of the Radio Corporation of America, or you think of General Electric.

I have said, "Let us not think of just those firms. Let us find some of the smaller outfits."

That is what we are doing to spread the situation. I think it must be done that way.

Senator MARTIN. It has worried me a lot. You pick up the trade journals and you notice that some big concern has purchased the assets and the stock of some small concern that made great progress along certain lines.

We are getting now to about 10 big steel companies. We are getting to about where there are 3 or 4 big automobile companies.

I think that our form of government is for the purpose of protecting the individual.

Secretary TALBOTT. We can control that in the Air Force as far as our companies are concerned. The president of one of the aircraft companies came to me and said, "I am thinking about taking over this other company."

I said, "If you take him over, we will not have any more business to give him."

"Would you not give me any more?"

I said, "No."

So the businesses have remained separate. I agree with you, that this question of consolidation is a dangerous thing in our present picture.

Senator MARTIN. That worries me. I have watched the development of military work for almost half a century. The first thing that I noticed was the gatling gun.

The development has usually been done by some little fellow in a little factory someplace. That is the history of it. If we destroy those things I am just wondering whether we are going to be in as good a position in world war III which we all pray to God may never come.

We have always talked peace, and then wars have come along very unexpectedly. I am not expecting world war III for a good many years in the future, because there is no willingness to fight. You have got to have the willingness to fight in order to have a war.

The thing just worries me. I know you are doing a grand job. I admire you very much. I know of a lot of the things that you are doing. I sincerely hope that the Department will do everything that it possibly can to keep up that competitive system of enterprise that has made it possible for us to win World War II which was the most difficult thing in all history.

Secretary TALBOTT. I think it is essential. I agree with you 100 percent.

Senator FLANDERS. May I bring up one point again? When, Mr. Secretary, you said a few minutes ago that 50 percent on the investment capital was not an unreasonable figure, then I asked you what was the actual experience in percentage on sales and you said 3.8.

Secretary TALBOTT. 3.8, yes.

Senator FLANDERS. And then you said that you thought that was a little too high and it should have been what?

Secretary TALBOTT. I did not say what it should have been. I just made the observation that this was an average and in some instances might be high.

Senator FLANDERS. All right. That is a little too high. It leaves a very little narrow margin for renegotiations.

Secretary TALBOTT. No, no, sir.

Senator FLANDERS. In percentage of sales, does it not?

Secretary TALBOTT. Perhaps on percentage on sales.

Mr. ROBERTS. May I let the record show that one figure, the 50 percent, is before taxes, and the other figure, 3.8, is after taxes?

Senator FLANDERS. Three and eight-tenths is after taxes?

Mr. ROBERTS. Yes, sir.

Senator FLANDERS. In effect what you do—the results so far as the contractor is concerned is what happens to him after taxes, is it not?

Mr. ROBERTS. Indeed, it is that.

That is why I brought it up.

Senator FLANDERS. After all, so far as sales are concerned you can renegotiate only comparatively a small amount on sales, if that is the experience, 3.8. But that amounts to a larger percentage perhaps in return on invested capital.

The CHAIRMAN. The 3.8 was the average of the industry, as I understood it.

Secretary TALBOTT. That is correct.

The CHAIRMAN. That was not the Government contracts segregated—3.8 was the average of the industry.

Secretary TALBOTT. Yes, sir.

Mr. ROBERTS. The industry taken as a whole.

The CHAIRMAN. That is an entirely different thing.

Senator FLANDERS. The airplane industry as a whole is pretty nearly Government.

The CHAIRMAN. I would not say so. There are a lot of commercial lines.

Secretary TALBOTT. Douglas has substantial commercial business.

Senator FLANDERS. You have to leave Douglas out.

Secretary TALBOTT. We do not leave him out of the 3.8.
Senator FLANDERS. All right.
The CHAIRMAN. Mr. Secretary, we thank you, sir.
Secretary TALBOTT. I would like to say one more thing, if I may, Mr. Chairman.
We have in our group of civilians who have come into this work, men who know the aviation business. Mr. Lewis, Assistant Secretary in Charge of Materiel spent 22 years in the aircraft industry in all phases of it. So we know these problems pretty well.
I would like to reiterate again it will be our pleasure, our determination to put everything on competitive bidding that can be done.
The CHAIRMAN. Before you leave the stand, let me see if I have this accurately. You have three methods of letting contracts.
One is by competitive advertised bid?
Secretary TALBOTT. Right.
The CHAIRMAN. You prefer that, if possible?
Secretary TALBOTT. Right.
The CHAIRMAN. The second is the negotiated contract which can be renegotiated?
Secretary TALBOTT. Right. Redetermination.
The CHAIRMAN. Redetermination?
Secretary TALBOTT. Yes.
The CHAIRMAN. The third is cost-plus-a-fixed-fee contract system?
Secretary TALBOTT. Yes, sir.
The CHAIRMAN. It is always a fixed-fee plus, not a percentage?
Secretary TALBOTT. That is right.
The CHAIRMAN. What percent of your business is on the cost-plus-a-fixed fee?
Mr. GOLDEN. It has varied in the past 3 years—it has varied from 15 to 24 percent on a cost-plus-a-fixed-fee basis.
The CHAIRMAN. Is that fixed fee at any time subject to renegotiation or redetermination?
Mr. ROBERTS. Yes, is is, Mr. Chairman.
The CHAIRMAN. How is that originally based? What is the procedure? How do you base your fixed fee? Do you base it on a percentage on the cost of the contract, or what is your general method?
Mr. LEWIS. It is based on the estimated cost of the contract before the contract is entered into.
The CHAIRMAN. What percent is that?
Mr. LEWIS. It would run between 4 to 6, 7 percent.
The CHAIRMAN. Seven percent?
Mr. LEWIS. Up to that. Some of them are lower.
The CHAIRMAN. How does that compare to this 3.8 figure we were talking about on the sales?
Mr. LEWIS. It would be much lower, because you see this 4 to 7 percent I speak of is before taxes and before disallowances which are sometimes substantial. It would result in substantially less.
The CHAIRMAN. Will you break it down on the tax basis, because sales and taxes are very different things?
Mr. LEWIS. If you followed the 52-percent rule of thumb that we have used in the discussion this morning, that would be one-half of it.
The CHAIRMAN. That would be 3.8 after taxes. And your figure is before taxes?

Mr. LEWIS. That is right.

The CHAIRMAN. How does that compare?

Mr. LEWIS. It is much lower. It would be 2 or 3½ percent at the outside after taxes.

The CHAIRMAN. How do you figure that?

Mr. LEWIS. The 4 to 7 percent is what we allow on the cost of the contract which is before taxes and also before certain disallowances. So if they made the 4 to 7 percent on the contract which they do not do, really they make something a little less than that after taxes, it would be one-half of that amount.

The CHAIRMAN. Then translating that into invested capital, which after all is what people figure on, what are final net profits? How much would it run then? How does the 3.8 run on invested-capital basis, that is, on the sales?

Secretary TALBOTT. The results for 1954, as we have said, were 3.8 percent on sales and 27 percent on investment.

The CHAIRMAN. In the airplane industry?

Secretary TALBOTT. Yes.

Mr. LEWIS. This would be just a part of that, you see.

The CHAIRMAN. Do you think the figure you have on a fixed-fee basis is less than the average of 3.8 on the sales?

Mr. LEWIS. Yes.

The CHAIRMAN. It could not be much less, could it?

Mr. LEWIS. It could, yes; it could be as little as one-half of that when you get all through after taxes.

The CHAIRMAN. On what do you base your statement that 3.8 on the sales means 27 percent as a profit on the assets?

Secretary TALBOTT. The invested capital.

The CHAIRMAN. How do you figure that?

Secretary TALBOTT. That is the way we get it from the balance sheets.

The CHAIRMAN. Could you furnish the committee a statement as to how you arrive at that figure?

Secretary TALBOTT. Very simply, sir.

The CHAIRMAN. It is not so simple; 3.8 on sales. Then you have got to translate it on the tax basis. Some firms make more.

Secretary TALBOTT. That is after taxes.

The CHAIRMAN. Or less on the 3.8 basis. That is the gross revenue.

Secretary TALBOTT. The 3.8 average is one that they show in their balance sheet after taxes, in their annual reports. They show you that they have done so much business, and that their return on the investment has been such and such a percentage. Then you go back and figure the amount against their working capital or their invested capital, and you get the other figure.

The CHAIRMAN. The 3.8 figure then on the gross is after taxes, and 27 percent on the invested capital?

Secretary TALBOTT. That is right.

The CHAIRMAN. Thank you very much.

Senator FLANDERS. I get a new idea from what was just said. I understand, do I, that the fixed fee is renegotiable?

Mr. ROBERTS. The fixed fee is renegotiable under the terms of the law.

Senator FLANDERS. It is not fixed, since it is renegotiable?

Mr. ROBERTS. Yes, sir.

Senator FLANDERS. I just wanted to get that clear.

Secretary TALBOTT. Those figures that I gave, of course, are before renegotiation.

Mr. ROBERTS. I would like to make one comment.

The CHAIRMAN. At this point I want Mr. Roberts to testify as to what percentage of all of the contracts that have been renegotiated, what has been saved to the Government on a percentage basis. If you have not got those now, please supply them.

Mr. ROBERTS. I shall be glad to have those figures compiled and furnish them to the committee as soon as possible.

Senator FLANDERS. I think Mr. Roberts had something to add.

Mr. ROBERTS. I wanted to make clear that the 3.8 on sales that we are talking about after taxes, and the 27 percent on the investment that we are talking about after taxes, is made up on an average of the results of the companies, the principal companies in the aircraft industries.

The CHAIRMAN. And not confined to the Government?

Mr. ROBERTS. No, sir. I wish to point out particularly that it includes a good deal of this cost-plus-fixed-fee business, so that it is an average, and therefore should be regarded in that light.

Senator MILLIKIN. I am sorry that I did not hear your testimony, Mr. Secretary, but I will read it.

The CHAIRMAN. Thank you very much, Mr. Secretary.

Secretary TALBOTT. Thank you.

The CHAIRMAN. Our next witness is Mr. Frank L. Roberts, Chairman of the Renegotiation Board. We are very glad to have you with us this morning, Mr. Roberts. You may proceed in your own way.

STATEMENT OF FRANK L. ROBERTS, CHAIRMAN OF THE RENEGOTIATION BOARD

Mr. ROBERTS. Mr. Chairman and members of the committee, the Board strongly urges a 2-year extension of the Renegotiation Act of 1951.

As you know, the Defense Department estimates an expenditure of $35 billion in the current fiscal year and a similar amount in the succeeding year. Such a heavy volume of procurement is certain to generate excessive profits in defense contracts, despite the best efforts of the military to prevent them by means of close initial pricing and redetermination clauses. The Board makes this prediction on the basis of its experience in conducting renegotation proceedings for years during which procurement volume reached comparable levels.

The likelihood of excessive profits is particularly great in contracts for complex equipment. Here, again, the procurement plans announced by the Defense Department promise a repetition of prior experience.

For example, the Air Force will continue with its program to expand strength to 137 wings, a project which includes the introduction of the latest types of supersonic planes. Even more intricate, perhaps, are the various types of guided missiles scheduled for development and production.

Since its establishment in 1951, the Board has recovered excessive profits in the gross amount of $335,139,490. The cost of Board opera-

tions to date is less than $16 million. These figures, however, represent only a portion of the money saved for the Government during this period. It is to be noted that renegotiation functions not only to recapture excessive profits but to prevent them. The mere existence of the Board, and of the procedures by which it reviews earnings, frequently induces contractors to avoid excessive profits by cooperating with procurement officials in setting close initial prices and in making downward adjustments, as contract experience reveals the need of them. The dollar savings resulting from this preventive aspect of renegotiation are, of course, beyond computation.

We do not overlook the burden that renegotiation places upon industry. Mindful of its obligation to lighten the load, as far as possible, the Board has developed procedures which minimize difficulties for contractors.

Reporting requirements have been simplified. The act provides that no contractor (other than brokers or agents) whose receipts or accruals from renegotiable business aggregate $500,000 or less, during any fiscal year ending on or after June 30, 1953, shall be renegotiated for that year. Most contractors who are subject to the law fall into this category. To make things as easy as possible for these smaller firms, our regulations require nothing more from them than a statement that they were below the floor.

Wherever feasible, contractors who are above the floor are also eliminated from renegotiation. We carefully examine all filings in order to "screen" out those which reveal no likelihood of excessive profits. Firms which fall into this category are notified that the Board plans no further action in their cases. Significantly, the number of those who are thus relieved from full-scale renegotiation is considerably greater than when the Board was first established. Some contractors, who formerly earned excessive profits are now in effect renegotiating themselves by means of close pricing.

In view of the widespread interest in the recently enacted exemption of standard commercial articles, I should like to give a brief description of the manner in which applications are handled. In each case the first question, of course, is whether the product for which exemption is claimed is actually a standard commercial article within the definition set forth in section 106 (a) (8) of the act. A committee has been established by the Board to handle the exemption problem. The committee examines each application.

When the committee finds that a product does not meet the statutory definition, it recommends denial of exemption. Every application covering a product which meets this first test is forwarded by the committee to the Board's staff of economists, for an answer to a second question: At the time the product was sold to the Government, was it also being sold in the commercial market under competitive conditions which would reasonably be expected to prevent excessive profits? An affirmative answer leads to a recommendation for exemption. All cases are submitted to the Board for decision.

Textile finishers have made a complaint about the standard commercial article exemption. The act, as now worded, appears to confine the exemption to sales of such articles; consequently, the Board has been compelled to deny exemption to contractors who process goods belonging to other persons.

If the committee wishes to extend the exemption to standard commercial services, we shall submit an amendment that we have drafted for the purpose.

Senator FLANDERS. Mr. Chairman, I would like to have that amendment presented, because a number of my constituents are concerned with this question of exemption processing, as well.

Mr. ROBERTS. We will submit it.

Senator MARTIN. You do not have it now?

Mr. ROBERTS. We have it now.

Senator MARTIN. If you will submit it, I think that it would help. I was going to ask a question on that.

Mr. ROBERTS. It was the interpretation, as we interpret the law, that prevented us from granting those exemptions.

Senator MARTIN. I know.

(The proposed amendment of H. R. 4904 is as follows:)

PROPOSED AMENDMENT OF H. R. 4904

Paragraph (8) of section 106 (a) of such act is hereby amended by inserting after "a standard commercial article" in the first sentence thereof "or a standard commercial service"; by inserting after "such article" in the first and second sentences thereof "or service"; by striking out "and" at the end of subparagraph (C); by changing subparagraph (D) to subparagraph (G); and by inserting the following after subparagraph (C):

(D) The term "service" means any processing or other operation performed by chemical, electrical, physical, or mechanical methods directly on materials owned by another person.

(E) The term "standard commercial service" means a service which is customarily performed by more than two persons for civilian industrial or commercial requirements, or is reasonably comparable with a service so performed.

(F) The term "reasonably comparable" means of the same kind, performed with the same or similar materials, and having the same or a similar result, without necessarily involving identical operations; and

The CHAIRMAN. I have a couple of questions that I would like to ask. This covers procurement. What are the exemptions?

Mr. ROBERTS. I am not sure that I understand your question. The standard commercial article——

The CHAIRMAN. This legislation covers all procurement of the Federal Government?

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. What is exempt? Does it cover everything, if not what is exempt?

Mr. ROBERTS. There are a great many exemptions, Mr. Chairman. There is the raw material exemption which takes out people who produce raw materials. There are exemptions of public utilities, regular transportation, and that sort of thing.

Then the most recent exemption was the standard commercial article exemption put in in the extension of the act to cover the year 1954.

The CHAIRMAN. Is a competitive advertised product exempted?

Mr. ROBERTS. It is not.

The CHAIRMAN. Negotiated contracts are included, of course. If there is a fixed fee, you just stated that is included for redetermination, on cost-plus contracts?

Mr. ROBERTS. That is right.

The CHAIRMAN. So the main exemptions, you say, are the natural resources?

Mr. ROBERTS. Yes.

The CHAIRMAN. Utilities?

Mr. ROBERTS. Utilities, et cetera.

The CHAIRMAN. That covers the exemptions. You make the suggestion here as to another amendment?

Mr. ROBERTS. We draw the committee's attention, Mr. Chairman, to the fact that the interpretation of the standard commercial article excluded the service people who may take a cotton textile product, finish it as they call it, and the language of the present exemption prevents us from granting them a standard commercial article exemption.

The CHAIRMAN. You favor that amendment?

Mr. ROBERTS. We present it to the committee as a matter that we have run into. We have no objection to it.

The CHAIRMAN. Have you any other suggestions as to amendments?

Mr. ROBERTS. None, Mr. Chairman. We think that the bill as presently written should be extended for the 2-year period.

The CHAIRMAN. It is estimated it will cover about $20 billion worth of procurement. That is the present amount that will come under the renegotiation?

Mr. ROBERTS. That is right.

The CHAIRMAN. I wish you would furnish to the committee a statement. I notice the report says that the refunds were $331 million and the voluntary refunds were $133 million, beginning in 1951 up to March 1955, a period of 4 years. I would like that as a percentage of the total amount subject to renegotiation during that period. It is not necessary to give it now, but just submit it by letter.

Senator MARTIN. Do you have any objection to the amendment that was made by the House?

Mr. ROBERTS. No, we have no objection to that amendment.

Senator MARTIN. I have no further questions.

Senator FLANDERS. I have no further questions.

Senator MILLIKIN. I have no further questions.

Senator CARLSON. On this proposed amendment, paragraph (e), reading:

> The term "standard commercial service" means a service which is customarily performed by more than two persons for civilian industrial or commercial requirements, or is reasonably comparable with a service so performed.

What would you have in mind as an illustration there?

Mr. ROBERTS. In the textile industry there are people who are private contractors outside that do the finishing of cotton goods. I am not familiar enough with that industry to describe what finishing is.

Senator FLANDERS. Bleaching would be one.

Mr. ROBERTS. They contract for that. The producer of the cotton textile goods probably would qualify as the maker of a "standard commercial article." He would be exempt, yet we have the situation where the man doing the finishing would be denied the exemption.

Senator FLANDERS. There would be an inequity as between the vertically organized company which carried it clear through from the raw cotton to the finished product, including the bleaching, as against the man in the bleaching business who did it for other companies.

The vertically organized outfit would get the advantage or disadvantage, and the other one would not.

Senator CARLSON. That is all.

Senator BENNETT. I would appreciate it if Mr. Roberts would like to comment on how well this exemption of the standard commercial article has worked. Has it lightened the load of the Board?

Mr. ROBERTS. Senator Bennett, I think it will lighten the load of the Board. To date I do not believe it has, because we have had to establish the procedures to carry it out. It is going into a new venture, so to speak, and we have had perhaps a little more effort required than I am sure will be required in the future. It will lighten the load of the Board from here on out.

Senator BENNETT. It has not presented you with any unusual or peculiar problems, because obviously you are not asking to have it repealed.

Mr. ROBERTS. That is right. It has presented a great many problems, but we feel it to be the will of the Congress that it be carried out, and we are doing our best to carry it out.

Senator BENNETT. You do not feel that its presence in the law has enabled people to escape renegotiation who should be renegotiated?

Mr. ROBERTS. No; I do not.

Senator BENNETT. That is all.

The CHAIRMAN. Thank you very much, Mr. Roberts.

Mr. ROBERTS. I have accurate figures on recoveries and voluntary refunds, and I would like to put them in the record, if I may.

The CHAIRMAN. At the same time, I would like you to put in the amount of expenditures subject to renegotiation.

Mr. ROBERTS. Yes, sir; I will furnish that later.

The CHAIRMAN. Very well. That may be done.

(The tabulation entitled "Results of Renegotiation Activity" is as follows:)

Results of renegotiation activity under the Renegotiation Acts of 1948 and 1951

	Gross refunds	Net after taxes
Agreements and orders, completed:		
1948 act	$28,934,488	$14,646,873
1951 act	263,923,816	90,750,223
Subtotal	292,858,304	105,397,096
Agreements and orders, in process	62,273,186	[1] 15,568,296
Total agreements or orders	355,131,490	120,965,392
Add: Voluntary refunds and price reductions disclosed in renegotiation proceedings	159,297,602	159,297,602
	514,429,092	280,262,994

[1] Based upon an estimated tax credit of 75 percent.

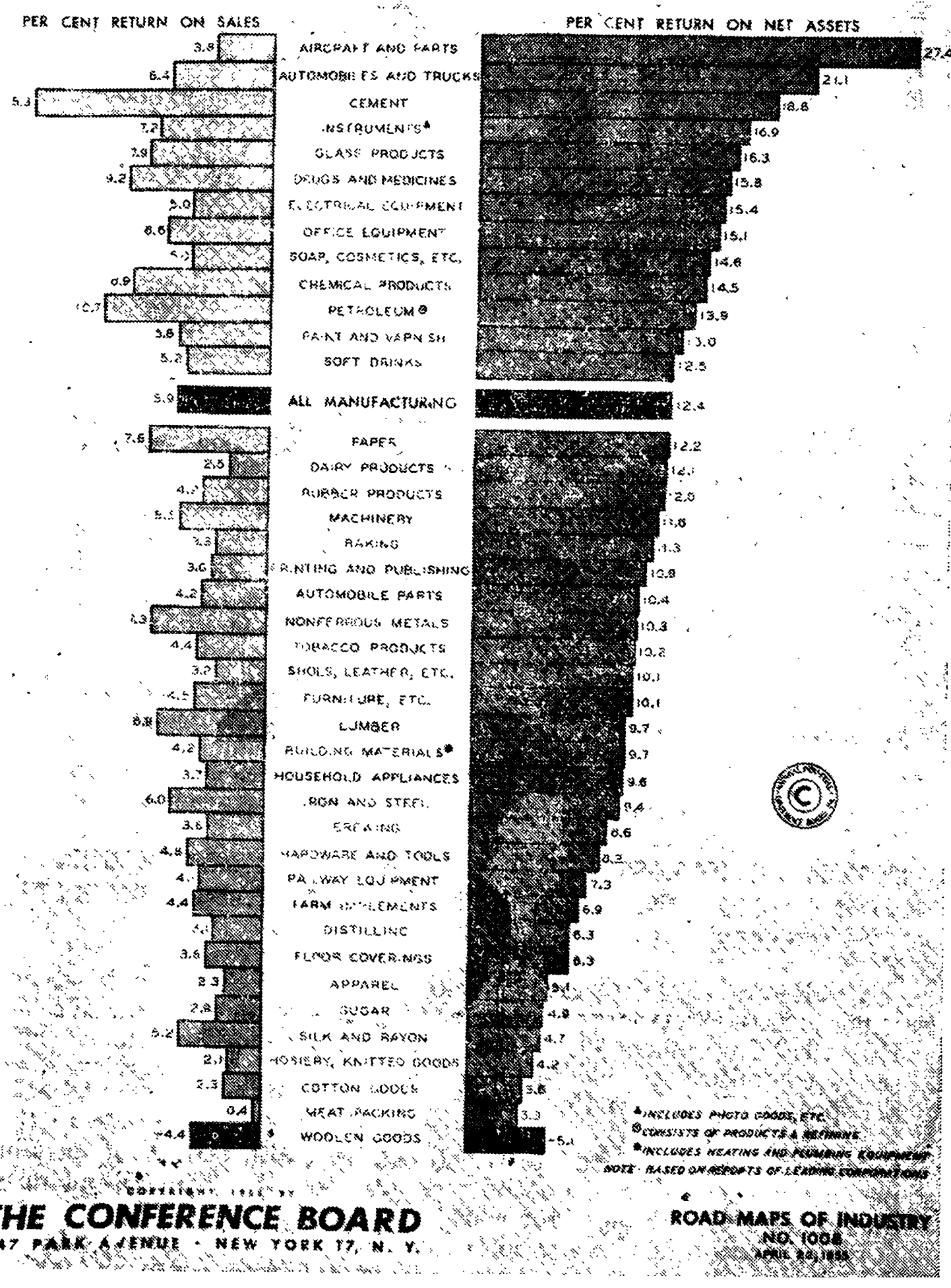
Mr. LEWIS. I would like to submit a document for the record which provides the information on profits after taxes.

The CHAIRMAN. That will be included in the record at this point.

(The tabulation entitled "Profits After Taxes" is as follows:)

PROFITS AFTER TAXES

LEADING MANUFACTURING GROUPS, 1954



THE CONFERENCE BOARD

247 PARK AVENUE · NEW YORK 17, N. Y.

ROAD MAPS OF INDUSTRY
NO. 1008
APRIL 24, 1955

Profits after taxes—Leading industrial groups, 1953 and 1954

	Companies reporting	Percent return on sales		Percent return on net assets	
		1954	1953	1954	1953
All reporting corporations	3,442	6.1	5.6	10.3	10.6
Manufacturing	1,778	5.9	5.3	12.4	12.7
Nonmanufacturing:					
Mining, quarrying	68	7.2	6.3	7.9	7.9
Trade	186	2.5	2.4	10.0	9.9
Transportation	226	6.7	7.6	4.5	6.1
Public utilities	317	12.6	12.5	9.3	9.2
Amusements, services, etc	116	4.7	4.3	11.8	10 5
Finance	751	-------	-------	8.5	8.1

Source: National City Bank of New York.

Profits after taxes shown on the front of this road map for leading manufacturing corporations are taken from the National City Bank's monthly letter for April 1955. Data are based on published reports of manufacturing corporations available on April 1, 1955. Since the data shown are for leading companies, they are normally somewhat higher than the rate of return reported for all United States corporations.

Companies for which profit ratios are shown in the table include about 50 percent of the assets of all United States corporations. Coverage in manufacturing as shown on the front is about 70 percent. In nonmanufacturing it runs about 30 percent.

Book net assets at the beginnig of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values.

Profit margins computed for all companies publishing sales or gross income figures, which represent about nine-tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales.

The CHAIRMAN. I must leave at this point, Senator Millikin. Will you assume the chair?

Senator MILLIKIN (presiding). Yes, Mr. Chairman.

We will next hear from Mr. Ross Nichols. We are very glad to have you here. You may proceed in you own way.

STATEMENT OF ROSS NICHOLS, CHAIRMAN OF THE GOVERNMENT CONTRACTS COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. NICHOLS. Mr. Chairman and members of the committee, my name is Ross Nichols. I am executive vice president of the Weston Electrical Instrument Corp., and chairman of the Government contracts committee of the National Association of Manufacturers. I am speaking today for that association.

Renegotiation is, of course, a device which runs contrary to the theory of competitive enterprise. It can be justified, if at all, only in periods of such abnormal activity as are encountered in all-out production and procurement for war.

Renegotiation is either second guessing, which is contrary to all principles of contract law, or is a disguised taxing measure which does not meet any of the criteria of a sound taxing system.

The same general objection can be offered against the profit-limitation provisions of the Vinson-Trammell Act and the Merchant Marine Act.

Supporters of renegotiation and other profit-limiting laws often justify their use by asserting that the procurement contract, like any other ordinary commercial contract, may contain any provision which is not contrary to public policy and which is mutually acceptable to the contracting parties. If this was a valid contention, Government suppliers would be able to refuse renegotiation clauses or the impact of the provisions of the Vinson-Trammell and Merchant Marine Acts in affected contracts, and Government contracting officers would be able to agree to the elimination of these clauses where they were satisfied that this was desirable in order to get a contract.

Actually, because the Vinson-Trammell and Merchant Marine Acts are on the books and Congress is giving consideration to a further retroactive extension of the renegotiation statute, the contracting officers have no freedom of action in this area and Government contractors can avoid these profit-limiting requirements only by abstaining from doing business with the Government. Thus, we have the anomalous situation where on one hand the Government is alleged to act as any individual party to a contract and on the other hand it exercises its prerogative as a sovereign.

In recent versions of the renegotiation law, Congress has seen fit to exempt certain types of transactions from renegotiation, but a recent ruling of the Department of the Treasury states that:

> Any contracts and subcontracts exempted from renegotiation under section 106 (a) (8) of the Renegotiation Act of 1951, as amended, will be subject to the provisions of the Vinson Act if they are for the construction and/or manufacture of any complete naval vessel or Army or Navy aircraft or any portion thereof.

Thus, it is the view of the Department of the Treasury that any contracts exempted from renegotiation as standard commercial articles become immediately subject to the profit-limitations provisions of the Vinson-Trammell and Merchant Marine Acts.

This unhappy result seems contrary to the intent of Congess as expressed in section 102 (d) of the late Renegotiation Act. Evidence that this is so is the recent amendment made by the House of Representatives to the pending extension bill It seems evident that no sound basis could exist for exampting standard commercial articles from one profit-limitation provision while at the same time subjecting them to another.

Clearly, there is no need for renegotiation in this regard since the necessary cost and pricing experience has already been acquired and prices made in a competitive market. Thus the same reasons for exemption of such articles from renegotiation are equally applicable to the profit-limitation provisions of the other acts.

There are a number of specific objections which should be urged against H. R. 4904:

First, that because the renegotiation law lapsed at December 31, 1954, the present law which would tack on to the old law is retroactive in its effect and constitutes unsound legislative practice.

Second, on balance we estimate that renegotiation is unprofitable for the Government. With corporate income taxes at the high level of 52 percent, slightly more than half of the recoveries which are reported by the Board would have accrued to the Government as income taxes. Add to this the cost of the operation of the Renegotiation Board and the very large expense incurred by each Government

contractor in connection with the maintenance of records, the preparation of reports, and the actual negotiation of the renegotiation and the aggregate overall cost will run very large indeed.

Third, renegotiation destroys incentives to maximum productive efficiency and lowest costs.

Renegotiation approximates the illegal cost-plus-percentage approach in that profit allowance patterns are fairly fixed: the higher the costs, the greater the aggregate profit allowed. A high-cost producer may obtain clearance but a low-cost producer may be called upon to refund the portion of profits representing efficiency and high productivity. For example, 1 producer may earn 10 percent on a $1 item while another, producing the same item, may make 15 percent on a price of 85 cents.

Actually, the Government should be concerned with the fact that 15 cents was saved per item by the low-cost producer. The Government does not contract to pay for a bundle of costs plus a preconceived profit margin, but pays the price of the item times the number of items contracted for.

Fourth, renegotiation encourages lax procurement practices and results in wasteful and costly procurement.

Many procurement officers tend to rely on the "second guessing" by renegotiation rather than negotiating a fair, firm price at the outset. Firm or fixed prices stimulates efficiency.

Fifth, renegotiation is not required in connection with developmental contracts or first production contracts, or other situations where both parties have difficulty in forecasting costs.

The services have available a cost-plus fixed-fee type of contract; they also make extensive use of a so-called redetermination provision, which, in effect, determines the final price after salient facts which were unknown when the contract was entered into become known in the course of its performance.

Sixth, the conditions which prompted Congress to first pass a renegotiation law no longer exist. At present, total Federal Government purchases of goods and services amount to slightly over 20 percent of the gross national product. Capacity has been greatly expanded and in virtually all industries some unutilized capacity exists which results in keen competition for Government business.

Seventh, discontinuance of renegotiation would bring into full play the forces of the free competitive system with resulting benefits to the Government.

Normal business practice calls for arms-length negotiations between buyers and sellers, each attempting to obtain the best deal. The Government in its purchasing has a tremendous advantage over commercial buyers in that it can call for all types of cost data and experience records on past procurements. Good purchasing calls for careful negotiations, resulting in agreement on terms and conditions, including a fixed price. The producer then attempts to beat his most optimistic forecasts in order to increase his profit. No matter how high a percentage of profit is earned, the buyer only pays the price which he agrees was reasonable at the conclusion of negotiations. Under these conditions, incentive to increased efficiency exists which means efficient utilization of materials and labor and savings to the Government in follow-on procurements.

Eighth, renegotiation injects unnecessary and undesirable uncertainty in the operations of contractors who have a substantial amount of Government business.

Contractors do not know the actual amount of their earnings until renegotiation has been completed which usually is long after the close of any fiscal year. This injects uncertainty into planning programs and may have a detrimental effect in that important policy decisions may be delayed. This is particularly true with respect to decisions regarding plant expansion programs so necessary for a growing and dynamic economy. Thus, new job opportunities for a growing labor force may be delayed.

I hope that from the evidence offered at these hearings your committee will recognize that in exploring negotiation you are dealing with a subject which has a really profound bearing upon both Government as a purchaser and upon the national economy as it bears in its uneven way on a very large segment of the American industry.

The National Association of Manufacturers regards further extension of renegotiation authority, and, indeed, the continuance of any profit-limiting device running collateral to the income-tax law, as being unjustified in the light of accumulated procurement experience, and as a consequence strongly urges the defeat of H. R. 4904. Thank you for this opportunity to present our views.

Senator MILLIKIN. Are there any questions? If not, thank you very much.

Mr. NICHOLS. Thank you.

Senator MILLIKIN. The next witness is Mr. Walter R. Howell, president of the National Association of Finishers of Textile Fabrics.

STATEMENT OF WALTER R. HOWELL, PRESIDENT, NATIONAL ASSOCIATION OF FINISHERS OF TEXTILE FABRICS

Mr. HOWELL. Mr. Chairman and members of the committee, my name is Walter R. Howell. I am executive vice president of the Bradford Dyeing Association, of Westerly Road, Long Island, and president of the National Association on Finishers of Textile Fabrics, which represents 65 textile finishing plants throughout the country.

I appreciate this opportunity of stating the views of the national association of the proposed amendment to the Defense Renegotiation Act of 1951.

The National Association of Finishers of Textile Fabrics does not take a position on the general question of whether the act should be extended or allowed to expire. Our position is that, if the act is extended as H. R. 4904 would provide, the act ought to be amended so as to make the standard commercial article exemption now in section 106 (a) (8) applicable to contracts for the performance of standard industrial services such as the textile finishing services rendered by the members of our association.

Senator MILLIKIN. Did you observe the amendment which was proposed here awhile ago?

Mr. HOWELL. I thought I heard it. I was delighted to hear it, but I did not see it. There were no copies that reached me.

Mr. HOWELL. That is just what we want. We have two types in the textile industry. We have the so-called verticals that the Senator

mentioned before. And we have the so-called job finishers or commission finishers.

The verticals handle these things right from their raw cotton, you might say, into the finished article, and they sell the commodity.

I am on the other side of the fence in my company. I am a job finisher. The people who sell the standard commercial article, the vertical people, are exempted from this. We do a service similar to what they can do in their own plant.

Some of the people do not have that. We have not been exempted. That is what we are asking for.

Senator MILLIKIN. Will you look that over and tell me if that is what you want?

Mr. HOWELL. I would say that would cover us, sir. I do not know these subdivisions that are marked here, but the basis of it is all right.

Senator MILLIKIN. Why do you not take a copy of it with you and study it and let us know if that is what you want.

Mr. HOWELL. I would like to do that.

Senator MILLIKIN. Tell us what your idea about it is.

Mr. HOWELL. I would say that this covers it, going over it hurriedly. I would like the opportunity to write in on it.

Senator MILLIKIN. In the meantime, if you feel that it is close enough to what you have in mind, you might want to extend your remarks in the record. Let us hear from you further, too, if you do not agree.

Mr. HOWELL. We will be glad to, sir.

Senator MILLIKIN. Thank you very much.

Mr. HOWELL. There is no real necessity for me continuing with my statement. It is pretty well covered here.

Senator BENNETT. May we have the statement in the record?

Mr. HOWELL. I will have a copy of it made. This one that I have here has been written over. I did not know that I should do that. I have never been down here before. I did not know that I was supposed to submit one, but I will have a copy made and have it delivered promptly, maybe today.

Senator MILLIKIN. Do that, and have it in the record.

Thank you very much. We will insert it in the record when it is received.

(The following telegram was later received for the record:)

NEW YORK, N. Y., *June 8, 1955.*

Miss ELIZABETH B. SPRINGER,
Chief Clerk, Senate Finance Committee,
Senate Office Building, Washington, D. C.:

Amendment to section 106 (a) (8) of Renegotiation Act proposed by Renegotiation Board to remove discrimination against job finishers by exempting standard commercial services is satisfactory to National Association of Finishers of Textile Fabrics and we urge approval thereof. Letter follows.

WALTER R. HOWELL,
President, National Association of Finishers of Textile Fabrics.

(The letter referred to in the telegram appears at p. 67.)

Senator MILLIKIN. Our next witness is Mr. Hugh Rawls, president of the Rawls Contractors, Inc.

Will you identify yourself for the record, Mr. Rawls?

STATEMENT OF HUGH RAWLS, PRESIDENT, RAWLS CONTRACTORS, INC., JACKSONVILLE, FLA.

Mr. RAWLS. Mr. Chairman and members of the committee, I am one of that vanishing breed that was mentioned earlier, the small contractor, who is attempting to get into defense business.

Our firm has been in the ship-repair business since 1951, and we qualify as small contractors. We have already been renegotiated once. All of the business that we have done and expect to do is on extremely or under extremely competitive conditions.

I might point out in passing that at the time we started, or since the time we organized our small firm, we have had a total of eight competitors. There are now 4 left, 3 of which are old-line firms. Ours is the only new firm.

Due to the broad coverage of the law as it affects us, our profits, or such profits as we are able to achieve, even after competitive bidding, are always extremely uncertain. We are unable to provide reserves to expand or increase our very limited facilities, because simply if we are renegotiated at a later date, we cannot forward those facilities in payment of renegotiation. They want cash.

We feel that competitive contracts where true competitive bidding is achieved should not be renegotiated, particularly in the case of smaller contractors as ourselves. Our gross volume of business will not exceed an average of over $1 million a year. We have only achieved the $1 million figure 1 time since we have been in business.

The years in question in which we were renegotiated, we actually only had four hundred-odd thousand dollars worth of business. We recommend and would like to earnestly suggest to your committee that small firms, particularly those firms doing less than $1 million a year, should be exempted from the provisions of renegotiation.

In other words, we recommend that you raise the floor from $500,000 to $1 million. We further recommend that due to the tax structure and also due to the keen competition existing under true competitive situations, that renegotiation be eliminated from competitive work.

I would like, if I may, to show you some results of competitive bidding. I have no prepared statement to give you, but I do have these tabulations. If you will notice, referring to the chart, you will note that they are all relatively small amounts. I think the largest one is under $30,000.

At that time, 1952, and in the early part of 1953, the Government issued their estimate of cost after the bids had been let. The Government estimate for the total of these bids was $219,095. I might point out that the Government has a large company of qualified estimators and engineers, and, as was pointed out in earlier testimony, certainly they should know what a job is worth.

Our firm successfully bid and completed these contracts for a price of $149,969—a saving of, roughly, 25 percent. A further saving below the next lower bidder, the grand total of the next bids being $173,715. That saving is approximately 10 to 12 percent.

63593—55——4

So that the Government did, in fact, achieve a lower price in the beginning, at the inception of the contract, than they themselves estimated was a fair price.

If we are able by our own ingenuity, our own ability, to get up a little earlier, to work a little harder, to stay up a little longer to beat the other fellow out, to make a few dollars, and at the same time save the Government a considerable amount of money, I do not think that those few dollars should be taken away from us.

Senator MILLIKIN. Where are you operating?

Mr. RAWLS. We operate in Jacksonville, Fla. We are in the ship-repair business and 96.4 percent of our business is done for the Government in the repair of Navy and Army vessels. We only do that type of work which practically everybody can do because we do not have the facilities to enter into the more complex types.

Senator MILLIKIN. Does this represent all of the contracts that you had?

Mr. RAWLS. No, sir. This represents only those contracts which the Government estimate was available for. They have since stopped releasing the Government estimate, so we have no way of knowing what the estimate of costs will have been since this period of time.

This is only intended as representative, but I will say that the same pattern still exists.

We are happy for the opportunity to compete for business. That is all we do want—an opportunity to compete and to compete fairly.

I might say also that our competitors have without exception, in one manner or another, certain Government facilities which are loaned or leased to them. We are the only ones in this business who have no Government facilities.

I was interested to listen to these many figures on returns in the aircraft industry.

Insofar as percentage of return related to invested capital and also percentage on sales is concerned, we would dislike to have our profits limited to invested capital because we had no capital when we started. We still have none.

We are able to make a profit. We can do your work cheaper. We are proving that every day. We have no opportunity to expand. I have been wanting to buy a crane for 3 years, but I am afraid that the Renegotiation Board will ask me for the money and I cannot send them the crane. I could not very well sell the crane at a loss to try to scratch up the money.

I would like incidentally, if I may, to have the opportunity of examining a copy of this amendment relating to service industries. I am not at all familiar with that.

Senator MILLIKIN. Do you wish your chart be made a part of the record?

Mr. RAWLS. Yes, sir.

Senator MILLIKIN. That will be done at this point in the record.

(The tabulation entitled "Successful Bids" is as follows:)

APPENDIX 1

Successful bids

Vessel	Date of award	2d low bidder	Government estimate	Rawls Bros.	Laris	Southern Shipbuilding	Gibbs	Merrill-Stevens
Metal enclosure	Aug. 8, 1952	$20,975.00	$24,985	$17,789	$20,975.00	$39,000	$41,000	(1)
ARL-20	Sept. 8, 1952	14,449.00	20,440	12,430	14,449.00	22,249	(1)	(1)
APD-61	Sept. 17, 1952	20,030.00	23,023	18,865	20,030.00	22,591	28,946	$23,640
DE-320	Oct. 3, 1952	13,272.50	15,126	11,750	13,272.50	16,982	19,791	17,705
APD-46	Sept. 24, 1952	14,948.00	15,979	14,815	16,121.00	14,948	18,365	19,434
ATA210	Oct. 10, 1952	1,550.00	600	1,276	(1)	1,550	4,200	(1)
DE 321	Oct. 14, 1952	16,742.00	18,426	12,530	16,742.00	16,987	18,295	24,758
LSM 535	Nov. 17, 1952	9,410.00	14,714	8,439	14,818.75	9,410	12,632	10,310
DE 251	Dec. 10, 1952	20,931.00	27,744	15,318	20,931.00	22,979	26,307	29,732
DE 245	Feb. 2, 1953	19,343.00	28,000	18,247	19,343.00	23,101	19,616	19,680
APD 122	Mar. 30, 1953	19,586.00	26,782	16,820	19,586.00	20,061	28,863	24,330
YON 183	May 18, 1953	2,479.00	3,276	1,690	4,250.00	2,479	(1)	4,873
Total		173,715.50	219,095	149,969				

[1] No bid.

Senator MILLIKIN. As to the amendment, we will give you a copy of it.

Mr. RAWLS. I am not a lawyer, so I do not know whether our firm qualifies as a service industry. I think it does in that primarily we sell labor. We are only selling material as incidental to the repair work that we do. So possibly we may or may not be construed to be in a service industry.

Senator BENNETT. I would think that you would not be construed to be such, because you do not sell what would be called a standard commercial service. You do not perform the identical operation on someone else's product. You are in the repair business. Your situation is completely different from the man who testified previously who takes someone else's cloth and bleaches it and hands the cloth back to him, and he in turn takes the cloth and sells it.

You are doing your work for the owner. You are not doing your work on a product that is going to be sold.

Mr. RAWLS. In other words, this, in effect, actually only concerns subcontractors.

Senator BENNETT. It concerns subcontractors who perform services on products which will later become standard commercial articles.

Mr. RAWLS. Which are exempt.

Senator BENNETT. Which are exempt. So I think you would not be involved in this amendment. I will be glad to hand you a copy of the amendment.

Mr. RAWLS. We do perform a standard commercial service in that the repair of machinery, the renewal and repair of steel work, painting, and so forth, is done by us.

Senator BENNETT. But actually every one of your operations is different.

Mr. RAWLS. That is true.

Senator BENNETT. Because of the condition of the product that is brought to you to be repaired.

Mr. RAWLS. If you will pardon me saying so, sir, I have already noticed in our small area down there that your Renegotiation Act as it is now written tends to maintain the status quo. The fellow who is already in the business stays in the business. The fellow who is trying to get in cannot get in.

The old and outmoded methods, the wasteful methods, the waste of labor, the lack of diligence in thinking and planning and attempting to cut costs are all eliminated to a great degree, simply because there is no incentive to a small, energetic firm to attempt to think and do and plan in a more constantly improved and efficient manner, because he is not permitted to retain any of the fruits of his labors.

Senator BENNETT. May I ask you a question? In what year were you renegotiated?

Mr. RAWLS. Fiscal 1951, I believe.

Senator BENNETT. That then ran from July 1951, to the end of June 1952—that is the fiscal year of 1951?

Mr. RAWLS. I am speaking of my firm's fiscal year which ends May 31. I am certain it ran from June 1, 1951, to June 1, 1952.

Senator BENNETT. None of these examples you have given us on this list, none of them have been renegotiated?

Mr. RAWLS. Not yet. We have been notified we are subject to being renegotiated. We have never had a contract yet that was not competitively bid, and I mean fiercely competitively bid.

Senator BENNETT. I would like to clear this point up. Your earlier testimony was that you had only been renegotiated on 1 year?

Mr. RAWLS. That is correct.

Senator BENNETT. And have you been notified that you are going to be—for what years have you been notified that you are going to be renegotiated?

Mr. RAWLS. I do not have those records with me, but I believe it is for fiscal 1952 and 1953.

Senator BENNETT. Then all of these contracts contained on this list, you think that you are subject to renegotiation?

Mr. RAWLS. Definitely.

Senator MILLIKIN. You may proceed.

Mr. RAWLS. The only further comment I have to make is to reiterate the statement I made in the beginning that it is our firm belief in two areas, at least, if the Renegotiation Act is reenacted, there are two definite areas in which it could be improved.

The first is where true competitive bidding exists.

The second is that as the law is now written it provides that you have your floor too low, we think.

The little fellow does not have a chance to ever get started or to expand his facilities or to increase his productive abilities due to the fact that if he does have a lucky year, the profits are taken away from him. If he has an unlucky year, he is wiped out.

Fifty percent of our competitors have been in the past 3 years.

Senator MILLIKIN. Have you an amendment, a specific amendment that you would like to suggest?

Mr. RAWLS. I would be very happy to submit one, sir.

Senator MILLIKIN. I wish you would.

Mr. RAWLS. All right, sir, I shall.

(The amendment and comments thereon are as follows:)

In accordance with the request made by the committee that I submit a suggested amendment to H. R. 4904, a bill to extend the Renegotiation Act of 1951 for 2 years, I submit herewith the following amendments for the consideration of the committee:

At the end of the bill, insert a new section as follows:

"SEC. . (a) Section 106 (a) of such Act (50 U. S. C., App., sec. 1216 (a)) is hereby amended—

(1) by inserting after "other than paragraph (8)" in paragraph (7) thereof the following: "or paragraph (9)";

(2) by striking out the period at the end of paragraph (8) and inserting in lieu thereof "; or"; and

(3) by adding at the end thereof a new paragraph, as follows:

"(9) any contract or subcontract awarded as a result of competitive bidding in which three or more bona fide bids are submitted."

(b) The amendments made by subsection (a) shall apply to contracts with the Departments and subcontracts only to the extent of the amounts received or accrued by a contractor or subcontractor after December 31, 1954.

At the end of the bill, insert a new section, as follows:

SEC. . (a) Section 105 (f) (1) of such act (50 U. S. C., App. sec. 1215 (f) (1)) is hereby amended by inserting after "$500,000, in the case of a fiscal year ending on or after June 30, 1953, "each place it appears therein the following: "and before January 1, 1955, or $1,000,000, in the case of a fiscal year ending after December 31, 1954,".

(b) Section 105 (f) (3) of such act (50 U. S. C., App., sec. 1215 (f) (3)) is hereby amended by inserting after "the $500,000 amount," in the second sentence thereof the following: "the $1,000,000 amount,".

WHY THE RENEGOTIATION ACT SHOULD BE AMENDED TO EXEMPT CONTRACTS RESULTING FROM TRUE COMPETITIVE BIDDING

1. Under competitive bidding the contractor must submit detailed sealed bids listing labor, overhead, materials, profit, and contingency costs. The contractor's bid cost must be lower than all other competitive bids and the bid cost must further be in line with the predetermined Government estimates prior to award of contracts.

2. Free enterprise and open competition effectively regulate profits, build stronger businesses, and promote ever more efficient operation.

3. Renegotiation is unnecessary under peacetime competitive market conditions, and under the present income-tax structure, which effectively regulates profits.

4. Renegotiation is a wartime act, enacted as a result of wartime conditions and has no place in a peacetime democratic system of government. Control of industry and arbitrary limitation of profits are not compatible with democracy. During peacetime supply inevitably more than meets demand as a result of free competition.

5. Renegotiation has a tendency to stifle small firms who through ingenuity, hard work, and close and efficient management, are able to deliver finished products to the Government at ever lower prices. By arbitrarily fixing of profits from smaller concerns, expansion of facilities is effectively prohibited, thereby causing inefficient methods and equipment to be used and status quo methods retained, inevitably resulting in greater ultimate cost to the Government.

6. Renegotiation of competitively bid contracts admits the failure of the various defense departments to properly implement the defense program. Free and open competition will go much further in lowering prices by forcing more tightly written specifications and better control of contracts at the time of their inception.

7. Renegotiation of competitively bid contracts causes an atmosphere of uncertainty to constantly prevail in those firms subject to renegotiation due to inability to estimate whether any reserves would be available for expansion of facilities or for retrenchment in case of losses.

It is respectfully submitted that for the above and many other reasons extension of the Renegotiation Act of 1951, H. R. 4904, be amended to exempt those contracts consummated through true competitive bidding.

REASONS WHY LIMITATIONS LISTED IN SECTION 105 (F) SHOULD BE INCREASED FROM $500,000 TO $1 MILLION

1. The small contractor, being the most vulnerable financially, should have some measure of protection in order to build up facilities, strengthen his financial position, and make provision to tide over poor years.

2. The avowed purpose of defense spending is to make our country strong and to broaden the base of Government procurement sources. Renegotiation of small, new firms often means the difference between survival and failure, and serves to defeat the intent of the Congress in broadening the procurement base.

3. Renegotiation of small firms has the effect of keeping these firms small, and stifling competition.

4. Renegotiation effectively prevents small firms with a fresh and vigorous outlook and efficient management from achieving greater efficiency through the building of better facilities.

It is requested that gross receipts exempt from renegotiation be increased from $500,000 to $1 million.

Senator BENNETT. Do you have anything else you would like to have put in the record?

Mr. RAWLS. Yes, sir. I will ask that I be permitted to put this in. I regret that I have no prepared statement, but I had no high-priced lawyer to write one for me.

There is a sample of the invitation to bid from the Navy, and also a sample of the invitation to bid from the Army. You will note that every possible protection is in there for the Government. In your cost breakdowns, all data has to be submitted, labor, material, overhead,

profit, contingencies, everything on each individual item, on each item of work to be done.

Senator MILLIKIN. Do you want these to be put in the record?

Mr. RAWLS. Yes, if I may.

Senator MILLIKIN. That may be done.

(Appendix 2 and appendix 3 are as follows:)

APPENDIX 2

CHARLESTOWN TRANSPORTATION DEPOT, UNITED STATES ARMY, NORTH CHARLESTOWN, SOUTH CAROLINA

Invitation to bid No. _____ Date _____

Name of project:

Principle dimensions:

Time and place of bid opening

Sealed bids in five (5) copies, subject to the terms and conditions of this invitation, its bid form, the attached general provisions and specifications No._____ will be received in the Purchasing and Contracting Office, Building 101, Headquarters, Charleston Transportation Depot, North Charleston, South Carolina, until the time indicated below and at that time publicly opened in the Conference Room, Building 105, Charleston Transportation Depot, North Charleston, South Carolina.

Time:_____ Date: _____

Availability of inspection

Vessel covered by this specification will be available for inspection by responsible bidders' representatives at the Charleston Transportation Depot, North Charleston, South Carolina, between the hours of_____and_____from this date until one (1) day prior to bid opening inclusive except Saturday, Sunday and holidays. Bidders will report to the Combined Maintenance Division for location of vessel.

Place of performance

Work will be performed while the vessel is in the Contractor's Plant. If the plant of the successful bidder is located in the Charleston Harbor Area, the Army will deliver the vessel to the Contractor's Plant and accept redelivery of the vessel at the Contractor's Plant upon completion of the work. If award is made to a Contractor whose plant is located outside the Charleston Harbor Area, Item 0.04 of the specifications entitled "Towage Services in Delivery and Redelivery of the Vessels" will be included in the Job Order, and the Contractor shall accept delivery of the vessel at the Charleston Transportation Depot and shall return the vessel to the Charleston Transportation Depot upon completion of all work upon the vessel.

Particular requirements

A responsible bidder shall have in his possession an executed United States Army Department of Defense Master Contract for Repair and Alteration of Vessels (DD Form 731), together with appropriate insurance to cover the herein specified repair work. (See Insurance Requirements attached.)

Performance period

The Contractor agrees that if awarded the contract, he will commence work within _____ calendar days after the date of receipt of notice to proceed, and that he will complete the work within _____ calendar days after the date of notice to proceed.

Basis of award

The right is reserved, as the interest of the Government may require, to reject any or all bids and to waiver any minor informality or irregularity in bids received. If the plant of the successful bidder is located in the Charleston Harbor area, the sum of $100.00 per tow will be utilized for Item 0.04 for evaluation purposes only. The award will be made to that responsible bidder whose bid, conforming to this Invitation, will be most advantageous to the Government. Award will be made on DD Form 731–1 (Job Order). Bidders are cautioned not to alter or change specification No. _____. To do so will be cause for rejection of bid.

Additional appendix

Upon completion of work by successful bidder, he will be required to furnish, together with his invoice, a listing of each assembly, subassembly, or parts renewed. The format shall be as follows:

1. Vessel designation: U. S. Army Vessel _____
2. Performance period: _____
3. Components reconditioned: _____
4. Manufacturer's complete identifying description including:

a. Manufacturer's catalog number and page number, if available. Indicate prime manufacturer, if known.
b. Manufacturer's part name.
c. Manufacturer's part number.
d. Quantity replaced.
e. Indicate if replacement was identical or not.

APPENDIX 3

Code: Ser A–

ASSISTANT INDUSTRIAL MANAGER, USN

1453 MORSE STREET

JACKSONVILLE, FLORIDA

Date: _____

From: Assistant Industrial Manager, USN, Jacksonville, Florida.
To:
Subj: _____ Invitation to Bid; forwarding of.
Encl: (1) Items _____ thru _____
Items _____ thru _____
Items _____ thru _____
Type Work: Quinquennial Topside.

1. It is requested that you submit a sealed bid on the items forwarded herewith as enclosure (1) subject to the terms and conditions specified in your NObs Contract. The sealed bid must list the total price and the material charge for each item, and to be further broken down to show the cost of direct labor, overhead and contingencies and profit (four copies required). This information is required by Clause 2 of your Master Contract for Repairs and Alteration of vessels.

2. The vessel is located and available for inspection at the U. S. Naval Station, Green Cove Springs, Florida. All persons entering the Station will be subject to the Regulations established by the Commanding Officer of the Station. This vessel will be made available to the contractor for inspection normal working hours on the _____. Upon entering the station it is requested that you have the guard at gate notify the quarterdeck of the respective subgroup to be visited.

3. This work will be done at the bidder's shipyard.

4. Bids will be opened publicly in the office of the Assistant Industrial Manager, USN, 1453 Morse Street, Jacksonville, Florida on _____ at _____.

5. The award will be made to the bidder whose bids conform to all the provision of the NObs Contract, and whose bids will be most advantageous to the Government.

6. The Assistant Industrial Manager reserves the right, however, to reject any or all bids.

7. It is to be further understood that, due to the stringency of funds the Assistant Industrial Manager reserves the right to cancel any individual item or group of items prior to making the award.

8. Work is to commence on or about _____, and upon receipt of notification to proceed from the Assistant Industrial Manager, USN, Jacksonville, Florida, and to be completed on or before _____.

9. Where inspection and/or reports indicate need for work beyond that described in the specifications or shown on plans, change orders will be issued to cover such additional work. The Assistant Industrial Manager reserves the right to determine if and when such Change Orders will be issued and the extent of the work to be performed thereunder.

10. Upon completion of this vessel the Contractor shall store the excess Government material for a period not to exceed 60 days and shall furnish within

10 days three (3) copies of a termination inventory of that Government furnished material held in storage to the Assistant Inspection Officer in the yard.

11. If you do not desire to bid on the enclosed specifications, please notify Code 2210, Flanders 9–6604, Extension 13 prior to the bid opening time.

J. W. DANEHOWER,
By direction.

Copy to:
BuShips Code
ComLantResFlt
ComFlaGrp
FlaGrpDet

Senator MILLIKIN. Mr. W. O. Schlesinger, of the Ideal Uniform Cap Co., who was scheduled to testify this morning, was unable to appear. In lieu thereof, his statement is submitted for the record.

(The statement of Mr. Schlesinger is as follows:)

IDEAL UNIFORM CAP CO.,
Freeport, N. Y., June 6, 1955.

CHAIRMAN, SENATE FINANCE COMMITTEE,
United States Senate, Washington, D. C.

DEAR SIR: I find that I am unable to attend the public hearings on the renegotiation extension bill, H. R. 4904. I would appreciate having you read this letter at the hearing and enter it into the official record.

The original renegotiation act had its birth during the war period when contractors made huge profits because demand exceeded supply. Today this situation no longer exists generally, especially in the soft-goods field. Therefore, many parts of the law have become outmoded and should be modified to comply with present-day purchasing methods of the Government.

I refer particularly to formal, firm-price bids. This type of bidding leaves no opening for the prospective contractor to bid a higher price and then bargain with the Government later to reach a happy medium. He can only enter one price, and it must be the right, if he expects to obtain the order. Consequently, every effort is made to reduce cost as much as possible. If during the course of filling the contract there are economies and efficiencies developed it does not seem fair that the Government should put the contractor to the expense of renegotiating and then possibly requesting part of the profits.

At the inception of the act, during the war period, almost all bids were the negotiated type, and I recall that the name "renegotiation" was adopted, as it did just what the name implies—renegotiated contracts that were originally negotiated. I do not believe that the act was intended to cover firm-price contracts resulting from formal bids.

As the Hoover Commission pointed out recently, very few bids are of the formal type, and perhaps, for that reason, treatment of this category has been overlooked.

I respectfully request that contracts resulting from formal bids be eliminated from the act so that it will apply only as originally intended, to negotiated contracts.

Very respectfully yours,

S. O. SCHLESINGER.

Senator MILLIKIN. Mr. William T. Darden, editor and publisher of Reports for Industry.

Please identify yourself for the record.

STATEMENT OF WILLIAM T. DARDEN, EDITOR AND PUBLISHER, DARDEN MONTHLY RENEGOTIATION REPORTS, AND REPORTS FOR INDUSTRY

Mr. DARDEN. Mr. Chairman and members of the committee, my name is William T. Darden. I am editor and publisher of Darden Monthly Renegotiation Reports, as well as special reports for industry.

I am opposed to the continuation of this act. In view of the time element, if it is agreeable with the chairman, I would just as soon file a statement for the record.

Senator MILLIKIN. That will be all right. Thank you very much. It will be made a part of the record.

Mr. DARDEN. Thank you.

(The prepared statement of William T. Darden is as follows:)

STATEMENT OF WILLIAM T. DARDEN, WASHINGTON, D. C.

My name is William T. Darden. I am editor and publisher of Darden's Monthly Renegotiation Reports (in addition to special reports for industry). With the exception of the Renegotiation Board officials, I have followed the overall application of the Renegotiation Act of 1951 since its inception, probably closer than any other individual. Therefore, I am appearing today in opposition to H. R. 4904 to extend the Renegotiation Act of 1951 for 2 years.

I shall briefly discuss the reasons why I am opposed to a continuation of the renegotiation authority. They are:

1. Experience has shown that we do not need the renegotiation concept;

2. Excessive administrative cost voids any value that might be attached to the theory that through renegotiation the maximum return is received for each dollar spent;

3. Renegotiation is not only a hindrance to broadening and strengthening the mobilization base, it often causes grave injustices to contractor and subcontractor.

When Congress passed legislation in 1951 to provide for the renegotiation of defense contracts there was justification. Having appropriated large funds for the national-defense program and not knowing to what proportions the Korean conflict would expand, it was necessary to rely on World War II experience. Now, however, after 3 years of renegotiation this committee can appraise the necessity for renegotiation in a period when defense production is secondary in volume to civilian production.

Since the beginning of the Korean conflict, the defense contracting and subcontracting field has been highly competitive. The number of prime contractors seeking defense business has been far larger than at any time during World War II. The number of subcontractors seeking defense business has been evidenced by the amount of advertising such contractors have placed in the newspapers. From the beginning of the Korean conflict one could look at the business section of the New York Times every Sunday and find ad after ad offering production facilities for defense work. One ad which appeared every Sunday read "2,000 subcontractors in the Long Island area seek defense work."

As a result bids have been so low that profits have been automatically curtailed which leaves no excuse for the determination of renegotiable profits.

This is substantiated by the Renegotiation Board's estimates that 164,500 contractor reports will be filed under the Renegotiation Act of 1951. The Board estimates that 109,500 of these reports will be filed by the contractors and subcontractors whose renegotiation business was less than the statutory floor therefore not subject to renegotiation. It was estimated that through headquarters screening process it would be determined that excessive profits did not exist in 33,450 cases. Of the 21,550 cases the Board estimates it will assign for full processing, we can assume, based on past experience, that excessive profits will be found in only about 3,225 cases.

We must also remember that, based on surveys, it costs the contractors an average of $1,500 in administrative expense per renegotiation filing. In other words, the 164,500 reports, which the Board estimates it will receive, will cost contractors and subcontractors about $245 million. This cost is tax deductible and I know this committee realizes that it is also passed on to the Government in the price paid for goods or services. To this must be added the administrative expenses of the Renegotiation Board which will be about $21 million, assuming that the act is not extended and the Board can wind up its affairs in 2½ years.

In summary you have about 87 percent of your defense contractors who are excluded from renegotiation because their volume of such business is below the "floor" or their reports indicate no possibility of excessive profits.

In about 11 percent of the cases, based on past experience, it will be determined after examination that no excessive profits exist. Excessive profits will be found in less than 2 percent of the total number of cases filed. Frankly, from what

I have been able to gather from contractors and subcontractors the number of excessive profit determination cases would have been much less if the Board had not employed the leveling-off-to-prior-volume and profits theory. I am informed by the contractors who have been through the renegotiation process that notwithstanding that various Senators and some members of this committee made it clear that volume increase of itself is not to be used as a basis for refund determinations, the renegotiation boards do use this factor, and admit it, in arriving at proposed settlements. Some of the Tax Court cases that have been filed under the Renegotiation Act of 1951 appear to confirm this.

The small percentage of excessive-profit cases in relation to the total number of contractors engaged in defense work points up the fact that competition plus improved procurement techniques have eliminated the necessity for renegotiation.

Some will say that although the number of excessive-profit cases are small in comparison, the dollar volume of determinations is large. But, is the dollar volume of determinations large enough to place renegotiation on a self-sustaining basis?

From the various reports made by the Board to Congress, it would appear to be a self-sustaining act. However, these reports only reflect total renegotiable determinations made on a before-tax basis. Under the act a contractor or subcontractor is allowed a credit for Federal income and excess-profits taxes. Therefore, to gain a true prospectus of the self-sustaining aspects of renegotiation one must deduct tax credits from renegotiation determinations, since these credits represent tax dollars collected prior to renegotiation. The results will give a true picture of the amount of new dollars recovered through renegotiation. Then one is in a position to compare new dollar recoveries against the cost of renegotiation to the contractors and the Government. This will prove the point that the value of renegotiation is voided by its cost of administration.

In recent months an effort has been made through the press to create an impression that all defense contractors were reaping millions of dollars in unjust profits. This has been an unfair charge, not supportable by facts, which reflects on all defense contractors as well as the procurement officials who are trying to do a conscientious job. I am not, and I am sure this committee is not unaware that these planted press stories appear only at the time our Congress is considering a continuation of the renegotiation authority.

Our President in his special message to Congress said "* * * in the interest of broadening and strengthening the mobilization base, we have encouraged the extensive use of subcontracting. Because the United States has no direct contractual relations with the subcontractors, the only protection against unreasonable prices by them is through the process of renegotiation."

We have today capable subcontractors who, having been through the renegotiation process, refuse to make their facilities available for defense production if receipts from such production is subject to renegotiation. The reason many subcontractors feel bitter about renegotiation is expressed in this letter from one of our subscribers:

"If you'll study the reports of big business defense contractors, you'll find they have no difficulty making and retaining (even with competition and price redetermination contracts) a good, but fair profit. Not so, as to small business—for whom this whole program seems to be designed as a crusher.

"I've a case in _____ where a company almost went broke trying to work out some difficult invention and design problems for the turbojet program on behalf of a prime contractor. For 3 years they made little or no money and the bosses worked for nominal salaries.

"In the fourth year (the renegotiable one) they were successful in working out the problem and made 26 percent on sales, before taxes. After taxes it was 8 percent. No dividends were paid or salaries raised. They paid off debt on the plant in order to clear decks for forthcoming orders (they hoped).

"What happened? Korea ended; orders never came, and the hypothetical 'profit' of the 1 renegotiable year became a myth. They dropped employees from 125 to 20. Yet, the Board (first the regional then on appeal to Washington) declined to recognize the long-range aspects of the problem; the terrific contribution to the defense effort—nor even the fact that the company followed instructions of the prime contractor in clearing decks for action which it was expected would be forthcoming.

"The Board said $65,000 excessive profits or else! The cash outlay, of course, was only $20,000 but they haven't got it and are being forced out of business as a result. So there goes another small business (a good engineering-type mind) and a payroll of over 100 people down the drain. Renegotiation?

The majority of subcontractors who enlarged their production capacity during the Korean conflict are now hungry for subcontracts.

Although the Government has no direct contractual relations with subcontractors, the present availability of subcontractor facilities has given the Government and its prime contractors a competitive price factor unknown in the previous history of our country. Furthermore, to state that renegotiation is the only protection against unreasonable prices by subcontractors is a reflection on the purchasing ability of the prime contractors. I have found that greater price care is exercised by prime contractors in letting subcontracts under Government prime contracts than is exercised under commercial business.

Government officials have stated that the Renegotiation Act is as necessary today as it was during World War II and during the Korean conflict.

Each time the question of renegotiation is before the Congress, World War II results are projected. I know of no one who doubts the value of renegotiation in a period of an all-out shooting war. Renegotiation is a war measure designed to deal with the problem of controlling prices and profits under Government contracts when competitive markets are overwhelmed by such contracts. However, we must remember that today expenditures for defense in relation to the total output of our economy is just reverse from the World War II period. Therefore, World War II results cannot be used as a guide in evaluating the need for renegotiation in today's economy.

If our procurement officials, after the experience of World War II and the Korean war, plus today's competitive factor, must rely upon statutory renegotiation, then something is wrong with the procurement setup, which should be the subject of study rather than the necessity for renegotiation.

The aircraft industry appears to have been selected as the whipping boy in connection with defense expenditures. No doubt this stems from the fact that about 50 percent of the Department of Defense procurement appropriation is earmarked for the Air Force.

However, a 3- to 4-percent (industry average) net profit on sales not unreasonable, nor is the return on investment-capital basis unreasonable. To properly appraise the profits of this industry one must consider its value in relation to our national defense. We must also remember that the greatest asset of this industry to our national defense is the know-how of the aircraft industry. This is an extremely important value added factor which does not appear in the return on investment capital side of the ledger.

With profits on sales at their present levels, we need have no fear that the aircraft industry is reaping excessive profits. However, if profit margins in this industry should increase, the Air Force through its redetermination provisions can recover any such excessive profits without having to rely on statutory renegotiation.

It is interesting to note that some 20 years ago the Congress did not consider a profit limitation of 12 percent on aircraft as unreasonable. There was no restriction by reason of return on invested capital under the Vinson-Trammel Act. Many contractors have found that the amount of profit they are allowed to retain under renegotiation is less than would have been granted under the Vinson-Trammel Act.

It is very difficult to understand how the Secretary of the Air Force can on one hand, in effect, say the financial health of the aircraft industry is essential to the defense of our country, then on the other hand say a 3.8 percent net profit on sales to this industry is too high.

Thank you for granting me the opportunity to appear before your committee.

Senator MILLIKIN. Does anybody else want to testify who has not been called? If not, thank you all very much.

The next meeting is at 10 o'clock tomorrow morning.

(By direction of the chairman, the following is made a part of the record:)

STATEMENT BY THE AMERICAN PAPER & PULP ASSOCIATION, NEW YORK, N. Y., IN OPPOSITION TO H. R. 4904

This statement is submitted on behalf of the American Paper & Pulp Association in opposition to H. R. 4904. The American Paper & Pulp Association is the overall trade association for the paper and pulp industry in the United States. The paper and pulp industry is the fifth largest industry in this country and has a total investment of $7,600,000,000 with annual sales approximating the same amount.

H. R. 4904 would extend the Renegotiation Act of 1951 for 2 years, through December 31, 1956. It would also amend section 102 (d) of the Renegotiation Act of 1951 to provide that the profit limitations under the Vinson-Trammel Act and the Merchant Marine Act shall not apply to any contract or subcontract if any of the receipts or accruals therefrom are subject to the Renegotiation Act of 1951 or would be subject thereto, except for the provisions of section 106 of such act. The amendment to section 102 (d) would be effective with respect to amounts received or accrued by contractors or subcontractors after December 31, 1953.

While there can be no disagreement about the need for adequate contracting procedure to enable the Federal Government to obtain what it needs at a fair and reasonable price, at the proper time, and of proper quality, the question remains how best to accomplish this objective. The immediate question is whether or not renegotiation helps or hinders in attaining this objective.

The American Paper & Pulp Association is firmly of the belief that renegotiation creates more harm—more cost and less efficiency to the Government—than it creates good and certainly this is true when there is no national emergency or shooting war.

There has indeed been no proper study conducted of the necessity for renegotiation. The Chairman of the Renegotiation Board has stated that since October 1951 through December 1954, $232 million has been turned over to the United States Treasury as a result of renegotiation. He estimated that the administrative cost aggregated $4½ million a year; in other words approximately $14 million for this period. However, the bulk of the cost of the operation and administration of the Renegotiation Act is borne by the private contractor and not only is this cost tax deductible but also it, in turn, is passed on to the Government in the price paid. Conservative estimates have been made that this cost for the October 1951 through December 1954 period aggregated $175 million. Furthermore, 52 percent of the above-noted sum of $232 million would have accrued to the Government through corporate income taxes and that amount, therefore, must be deducted from the $232 million to get the proper fiscal picture.

Representatives Mason and Curtis, both distinguished members of the House Ways and Means Committee, have stated: "Both the Bonner subcommittee and the Small Business Committee in the 82d Congress conducted 2 years extensive hearings and studies into the subject of military procurement and contracting. We think these studies indicate one very basic conclusion: It is most important to good and efficient purchasing that the Federal Government not employ shyster tactics either by administrative procedures or by law in its dealings with private enterprise.

"The time is present right now when many fine, honest, and efficient companies will neither negotiate nor bid on contracts with the United States Government. The United States Government in its procuring will pay the price many times over if the only people it can deal with are the less efficient, less fine, and less honest concerns and this will be true no matter how many devices like renegotiation we may set up to check the trend of higher costs."

The American Paper & Pulp Association respectfully urges:

1. There is no place for renegotiation in peacetime.
2. Renegotiation destroys incentives to maximum productive efficiency and lowest cost.
3. Renegotiation encourages lax procurement and results in wasteful and costly procurement.
4. The continuance of the discontinuance of renegotiation would bring into full play the forces of the free competitive system.
5. The cost of administering renegotiation is far greater than the amount of money recovered by the Government.

We oppose H. R. 4904 and urge that it be not reported from this committee.

RECOMMENDATION OF THE YOUNGSTOWN CHAMBER OF COMMERCE SUBMITTED BY L. D. WOODWORTH, PRESIDENT

The Youngstown Chamber of Commerce wishes to record the opposition of its membership to a further extension of the Renegotiation Act.

Renegotiation was conceived as a war-emergency measure. It was resorted to at the start of World War II in recognition of the fact that defense procurement agencies could not obtain close, firm prices in a time of disruption of the national economy resulting from all-out mobilization for war.

It was an extraordinary procedure designed to deal retroactively with the difficulties presented by (1) widespread lack of production experience and of cost data on the part of contractors turning to war production, (2) inexperience of hastily recruited procurement personnel, and (3) absence of competitive conditions in the disrupted economy.

Ten years after the end of the war, and with military procurement decreasing, these conditions have disappeared. In partial recognition of this, Congress has already exempted standard commercial articles from renegotiation. For other procurement items, at both the prime and subcontract levels, alternative sources of supply and a high degree of competition now exist.

In the intervening years of large-scale defense buying, the Government procurement services have developed highly sophisticated buying techniques. They now have available a series of contracting devices highly developed and fully adequate for obtaining sound pricing even in the fields of new weapons and of research and development.

In addition to public bidding and cost reimbursement type contracts, these devices include the redetermination of price on individual fixed-price contracts during the course of their performance, both at the prime and subcontract levels, escalation to avoid contingency allowances in fixed-price contracts, incentive-type contracts under which profit varies with cost reductions achieved, and the use of bidding procedures as a preliminary to subsequent negotiation of contracts.

We believe that pricing is a procurement function which today can and should be discharged by the procurement officials. Not only do we believe the Renegotiation Act is no longer necessary, but we think in all probability it will cost the Government more than it will save, for inevitably it restricts normal incentives to efficiency. We know the cost of conducting renegotiation and the prolonged uncertainty it involves place a heavy burden on industry.

We therefore believe it is contrary to the public interest to perpetuate in these times procedures which vest in any group of men the highly arbitrary powers of retroactive determination conferred by this act.

Accordingly, we urge that S. 1017 be rejected.

STATEMENT OF GEORGE S. EATON, EXECUTIVE SECRETARY, NATIONAL TOOL & DIE MANUFACTURERS ASSOCIATION, CLEVELAND, OHIO

Speaking from the viewpoint of the manufacturers of special tools and dies, many of whom also do some precision production work, it is my purpose to urge—

(1) That the Renegotiation Act not be extended,

(2) That if it is extended, the extension be for only 1 year, and

(3) That if it is extended, all productive equipment which does not become a part of the end product be exempted, as was the case under the 1948 Renegotiation Act.

Renegotiation has no place in a peacetime economy such as we are now in where normal competitive conditions provide fully adequate safeguards against excessive profits, except possibly in the case of weapons of defense so new that no production experience is yet available. In such instances, price redetermination and other available techniques offer a means of insuring that no more than a reasonable profit may be retained by the contractor.

The net return to the Government from renegotiation is very small—or in fact, entirely lacking, when its effect on income-tax payments is adequately allowed for.

The cost of preparing reports for the Renegotiation Board may run into thousands of dollars for a single small company, even though clearance is given in the end. And the top executives' time required for handling these proceedings, in the case of small companies like those making up the special tool and die industry, is not only costly but most disturbing to the normal operation of the business.

With the Renegotiation Board still working on returns for 1951, it is obvious that the businesses concerned are handicapped by not knowing what their financial status really is.

While the regional boards are instructed by the law to give consideration to the six statutory factors in deciding what are excessive profits, and in general we believe are trying to do a conscientious job, there has been much complaint

that they are unwilling to give proper credit for unusual efficiency of operations. This tendency to cut the efficient shop's profit down to about the same level as the inefficient, of course removes the incentive that has brought such remarkable cost reductions in American industry.

The mere fact that a contractor must expect to have taken away all but a relatively low percentage of profit means that he is not apt to put in the extra thought, ingenuity, and careful attention that results in lowering costs, or to buy more efficient production equipment for the job.

Since it is not possible to measure accurately the comparative performance of Government contractors, under the six statutory factors, and decisions must be based on personal judgments, there are bound to be discrepancies and inequities in the settlements offered, no matter how sincerely the renegotiators strive to be fair.

The admitted unfairness of the miscalled excess-profits tax is being perpetuated in lesser degree by renegotiation, which has no place in today's economy.

However, if renegotiation is extended, tool and die manufacturers feel strongly that its impact on small businesses such as theirs should be lightened.

SHIPBUILDERS COUNCIL OF AMERICA,
New York 6, N. Y., May 31, 1955.

Hon. HARRY F. BYRD,
Chairman, Senate Committee on Finance,
United States Senate, Washington 25, D. C.

DEAR SENATOR BYRD: In connection with pending bill H. R. 4904, to amend and extend the Renegotiation Act of 1951, the Shipbuilders Council of America appreciates the privilege which has been afforded to it to submit for consideration by your committee the attached statement suggesting and supporting a further amendment of subsection 102 (d) of the act to insure that ship-repair and alteration contracts covered by the Renegotiation Act are not concurrently subject to conflicting administrative profit recapture techniques.

The Shipbuilders Council is a national trade association of private shipbuilding and ship-repair companies. At the present time it includes in its membership practically all of the private industry in this field.

The members of the council cannot help but feel that the committee will appreciate the inequity of concurrent profit recapture and renegotiation in the case cited and, as a result will recommend the suggested amendment for adoption by the Senate. Such action would operate to suspend administrative recapture of profit while renegotiation is in effect in the same manner that subsection 102 (d) now does with respect to the statutory recapture provision of the Vinson and Merchant Marine Acts.

Respectfully submitted.

L. R. SANFORD, *President.*

STATEMENT OF SHIPBUILDERS COUNCIL OF AMERICA SUGGESTING A FURTHER AMENDMENT TO H. R. 4904

In connection with pending bill H. R. 4904, to amend and extend the Renegotiation Act of 1951, the Shipbuilders Council of America requests consideration by the committee of the urgent need for adoption of a further amendment to the bill along the lines suggested herein relating to a contractual profit recapture system now being imposed by the Maritime Administration, which system that agency has stated it will continue to impose even though the Renegotiation Act is extended.

In August 1954 the Maritime Administration informed the Shipbuilders Council of America and the ship-repair industry generally that it had decided that contracts for the repair of vessels under its jurisdiction henceforth would be awarded only to those contractors who would agree to the inclusion in their contracts and subcontracts of a provision for the recapture of excess profits. A copy of the required contract provision and covering letter from the Maritime Administration is attached. At the time this notice was received by the council, a bill to extend the Renegotiation Act of 1951 for another year to December 31, 1954, had already been passed by the Congress but had not yet been acted upon by the President.

Thereafter, on September 2, 1954, the day after the extension bill was signed by the President (Public Law 764, 83d Cong.), the Shipbuilders Council requested the Maritime Administration to withdraw its profit recapture requirement be-

cause it would obviously conflict with renegotiation. The Administration promptly denied this request. It took the position that there is nothing in subsection 102 (d) or any other section of the Renegotiation Act of 1951 which prohibits the Maritime Administration from imposing its own profit-recapture system and that it could impose such recapture even though the contracts which would be covered would also be subject to the Renegotiation Act.

Unfortunately, due to the depressed state of the ship-repair industry, the various ship-repair contractors reluctantly agreed to the dual recapture arrangement imposed upon them by the Maritime Administration as a condition of eligibility for any further award of repair contracts.

Early in November 1954 the council renewed its protest against the use of such a recapture provision in the master repair contracts. In connection with this protest, the council again called the Administrator's attention to the conflicting dual application of renegotiation and the Administration's contractual profit recapture system, but to no avail. The Administration merely confirmed that it would continue to require contractors to agree by contract to subject themselves to profit recapture as a condition precedent to any eligibility for award of Maritime Administration controlled vessel repair work.

The Maritime Administrator, in his reply to the council's November 1954 request that the contract provision be deleted, noted that "it lies within the administrative discretion of the Maritime Administration whether or not bids on ship-repair work are invited subject to provisions for the recapture of excess profits. It must also be noted that the 10 percent limitation is the same as the percentage provided in the Navy Department's Vinson Act, and in the Merchant Marine Act, 1936, as amended. It is our opinion that the regulations for determining profit of the Federal Maritime Board and the Maritime Administration which have been used in connection with ship construction and reconstruction and reconditioning work are applicable to ship-repair work as well."

Actually, there is no provision in any law requiring the Maritime Administration to include a profit recapture provision in its repair contracts and such inclusion, based on mere administrative discretion, is an extraordinary assumption of power by the Maritime Administration in a field which usually and more properly is left to Congress. It is significant that while Congress included a profit-recapture provision in the Merchant Marine Act of 1936, it did not specify ship repairs as subject to such a provision. If the Congress had any intent of applying profit recapture to repair work, it is presumed that it would have so stated. The fact that it did not so state cannot help but be indicative of a contrary intent.

It is apparent that no purpose will be served by any further appeal to the Maritime Administration at this time in view of its claim of administrative prerogative to amend the provisions of the Merchant Marine Act by means of contract requirements. And this is the practical effect of such action by the Maritime Administration.

The ship repair members of the council feel that it is important in connection with the consideration of H. R. 4904, that Congress be informed of the position which has been taken by the Maritime Administration in this matter and of the pressing need to further amend section 102 (d) of the act to insure that ship repair, ship alteration, and similar Government contracts, which will again be covered by the Renegotiation Act if it is extended, are not concurrently subject to conflicting administrative profit recapture requirements.

Obviously it is the intent of subsection 102 (d) of the act that the techniques of renegotiation as a means of profit control should be used with respect to all contracts and subcontracts covered by the act during any period the act is in effect and that the conflicting techniques required by such special laws as the Vinson Act and Merchant Marine Act are not to be imposed at the same time. In fact, part of section 102 (d) was actually inserted in the original 1951 act as a result of specific suggestions made by the then Secretary of Commerce, Mr. Charles Sawyer, in a letter to the chairman of the Finance Committee under date of February 9, 1951.

At that time the Secretary of Commerce wrote:

"The Department is inclined to concur in the views expressed in the report of the Committee on Ways and Means, accompanying H. R. 1724, which stressed the desirability of keeping 'final responsibility for the renegotiation of Government contracts separate from the procurement authorities which initially issued the contracts—it being obvious that the renegotiation, after the end of a fiscal year, of a contractor's total receipts and accruals from defense contracts during that fiscal year is more of a financial operation than one relating to the procurement of perhaps several very diverse products of the contractor.

"It is suggested that your committee give consideration to an amendment to follow section 102 (c), headed 'Suspension of certain profit limitation,' to provide for the suspension of the profit-limitation provisions in section 505 (b) of the Merchant Marine Act, 1936. You may deem this to be desirable, as the section of the Merchant Marine Act referred to provides for a limitation of profit to 10 percent of the contract price of such contracts as are completed within the taxable year, and also for carrying over a net loss in 1 year in determining the excess profit for the next succeeding year, whereas the Renegotiation Board set up under the new bill may determine the allowable profit at less than 10 percent, and will, in most instances, consider the total receipts and accruals during each fiscal year, regardless of the completion of any particular contract within that year. Also, the new bill, in contradistinction to the procedure under section 505 (b) of the Merchant Marine Act, provides that 'no amount shall be allowed as an item of cost by reason of the application of the carryover or a carryback'."

It is submitted that all of the considerations which led to the original suspension of the Vinson and Merchant Marine Act profit-limitation provisions apply with equal force to the administrative recapture system now being imposed on ship repairing by the Maritime Administration.

The council strongly urges that, in the event the committee decides to recommend the enactment of legislation extending the Renegotiation Act, it will also recommend the adoption of an amendment to the act to suspend the administrative recapture of profit while renegotiation is in effect in the same manner that subsection 102 (d) of the act now provides with respect to the statutory provisions of the Vinson and Merchant Marine Acts.

The pending bill H. R. 4904 as passed by the House already provides for an amendment to subsection 102 (d) of the act to take care of a situation which has arisen with respect to the "standard commercial article" exemption enacted last year. In order to prevent the inequitable concurrent profit recapture and renegotiation cited herein, it is suggested that such subsection 102 (d), as it would be amended by the pending bill, might be amended further to read as follows:

"(d) SUSPENSION OF CERTAIN PROFIT LIMITATIONS.—Notwithstanding any agreement to the contrary, (*1*) the profit-limitation provisions of the act of March 27, 1934 (48 Stat. 503, 505), as amended and supplemented, and of section 505 (b) of the Merchant Marine Act, 1936, as amended and supplemented (46 U. S. C. 1155 (b)), shall not apply, in the case of such act of March 27, 1934, to any contract or subcontract if any of the receipts or accruals therefrom are subject to this title or would be subject to this title except for the provisions of section 106, and, in the case of the Merchant Marine Act, 1936, to any contract or subcontract entered into after December 31, 1950, if any of the receipts or accruals therefrom are subject to this title or would be subject to this title except for the provisions of section 106; (*2*) *no contract or subcontract for the repair or alteration of a vessel or portion thereof entered into by or for the United States if any of the receipts or accruals therefrom are subject to this title or would be subject to this title except for the provisions of section 106, shall be subject to any profit provision except as may be specifically required by law.*"

This suggested additional language is restricted to vessel repair and alteration contracts so as not to interfere with or have any effect on Government procurement contracts in other fields. Also, the suggested amendment is made applicable to contracts by or for the United States rather than only to those of the Maritime Administration in order to eliminate the possibility that, because of the precedent set by the Maritime Administration, a similar situation might arise with respect to vessel repairs for the defense agencies including the Coast Guard.

As hereinbefore stated, the members of the Shipbuilders Council of America feel confident that the committee will appreciate the inequity of allowing the Maritime Administration to continue in effect its own administratively adopted profit recapture system at the same time that the Renegotiation Act is in effect and that, as a result, it will recommend the amendment suggested for adoption. Such action would be entirely consistent with present provisions of the Renegotiation Act with respect to the profit limiting provisions of the Vinson and Merchant Marine Acts.

63593—55——5

UNITED STATES DEPARTMENT OF COMMERCE,
MARITIME ADMINISTRATION,
Washington, D. C., August 27, 1954.

Mr. L. R. SANFORD,
President, Shipbuilders Council of America,
21 West Street, New York, N. Y.

DEAR MR. SANFORD: There is enclosed for your information a copy of the Office of Ship Construction and Repair Amendment to the Marad lump sum contract, dated August 24, 1954.

As you know, the Maritime Administration has determined that a provision for recapture of excess profits is to be made a part of all Marad lump sum repair contracts awarded in connection with the emergency ship-repair program. Therefore the invitations to bid and job orders will include this provision.

Sincerely yours,

E. C. UPTON, Jr.,
Acting Maritime Administrator.

Enclosure.

AMENDMENT TO THE MARAD LUMP-SUM REPAIR CONTRACT

REPORT OF COST—EXCESS PROFITS—SUBCONTRACTORS

OFFICE OF SHIP CONSTRUCTION AND REPAIR,
August 24, 1954.

Article (a) In the event any work is awarded subject to the provisions of this article the contractor agrees that as to job order covering such work, and the suppplemental job orders thereto:

(i) To make a report under oath to the Administration upon the completion of the work awarded subject to the provisions of this article, as modified by all change orders in connection with such awarded work, setting forth in the form prescribed by the administration the total contract price of such work, as modified by the applicable change orders, if any, the total cost of performing such work, as modified, the amount of the contractor's overhead charged to such cost, the net profit and the percentage such net profit bears to said contract price, or said modified contract price, and such other information as the administration shall prescribe.

(ii) To pay to the Administration profit, as shall be determined by the Administration, in excess of 10 percent of the total contract price or said modified contract price, covering work subject to the provisions of this article or work under subcontracts for work subject to provisions substantially the same as set out in this article under other lump-sum ship-repair contracts of the Administration as is completed by the contractor within the income taxable year, which such amount or amounts shall become the sole property of the United States: *Provided, however*, That, if there is a net loss on all such work or subcontract work such net loss shall be allowed as a credit in determining the excess profit, if any, for the next succeeding income taxable year: *Prvided*, That, if such amount is not voluntarily paid, the Administration shall determine the amount of such excess profit and collect it in the same manner that other debts due the United States may be collected.

(iii) To make no subdivisions of a job order or supplemental job order subject to the provisions of this article or any subcontract for work subject to the provisions of this article for the purpose of evading the provisions of this article, and any subdivisions of such job order or supplement job order or subcontract in excess of $10,000 shall be subject to the conditions prescribed in this article.

(iv) That the books, files, and all other records of the contractor, or any holding, subsidiary, affiliated, or associated company shall at all times be subject to inspection and audit by any person designated by the Administration, and the premises, including the vessel, of the contractor, shall at all times be subject to inspection by the representatives of the Administration.

(v) The amount of profit derived by the contractor from the performance of the work covered hereby shall be determined by the Administration in accordance with the Regulations Prescribing Method of Determining Profit, as revised by the Federal Maritime Board and Administration, United States Department of Commerce, July 21, 1952, including all amendments through July 29, 1954.

Article (b). The contractor further agrees to include in its subcontracts for work or materials required for a job order, or supplemental job orders thereto, subject to the provisions of this article, the agreement that such subcontractor shall pay to the Administration excess profit in accordance with provisions of paragraph (a) above, in the event such subcontract, as may be modified, is in excess of $10,000, and the agreement that the subcontractor agrees that all of its subcontracts with the contractor for the same article or articles, as defined in said regulations, required for a job order or supplemental job orders thereto, subject to the provisions of this article, shall be deemed to be a single subcontract for the purposes of its agreement to pay excess profit.

PEAT, MARWICK, MITCHELL & CO.,
CERTIFIED PUBLIC ACCOUNTANTS,
Chicago 3, Ill., May 10, 1955.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SIR: We understand that there is pending before your committee a bill passed by the House of Representatives (H. R. 4904) to extend the Renegotiation Act of 1951 and its companion Senate bill (S. 1017). On behalf of our many clients affected thereby, we wish to submit for the record our recommendations having to do with profit limitations of other existing statutes. Specifically, such limitations are provided for in the Vinson-Trammel Act, as amended, and the Merchant Marine Act of 1936, as amended, which by Revenue Ruling 55–173 of the Commissioner of Internal Revenue have been declared applicable to receipts and accruals which may be exempted from renegotiation under section 106 (a) (8) of the Renegotiation Act. It should be made clear that our recommendations in this connection are in accordance with the wording of the bill as passed by the House of Representatives.

In making this recommendation, we wish to state clearly that no unqualified approval or rejection of the renegotiation process is intended or implied. As a matter of opinion, we agree in substantial part with the views of various industrial organizations and associations as they have been expressed to your committee, particularly as to the pressing needs for a top-level review of present Government contracting procedures in their entirety, and toward the development of sound and well-integrated procedures that will eliminate most of the troublesome and costly overlapping procurement devices presently employed. We wholeheartedly support suggestions and proposals that have been made for extensive public hearings on this and related subjects, toward the objective of achieving the most effective and economical system of Government procurement possible.

We recognize, however, that as a present procurement expedient, your committee may decide to carry out the request of the President in his message to the Congress of March 4, 1955, for extension of the Renegotiation Act as a necessary protective device insuring reasonable prices to the Government in its continuing military purchases on a vast scale. Admittedly, there are persuasive arguments for continuing renegotiation as one of many necessary instruments in the complex field of Government military procurement, and in this event, we urge your committee to consider carefully the House-approved amendment. We believe that its effect is to continue application of renegotiation procedures in those specialized areas of procurement for which it was originally, and has since, been intended, and at the same time carry out the true intent of Congress at the time the act was extended for the year 1954, to free those areas of Government purchasing from its synthetic controls where relatively normal competitive conditions have reestablished those normal controls which are incident to a free market.

The House amendment, which we support, would revise section 102 (d) of the Renegotiation Act by inserting after the word "title" each place it appears, the words "or would be subject to this title except for the provisions of section 106" thus making it read as follows:

"(d) SUSPENSION OF CERTAIN PROFIT LIMITATIONS.—Notwithstanding any agreement to the contrary, the profit-limitation provisions of the Act of March 27, 1934 (48 Stat. 503, 505), as amended and supplemented, and of section 505 (b) of the Merchant Marine Act, 1936, as amended and supplemented (46 U. S. C. 1155 (b)), shall not apply, in the case of such Act of March 27, 1934, to any con-

tract or subcontract if any of the receipts or accruals therefrom are subject to this title *or would be subject to this title except for the provisions of section 106*, and, in the case of the Merchant Marine Act, 1936, to any contract or subcontract entered into after December 31, 1950, if any of the receipts or accruals therefrom are subject to this title *or would be subject to this title except for the provisions of section 106*." [Italics indicate House-approved amendment.]

This amendment is necessary in order to clarify the situation created by the issuance of the aforementioned Revenue Ruling 55–173. In extending the Renegotiation Act for 1 year to December 31, 1954, the Congress had recognized the true economic fact that competitive conditions had been reestablished in virtually all areas of normal product output, that supplies of standard commercial articles were in near balance with aggregate civilian and Government demand, and that once again commercial enterprises in virtually all industrial fields were actively competing for Government orders. Accordingly, the Congress acted to exempt sales of standard commercial articles from renegotiation except in those cases where the Renegotiation Board determined that competitive conditions affecting such sales in individual cases were such as would not reasonably prevent excessive profits. The burden of proof was placed on each contractor and subcontractor to substantiate by all reasonable means that active competitive conditions did exist with respect to each of its individual product lines, and the Board was empowered to accept or reject each individual application for the exemption as it saw fit. This procedure was well calculated to insure adequate protection to the Government against unreasonable prices for the goods it bought.

To make sales so exempted, after careful screening by the Renegotiation Board, subject to the profit limitations of the other cited acts, has appearances of subjecting reasonable profits earned from fair business dealing to conditions of "double jeopardy." At the same time, it adds further to the administrative burdens and clerical costs imposed on companies doing business with the Government, a fact that weighed heavily in earlier decisions to suspend the provisions of the Vinson-Trammel Act where renegotiation was applicable. Thus, it would appear that the true intent of the Congress to eliminate an unnecessary administrative procedure where warranted by economic conditions is to be defeated by imposing even more complex and burdensome reporting procedures.

In this connection, your committee should consider the true nature of the Vinson-Trammel and Merchant Marine Acts. Basically, these are cost-plus procedures which have long been in disrepute as effective purchasing techniques. By actual experience they have been proved costly, both to the Government and business, since incentives for efficiency and cost control are vitually eliminated thereunder. To impose this profit limitation method, in lieu of overall renegotiation, which calls for reasoned business judgment in allowing reasonable profits on Government business, represents a disastrous step backward in the common effort to achieve fair dealing in the public interest. To do so would, in the final analysis, prove costly to the Government since it would inevitably close off vast sections of our national productive resources which can survive and perpetuate themselves only upon retention of adequate profit returns.

This statement is submited on behalf of our many clients in virtually all areas of industrial and commercial activity which, in the normal course of their businesses, are contractors and subcontractors to the United States Government.

Very truly yours,

PEAT, MARWICK, MITCHELL & CO.
THOMAS J. GREEN, *Partner*.
ROBERT S. MACCLURE, *Partner*.

CENTRAL FIBRE PRODUCTS CO., INC.,
Quincy, Ill., June 2, 1955.

Re Renegotiation Act.

Hon. HARRY F. BYRD,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: Our company manufactures paperboard and paper products. We have been put to an unusual amount of work in proving our exemption from renegotiation. The same would have been quite evident had an overall study been made of the paperboard and paper products industry and such companies would have been automatically exempt.

We think the present Renegotiation Act which is up for extension should not be extended. A new act should provide either for exemption of a million dollars of renegotiable business or should provide for renegotiation of contracts specifically manufactured to Government specifications.

The standard commercial article exemption is a helpful move, but there again we have had to employ attorneys and spend considerable time preparing our pleas.

We believe this matter of renegotiation has political aspects; however, we think that it can be directed specifically to business done under bidding arrangements or other specific identification to eliminate the general yardstick rules now provided.

On the other hand, may we say that the members of the Renegotiation Board staff have been very courteous and quite reasonable in our discussions with them, which was not true to the same extent during World War II.

We trust that you will give your support to giving the new Renegotiation Act a chance to die and pass tomething that would be as much good to the Government at a much lower overhead.

Yours truly,

J. EARL PRESSON, *Controller.*

MANUFACTURING CHEMISTS' ASSOCIATION, INC.,
Washington 6, D. C., May 2, 1955.

Subject: Proposed Extension of Renegotiation Act.

Hon. HARRY F. BYRD,
Chairman, Committtee on Finance,
United States Senate, Washington, D. C.

DEAR MR. CHAIRMAN: In view of the passage recently by the House of Representatives of H. R. 4904, to extend the Renegotiation Act of 1951 for 2 years, it is presumed that as soon as its schedule permits, the Committee on Finance will consider H. R. 4904, or some other bill, to extend the Renegotiation Act. While the Manufacturing Chemists' Association, Inc., believes that the Government would not be placed at a disadvantage if the Renegotiation Act were not extended, we are not opposing extension of the act. However, if the Renegotiation Act is to be extended, we are hopeful that an amendment can be included to grant relief with respect to the exemption of standard commercial articles.

As you know, the Renegotiation Act which expired at the end of 1954 provided that contracts for making or supplying standard commercial articles should be exempted from renegotiation, but the Renegotiation Board was given 6 months in which it could make certain findings as to the competitive conditions affecting the sale of such articles and thereby to cancel the exemption of such articles from renegotiation. Because this exemption is contingent upon interpretation and findings by the Renegotiation Board, much uncertainty exists, and industry therefore must devote a considerable number of man-hours and expend substantial sums of money for segregating sales, maintaining company records, submitting reports, and related paperwork activities. Then if no finding of inadequate competition is made by the Board with respect to a particular standard commercial article, thereby leaving it exempt from renegotiation, the considerable expense already incurred by industry in keeping records, and by Government in reviewing and evaluating such records, will have been wasted. Even in those very few cases where a finding of inadequate competition with respect to a standard article may ultimately be made, it seems doubtful that a net saving to the Government will result. This unnecessary cost and burdensome practice could be eliminated by correcting the relevant section of the Renegotiation Act, if the act is extended.

This matter was comprehensively studied by the Hoover Commission paperwork task force which is recommending that if the Renegotiation Act is to be extended appropriate amendments should be included to require mandatory exemption from renegotiation of articles conforming to an appropriately defined category of standard commercial articles.

The Manufacturing Chemists' Association, Inc., subscribes wholeheartedly to these recommendations and although it urged the House Committee of Ways and Means to carry them out, that committee did not include in its recommendations any favorable action on our request. In passing H. R. 4904, the House of Representatives followed the recommendations of the Ways and Means Committee and did not alleviate the hardship which is being discussed in this letter.

This is a problem of no small magnitude which faces contractors who supply the Government with standard commercial articles. If the Committee on Finance decides to recommend extension of the Renegotiation Act, we earnestly solicit favorable consideration by the committee of an amendment to eliminate the contingent feature of the exemption for standard commercial articles.

Sincerely yours,

WILLIAM C. FOSTER.

STATEMENT OF H. E. FOREMAN, MANAGING DIRECTOR, THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, INC.

This statement is presented on behalf of the Associated General Contractors of America, a national trade association representing some 6,500 firms throughout the Nation that do a substantial majority of the construction work executed by contract.

It is respectfully requested that the Senate Finance Committee exempt from the proposed extension of the Renegotiation Act of 1951 any contract with a department, awarded as a result of competitive bidding, but not including negotiated fixed price contracts, for the construction of any building, structure improvement, or facility, or any subcontract directly or indirectly under a contract.

Competitive-bid contracts were exempted under the Renegotiation Act of 1943 as well as under the Renegotiation Act of 1948. This committee can readily check to ascertain whether the inclusion in the 1951 act of renegotiating competitive-bid contracts has resulted in any net monetary gain to the United States Government. As to the general contractors, it means increased costs and the keeping of burdensome records.

It is difficult to visualize how competitive-bid contracts can result in excessive profits. The work is advertised competitively, specifications and drawings are furnished. There can be no argument that all of the facts were not known. Regardless of any emergency, there is seldom, if ever, any shortage of qualified bidders in the construction industry. Experience has proven that competitive bidding is a reasonable and efficient safeguard against the realization of excessive profits on all routine, advertised-type construction contracts.

In conclusion, it is again respectfully requested that this committee exempt from the proposed extension the renegotiation of competitive-bid construction contracts, which is felt to be unfruitful to the Government and burdensome to the industry members.

RADIO-ELECTRONICS-TELEVISION MANUFACTURERS ASSOCIATION,
Washington 5, D. C., June 7, 1955.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
United States Capitol, Washington, D. C.

DEAR SENATOR BYRD: The Radio-Electronics-Television Manufacturers Association, comprising nearly 400 manufacturers of radio and electronics products, and including a large proportion of the Nation's military electronics suppliers, has a continuing interest in the effect of renegotiation legislation on the industrial mobilization base. The members of our association were recently gratified to learn that H. R. 4904, the bill extending the renegotiation act, has been amended to exempt standard commercial articles from the Vinson-Trammel Act to the same extent that such articles are now exempt from renegotiation.

We urge that this important amendment be retained in H. R. 4904 when the Senate Finance Committee reports the bill to the Senate. The amendment rectifies an oversight which occurred when Congress inadvertently exempted standard commercial articles from renegotiation without exempting them from the Vinson-Trammel Act. As such, its purpose is to fulfill the intent of Congress in exempting from legislative profit restrictions a class of articles produced in the competitive environment of the open market. Unless the amendment becomes law, the existing anomaly of an exemption which subjects the contractor to profit-limitation provisions of equal or greater stringency will be protracted for at least 2 years and perhaps longer. To our knowledge no opposition exists to the amendment, and its continued retention in H. R. 4904 is supported by every consideration of reason and logic.

Sincerely yours,

GLEN MCDANIEL.

HENRY OWENS & CO., INC.,
Cranston 7, R. I., June 2, 1955.

The Honorable HARRY F. BYRD,
Chairman, Senate Finance Committee,
United States Senate, Washington 25, D. C.

DEAR SIR: It is our understanding that the House has passed bill 4904 to extend renegotiation for another 2 years.

We have written previously to the Senate Finance Committee (June 17, 1954) in regard to raising the floor on the renegotiation law from $500,000 to a floor, which we believe is more in line with the present increase of products and services, of $1 million.

During World War II, the renegotiation floor was $500,000, and as prices for products and services have gone up considerably since that time; and in many cases over 100 percent, we feel that as an aid to small business this floor should be $1 million. It is our feeling that renegotiation should be eliminated entirely, especially for small business.

We find that on fixed-price contracts, due to the intense bidding in the metal trades industry, that all the profit is squeezed out of any prices we submit. Therefore, it is our feeling that fixed-price contracts should be exempt from renegotiation. We also believe that if renegotiation is necessary, it should be a carryback and carry-forward situation similar to our Federal income tax laws.

It is also our opinion that small business needs any reasonable profits it can obtain to finance its own growth. It would seem much better, if business could use any of its excess profits to expand rather than turning some of these profits back to the Government in excessive taxation; as the Federal income tax at the 52-percent rate seems to be a very large amount to pay to maintain our desired form of American Government.

It is our hope that you will study the above recommendations and seriously consider them prior to acting on H. R. 4904, which seriously retards growth and expansion for small business.

Very truly yours,

G. W. PARKER, *Controller.*

NATIONAL ASSOCIATION OF FINISHERS OF TEXTILE FABRICS,
New York, N. Y., June 8, 1955.

Senator HARRY FLOOD BYRD,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: I have the honor of enclosing, in pursuance of a suggestion made in the course of my testimony at yesterday's hearing, the full text of my prepared statement on behalf of the National Association of Finishers of Textile Fabrics, with respect to the amendment of H. R. 4904.

Because the chairman pro tempore invited me to examine the text of a proposed amendment to H. R. 4904 proposed by the Chairman of the Renegotiation Board, I curtailed the oral delivery of my statement.

Having had an opportunity to examine the language of the proposed amendment, I take pleasure in notifying the committee that it would be acceptable to the National Association of Finishers of Textile Fabrics, because it would remove the unfair and unintended discrimination against job finishers of textile fabrics, by putting them, as persons who furnish a standard commercial service, on the same footing as persons who manufacture and sell standard commercial articles.

I return herewith the copy of the proposed amendment that was delivered to me.

On behalf of the association I wish to express my appreciation for the courtesy extended to us by the committee.

Very truly yours,

WALTER R. HOWELL, *President.*

PROPOSED AMENDMENT OF H. R. 4904

Paragraph (8) of section 106 (a) of such act is hereby amended by inserting after "a standard commercial article" in the first sentence thereof "or a standard commercial service"; by inserting after "such article" in the first and second sentences thereof "or service"; by striking out "and" at the end of subparagraph

(C); by changing subparagraph (D) to subparagraph (G); and by inserting the following after subparagraph (C):

"(D) The term "service" means any processing or other operation performed by chemical, electrical, physical, or mechanical methods directly on materials owned by another person;

"(E) The term 'standard commercial service' means a service which is customarily performed by more than two persons for civilian, industrial, or commercial requirements, or is reasonably comparable with a service so performed;

"(F) The term 'reasonably comparable' means of the same kind, performed with the same or similar materials, and having the same or a similar result, without necessarily involving identical operations; and."

STATEMENT TO THE SENATE FINANCE COMMITTEE ON H. R. 4904

My name is Walter R. Howell. I am executive vice president of the Bradford Dyeing Association, of Westerly, R. I., and president of the National Association of Finishers of Textile Fabrics, 40 Worth Street, New York, N. Y., which represents 65 textile-finishing plants throughout the country. I appreciate this opportunity of stating the views of the national association on the proposed amendments to the Defense Renegotiation Act of 1951.

The National Association of Finishers of Textile Fabrics does not take a position on the general question whether the act should be extended or allowed to expire. Our position is that, if the act is extended as H. R. 4904 would provide, the act ought to be amended so as to make the standard commercial article exemption, now in section 106 (a) (8), applicable to contracts for the performance of standard industrial services, such as the textile finishing services rendered by the members of our association. In our opinion such an amendment would not reflect a change in the statutory policy, but would merely correct an accident of wording. The amendment we propose would injure no industry, no member of the public, no section of the country, and would not put any profiteers beyond the reach of governmental pursuit. Its only effect would be to rectify a discrimination that Congress never intended.

To explain the reason for the amendment we propose, I must describe, though briefly, the structure of our industry. Textile finishers are people who get gray cloth as it comes from the mill and bleach, dye, print, or otherwise finish the gray cloth in accordance with instructions given to them by textile converters. We also apply various processes to make the goods shrink resistant, crease resistant, water repellent, fire resistant, and so on.

Some textile companies are integrated or vertical companies; that is, they weave the yarn into gray cloth, they have their own converting department which styles the fabric, and they do their own finishing. In some cases they may also make consumer items from the finished fabric. Other textile companies perform some though not all of these operations in their own organizations. But many textile manufacturers have their finishing done for them by an outside finisher, who is known as a job finisher or a commission finisher; in these cases what happens is that a converter who has title to the gray cloth will have it finished by a job or commission finisher for a service fee and then sell the finished cloth to a maker of apparel or of some other consumer item. A job or commission finisher does not take title to the cloth he works on.

Now, section 106 (a) (8) of the Renegotiation Act, which was added to the statute by an amendment enacted in 1954, is known as the standard commercial article exemption. Its purpose is to relieve the Renegotiation Board, as well as contractors and subcontractors, of the burden of renegotiation when the Government procures items that are substantially identical with similar items sold for commercial use in a competitive market. As this committee stated in its report (S. Rept. 643, 83d Cong., 1st sess):

"* * * in the case of standard commercial articles there is in most cases no basis or need for renegotiation since cost and pricing experience has already been acquired and prices made in a competitive market."

Nothing in the legislative history of the 1954 amendment indicates that Congress meant to discriminate between contracts for the sale of tangible items and contracts for the performance of industrial services. Unfortunately, however, the amendment used the term "articles"; and the Renegotiation Board has interpreted the wording of the exemption as binding the Board to apply the exemption only to articles and not to services, even though the services are standard and are performed under competitive conditions.

One effect of this accident of wording, as interpreted by the Renegotiation Board, is that, while vertical finishers—companies that happen to own the cloth they finish—are exempt from renegotiation because they are furnishing an "article," nevertheless job finishers are not exempt, because they are performing a service. Yet job finishers compete just as vigorously as do the finishing departments of vertical companies. Job finishers compete not only with other job finishers but also with the vertical finishers; any converter who contracts with a job finisher must figure the finisher's price in with other components of cost on which he will base his price to his customer, just as a vertical company that does its own finishing will figure its finishing department's costs as one of the components on which its price is based.

Thus the wording of the standard commercial article exemption has a capricious, discriminatory, and unintended effect on the finishing industry. My association, which comprises both job finishers and vertical finishers, submits to the committee that this accidental discrimination is unfair and should be rectified. We have proposed an amendment to section 106 (a) (8) to make the correction, and we have furnished members of the committee with the text of section 106 (a) (8) as it would look after the amendment is made in our statement and letter dated April 17 that was mailed to all members of the committee.

Under the amendment that we propose, the Government would still be doubly protected against the danger of excessive profits by job finishers. First, the Government would be protected legally, because by the terms of the statute the Renegotiation Board would be authorized to withhold the exemption upon finding that competitive conditions were such as would not reasonably prevent excessive profits. Second, the Government would be protected commercially, because competitive conditions in the finishing industry are in fact such as to prevent excessive profits. Most finishing processes are standard processes used by substantially all of the plants in the industry. Finishers' customers have to meet competitive market conditions, and therefore the prices offered by finishers tend to be closely grouped. National-defense business for finishers is very like their civilian business, except that, if anything, the prices tend to be even lower for national-defense business than for civilian business. This is because the size of Government orders makes them attractive to prime contractors, who quote lower overall prices to the Government and then in turn force lower prices on the finishers. In this way, finishers' prices for national-defense business are held down by competition and by the bargaining power of their customers.

This completes my prepared statement on behalf of extending the standard commercial article exemption to cover standard commercial services. We have already submitted to your committee a memorandum in support of our proposed amendment, which goes into additional detail, but I should be glad to try and answer any questions that the committee has at this time or later.

(Whereupon, at 12:30 p. m., the committee adjourned, to reconvene at 10 a. m., Wednesday, June 8, 1955.)

RENEGOTIATION ACT EXTENSION

WEDNESDAY, JUNE 8, 1955

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to adjournment, at 10:20 a. m., in room 312, Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

Present: Senators Byrd (chairman), Smathers, Williams, Flanders, Malone, and Bennett.

Also present: Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The hearing will come to order.

I submit for the record the report of the Treasury Department which I received today.

(The report referred to follows:)

TREASURY DEPARTMENT,
Washington 25, June 8, 1955.

Hon. HARRY F. BYRD,
Chairman, Senate Committee on Finance,
Senate Office Building, Washington, D. C.

MY DEAR MR. CHAIRMAN: Reference is made to your request of May 3, 1955, for the views of this Department on H. R. 4904, 84th Congress, 1st session, a bill to extend the Renegotiation Act of 1951 for 2 years. The bill carries out the request of the President in his message to the Congress of March 4, 1955, for extension of the Renegotiation Act of 1951 for 2 years, to December 31, 1956.

This measure was enacted in 1951 and amended in 1954 to make possible the recapture of excessive profits from contractors and subcontractors doing business with the Government under the extensive defense program upon which the country is embarked. So long as this program continues, the Government must retain the means designed to prevent excessive profits on defense contracts. In the words of the President, "* * * so long as defense expenditures represent more than half of the national budget, we must do everything in our power to see to it that the maximum return is received for every dollar spent." The Renegotiation Act of 1951, as amended, is essential for the attainment of this result in a manner involving a minimum of interference with the Government's traditional commercial relationships with its suppliers.

The Department fully endorses the extension of the Renegotiation Act of 1951 for 2 years and recommends enactment of H. R. 4904.

The Director, Bureau of the Budget, has advised the Treasury Department that there is no objection to the presentation of this report.

Sincerely yours,

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

The CHAIRMAN. We have a very distinguished Senator with us this morning. We welcome you, Senator Case, and we are very glad to hear from you.

STATEMENT OF HON. FRANCIS CASE, A UNITED STATES SENATOR FROM THE STATE OF SOUTH DAKOTA

Senator CASE. Mr. Chairman and members of the committee, this is the first time that I have appeared before the Senate Committee on Finance in support of a particular bill. I do so here, Mr. Chairman, and ask for the privilege because of my very great interest in the Renegotiation Act.

As I think the chairman and members of the committee may know, what is known as renegotiation in Government defense contracts was initiated by an amendment which I offered to the sixth supplemental Defense bill in the House of Representatives in the spring of 1942.

At that time we were engaged in the buildup for World War II and we found it necessary to encourage production very rapidly by letting letters of intent.

We also were expediting production by providing tools and equipment by the Government, so that there was no invested capital or, at least, a reduction in the invested capital by the contractor.

In addition to that, we were asking many manufacturers who had no experience whatever in making military equipment to drop their normal production and switch over to producing something in which they had no production experience and no pricing experience.

Reports of unusual and exorbitant profits were being made and an attempt was being made voluntarily to accomplish some revision of pricing agreements. That was only partially successful.

So I suggested that we provide a requirement that would require the contractor to submit an audit of costs and agree to abide by a redetermination based upon that.

That was the basis of renegotiation.

The amendment to the sixth supplemental Defense bill was later extended in the Internal Revenue Act of 1943.

Under renegotiation as it was developed and extended, something over $11 billion of excessive profits were recovered in war contracts during World War II.

And the Secretary of the Army, Mr. Patterson, told us in those days that renegotiation was even more important and useful to the Government in forward pricing than it was in recaptures.

During the early days many of us thought that there would be no need for renegotiation in peacetimes and that there possibly might not be, if peacetimes were what we thought they would be. We did not foresee the extent to which procurement of military materiel and equipment would continue in these days under the pressures of the cold war and in the new fields of electronics, supersonic speeds and atomic power devices, and by the continued aid of Government-owned tools and plants.

We revived renegotiation early in the Korean war. I understand that under that law, something over $468 million has been recovered since January 1, 1951.

It might also be mentioned that when renegotiation was started we did not have the excess-profits tax, but even with the excess-profits tax we discovered that it was impossible to get sound pricing or sound contracts for the pricing of some of these new items of equipment because of two reasons. That is, there are two principal reasons why ordinary

tax laws based on a percentage of cost, or profits, do not adequately protect the Government or the public in this field.

The first reason is that no company has adequate experience in the production of some of these new gadgets to price soundly in quantity production.

The second reason is that the Government supplies aids in the form of toools, plants, and technical assistance in many cases, so that neither the invested capital nor the gross of profits provide a sound basis for taxes levied on a percentage basis.

At one time I was fairly familiar with the procurement of materiel and equipment when I was on the Appropriations Committee of the House. I am not so familiar with the actual procurement in these days, but I did go to the Renegotiation Board and asked them to give me some cases that would illustrate the two situations which I have mentioned, and from them I have obtained a few sample cases which are current under the act of 1951.

One contractor whom I shall designate as contractor A designed and manufactured electronic connectors and adapters, largely for aircraft. Renegotiable sales were just under $2 million but the yielded profits of almost $1 million or actual 50.5 percent of the business.

This contractor's investment in machinery and equipment was only $14,000 when he began the year, and was only $48,000 at its end. Yet on that investment—an investment of $48,000—by the end of the year he had a profit of $1 million.

Over 90 percent of the work was subcontracted.

The return on the net worth of this manufacturer contractor was 778.9 percent.

Under renegotiation a refund of $750,000 of the $1 million was determined.

Contractor B, engineered and made oil filters for jet engines and tanks. His renegotiable sales of $4,500,000 produced profits of 24.1 percent on the business, but 115.9 percent of net worth.

A refund of $550,000 was determined in this case.

Contractor C illustrates a case where the Government supplies equipment. This was a plant making gears. Profits of approximately $4 million were being made on sales of $16 million—actually a little better than 24 percent on the business, but in this plant the Government had placed machinery valued at $1,375,000. The return on the net worth of the contractor would have been 89.28 percent on this gear business, except for the refund of $2,400,000 through renegotiation.

Contractor D manufactured tools, jigs, and dies. Sales would have returned 58.4 percent of the gross or 306.7 percent of the net worth of the partners in this business except for renegotiation.

Contractor E manufactures electrical relays. On sales to the Government of $5 million, he would have had a 32-percent profit on business, but a return of 301.4 percent on the investment.

Contractor F produces trailer undercarriages and other equipment. Sales of approximately $4 million would have given him 45.7 percent on the business, and a return of 568.8 on his net worth. Renegotiation yielded a refund of $1,100,000 on the $4 million worth of procurement.

It seems to me that examples of this sort clearly indicate the necessity for extending the Renegotiation Act.

I understand that the bill before the committee is H. R. 4904. I had introduced an amendment to H. R. 4259, the general tax bill on the 28th of February. The chairman of the committee very graciously suggested that if we did not tie it to that act at that time, an opportunity would be afforded for a hearing later on. And this is that time.

I appreciate very much your courtesy, Mr. Chairman.

The CHAIRMAN. Are there any questions? Senator Flanders?

Senator FLANDERS. No.

Senator SMATHERS. I have one question. Is your amendment that you have proposed an amendment to H. R. 4904 or H. R. 4259, or is H. R. 4904 in its present form acceptable to you?

Senator CASE. H. R. 4904 is generally acceptable. I have no objection whatever if the committee might consider amendments. My amendment merely would have extended the Renegotiation Act of 1951 by striking out "December 31, 1954" and inserting "December 31, 1956."

Senator SMATHERS. So that your amendment is already a part of H. R. 4904?

Senator CASE. In effect; yes, it is.

The CHAIRMAN. Are there any further questions?

Senator CASE. I might state that I have only one copy of this general statement, but some others are being prepared and they will be made available to the committee members and the press or anyone else who wants them.

The CHAIRMAN. Thank you for coming in, Senator Case. We hope you will come in again soon.

Senator CASE. Thank you very much.

The CHAIRMAN. The next witness is Mr. Terry Rice, who is accompanied by Leslie Mills, representing the United States Chamber of Commerce.

Will you identify yourself for the record? You may proceed, sir.

STATEMENT OF THERON J. RICE, ACCOMPANIED BY LESLIE MILLS, REPRESENTING THE CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. RICE. Mr. Chairman and members of the committee, my name is Theron J. Rice. I appear today for the Chamber of Commerce of the United States, a federation of more than 3,100 chambers of commerce and trade, industrial and professional organizations. I am manager of the chamber's national defense department.

I have with me Mr. Leslie Mills, a certified public accountant, of New York City.

Before I present the views of our membership on H. R. 4904, which would reenact and extend the Renegotiation Act for 2 years, I want to express the appreciation of the national chamber for the opportunity to testify on this important legislation. The chamber is confident that a searching inquiry into this matter by the appropriate congressional committees—with particular attention to the relationship of renegotiation and other procurement techniques and procedures—will produce overwhelming evidence that renegotiation not only is unncessary but is undesirable under current economic conditions.

The national chamber strongly opposes reenactment of the Renegotiation Act in any form.

As we advised this committee in a March 10 letter to Chairman Byrd—written in anticipation of an effort to tie renegotiation to the corporate and excise tax extension bill—the chamber believes the extraordinary profit control procedures authorized by this act can be justified only in a wartime economy, to permit the retroactive adjustment of earnings on certain types of items purchased in abnormal volume and under truly emergency conditions. At all other times renegotiation leads to lax procurement, on both sides of the negotiating table.

The goal of procurement policy must be firm initial pricing, with maximum reliance upon fixed-price type contracts. An inevitable by-product of renegotiation is continued reliance on the ex post facto correction of mistakes.

Despite the fact that our Nation technically remains in a period of national emergency, the current level of defense spending no longer can be considered abnormal and the current economic situation is characterized by intensely competitive conditions.

Under these circumstances, and in view of the many improvements in procurement techniques since the war, there is no reason why the Government cannot obtain reasonable prices through normal procurement methods.

If renegotiation—which always has been considered an "emergency measure"—can be justified under current conditions, it can be justified indefinitely, and I am sure it is not the intent of Congress to make renegotiation a permanent part of our economic life.

Renegotiation was a hastily conceived device that originated early in World War II when the Federal Government was buying, in frenzied but necessary haste, nearly 40 percent of the total output of private industry. At that time, the emphasis was on price adjustment of individual defense contracts. The 1951 act was modeled after the World War II measure, and was enacted amid warnings that the annual rate of national security expenditures would rise at least $15 billion higher than the actual figure of $50 billion.

We now are in a period of continuing military preparedness that is consuming only 5 percent of the Nation's total output of goods and services. Even so, renegotiation remains in effect, with the emphasis having shifted to overall profit limitation on the renegotiable segment of a contractor's general business.

Renegotiation has many defects. For example:

1. In lieu of a set profit, there are six statutory factors the Renegotiation Board must consider when renegotiating a contract. However, it is a well-established fact that the Board has neither the skilled personnel nor sufficient time to evaluate accurately such of these factors as the relative efficiency of contractors, the reasonableness of their costs, the true value of capital employed or the relative risks assumed in different operations. This is not said in criticism of the Board but rather in criticism of the impossible kind of statute it is required to administer. In effect, the Board is imposing a tax without a rate schedule, without adequate administrative review procedure, without proper provision for judicial review, without advance understanding of the burden, and without information as to the relative competitive factors.

2. Because of delays in the disposition of renegotiation cases, a number of companies still do not know how much they actually earned in 1951, and in many industries the Board has made only a small dent in 1952 cases. This has been a deterrent to long-range planning for facilities, engineering development, and new products, and in many instances to short-term planning for working capital requirements.

Is a new Renegotiation Act necessary?

I now would like to consider the four major arguments in support of H. R. 4904, as stated in the President's March 4 message to Congress and subsequent testimony by Defense Department spokesmen.

Reason No. 1: So long as defense expenditures represent more than half of the national budget, we must do everything in our power to see to it that the maximum return is received for each dollar.

Answer: The national chamber believes reenactment of the Renegotiation Act would be inconsistent with—rather than in furtherance of—this objective. We take this position because:

(*a*) Although defense spending ($34 billion) in fiscal 1956 will account for more than half of the national budget, only $16 billion will be spent for major procurement and not more than $10 billion of that amount could qualify for renegotiation on the basis of the criteria described in the March 4 message to Congress.

(*b*) Despite persistent and, we think, exaggerated claims regarding funds turned over to the Treasury as the result of renegotiation, there is good reason to doubt that there has been any net recovery. In fact, we believe the net cost to the economy and to the Treasury is far greater than any refunds collectible under the act.

I might say at this point that the report of the House Ways and Means Committee, particularly the minority report, brings out in considerable detail just how much savings there may or may not have been under the act. And I might suggest, too, sir that when Mr. Roberts provides the data you asked him for yesterday, if he could get you net figures as well as gross figures, it might make a very interesting comparison.

The CHAIRMAN. What do you mean by "net figures"?

Mr. RICE. Net savings to the Government, sir, as contrasted with gross savings.

Senator FLANDERS. Are you referring to loss of taxes as against gains by renegotiation?

Mr. RICE. No, sir; I am referring——

Senator FLANDERS. There is a difference there, of course.

Mr. RICE. I am referring to the total costs of renegotiation which should be subtracted from the gross figures that have been mentioned by the administration witnesses.

Senator FLANDERS. The cost of administering the act?

Mr. RICE. The cost of administering the act—the money which would have been accrued by the Government as a result of taxes.

Senator FLANDERS. The taxes do get into the net?

Mr. RICE. Yes, sir.

Senator FLANDERS. All right.

The CHAIRMAN. You are not speaking of that kind of net, are you, of taxes?

Mr. RICE. I do not know if I follow your question, sir. There are gross figures on money that has been collected as a result of renegotia-

tion. From that gross figure there have to be certain sums of money substracted to get the true value of renegotiation.

The CHAIRMAN. When you speak of net figures you mean after taking the expenses of administration?

Mr. RICE. The expenses of administration, the expenses of compliance with the law. I do think you have to take into consideration the fact that a considerable amount of money that the Government has had returned to it under the renegotiation process would have come back to the Government anyhow under the tax laws that were in effect at the same time the renegotiation process was in effect.

I do not think you can ignore those tax returns to the Government, if you are trying to get a true picture of the value of renegotiation in protecting the Government's interest.

The CHAIRMAN. Do you agree with the figures in the report that there was a refund pursuant to renegotiation agreements or orders of $331 million?

Mr. RICE. I would have no choice but to accept those figures as correct, sir, but they are not net figures. They are gross figures, I believe. I think Mr. Roberts yesterday used the word "gross" in describing them.

The CHAIRMAN. In order to get a net, what would you do?

Mr. RICE. You would subtract from that gross figure three major categories of funds, I think.

No. 1, the money that would have come back to the Government, anyhow, under the tax laws in effect. Part of that was recaptured under renegotiation.

The CHAIRMAN. That would roughly be 52 percent?

Mr. RICE. Well, this return covers periods of time during which we had the excess-profits tax, which was a lot higher than 52 percent.

The second major category of funds you would have to subtract is the cost of compliance with the law which in a great many companies is a very considerable amount. In the House minority report it was estimated that it might be one-tenth of 1 percent of the total amount of procurement subject to renegotiation, which would be $175 million.

And the third expenditure item would be the cost of administering the act, which is about $14 million or $15 million.

The CHAIRMAN. Very well, you may proceed.

Mr. RICE. (*c*) There is considerable evidence that procurement costs to the Government are much higher as a result of renegotiation. For example, low-cost efficient companies who can compete to advantage in the commercial market have little interest in selling their products to the Government, under circumstances which would entail a retroactive reduction of prices which are entirely acceptable in the commercial market. This tends to leave much of the Government procurement field to high-cost marginal producers. Second, no matter how hard the Renegotiation Board tries—and it does try—to stay away from a cost-plus approach, the net result—despite the 6 statutory factors it must consider—is not much more than cost-plus. Thus, the Government, which forbids cost-plus percentage contracting, is the victim of it throught renegotiation. Third, it often is claimed that the very existence of renegotiation saves the Government money because the threat of it holds prices and profits down. This position has no validity. The threat of renegotiation is not a factor in direct

defense procurement, and competition, not the threat of renegotiation, determines prices of indirect procurement.

Reason No. 2: Because of the complex nature of modern military equipment, the lack of experience in producing it and the frequent necessity for alterations during the life of a contract, it is impossible for the Government to determine, when the procurement contract is made, what constitutes a fair price and for the supplier to forecast accurately his costs.

During the past few years, the Government procurement services have developed many improved buying techniques and procedures. They now have availaible a series of contracting devices which should be fully adequate for obtaining sound pricing, even in the fields of new weapons and of research and development. In addition to public bidding and cost reimbursement type contracts, these devices include the redetermination of prices on fixed price contracts during the course of their performance, both at the prime and subcontract levels; escalation to avoid contingency allowances in fixed price contracts; incentive type contracts under which profit varies with cost reductions achieved, and the use of bidding procedures as a preliminary to subsequent negotiation of contracts. As recently as April 4, the Government Printing Office published a complete revision of part 3, section 4, of the Armed Services Procurement Regulations, which explains in detail what types of negotiated contracts should be used in those instances where, for example—

> the nature and complexity of the procurement is such that costs of performance cannot be estimated with reasonable accuracy.

That is from page 324, revision No. 4 to 1955 edition of ASPR.

It is no answer to this problem to say that these procurement methods have not been eliminating all excessive profits. With renegotiation in the background it has not been necessary for them to be effective. The answer lies in more effective contract negotiations—not in extending the Renegotiation Act, which is more the cause of the problem than a tool for its solution.

Several days ago in testimony before the Senate Appropriations Committee I think it is pertinent to note at this point that the Assistant Secretary of the Air Force, Mr. Lewis, in answer to a question by Senator Dworshak said, and I quote:

> The Air Force has adequate controls to prevent excessive profits, but there is always the possibility that somebody might make a windfall.

I submit that is not a very sound argument for renegotiation. It sounds more like a cushion to fall back on.

Reason No. 3: There are situations where the Government is unable to obtain the price benefits that accrue from normal competition.

I already have mentioned the increasingly vigorous competition that is prevalent throughout American industry. In those isolated areas where items needed by the Government must be obtained from a limited number of suppliers who are, in many instances, entirely dependent upon Government orders, negotiated procurement is employed and the Government retains a strong bargaining position. In addition, contracts for virtually all procurement of this type contain some kind of repricing clause. Under the circumstances, the chamber must disagree with the contention that the costly and time-consuming process

of renegotiation is necessary merely because competition does not exist for a few products.

Reason No. 4: Because the United States has no direct contractual relations with subcontractors, the only protection against unreasonable prices by them is through the process of renegotiation.

The chamber would like to be able to agree with the claim that the Government has no direct contractual relations with subcontractors, because that is the way it should be. The selection and payment of subcontractors for work on defense contracts is a proper function and responsibility of prime contractors—not the Government. However, in addition to the protection afforded by active competition at the subcontract level, Congress should be aware of the fact that procurement officials exercise effective control over subcontractors in many ways. For example:

(*a*) There is a growing practice to require by contract that prime contractors pass on price redetermination provisions to their subcontractors.

(*b*) Whenever a defense contract is terminated for the convenience of the Government, a Federal contracting officer must approve the terms of any settlement (above $10,000) between the prime contractor and his subcontractors.

(*c*) Under authority contained in laws and regulations which provide for setasides for areas of labor surplus, fair share of contracts for small business, and many other programs, the Government exercises considerable control over subcontractor selection. In many instances, primes are required to award work to other than their lowest cost suppliers, and the prices paid for such work ultimately are reflected in the prices paid by the Government for the finished products or services.

In the light of these examples of Government controls over subcontractors, the claim that renegotiation is needed to prevent unreasonable profits by them would seem to be ill founded.

In summary, the national chamber believes that reenactment and extension of the Renegotiation Act cannot be justified on any grounds. Continuation of renegotiation under current conditions would hamper, not help, the defense effort. We sincerely hope your committee and the Congress will arrive at this same conclusion.

The CHAIRMAN. Thank you very much, Mr. Rice. I think you have made a very clear statement. Are there any questions, Senator Flanders?

Senator FLANDERS. I would like to ask you, sir, if you were present yesterday when Secretary Talbott was testifying.

Mr. RICE. Yes, sir, I was.

Senator FLANDERS. As he described the process of placing a contract for large expenditures in the furnishing of airplanes to the Government do you see any way in which renegotiations could be properly avoided in that method of placing contracts?

Mr. RICE. Yes, I do, Senator Flanders.

Senator FLANDERS. What is the alternative?

Mr. RICE. It seems to me the great weakness in Secretary Talbott's presentation yesterday was, first of all you gentlemen unintentionally got off the discussion of the merits of renegotiation. You got into a discussion of competitive bidding versus negotiated bidding. But to answer your question——

Senator FLANDERS. That is not off the subject.

Mr. RICE. No, sir, it is not off the subject but it dwelled on that at length. I might say this, the type of procurement that Secretary Talbott cited yesterday as justification for extension of this law is not going to be the exception any more. It is going to be the normal type of procurement. We are not going back to buying noncomplex items of equipment. We are going to keep on buying things that are of a very complicated nature.

So it seems to me that your procurement regulations, your procurement laws, your procurement procedures have got to be geared to that kind of procurement, rather than relying on a bill which they are now asking for to be extended for 2 years. I do not know why 2 years.

The situation that they say they need it for is going to be a continuing thing. As a matter of fact, Secretary Thomas in his testimony on the House side made the statement that:

> Renegotiation should remain on the statute as long as unrest continues and purchases of the United States Government represents a large portion of the national economy.

That is not a 2-year proposition. It seems to me that this emergency measure, having been extended into a relatively peacetime economy, has outlived its usefulness.

The Secretary of Commerce takes the same position, incidentally, and was very much against the administration request for an extension of this law.

Senator FLANDERS. The practical reasons for extending it over a period makes it necessary for the Congress to take a new look at it. I certainly would not under any circumstances vote for an extension beyond the period mentioned, because this way it automatically comes back to us for rejudgment. That is the reason for the comparatively short term.

I would like to ask you what kind of contract you would suggest—what kind of contracts could be devised to meet the conditions under which contracts are now made with the leading producers of airplanes?

Mr. RICE. I think that they already have available to them, Senator Flanders, a multitude of contracts which can be adapted to the situations that they now say require the extension of this law. I only cited one such revision in this armed services procurement regulation. This is the document I referred to, and it is full of descriptions under what circumstances shall certain types of contracts be applicable to the situation that the contracting officer is confronted with. There must be 8 or 10 similar citations in here.

Senator FLANDERS. Just to put the thing in a nutshell, are you saying that the renegotiation process should be in the contract and should be carried out by the Air Force?

Mr. RICE. By all means, yes, sir.

Senator FLANDERS. That is the argument you are making, that renegotiation should not be in a separate subdivision of the Government, but should be part of the normal process of the placing and the pricing and the paying for contracts in the Air Force?

Mr. RICE. That is right. And the reason is because renegotiation of contracts is a part of the procurement process. It should be. We now have actually the renegotiation of prices, during the course of the

contract. They call it redetermination, but it is nothing in the world, using it as a verb, but the renegotiation of the price to be paid.

Senator FLANDERS. I noted at 1 or 2 points in your testimony here a sort of scaling down of the difficulties. It seems to me—well, for instance, on page 4, under "(a)," in answer to "Reason No. 1"—$10 billion is a lot of money. I would say that almost all of these defense expenditures, that is, for airplanes and their equipment, is difficult to put through on a straight bid basis, so that extraordinary means outside the usual means of pricing have to come into effect.

And if I understand you, you are suggesting renegotiation for this really vast mass of billions upon billions of expenditures—renegotiation as a part of the regular function of the contracting in the Air Force. I am not saying that I would accept the case there, but you can make a case for it. But it applies to the major item in our whole defense expenditure and not to some minor portion of it.

Mr. RICE. You are quite right. I am not trying to make a case for the transfer of the renegotiation function to the Department of Defense. I am saying that we now have in operation, in effect under the current procurement laws and regulations, a process of renegotiation, using it as a verb, that we renegotiate the prices of almost all of the contracts involving these types of equipment that are cited as justification for this law.

The Pentagon negotiates a contract. Later on they sit down with the contractor by mutual consent at a point where they can arrive at a better determination of what is a fair price to the Government and to the contractor.

And they redetermine the price.

Then the contract is fulfilled a year or 2 years later.

In some case another agency of the Government, completely outside of the Pentagon, comes along and says: "Despite the fact that your contract was redetermined we still are going to take a look at it and we might say to you that you still made too much money."

Senator FLANDERS. As a matter of fact, they do.

Mr. RICE. These are overlapping profit limitations that we think are just contrary to sound procurement procedures.

Senator FLANDERS. As a matter of fact, the renegotiation outfit does come along and does say to the Pentagon: "Your contractor made too much money."

It does reduce the profits. And returns a part of them as net to the Government.

Do you say in practice then, if you criticize it, that it would seem to come to one of two alternatives, either first the Pentagon failed in its negotiations, or, second, the Renegotiation Board was unreasonable in its determinations? If you criticize the process, which of those two alternatives, or is there some other that you have in mind?

Mr. RICE. Well, I do not want to sit here and make an accusation that the Board has been unreasonable, nor do I want to make a blanket statement that the Pentagon has failed. I do think there is considerable room for improvement in the normal procurement processes of the Defense Department.

I also say that if there have been individual companies that have made what have been called excessive profits, I do not think that is in itself an argument for the extension of the renegotiation law, because that law was designed to deal with a situation that no longer exists.

You gentlemen in your debate of this bill last year, on the floor of the Senate—I think it was in an exchange between Senator Martin and Senator Millikin—I think made it quite clear—I have the transcript from the Congressional Record here—that volume alone is not a justification for renegotiation—volume of spending alone.

Senator FLANDERS. Volume alone is not. It seems to me that the case for it lies in these vast billions that are spent outside of the ordinary commercial controls of competition and outside the possible area of advertised bids and bidding. If it has any field at all it seems to me that that is the field for renegotiation.

Mr. RICE. I would quite agree with you, Senator Flanders, but I contend that a better solution to extension of renegotiation is to gear our procurement processes to the realization that that is going to be a continuous thing and not to keep coming up here every 2 years or every year and asking for the extension of a law which serves as a cushion to the contracting officers. For example, put yourself in the place of a contracting officer—if you know that somebody else is always going to get another crack at this man, you will not be quite as careful and sharp as you would be if you knew that this was your one and only opportunity to arrive at a fair price.

Senator FLANDERS. You must remember that this is in a noncompetitive field. What is going to prevent me from making the best case I can with the Pentagon?

Mr. RICE. It is noncompetitive, but the company is in the position, too, of having only one customer. So the Government is in a strong bargaining position. He cannot sell a B–52 to anybody but the Government.

Senator FLANDERS. And neither does the Government get a B–52 from anybody but one person.

Mr. RICE. That is right.

Senator FLANDERS. It is a unique situation in American business. I think it has to be looked at uniquely. It may be that renegotiation is not the way, but certainly we have to recognize that the situation is something completely outside of the ordinary course of private business, as we understand it.

Mr. RICE. I quite agree with you.

The CHAIRMAN. Thank you very much.

Mr. RICE. Thank you.

STATEMENT OF CHARLES W. STEWART, OF THE MACHINERY AND ALLIED PRODUCTS INSTITUTE

The CHAIRMAN. The next witness is Charles W. Stewart, of the Machinery and Allied Products Institute.

We are glad to have you here, Mr. Stewart. Will you identify yourself for the record?

Mr. STEWART. Mr. Chairman, and members of the committee, we have submitted for inclusion in the record a rather lengthy statement. I am somewhat chagrined to find that one of the opening statements in it is to the effect that it is a summary of a more lengthy presentation. I think that will indicate how strongly we feel about the subject. I would like to submit that statement for the record, and then make a few comments orally so as to save the committee's time and to point up what we believe to be the most salient aspects of this problem.

The CHAIRMAN. Without objection, the statement will be inserted in the record.

(Mr. Stewart's prepared statement appears at the end of his oral testimony.)

Mr. STEWART. I have with me Mr. Rowland Brown of our staff.

I am the executive vice president of the Machinery & Allied Products Institute. Mr. Brown is an attorney with our organization. We are located in Washington.

I think it might be well in order to bring into focus 1 or 2 comments made by the distinguished Senator Case to refer to his examples in brief.

I think it is extraordinarily important in the subject of renegotiation, as we recommend in our statement, that a very careful and searching study of the subject be made before we perpetuate it as a permanent part of the statutes.

I think that in order to get at the real issues involved we need more comprehesnive and more representative data than the type of data which was furnished by Senator Case. May I illustrate that very briefly?

Some of the examples which Senator Case gave were aircraft examples relating to the special area of problem procurement, to which Senator Flanders has been refering.

It is not clear from the examples as cited what years were involved. It is entirely possible that they were in the early buildup Korean period and, therefore, are not relevant or pertinent to the present problem which is quite different, in our judgment.

We submit that it might be well for the Renegotiation Board to undertake an examination of its refunds in order to show by breakdown, so far as information is available, to what extent refunds would be obtained from the special area of military procurement which has been given so much attention by the Air Force representatives and by members of the committee this morning, as distinguished from what might be termed "normal commercial products," which the Government buys as a general practice and which are also available on the general commercial market.

I recognize that such data may not be available with absolute precision, but in order to get a real picture of the issues involved here we have to know, not alone the refunds, but the kind of cases that are involved, the kind of products that are involved, so that we can determine the real scope of the problem.

I think that yesterday, Mr. Chairman, you made a point which has been alluded to this morning and which I view a little differently from the previous witness. I should like to comment on it briefly so as to tie in with what I have to say.

You referred to the matter of the need for more emphasis on advertised bidding. We subscribe very much to that approach.

We believe, however, that there are situations where advertised bidding may not be necessarily the answer. But unless we make an effort currently to emphasize advertised bidding we shall not make progress in that direction.

And I believe that that is one of the fallacies in the procurement policy at the present time.

However, the question of advertising versus nonadvertising is not really the crux of the problem, in our judgment. The real question is whether or not the Government is getting the best price.

If advertising in a particular case brings that result, advertising should be used, in our judgment.

If another alternative procurement method brings that result, that alternative should be used.

So we submit that the real criterion here in terms of procurement policy, and the real criterion in terms of whether or not renegotiation is necessary is whether without renegotiation in individual cases, by using one technique or another, be it advertising, be it negotiation, be it a combination of both, which is quite commonly used, the Government can insure itself a reasonable price.

We think, secondly, it is very important not to have discussion dovetailed entirely into the matter of profits. For we can conceive of many cases, if not most cases, where the proper question should be whether or not the Government is getting a competitive price and the best product, as distinguished from whether or not one company makes more in terms of profits than another.

Before going to a list of points which I should like to emphasize, I want to make one observation with reference to the present Renegotiation Board and its staff.

The Machinery Institute has followed this subject for a good many years. We are fully appreciative of its complexities, of its significance to the American economy, and of the tremendously difficult job which is assigned to the Renegotiation Board personnel.

I can say in behalf of the institute we have high regard for the chairman of the board and for all of its members. We have never had a better relationship with a Government agency in terms of cooperation, in terms of a willingness to sit down and talk over problems, and, in our judgment, an organization that is attempting to do a job to the best of its ability. Our criticisms therefore which are quite severe go to the question of the act, the process, the technique which is implicit in renegotiation, as distinguished from the men that administer it and the problem that they have in administering it.

My oral comments will be divided into three brief sections.

First, what are the issues?

Second, what are our recommendations?

And, third, I would like to deal with some misunderstandings that are very prevalent in the area of renegotiation.

It seems to me that the issues really are quite clear, and the most important and overriding issue is one which I fear the committee may be overlooking.

It is true, as Senator Flanders has stated, that the committee bill before this committee at the present time calls for an extension of 2 years. However, the proposition that has been placed before this committee is that this bill is necessary for at least 2 years because certain procurement problems exist.

Collaterally, it may be said those making the recommendation for extension state that these programs will exist for an indefinite period of time.

So that what we have in effect before this committee at the present time is a rationale in support of the proposition that we have a pro-

curement problem which will be with us for a good many years, if not indefinitely, and we need renegotiation in order to deal with it.

Therefore, we submit that the real question before this committee at the present time is whether or not we should extend renegotiation indefinitely, from the standpoint of the proposition that has been put to the committee.

The second issue relates to the broad question that is involved in a further or indefinite extension of renegotiation.

In our judgment, renegotiation is an extraordinary device. It is a device which was conceived for emergency purposes. It is one of the broadest and most unlimited exercise of power that has ever been delegated in my time to an administrative agency. And we shall spell that out in a moment.

And we believe that it has disincentive and control aspects, not because of the administrators of it, but because of its character, which should not be carried into a nonemergency period on an across-the-board basis, which is the way this statute is placed before this committee.

The third issue assumes an extension of renegotiation which it may be the judgment of this committee to act upon and poses the question as to what form the extension shall take.

Once again, referring to the rationale that has been placed before this committee in support of extension, that rationale is grounded in the proposition that we have problem with regard to aircraft or "aircraft systems," as the Assistant Secretary for Materiel stated yesterday, missiles, and other special military products.

The problem therefore is a limited one; it is a specialized one.

If we have an extension of renegotiation, let us define the problem and then let us tailor the renegotiation process to meet that problem, if renegotiation is to be extended at all.

So the next issue is, why not tailor it, and how can it be tailored?

Our conclusions, gentlemen, are first, as I have briefly stated, that renegotiation in our judgment as a general device of the type that is placed before this committee is not necessary.

We so conclude first because we believe that, generally speaking, economic conditions are competitive so as to insure a reasonable price. And I emphasize "price."

Secondly, in those limited areas where economic conditions do not permit the type of close pricing that is clearly available in the general economy, there are other procurement devices available to the Government, and those devices are spelled out in our statement, beginning on page 18.

They include price redetermination which has been referred to. They include special contract techniques such as advance analysis of costs, audits, various types of incentive contracts, and so on.

We believe the procurement people in this country are extremely more sophisticated than we give them credit for being. We believe that over a period of 11 or 12 years they have gained an experience which we are not fully recognizing. We believe that if they are not sufficiently sophisticated with that kind of background, they never will be, because they have had a training period that is extraordinary in this country's history.

Now we recognize that renegotiation may have some advantages under emergency conditions, but we believe its defects are so many

and so serious and that they are aggravated under nonemergency conditions that neither the Government nor industry can afford to continue renegotiation on the statute books.

On page 7 of our statement, for example, we refer briefly to what we consider to be the principal disadvantages, the inducement it creates for careless procurement. We must not overlook that.

Renegotiation is a "crutch" for Government contracting personnel. It is leaned upon by the procurement man who then has no incentive to do a tight job initially. It impairs the incentives to economy and efficiency on the part of the contractor. It places a tremendous burden on management. Its results are almost completely arbitrary. As the chairman of the Board said yesterday, the important factor is the "judgment factor."

What, in effect, we have in renegotiation is a process by which I, as a member of the Board, or a member of this committee as a member of the Board, may sit down with a set of facts, and on the basis of certain broad criteria as stated in the law make a judgment with respect to what the profits of an individual company should be. And in all fairness, it seems to me that that process is contrary to our system. It puts such people as the chairman of the Renegotiations Board yesterday in the position of having to answer the question which was put to him, either by the Chair or by a member of this committee, "What do you think a fair return on an aircraft manufacturer's equity capital should be?"

Should he be placed in that position? Can he possibly answer that question fairly?

And yet every day in the renegotiation process that question is put with respect to individual companies and the decision is made fundamentally on the basis of an individual's judgment. And those judgments vary from board to board, from individual to individual, and company situation to company situation.

Another disadvantage is the probable net loss to the Treasury from the imposition of renegotiation which has been referred to, and I will allude to briefly, and the long, continuing financial uncertainty which renegotiation produces.

Some companies are in the position of having 1951 cases open. How can they make decent business management judgments under those circumstances? It is not always the fault of the Board. It is the process.

Our general conclusion, therefore, is that renegotiation should not be extended. On the other hand, we feel an obligation to be responsive to this committee. If you do decide to extend the act, we feel as intimated at the beginning of my statement, that you should tailor it to the problem.

We have some suggestions as to how that tailoring process might be undertaken. Others may have better ideas as to how the tailoring might be accomplished.

First of all, and fundamentally, it ought to be tailored to meet the objective of the Department of Defense and of the President.

I sat here and listened yesterday to Secretary Talbott and his associates. I did not hear a single product mentioned except aircraft and aircraft systems—not one other product.

There are special military procurement problems here which need to be faced up to. The dimensions of the problem need to be measured, and then we need to deal with it if we are going to have renegotiation.

How can we deal with them?

First, we believe that the statutory exemptions already included in the statute are well reasoned. And with 1 or 2 minor technical exemptions, well stated. They restrict the area of renegotiation. They help bring it down to earth, in terms of the problem that confronts us.

They should, therefore, be continued in the law. We understand it is the pleasure of the Chairman of the Renegotiation Board and of this committee to so continue them. At least, that is being recommended to this committee.

Second, we believe that there are a number of fringe agencies that have very little to do with this process of military procurement. The Coast and Geodetic Survey, TVA, Bonneville Dam, Home Finance, and a number of other agencies that are now designated for renegotiation, buy products, which, in our judgment, are highly competitive, which do not tie into this area of special procurement and which can be easily eliminated from the renegotiation picture by a simple amendment to the law.

Third, we believe that in accordance with the line of approach that Senator Flanders was taking in questioning the committee should give consideration to a technique which was adopted in the 1948 act. I think it is always well to go back and look the lesson over that we learned in the past. And in the history of renegotiation we find at one time that there was a restricted area of renegotiation by a technique called affirmative designation. And in that area the Congress said to the procurement agency, "You define those areas where special emergency devices such as renegotiation is necessary—describe them." Hold the renegotiation authority in the Renegotiation Board which does the very best job it possibly can under this difficult statute, but have the people that are encountering the procurement problems put on the table the problems that they are faced with, define them, and then limit the renegotiation process to this area.

Senator FLANDERS. Will you excuse me at this point, Mr. Chairman, if I ask a question?

The CHAIRMAN. Proceed.

Senator FLANDERS. Is what you are saying in substance that instead of saying negatively you shall not renegotiate A, you shall not renegotiate B, and renegotiate C—are you saying that only "XYZ shall be renegotiated"—putting it positively instead of negatively?

Mr. STEWART. I think it is a little bit of both. I think the problem, Senator Flanders, is that we must address ourselves to this specialized area of military procurement that we are all concerned about, that you have a concern about, that the Secretary of the Air Force has a concern about. We have in part dealt with that problem already through definable exemptions that are contained in the law. They are in the process of working. That part is accomplished. For the relationship between present exemptions and our further recommendations please refer to page 30 of our statement.

We are dealing only with the basket that remains now subject to renegotiation. I say deal with that basket in this way; indicate in the statute that the procurement officials—the designated authority—

the Secretary of Defense or someone else—it was the Secretary of Defense in the 1948 act—shall designate only those areas which in his judgment, from a procurement problem, should be continued to be renegotiable.

The renegotiation process would be continued to be carried out by the Renegotiation Board.

Let me spell it out a little further.

Yesterday the question was put to Assistant Secretary Lewis, "What is your problem?" He said that his problem was confined to aircraft and aircraft systems. He said that everything else that the Air Force buys he can buy competitively.

Senator FLANDERS. I would question that statement, because it seems to me that the missile area is in the same sort of a category that the airplanes are.

Mr. STEWART. I do not think that there is any difference of opinion between us, sir. I think by aircraft systems he would have included missiles.

Senator FLANDERS. I see.

Mr. STEWART. I think that what he was trying to say was that there is an area of special military product that we buy which is distinguishable from conventional military equipment, industrial equipment, and commercial products.

All I am suggesting is that if off the cuff the Secretary or the Assistant Secretary of the Air Force can make that determination, subject to later study, he can also make a determination in more exact terms of those areas where a special procurement tool is needed, and the Renegotiation Board can carry out its function with respect to that specific area. It is not necessary to use a shotgun technique to accomplish a marksman's objective.

We believe also that there are some techincal provisions in the present law that might be looked at. There is a provision carried over into section 106 (c) on "fractional renegotiation" which is called, in technical terms, the end-product limitation.

I do not think it is fair to take the committee's time on that. It is covered in the document which we have placed before you at page 25. We believe that was an inadvertent carryover from the previous act and should be corrected. We have discussed it with representatives of the Renegotiation Board.

We believe also that the question which came before the committee yesterday with reference to the applicaton of the standard commercial article exemption should be applied to services broadly rather than to specific types of service. For example, the installation of an air-conditioning or heating system in a building is in fact a combination of a standard commercial product and commercial service but by present enterpretation is not subject to the standard commercial article exemption. This is covered in detail in our statement on page 25.

We believe, gentlemen, that the law should not be extended for a period greater than 1 year if it is to be extended at all. We do not see any reason for a longer period. if our objective is to look at this again at the end of the given period, to extend for 2 years is to freeze it into the law for a longer period of time.

With due respect to the President we do not subscribe to the argument made in his message, namely, that this then is a procurement

bulge which should be looked at as a whole through the entire Korean period. Renegotiation in any case is conducted on a year-to-year basis, and we believe that if the 1-year extension—if you choose to extend the law—were accompanied by a request or a directive that an overall study of this whole problem be made during that period, we would then have at the end of the period of 12 months better data, better appraisal of the issues that are involved here, and a better opportunity for this committee on a second occasion to see all of the issues and act upon them.

I wanted to deal with a series of misunderstandings which we think pertain to the subject of renegotiations. Because of time limitations I shall refer to only 1 or 2. We believe that the question of return to the Government from renegotiation is badly exaggerated. It is covered in this statement beginning at page 10.

We believe that the procurement area in terms of the dollar volume is grossly exaggerated. That is covered in our statement at page 21.

We believe that the whole process of renegotiation is misunderstood in many areas. It should be made clear that it is not a magical, precise formula. It was intended only as a rough justice when everybody was renegotiable. In our judgment it is not appropriate to the specialized problem which we have today.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Stewart.

Senator FLANDERS. I have 1 or 2 more questions.

The CHAIRMAN. Yes, sir; Senator Flanders.

Senator FLANDERS. Would you be inclined to say categorically that renegotiation should apply to nothing but defense contracts?

Mr. STEWART. I strongly urge, Senator Flanders, that renegotiation should be limited to special military products and military components thereof, but I do feel that I have enough data in terms of the recoveries that have been made in terms of the problem that the Air Force confronts to document that conclusion completely. I think, however, I would be borne out if a study were conducted of this subject.

I think that what has happened here is that purely by inertia or by habit or by just failure to sit down and study out the problem, we have continued a device which was a broad-scale device and which is no longer appropriate to a specialized program or problem.

Senator FLANDERS. Would you recommend writing into this act the requirement for a study?

Mr. STEWART. I would, sir.

Senator FLANDERS. That is, you would feel the act is inappropriate unless it is for a shorter term and requires a study to be reported on within the 12 months before we are asked to extend the act again?

Mr. STEWART. I feel very strongly about it, sir. I think we will be in the same position we are now in, the same position we were in last year, unless such an overall study is conducted and we would be glad to contribute to it.

Senator FLANDERS. I was just going to ask that question, whether you would be willing to send a memorandum to the committee indicating the lines in which you think the study should be undertaken, the questions which should be answered.

Mr. STEWART. We will be delighted to, sir.

Senator FLANDERS. I would suggest then, Mr. Chairman, that we take such a memorandum into account. Can that be prepared fairly quickly?

Mr. STEWART. Yes, sir.

The CHAIRMAN. Can it be prepared today?

Mr. STEWART. It can be prepared today, sir.

The CHAIRMAN. Senator Malone, do you have any questions?

Senator MALONE. What, if you know, if the amount annually or an average annual amount that is renegotiated?

Mr. STEWART. The amount of money that is actually subject to renegotiation?

Senator MALONE. Yes.

Mr. STEWART. I do not know the answer to that question, sir. I think you can get it from the Board much more readily. I have seen the figures that the Chairman of the Board has furnished this committee on refunds. I know the general area of procurement. For example, I believe that currently we are dealing with about $16 billion that are technically renegotiable. Within that area of $16 billion, roughly about $9½ billion are probably subject to renegotiation in the practical sense. Most of the balance consists of products which are bought competitively.

Within the $9½ billion, approximately $7.5 is for aircraft, $0.67 for guided missiles, and $1.37 for research and development. Thus even with limited data it is possible to delineate the area of concern.

Senator MALONE. We can get that information then. It seems the recovery is a rather small percentage.

Mr. STEWART. I do not want to do an injustice to the Board. They have much more complete data than I have. I have not seen it. Frankly, I would like to see it.

It is clear that the data that has been submitted to the committee is, as the gentleman who preceded me indicated, gross data. To make that point again, and I think it deserves emphasis, the data furnished is in terms of total recoveries and without relationship to the pertinent gross renegotiated sales. They have not been reduced by the amount of tax refunds resulting from the reduction in profits. Furthermore, it does not take into consideration the cost of administrative expenses of the Board.

And, in addition, some price tag must be put on the cost to industry of compliance and to the public interest in terms of the effect of renegotiation on incentives and efficiency.

Senator MALONE. In these contracts that can be let, where specifications can be written and are blueprinted, what is your opinion about that? Should competitive bids, that is, when there are competitive bids on such specifications, should they be renegotiated?

Mr. STEWART. Are you asking me, sir, should contracts which are let as a result of competitive bidding be subject to renegotiation?

Senator MALONE. Where you can furnish accurate specifications and blueprints.

Mr. STEWART. And where competitive bidding results in a contract?

Senator MALONE. That is right.

Mr. STEWART. In those cases I feel that there is sufficient competition present to bring the Government a reasonable price. However, I think it is unfair to impute to competitive bidding a magic result

as compared with a result that might be obtained without competitive bidding in every case, because we have a number of opportunities in procurement to use combinations, hybrid devices. You can have competitive bidding and then negotiate a contract, without letting the contract as a result directly of the competitive bidding.

Our general proposition, Senator Malone, is this, that when the Government can insure itself a reasonable price by competitive bidding or by negotiation or by other devices, it does not need renegotiation. Moreover, we emphasize that in the general economy competitive conditions prevail.

Senator MALONE. My particular point is when they know exactly what they want, they know the amount of the material they want, and write accurate specifications, what would prevent a fair bid?

Mr. STEWART. I cannot conceive of any unless when the bids that were received were unrepresentative. I believe the Government has the authority to throw them out in such cases.

Senator MALONE. Well, then, do you sbuscribe to the information developed yesterday that where bids are let on performance, no detailed specifications, then perhaps renegotiation might still be either necessary or advisable?

Mr. STEWART. I do not accept that without further study, Senator Malone, for this reason: I am not satisfied that the Services are using to the extent fully available other devices, such as price redetermination. It is that kind of a question, sir, that I think needs to be included in this study.

Senator MALONE. This line of questioning is simply to the point that if you know what you want, you know the quantity you want, and you have real competitive bidding, if you are still going to renegotiate, and if so, are you not defeating the very objective that you are shooting at in asking for a bid?

Mr. STEWART. You are saying that if you have renegotiation on top of a procedure which guarantees the protection of the public interest, you are defeating the objective of competitive bidding.

Senator MALONE. Why have the competitive bids, if you are going to do this, anyway?

Mr. STEWART. I would agree with that, sir.

Senator MALONE. Thank you.

The CHAIRMAN. Thank you.

Mr. STEWART. Thank you.

(Mr. Stewart's prepared statement and supplemental memorandum follows:)

STATEMENT OF THE MACHINERY & ALLIED PRODUCTS INSTITUTE ON THE PROPOSED EXTENSION OF RENEGOTIATION

(Presented by Charles W. Stewart, executive vice president)

Mr. Chairman and members of the committee, we greatly appreciate the opportunity to present in behalf of the capital goods industries the views of the Machinery & Allied Products Institute on the proposed legislation (H. R. 4904) extending until December 31, 1956, the Renegotiation Act of 1951, as amended.

INTRODUCTORY COMMENTS

This statement will serve as a summary of the views of the institute, which we would like to supplement by a more lengthy presentation to be filed for the record within a few days. The supplemental statement will include a detailed

analysis of present economic conditions, which of course bear upon the question of extension of renegotiation, a more technical treatment of certain statutory and administrative problems involved in renegotiation under the 1951 act, as amended, and consideration of points made yesterday by Government spokesmen representing the military services and the Renegotiation Board.

First, we should like to commend the committee for its decision to hold public hearings on a subject which, in our judgment, has not received sufficient attention by the Congress, Government, and other interested groups. We hope, however, that these hearings will serve as only a starting point for a searching and long overdue inquiry into the nature and effect of the renegotiation process as a procurement device under present economic conditions. As to the urgency of such an inquiry, it is our firm belief that the present international situation and the high level of military procurement which it requires are likely to last for a considerable period of time, and we are therefore at a juncture where the basic policies and procedures now adopted may be with us for a long time. In other words, it may be that the committee has before it the question of an indefinite extension of renegotiation as a matter of principle. We should like to emphasize that we believe that in making this inquiry the committee should not consider renegotiation in a vacuum but relate it to other available procurement devices and the profit-limitation provisions of the Vinson-Trammell and Merchant Marine Acts.

RENEGOTIATION IN PERSPECTIVE

Let us place the subject of renegotiation in its proper perspective.

As an introduction to this complex and frequently misunderstood subject, we will consider it in relation to the circumstances which gave rise to its adoption, the legislative conditions which have surrounded previous extensions, and the indisputable facts of life in Government procurement and in our economy today.

Renegotiation was adopted originally in a total war economy and justified on the grounds that the disruption of normally competitive markets and the haste and inexperience of military procurement officers required some means of recapturing retroactively excessive profits which might result from defense business. A similar justification was advanced for reenactment of the law in 1951, although subsequent events have tended to belie the predictions of the act's proponents.

The primary consideration of the committee in its deliberations on this legislation is, of course, the protection of the Government's interest. Properly considered, renegotiation is a statutory tool of emergency procurement. The proper inquiry of the committee becomes the effectiveness of renegotiation as a procurement device, since the ultimate interest of the Government in this area is the most efficient system of military purchasing possible. As we have previously suggested, it is important that in making this inquiry the committee relate the process of renegotiation to other procurement devices and give due weight to current economic conditions.

Although the President has urged prompt action by the Congress, we must respectfully register our disagreement with this recommendation for immediate congressional action. There is no need for haste in the consideration of this legislation, and, on the contrary, there is the distinct possibility of injustice and error in a too-hasty extension of this act. Renegotiation has almost always been legislated on a retroactive basis, and there is no reason why time cannot be taken in this instance to study all the issues.

In this connection, it is a fortunate circumstance that the committee will soon have available to it the report of the Procurement Task Force of the Hoover Commission. That report will serve, we expect, to demonstrate our contention that the military services today are becoming so experienced in broad-scale procurement that little or no possibility exists of unreasonable prices on defense contracts. This report will also probably treat renegotiation as only one of a series of procurement issues, which, as we have emphasized, is the proper approach to a study of renegotiation. Moreover, if the committee is not satisfied with this report and if an overall inquiry into procurement matters, including renegotiation, is outside its own purview, we suggest that the Senate, through its Government Operations Committee, might profitably undertake an extensive independent inquiry into Government procurement—how it is carried on, the devices being employed to protect the Government's interest, the extent to which they overlap, and the extent to which they are successful.

The President's current proposal for extension of renegotiation is premised, in the main, upon the complex nature of modern military equipment and the absence of competition which results from procurement of novel items of supply.

This premise has been further underlined by military service spokesmen. Disregarding for the moment weapons which are still in a developmental stage, there would seem to be no question that full, free, and vigorous competition has been restored to the American economy and that, as to the vast majority of items procured by the military services, the Government has available to it close contract prices competitively established.

In the very narrow and specialized sector of defense procurement where competition may not be sufficient by itself to protect the Government's interest, there are available to the military a wide variety of proven procurement techniques by which reasonable prices on such defense business can be insured. Moreover, recent defense contracting trends can only be interpreted as suggesting that procurement officers have become increasingly skilled and sophisticated bargainers during the post-Korean period.

These factors lead to our conclusion that further extension of renegotiation is unwarranted and would be tantamount to endorsing the perpetuation of renegotiation.

Finally, although we oppose most strongly any further extension of the Renegotiation Act, we acknowledge the possibility that Congress may feel compelled to honor the Presidential request. If this be the case—and our acknowleagment of this fact in no way diminishes our opposition to renegotiation—then we urge certain concrete recommendations for amendment of the present act which would, we believe, satisfy entirely the suggestions of the President to consider renegotiation within the very limited area of specialized procurement about which he expressed concern and, at the same time, eliminate certain of the more objectionable features of the present legislation in the light of current economic and procurement conditions.

DISADVANTAGES OF RENEGOTIATION

The concept of renegotiation had its origin during the early years of World War II when the Federal Government was purchasing 30 to 40 percent of the total output of private industry. With this overall take, Government was, of course, absorbing the entire output of many individual industries and a major portion of the output of many others. It was buying unprecedented quantities of military equipment in frenzied and necessary haste with an overworked procurement organization, often purchasing from contractors unfamiliar with both the product and the necessary production techniques. The present act, modeled after World War II experience, was conceived in the buildup which followed the outbreak of the Korean conflict and in the short-term distortion to our economy resulting therefrom.

Thus, in each case, renegotiation was a hastily conceived improvisation to facilitate the rapid placement of contracts under war conditions. Insofar as it gave the contractor the benefit of an overall review of his Government contract profits and attempted—at least in theory—to provide some measure of flexibility by the introduction of statutory factors, it represented a distinct improvement over the crude, inequitable, and outmoded fixed-percentage-of-profit limitations of the type embodied in the Vinson-Trammell and Merchant Marine Acts.

However, despite the commendable objective of introducing certain flexible criteria aimed at rewarding efficiency, contribution to the war effort, risks involved, etc., renegotiation in practice remains a basically undemocratic, arbitrary and altogether inscrutable process. Whatever may have been its virtues during the war emergency, we submit that its defects are so serious that its role in the present situation—with less than 5 percent of the Nation's current output of goods and services going to major military procurement and construction—is, at the most, a limited one. Indeed, in our judgement, renegotiation is unnecessary.

We should have these same misgivings over the adoption of the renegotiation process as part of our permanent legislation governing Government-industry relations even were the act capable of being administered in accordance with the objective which its original proponents had in mind. However, a brief inquiry into the burdensome, arbitrary, and disincentive process in practice as distinguished from theory, should dispel any doubts as to its desirability under present conditions.

Enumeration of principal disadvantages

Renegotiation possesses six principal disadvantages: (1) The inducement it creates for careless procurement; (2) the impairment of incentives to economy and efficiency; (3) the burden it places on management; (4) the arbitrariness of

its results; (5) the probable net loss to the Treasury from its imposition; and (6) the long, continuing financial uncertainty which it produces. We shall undertake no extended treatment of all of these disadvantages in this summary statement. However, we should like to highlight certain of these points and to illustrate them with typical examples.

Disincentive nature of the renegotiation process.—Despite protestations to the contrary, the renegotiation process, as it is applied to individual contractors, is by its very nature so lacking in standards as to represent one of the most arbitrary and undemocratic grants of Federal power on our statute books today. Thus, while alleging to take into account and reward the individual contractor for his efficiency, contribution to the defense effort, product research and development, assumption of risks, utilization of capital, etc., the process is so completely inexplicable to the contractor himself that there is, in fact, little incentive for the efficient producer to pare costs and maximize productivity. Foremost among the disincentive features of the renegotiation process are the inconsistent standards used by various renegotiators, the inevitable rules of thumb that evidence themselves from certain patterns of refunds; and attempts by regional personnel to solicit profit and cost breakdown on a product line rather than on an overall basis.

Particularly frustrating to contractors is the failure of some regional boards—and, indeed, the statutory board—to give any definitive reasons or methods by which they arrived at their refund determination, except by a pro forma recital of statutory factors. While it is not infrequent that an appeal to the statutory board in Washington has resulted in a reduction in the refund or a clearance order, many contractors are not even provided sufficient information in the statement of facts and reasons to enable them to make an intelligent appeal on the regional board's action.

These conditions exist, these problems arise, not because renegotiating personnel are not making every effort to do the best job possible and not because renegotiating personnel are inefficient. Rather, they arise because of the nature of the process itself, which is almost impossible of orderly, clean and equitable administration, particularly under the kind of economic conditions which now prevail.

Secretary Thomas, in his statement to the Ways and Means Committee, recognized the danger inherent in the renegotiation process of rewarding the inefficient high-cost producer. We submit that, in spite of conscientious efforts on the part of the Renegotiation Board and its staff to meet the problem and despite the efforts of Congress to spell out standards in the law, the situation of which he warns prevails, in fact, today.

Burden on management.—Not the least of the waste of scarce resources occasioned by renegotiation is the time and effort of top management and professional personnel which is devoted annually to renegotiation procedures in both industry and Government. Any company having a significant amount of renegotiable business is forced, by the complexity and scope of the process, to assign at least one of its key management personnel—and a substantial number of accounting and clerical staff—to handling their case. This pattern is generally the same irrespective of the size of the company and whether or not the company earns what the Renegotiation Board considers to be a "reasonable profit" and is subsequently given a clearance or is subject to a refund. Indeed, we have had cases brought to our attention of companies which suffered a substantial loss on Government business who were required not only to provide the normal filing data but incur the additional time and expense of submitting considerable supplementary information before obtaining a clearance.

Moreover, the process requires such an extended period of time that even were the act allowed to expire, these companies would be tied up for a number of years completing the processing of prior years' business. Some firms are still being renegotiated on their 1951 business after being repeatedly asked for waivers in the running of the period of limitations. One further burdensome aspect of this process is the not infrequent request by the Renegotiation Board, after a long period of inactivity on a case, for a meeting or the filing of additional information at a time when the companies' personnel assigned to the problem is unavailable. This involves either the added expense and inconvenience of rushing back to the matter or of educating other members of the company on the complicated features of the process and the prior history of the case. Similarly, with the normal change in personnel at the Renegotiation Board and the closing of two of the regional boards, new people are constantly being assigned to a case, which requires the company to cover some of the same ground over and over in order to obtain an intelligent appraisal.

Cost of renegotiation

One of the most frequently overlooked but crucial considerations in assessing the merits of extending renegotiation is the cost of the process to the Treasury and ultimately to the taxpayer. We think it quite probable that the renegotiation process under the current act results in a net loss to the Treasury. Under 1955 economic conditions and the concentration of procurement impact in a limited area of our economy, this conclusion is even more justified. However, because the statistics to prove this conclusively are not readily available, we can only point up some of the facts which lead us to this conclusion.

Has the 1951 act yielded any net revenue?—According to the recent testimony of the Renegotiation Board, recoveries through December 31, 1954, amounted to $232 million, while the Board's expenditures for administration of the 1951 act have run only $14 million over the same period.[1] This testimony may leave the impression that the Treasury reaps the difference of $218 million. Such an impression would be misleading for a number of reasons. In the first place, the reported recoveries are not net figures from an income-tax standpoint; inasmuch as these refunds are themselves deductible, only the balance, after deduction of the applicable corporate tax rate, can properly be called a net recovery of taxes to the Government. When the excess-profits tax, as well as the normal corporate rates, is applied here (the determinations made by the Renegotiation Board to date deal with contract deliveries made prior to calendar year 1954), the tax yield works down to somewhere between $42 and $111 million, depending on the proportion of these recoveries which was subject to the maximum corporate tax rate, including excess profits, amounting in all to 82 percent.

In addition, before this net tax recovery can be translated into a benefit to the Treasury there must be subtracted not only the $14 million of Government costs but the direct costs to industry for compliance as well, since these latter costs are also tax deductible. While there are no firm figures on the cost of industry compliance, we estimate that they may amount to as much as one-tenth of 1 percent of the dollar value of renegotiable Government business. Applied to the $175 billion of Government contracting subject to renegotiation, the total cost to industry could run as high as $175 million. If it is true that industry's tax-deductible expenses for compliance run to this level, no net gain to the Treasury would appear to result. Wholly apart from the factor of compliance costs is the probability that the higher prices paid by Government, resulting from a greatly reduced lack of incentive for efficient production on Government business, might wipe out any potential tax gain.

Apparently anticipating this inevitable conclusion, the proponents of renegotiation now seek refuge in the nebulous contention that the mere existence of the Renegotiation Act has "had a salutary effect upon contract pricing" by prompting contractors to negotiate closer prices at the inception of the contract. On the contrary, we believe renegotiation constitutes a "crutch" which leads to loose and careless negotiation by contracting officers. Aside from the dubious validity of this argument, we respectfully submit that the loss to the economy resulting from the lack of incentive by the renegotiatble contractor to cut costs and maximize production more than offsets any possible gain.

Even were the committee to overlook what we consider to be the overriding consideration involved here—the dangerous precedent of perpetuating this extraordinary wartime grant of Federal authority as a permanent fixture of our economy—it is incumbent on the Congress to inquire into the precise nature of the present procurement problem and the alternative procurement devices which are available to insure that the act is not extended in its present form to encompass those areas in which the anticipated refunds, if any, would not outweigh the cost of the taxpayers.

COMPETITIVE CHARACTER OF OUR PRESENT ECONOMY

Inasmuch as we adopt the existence of competitive markets as the major criterion for deciding whether renegotiation is needed, let us now turn to an analysis of our present economy to determine whether or not this criterion has been satisfied.

The 4½ years since the invasion of Korea have witnessed the maintenance of competitive conditions in a vast number of markets. In the remainder, com-

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[1] Hearings before the Subcommittee on Independent Offices Appropriations for 1956, House Appropriations Committee, February 2, 1955. Chairman Roberts, in his statement to the Finance Committee on June 7, 1955, reported the latest Renegotiation Board's gross recoveries at $355 million.

petition has reemerged after a short-lived eclipse under the stress of heavy post-Korean contract placement. A short review of the Nation's economic situation during the past year will suffice to demonstrate the competitive nature of industrial markets today.

THE DEFENSE PROGRAM AND THE NATIONAL ECONOMY

At the time of passage of the Renegotiation Act of 1951, officials responsible for the defense program were freely predicting that national security expenditures would rise to an annual rate of $65 billion by the end of 1952. The actual extent of defense procurement falls far short of the proportions originally estimated. Expenditures on national-security programs in fiscal 1953 amounted, at annual rates, not to $65 billion, but to less than $50 billion. Subsequent declines in the level of expenditure for national security (including military aid abroad) have brought the overall impact of such procurement down to $41 billion in fiscal 1955, where it is expected to stabilize at least through fiscal 1956. If we subtract from this $41 billion the approximately $25 billion which will be allocated to pay, services, and current operation of the armed services and for the administrative expenses of the other national-security programs, we arrive at a figure of about $16 billion which will be spent for major procurement and construction, including atomic energy and research and development. This represents less than 5 percent of the Nation's current $365 billion output of goods and services.

Since Korea, the output of our economy has increased by $84 billion, from a rate of $278 billion in the second quarter of 1950 to a rate of about $362 billion in the fourth quarter of 1954. Increased expenditures for national security have absorbed only $22 billion of this added output, leaving $62 billion for use by the civilian economy. Moreover, at noted above, currently unused resources could add another $20 billion to the amounts available for military or civilian purposes.

This is hardly the picture of an all-out mobilization, choking off competitive markets and making orderly pricing of needed armaments impossible. On the contrary, it bespeaks generally competitive conditions.

Reasonable prices the basic criterion.—The proper concern of procurement policy is the reasonableness of prices paid by the Government. Consequently, the crucial factor is price, not contractors' profits. In the absence of collusion or other special circumstances, the existence of alternative sources of supply, both actual and potential, guarantees the maintenance of competitive conditions and insures against the payment of inflated prices by the Government, as well as by any other purchaser.

Where normally competitive conditions are present, therefore, the question of profit is irrelevant, since the level of profits obtained in competition reflects the degree of efficiency attained by the producer. Consideration of renegotiation is justified only where a military emergency makes such huge and unusual claims upon the productive resources of the Nation that competitive prices can no longer be reasonably established in advance.

Despite the fact that the ultimate goal of procurement policy—and of renegotiation when properly conceived—is the reasonableness of the price paid by the Government, much of the discussion on the alleged need for renegotiation centers around the level of profits earned by defense contractors. To some extent this is understandable since there is an intimate connection between prices and profits, although profits are by no means the proper criterion of price reasonableness. Taking issue first, then, with the proponents of renegotiation on their favorite battleground—that of the level of profits—let us review the trend of profits in manufacturing industries generally and, more particularly, in the capital-goods industries.

Profits.—The tables following compare corporate profits prior to Korea (average of the years 1947–50) with profits earned in 1953 and in the first three quarters of 1954 for all manufacturing corporations and for the machinery and transportation equipment industries. Insofar as the rationale of renegotiation lies in a mushrooming of profits, the facts belie the necessity for its continuation. Measured as a return on equity or sales, before or after taxes, profits during both 1953 and 1954 were below the pre-Korean level. Since renegotiation is on a before-tax basis, it is important to note that, for manufacturing as a whole and the machinery groups, before-tax profits on stockholders' equity during the past 2 years show at rates well below the level preceding Korea. Measured against sales, the reduction is equally noticeable.

It is significant also to observe that after-tax profits, whether measured as a ration of stockholders' equity or of sales, were only some two-thirds as large in 1953 and 1954 as in the 1947–50 period.

In the face of these generally lower profit levels, before as well as after taxes, any attempt to justify the need for a further recapture of profits through renegotiation must obviously look to some arbitrary "permissive" level rather than to a recent historical benchmark such as the period prior to Korea.

Relation of profits before taxes to stockholders' equity and to sales

	To equity (profit ratio)			To sales (cents on dollar)		
	1947–50 average	1953	1954	1947–50 average	1953	1954
All manufacturing	24.4	22.6	21.5	11.0	9.2	8.4
Machinery:						
Nonelectrical	24.7	23.6	18.2	12.0	10.1	9.2
Electrical	30.6	33.6	25.0	10.8	10.6	9.0
Transportation equipment:						
Motor vehicles and parts	38.6	38.7	29.8	13.4	10.8	10.6
Aircraft, ships, railroad, and other	12.5	37.3	33.4	6.2	7.2	7.5

Relation of profits after taxes to stockholders' equity and to sales

	To equity (profit ratio)			To sales (cents on dollar)		
	1947–50 average	1953	1954	1947–50 average	1953	1954
All manufacturing	14.8	10.4	9.9	6.7	4.3	4.5
Machinery:						
Nonelectrical	14.5	9.7	8.6	7.1	4.2	4.4
Electrical	17.8	12.9	12.4	6.3	4.1	4.5
Transportation equipment:						
Motor vehicles and parts	21.7	13.7	14.1	7.4	3.9	5.1
Aircraft, ships, railroad, and other	6.6	13.3	16.5	3.4	2.6	3.7

Source: Quarterly Financial Reports for United States Manufacturing Corporations, Federal Trade Commission and Securities and Exchange Commission.

Prices.—The likelihood of realizing firm and reasonable prices in the capital goods industries is evidenced by the history of capital goods prices. Since 1939, while prices of all industrial commodities have risen 97 percent, average hourly earnings in all United States business 172 percent, and construction costs 153 percent, machinery and equipment prices have increased only 78 percent. During the interwar period (1922–41), the ratio of machinery and equipment prices to the wages paid by commercial users of machinery and related equipment declined at an average rate of 1.13 percent annually. From 1939 onward, however, price increases have lagged wage increases at better than this historical rate, with the result that the price-wage ratio is now (end of 1954) 20 percent below its trend value.

The rapid productivity increases and the force of competitive pricing which make this record possible are equally as applicable to the defense as to the civilian business of machinery and equipment producers. Under such circumstances, the extension of a procurement device like renegotiation, to achieve clumsily and inefficiently what the fine adjustments of market competition smoothly accomplish, is patently superfluous.

Economic situation—Summary

Viewed from whatever perspective one wishes to take, the economic situation of the Nation is characterized by competitive conditions favorable to orderly procurement. Production, shipments, and new orders are in approximate balance; order backlogs have rapidly declined; production capacity exceeds actual output with the result that there is still competition for the open capacity; prices have remained stable in the face of wage increases; defense contracts have declined in volume; and, finally, profit rates reflecting these conditions are below pre-Korean levels.

THE ADMINISTRATION'S CASE FOR EXTENSION OF RENEGOTIATION

The President has suggested that a further extension of this extraordinary method of profit control is necessary because (1) the complex nature of modern military equipment does not permit proper procurement pricing; (2) in certain cases only limited sources of supply exist, thereby resulting in a lack of normal competition; and (3) it is the only protection the Government has against the charging of unreasonable prices by subcontractors. As a part of our attempt to place the whole matter of renegotiation in its proper perspective, it seems to us necessary to consider with some care the relatively limited scope of the procurement problem to which the President's message refers.

The Presidential message urging extension of renegotiation and the testimony of Department of Defense witnesses before the House Ways and Means Committee on H. R. 4904 suggest the inadequacy of military contracting techniques to prevent excessive profits on defense contracts. On the basis of widespread member company experience we must enter a respectful disagreement with this point of view, at least insofar as it applies to the whole field of defense procurement. Disregarding for the moment a relatively limited field of defense procurement with which we shall deal later, it seems fair to inquire if military procurement officers are in fact as unsophisticated, as inexperineced, and as helpless to prevent the collection of excessive profits as these arguments would seem to suggest.

Two principal factors bear on this question. First, there is the question of the extent of military procurement experience and, second, the question of the tools—that is to say, the contracting techniques—by which military procurement is accomplished.

Military procurement experience

The military departments have been engaged in very heavy procurement programs for 11 of the last 15 years, and throughout this period there has been a continuous evolution of ever newer and ever more complex weapons. The fact is that the military services have unparalleled experience in procurement and, as we have suggested, they have more than a decade of experience in dealing with the specialized problems raised by the procurement of novel and complex military equipment. In brief, if the military departments are not by now sufficiently experienced in all aspects of defense procurement, one seems justified in asking if they ever will be.

Military contracting methods[2]

Military contracting officers have available to them a wide range of contracting devices which are the direct and natural result of their unprecedented experience in large-scale purchasing, the use of which is such as to insure generally reasonable prices. First of all, the military departments may let contracts by advertised bids. For the fiscal year 1954 some 15 percent of all defense contracts were so let, and we dismiss that portion of the total defense budget from further discussion since it seems clear that as to such contracts there is no question of the existence of substantial competition.

Negotiated defense business, constituting some 85 percent of the total in fiscal year 1954, may be divided into 2 broad categories: cost-reimbursement type contracts—further subdivided into 4 subclassifications—and fixed-price contracts of 5 general types.

Cost-reimbursement type contracts.—From 1952 through 1954 the use of cost-reimbursement type contracts increased from about 18 percent of total defense procurement to almost 30 percent of the whole. There can be no question, we believe, as to the adequate protection of the Government's interest under contracts of this type, since the reimbursement of all costs under such contracts is tested by a well-defined set of administrative cost principles considerably narrower in its concept of cost allowability than that contained in the Renegotiation Act itself. This is not to suggest that we necessarily favor the use of such contracts nor the widespread use of administrative cost principles which do not agree with normal accounting practices; but insofar as their use bears on the proposed legislation now before this committee, we reiterate our contention that there would appear to be no doubt of the complete protection of the Government's interest where such contracts are employed.

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[2] All figures used in this discussion were supplied by the Office of the Assistant Secretary of Defense (Supply and Logistics).

By thus eliminating from consideration contracts let by formal advertising and cost-reimbursement type contracts, we have for further study some 55 percent of total defense procurement (based on fiscal year 1954 figures), embracing all fixed-price, negotiated contracts. Certain trends of the greatest significance emerge from the study of this procurement area wherein, presumably, the greatest difficulty is encountered in achieving reasonable contract prices.

Negotiated, fixed-price contracts.—Military procurement officers may contract by means of straight, fixed-price agreements, redeterminable, fixed-price contracts with prices adjustable upward or downward, redeterminable contracts containing a maximum figure above which the contract price may not rise, straight, fixed-price contracts providing for price escalation where labor or material costs increase as shown by established indexes, and incentive-type contracts under which the producer's profit varies directly with cost reductions achieved. Now let us consider what has happened in the area of fixed-price, negotiated contracting during the 3-year period 1952–54.

In 1952, nearly 51 percent of all defense contracts contained redetermination clauses of one kind or another. It may properly be inferred from this, we believe, that during this period a very considerable indecision existed on the part of contracting officers as to what constituted reasonable prices. However, by 1954 the use of redetermination clauses had decreased from 51 percent of all defense contracts to a little more than 7 percent. The obvious conclusion is that certainty born of experience and the return of intense competition to the market place had replaced earlier indecision and inexperience on the part of contracting officers. Again, whereas about 31 percent of defense procurement in 1952 was of the firm, fixed-price or escalation type, the percentage figures for these 2 contract types (including, of course, contracts let by advertised bid) had increased by 1954 to more than 63 percent of the total.

Thus we conclude that the further extension of renegotiation cannot be justified either on the grounds of inexperience or on the basis of inadequate contracting techniques. As we have already pointed out, the military departments not only have vast experience in purchasing but experience extending over many years in the procurement of continuously evolving new weapons. From this experience military procurement has developed no less than nine distinct contract types designed to meet all of the varying procurement situations which may arise in defense purchasing. And the changing pattern evident in the use of varied contract types points to continuously increasing skill in bargaining by military contracting officers.

The scope of the problem

There appears to be a universal tendency in discussing renegotiation to consider the defense budget in terms of its entirety; thus the President suggests the need for extension on the basis that more than half of the national budget is represented by defense expenditures. Hence, if we assume, without admitting, the desirability of extending renegotiation for the reasons outlined by the President, it seems entirely appropriate to define the area of defense procurement to which renegotiation might be properly applied under any circumstances.

Breakdown of the defense budget.—In recent hearings before the House Appropriations Committee, the Department of Defense has proposed an expenditure budget for fiscal year 1956 of $32.75 billion. Of this total about one-half may be eliminated from consideration immediately on the ground that such expenditures are not subject to renegotiation.[3]

Approximately $16 billion remain for consideration, of which about $9.5 billion would appear to satisfy the requirements of the Presidential message. This latter total is composed of $7.5 billion for aircraft procurement, $675 million for guided missiles, and $1.37 billion for research and development. In addition, probably some portion of the approximately $1 billion planned for expenditure on ships and harbor craft fall within this category, although the precise amount is not ascertainable from the tabular presentation of these figures to the House Appropriations Committee.

Certainly, the sum of $9.5 billion is a great deal of money, representing in all nearly one-third of the total defense expenditure budget. However, the mere recital of the types of procurement for which this great sum of money is to be expended suggests, we submit, the relatively limited scope of the

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[3] Statement of the Honorable Roger Lewis, Assistant Secretary of the Air Force for Material, before the Committee on Ways and Means, House of Representatives, on H. R. 4904, to extend the Renegotiation Act of 1951 for 2 years.

problem to which the Presidential request for extension of renegotiation is addressed. We repeat that most. if not all, of the procurement situations contemplated by the Presidential message fall within the area of aircraft, guided missiles, research and development, and, in some measure, ships and harbor craft. It is not without significance that the Department of the Air Force was designated as Department of Defense representative on this question. Moreover, we note that the testimony of Air Force spokesmen before this committee was restricted exclusively to procurement of aircraft and so-called aircraft systems. These same spokesmen declare that no initial pricing problem exists with reference to other types of procurement.

We raise these considerations as a reiteration of our belief that the discussion of renegotiation, both in the press and in legislative hearings, all too often tends toward exaggeration. The problem, as we have suggested above, is of considerably smaller proportions and of far more limited scope than is generally supposed. Assuming, therefore, that Congress decides upon the advisability of continuing renegotiation in any form—and our admission of this possibility does not lessen in any way our general opposition on principle to the act's further extension—the problem of reasonable prices may, in our judgment, be dealt with most adequately by amendment of the present act in conformity with recommendations advanced later in this statement.

RECOMMENDATIONS

We believe that any further extension of renegotiation is unnecessary. Moreover, we believe that a 2-year extension, given the present state of defense procurement—which has every appearance of continuing indefinitely—would be tantamount to adopting this legislation as a permanent part of our procurement policy.

If, however, the Congress, in its judgment, feels compelled to extend the act, we respectfully submit that it should do so only after considering every possible means of fitting the cure to the sickness. We recommend the following amendments for your careful consideration.

Present statutory exemptions

Before setting forth our recommendations for limiting the scope of the act to those areas of military procurement about which proponents of extension express primary concern, we should like to reaffirm our general approval of the existing exemptions to the Renegotiation Act, both statutory and administrative. However, while they are thoroughly sound in conception and have immeasurably reduced the burden on both contractor and Board, they contain certain inadvertent inconsistencies which inevitably arise when provisions as complicated as these are adopted without time for careful consideration.

The first of these, the application of the profit limitation provisions of the Vinson-Trammel Act to standard commercial articles—which we pointed up in a statement to the Ways and Means Committee—has effectively been cured in the present amended version of H. R. 4904.

A second inequitable and presumably unintended situation has arisen from the application of the standard commercial article exemption. The problem arises from a strict definition of the term "product." Thus, contractors who perform a service which is similar and competitive with a service performed by others are denied the application of the standard commercial article exemption. Similarly, where a company sells and installs a standard commercial heating, plumbing, air-conditioning, or other system in a Government building, it is considered under a recent ruling of the Renegotiation Board to be a contract for the construction of an improvement on or to real property and not a contract for the making or furnishing of a standard commercial article. In both of these situations the company may be, and is almost certainly likely to be, subject to strong competition. Nevertheless, under the existing law it is subject to renegotiation on this contract. The amendment submitted by the Renegotiation Board yesterday has not been available to us for study, but the committee should adopt language broad enough to cover various service and installation contract situations.

Another important defect which arises from the statutory amendments of last year is the inadvertent retention of the "end product" limitation in the "durable productive equipment" partial exemption. We did not bring this matter to the attention of the Ways and Means Committee because of the prior unavailability of a definitive ruling by the Board on the matter.

Section 106 (c) of the act, as amended, which you will recall grants a partial exemption to manufacturers of "durable productive equipment," was extended retroactively last year to cover prime contracts and subcontracts for the account of the Government. Prior to that time, this fractional exemption had been restricted only to subcontracts for equipment which was not to be subsequently incorporated into an end product. Apparently through inadvertence, this end-product limitation was retained when the exemption was enlarged to cover prime contracts. The Renegotiation Board, in a literal interpretation of this provision, has ruled that, as presently drafted, the exemption does not apply to a subcontract for any item which is subsequently incorporated by the prime contractor into a product which is sold to the Government. Thus we have the anomalous situation of a piece of productive equipment partially exempt when sold directly to the Government but wholly renegotiable when sold to a prime contractor. This result holds true even in those cases where the prime contractor, after incorporating this item into another piece of "durable productive equipment," is only partially renegotiable on his direct sale to the Government.

The Renegotiation Board is cognizant of the inequitable and unintended results of this inadvertence but has taken a firm position that it is entirely a matter for legislative correction. This can be achieved by simply eliminating the end-product limitation itself without disturbing the rest of the provision. As in the case of the standard commercial article amendment, the correction would be clarifying in nature and retroactive to the effective dates of last year's amendment to section 106 (c).

Further amendments required

While we are in full accord with the objectives which Congress had in mind in adopting the statutory exemptions now contained in the act, and with the permissive administrative exemptions which the Renegotiation Board has developed over the years, we respectfully submit that the remaining area still subject to renegotiation is far broader than the needs outlined in the President's message dictate. Basically, the administration's concern, regardless of the language used to describe it or the justification advanced for it, is simply that a large part of the current and prospective military budget is designated for jet aircraft, guided missiles, nuclear weapons and devices, new weapons and research development projects, for which it is claimed there is inadequate pricing experience and insufficient competition. The spokesmen for the Department of Defense, in their testimony before this committee, were quite clear and unanimous on this point. Surely then, even if we were to accept this contention, there can be no justification whatsoever for extending renegotiation beyond this area. While these items of military procurement represent a substantial segment of the defense budget, it must also be recognized that they involve a much smaller portion of our industry and, similarly, a much smaller portion of our total economy than is presently subject to renegotiation.

Although it may be impossible, and indeed undesirable, to attempt drawing a precise dividing line by statutory language, we believe that this goal may be achieved by other means. In this regard we have been careful to avoid recommending the adtoption of further exemptions of the present type which require extensive filings and correspondence and difficult problems of interpretation for both industry and the already overloaded Renegotiation Board staff. The limitations we have recommended are either entirely self-executing or within the function of the cognizant procurement officials who are already concerned with the specific problem at hand.

Elimination of fringe agencies

A preliminary step which should immediately be taken to limit the scope of the act to those areas with which the President's message is concerned is the elimination from the coverage of the Renegotiation Act of those contracts entered into with certain Government agencies whose procurement falls entirely outside the scope of the problem we have been discussing. There has been a tendency in recent years for the administration, under its authority in section 103 (a), to bring in every conceivable Government purchaser, such as House and Home Finance Agency, Bonneville Power Administration, Bureau of Mines, Bureau of Reclamation, TVA, United States Geological Survey, etc. Few, if any, of these have any responsibility whatsoever for the special military procurement areas with which the President's message is concerned. What is even more significant is that ample pricing experience exists in these areas. Cer-

tainly there is no emergency which prohibits these departments from contracting initially in a proper and careful manner. This is precisely the type of renegotiation coverage which raises the cost of the process itself out of all proportion to any amount of profits which might conceivably be involved. Although much of the equipment purchased by these departments is already fractionally exempt, the burden and cost of compliance is as heavy as if it were wholly renegotiable. Unfortunately, the present justification by which certain contracts of these agencies have been brought within renegotiation, namely, that they have a "direct and immediate connection with the national defense", has been so broadly interpreted as to have little or no validity under the present circumstances. We therefore urge a statutory amendment eliminating the procurement of these fringe agencies from renegotiation.

Affirmative designation of renegotiable contracts

The principal change which we recommend is the further narrowing of the procurement area within our Defense Establishment. Here it seems to us Congress might well revert to a method somewhat similar to that employed in section 401 of the Second Deficiency Appropriation Act of 1948, wherein responsible administrative authority (the Secretary of Defense) was given the responsibility to designate for renegotiation those classes of contracts that, in his judgment, merited the designation. This seems to us the logical approach under present conditions where a general presumption exists in favor of firm pricing rather than renegotiability and where the really troublesome procurement problem is limited to enlarged procurement of new types of aircraft not unlike the buildup which we were undergoing on a smaller scale in 1948 and 1949.

Statement of congressional intent needed.—While this approach will put renegotiation in its proper place as an instrument of procurement policy to be used like any other device, selectively, and in appropriate cases, at the discretion of the procurement authorities, it will not suffice in our judgment without an explicit statement of congressional intent set forth in the Renegotiation Act itself. This statement should make it unmistakably clear that the purpose of renegotiation is to correct retroactively for mistakes in the pricing of Government contracts and subcontracts, and it is to be used by the military and atomic energy procurement agencies only when, for some reason, adequate protection for the Government cannot be secured through various contractual provisions at the time a contract is let.

This statement of congressional intent should emphasize that nonrenegotiable pricing is the normal goal of procurement policy and should be employed as widely as conditions permit so as not to interfere unwisely with the maintenance of a normal commercial relationship between the Government and its suppliers. It should indicate that in normal competitive markets the price of the best supplier is presumably a reasonable price requiring no retroactive review. This affirmative designation need not and should not be done on a contract-by-contract basis but for those procurement areas which, in the judgment of the officials responsible for purchasing, come within the purview of this intent. As experience is gained, these areas would obviously change. This flexibility is essential should the Congress decide to extend the act for 2 years. One other desirable feature of this approach is its flexibility in case of war. Our recommendations and analysis herein are based upon the present cold war situation. Should a war of any considerable magnitude break out, a fresh look at the problem would be in order. However, the military departments under this proposed method would have at their disposal the proper means to safeguard themselves until such time as Congress could reexamine the situation.

Renegotiation and price redetermination.—Inasmuch as renegotiation would apply only to those areas in which procurement agencies have felt compelled to employ price redetermination and other price review devices, the Congress should indicate that where renegotiation is applicable, price redetermination should not, as a general rule, be required in addition. Where a contract will be subsequently renegotiated, price redetermination should be used only in unusual cases. Where, however, procurement officials consider it necessary to use redetermination clauses, contracts so drawn should not be excluded from renegotiation, since this would negate one of the principal purposes, that is, the overall character of the renegotiation process.

Relationship of the present statutory exemption.—The present exemptions, both statutory and administrative, would continue to have their place. It is probable that some contracts or products now wholly or fractionally exempt from renegotiation would be included within procurement areas affirmatively

designated as renegotiable. Although not readily identifiable at the time of affirmative designation of renegotiable procurement areas, they would continue to be excluded from the process by present statutory and administrative exemptions.

This would obviously hold true in the case of small companies whose renegotiable business falls under the statutory floor of $500,000. Similarly, the fractionable renegotiation provision would remain applicable to any piece of durable productive equipment which could be adapted, converted, or retooled for commercial use, regardless of its affirmative designation by the military departments. Finally, there are items to be incorporated into the most experimental of jet aircraft, new weapons, etc., which are so standardized as to clearly qualify under either the standard commercial article exemption or the stock item exemption, e. g., bearings, circuit breakers, fasteners, and numerous other items.

Overlapping profit controls

As we have suggested earlier, renegotiation cannot and should not be considered by itself. Careful study should be given to available alternative procurement and contracting techniques which have been developed steadily, and only recently revised, to cope with every conceivable pricing and procurement problem which is likely to arise before perpetuating this favorite crutch of careless procurement. The matter is timely not only because the issue of renegotiation is now before the Congress but because the procurement task force of the Hoover Commission is close to completing its report to the Commission. If, at the discretion of the Congress, this study could be best undertaken by the Government Operations Committee or by another body of the Congress, we naturally defer to that judgment.

Interrelationship of renegotiation and Vinson-Trammell Act.—One of the things which a study of the overall problem would point up is the complicated and wholly unnecessary overlapping of profit-limitation legislation now on the statute books. As you know, the profit-limitation provisions of the Vinson-Trammel Act have existed since 1934. This method of an arbitrary percentage of profit limitation, which was tacked on the bill on the floor of the House after it was reported out by the committee, was devised at a time in which military procurement was only a small fraction of what it is today. It was admittedly a crude device, conceived prior to the experience in procurement gained during World War II and the Korean conflict. Its subsequent suspensions, during World War II, during the period of excess-profits tax, and—more recently—under the Renegotiation Act, attest to the fact that the Congress has consistently recognized it as an inappropriate alternative. Indeed on of the reasons which has prompted certain procurement officials to urge a further extension of renegotiation at this time is their recognition of the fact that the Government as well as business could not effectively operate under these outmoded procedures.

Recent Internal Revenue ruling.—Although the profit limitation provisions of the Vinson-Trammell Act do not appear to be favorably regarded by the procurement services, the Congress, or the Internal Revenue Service (which is charged with their administration), they continue to remain on the statute books. While these provisions of the act, until recently, were merely a threat to contractors making aircraft, ships or components thereof, an interpretation by the Internal Revenue Service to the Renegotiation Board, dated January 11, which was not published until March 13 (Revenue Ruling 55–173), would place these contracts exempted from renegotiation by reason of the standard commercial article exemption back under the Vinson-Trammell Act. Thus, the clear intent of Congress to exempt from renegotiation those contracts for standard commercial articles for which there exists sufficient competition has been thwarted by this interpretation which has the effect of reimposing even more arbitrary and stringent profit control. The House Ways and Means Committee, taking cognizance of the problem, has amended H. R. 4904 to nullify the Treasury ruling. We respectfully submit, however, the only logical and clear solution to the problem and the only one which guarantees against similar inconsistent situations arising in the future is the repeal of these universally discredited provisions.

As we have previously indicated, we are aware of the fact these acts may not be the responsibility of the Finance Committee but may properly be subjects for consideration by other committees of the Senate. We submit, however, that renegotiation and Vinson-Trammell cannot be artificially separated, and, indeed, the compartmentalization to which the problem of procurement and profit control has been subject has inevitably led to these undesired and often absurd results.

We strongly urge that the report of this committee contain a strong recommendation for a review by the appropriate committees of Congress of the profit limitation provisions of the Merchant Marine and Vinson-Trammell Acts.

Additional recommendations

We have two further recommendations for consideration by the committee in case it is decided to extend the act.

First, we believe that under no circumstances should the extension be for a period longer than 1 year. An extension for a longer period implies an extension of a more permanent character and it is this implication with which we are especially concerned. Moreover, we believe that there should be during this period of 1 year a thoroughgoing study and revaluation of the renegotiation law and its administration in relation to other procurement devices. By limiting the extension to 1 year an additional incentive will be provided to complete the study and report back to the Congress within that period of time.

As a collateral recommendation, we urge this committee to indicate, either in its committee report or by a provision to be included in the bill, that a study of renegotiation and related procurement devices should be conducted by the appropriate Government authorities. We naturally would defer to the committee as to whether this is appropriate subject matter for a statement in the report or for inclusion in the statute itself. But we have a deep conviction that unless the law is extended for only a 1-year period and unless a study is either recommended or directed by the Congress, we will be engaged forevermore in the process of perpetuating renegotiation.

On final comment with respect to the President's recommendation for a 2-year rather than a 1-year extension. It is indicated in his message and repeated by representatives of the military departments that the 2-year extension is appropriate because we should deal with the defense buildup since Korea as a whole. This implies that renegotiation contemplates an analysis of several years' procurement on an overall basis. Actually, renegotiation is conducted on a year-to-year basis and the Board looks neither backward nor forward in viewing a particular year's renegotiable business. For this reason we do not agree with the recommendation that a 2-year extension is necessary in order to accommodate the extension period to the current long-range cold war buildup of national defenses.

MACHINERY & ALLIED PRODUCTS INSTITUTE,
Washington, D. C., June 8, 1955.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: During the course of my testimony today in behalf of the Machinery & Allied Products Institute, you and Senator Flanders requested that the institute submit a supplemental memorandum outlining in more detail the comprehensive study of the subject of renegotiation whch was suggested in our testimony. The enclosed memorandum was prepared in response to your request. We are sure that you will appreciate that it was drafted under considerable pressure because of your wish that it be submitted within a few hours.

We should like to reiterate the basic position stated in our presentation to the Committeee on Finance today, namely, that, in the light of the institute's experience and our extensive studies over the years, renegotiation is inappropriate and unnecessary under present economic conditions. Moreover, we should like to underline our view that if the committee does approve a further extension of renegotiation authority, that extension should embody the amendments to the statute which we propose beginning on page 24 of our statement, an extra copy of which is enclosed. We particularly call your attention to our suggestion that if the committee does vote to extend renegotiation, the statute should be tailored to meet the unusual procurement problem involving special weapons as outlined by the President and more recently described by official spokesmen for the Department of Defense in hearings before your committee.

We feel strongly that the act should not be extended in its present form until the comprehensive study which we have recommended is completed. If, however, the committee feels obliged, because of the President's request, to report out a bill promptly, we suggest that the amendments which we have proposed, including the special tailoring of the legislation to meet the unusual procure-

ment problem with which the President is concerned, can and should be embodied in the bill as reported.

If we can be of further service to you or to the staff of the committee we hope that you will call on us.

Respectfully,

CHARLES STEWART,
Executive Vice President.

SUPPLEMENTAL MEMORANDUM TO STATEMENT OF MACHINERY AND ALLIED PRODUCTS INSTITUTE

STATEMENT OF THE PROBLEM

A major national issue of deep significance to the public interest is the question as to whether renegotiation is an appropriate device to be employed by the Government in the light of the curernt international situation, domestic economic conditions, and prevailing procurement problems.

The question of renegotiation is related closely to the broad problems of procurement, including various procurement devices now employed or available to Government procurement agencies and various statutory provisions covering profit limitations on Government contracts and other contracting matters. Thus, although the principal question is renegotiation, its ramifications relate to other procurement devices.

The urgency of the study is underlined by two facts: (1) Renegotiation was adopted originally in a total war economy and justified on the grounds that the disruption of normally competitive markets and the haste and inexperience of military procurement officers required some means of recapturing retroactively excessive profits which might result from defense business. The law has been extended several times without adequate study of changes in conditions. (2) The United States is now engaged in a long-term preparedness program, with primary emphasis on weapons of novel design, involving planning far in advance with "no assumed fixed date of maximum danger."

RECOMMENDATIONS

The Congress should direct the organization of a study group for the purpose of engaging in a comprehensive analysis of renegotiation and related procurement devices, both statutory and administrative. This study should be conducted by a nonpartisan group including representatives of the Congress, procurement agencies, the Renegotiation Board, and industry. The study group should be organized as soon as practicable and its study completed at the earliest possible date.

The study should be addressed primarily to renegotiation and related profit-limitation devices and should engage broader questions of procurement only as they relate to this problem. For this reason the study responsibility should not be assigned to any existing organization assigned other duties.

MATTERS SUGGESTED FOR CONSIDERATION IN THE RECOMMENDED STUDY

I. Analysis of the problems of procurement of defense materiel, particularly as they relate to procurement techniques:

A. Detailed breakdown of the current and prospective military budgets.

B. Relationship of defense procurement to gross national product and resulting economic impact.

C. Product-line analysis of Government purchases and delineation of the area which might require special or unusual procurement methods.

II. Administrative procurement devices designed to meet unusual procurement problems:

A. Analysis of the nature and use of various types of contracts, including those let as a result of competitive bids, those which include price redetermination clauses, those which include incentive provisions, etc.

B. Analysis of the results obtained by the military services in the use of these various procurement techniques, with special reference to the application to unusual procurement problems.

C. Utilization of noncontractual procurement techniques, such as cost analyses, special audits, etc.

D. Consideration of the development of new contract types or additional procurement techniques:

III. Renegotiation as a special statutory procurement device:

A. The principle and purpose underlying renegotiation.

B. Detailed analysis of the renegotiation process in operation:

1. Significance of the "judgment factor" in renegotiation determinations.

2. Nature, efficacy and application of statutory standards.

3. Comparison of criteria and standards as applied among different renegotiators and the various boards.

C. The cost of renegotiation:

1. Determination of net return to the Government after deducting—

(*a*) Tax refunds;

(*b*) Cost of maintaining the Renegotiation Board and its staff; and

(*c*) Cost of industry compliance.

The net refund thus arrived at should be compared to the total defense expenditures subject to the Renegotiation Act before the application of the various statutory and administrative exemptions. The analysis of refunds should be sufficiently detailed to distinguish between refunds resulting from peak Korean procurement and refunds relating to post-Korean military procurement. In addition, to the extent feasible, the breakdown should show the broad categories of products to which refunds relate.

2. In determining the cost of renegotiation, it is necessary to study the effect of renegotiation on the efficiency of contracting officers in establishing prices and on incentives affecting contractors to reduce cost and maximize efficiency. Does renegotiation, in fact, result in closer initial pricing?

D. Detailed examination of the advantages and disadvantages of renegotiation.

E. Effect of the renegotiation process on broad national economic policies such as encouragement of small business, elimination of controls, competitive pricing, development of a strong mobilization base with a maximum of efficient Government contractors as a part of that base, etc.

IV. Other statutory profit limitations and similar provisions. Review of the profit limitation provisions of the Vinson-Trammell and Merchant Marine Acts in the light of their original purpose and their place in present procurement programs.

The CHAIRMAN. We will next hear from Mr. J. R. Barnes, of the Illinois Manufacturers Association.

You may proceed in your own manner. Please identify yourself for the record.

STATEMENT OF JOSEPH R. BARNES, REPRESENTING THE ILLINOIS MANUFACTURERS ASSOCIATION, CHICAGO, ILL.

Mr. BARNES. Mr. Chairman and members of the committee, the committee has copies of our statement. I do not believe that we have advanced any arguments that have not been well covered by previous witnesses.

I should like to have my statement made a part of the record.

The CHAIRMAN. That may be done.

(The statement referred to is as follows:)

STATEMENT OF JOSEPH R. BARNES, OF THE ILLINOIS MANUFACTURERS ASSOCIATION

My name is Joseph R. Barnes, of Chicago, Ill., and I am here representing the Illinois Manufacturers Association. The association has a membership of almost 5,000 firms of all sizes.

The Illinois Manufacturers Association, through resolution of its board of directors, is on record as being in opposition to the principle of renegotiation. Accordingly, we are opposed to the enactment of H. R. 4904, and it is to give your our views upon this legislation that I appear here today.

The case in favor of renegotiation and its extension is simple; consists of the allegation that industry can and does realize excessive profits by doing business with the Government.

This question arises: Why should these particular profits be subject to the caprice and whim of individual-appointed Government employees? Certainly, no Member of this Congress would agree to a proposal under which individuals, or boards, or commissions, would be empowered to set separate and individual tax rates for each and every corporation and individual in the United States. And yet, that is exactly what Congress has done in placing the power of the renegotiation of profits in the hands of the Renegotiation Board.

Renegotiation is bad in other respects. It is certainly no inducement to careful procurement. The contracting office feels it can always rely upon the renegotiation authorities to rectify any unwise contracts it may place. Without the "pad" of renegotiation, contract placement should improve.

Furthermore, the competitive condition of our economy today would make almost impossible the realizing of unreasonable profits, except in unusual cases. Our inquiries among several of the procurement agencies of the Government, located in Chicago, indicate that they are experiencing no lack of bidders upon any of the items they are currently purchasing. This is a healthy condition, and one which will bring the lowest prices in Government purchases, and, because of competition, makes renegotiation unnecessary. Further curtailment of defense expenditures will naturally increase the competition for available Government business, and will make still lower prices available to the procurement agencies.

Certainly, the sufficiency of bidders which has been indicated by our inquiries in Chicago may lessen in some degree the importance of our next point. However, we still feel that more manufacturers would seek to obtain Government contracts, if the threat of renegotiation was removed. There are several reasons for this assumption.

First, the manufacturer who involves himself in Government contracts may not know his financial standing for a number of years. I understand that renegotiation for the year of 1951 has not yet been completed for some contractors. No one can conduct his 1955 business without knowing his 1951 results. Reserves must be made to cover possible refunds, and while this may not be too important to large corporations, with adequate financial resources and bank credit, yet to a small company, with limited financial assets, it may mean the difference between expansion and retraction of the business. The potential liability for renegotiation of profits can easily tie up for a long time cash moneys that would otherwise be spent upon expansion of facilities and markets. Just how much of a deterrent this may be to prospective bidders, I do not know, but I think we must admit that it is certainly not an attraction.

Next, renegotiation places a heavy burden upon management, upon accounting officers and departments, and upon other specialized personnel. Every year the cost to private industry in time and energy occasioned by renegotiation proceedings runs into many millions of dollars. Of course, these expenses are deductible for purposes of renegotiation. But the greater loss is that management and technical skills are diverted to the nonproductive renegotiation procedures, and are not available for necessary administrative functions involving the improvement and price reduction of commercial products.

In addition, renegotiation discourages all costs savings and economies. If the effect of economies in operation is only to be translated into terms of refunds to the Government, instead of into increased returns to the workers and to the company, certainly the incentive for discovering and introducing more efficient methods of operation is entirely removed. Instead of bonuses for more efficient operation and administration, renegotiation imposes a penalty in most cases. There is no rhyme or reason to this philosophy.

One other point although I do not believe the exact figures are obtainable, I believe that it has been conceded that renegotiation "recoveries" will do little more than balance the expenditures involved in this effort. And let us be sure to include in this compilation not only the direct outlays by the operation of the Government agency itself, but also the expenditures of the manufacturing industry in the loss of time of executive, administrative, and technical personnel.

To sum up:

We believe that renegotiation should not be extended, but should be allowed to expire under the terms of the present act.

We believe that the arbitrary determinations of renegotiation are wrong in principle.

We believe that renegotiation has impaired the efficiency of defense procurement.

We believe that today's competitive conditions make renegotiation unnecessary except in unusual cases, which could be handled by repricing and price redetermination.

We believe that renegotiation discourages many manufacturers from seeking Government contracts.

We believe that renegotiation stifles all incentives and desires for economy and efficiency in production.

We believe that renegotiation is resulting in a loss to our national economy.

We believe that the renegotiation method of setting differing tax rates for individual corporations is unwise and un-American.

Thank you.

Mr. BARNES. If I may, I should like to sum up very briefly our position. I have another witness from Illinois today, Mr. Burgess, who is the head of a manufacturing corporation, and who has had practical experience with renegotiation, and I believe his testimony will be interesting to you.

To sum up our position, we believe that renegotiation should not be extended, but should be allowed to expire under the terms of the present act.

We believe that the arbitrary determinations of renegotiation are wrong in principle.

We believe that renegotiation has impaired the efficiency of defense procurement.

We believe that today's competitive conditions make renegotiation unnecessary except in unusual cases, which could be handled by repricing and price redetermination.

We believe that renegotiation discourages many manufacturers from seeking Government contracts.

We believe that renegotiation stifles all incentives and desires for economy and efficiency in production.

We believe that renegotiation is resulting in a loss to our national economy.

We believe that the renegotiation method of setting differing tax rates for individual corporations is unwise and un-American.

The CHAIRMAN. Thank you very much, Mr. Barnes. Are there any questions? Does that complete your statement?

Mr. BARNES. Yes.

The CHAIRMAN. We have the distinguished Senator from Idaho present, Senator Dworshak. We shall be glad to hear from you now.

STATEMENT OF HON. HENRY C. DWORSHAK, A UNITED STATES SENATOR FROM THE STATE OF IDAHO

Senator DWORSHAK. Thank you, Mr. Chairman, and members of the committee, I appreciate this invitation to make a brief statement on the proposed extension of the Renegotiation Act.

As the committee is aware, I introduced a bill on February 9, to extend the act for 2 years, or until December 31, 1956, which bill is Senate 1017.

For several weeks, as a member of the Appropriations Committee of the Senate, I have been listening to testimony on the part of the leaders of our Defense Establishment, indicating that our major national-security program will cost over $40 billion in the next fiscal year.

It was approximately this same amount during 1955. In that overall sum is included about $13 billion for the procurement of aircraft,

ships, tanks, and other military equipment. We are not engaged in actual war, but obviously the Federal Government is faced with the tremendous problem of continuing to expend huge sums annually for the maintenance of our national defense.

In the fiscal year 1954, we had a deficit of about $3 billion. In the fiscal year 1955, the fiscal year ending June 30, 1955, we face approximately a $4½ billion deficit. For the next fiscal year, 1956, while the President has estimated the anticipated deficit at about $2½ billion, it will probably run higher and possibly as much as $5 billion.

All of this indicates that we are not operating under normal peacetime conditions.

Mr. Chairman, I have a copy of a letter written to you on March 18, 1955, by the Secretary of the Air Force, Hon. Harold Talbott, giving unqualified support to S. 1017, which is exactly the same as the House bill which is currently under consideration by your committee.

I want to emphasize my testimony by quoting 2 or 3 brief paragraphs from Secretary Talbott's letter:

> On March 4, 1955, the President in his message to the Congress strongly urged an extension of the Renegotiation Act of 1951 at least until December 31, 1956. The Department of Defense strongly recommends an extension of the act for the same reasons, and the following, which particularly concern the Department of Defense.

And then there is enumerated the great responsibility resting upon the Department of Air to develop the 137-wing program.

I should like to quote the paragraph which refers to this from the Secretary's letter, as follows:

> Significantly, expenditures by the Government during the next 2 calendar years will include moneys for the completion of the expansion of the Air Force to 137 wings. It is felt that the entire period of expansion since the beginning of the Korean hostilities should be considered as a whole insofar as renegotiation treatment is concerned; additionally, the next 2 years also will see an introduction into the Air Force program of the latest types of supersonic aircraft. While substantial strides in pricing policies and techniques have been made, exorbitant profits cannot be eliminated altogether, particularly where volume is abnormal. In the changing technology of defense effort, new equipment becomes more complex and past production and cost experience is not necessarily satisfactory for forecasting costs and avoiding unconscionable profits. * * * Experience has proved that statutory renegotiation is an effective method of insuring against abnormal profits, and has proved particularly effective in the subcontracting areas where maintenance of sufficient controls to prevent excessive profits is extremely difficult.

One more brief comment from the Secretary's letter is as follows:

> It is impossible to determine the fiscal effect of this legislation. It is a generally accepted fact, however, that the presence of a renegotiation statute assists in negotiating lower prices than would otherwise be true. This is particularly true where there is a lack of effective competition. In view of the foregoing, the Department of Defense strongly urges the enactment of S. 1017.

I had compiled earlier this calendar year some data showing to what extent there has been abnormally high profits by the aircraft companies doing business with the Federal Government. I do not intend to ask that this data, which was compiled by a member of the staff of the Appropriations Committee, be included in the hearing, but I should like to file this for the information of the members of this committee.

The CHAIRMAN. I presume that you want to put it in the record?

Senator DWORSHAK. No, I do not think that I care to put it in the record. I think I will just submit it for the use of the members of the committee.

I just want to call attention to the fact, without mentioning specific names of these aircraft manufacturers, that there have been abnormally high cash dividends. In addition to that, obviously to lower the percentage of profit resulting from Federal Government business to provide the aircraft for our defense establishment, there have been unusual stock splits. These data indicate in a particular instance there were two 100-percent stock distributions; one on March 3, 1952, and one on November 15, 1954. Another one of the leading manufacturers had 100-percent stock distribution on May 29, 1951, and 100-percent stock distribution on May 27, 1954, and a third, 50-percent stock distribution on March 3, 1955.

I could continue to show that the same pattern has been followed by practically all of these contractors for aircraft with the Federal Government.

I submit these facts not for the inclusion in the printed hearings, but solely for the information of the Committee on Finance.

I also want briefly to refer to a letter which I received from a prominent businessman in New London, Conn., dated December 30, 1954, from which I will quote just one paragraph. He called attention in his letter particularly to the necessity of trying to hold down Federal expenditures to balance the budget, which, of course, is one of the major objectives of the distinguished chairman of this committee. This man said that he did not care whether his name was given or not, so I shall give his name which is Mr. Stanley A. Goldsmith, New London, Conn. He stated as follows, in the paragraph that I wish to quote:

> I will give you a concrete example. Among the many stocks which I hold, I bought 100 shares of Douglas Aircraft at 54, 2 or 3 years ago. This means an investment of $5,400. Since then it has split 2 for 1, and now sells for around 130. I therefore have a paper profit of somewhere around $20,000 without lifting a finger. Am I entitled to these profits? Should a corporation be allowed to make such huge profits at the expense of the Government? I plainly ask you why should the Government not be allowed to recapture some of these unwarranted profits from these corporations? This would be a simple way to balance the budget and somewhat reduce the national debt.

I shall not belabor this statement before the members of your committee, Mr. Chairman.

In conclusion, I merely want to point out that while we are not engaged in actual war at this time, I have indicated that we are operating with annual deficits, and the Federal Government is still drafting young Americans to serve in the Armed Forces of our country. And the taxpayers are still paying abnormally heavy taxes.

And so I say in good conscience, and in all sincerity, Mr. Chairman, that so long as we are operating under such conditions, with the desire to maintain and preserve our free enterprise system, I am sure that no one can justifiably contend at this time that we should not continue in operation the Renegotiation Act.

Certainly there can be no injustices, no discrimination, so far as the manufacturers of aircraft or other war equipment may be concerned.

I think they are entitled to a fair play and equitable treatment. I think that they are receiving just that. And that they will realize the necessity of cooperating as patriotic Americans with the young men

and the young women who serve in our Armed Forces and with all taxpayers in this country to maintain, at the very least from the psychological standpoint, a renegotiation program which gives assurance to the people of this country that we are trying to eliminate excess profits and to provide for equal participation by all in our national defense.

Thank you.

The CHAIRMAN. Thank you very much, Senator Dworshak.

Are there any questions?

Senator MALONE. I think you have made a very fine statement, Senator Dworshak. Your position on the Appropriations Committee makes you very able in that field.

Were these profits made by these companies that you referred while renegotiation was in effect?

Senator DWORSHAK. Yes. They were for periods prior to December 31, 1954, when the Renegotiation Act expired. I must point out that while I have not charged that these profits have been excessive, if it should subsequently develop there has been such profits, then certainly under the terms of the Renegotiation Act the Federal Government will have an opportunity to confer in a friendly manner with these companies.

Senator MALONE. After they have been approved by the Renegotiation Board, the Government could not go back and renegotiate, could they?

Senator DWORSHAK. I do not think so. I think that that is an administrative policy. Of course, then there would only be the machinery of our tax laws to recapture any excess profits.

Senator MALONE. Do you through your Appropriations Committee have information that the amount that has ben renegotiated and the amount recovered, that is, as to what percentage it is?

Senator DWORSHAK. No, Senator Malone; that is not a part of our function. I suppose that as individual members we might have obtained that information.

Senator MALONE. I just thought that you might have it. We can get it.

Senator DWORSHAK. I think that would be very pertinent. My main interest is that as we have listened to the testimony of our officials in the various branches of the Department of Defense, it is apparent that we will probably continue at the $40 billion expenditure level for several years. Under these circumstances, I can see no reason now for making any drastice change in the procedures which we have been following.

Senator MALONE. In the matter of bidding, the policy of asking for bids on contracts, when they finally arrive at just exactly what they want—and testimony has shown here they do not always know exactly what they want, so that specifications can be written—it is merely performance that they ask for—there would be a field there that the contractor would have to design and perhaps not even know exactly what his expense would be, but when they finally arrive at specifications, for example, there are many subcontractors operating, smaller companies that we never hear of very much—and when they are given specific specifications and instructions and blueprints, and the number of each item—and I am informed several dozen bids, maybe 100 bids are had on a job—and they sharpen their pencils because they get

pretty hungry after a war is over—what do you think then, could there be made an exception in that case?

Senator DWORSHAK. I think that from the observations I have made, as a member of the Appropriations Committee, that most of these procurement contracts are on a negotiated bid basis. I do not know what procedure is used for placing subcontracts, but I do not know that there are such rapid changes in design and in modernizing our aircraft and in building military equipment of various kinds, that it is necessary to change designs after contracts have been placed.

Obviously, under the negotiation principle we eliminate the element of competitive bidding almost entirely.

Senator MALONE. I had only reference to one, when it could be relatively competitive, and they put up a bond for performance, so that they lose the bond if they renege on the contract or might lose money on the contract.

Senator DWORSHAK. I presume you are referring primarily to subcontracts.

Senator MALONE. To any contract that had exact specifications, so that there could be real competitive bidding by many persons, and they do put up a bond for performance. I only ask this because you are on the Appropriations Commitee and you have an opportunity to watch it more than I have on this committee.

Senator DWORSHAK. Unfortunately, we do not get into the mechanical aspects, the administrative details of these contracts. As we received classified information, indicating how rapidly and how drastically changes are made in the designs of aircraft and in other military equipment, it became apparent how very difficult it is to operate on a competitive bid basis.

Senator MALONE. I think that is true in a field where these changes take place. I had reference only to bids where specific blueprints and specifications could be written, with the number of each material required. I just thought that you might have some information on that.

Senator DWORSHAK. No, I regret that we do not have that, although we could have some member of the staff make a study of it.

Senator MALONE. Thank you.

Senator DWORSHAK. Thank you.

The CHAIRMAN. The Chair is very sorry to say that he has to leave to go to the floor of the Senate on another matter. We will ask Senator Flanders to take the chair now.

Senator FLANDERS (presiding). The next name on the list before me is that of Mr. Heyer, president of the Heyer Products Co., Inc.

Do you have a written statement, sir?

STATEMENT OF B. F. W. HEYER, PRESIDENT, HEYER PRODUCTS CO., INC., BELLEVILLE, N. J., ACCOMPANIED BY CARL I. SHIPLEY, COUNSEL

Mr. HEYER. Mr. Chairman and members of the committee, I do not have a prepared statement, but will submit a supplemental statement to be included in the transcript following my testimony.

Senator FLANDERS. Then you can proceed orally.

Mr. HEYER. Mr. Chairman, and members of the committee, my name is Benjamin Heyer, president of the Heyer Products Co., Inc. And this is Mr. Carl Shipley, my Washington counsel.

Senator BENNETT. Where is your company located?

Mr. HEYER. My company is located in Belleville, N. J. It is a small company employing approximately 350 people.

Senator FLANDERS. What do you make?

Mr. HEYER. We manufacture electrical equipment. Approximately one-third of our business is with the Government and two-thirds is civilian. We build equipment such as starting equipment for jet engines, motor tune-up equipment, some for the Government as well as for civilians.

I represent no organization. In fact, I am like a voice in the wilderness, a small-business man trying to be heard in Washington.

I appreciate this opportunity, Mr. Chairman, to appear before this committee. Small-business men, according to the information I have received, in the manufacturing business produce approximately 40 percent of the total volume. Therefore, although individually we are unimportant, collectively we do represent a large potential in this country.

My experience has been firsthand, because of the small size of my company. In other words, I have been through renegotiation after World War II on a million dollars' worth of contracts, at a cost of approximately $20,000 to my company. It took a year and a half.

I have recently been through renegotiation, or should we say "redetermination" of a $15,000 contract that cost me approximately $5,000, to redetermine.

I have held contracts of all types, mostly contracts obtained on advertised bids as the lowest bidder. I have had some contracts with redetermination clauses.

My considered opinion is that due to the process involved in a negotiated contract, that renegotiation, or, at least, an adjustment of the price is absolutely necessary to protect the Government.

And, of course, to protect the taxpayer. I base that upon my personal experience in negotiating contracts in which I know that there has been no true negotiation. Negotiation is a word used so that the contract can be given to whomever the procurement officer wishes to give it to. It is a word used to give a contract to whomever they want to give it to, in order to meet the requirements of the procurement act, rather than to give it to the lowest bidder. That, at least, has been my experience, and the experience of many, many other companies.

I think it would be substantiated by a check into the matter by the committee. I have been able to obtain gross profits on negotiated contracts that were equal to or greater than my civilian profits. Without renegotiation we would have undoubtedly made more money than we should, and that is not fair in view of the great expenditures being made by the Government.

Senator FLANDERS. May I inquire what proportion of your business is Government business?

Mr. HEYER. Approximately one-third, Mr. Chairman.

As to the approximately $1 million or $1,500,000 a year, it is truly representative of small business and not of airplane manufacturers or people of that kind, whose testimony seems to have dominated the hearings so far.

On the other hand, I have received many contracts from advertised bids. On these bids the markup that we have been able to get has generally been below the average necessary to operate our business. The only reason we could take the bids was because it was plus business, in other words, our overhead was being paid for by our civilian business, and we could take these contracts at much less than normal markup in order to have what we call a little extra cushion. And to the extent that it has been extra, over and above overhead, paid by civilian business, the contracts have been profitable. An accountant, however, would say that we lost money on the contracts.

The experience I have had has been that the competition for advertised bids is strictly cutthroat. Sometimes as many as 75 or 100 people will bid on a product which we and maybe half a dozen people manufacture, and which none of the other people have ever made. They put in prices that are strictly meaningless, so far as costs are concerned. And they frequently lose money on the contracts.

In order to get any of these contracts, it is necessary for a manufacturer to bid a very low figure. It is my considered opinion as far as renegotiation is concerned that it should be eliminated on all advertised contracts.

In other words, when a manufacturer goes to the effort and makes the sacrifices that he must in order to get an advertised contract, which in many cases he will lose on, if he is fortunate enough to make a little extra on some contract which he took in open competition, it seems to me that it is only fair that it should not be necessary for him to be renegotiated.

Senator FLANDERS. May I inquire again, have you ever been renegotiated on an advertised bid contract?

Mr. HEYER. We have not.

Senator FLANDERS. My recollection is that you might be.

Mr. HEYER. The reason we have not is because we have lost money in the last 2 years. We were in the brackets that could not have been renegotiated.

Senator FLANDERS. So you protected yourselves from renegotiation by avoiding profits?

Mr. HEYER. We did not do that on purpose. Our civilian business was not sufficient to support our overhead. Our gross on our Government contracts was not sufficient to pay its own way, and we showed a slight loss.

However, in the coming year, after going through 2 difficult years, we expect to show a substantial profit. I do not doubt but that we will be renegotiated, although these are all advertised contracts. I have no doubt that a large percentage of what we might make to offset past losses, will be taken away, despite the fact that we obtained these contracts in an open competitive basis on advertised bids.

The expenses involved for a small company are terrific compared to a large company. We do not have attorneys that can carry on renegotiation. We have to hire outside firms.

Mr. SHIPLEY. On that point, Senator Flanders, I heard you asking your counsel about it. It is my understanding that under the 1948 act, advertised bids were excluded, but under the present act they are included. The advertised and the negotiated contracts are lumped together.

Senator FLANDERS. Yes. Your plea, then, Mr. Heyer, is that the act shall go back to the 1948 basis in which advertised bids were not subject to renegotiation. That is what you are asking for?

Mr. HEYER. That is correct.

Senator FLANDERS. And have you any other points that you feel should be incorporated in the new act?

Mr. HEYER. Yes, sir. I believe that on negotiated contracts small business should have an exemption of at least $500,000 before they would be negotiated—that is for a negotiated contract—before they would be renegotiated.

Mr. SHIPLEY. They have that now.

Mr. HEYER. I believe that is now in the act.

Senator FLANDERS. You propose to leave that as it is, then?

Mr. HEYER. Yes, sir. Although it would be fairer to exempt small business up to $750,000 or $1 million on negotiated contracts.

Senator FLANDERS. What other points have you? I am informed that the exemption is for the aggregate, that is, the annual aggregate, and not for individual contracts of that size.

Mr. HEYER. That is the way I understand it.

The reason I believe in and would recommend that the advertised contracts be omitted is because of a considerable abuse that has taken place. The way it is right now, if a company has a large number of negotiated contracts which they have obtained at a full markup, and you fill out a form and you get the full markup, you get your profit when you negotiate the contract, such as they call negotiations, with the understanding that it will be renegotiated down—that is the basis upon which this thing works in a practical manner—then if you have with that a small quantity of advertised contracts, you can take those at a large loss and pay for the loss on the advertised contracts by the profit, the extra profit that you make on the negotiated contracts.

Senator FLANDERS. What is your suggestion with respect to that?

Mr. HEYER. My suggestion is that the advertised contracts be all exempted from renegotiation.

Senator FLANDERS. Have you any other suggestions?

Mr. HEYER. No. I feel that the act is essential in substantially its present form, so far as negotiated contracts are concerned. I don't see how the Government could protect itself because of the very nature of letting a contract for a product on which there are no specifications, no design, no cost determination, and no way of telling what the company's overhead will be during the years that the contract is in force. I think that the only protection that the Government has is renegotiation.

I do not think that price redetermination means anything for the simple reason if somebody has six different contracts and they are all based at different points, and all of the contracts are for the same product, their cost will be less than if they are all for a different product.

If you renegotiate, redetermine the price on the second contract, and then you get a third of a fourth of a fifth contract for the same thing, obviously your costs will go down.

If, on the other hand, the new contracts are for different products, your costs may go up.

I do not see any way except to do it on the basis of renegotiation. I think, also, that renegotiation might be treated on the basis of carry forward and carry backward, like they do with income taxes.

Senator FLANDERS. That is then another suggestion?

Mr. HEYER. Another suggestion, and that would spread the burden over a period of years, since the contracts invariably go beyond 12 months. I have never had a contract which from the time I received it until the time I produced on it was done within the year's period that renegotiation takes place. I have a plant right now that is half shut down. We just got approval on about $1 million worth of Government contracts which we have had for a year. They have been testing samples. It takes a long time to approve the samples. These units will go into production starting in July or August. They will all be made in my next fiscal year.

The losses that I have sustained in my plant, holding it in readiness for these contracts, cannot be applied directly against profits that I might make next year. If there were a carry forward and carry backward like income taxes, then we would hit an average in which over the years companies engaging in Government business would be guaranteed at least a fair return for their efforts.

That, Mr. Chairman, is it.

Senator FLANDERS. Mr. Heyer, you have made definite suggestions, clearly expressed, and we are glad to have them before us. Thank you.

Mr. HEYER. Thank you very much.

(The following letter was later received for the record:)

HEYER PRODUCTS CO., INC.,
Belleville, N. J., June 8, 1955.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR BYRD: As a supplement to my oral testimony before the Finance Committee on June 8, 1955, at the hearings on extension of the Renegotiation Act of 1951 (H. R. 4904), I submit this statement and request that it be inserted in the transcript following my testimony.

It has been my experience that large companies in bidding on advertised contracts, i. e., competitive bids on written specifications, sometimes submit bids far below prime costs simply to get the business. They know that the losses incurred can be offset by excess profits on negotiated contracts. A small business such as mine has very few, if any, negotiated contracts. Thus, the Renegotiation Act is used to capture the market on a given item at the expense of small business. Under the present act, a company can bail out a loss on advertised contracts at the expense of its excess profits on negotiated contracts. Exempting advertised contracts from renegotiation would solve this problem. When a bid is advertised, there is open competition and the Government awards the contract to the low bidder. The regular Federal income tax collects the proper revenue on the profit. Unless Congress intends to abandon the free-enterprise system, no profit can be called excess when it survives free and open competition. It is the earned reward of those who perform well. If the Government is going to participate in the profits on advertised contracts, it should, in all fairness, participate in the losses.

There is no question but that renegotiating negotiated contracts is necessary when the receipts and accruals exceed $500,000. It has been my experience that, in the absence of competitive bidding, profits can sometimes be unreasonable. Certain types of complex electronics, atomic, and aeronautical equipment are so new and so complicated that competitive bidding is not practical. These types of contracts must be negotiated in the first instance, and renegotiated in the second to protect the public from being victim of excessive profits. It is only advertised bids which should be excluded from renegotiation, as I understand they were in the 1948 act.

A carry-back and carry-forward provision in the Renegotiation Act the same as that in the Federal income-tax law would be an improvement.

I trust your committee will consider these suggested amendments.
With good wishes, I am,
Very truly yours,

B. F. W. HEYER, *President.*
By CARL L. SHIPLEY, *Attorney.*

Senator FLANDERS. I would like to ask Senator Morse to introduce the next witness, Mr. Rushlight, of Portland, Oreg. We will hear you now, Mr. Rushlight, and then go back to Mr. Burgess.

Senator MORSE. May it please the committee and the chairman, I wish to present to the committee Mr. W. A. Rushlight, a contractor and wholesale plumbing businessman in the city of Portland, Oreg.

He will not take the necessary time, may I assure the committee, to explain all of his difficulties in connection with the series of renegotiation problems, yet I thought it very important that this responsible businessman in my State have an opportunity at least to thumbnail sketch before the committee some of his problems.

And may I say most respectfully that if the committee wants a guinea-pig case to illustrate the need for revision of the Renegotiation Act, Mr. Rushlight is my guinea pig, because I have spent in my office over the years a great many hours in time trying to help him solve some of his problems with the Government over matters that he will very briefly sketch to the committee.

I appreciate very much this opportunity to have him present his case to the committee.

Senator FLANDERS. Thank you, Senator Morse.

I may say that your guinea pig does not seem to have been tested to destruction. [Laughter.]

Senator MORSE. I never let him get me down.

Senator FLANDERS. Mr. Rushlight, since we have a number of other witnesses, I am grateful for the suggestion that Senator Morse made. I presume, with your approval, that you perhaps have something to leave with the committee, and then can touch the high spots?

STATEMENT OF W. A. RUSHLIGHT, REPRESENTING W. A. RUSHLIGHT CO., PORTLAND, OREG.

Mr. RUSHLIGHT. Mr. Chairman, and members of the committee, I could do that, Senator.

Senator FLANDERS. Will you first identify yourself for the sake of the record?

Mr. RUSHLIGHT. My name is W. A. Rushlight, Portland, Oreg. I am a partner of W. A. Rushlight Co., Portland, Oreg., and president of the Rushlight Automatic Sprinkler Co. The W. A. Rushlight Co. was set up during the war years to engage in warwork.

I have a prepared statement, Senator Flanders, but I do not believe that you will want me to take up the time to read this statement. The statement is self-explanatory.

Senator FLANDERS. That will be incorporated in the record at this point.

(The prepared statement of Mr. W. A. Rushlight is as follows:)

STATEMENT OF W. A. RUSHLIGHT, PARTNER, W. A. RUSHLIGHT CO., PORTLAND, OREG.

My name is W. A. Rushlight. I am a partner in W. A. Rushlight Co., of Portland, Oreg., a company which performed over $3½ million worth of construction,

principally for defense, during the years 1942–45 inclusive. That company has now been liquidated, except for disposition of a unilateral determination made by the Army under the Renegotiation Act of 1942 as amended by the act of 1943, whereby the Government claims that profits earned during the year 1942 by this company are excessive in the amount of $80,000.

I am at present also interested in other companies in the construction industry which are performing contracts subject to renegotiation; therefore I have both considerable experience with the administration and effect of prior renegotiation acts, and a deep interest and concern in the bill before this committee, the purpose of which is to extend the Renegotiation Act of 1951.

My purpose in appearing before this committee is to call to your attention several inequities which prevail under the Renegotiation Act of 1951. These situations, for the most part, were recognized by this committee at the time the act of 1951 was considered, but it was felt that in the administration of the act by the Renegotiation Board, through proper use of the discretionary powers granted to the Board by Congress, these inequities would be overcome.

Such has not been the case.

Neither this committee nor Congress, however, can be criticized for the failure of the Board to carry out the intention of Congress as expressed in the hearings held by the various committees and in the debate on the floor of the Senate. Since no adequate remedy is now available at law or in equity, our only purpose is to present these situations to the notice of this committee, with confidence that the committee will amend the present bill so that fair treatment is assured in the law and is not left to the discretion of the Renegotiation Board. The changes we suggest are set forth below.

(*a*) We urge that a mandatory exemption from renegotiation be required for all construction contracts which have been let as a result of competitive bidding.

A review of the hearings and the debate in connection with the enactment of the act of 1951 plainly shows that Congress did not intend this law to cover contracts let by competitive bid. The Renegotiation Act of 1943 contained the following exemption under section 403 (i) (1) (E):

"The provisions of this section shall not apply to any contract with a department, awarded as a result of competitive bidding, for the construction of any building, structure, improvement or facility."

This exemption was omitted from the 1951 House bill, but was added by the Senate in its amendment No. 58. However, the conference report provided that the Senate amendment would be changed to substitute a mandatory exemption of any contract which the Board determines does not have a direct and immediate connection with the national defense.

Also, according to the statement of Senator George before the Senate on January 29, 1951, "This bill is intended to prevent exorbitant and unconscionable costs from being charged to the Government * * * the bill gives the Renegotiation Board discretionary authority to exempt from renegotiation any contract or subcontract where, in the opinion of the Board, the provisions of the contract or subcontract are otherwise adequate to prevent excessive profits" (sec. 106 (d) (3)). "I believe that the Board should not hesitate to use this power."

It was upon the assumption that the Board would act under section 106 (d) to exempt contracts competitively bid that the bill was passed without Senate amendment No. 58.

It is obvious that a contract obtained by competitive bidding will not result in exorbitant and unconscionable costs to the Government. This was recognized by Congress, when in extending the act of 1951 by Public Law 764, 83d Congress, it included a mandatory exemption for standard commercial articles, and used as a basis for such exemption the theory that competition would tend to keep the profits from the sale of such articles reasonable.

It is even more true that competitive bidding for fixed-price contracts will tend to eliminate any possibility of unreasonable profits being earned.

It is also apparent that the statutory factors set up for determining reasonableness of profits were designed to apply to the manufacturer of a quantity of like products, and to compare his costs and efficiency with those of another manufacturer of similar products. These same factors cannot be extended to competitively bid construction contracts. No two such contracts are identical, nor even closely comparable. Each is subject to individual vagaries of soil and water conditions, weather, delays and other factors affecting costs. This fact is recognized in staff bulletins issued by the Board. (See Renegotiation Staff Bulletin No. 12, Part V (2) (b).) And renegotiators are cautioned against drawing conclu-

sions based on such comparisons. Yet our contacts with the Board have shown that too much weight is given in construction cases, to a comparison of one contractor's costs to those of another who may have worked under completely dissimilar conditions, and to ratios of costs and overhead expenses expressed as a percentage of sales, rather than to the savings in cost to the Government from completion of the contract at the low bid price.

Our experience with the Board has also shown that not enough weight is given to the fact that the contractor has assumed a great deal of risk in guaranteeing to perform a construction contract at a guaranteed, fixed price, and that he has saved the Government the difference between his bid and that of the next bidder at the time he signs his contract.

For these reasons, we urge an amendment exempting fixed price construction contracts arrived at as a result of competitive bidding.

(*b*) We urge that the Renegotiation Act be conformed to the Internal Revenue Code by providing the same loss carryback and carryover provisions now in the Code.

The injustices of reclaiming so-called excessive profits from 1 year, without adjustment for losses in other years, can best be demonstrated by referring to exhibit 1, attached. This exhibit shows the net profit from renegotiable business earned by W. A. Rushlight Co. in each of the years 1942 through 1945. This exhibit, which was prepared for use in an appeal to the Tax Court, has been verified and approved by the Department of Justice as to the correctness of the figures shown.

This exhibit reveals that for the 4-year period in which we were actively engaged in the defense effort, our company realized a net profit on renegotiable business of only $8,686.68, on sales of $3½ million, and this before any allowance for partners' salaries.

In spite of this obviously inadequate return, the Board for 1942, since it treats each fiscal year alone, demands from us $80,000 as so-called excessive profits. Is this the "exorbitant and unconsionable" profit referred to by Senator George? The Department of Justice is required to prosecute cases assigned it according to the letter of the law, and regardless of the inequity plainly evident must make every effort to collect the full amount asked, with the result that if we are unsuccessful in the Tax Court we will have given 4 years' effort and $70,000 from our own pockets, for the privilege of assisting in the defense effort.

This type of situation can only be corrected by extending the full carryback and carryover provisions of the Internal Revenue Code to renegotiation.

Any claim that such an amendment would make renegotiation unworkable is without foundation, since these provisions in the Internal Revenue Code have been in effect for many years, without causing any collapse in the administration of our income tax laws.

(*c*) We urge that the right of appeal to the Federal courts be given to renegotiation cases.

A study of the history of renegotiation cases appealed to the Tax Court shows a marked tendency upon the part of the Tax Court to accept the determinations made by the Renegotiation Board. The Tax Court, by the terms of the Renegotiation Act, is not only a court of original jurisdiction, but also a court of last resort. In no other type of case, to our knowledge, is the individual restricted from the right of appeal from the decision of the Tax Court. Since the renegotiation law is, as no less an authority than Senator George has said, essentially a taxing statute, the taxpayer should be entitled to the same appellate procedure as in other tax matters. As a corollary to this suggestion, we urge that the hearings, and deliberations of the Board be made a part of the record, available for use not only to appellate bodies, but also by the Board members themselves in later deliberations. We have been present at many hearings at which evidence was presented and discussed, but which was easily forgotten and was not available for review by the Board at a later date because no record had been made. We realize this is primarily a matter for administartion by the Board, but feel this record should also be available to the Tax Court or other courts upon appeal.

We appreciate the opportunity of expressing our views before this committee, and respectfully urge its earnest consideration of (*a*) the exemption of construction contracts let by competitive bid; (*b*) the inclusion in the act of the loss carryback and carryover provisions of the Internal Revenue Code; and (*c*) the granting of the right of appeal from the decisions of the Tax Court.

W. A. RUSHLIGHT & Co.

Summary of net profit from renegotiable business, years 1942–45, per audit statement of Internal Revenue Service

	1942	1943	1944	1945	Total
Sales	$471,485.04	$1,198,431.48	$1,075,312.14	$807,706.17	$3,552,934.83
Cost of sales:					
Labor, material, and direct expense	319,159.11	851,771.13	965,637.61	711,920.94	2,848,488.79
Indirect expense	14,933.39	86,013.35	110,372.55	94,210.44	305,529.73
Total	334,092.50	937,784.48	1,076,010.16	806,131.38	3,154,018.52
Profit from completed contracts	137,392.54	260,647.00	(698.02)	1,574.79	398,916.31
Other income:					
Joint venture income	66,522.89	10,973.74	37,142.51	(17,305.31)	97,333.83
Sale of salvaged material			10,917.40	56,112.04	67,029.44
Rents		1,000.00	2,641.00	16,699.32	20,340.32
Interest			713.85	409.89	1,123.74
Gross profit	203,915.43	272,620.74	50,716.74	57,490.73	584,743.64
Other deductions:					
Operating loss, steel works division		28,417.80	102,779.27	124,829.11	256,026.18
Loss on sale and abandonment of steel works		65,562.32		12,228.95	77,791.27
Bad debt, Farragut contract				7,716.00	7,716.00
Additional costs, Farragut contract			24,654.30		24,654.30
Prior-year charges				4,857.32	4,857.32
Total		93,980.12	127,433.57	149,631.38	371,045.07
Net profit (loss) per audit	203,915.43	178,640.62	(76,716.83)	(92,140.65)	213,698.57
Less nonrenegotiable items:					
Joint venture income	66,522.89	10,973.74	37,142.51	(17,305.31)	97,333.83
Rents		1,000.00	2,641.00	16,699.32	20,340.32
Interest			713.85	409.89	1,123.74
Profit from nonrenegotiable contracts		32,791.00	37,138.00	16,285.00	86,214.00
Total	66,522.89	44,764.74	77,635.36	16,088.90	205,011.89
Net profit (loss) from renegotiable business	137,392.54	133,875.88	(154,352.19)	(108,229.55)	8,686.68

Mr. RUSHLIGHT. I do want to say that I believe that the Renegotiation Act has created a great many evils due to the difficulty in administering the act. In fact, in the contracting business, it is a highly competitive business. We are not what you would call large operators. We are small operators.

As a result of the effect of the act on us and many more like us, we find that we will be unable to continue bidding on Government business if this act remains in force and effect, because we cannot afford to go through the expense and take the time it requires to keep our businesses solvent.

Senator FLANDERS. Excuse me just a moment.

I note here in your statement suggestions A, B, and C.

Mr. RUSHLIGHT. Yes, sir.

Senator FLANDERS. A says:

> We urge that a mandatory exemption from renegotiation be required for all construction contracts which have been let as a result of competitive bidding.

What is the situation on that in your present law?

Mr. RUSHLIGHT. They are renegotiable.

Senator FLANDERS. Subject to renegotiation?

Mr. RUSHLIGHT. Yes.

Senator FLANDERS. I have a number of telegrams from various people engaged in the construction industry asking for that same exemption. You say here that the Renegotiation Act of 1943 contained such an exemption?

Mr. RUSHLIGHT. Yes, sir.

Senator FLANDERS. And it is not now in the act?

Mr. RUSHLIGHT. That is right.

Senator FLANDERS. That is point No. 1. Next, B:

We urge the Renegotiation Act be conformed to the Internal Revenue Code by providing the same loss carryback and carryover provisions now in the code.

That was also the previous witness' suggestion; but by reason of being exempted of renegotiation under your suggestion A, you begin to lose your interest, do you not, in B?

Mr. RUSHLIGHT. Yes, sir; that is right.

Senator FLANDERS. But still on the chance that you may not get A, you present B?

Mr. RUSHLIGHT. Under B we have a very good example, as Senator Morse pointed out, as to what the effect of the act is on a small contractor operating under the act as it now stands, without the loss carryback and carryover provisions.

During the war years our company, W. A. Rushlight Co., which was engaged entirely in war work, did about $3,500,000 worth of work and ended up making a gross profit of $8,686.68. Yet at the same time, because of the peculiarities of the act, the Government is now suing us for $80,000. That means that we would have to pay the difference out of pocket between $8,000 and $80,000 for the privilege of having worked 18 hours a day to further the war effort. That is the unfair part of the act.

Senator FLANDERS. That is due to the distribution of the work through the fiscal years?

Mr. RUSHLIGHT. That is true. In the year in question in which they are asking for the $80,000, we had a high profit. They were subsequently invested into the war effort, and we took subsequent losses, which made this net result.

Looking at that net result, we had no salaries for myself or any of the other partners in the venture; none of us received any salaries under this venture. As a result of that, I came back here in 1951. Senator George was then chairman of this committee, and with his help and the help of Senator Morse, we introduced legislation on the floor of the Senate which was unanimously adopted by the Senate. I have the record here.

That was done on February 19, 1951. Senator Morse introduced an amendment which would provide for relief of such cases as ours, because everyone connected with the act, or with the Justice Department—all of the Senators I have talked to—even the attorneys involved for the Justice Department, conceded the injustice of this situation. In fact, the Justice Department over the years has tried on several different occasions to get us into Federal court, to sue us for this money. And the Federal court in Oregon has refused to try the case on the grounds that it was an administrative matter and we should seek relief administratively.

Well, that relief we have been unable to get.

Senator FLANDERS. That brings you up to your point C, in which you urge the right of appeal to the Federal courts be given to renegotiation cases.

Mr. RUSHLIGHT. Yes. In that connection, all of the accountants and the lawyers tell us that we have discussed the matter with, the experience has shown that because of the conditions and terms of the act, the Federal Tax Court has become nothing more nor less than a rubberstamp for the decisions of the Board. We recently had to try this case that I have been trying to get relief on for 12 years. In that case we were not permitted to even put on our testimony. I brought back with me a copy of that testimony which I would like to give the committee to show you the unfair consideration of these cases by the Tax Court.

Senator FLANDERS. We will be glad to have that document for the information of the committee.

Mr. RUSHLIGHT. I gave it to Senator Morse.

I have so many things to tell you that I do not know where to start.

Senator FLANDERS. We have the A, B, and C of your problems here.

Mr. RUSHLIGHT. We feel if we could get into an appellate court the same as in internal revenue matters, we could get justice in that court, but we find that as the record discloses, in all of the cases taken up with the Tax Court, that it is impossible to get justice there in cases of this kind. I am not criticizing the Tax Court, because I feel from the advice of our attorneys that the Tax Court does not have the power to grant this relief.

That was the purpose of Senator Morse's amendment, which was concurred in unanimously by the Senate in 1951, but it failed to pass due, as I understand, from Senator George, because Members of the House refused to go along with it in conference. Why, I do not know.

That brings us up to another current question that I would like to take a few minutes of the committee's time with.

About 3 years ago we entered into a contract in Alaska for $6 million worth of work. It is a competitive bid contract. It is subject to renegotiation.

As you know, the committee in its judgment saw fit in the passage of the act to permit exemption of the Alaska contracts competitively bid.

For your information, Senator Flanders, a lot of contractors have gone broke in Alaska because of the hazards up there.

We set up, because we did not have the finances to handle it ourselves, a joint venture which is common for small contractors to engage in, in order to get additional strength.

The Army engineers at that time were unable to get bidders in Alaska. They had a field of engineers traveling from town to town. I attended one of their meetings in Portland, Ore. We organized this group to bid on this $6 million worth of military construction on a competitive-bid basis. That group was composed of specialist contractors in various fields as differentiated from a general contractor.

A genreal contractor is one who does usually the concrete work and assumes general charge of the project, for your information. He sublets all of the major features of that work to specialists as myself,

a plumber, to specialists in the electrical and plastering business, and the like.

For your information, based on minimum standards, the cost of a building, represented by the general contractor's profit and all of the subtrades has been conservatively estimated to be about 40 percent of the cost of the building.

Well, we conceived the idea of setting up to do this defense work, a group of specialists to eliminate that multiplicity of profits. As a result of that we saved the Government—it scared the tar out of us at the time—$500,000 in our original bid price. We were $500,000 low.

As a result of hard work, and you might say running scared, because we though we were going to lose our shirts because we were bidding against oldtime, experienced bidders in Alaska, we made a profit of a little better than 10 percent. In order to do that we had to denude all of our resources and all of our capital and all of our top keymen and put them into this job, because we were running scared—we were doing everything we could to keep the costs down.

As a result of that, we made this 10.3 percent profit. It was the only job up to that time in Fairbanks, Alaska, that had ever been completed on schedule for the Army engineers.

At the current moment—this is a current transaction that is now proceeding—I am giving you concrete examples so that you can see what it is doing to the construction industry: the Renegotiating Board has informed us that they want $200,000 back. That would be all right if we had that money, but the trouble is that our respective companies that went into this joint venture, because they denuded themslves of capital, personnel, et cetera—that is not profit, but it is renegotiated on the basis of profit—do you see what I mean? Let me point out another thing.

I have those statements here, Senator, complete financial statements of those two companies, our company, and the joint venture, to show you the other side of the picture, because the trouble with this Renegotiation Act is that it is almost impossible as I see it, to draw any law that can fit all of these conditions that develop in the construction industry.

I do not know anything about the airplane industry or any of these other industries, but I do know the construction business.

Senator FLANDERS. They get back to your recommendation A, that mandatory exemption for renegotiation, and you offer this situation as an exhibit?

Mr. RUSHLIGHT. Yes, sir.

Senator FLANDERS. In support of that recommendation?

Mr. RUSHLIGHT. Yes, sir.

Senator FLANDERS. The case is one that warrants our consideration when we come to write up the bill. Thank you for the information.

Mr. RUSHLIGHT. I would like to leave those documents with you.

I might say I think it is very important that today again, notwithstanding the contracting business is at a low ebb—there are a lot of contractors who are out of work—this Government is having difficulty getting contractors, that is, small contractors, like myself, to bid on Government contracts, because it is impossible for the small contractor to go through this procedure and end up like we have ended up in these two cases, even though we have made a profit.

I might also point out to you, I think it is very important, that in a great many of these military contracts the situation exists which a previous witness testified to here a few minutes ago, whereby the larger contractors—and I am not finding fault with them, I think it is good business on their part—because of their size and their capital are able to take millions of dollars worth of this type of business. Therefore, they quite often, because of renegotiation, will take contracts at a loss because it is the same as making another profit. Do you see what I mean?

Senator FLANDERS. Yes.

Mr. RUSHLIGHT. Therefore, it eliminates the little fellow from competing on those contracts.

We feel the small contractors can do a job better and cheaper for the Government and save the Government money and do a better job than the larger contractors, because we give personal attention to our business.

The operation of this act is such that you are going to largely eliminate them—you have already eliminated them largely—the small contractor from competitive bidding on building projects, because it just does not work out.

In my present situation I could not afford, even though we saved the Government $500,000 on this last situation, to do any more of that type of work.

Senator FLANDERS. This again comes back to A. If that is taken care of, your other problems are pretty well met?

Mr. RUSHLIGHT. In any of these situations that I have pointed out here, unless they were made retroactive, would not take care of our old situation back in 1942.

Senator FLANDERS. So you make an additional suggestion, do you, of a retroactive application of your item A?

Mr. RUSHLIGHT. We had suggested before through Senator Morse's office—and it was his thought as expressed in the amendment to the bill—that the Board be allowed to grant justice in these inequitable cases. The Board does not have the power to grant relief in cases of this kind, I must say in fairness to them. In effect, a contractor can go broke, owing the Government money. That is obviously unfair.

Senator FLANDERS. Yes. And the definite suggestion there is to give the Board authority to go back over its decisions where they have been shown in the passage of time to be obviously unequitable.

Mr. RUSHLIGHT. That is right. They have no such authority under the present act.

Senator FLANDERS. We will put that down then as A-sub-1.

Mr. RUSHLIGHT. Thank you very much. I could go on here and tell you about many other factors that are eliminating us from the business of giving the Government competitive bids, but it would take all afternoon if I gave you a complete, full story.

Senator MORSE. I would like to have permission, if the committee will allow, that I be allowed to file a supplementary statement for the record amplifying Mr. Rushlight's statement, bringing out the experience in my office in connection with this case.

Senator FLANDERS. We will be very glad to have you do so.

Senator MORSE. Thank you very much.

(The supplementary statement is as follows:)

SUPPLEMENTARY STATEMENT OF SENATOR WAYNE MORSE

In connection with its deliberations upon the extension of the Renegotiation Act, I urge that the committee give serious consideration to the following matters that are of great importance to the so-called small-business segment of our economy:

(1) *An exemption for construction contracts that have been made under competitive bidding*

Businessmen of my State have strongly urged that there be an exemption from renegotiation for construction contracts which have been let by competitive bidding. These businessmen point out, with considerable logic, that the Government is adequately protected because it gets the full benefit of maximum savings in price before the award of such contracts.

A case in point has been brought to the attention of the committee this morning by Mr. Rushlight. It involves the Rushlight-Macri Co., a joint venture of specialist contractors who united their resources to bid on a Government contract in Alaska. The Rushlight-Macri Co., I am advised, was approximately $500,000 below the next bidder. Mr. Rushlight, who is a very reputable and experienced contractor, indicates that the joint venturers, through diligence and careful attention to detail ended up with a net profit of approximately 10 percent; that even though the Government saved a large sum on the competitive-bid basis before the award of the contract, the Renegotiation Board has asked that $200,000 be returned to the Government by the company. A statement of one of the joint venturers, A. G. Rushlight & Co., has been presented to the committee. It shows that this company made a very small profit due to the fact that its entire resources, organization, and capital were in effect put at the disposal of the Government during the performance of the contracts. The experience of the other companies associated in the venture is similar.

I am seriously concerned over indications that the Renegotiation Act can operate to the detriment of small contractors who obtained their business during the war on competitive basis. The prepared statement of Mr. Rushlight clearly describes one of the inequities of the Renegotiation Act as it affects a typical small business. I earnestly suggest the consideration of an amendment authorizing the Renegotiation Board and the Tax Court of the United States to grant equity in cases such as that described by Mr. Rushlight.

(2) *Carryover of losses*

I further suggest to the committee that there be included an amendment to the Renegotiation Extension Act providing for the same method for the carryover of losses and profits as that provided by the Internal Revenue Code. Many members of the committee may recall that I introduced such an amendment when the Senate was considering the extension bill of 1951. My amendment carried in the Senate of the United States but it was dropped in the conference report, due, I am informed, to opposition on the House side.

(3) *The need for detailed reports*

It is my understanding that no detailed reports are made to the Government by the Renegotiation Board concerning their handling and settling of cases. A wide scope of powers which the act confers upon the Renegotiation Board certainly warrants a system of checks and balances which would result from such a reporting requirement. There are bound to be instances in which inequities arise in the administration of the Board's functions and the Renegotiation Act leaves in a nebulous state many matters involving the dealings of contractors and the Government. For example, it is extremely difficult to ascertain what constitutes a fair margin of profit. Again, what is meant by "efficiency" within the meaning of the act? What constitutes hazards in determining profits and efficiency?

(4) *The importance of published standards*

Businessmen in my State have told me that a person dealing under the Renegotiation Act is in a position comparable to that of one trying to do business with a ghost. Apparently there are no published standards included in a set of rules and regulations to which a businessman may refer in advance of dealings on transactions subject to renegotiation. For example, if taxpayers were dealt

with in a similar fashion by internal revenue agents—if the Internal Revenue Code were drafted along the lines of the Renegotiation Act, a revenue agent assigned to a given case could use some extremely arbitrary powers. A businessman might be quite surprised and extremely dismayed if the internal revenue collector were to say to him "you grossed $100,000; in my opinion your tax should be $99,500." Under such circumstances a businessman would be unable to protect his business and there would be few, if any, that would be willing to extend credit to his firm. He would have no alternative but to discontinue his business operations. Many small-business men in my State tell me that because of comparable experiences in renegotiation, they are going to have to avoid future Government business which is subject to renegotiation.

(5) *Adjustment of inequities*

Two additional amendments to the Renegotiation Act might go a long distance toward eliminating inequities. One of these would provide that where claims are referred by the Renegotiation Board to the Department of Justice, the latter agency should have the right—which it now claims it does not possess—to make adjustments of inequities in arriving at settlements of such claims. However, there should be a proviso requiring that settlements of this type be reported to Congress in a manner similar to the reporting that is done in connection with internal revenue cases.

A second amendment would be directed to the Tax Court.

The tax courts have generally indicated that they too, lack the authority under the Renegotiation Act to consider alleged inequities.

(6) *Court review of Tax Court renegotiation cases*

Businessmen in my State have complained of the fact that they lack the benefit of court review of decisions handed down by the Tax Court in renegotiation cases. It would seem appropriate for the committee to consider the advisability of modifying the Renegotiation Act so as to provide for a court review plan applicable to Tax Court renegotiation decisions. The review might be similar to that which is available to taxpayers in cases involving internal revenue matters.

(7) *Liability of joint ventures under the Renegotiation Act*

In cases of joint ventures, the Renegotiation Board has ruled that each separate company and each individual member of the joint venture is responsible for the entire renegotiation liability. This forces the joint venture, in order to protect its various members, to hold large sums in reserve against potential liability. These sums become idle and unworkable capital. Bearing in mind that it often takes years for the Renegotiation Board to issue a decision, a small-business man is likely to withdraw from bidding in competition on Federal construction projects. Obviously, the Government suffers thereby.

Senator FLANDERS. Our next witness is Mr. Burgess. We are very glad to have you.

You may proceed in your own way. Will you please identify yourself for the record?

STATEMENT OF C. M. BURGESS, PRESIDENT, BURGESS-NORTON MANUFACTURING CO., GENEVA, ILL.

Mr. BURGESS. Mr. Chairman, and members of the committee, my name is C. M. Burgess, president of the Burgess-Norton Manufacturing Co., Geneva, Ill.

Senator FLANDERS. What is the product of your firm?

Mr. BURGESS. We manufacture certain component parts utilized on tracklaying vehicles, and do all of our work on a subcontract basis.

Senator FLANDERS. All right, you may proceed.

Mr. BURGESS. First, I wish to thank you for the opportunity of appearing before your committee in opposition to any extension of the Renegotiation Act of 1951. I represent no association and no group of contractors. I am offering my arguments in hope that they will result in making it easier for small and medium business and the Gov-

ernment to deal one with the other, by eliminating certain controls during peacetime. I think the statements I will make are fairly representative of many companies of our size in the industry.

I am the president of Burgess-Norton Manufacturing Co., of Geneva, Ill., organized in 1903, 52 years ago, and have served in that capacity since 1922, a period of 33 years. Our company was, until 1941, what would now be classified as "small business." It is now, in 1955, employing about 575 persons and by Government classification is technically no longer small. We in our organization think of it as a small business.

In 1939 we began to develop and manufacture certain ordnance parts known as the metal components used in the tracks produced for use on tracklaying vehicles, primarily tanks. At the request of the Ordnance Department, United States Army, we, a small company, were in 1941–45 an important factor of supply to the Ordnance Department of the parts which we made. Operations in our own plant were increased and we were administrative and directive head of a production pool of seven plants, including our own. This was a successful operation for the Government as evidenced by the presentation to our company of five E awards.

Following the end of World War II, a period of about 18 months to 2 years ensued during which we made none of these parts, but in that period of time we deactivated the 6 plants which were under our supervision as associated contractors. Beginning in 1947 we resumed in our own plant, with our own equipment, production and engineering research and development activities of ordnance parts on a commercial basis, as a subcontractor of a product ultimately used by ordnance.

These operations continued to 1951 on a competitive basis when we were again asked by Ordnance to take over the responsibility of heading a production pool. Before this pool reached a production capacity for which our company and the Government tooled it, the requirements were drastically cut. Except for some few engineering projects, our business from 1951 throughout the war period down to the present date, I again want to reiterate, so far as these parts are concerned, has been conducted as a first or second tier or subcontractor.

We have no substitute for renegotiation during time of war when the available productive capacity is less than the requirements and the Government must of necessity allocate orders to both prime and subcontractors on a negotiated basis. We believe the renegotiation boards have done an outstanding job to date. We entered into renegotiation agreements for the years 1942, 1943, 1944, 1945, and 1951 in a manner reasonably satisfactory to us. Two of these agreements, 1945 and 1951, were made with the Washington Renegotiation Board after taking an appeal from the district or regional board. We have nothing but praise for the courtesy and consideration given to our company by the regional board and the Washington Board in connection with renegotiation. We think the Board has been very fair in connection with the problem before it. I headed the crew that got up the data and I carried on the discussion with the Board in most cases, without the benefit of any technical counsel.

I was personally engaged in connection with all of the details incident to renegotiation for each of these years. I think I know something about how renegotiation operates—the advantages to the Gov-

ernment and contractor during wartime and the disadvantages to the contractor in the peacetime economy. I therefore make the following general statements:

First, renegotiation is a form of Government control imposed by Congress during time of war or national emergency. Continuation of such controls in a peacetime economy is presumed to be unnecessary. Also, the Renegotiation Act is contrary to the theory of free enterprise.

Senator FLANDERS. You join the previous witnesses in that?

Mr. BURGESS. I realize this is repetitive in some instances.

Senator FLANDERS. But you add your voice to theirs?

Mr. BURGESS. That is right.

Senator FLANDERS. You doubt the necessity for renegotiation in peacetime?

Mr. BURGESS. That is correct, sir.

Second, renegotiation is no longer necessary in order that the Government may obtain the benefit of low prices. Better procurement methods, contractual relations, competitive bidding, price redetermination, and competition in most instances have eliminated any reason for renegotiation.

Third, it will probably cost the Government and industry combined to renegotiate business involved after January 1, 1955, than will be recovered, after giving effect to all applicable taxes.

Fourth, renegotiation beyond the year 1954 is detrimental to the economic position of small and medium industry.

Now, because other witnesses have taken issue with the President's message in almost the same manner that I take issue with it.

I will also want to interpolate in this report, after listening to the testimony yesterday and this morning, that part in which I made the statement in this report that renegotiation is under no condition necessary and will state that I believe it is probably desirable in a limited area, particularly the area referred to by Secretary Talbott. However, I am talking primarily again from small and medium business, which is in competition. That competition is very keen today. Facilities designed for defense production are far in excess of the present requirements of the Government.

The reference by the President to the need of subcontractors under the Renegotiation Act is by no means complimentary to the prime contractor who has during peacetime within his own control and discretion the determination as to his subcontractors, and presumably he can largely control the prices which he will pay the subcontractors.

Generally, the Government during peacetime in no instances directs or suggests who the subcontractors should be. The only modification of this statement is that Congress has been very much aware of the desire to distribute on a subcontract basis as much of the defense business as possible to so-called small industry. It is this small industry which I will attempt to prove is and will be hurt by the continuation of renegotiation.

The President stated that over 50 percent of the national budget is to be spent for defense purposes. He did not imply or mean that 50 percent of the country's economy and industrial production are geared to defense. If it were so, we should have all the controls we had before, and perhaps more, in effect at this time. I do not think

the reasons submitted are substantial enough to warrant continuation of the Renegotiation Act.

Most of the witnesses up to now, both the proponents and opponents of renegotiation, with one or two exceptions, have referred to renegotiation in connection with this relation to large prime contractors and large procurement orders. Very little, if anything, has been said about its effect on small industry and its relation to subcontractors.

The Small Business Administration, as you know, is doing everything possible to see that small business gets a bigger share of this. I intend to prove that small business will be hurt by the continuation of renegotiation. Considerable attention has been given to the amendment provided 1 year ago, which, in effect, excludes from renegotiation standard commercial products procured on a competitive cost basis. This exclusion of so-called standard commercial products and the raising of the dollar annual volume of business excluded to $500,000 has been very beneficial to many businesses. It is my opinion that this amendment should be further amended to permit the Renegotiation Board to exclude from renegotiation certain military items similar to but not identical, and serving the same purpose as similar items produced for commercial purposes.

It is my understanding, my interpretation of the amendment referred to, that it will not allow the Renegotiation Board to recognize as a standard commercial item, an item, for instance, which bears an ordnance part number, if it is not identical to the commercial article. Particularly should these military items be excluded from renegotiation when evidence can be produced to show that the contractor, whether he be a prime or subcontractor, was in competition with one or more unrelated companies. And by "unrelated," I mean one in which he did not have a financial interest.

We would recommend a further study of this particular phase covering the subject of "exclusion from renegotiations."

We think there should be some elaboration made on that taking more of the small businesses out under the Standard Commercial Practices Act by extending it to cover some military items.

I want to make this point: When renegotiation recovers from a contractor an amount of money or when the contractor voluntarily refunds to the Government in anticipation of renegotiation or price redetermination, the local newspapers, regardless of how small that amount is, publish that, and it is published as the gross figure and the wrong impression is created with the public. For instance, it is indicated that my company may have made a refund of $100,000 voluntarily and later on that renegotiation required us to turn back $250,000. That sounds like a lot of money. And what kind of people were we to build up those kinds of profits?

So I think that the reports of moneys recovered for the record should at least refer to the fact in all instances that those sums are before tax application.

Senator FLANDERS. I can think of similar cases in another line when it was announced that the president of a certain steel company was going to get $300,000 more. That $300,000 was printed as a gross and accepted as a gross by every reader. The fact that it was in the top bracket and that he got almost none of it, is not realized. You are speaking in the same vein?

Mr. BURGESS. Yes, sir, the same idea.

There will continue to be very sizable recoveries from as yet unsettled renegotiation cases from the years 1952, 1953, and 1954. The amounts will diminish rapidly for the years 1953 and 1954 and with the exception of a very limited number of companies there will be practically no recovery from smaller medium-sized contractors in 1955. This is for five reasons:

(1) Reduced volume, (2) price redetermination, (3) better procurement practices, (4) less contractors' risks—and by that I mean you are going to have business on a more factual basis of anticipating a legitimate profit and you will not have the contractor pad the price on the theory that he is taking a gamble, (5) more competition—all of which tend to reduce and stabilize profit margins.

It is possible that the cost to the Government and industry combined of renegotiations for 1955 and 1956 business will exceed the net recoveries made after a 52-percent tax adjustment. I say only possibly because only history will tell.

I previously made the statement that renegotiation beyond the year 1954 is detrimental to the economic position of small and medium industries. I have already explained why I think it is unnecessary for the Government to be protected by an extension of the Renegotiation Act.

In addition, I contend that it is detrimental to business because of the time and cost involved in the compilation of numerous reports, and many conferences between auditors, production executives, engineers, and management executives of the contractors with renegotiation representatives to settle each year's renegotiations. I point out that our 1952 case has not at this time reached the negotiation stage. As a result only the preliminary contractors reports have been filed for 1953–54 renegotiation.

You do not negotiate preceding years until you close up the years preceding. Two years have elapsed since preliminary filings were made for 1952. At this rate I would assume it will be July 1959 before 75 percent of any 1955 cases are settled, assuming the Renegotiation Act is continued. Such time-consuming projects divert the attention of top executives and contractors' personnel from the problems of commercial business.

Assume a small contractor has settled for 1951. His defense production volume probably increased in 1952—it went up or down in 1953—and down in 1954—and will be less in 1955. He has no reason to assume that the percentage of profit he was allowed for 1951 will be allowed for the following years as yet to be renegotiated.

The reason he cannot assume that is because different complexions of different boards, by reason of change of personnel or change of the staff, will interpret the statutory regulations in a different manner. He might be allowed more—he might be allowed less. He might assume a figure and perhaps make voluntary refunds to adjust his earnings downward. Then if he is a conservative manager he will protect himself against what renegotiation might ask by setting up a liquid reserve.

For example, this could amount to as much as $50,000 for each year yet to be renegotiated. Three such years would require a $150,000 cash reserve. At this time the defense orders for small and medium industry, except for a few isolated cases, have been mostly completed. There

may be enough volume in 1955 to put this contractor over the $500,000 limit and require renegotiation of his business.

Assume this contractor has a chance to expand his commercial business at this time by the purchase of new machinery and the building of a small addition. He would not dare do this. However, if he knew he did not need the $150,000 for renegotiation he might proceed with the expansion. Well-managed and ambitious small business today has untold opportunities for profitable expansion if it has the capital to expend for that purpose. Small business could also go bankrupt if it does not provide proper reserves for possible renegotiation refunds. Small business therefore which is involved in renegotiation does not know which way to go. It has probably provided for the Renegotiation Act of 1951 as extended to December 31, 1954, but it will be under considerable handicap because of lack of determination as to profits if it finds itself in a similar continuing position by reasons of its reduced 1955 and 1956 defense contract business. This is important.

If it has only limited bank credit, none at all for capital investments, is too small for an insurance company loan and is too small for public financing—all it can do is hold up its plans for expansion and wait 3 years to see whether or not its cash reserve is in part or entirely taken away by reason of negotiation, or perhaps not at all.

Even though the cash reserve may not finally be required for a renegotiation refund, the opportune moment for expansion may have passed during the 3-year interval. As a result of a no expansion the contractor would not increase its payroll, its earnings might go down instead of up, it might have paid less dividends to its stockholders. Thus it could be a victim of circumstances brought about by the delay caused by renegotiation. If you multiply this hypothetical case by an arbitrary 3,000 firms, you get some idea as to what effect it has and would have on small and medium industry, the people in the towns in which the contractor is situated, and the public in general.

Senator FLANDERS. Is this case taken from experience or otherwise, may I inquire?

Mr. BURGESS. I was just going to add that it was our own case. We have reserved—Mr. Roberts does not know this—but I will tell him this—we have reserved for 1952, 1953 and 1954 a total of $300,000 and put it in Government bonds, not because we think that renegotiation is going to claim it, because we do not know whether they are going to claim it or not.

We set that reserve up predicated on the deal we made for 1951, and more or less used an arbitrary figure.

We would like to develop and introduce into our business a new product which will require some additional building, about a couple of hundred thousand dollars worth of machine tools and probably $100,000 worth of engineering activity. We cannot afford to take the gamble on adding something to the $300,000. And we would be willing to spend $500,000 to expand our business to employ another 150 people if we knew how much if any of the reserve is going to be taken by renegotiation.

I realize that renegotiation cannot give us the answer to it, but I have this suggestion to make.

If renegotiation is to be continued, this particular problem can be eliminated by Congress if the Renegotiation Board were given a suffi-

cient appropriation to employ the personnel required to bring its cases down to a current date, and in the future require settlement of all cases within 15 months after the end of the contractor's fiscal year.

It may cost the Government more today, but theoretically it would cost the Government no more in the long run.

In summary, the Renegotiation Act should not be extended because:

(*a*) Control of profits can be exercised by good procurement practice, negotiated contracts, competitive bidding, and price redetermination.

(*b*) Renegotiation is an emergency control and should be used only in time of war or national emergency.

(*c*) The combined cost to the Government and industry of renegotiation for 1955 and 1956 may probably exceed any obtainable refunds, after giving effect to applicable income taxes.

(*d*) The capital needed by small and medium industry will be tied up for long periods of time delaying expansion, if this act is continued.

Second, if the Renegotiation Act is extended, and I think that you will extend it:

(*a*) It should be amended to cover only a limited number of contractors in the very small area of highly specialized noncompetitive production.

(*b*) In lieu of (*a*) above it should raise the minimum amount of sales subject to renegotiation from $500,000 to $5 million, or from some other amount as might be recommended after proper study by the Renegotiation Board.

(*c*) It should be amended to eliminate from renegotiation all business which can be proved to have been sold by the contractor on a competitive basis regardless of any classification as to the types of products involved, except during war.

(*d*) It should require that an agreement be reached between the contractor and the Government within 15 months after the end of the contractor's fiscal year, unless reasons satisfactory to the Washington Board an extension of 6 months is agreed.

I just want to add this one comment. We have heard nothing except the matter of negotiated contracts, public inquiries on which bids are made, and all of which have to do with prime contracts.

The subcontractor today is selling his product as we are to our customer who in turn is a subcontractor on a commercial basis, as we would sell any other production that we are making in the plant. The Government does not tell the prime that he should buy these parts from Burgess-Norton in peacetime. Therefore, why should the Government have any jurisdiction over the subcontractor insofar as renegotiation is concerned other than to satisfy itself that that subcontractor is in a competitive field, whether he is making military products or commercial products?

Senator FLANDERS. Thank you, sir.

Mr. BURGESS. Thank you.

Senator FLANDERS. The next witness is Mr. Wendell S. Fletcher, president of the Fletcher Aviation Corp. We are glad to have you before us.

STATEMENT OF WENDELL S. FLETCHER, PRESIDENT, FLETCHER AVIATION CORP., ROSEMEAD, CALIF.

Mr. FLETCHER. Mr. Chairman and members of the committee, I will not read my prepared statement, owing to the short time available, but I would like to read some very short notes that I have here.

Senator FLANDERS. Your prepared statement will be made a part of the record at this point.

(The prepared statement of Mr. Wendell S. Fletcher is as follows:)

STATEMENT OF WENDELL S. FLETCHER, PRESIDENT, FLETCHER AVIATION CORP.

Mr. Chairman and members of the committee, Russian defense production is yours and my grave concern. You have a responsible legislative position. I and my company have a responsibility to invent, design, manufacture, and deliver defense items to our military. I assure you that I and the other men of industry are basically honest. You legislators have got to treat us as honest men, and let us get back to work at defending this Nation. We currently are using 75 percent of our effort defending our businesses from the hoards of people armed with legislation that says "reasonable shall be the treatment."

1. Make it positive

Uphold article I, section 8, page 8 of the Constitution: "To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries."

We give to Congress the power to pass laws that allow inventors, authors, and artists, for a limited number of years, to keep anyone else from making or selling their work without their permission.

We should get (*a*) a chance to use and enjoy the many things created by American inventors, authors, and artists; (*b*) the right to enjoy the money and fame that may come from anything you invent or create.

This incentive must not be stifled if we are to endure. Prohibit, by firm legislation, the Defense Department from procuring any proprietary rights. Pay decent royalties, protect the incentive. Every patent taken has killed a man's incentive to go on inventing.

Review the 1925 Morrow Board's findings that proprietary rights in design be fully recognized. Review Congress' Procurement Act of 1926.

Review Federal Aviation Commission of 1935 recommendations and acts following which gave us an Air Force that won World War II.

Review the Finletter Commission of 1947 and Congressional Aviation Board of 1948. Always we get restrictive unwieldly acts which revert interpretation thereof back to confiscatory practices. Now is the time to meet the Russian challenge. Set defense industry on a sound road. Review the good American ideas set forth by these recommendations. Enact and enforce clear, simple legislation protecting proprietary rights of design, patent, manufacturing, etc., in Government contracts similar to thoughts in Federal Code 18 (1905): "Whoever, being an officer or employee of the United States * * * publishes, divulges, discloses, or makes known in any manner * * * any information coming to him in the course of his employment or official duties * * * which information concerns or relates to the trade secrets, processes, operations, style of work, or apparatus, or to the identity, confidential statistical data, amount or source of any income, * * * shall be fined not more than $1,000, or imprisoned not more than 1 year, or both; and shall be removed from office or employment."

Imagine having to set down every taxpayer in front of some buster who would determine a reasonable tax. Chaotic though, huh? We who defend this Nation do this at contract negotiation, price determination, and renegotiation but are allowed to figure out our taxes. Why? Meet this challenge—whip it. Free American initiative to defeat the Russian challenge.

2. Make it positive

How much profit do you want us to make? Say it, damn it. Stop the 100,000 little job makers in the Pentagon, Wright Field, Ordnance of Brooklyn, Philadelphia Navy, etc., etc., from each using blackmail, coercion, threats, and millions of hours haggling over "reasonable profit." On top of this Congress

threatens us with profit investigation. More delay, hours lost. If you were a Russian, could you conceive a better plan to confuse, frustrate, and occupy our people in other than the defense of the United States of America? For God and country's sake get this horde off our back by simply saying what profit we can have. Make it fair in amount and equal in operation. A percent on total volume is it. The income tax based on percent, not "reasonable." Capital involved should not be confused. Turnover and risk takes care of this. In my letter to you of May 9, 1955, I suggested a renegotiation plan—the first $1 million at 12 percent, the next $10 million at 10 percent, the next $100 million at 8 percent, the next $250 million at 7 percent and all above this at 6 percent. This would help. It must be a mandatory regulation for all contracting, i. e.: The percent profit on individual contracts should be limited as outlined. This covers redetermination. Then, total yearly contracts are to be reviewed by the same standards. Here the additive volume would automatically adjust total yearly profits equitably, fairly, and uniform. This cover renegotiation.

All auditing shall be to one standard, defined as costs now acceptable by the Internal Revenue Department. Audits by certified public accounting firms shall be acceptable. Remember, you have your GAO to police this.

This plan would simplify procurement for the Government and allow the manufacturer more time on the constructive future defense. Fire thousands of haggling pseudo Government auditors, each group of which has its own new set of rules and interpretations of statutes, ASPRS, directives, etc. Internal Revenue Department rules and regulations are acceptable and workable. We pay you our taxes that way. What makes other payments so different?

Make it sound and simple. You have the Vincent-Trammel Act of 10 percent on shipbuilding and 12 percent on aviation. Lump it all here on a self-administering basis, clothing, guns, boats, aircraft, all of it to be:

	Percent
On first $1,000,000	12
On next $10,000,000	10
On next $100,000,000	8
On next $250,000,000	7
All above	6

Cover all contracting, price redetermination, renegotiation with one simple act revision.

In answer to your concern over testimony given June 7, 1955, to you: My company finds no lack of diligence on the part of the Defense Department. My complaint is that they are diligent beyond the point of law, because the law is vague.

They secure bids in competition, then take the winner into negotiation. Ending up with a price redetermination and an incentive as follows:

Bid price becomes ceiling 5 percent to 10 percent. Reduction becomes target. Percent profit is new one on target, not bid price.

Contractor is forced to accept this or be disqualified. He tells himself "take it," the ceiling is your bid. He now is offered 10 percent of the savings below ceiling (his bid price). Hardly an incentive when he faces a stiff fight at renegotiation to get costs.

Ceiling should be 10 percent over bid. Bid and profit thereon should be target. Savings under bid should give 25 percent to contractor plus bid percent on target.

Mr. FLETCHER. In the first place, we do not subscribe to the necessity for a Renegotiation Act. The Russian jet airpower shocks us. We find Russia in possession of advanced aircraft. Whether they lead us or not, they are too close for comfort.

Gentlemen, we have a cancer in our defense system—vague legislation. Just as in the human body this cancer must be removed from procurement legislation.

Yesterday you seemed concerned over the Defense Department being thoroughly diligent in contracting. Let me assure you from first-hand experience that they are very diligent people trying to govern procurement as it is spelled out in the vague legislation.

We need simple, straightforward legislation like the Internal Revenue Act which results in facts such as percent on income and auditing

rules thereon, with the taxpayer allowed to figure it out and pay it.

Our only complaint of the Defense Department is overzealousness to carry out your desires.

"Reasonable" has no boundary. Hence, a multitude of auditing groups are set up to pursue what is "reasonable." A 48-inch stack, so high, of interpretations are in existence trying to define the 1½-inch-thick Armed Service Procurement Regulations. Auditors lack definite rules so that they merely set aside items which are touched upon. No firm rule exists to set these costs back in. Negotiating is frustrated; stymied, in fact.

We need, and the Defense Department needs, simple, straightforward rules. A single set of auditing rules. And those should be the present costs allowed by the Internal Revenue.

Second, the right to use certified public accountant reports to substantiate findings, just as in income-tax returns.

Third, prohibit procurement of proprietary rights. Protect incentive. Pay decent royalties. End violations of the constitutional article I, section 8, clause 8. That is the article that gives the citizens of the United States a right to their patents and is explained further in this prepared statement.

Fourth, how much profit do you want us to make? Name it. Take the Defense Department off the hook. Give us a scale of profits. It will end millions of words of haggling. And believe me, I have had a couple of million of my own.

Senator FLANDERS. You have in your document a suggested definite scale of profits. Is that on contracts or on a yearly basis? For instance, when you say 12 percent on the first 1 million, 10 percent on the next, 8 percent on the next, 7 percent on the next, are those dollar amounts, the size of the contract, or do they represent yearly business?

Mr. FLETCHER. They are both, sir. In these notes that I am just going over quickly now I explain it very thoroughly.

Senator FLANDERS. All right. You may proceed.

Also, will you explain whether the 12 percent is profit on invested capital or profit on sales?

Mr. FLETCHER. I can answer that right now. It is profit on sales, because of my experience with that, if I have to work on a small capital I have to risk it that many more times. I have to be that much more diligent to be able to do the volume of business, and, therefore, I feel that I have risked my money more times, and that the profit on the gross business is the only item to look at. That is what you look at in your income tax. They do not give us any comfort one way or another in the income tax.

So I do not believe we should discriminate one way or the other. Take the total business and say what you want us to pay and let us pay it.

Then, make it applicable to all contracts. It will determine the percent of profit automatically in vertical and horizontal contracts. That would answer that problem that you had yesterday in the servicing companies, whether it was done vertically, inside the company, whether it was done horizontally outside. Both would have a fair treatment. They do not have it now.

Your contract administrators and contractors are swimming upstream in a sea of mud. Clear the water, still the water, and we can

make greater progress in the future, and match and then exceed this Russian devil.

The defense people are not stupid, but they are burdened with rules which require experience and judgment far beyond their ken. How can they ever treat "reasonable" in a like manner? Not even the collosal renegotiation regime can do it. And they hit only one element, that is, renegotiation.

This is where I cover all of the things that you were about to ask, sir.

Give us one firm set of rules, applicable on the inception of contracting.

When I sit down with the negotiating contractor I want a set of percentages like that, so all he has to do is to flip a page and say, "This is $10 million, O. K. That is what you got." O. K., we are done. There, in about six words, we are through haggling about the profit.

Now make it applicable on the closing of the contract. There comes price redetermination. In the matter of closing the contract if we have a firm set of percentage rules we can figure it out quickly.

Then take this same set of simple rules and make them applicable to the year's business. The total volume of business. Now we have covered renegotiation. And you have got one simple set of rules that these overburdened Defense Department procurement people can work under.

It is pathetic to work with them, because they are so frustrated with this 48-inch stack of regulations. They are fearful that they will violate one of those regulations trying to interpret the Armed Services Procurement Regulations.

We want one set of rules. You can analyze it this way: As kids you have all played a baseball game in which you made up rules as you went along. It was not much of a ball game, but a swell fight. That is exactly what we have got now. We make up the rules as we go.

Shall we beat the Russians or keep up the family fight?

Gentlemen, I know whereof I speak. I have to sue on a renegotiation of 1950. I have contracts in dispute, in redetermination because of findings of facts by the defense auditor which are in complete dispute.

Limitations are running out on me on that. So I have to file in the Court of Claims.

I have contract negotiations going on right now in which several million words are being spent in that.

I have also proprietary rights in balance in which I either have to give them up, to get a contract, or hang on to them and not to get a contract.

It all comes from diligent, well-meaning men armed with vague legislation.

Take me off the hook, too. One set of rules will let us all go to work 100 percent on defense.

Thank you.

Senator FLANDERS. Thank you, Mr. Fletcher. You have made a very eloquent and picturesque presentation. I can assure you that your points will be taken into account and your prepared statement will be made a part of the record.

Mr. FLETCHER. Thank you.

Senator FLANDERS. The next witness is Mr. Austin E. Page of the Lane Construction Corp. Will you identify yourself for the record?

STATEMENT OF AUSTIN E. PAGE, WEST HARTFORD, CONN., VICE PRESIDENT AND CHIEF ENGINEER, LANE CONSTRUCTION CORP., REPRESENTING AMERICAN ROAD BUILDERS' ASSOCIATION

Mr. PAGE. Mr. Chairman and gentlemen of the committee, my name is Austin E. Page. My residence is West Hartford, Conn. I am vice president and chief engineer of the Lane Construction Corp. We have been in the construction industry for the past 65 years.

Senator FLANDERS. Not personally?

Mr. PAGE. Not personally, sir, no.

Senator FLANDERS. You are also here in a representative capacity, are you not?

Mr. PAGE. Yes, sir.

Senator FLANDERS. Of the American Road Builders' Association?

Mr. PAGE. That is correct, sir.

Senator FLANDERS. You may proceed.

Mr. PAGE. I am deeply grateful for the privilege of this appearance. My remarks are made on behalf of the contractors division of the American Road Builders' Association. Let me explain that, in addition to roadbuilding, many of our contractor members engage in the construction of airports, depots, buildings, and other such military installations and facilities. My remarks will be confined to those operations of our members dealing with, in a broad sense, military installations and facilities.

First, let me say that the organization I represent does not in any sense object to the principle of renegotiation. Our testimony will be solely directed toward conditions currently existing in the construction industry which, in our judgment, no longer justify continuing renegotiation procedures insofar as competitive construction contracts are concerned.

The Renegotiation Act of 1951, as amended, now exempts standard commercial articles. Although construction contracts do not fall within this category, we believe that competitive conditions in the construction industry today offer a comparable basis for exemption. Certainly there is nothing novel presented in moving a yard of dirt, placing a yard of concrete, or building entire facilities such as airports, depots, buildings, and so forth. The various Government agencies having jurisdiction over construction are amply staffed with highly competent engineers who are quite capable of drafting specifications in sufficient detail to form an adequate basis for competitive bidding. Also, these same engineers are fully qualified to make accurate estimates of construction costs. Thus, the reasonableness of bids can be readily ascertained. In the event of insufficient competition or other abnormal conditions, these facts can be quickly determined, and, in the discretion of the contracting officer, the bids involved can be rejected by the Federal Government. In this manner, the interests of the Federal Government are adequately protected under such normal conditions as now exist in the construction industry.

Private enterprise is the backbone of a free nation and a sound economy. Competition is the very heart of our highly successful American business system. In the interests of encouraging competition and perpetuating the system of private enterprise, we respectfully urge your favorable consideration of an amendment to the legislation under consideration which would exempt from renegotiation the construction, reconstruction, betterment or repair of public works, military installations and facilities, and other related projects constructed pursuant to contracts awarded on the basis of open competitive bidding.

I should like to add at that point, if I may, if the committee sees fit to adopt this amendment we believe it would be reasonable to grant discretionary powers to the Renegotiation Board to exempt from renegotiation similar contracts during the last few years.

Senator FLANDERS. That is, you would make it retroactive, in the discretion of the Board?

Mr. PAGE. Yes, sir.

In an effort to conserve the time of this important committee we have tried to be brief. If additional information is desired, we shall be pleased to submit it.

Mr. Chairman, may I again thank you for this opportunity to present our views.

We have in mind, if you are interested, sir, a provision which was a part of the Renegotiation Act of 1943, but which was later, for some reason, dropped out. This provision reads:

> Any contract with the Department awarded as a result of competitive bidding for the construction of any building, structure, improvement, or facility will not come within the provisions of this section.

We believe that if that amendment should be adopted it might be well to include the word "subcontract," so that it would read "any contract or subcontract."

Senator FLANDERS. Thank you, sir.

Mr. PAGE. Thank you, Senator.

Senator FLANDERS. This concludes the list of witnesses, and we thank all of you.

(The following was later received for the record:)

KIRLIN, CAMPBELL & KEATING,
Washington 4, D. C., June 9, 1955.

Re H. R. 4904

HON. HARRY F. BYRD,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR BYRD: I am writing on behalf of the National Association of River and Harbor Contractors, which is composed of the principal dredging contractors engaged in river and harbor work throughout the United States. Our member companies are located on both the Atlantic and Pacific coasts, on the gulf and the Great Lakes, and in Hawaii. Most of them have been in business a long time, and one or more of them have participated in every important dredging job that has been undertaken through private contracting in this country during the past 50 years. During the late war they were busy dredging harbors, constructing bases and airfields, etc., in Europe, Africa, Australia, and the far islands of the Pacific, as well as nearer home in North and South America. In peacetime they have engaged in the more normal activities of constructing safe and adequate harbors, dredging rivers, and building dikes, levees, and breakwaters usually under municipal, State, or Federal supervision.

A large part of the river and harbor filling and construction work done by members of the association is supervised by Army and Navy engineers under contracts with the Departments of the Army, Navy, and Air Force. During the war many of these dredging contracts were negotiated. Due to this fact, and because of the speed with which the contracts had to be entered into and the large volume of work involved, profits under these contracts were quite properly subject to the provisions of the wartime renegotiation acts. A similar situation was faced during the recent Korean emergency, and again all such contracts were included among those to be renegotiated under the Renegotiation Act of 1951.

Since the Korean emergency, however, a change in contracting policy has taken place in the service departments. While they still have authority to negotiate contracts, it has become increasingly the practice, now that time permits, to let contracts by competitive bidding.

Consequently, a large number of the contracts that members of the association are now performing for the armed services were obtained as a result of competitive bidding. When contracts are let by this more standardized method, the possibility of making excessive profits is eliminated. It could be said that competition wrings the profit out of the contracts. The bidders have ample time to analyze the costs and have every incentive to cut their profits in order to submit a low bid and obtain the contract. The services also have sufficient time to analyze and weigh the bids before letting the contract.

Under these circumstances, it is respectfully urged that there is no necessity of continuing under the Renegotiation Act of 1951 contracts obtained from the service departments on a competitive bid basis, and certainly at the present time there is not sufficient dredging work in the aggregate to cause any concern about excessive profits as the result of volume alone. Most of our plant and equipment have stood idle for several years, and to remain active at all, many of our companies have had to seek work in foreign countries.

It is therefore requested that H. R. 4904 be amended by adding a section which would increase the mandatory exemptions set forth in section 106 (a) of the present act as follows:

"SEC. 3. Subsection (a) of section 106 of the Renegotiation Act of 1951 is hereby amended by inserting at the end thereof the following:

"(9) Any contract or subcontract obtained as the result of competitive bidding."

Your careful consideration of this amendment will be greatly appreciated.

Respectfully,

ROBERT E. KLINE, Jr.

(Thereupon, at 1:05 p. m., the committee adjourned.)

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