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Albert J. Browning

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PRICE CONTROL IN WAR PROCUREMENT

BRIG. GEN. ALBERT J. BROWNING

The aims and spirit of over-all renegotiation of war contracts have nowhere been more succinctly stated than in a recent advertisement by one of the nation's largest war contractors. In a half-page message placed in daily newspapers throughout the country, International Harvester Company spoke of "the money you won't have to pay."¹ Pertinent to any discussion of controlling the prices of war materiel is the following excerpt from this advertisement:

"Savings are what you get when you put experienced, competent production men on a new manufacturing job. Not at first, of course. Those first guns and shells and airplanes are expensive. But as the job runs on, the savings start to come. An engineer designs a new tool to reduce losses from spoiled work and to increase output. A foreman relocates machines in his department to save 2 cents on each piece in the handling of materials. An employee gets an idea and submits a suggestion for better production to his Labor-Management Production Drive Committee. All this, of course, while the quality of work is maintained or improved, for quality always comes first.

"Small things? Yes. Small as so many drops of water. But when you put together thousands of drops of water, you get an ocean. And when you put together thousands of improvements and refinements in manufacturing, you get a saving to make anybody blink.

"Consider the savings already made possible on three of the many war jobs the Harvester Company is doing—a 20 mm. aircraft cannon, an anti-tank gun carriage, and the Oerlikon anti-aircraft gun mount.

"The price of the Oerlikon gun mount has been cut almost in half. The price of the anti-tank gun carriage has been reduced one-third. The original price of the 20-mm. cannon would buy two cannons now.

"On those three jobs the reductions in price our Company has made to the government—which means to you who pay the government's bills—amount to more than \$16,000,000. That is the difference between the original price and the price today. That is the savings, the money you will *not* have to pay.

"These price reductions were voluntary. They stemmed from a pledge, made officially by this Company, that we would handle all war work at no more than a moderate profit, and that we would give the

¹See The Washington Post, Aug. 11, 1943; and other leading newspapers.

government the benefit of manufacturing savings by voluntarily reducing prices whenever possible. That pledge was made *before* there was any law regulating profits or prices on war production.

"Further savings will be made on these jobs. And savings will be made on thousands of other jobs in the enormous war production program of American industry."

The \$16,000,000 savings effected on three items plus savings reported by thousands of other American companies have resulted, in the sixteen months through August, 1943, in refunds or price reductions on war material totalling well over four billion dollars.² It is estimated that no more than approximately 70% of these refunds and price reductions would have been recovered by taxes. The magnitude of this is indicated by the fact that the more than \$1,000,000,000 of net savings that would not have been recovered by taxes represent approximately half of the total income taxes paid by corporations and individuals in 1940. While it is difficult to estimate with any high degree of accuracy the amount of net savings that will be effected during the balance of this year, it is likely that the total will be materially increased.

Thousands of American corporations are insuring the success of the Government's program to keep down the cost of the war. As indicated in the advertisement quoted above, management "know-how" combined with labor "know-how" and added to substantially increased volume of production have made it possible to reduce the cost of things necessary to the winning of the war. And agreements to reduce prices and to make refunds to the Government, as the advertisement also suggests, have been voluntary on the part of industry.

Those two elements are inherent in war contract renegotiation—lower prices through increased efficiency and price adjustment through voluntary agreement.

I. BACKGROUND OF PRICE CONTROL

A. *Early Methods in the United States*

The need for price adjustment on war contracts is not new or peculiar to this war. It has been present in every war in which this country has engaged. By its very nature, war upsets normal economic equilibrium. This becomes increasingly mechanized and geographically extensive. Shortages of every sort develop, breaking all the laws of supply and demand which,

²See text pp. 172-173 *infra*.

in peace-times, tend to provide some semblance of stability in the price structure.

More than a century and a half ago George Washington was confronted with the problem of controlling prices of material for his Colonials. So concerned was he about the problem that he wrote numerous letters about it, among others one to the President of Congress³ about "the exorbitant price exacted by merchants and vendors of goods for every necessary they dispose of. I am sensible the trouble and risk in importing give a right to a generous price, and that such, from the motives of policy, should be paid; but yet I cannot conceive that they, in direct violation of every principle of generosity, of reason, and of justice, should be allowed, if it is possible to restrain them, to avail themselves of the difficulties of the times, and to amass fortunes upon the public ruin."

The "trouble and the risk" to which the first President alluded remain in all instances of war production, and so, too, there remains the recognition that these factors "give a right to a generous price." At the same time, Washington's hypothesis that producers of war materiel and services should not "avail themselves of the difficulties of the times" or "amass fortunes upon the public ruin" is widely recognized throughout the world today not only by the men who fight and by those who foot the bill, but by the very producers themselves.

During the Spanish-American War Congress passed the first law designed to control the price of materiel when it limited the price of armor plate. In World War I another step along the road of sound price control was taken with the "cost-plus-a-percentage-of-cost" contracts. These boomeranged, however, for they provided an incentive not to reduce costs but to increase them, since a profit of 10% on \$200 is just twice as great as a profit of 10% on \$100. Likewise, the excess profits tax instituted during the World War I provided incentive to increase prices with the view to having the increased price cover the increased tax.

The most potentially effective step to control prices of World War I materiel, however, was taken more than a month before this country became a belligerent.⁴ The Naval Affairs Appropriation Act of March 4, 1917, gave the President power to "take immediate possession of any factory of such person" who refused or failed to give to the United-States preference in the execution of orders "at such reasonable price as shall be determined by the President." While this Act also gave the president power to take

³EISNER & ROSENBLUM, *GEORGE WASHINGTON ON PRICE CONTROL*.

⁴Naval Services Appropriation Act, 39 STAT. 1193 (1917).

other action, the section quoted represents the nub of the attempt on the part of Congress to control prices in time of war. The phrase, "such reasonable price as shall be determined by the President," is used again later in the Act, but the Act also recognized that contractors are entitled to a fair profit, for it gave the Secretary of the Navy the right to contract for the construction of battle cruisers "upon the basis of actual cost, plus a reasonable profit to be determined by him."

B. Survey of Foreign Methods

Meantime, with the advent of the war in Europe in 1939, England, Canada, Australia, Germany, and Italy tackled the problem of controlling the prices of war materiel. Significantly, in England, as in the United States, those who have opposed renegotiation have contended that it is more important to produce than to keep costs down. This argument, which appears sound on the surface, is fallacious. During wartime it is against the public interest to waste manpower, money and materials. Production at all costs will contribute to post-war economic ills. The British view is best stated as follows:⁵

"The effort to maintain or restore some incentive to cheap production, which is the object of modification or adjustments in renegotiated contracts, has been disparaged on the ground that output is more important than price and that attempts to effect paltry economies may seriously disturb the productive organization. The answer to this lies in the relation between costs and efficiency, which experience shows to be so close that maximum output is unlikely to be attained under conditions in which costs are to any considerable extent above the minimum. Unwillingness to press for a return to fixed prices seems to be associated with the misapprehension that maximum output and economy are distinct and frequently incompatible items."

In England prices are controlled in large measure through attention to costs and profits. The costing system has prevailed, and policies on profits have emphasized return on capital employed. The rate which is generally recognized as fair in England would shock most American war contractors, for it represents a return on employed capital of only 7½ per cent before taxes. This, however, is modified by the performance factor, contractors being rewarded upon the basis of whether their performance has been good, bad or indifferent. In England, inefficient contractors are given short shrift. If such a contractor cannot step up his efficiency, his employees are as like

⁵Select Committee on Natl. Expenditures, Fourth Report, Section 1940-41.

as not to be assigned to another plant and he himself to a job as an assistant superintendent elsewhere.

In England, too, the whole emphasis is on profit before taxes—which means, of course, on prices without regard to taxes.

The Canadian government has had an easier problem with wartime profit control because a large portion of the munitions are manufactured in government plants, where costs are known and where spot checks are made. Originally, some contracts were negotiated on a cost-plus-fixed fee basis, with an added percentage being allowed for reduction in costs. Later this practice was abandoned in favor of so-called target-price contracts.⁶

The target system, used in Canada and Great Britain in the early stages of the war, operated as follows: Firms manufacturing new articles were given a set price. For example, if forceps were being produced for the first time, the price might have been set at £1 each. The contract and cost prices were re-examined at the end of a specified period and the price was reduced. There was no effort, however, to recapture profits on a retroactive basis as is practiced under the renegotiation law of the United States.

The target system was abandoned because it was determined that if enough information was available to set a target price, a fixed price could be based on that same information. At the present time both Canada's and Great Britain's prices are controlled, in the main, by a system of post-auditing, which obviously involves the use of specialized manpower.

Another marked difference in wartime manufacturing in Canada is that the large contracts are carried out by about twenty government companies, operated by business men. Spot checks on costs are constantly made.

Turning to Australia, we find that the Supply Act of 1939⁷ specifically required the control of costing and the limitation of profits. An "Accounting Panel" laid down broad general principles. It was recognized that the ordinary contract system of awards to the lowest or most attractive bidders was not appropriate to specialized munitions, and soon became futile for ordinary supplies because of congestion, inefficient workshops, and the lack of any real competition. Allowances are lower on war supplies than on civil supplies, since selling costs may not be included. The virtual centralization of authority in the Munitions Director of Finance, and the confidence felt in his judgment both by the manufacturers and the Treasury have usually provided a solution for particular problems.

⁶Stam, *Handling of War Contracts in Canada and Great Britain, Hearings before Sen. Fin. Subcom. on Sec. 403 of Pub. L. No. 528, 77th Cong., 2d Sess. (1942) 77-79.*

⁷Supply and Development Act of 1939, COMMONWEALTH STATUTORY RULES OF 1939, pp. 670-706.

As might be expected, Germany, which for long before the war, of course, had close control over prices, systematized its control over prices of war materiel on a basis which ruled out all sentiment. The Nazis realized that profiteering in World War I had contributed to disintegration of civilian and military morale.⁸ In 1941 they adopted a form of contract renegotiation. Significantly, they stated frankly that such measures were put into force in order to obtain production efficiency.⁹

German munitions makers are placed in two groups. Group I, or the low-cost war producers, are rewarded handsomely by the government through the expedient of forgiving excess war profits taxes over and above levels fixed by the Minister of Economics. Group II, or inefficient producers, must not only pay heavy taxes, but are threatened with the penalty of losing raw materials and manpower if they do not produce efficiently.

Italy, too, for a long time had price controls in effect before the war. But if word reaching beyond the borders of Fortress Europe is to be taken at its face value, it was some time before the Fascists became aware of the need of applying controls to war production. A Reuter's dispatch¹⁰ from London on April 24 of this year told that the Rome radio had said that the then Premier Mussolini had just given orders for a cut in state payments to contractors. "When arrangements have to be made in a hurry the state often accepts prices which turn out far too high," Mussolini told the commission for revision of war contracts," according to the dispatch. Reuter's continued its report as follows: "Revision of these prices has now become necessary for political and moral, as well as for financial reasons. Mussolini ordered the commission to 'cut out all profits which are not justified by the amount of capital engaged in the business or work done.'"

It will be noted that, in its control of prices, Italy, like England, places emphasis on the capital investment of a war contractor.

Another one of the great belligerents, Russia, of course has relatively no problem of controlling either prices or profits, being without a profit system such as is utilized in capitalistic nations.

What the practice of price control in wartime Japan may be it has been impossible to ascertain.

⁸General Ludendorff is reported to have said:

"Profiteering was a deadly sin, and our inability to eradicate it was a matter of greatest regret to me from the point of view of morale. Many times I made an effort to get at the bottom of it. The war profiteer is a loathsome phenomenon and the conception of his influence have done us incalculable harm."

⁹See DOBLIN, *SUBCONTRACTING IN GERMAN DEFENSE INDUSTRIES*.

¹⁰Reported in *Washington Times-Herald*, April 24, 1943.

So it is found that the important warring nations of each side have developed a system of price and profit control. Like the airplane, it is a modern wartime phenomenon, a development which became necessary because of the scope of modern war, its complexities, and the intense use of materiel on a scale never before contemplated, and also because of the importance of the morale of civilians and of the men who are doing the actual fighting.

C. Price Control During World War I

Returning to our own history of price control of war materiel in this country, general limitations on costs in contracts in the last war were drawn up by a committee composed of representatives of both Congress and the Executive departments of the Government. The proposals were issued in July, 1917, under the title of "Uniform Contracts and Cost Accounting Definitions and Methods," forming the first basis for control of costs.¹¹

A straight purchase-and-sale contract was recommended by the conference in July, 1917, as possibly the best method of keeping costs down. The formula was not rigid, however, the conference recognizing that new armaments present cost problems not covered by the original recommendations. As a consequence, cost-plus-a-percentage-of-cost contracts were to be permitted.

The conference even set forth the items which were to be included in the over-all formula for determining costs. These were direct labor and materials, and a fair proportion of overhead. Excluded in computing overhead were interest, rent, advertising, collection expenses, credit losses, customers' discounts, and federal income and excess profits taxes.

Allowable items in the contract price were to include, among others: spoiled work not due to negligence, accrued liability insurance, taxes (except federal excess profit and income taxes), administrative expenses, employees' welfare, packing, depreciation and depletion.

On the basis of the joint conference's recommendations, the Navy Department adopted a standard cost-plus contract form, which was strongly criticized in post-war years and which led to demands for adoption of an elastic formula. The criticism leveled at cost-plus-a-percentage-of-cost contracts, perhaps more than any other factor, led to the subsequent joint recommendation by the Secretaries of the War and Navy Departments to sponsor an elastic formula for price and profit control.

Prior to the outbreak of war in 1917, as has been indicated above, Con-

¹¹SCHWARTZ, PROFIT LIMITATIONS: THE EXPERIENCE OF WORLD WAR I (War Service Section, Library of Congress, Washington, D. C.).

gress had granted the Secretaries of War and Navy authority to place compulsory orders for goods with manufacturers and even to commandeer their plants if they failed to furnish supplies "at a reasonable price as determined" by the Secretaries.¹²

In effect this authority vested in the Army and Navy power to requisition or commandeer not only manufacturing facilities, but also raw materials. To carry out commandeering operations the Navy Department created in 1917 a board known as the Naval Board of Commandeering and Appraisal.

Commandeering was used as a profit control measure by the Navy, as in the case of tin. In 1918 tin prices had risen to abnormally high levels and there was considerable hoarding. This critical metal was actually unobtainable in the open market. To break the back of the corner, the Navy issued a blanket commandeering order to the important tin brokers. When this became known, considerable quantities of the metal were released in the market, causing a price decline.

The War Department created a board of appraisers to fix compensation for property requisitioned by the Secretary of War.¹³ Some of the commodities commandeered or requisitioned by the Army included wool, cotton, heavy duck, and canned goods.

Generally speaking commandeering was not used extensively. In recalcitrant cases, however, the power which the Congress vested in the War and Navy Departments was extremely important. A student of the subject, J. F. Crowell, has cited the following as conditions justifying the use of the commandeering authority:¹⁴

"(1) Where the partial or complete breakdown has occurred of the usual economic conditions under which values are determinable with any approach to fairness and justice, on the ordinary basis of supply and demand for services and goods.

"(2) Where the tendency of the trade is, in anticipation of scarcity condition of supply, to accumulate unduly large quantities for speculative control and extortion of unreasonably high prices from the public powers and private necessity.

"(3) Where there is unwillingness to bring holders of commodities and of individual and corporate services to recognize a common basis of obligation not to take advantage of a national emergency by putting personal profit above collective welfare in the hour of national peril.

¹²39 STAT. 213 (1917).

¹³War Dept. General Order No. 39 (April 1, 1918).

¹⁴CROWELL, GOVERNMENT WAR CONTRACTS (1920) 48-49.

“(4) Where the unwillingness to accept compensation on the basis of actual costs plus reasonable profit becomes a serious handicap to the rate of speed and effectiveness of mobilization of national resources.

“(5) Where commandeering may be required to forestall or prevent the quick rise in the costs of living superinduced by the race for excessive profits and extortionate wages exacted by the crisis in public existence.

“(6) Where it is difficult or impossible to recoup the extraordinary need for public revenues from taxes on excess profits and unearned income from salaries and wages or other sources.”

Another important phase of wartime profit control was price-fixing carried out by the War Industries Board and the Price Fixing Committee appointed by President Wilson on March 14, 1918. The Board and the Price Fixing Committee fixed the prices on a majority of the basic war materials, but the War and Navy Departments also fixed “fair and reasonable” prices for materials they themselves bought.

In addition to these measures, corporation taxes and excess profits taxes were used not only to help in financing the war out of current revenue, but also as brakes against excessive profits accruing to war contractors. That this financial war mobilization program was not sufficient to stem profiteering and inflation tides is attested by the post-war public and Congressional revulsion against war profiteers.

II. SUMMARY OF LEGISLATION, 1919-1940

A total of 168 resolutions and bills were introduced in Congress between 1919 and the fall of France in June, 1940, all having the avowed purpose of taking the profit out of war, a slogan which gained nationwide publicity under the impetus of the American Legion's campaign.

The first attempt to provide for legislative means to limit war profits is credited to the late Senator Lundeen of Minnesota. As a member of the House he introduced on February 28, 1919, a bill¹⁵ to provide for government monopoly in the manufacture and sale of munitions of war. Mr. Lundeen's bill was aimed at the future war profiteer.

In the following year, Representative Little of Kansas went a little further. He offered a resolution¹⁶ in the House instructing the Attorney General to restrain the distribution of war profits and instructing the House Ways and Means Committee to devise a plan to tax these profits for veterans' benefits.

¹⁵H. R. REP. No. 16, 65th Cong., 3d Sess. (1919).

¹⁶H. J. RES. No. 315, 66th Cong., 2d Sess. (1920).

These initial attempts were simply Congress' recognition of national agitation against the war profiteer. Their genesis lies in the fact that dissatisfaction after the Armistice let-down was not confined to the demobilized army, but spread to civilians.

Between 1920 and 1930 Congress was pre-occupied off and on with the problem of controlling war profits and mobilizing national resources in time of war. The driving force behind these efforts was the American Legion which adopted a program envisaging "universal legislation" to equalize the burdens of war.

In 1922 Representative McSwain of South Carolina introduced a resolution¹⁷ providing for the creation of a Congressional committee to investigate the subject of taking the profit out of war. Representative McSwain's proposal had the indorsement of President Warren G. Harding. In one of his last public addresses, the President said:

"I have said before, and I choose to repeat it very deliberately now, that if war must come again—God grant that it shall not—then we must draft all of the nation in carrying it on. . . . It will be righteous and just, it will be more effective in war and marked by less regret in the aftermath if we draft all of capital, all of industry, all of agriculture, all of commerce, all of talent and capacity of energy of every description to make the supreme and united and unselfish fight for the national triumph. When we do that, there will be less war. When we do that, the contest will be aglow with unsullied patriotism, untouched by profiteering in any service."

Harding was but one of five presidents who have endorsed universal legislation and elimination of war profiteering.

Between 1922 and 1924 ten more bills and resolutions¹⁸ were introduced in Congress for control of wartime profits, but Congress took no action. In 1924 Republicans and Democrats alike took cognizance of the movement for profit controls, both adopting platforms during the 1924 conventions for universal service in time of war.

The 1924 Democratic platform read:¹⁹

"In the event of war in which the manpower of the nation is drafted, all other resources should likewise be drafted. This will tend to discourage war by depriving it of its profits."

¹⁷H. J. RES. No. 400, 67th Cong., 4th Sess. (1922).

¹⁸H. R. REP. No. 13201, 67th Cong., 4th Sess. (1922); H. J. RES. Nos. 76 and 85, 68th Cong., 1st Sess. (1923); H. R. REPS. Nos. 4841, 5332, and 8111, H. J. RES. Nos. 128 and 271, H. RES. No. 183, and SEN. REP. No. 2561, 68th Cong., 1st Sess. (1924).

¹⁹See Republican Campaign Text Book of 1924 at 85; Democratic Campaign Book of 1924 at 39.

The 1924 Republican platform statement read:²⁰

"We believe that in time of war the nation should draft for its defenses not only its citizens but also every resource which may contribute to success. The country demands that should the United States ever again be called upon to defend itself by arms, the President be empowered to draft such material resources and such services as may be required, and to stabilize prices of services and essential commodities, whether utilized in actual warfare or private activity."

The first definite step taken in the direction of controlling war profits was in 1930 when Congress, by joint resolution²¹ created the War Policies Commission to "study and consider amending the constitution of the United States to provide that private property may be taken by Congress for public use during war, and methods of equalizing the burdens and to remove the profits of war, together with a study of policies to be pursued in the event of war."

The Commission held hearings in March and May, 1931, and submitted its recommendations to the President in March, 1932. It devoted considerable testimony to the problems of minimizing war profits and concluded that controls could be adopted through price-fixing. However, it significantly recognized that profits would accrue to low-cost producers and recommended that these should be taxed.

Proposals submitted by the War Policies Commission were not acted upon, but they did accomplish one purpose: They laid the groundwork for the munitions investigations, which excoriated all industry because of the mistakes and the greediness of the minority. Senator Gerald P. Nye (R., N. D.), and Senator Arthur H. Vandenburg (R., Mich.), introduced a joint resolution²² in the Senate for an investigation of the munitions industry.

The committee, popularly known as the Nye Committee, held extensive hearings from the fall of 1934 to the spring of 1936. The newspaper publicity attendant upon these hearings was, to say the least, damaging to industry as a whole. The depredations of a few industrialists smeared the whole system of private enterprise. Such headlines as these appeared in the nation's press: "Senator Charges Profiteers Plot Another Conflict," "War 'Profits' Become War Debts," "Voters Against Private Munitions Manufacture in National Poll," "Senate Committee Asks U. S. Ownership of War Facilities," "Democratic Women Urge Peace Plank and War Profit

²⁰*Ibid.*

²¹46 STAT. 825 (1930).

²²SEN. RES. No. 206, 73rd Cong., 2d Sess. (1934).

Ban," "Senators Urge Nationalization of Arms Plants," "Munition Makers Can't Be Trusted, Probers Declare."

Of cost-plus-percentage-of-cost contracts, the Munitions Investigating Committee said:²³

"The Committee finds: . . . that the record of the present ship-building companies during the war wherever examined, was close to being disgraceful.

"They made considerable profits. On Treasury audits they secured cost-plus contracts and added questionable charges to the cost. They took their profits on these ships after the wartime taxes had been repealed. They secured changes in contract dates to avoid war taxes. They bought from the government, very cheaply, yards which had been built expensively at government costs. In one case this was pre-arranged before the yard was built. One yard did not build necessary additions until it was threatened with being commandeered. Knowingly exorbitant claims were filed against the government for cancellation (of contracts). Huge bonuses were paid to officers. Profits were concealed as rentals.

"After the war was over keels for \$181,247,000 worth of destroyers were laid, which was probably the largest post-war favor done by any government to any munitions group.

"The committee finds no assurance in the wartime history of these companies to lead it to believe that they would suddenly change their spots in the case of another war."

One of the first men to recognize the failure of a stiff excess profits tax to eliminate unconscionable war profits was Bernard M. Baruch, head of the War Industries Board in World War I, and an advisor to President Roosevelt in this war. Testifying before the War Policies Commission, Mr. Baruch had this to say about the excess profits tax as a profit inflation antidote:

"Excess profits (taxes) standing alone have no effect whatever to check inflation. Their only effect is to increase it. Thus twenty per cent of \$500,000 is \$100,000 and 20 per cent of \$1,000,000 is \$200,000. One way to increase \$500,000 profit to \$1,000,000 without increased risk or effort is to double the price. For this reason there is more incentive to increase prices—and, therefore, profits—under an 80 per cent excess profits tax than there is without it. Indeed, the main result of such a system is to induce rapid price increase to absorb the tax. Precisely because it accelerates and in no-wise checks inflation the excess profits tax—without more—offers no cure at all for war evils. On the contrary it aggravates them."

That war profits spiraled in World War I despite heavy taxes and even

²³SEN. REP. No. 944, part 1, 74th Cong., 2d Sess. (1936) 9.

before this country entered the conflict is shown in the following statistics: Profits after taxes as a percentage of sales in the case of sugar companies advanced from 10.2 per cent in 1915 to 19.1 per cent in 1916; industrial chemicals from 12.6 per cent to 20.1 per cent; machinery from 11.1 per cent to 22.7 percent; petroleum products from 18.6 per cent to 35.4 per cent; coke from 13.3 per cent to 81.9 per cent.²⁴

The post-war revelations of huge profits led to wide agreement that in a national emergency every person and every element, whether it be economic or financial, should be conscripted to wage war against the enemy. It also led to wide agreement that profits in the time of war should be limited.

However, it was not until 1934 that the first profit limitation measure was actually adopted by Congress. In that year, the Congress enacted the Vinson Act²⁵ which set profit limits on naval contracts. In 1936 it passed the profit limitations Merchant Marine Act.²⁶ The Vinson Act was subsequently amended limiting profits on naval contracts to 8, 10 and 12 per cent.²⁷

The Vinson Act significantly set a rigid profit limit, despite overwhelming evidence that inflexible profit limits work to the advantage of some companies and to the disadvantage of others.

These earlier experiments with profit control sufficed because the United States was not at war. However, certain members of the Congress had been preparing for profit limitation controls if the United States was involved in the conflict. At the outbreak of the European war Senator Bone introduced a measure²⁸ for himself and forty-nine other senators proposing a 99 per cent excess profits tax on the income of all individuals exceeding \$20,000, and suggested that all corporate income in excess of 6 per cent of an adjusted capital stock value should be confiscated.

Senator Connally in 1939 also introduced a bill²⁹ carrying a top tax rate of 80 per cent for individuals whose surtax net income exceeded \$50,000, and varying schedules for corporations, which were divided into five separate classes for tax purposes. Both the Bone and Connally bills were in line with the proposals made by the War Policies Commission to President Hoover in 1932 to avert recurrence of World War I events, if the United

²⁴Manly, *Have Profits Kept Pace With the Cost of Living?* (1920) 89 ANNALS OF AM. ACAD. OF POLI. & SOC. SCI. 157.

²⁵48 STAT. 503 (1934), 34 U. S. C. §§ 494, 495 (1940).

²⁶49 STAT. 1985 (1936), 46 U. S. C. § 1101 (1940).

²⁷49 STAT. 1926 (1936), 34 U. S. C. § 496 (1940). See Walsh, *History of Profit Limitations on War Contracts, Hearings before Sen. Fin. Subcom. on Sec. 403 of Pub. L. No. 528, 77th Cong., 2d Sess. (1942)* 74.

²⁸SEN. REP. No. 1885, 76th Cong., 1st Sess. (1939).

²⁹SEN. REP. No. 2160, 76th Cong., 1st Sess. (1939).

States again was engaged by enemies. The commission had proposed in that year a war profits tax that would tax profits of individuals and corporations at 95 per cent.

III. RENEGOTIATION—1943 STYLE

With the outbreak of World War II, it soon became apparent that it would be necessary to place contracts for materiel and services in unprecedented volume, and that a very substantial portion of the materiel required for the prosecution of the war would involve items with which both contractors and contracting officers had had no experience. Early in 1942, shortly after I was appointed Chief of the Purchases Branch of the War Department, two developments indicated that the unprecedented nature and volume of war products would lead inevitably to the realization of excessive war profits. Annual financial reports of war contractors began appearing in the newspapers. These reflected tremendously increased profits derived from the defense program of 1941. It became increasingly evident that, with the substantial increase in expenditures for war, corporate profits on war contracts would be even higher than they had been on defense contracts.

A. Beginnings of Renegotiation

In the meantime, the Congress had become concerned about the reportedly large profits being realized by one of the nation's leading contractors, Jack & Heintz, Inc., of Cleveland, Ohio. On March 23, 1942, the House Naval Affairs Committee of Congress conducted a hearing³⁰ on the profits of Jack & Heintz, Inc., at which were divulged facts about officer and employee bonuses and high profits in terms of invested capital, which received a large amount of sensational publicity in the press of the nation. That same night, with other representatives of the Purchases Branch, I met with officials of Jack & Heintz for the purpose of reviewing the firm's contracts with the War Department. The meeting resulted in an agreement on the part of the company to reduce its prices on individual contracts, totaling slightly over \$50,000,000, by an over-all amount slightly in excess of \$10,000,000. This was the first instance of over-all renegotiation of contracts based on anticipated profits in World War II and, so far as I know, the first instance in which a war contractor, through negotiation with representatives of the Government, voluntarily agreed to broad-scale price reductions on its contracts in view of anticipated profits. It was formalized when,

³⁰Hearings before House Naval Affairs Comm. on H. Res. No. 162 (vol. 1; Mar. 23, 1942) 77th Cong., 2d Sess.

under date of April 1, the company furnished us with a detailed schedule of existing contracts with the War Department, showing old and new unit prices on each item and aggregate prices on each contract.

On March 28, another similar meeting was held with the officials of Continental Motors Corporation, which resulted in a voluntary agreement on their part to reduce prices on existing contracts for a total of \$40,000,000. On April 6, a meeting was held with a third company, The Sperry Corporation, whose officials willingly and promptly effected price reductions in the aggregate amount of \$100,000,000.³¹

B. Price Adjustment Board

In the meantime, under date of March 27, a memorandum³² was prepared,

³¹In The Sperry Corporation's Annual Report to its stockholders for 1942, the following statement was made:

"In estimating prices on contracts for many new products developed by the company, it was necessary to provide for a number of contingencies in the manufacture of such products, the contract for some of which ran as long as two years. Results achieved by us in the manufacture of both the newly developed and the standard products have exceeded our expectations. As a consequence, our profits before taxes have been larger than was anticipated or desired. While our over-all margin of profit was somewhat less than the normal peacetime margin, your management was in accord with the prevailing thought that there should be a reduction in rates of profit during the war period. Accordingly, your company was one of the first to propose to the Government a substantial reduction in its anticipated profits on its contracts. Shortly thereafter, Congress passed a law providing for the renegotiation of profits on war contracts. Your management believes that renegotiation is the fairest means of adjusting the profits on contracts for the many and varied types of products being produced for the war. Any flat yardstick would have resulted in many inequities and hardships!"

³²Among other sections in the memorandum are the following:

Operating Policies

The following principles will be observed by the Price Adjustment Board in dealings with contractors:

1. The Board will endeavor to arrange for a readjustment in contract price or to obtain a return of payments made pursuant to a contract to the extent which will result in limiting the contractor to a fair and reasonable profit.

2. In judging the reasonableness of profit, the Board will consider:

(a) the total profit made by the contractor before allowance for federal income and excess profit tax.

(b) the amount of profit per unit based on estimated or actual cost.

3. In determining the estimated or actual cost per unit of performance of the contract, the Board will give consideration to all items of cost, including the following:

A. Factory Cost:

1. Direct materials
2. Direct productive labor
3. Direct engineering labor
4. Miscellaneous direct factory charges
5. Indirect factory expenses

B. Other manufacturing costs

C. Miscellaneous direct expenses

outlining the "Policy and Procedure" of what we described as the War Department Price Adjustment Board. Because this memorandum was prepared one month before the enactment of what was to become known as the Renegotiation Statute, it is interesting to note the similarity between the policies and procedures laid down therein and the policies and procedures prescribed in a Joint Statement of the War, Navy, and Treasury Departments and the Maritime Commission one year later, under date of March 31, 1943.³³ The preamble to the memorandum of the Price Adjustment Board, captioned "Purpose of the Board", reads as follows:

"The Price Adjustment Board will serve as a focal point for the review of contracts existing between the War Department and its contractors. Its duties will be to make sure that the War Department is doing an economical job of purchasing and that contractors are not making excess or unreasonable profits on war orders. In its review of contractor profits the Board will endeavor to eliminate from contractor cost calculations exorbitant items of whatever nature.

"The Board will assist the Services in securing an adjustment in contract prices that will accomplish the foregoing objectives.

"The Board will also serve contractors who feel that their contract prices are such that a likelihood exists that they will make excessive or unreasonable profits. It will invite war contractors finding themselves in this position to consult with it for the purpose of arriving at a fair and equitable voluntary adjustment."

Prescribed principles to be observed by the Board in dealing with contractors, cost factors to be considered in determining the estimated or actual cost per unit of performance of the contract, and general factors to be considered in determining the amount of profit to be viewed as reasonable

D. Indirect engineering expenses

E. Expenses of distribution, servicing and administration

F. Guarantee expenses

4. The Board will in general be guided by the cost accounting system regularly utilized by the contractor, except that the Board will, in appropriate cases, disallow salaries, bonuses or other expenditures which are clearly excessive. * * *

6. In cases where performance has been substantially or wholly completed, consideration will be given to the extent to which the contractor has met or anticipated delivery schedules.

7. The Board shall not be limited to the foregoing factors but may give consideration to any other factors which in its judgment are reasonably applicable.

The Price Adjustment Board function will be completed when an agreement is arrived at with the contractor setting a limiting figure that shall be considered a reasonable profit before federal income and excess profit taxes. From this point forward, it is contemplated that the contractor will renegotiate contracts with the Service or Services involved so as to bring its total profit down to the agreed upon figure.

³³See C. C. H. War Law Service (Govt. Contracts 2) ¶ 27,275.

were identical to those which have been followed consistently by the War Department Price Adjustment Board under the Renegotiation Statute.

Steps had been taken to assemble a Board personnel, and within several weeks a number of business and professional leaders had agreed to serve as members of the first War Department Price Adjustment Board.

C. *The Renegotiation Statute*

During this time, the Congress began consideration of the Sixth Supplemental National Defense Appropriations Act of 1942.³⁴ In the course of the debate on this Act, the House adopted by a vote of 70 to 8 the so-called Case Amendment, placing a 6 per cent profit limitation on war contracts. The amendment was rejected by the Senate.

At the request of the Chairman of the Senate Subcommittee on Appropriations, the Chairman of the War Production Board, and representatives of the War and Navy Departments agreed to submit suggestions to the Subcommittee for a substitute method of preventing excessive profits on war contracts.

Lieutenant General Brehon Somervell, Chief of the Army Service Forces, presented the substitute which was based on the theory that if every contract price could be pre-examined by the parties in the light of actual experience under the contract, it should be possible to eliminate the bulk of excessive profits. No compulsion upon the contractor was contemplated other than that he:

- (1) Furnish adequate data as to actual and legitimate costs; and
- (2) In the light of such data, bargain in good faith, for the purpose of readjusting the contract price.³⁵

In opposing a set profit limitation the Under Secretary of War, Mr. Robert P. Patterson, gave members of the Subcommittee the following reasons:

“(1) *Effect of costs*: In our view, the control of profits is an integral part of the problem of controlling costs and prices, and any method must be evaluated by its effects on all three aspects. From this point of view we feel that renegotiation is far superior to a fixed percentage limitation.

“(2) *Uniformity*: In the second place, a flat percentage limitation does not really achieve its prime objective of uniformity of treatment. Although it allows a fixed uniform per cent of profit on gross sales, this will be most unfair as applied to the diverse types of business engaged in war

³⁴56 STAT. 245, 50 U. S. C. § 1191 (Supp. 1942).

³⁵See *Testimony of Under-Secretary of War Patterson at Hearings before Sen. Fin. Subcom. on Sec. 403 of Pub. L. No. 528, 77th Cong., 2d Sess. (1942) 3.*

work. It takes no account of the fact that in different lines of business the same volume of sales may require widely different amounts of capital, skill, and work, depending on the rate of turnover."

In the course of his testimony, Mr. Patterson emphasized that even if the renegotiation statute were repealed, the Technical Services of the Army and the Army Air Forces would continue their duty of supervising prices of contractors and subcontractors. The obligation would still remain to "buy right" and the task would have to be performed by the services as part of their procurement function.

Section 403,³⁶ enacted April 28, 1942, and thrice amended, provides for adjustment, accomplished through over-all renegotiation of certain war contracts and subcontracts. Renegotiation has been conducted by the Price Adjustment Board of either the Army, Navy, Treasury, War Shipping Administration, Maritime Commission, or Reconstruction Finance Corporation, whichever has generally the dollar preponderance of contracts with the company in question. In large measure this policy has resulted in making assignments by industries, the Office of the Quartermaster General being assigned most of the textile and food contractors, Army Air Forces having most of the aircraft companies, the Surgeon General most of the medical supply contracts, *etc.* In the interest of promoting greater uniformity of treatment, assignment by industries rather than by preponderance of dollar volume of contracts is now being emphasized to a greater extent than in the early stages of renegotiation.

Contractors and subcontractors whose aggregate renegotiable sales are less than \$100,000 in a fiscal year are exempted.³⁷ [For brokers and agents, the exemption is \$25,000.] The War and Navy Departments have suggested that this exemption should be increased to \$500,000. Also exempted are prime contracts and subcontracts made with other federal or local government agencies or a foreign government³⁸ and those which are for the product of a mine, oil, or gas well, or other mineral or natural deposit or timber which has not been processed, refined or treated beyond the first form or state suitable for industrial use.³⁹ Other exemptions include contracts with public utilities and railroads, and contracts for perishable foods.⁴⁰

Excessive profits are determined by an over-all study of a company's financial position. Except for most construction contracts, the profits, past and

³⁶Pub. L. No. 528, § 403, 56 STAT. 245, 50 U. S. C. § 1191 (Supp. 1942).

³⁷*Id.* at (c) (6) (iii).

³⁸*Id.* at (i) (1) (i).

³⁹*Id.* at (i) (1) (ii).

⁴⁰*Id.* at (i) (2) (ii).

prospective, from its contracts are usually taken as a whole rather than by analyzing each individual contract on a unit cost basis. The statute does not confer any authority of renegotiation with respect to profits other than war contracts⁴¹ and all commercial or non-war profits are segregated and no renegotiation with respect thereto takes place. The statute provides that a renegotiation clause shall be inserted in every war contract of \$100,000 or more,⁴² although the omission of this clause on smaller contracts does not of itself exempt them from renegotiation.^{42*}

Perhaps the most important function of renegotiation is to encourage price reductions and increase efficiency. Thus it is that, in determining the margin of profit to which a contractor is entitled, consideration is given to the manner in which his operations compare with those of other contractors with respect to the applicable factors. Among the factors taken into consideration are the following:

- (a) Price reductions and comparative prices.
- (b) Efficiency in reducing costs.
- (c) Economy in the use of raw materials.
- (d) Efficiency in the use of facilities and in the conservation of manpower.
- (e) Character and extent of subcontracting.
- (f) Quality of production.
- (g) Complexity of manufacturing technique.
- (h) Rate of delivery and turnover.
- (i) Inventive and developmental contribution with respect to important war products.
- (j) Co-operation with the Government and with other contractors in developing and supplying technical assistance to alternative or competitive sources of supply and the effect thereof on the contractor's future peacetime business.
- (k) Nature of capital at risk: whether the contractor's or the Government's.
- (l) Timing of contractor's contribution: whether early in the production program at considerable risk or later at less risk.
- (m) Recognition of special problems confronted by high-cost producers whose production is essential despite handicaps beyond the contractor's control.

⁴¹The authority delegated by the statute is limited to the Secretaries of the "Departments." [50 U. S. C. § 1191 (b).] "Departments" is defined in the statute to include only the War, Navy, and Treasury Departments, the Maritime Commission, Defense Plant Corporation, Metals Reserve Company, Defense Supplies Corporation, and Rubber Reserve Company. There is only one Price Adjustment Board for the last four. [*Id.* at (a) (1).]

⁴²*Id.* at (b).

^{42*}See C. C. H. War Law Service (Govt. Contracts 2) ¶ 27,284,50.

- (n) Fair return in relation to sales and to net worth or capital investment.

Consideration is also given to possible increases in cost of materials, imminent wage increases, and the risks assumed by a contractor such as inexperience in new types of production, delays from inability to obtain materials, rejections, spoilage, "cut-backs" in quantities, and guarantees of quality and performance of the product. It is also recognized that a contractor whose pricing policy results in comparatively reasonable profits is entitled to more favorable treatment than a contractor whose pricing policy results in a large amount of unreasonable profits unless this is attributable to reduced costs rather than over-pricing. The contractor who maintains only a reasonable margin of profit is subjected to the risks incident to the performance of a fixed price contract, while the contractor who practices over-pricing usually has taken few, if any, of such risks, for he has an ample cushion to protect himself against rising costs. In the latter case, the profit of the contractor should be adjusted in the direction of the fee that might have been allowed under a cost-plus-fixed-fee contract for the production of similar articles.

The contractor in every instance is given ample opportunity to develop and present facts with respect to all of the above factors, and to any other factors which in his particular case may be relevant to his over-all quality of performance, upon which his profit reward is based.

Excessive profits realized, or likely to be realized, may be eliminated in various ways:⁴³

- (1) By reduction in the contract price of the contract or subcontract, or by other revision in its terms;
- (2) By withholding from amounts, otherwise due to the contractor or subcontractor, any amount of excessive profits;
- (3) By directing a contractor to withhold for the account of the United States, from amounts otherwise due to the subcontractor, any amount of excessive profits under the subcontract;
- (4) By recovery from the contractor or subcontractor, through repayment, credit, or suit of any amount of excessive profits actually paid to him; or
- (5) By any combination of these methods as may be deemed desirable.

Since early this year greater emphasis has been placed on so-called "forward pricing," or periodic checks, in order to reduce costs and thereby eliminate the necessity of recapture of excessive profits. The War Department has set up a separate division to carry out this policy.

⁴³50 U. S. C. § 1191 (c) (2).

The law specifically authorizes final agreements for a specified past or future period when a contractor or subcontractor has renegotiated in good faith and agreed to eliminate excessive profits for such period.⁴⁴ Two provisions effect a statute of limitation on renegotiation. One prohibits renegotiation after one year from the close of the fiscal year in which the contract or subcontract was completed or terminated.⁴⁵ The other authorizes a contractor to file financial and cost statements for a prior fiscal period and obtain clearance under the statute unless notice is received that renegotiation proceedings are to be initiated, and unless proceedings are actually initiated within sixty days after the giving of such notice.⁴⁶

D. Renegotiation vs. Excess Profits Taxes

In the course of debate before Congress and in testimony before various committees, witnesses and some members of Congress predicted disastrous consequences for industry because of operation of the law. The general argument most often given was that the excess profits tax would recapture excessive profits.

Failure of the excess profits tax to prevent profiteering during World War I has been treated above in general terms. Perhaps at this point it would be appropriate to elaborate somewhat on the inability of high taxes to perform the same job renegotiation performs. Testifying before the Naval Affairs Committee of the House of Representatives on June 30 of this year, Mr. Maurice Karker, then Chairman of the War Department Price Adjustment Board, commented as follows:⁴⁷

"A few voices have been heard to suggest that excessive profits should be eliminated by increasing the corporate tax rates, even to the extent of 100% of all profits above stipulated earnings over the earnings of a corporation's base period, with a post-war refund of 10%.

"This suggestion overlooks entirely the inequities which would result from an elimination of capital investment as a base for the determination of taxable earnings; it would reward present inefficiencies because of previous poor earnings irrespective of favorable changes in ownership, management or products or high and effective degree of participation and contribution to the war effort; it would destroy effectiveness toward price reductions but would, on the contrary, encourage high prices; it would make industry unmindful of costs which under such a tax would so largely be paid for by the Government; it would encourage reckless expenditure in the present in the hope of establish-

⁴⁴*Id.* at (c) (4).

⁴⁵*Id.* at (c) (6).

⁴⁶*Id.* at (c) (5).

⁴⁷*Hearings before House Naval Affairs Comm., 78th Cong., 1st Sess. (1943).*

ing added opportunity for earnings in the future; and it would keep subject to renegotiation the many individuals and partnerships who have no base period comparisons, thus creating illogical and unjust discriminations between contractors and inexplicable confusions in procurement."

In essence, renegotiation is part of the procurement function, and is not in any respect a taxing function. Excess profits taxes, moreover, operate too late, and reach only what is left after all payments, costs and expenses by a producer are met. Accordingly, they do not restrain the tendency toward inflation. Renegotiation, on the other hand, should result in a reduction in the amount of money Congress would otherwise have to appropriate, and the Treasury would have to raise either through taxation or increasing the national debt.

Finally, to depend on taxes to eliminate excessive profits would be tantamount to depending on a fixed formula. Neither can eliminate excessive profits without the attendant "cost plus" evils. Neither provides efficiency incentive.

To go from the general to the particular, a few actual examples will emphasize the point. The examples that follow are not at all unusual.

Contractor *A* in 1942 had a net profit after taxes of 125 per cent of invested capital on gross sales equal to 15 times his peacetime average; net profit after taxes was 23 times average peacetime profit. The net profit after taxes of Contractor *B* ran as follows: 1936—\$4,000; 1937—\$7,000; 1938—deficit of \$3,000; 1940—\$4,000; 1941—\$509,000 (1031 per cent of net worth); 1942—\$931,000 (including post-war credit of \$254,000). After taxes Contractor *C* had a 1942 profit of 100 per cent of invested capital equal to 10 times peacetime profit on a gross 15 times peacetime business. Net after taxes of Contractor *D* ran as follows: 1936—\$3,000; 1937—\$10,000; 1938—\$4,000; 1939—\$29,000; 1940—\$21,000; 1941—\$252,000 (225 per cent of net worth); 1942—\$1,519,000 (including post-war credit of \$686,000). These are only a few of a large number of cases of profits which have ballooned tremendously in spite of excess profits taxes but which can be, and have been, brought into reason by renegotiation.

E. Aims of Renegotiation

Two months after their formal organization, the price adjustment boards of the departments issued a statement on policy, emphasizing their recognition of the need of maintaining the profit incentive, the traditional right of American business. The joint statement said:⁴⁸

⁴⁸See C. C. H. War Law Service (Govt. Contracts 2) ¶ 27,275.

"The profit incentive must be maintained in order to obtain more and larger war production. However, there is the obligation to keep prices down and avoid an inflation that could become disastrous. The overall dollar cost of this war must be kept as low as possible to lessen thereby the burden of taxes which the post-war public will pay to carry the rising national debt.

"The right to a reasonable profit is basic. There are abnormal risks and variable factors to be considered in realistically measuring a war contractor's status. Each case presents individual problems. The Boards encourage an uninterrupted, efficient and maximum production of war goods on a low cost basis, and the efficient manufacturer deserves the protection of a reasonable operating profit."

These views of the Boards, and earlier testimony of Mr. Patterson and Maurice Karker, former chairman of the War Department Price Adjustment Board, were supported by a special Senate subcommittee investigating the national defense program.⁴⁹ Its report, dealing with the renegotiation of war contracts said:

"(1) Because of the wartime need for rapid procurement of materials of war, new materials with which there has been no previous manufacturing experience and other articles previously manufactured only in relatively small quantities, some procedure for subsequent price adjustment is necessary and desirable if excessive war profits and costs are to be avoided.

"(2) Taxes alone will not do the job because (a) higher corporate tax rates are likely to encourage higher costs and discourage economical production; (b) no scheme of taxation has been devised which is sufficiently flexible to provide an incentive for efficient low-cost production; (c) a profit percentage which would fairly reward one war contractor with one type of financial structure would provide inordinately excessive profits for a third contractor with a still different financial problem.

"(3) War contractors in most cases can protect themselves against loss by escalator clauses and other contract provisions for contingencies. The people can obtain protection in many cases only through some procedure such as renegotiation.

"(4) Experience has shown 'cost-plus' contracts to be worse than worthless in the effort to prevent excessive costs. They strongly tend to increase costs instead of the reverse."

F. Renegotiation in Action

1. Results of Renegotiation.—The strong opposition expressed by in-

⁴⁹SEN. REP. No. 10, part 5, 78th Cong., 1st Sess. (1943) 2.

dustry to renegotiation has gradually been reduced. Earlier fears have disappeared and in many instances a number of companies have advertised in newspapers of general circulation and in trade journals not only the fact that their war business has been renegotiated, but that they are proud to report that they have attained lower costs of production.

Here are two examples of enlightened corporate public relations:

The annual report of Bendix Aviation Corporation, for the 1942 calendar year said: "The greatly increased volume enabled us to improve efficiency of operations and to reduce profit margins; [and] on the basis of the full year's operations made it possible to return to the government \$65,400,000 in renegotiating this year's contracts."

The 1942 annual report of United Aircraft Corporation said: "The directors and officers wholeheartedly support the principle of renegotiation that wartime contracts awarded under extraordinary war conditions can be adjusted to a fair and reasonable basis." This position was amplified by a joint statement issued by Frederick B. Rentschler, chairman, and Eugene B. Wilson, president of the company, reading, in parts, as follows: "Price reductions, before excessive profits can accrue, tend to keep costs at a minimum. In this respect, renegotiation is superior to a broad profit limitation, which reaches profits only after they accrue and affords no incentive to reduce costs. Renegotiation permits comparison of contractors in terms of relative performance and leads to rewards for performance. . . . It is believed that full acceptance by industry of the principle of renegotiation is to its own interest, as well as that of the public."

The Automotive Council for War Production in its March, 1943 Bulletin said: "Mr. and Mrs. America, however, are not alone in their efforts in saving money so that the cost of the war can be borne. For, at the production front of the automotive industry many sizeable reductions in the cost of war materials are being effected. The price reductions in the cost of war materials are due to savings brought about through improved designs, improved material and through substitution in some cases of equal or better, but less expensive materials."

The Senate subcommittee which investigated renegotiation stated that the results obtained by the War Department Price Adjustment Board were "significant."

Renegotiations of war contracts by the Price Adjustment agencies of the War, Navy, and Treasury Departments and the Maritime Commission through September 30, 1943, resulted in commitments for the elimination of excessive profits in the amount of \$4,747,176,000.

This figure does not include those savings secured through lower prices in successive contracts, not susceptible of accurate measurements or even an approximate estimation, but which are savings undoubtedly many times greater than the measurable recoveries and price reductions in existing contracts making up the figures here presented.

Of the total savings for the 17 months since the authorization of the Price Adjustment Boards and their associated agencies, \$2,262,210,000 represents the recovery of excessive profits realized, and \$2,484,966,000 represents price reductions for future deliveries on existing contracts.

The breakdown by the four agencies was as follows:

	Recoveries	Price Reductions	Total
Army	\$1,500,042,000	\$1,753,874,000	\$3,253,916,000
Navy	684,698,000	683,840,000	1,368,538,000
Treasury	2,890,000		2,890,000
Maritime Commission	74,580,000	47,252,000	121,832,000
Total	\$2,262,210,000	\$2,484,966,000	\$4,747,176,000

The rate of renegotiation is continuing to be substantially accelerated. As of the end of September, written or oral agreements covering 1942 fiscal year prices and profits had been reached with 8,665 war contractors.

The over-all total of \$4,747,176,000 does not tell the story as eloquently as do the individual price reductions obtained for articles ranging from bombers to buttons. Nearly every item which a soldier uses in his training or in battle comes under the scrutiny of the procurement officers, the field or regional offices of the Price Adjustment Board, or the Board itself.

For example, bomber frames in March, 1942, were quoted at \$235,000 each, exclusive of armament, radio equipment, *etc.* By the first quarter of 1943, the price was down to \$160,000.

A small item like forceps cost \$2.75 each in March, 1942, but its price has been reduced to \$2.15 each. It is the constant watch kept on such small costs that will affect the over-all cost of the war and contribute to economy.

The following is a list of typical items used by the Army showing comparative prices for 1942 and 1943. Concurrent with price reductions, quality has improved:

	Current Unit Price	Price for Similar 1942 Period
Bombers (Air frames only)	\$160,000	\$235,000
Fighters (Air frames only)	72,000	84,000
Human Parachutes (Assembly)	70	90
Cargo Parachutes (Assembly)	40	65

Airplane Engines	8,000	15,900
50-Calibre Machine Guns	300 ⁵⁰ (approximate)	935
Attack Bomber (Air frames only)	64,000	81,000
Automatic Pilots	2,200	4,500
X-Ray Field Unit	487	589
Forceps	2.15	2.75
Sulphadiazine	11.25	20.80

For about a year after the enactment of Section 403, *supra*, criticism was levelled at the statute because renegotiation was novel, although the armed services had practiced price review in their procurement functions for many years. The House subcommittee investigation, however, brushed away most of the criticism, but suggested that some changes were necessary to obtain uniformity of practice among the Price Adjustment Boards.

2. *Principles, Policy and Procedure.*—For some months prior to the issue of the investigation report, the four Boards then operating under the act were engaged in drafting principles, policies and procedures, outlining factors to be considered in determining the existence of excessive profits. Just as Section 403 is considered the *magna charta* against profiteering, so are the principles, policies and procedures agreed upon by the Boards as summed up in a Joint Statement the *magna charta* to assure industry as fair and uniform treatment as is humanly possible.

The Joint Statement said:⁵¹

“In the present emergency the existence of excessive profits does not necessarily indicate that a contractor has taken undue advantage of the government or that the contracting officers have failed to exercise good judgment under all of the circumstances. Companies have been asked to produce war equipment with which neither they nor others have had any previous experience, and in quantities far beyond anything previously contemplated. Under such circumstances the estimate of costs have necessarily been unreliable and when subjected to the test of actual production have often proved to be substantially higher than the actual costs. Consequently, many contractors have been left with profits which they neither anticipated nor wish to retain. The true purpose of renegotiation is to determine, preferably by agreement, the amount of these profits which exceed a fair margin under all the circumstances, and these circumstances are bound to vary in individual cases.”

The statement then outlined general principles to be followed by the four Boards in determining excessive profits. At the outset the Boards point out that the stimulation of quantity production is of primary importance, thereby

⁵⁰Negotiations now under way are expected to reduce the price materially below this.

⁵¹C. C. H. War Law Service (Govt. Contracts 2) ¶ 27,279.

denying once and for all that renegotiation must be considered as a punitive, revenue measure.

The other points made are:

(1) That reasonable profits in every case should be determined with reference to the particular performance factors present without limitation or restriction by any fixed formula with respect to rate of profit, or otherwise.

(2) That the profits of the contractor ordinarily will be determined on his war business as a whole for a fiscal period, rather than on specific contracts separately, with the possible exception of certain construction contracts. Fixed price contracts are negotiated separately from fees on cost-plus-fixed-fee contracts.

(3) That as volume increases the margin of profit should decrease. This is particularly true in those cases where the amount of business done is abnormally large in relation to the amount of the contractor's own capital and company-owned plant, and where such production is made possible only by capital and plant furnished by the Government.

(4) That in determining what margin of profit is fair, consideration should be given to the corresponding profits in pre-war base years of the particular contractor and for the industry, especially in cases where the war products are substantially like pre-war products.

(5) That the reasonableness of profits should be determined before provision for Federal income and excess profits taxes.

(6) That a contractor's right to a reasonable profit and his need for working capital should be distinguished. A contractor should not be allowed to earn excessive profits on war contracts merely because he lacks adequate working capital in relation to a greatly increased volume of business.

IV. CONCLUSION

The most important thing to bear in mind in connection with the renegotiation of war contracts in the United States is that in its administration there has been adopted and followed the guiding principle that its application shall provide incentive and reward for the production of more of the requirements for war, more of everything in relation to the available manpower, facilities and raw materials, at constantly decreasing costs of production and therefore at lower prices; that there shall be greater reward in dollars and in percentage of price to those producers who conserve the supply of strategic materials; who obtain the maximum of output from competent and devoted labor; who make the most of machine tools and other facilities available, and who use power, supervision, overhead and the other elements of production with rigid economy and high efficiency.