EXTENSION OF RENEGOTIATION BOARD

HEARING

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-THIRD CONGRESS

SECOND SESSION

ON

H. R. 6287

AN ACT TO EXTEND AND AMEND THE RENEGOTIATION ACT OF 1951

FEBRUARY 25, 1954

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EXTENSION OF RENEGOTIATION BOARD

THURSDAY, FEBRUARY 25, 1954

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

The committee met, pursuant to call, in room 312, Senate Office Building, at 10 a. m., Senator Eugene D. Millikin (chairman) presiding.

Present: Senators Millikin, Martin, Williams, Flanders, Bennett, George, Hoey, Kerr, Frear, and Long.

Also present: Mrs. Elizabeth B. Springer, chief clerk of the committee.

The CHAIRMAN. The committee will come to order. The meeting has been called today to receive the views of the Renegotiation Board on the bill H. R. 6287, to extend and amend the Renegotiation Act of 1951, which bill was favorably reported to the Senate by the Committee on Finance on July 25, 1953, and is now pending on the Senate Calendar.

The reporter will place in the record at this point a copy of the bill under discussion, as well as the accompanying report of the Committee on Finance.

(The matter referred to follows:)

[H. R. 6287, 83d Cong., 1st sess., Rept. No. 643]

AN ACT To extend and amend the Renegotiation Act of 1951

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 is hereby amended by striking out "December 31, 1953" and inserting in lieu thereof "December 31, 1954."

SEC. 2. (a) Section 105 (f) (1) of such Act is amended by striking out "$250,000" wherever it appears therein and inserting in lieu thereof the following: "$250,000, in the case of a fiscal year ending before June 30, 1953, or $500,000, in the case of a fiscal year ending on or after June 30, 1953".

(b) Section 105 (f) (3) of such Act is amended by inserting, in the second sentence thereof, after "the $250,000 amount" the following: ", the $500,000 amount,".

SEC. 2 *3.* (a) Paragraph (6) of section 106 (a) of such Act is hereby amended by inserting immediately following the second period therein the following: "In designating those classes and types of contracts which shall be exempt and in exempting any individual contract under this paragraph, the Board shall consider as not having a direct or immediate connection with national defense any contract for the furnishing of materials or services to be used by the United States, a Department or agency thereof, in the manufacture and sale of synthetic rubbers to a private person or to private persons which are to be used for nondefense purposes. If the use by such private person or persons shall be partly for defense and partly for nondefense purposes, the Board shall consider as not having a direct or immediate connection with national defense that portion of the contract which is determined not to have been used for national defense purposes. The method used in making such determination shall be subject to approval by the Board."

(b) The amendment made by subsection (a) shall be effective as if it were a part of such Renegotiation Act of 1951 on the date of its enactment.

SEC. ~~3~~ *4.* (a) Paragraph (1) of section 106 (c) of such Act is hereby amended by striking out "from subcontracts" and inserting in lieu thereof "from contracts or subcontracts."

(b) Paragraph (2) of such section 106 (c) is hereby amended to read as follows:

"(2) DEFINITION.—For the purpose of this subsection, the term 'durable productive equipment' means machinery, tools, or other equipment which does not become a part of an end product, or of an article incorporated therein, and which has an average useful life of more than five years."

(c) The amendments made by subsections (a) and (b) shall apply only with respect to fiscal years (as defined in section 103 (h) of the Renegotiation Act of 1951) ending on or after June 30, 1953.

~~SEC. 4. Section 106 (d) of such Act is hereby amended by striking out the period at the end of paragraph (5) and inserting in lieu thereof a semicolon, and by inserting after paragraph (5) the following new paragraph:~~

~~"(6) any contract or subcontract for the making or furnishing of a standard commercial article, if, in the opinion of the Board, competitive conditions affecting the sale of such article are such as will reasonably protect the Government against excessive prices."~~

SEC. 5. (a) Section 106 (a) of such Act is hereby amended by striking out the period at the end of paragraph (7) and inserting in lieu thereof a semicolon, and by inserting after paragraph (7) the following new paragraph:

"(8) any contract or subcontract for the making or furnishing of a standard commercial article, unless the Board makes a specific finding that competitive conditions affecting the sale of such article are such as will not reasonably protect the Government from excessive prices. For the purpose of this paragraph—

"(A) The term 'article' includes any material, part, assembly, machinery, equipment, or other personal property: and

"(B) The term 'standard commercial article' means an article—

"(1) which is substantially identical in every material respect with an article which was manufactured and sold, and in general civilian, industrial, or commercial use, prior to June 1, 1950, or

"(2) which is substantially identical in every material respect with an article which is manufactured and sold, as a competitive product, by more than one manufacturer, or which is an article of the same kind and having the same use or uses as an article manufactured and sold, as a competitive product, by more than one manufacturer, or

(3) which is the subject of any prime contract entered into pursuant to competitive bidding.

"An article made in whole or in part of substitute materials but otherwise identical in every material respect with the article with which it is compared under clause (1) or (2) shall be considered as identical in every material respect with such article with which it is so compared."

(b) The amendment made by this section shall apply only with respect to fiscal years (as defined in section 103 (h) of the Renegotiation Act of 1951) ending on or after June 30, 1953.

SEC. ~~5~~ *6.* Section 201 (h) of the Renegotiation Act of 1951 is hereby amended by striking out "two years" and inserting in lieu thereof "three years".

Passed the House of Representatives July 22, 1953.

Attest:

LYLE O. SNADER, *Clerk.*

[S. Rept. No. 643, 83d Cong., 1st sess.]

RENEGOTIATION ACT OF 1951

The Committee on Finance, to whom was referred the bill (H. R. 6287) to extend and amend the Renegotiation Act of 1951, having considered the same, report favorably thereon with amendments and recommend that the bill do pass.

The amendments are as follows:

Page 1, after line 5, insert:

"SEC. 2. (a) Section 105 (f) (1) of such Act is amended by striking out '$250,000' wherever it appears therein and inserting in lieu thereof the following: '$250,000, in the case of a fiscal year ending before June 30, 1953, or $500,000, in the case of a fiscal year ending on or after June 30, 1953.'

"(b) Section 105 (f) (3) of such Act is amended by inserting, in the second sentence thereof, after 'the $250,000 amount' the following: ', the $500,000 amount,"

Strike out section 4 and insert in lieu thereof the following:

"SEC. 5. (a) Section 106 (a) of such Act is hereby amended by striking out the period at the end of paragraph (7) and inserting in lieu thereof a semicolon, and by inserting after paragraph (7) the following new paragraph:

"'(8) any contract or subcontract for the making or furnishing of a standard commercial article, unless the Board makes a specific finding that competitive conditions affecting the sale of such article are such as will not reasonably protect the Government from excessive prices. For the purpose of this paragraph—

"'(A) The term "article" includes any material, part, assembly, machinery, equipment, or other personal property; and

"'(B) The term "standard commercial article" means an article—

"(1) which is substantially identical in every material respect with an article which was manufactured and sold, and in general civilian, industrial, or commercial use, prior to June 1, 1950, or

"'(2) which is substantially identical in every material respect with an article which is manufactured and sold, as a competitive product, by more than one manufacturer, or which is an article of the same kind and having the same use or uses as an article manufactured and sold, as a competitive product, by more than one manufacturer, or

"'(3) which is the subject of any prime contract entered into pursuant to competitive bidding.

An article made in whole or in part of substitute materials but otherwise identical in every material respect with the article with which it is compared under clause (1) or (2) shall be considered as identical in every material respect with such article with which it is so compared.'

"(b) The amendment made by this section shall apply only with respect to fiscal years (as defined in section 103 (h) of the Renegotiation Act of 1951) ending on or after June 30, 1953."

PURPOSE

Section 1 of the bill amends the Renegotiation Act of 1951 to extend the renegotiation authority for 1 year to December 31, 1954. The present expiration date is December 31, 1953. In addition, the bill provides other amendments to the act which are described hereafter in the report.

GENERAL STATEMENT

1-YEAR EXTENSION

Your committee considers an extension of the renegotiation law necessary, beyond the present expiration date of December 31, 1953, because of the continuing tension in international affairs. The Congress has appropriated vast sums of money which have been and will be obligated for the procurement of needed defense materials and equipment and related purposes. Substantial deliveries and other performance of these defense contracts and subcontracts will continue to be made beyond the current calendar year, so that profits will accrue to contractors, even though the funds involved may have been appropriated and obligated at earlier dates. Unless the Renegotiation Act of 1951 is extended for at least 1 year, then considerable amounts which will be received or accrued by defense contractors and subcontractors during 1954 will not be subject to renegotiation, and the Government will not be adequately protected against the payment of excessive prices in the execution of the national defense program.

The 1951 act is applicable (1) to contracts and related subcontracts with departments named in section 103 (a) to the extent of amounts received or accrued on or after January 1, 1951, and (2) to contracts with departments or agencies designated by the President, to the extent of amounts received on or after the 1st day of the 1st month beginning after the date of such designation. The 1951 act is not applicable to receipts or accruals attributable to performance after December 31, 1953.

Under the bill, renegotiation will not be applicable to receipts or accruals attributable to performance after December 31, 1954.

INCREASING MINIMUM AMOUNT SUBJECT TO RENEGOTIATION

Section 2 of the bill raises the minimum amount subject to renegotiation from $250,000 to $500,000 with respect to fiscal years ending on and after June 30, 1953. This will permit the Board to concentrate on the larger cases, and therefore facilitate administration of the act.

SYNTHETIC RUBBER

Section 3 of the bill amends paragraph (6) of section 106 (a), relating to mandatory exemptions, by providing that in designating classes and types of contracts which shall be exempt under this paragraph, the Board shall consider as not having a direct or immediate connection with the national defense, contracts for furnishing materials or services to be used by the United States, a department or agency thereof in the manufacture and sale of synthetic rubbers to a private person or persons which are to be used for nondefense purposes.

The amendment is necessary to clear up an ambiguity which results from the fact that the Reconstruction Finance Corporation is one of the departments, contracts with which are subject to renegotiation under the Renegotiation Act of 1951. Contracts with the RFC include purchases of materials for the production of synthetic rubber.

However, the synthetic rubber produced in Government-owned plants is sold to private companies for the production of rubber products and only a portion of the production of such private companies ends up in actual Government procurement.

It was obviously the intention of Congress to renegotiate only those contracts having a direct and immediate connection with the national defense.

It was not intended to renegotiate purchases of materials for use in manufacturing rubber destined for ultimate civilian end use. This amendment is intended to clarify the intention of Congress that renegotiation of purchases of materials by RFC for the manufacture of synthetic rubber should apply only to the portion of such purchases that will ultimately be used by one of the Departments covered by the act. The remaining portion of such purchases should be exempt under section 106 (a) (6) of the act.

The amendment is retroactive to the effective date of the 1951 act.

PRIME CONTRACTS FOR MACHINE TOOLS

Section 106 (a) of the 1951 act restricts the renegotiability of subcontracts for durable productive equipment to a proportion of those sales equal to the ratio between 5 years and the average useful service life of the equipment. Section 4 of the bill makes this treatment applicable to prime contracts as well as subcontracts. Under the amendment, if the Government purchases for its own account a $100,000 machine tool having an estimated useful life of 20 years, the portion of the profits subject to renegotiation will be the proportion which 5 years bears to the estimated useful life, which is one-fourth, or $25,000.

Under the bill the amendment would be effective for fiscal years ending on or after June 30, 1953.

The fact that many Government purchases of machine tools at the present are for stockpiling purposes makes this amendment essential. By making sales of this type to the Government, the industry is, in effect, destroying the future market for its products because the eventual release of the Government stockpile will serve to satisfy normal demand. Thus, the amendment merely requires recognition of the fact that defense use can be expected to represent only a portion of the useful life of the equipment sold under prime contracts.

The committee understands that in World War II renegotiation, when machine tools and other durable equipment were sold to private contractors, the sale was treated as renegotiable only to the extent that tools or equipment were to be used in defense production, so that if, for example, the anticipated use in defense production was 60 percent, and in civilian production 40 percent, then 60 percent of the sale price was treated as renegotiable. In adopting section 106 (c) of the 1951 act, the committee did not intend for this percentage of use method of segregating renegotiable sales to be superseded, nor, in the committee's opinion, did the Congress so intend. The initial interpretation of the Renegotiation

Board was otherwise, but after conference with the committee the Board revised its regulations to conform to the intent of Congress as the committee understood it. The committee expects that the same practice will apply under the section as amended in the bill, with respect to sales not made to or on account of the Government.

STANDARD COMMERCIAL ARTICLES

The House bill contained a permissible exemption for standard commercial articles. Your committee amendment provides for a mandatory exemption for standard commercial articles in all cases except where the Board makes a specific finding that competitive conditions affecting the sale of such articles are not such as will reasonably protect the Government against excessive prices. The committee believes that 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. It is believed that in the few cases where renegotiation is necessary to insure the Government against excessive prices, the public interest will be protected by giving the Board authority to make specific findings as to the lack of proper competitive conditions in such cases. The committee amendment contains a definition of standard commercial articles. In general this is patterned after the definition of standard commercial articles in the Renegotiation Act of 1943. However, there is also included in the definition of a standard commercial article an article which is the subject of any prime contract entered into pursuant to competitive bidding. It is believed that the prices of articles furnished pursuant to a contract with the Government awarded as a result of competitive bidding will not be excessive except in rare cases and in such rare cases the exemption will not apply where the Board makes a specific finding that competitive conditions affecting the sale of such articles are such as will not reasonably protect the Government against excessive prices.

SUBSTITUTION OF PARTIES UNDER WORLD WAR II RENEGOTIATION ACT

The bill in section 6 extends for 1 additional year the time in which the United States can be substituted for the World War II Contract Price Adjustment Board in suits before the Tax Court. If this extension is not granted, a number of suits now pending in that court will be subject to dismissal on a technicality rather than on the merits. Under existing law the substitution was required to be made within 2 years after March 23, 1951, the effective date of the Renegotiation Act of 1951.

TECHNICAL EXPLANATION OF THE BILL

SECTION 1

Subsection (a) of section 102 of the Renegotiation Act of 1951 provides that title I of that act shall not apply to receipts or accruals attributable to performance after December 31, 1953. The first section of the bill would change this date to December 31, 1954.

SECTION 2

This section amends section 105 (f) of the Renegotiation Act of 1951 by striking out the minimum exemption from renegotiation of $250,000 and substituting therefor an exemption of $500,000. This amendment is applicable to fiscal years ending on or after June 30, 1953.

SECTION 3

Subsection (a) of section 106 of the Renegotiation Act of 1951 contains mandatory exemptions from renegotiation. Paragraph (6) exempts any contract which the Renegotiation Board determines does not have a direct and immediate connection with the national defense. It requires the Board to prescribe regulations designating those classes and types of contracts which are exempt and (in accordance with regulations prescribed by it) to exempt any individual contract not falling within any such class or type if it determines that such contract does not have a direct and immediate connection with the national defense.

Section 3 (a) of the bill amends paragraph (6) so as to require the Board, in designating those classes and types of contracts which shall be exempt and

in exempting any individual contract under the paragraph, to consider as not having a direct or immediate connection with national defense any contract for the furnishing of materials or services to be used by the United States, a department (as defined in section 103 (a) of the Renegotiation Act) or agency thereof, in the manufacture and sale of synthetic rubbers to a private person or to private persons which are to be used for nondefense purposes. If the use by such private person or persons is partly for defense and partly for nondefense purposes, the Renegotiation Board is required to consider as not having a direct or immediate connection with national defense that portion of the contract which is determined not to have been used for national-defense purposes. The method used in making such determination is to be subject to approval by the Renegotiation Board.

The amendment made by section 3 of the bill is to be effective as if it were a part of the Renegotiation Act of 1951 on the date of its enactment.

SECTION 4

Subsection (c) of section 106 of the Renegotiation Act of 1951 provides a partial mandatory exemption for new "durable productive equipment" which is defined, in general, to mean machinery, tools, or other equipment which does not become a part of an end product. Under existing law the exemption applies to receipts and accruals (other than rents), from subcontracts for new durable productive equipment but does not apply to receipts and accruals from contracts for the same items when furnished to the Government.

Subsections (a) and (b) of section 4 of the bill make the changes which are necessary to extend the existing exemption that applies to subcontracts so that it will also apply to contracts with the Government. Under subsection (c) of section 4 of the bill the amendments made by subsections (a) and (b) will apply only with respect to fiscal years (as defined in section 103 (h) of the Renegotiation Act of 1951) which end on or after June 30, 1953. Section 103 (h) of the act defines the term "fiscal year" to mean the taxable year of the contractor or subcontractor under chapter 1 of the Internal Revenue Code, except that where any readjustment of interest occurs in a partnership as defined in section 3797 (a) (2) of such code, the fiscal year of the partnership or partnerships involved in such readjustments is determined in accordance with regulations prescribed by the Renegotiation Board.

SECTION 5

Your committee amendments add to the list of mandatory exemptions contracts or subcontracts for the making or furnishing of a standard commercial article unless the Board makes a specific finding that competitive conditions affecting the sale of such articles are such as will not reasonably protect the Government from excessive prices. Standard commercial articles are specifically defined in section 5 of the bill.

SECTION 6

Substitution of parties, see first part of report.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

"RENEGOTIATION ACT OF 1951

"SEC. 102. CONTRACTS SUBJECT TO RENEGOTIATION.

"(a) IN GENERAL.—The provisions of this title shall be applicable (1) to all contracts with the Departments specifically named in section 103 (a), and related subcontracts, to the extent of the amounts received or accrued by a contractor or subcontractor on or after the first day of January 1951, whether such contracts or subcontracts were made on, before, or after such first day, and (2) to all contracts with the Departments designated by the President under section 103 (a), and related subcontracts, to the extent of the amounts received or accrued by a contractor or subcontractor on or after the first day of the first month beginning

after the date of such designation, whether such contracts or subcontracts were made on, before, or after such first day; but the provisions of this title shall not be applicable to receipts or accruals attributable to performance, under contracts or subcontracts, after December 31, [1953] *1954*.

* * * * * * *

"SEC. 105.

"(f) MINIMUM AMOUNTS SUBJECT TO RENEGOTIATION.—

(1) IN GENERAL.—If the aggregate of the amounts received or accrued during a fiscal year (and on or after the applicable effective date specified in section 102 (a)) by a contractor or subcontractor, and all persons under control of or controlling or under common control with the contractor or subcontractor, under contracts with the Departments and subcontracts described in section 103 (g) (1) and (2), is not more than [$250,000], *$250,000, in the case of a fiscal year ending before June 30, 1953, or $500,000, in the case of a fiscal year ending on or after June 30, 1953*, the receipts or accruals from such contracts and subcontracts shall not, for such fiscal year, be renegotiated under this title. If the aggregate of such amounts received or accrued during the fiscal year under such contracts and subcontracts is more than [$250,000], *$250,000 in the case of a fiscal year ending before June 30, 1953, or $500,000, in the case of a fiscal year ending on or after June 30, 1953*, no determination of excessive profits to be eliminated for such year with respect to such contracts and subcontracts shall be in an amount greater than the amount by which such aggregate exceeds [$250,000], *$250,000, in the case of a fiscal year ending before June 30, 1953, or $500,000, in the case of a fiscal year ending on or after June 30, 1953.*

* * * * * * *

"(3) COMPUTATION.—In computing the aggregate of the amounts received or accrued during any fiscal year for the purposes of paragraphs (1) and (2) of this subsection, there shall be eliminated all amounts received or accrued by a contractor or subcontractor from all persons under control of or controlling or under common control with the contractor or subcontractor and all amounts received or accrued by each such person from such contractor or subcontractor and from each other such person. If the fiscal year is a fractional part of twelve months, [the $250,000] *the $500,000* amount and the $25,000 amount shall be reduced to the same fractional part thereof for the purposes of paragraphs (1) and (2). In the case of a fiscal year beginning in 1950 and ending in 1951, the $250,000 amount and the $25,000 amount shall be reduced to an amount which bears the same ratio to $250,000 or $25,000, as the case may be, as the number of days in such fiscal year after December 31, 1950, bears to 365, but this sentence shall have no application if the contractor or subcontractor has made an agreement with the Board pursuant to section 102 (c) for the application of the provisions of this title to receipts or accruals prior to January 1, 1951, during such fiscal year.

"SEC. 106. EXEMPTIONS.

"(a) MANDATORY EXEMPTIONS.—The provisions of this title shall not apply to—

* * * * * * *

"(6) any contract which the Board determines does not have a direct and immediate connection with the national defense. The Board shall prescribe regulations designating those classes and types of contracts which shall be exempt under this paragraph; and the Board shall, in accordance with regulations prescribed by it, exempt any individual contract not falling within any such class or type if it determines that such contract does not have a direct and immediate connection with the national defense. *In designating those classes and types of contracts which shall be exempt and in exempting any individual contract under this paragraph, the Board shall consider as not having a direct or immediate connection with national defense any contract for the furnishing of materials or services to be used by the United States, a Department or agency thereof, in the manufacture and sale of synthetic rubbers to a private person or to private persons which are to be used for nondefense purposes. If the use by such private person or persons shall be partly for defense and partly for nondefense purposes, the Board shall consider as not having a direct or immediate connection with national defense that portion of the contract which is determined not to have been used for national defense purposes. The method used in making such deter-*

mination shall be subject to approval by the Board. Notwithstanding section 108 of this title, regulations prescribed by the Board, under this paragraph, and any determination of the Board that a contract is or is not exempt under this paragraph, shall not be reviewed or redetermined by the Tax Court or by any other court or agency; or

* * * * * * *

"(c) PARTIAL MANDATORY EXEMPTION FOR DURABLE PRODUCTIVE EQUIPMENT.—

"(1) —IN GENERAL.—The provisions of this title shall not apply to receipts or accruals (other than rents) from *contracts or* subcontracts for new durable productive equipment, except to that part of such receipts or accruals which bears the same ratio to the total of such receipts or accruals as five years bears to the average useful life of such equipment as set forth in Bulletin F of the Bureau of Internal Revenue (1942 edition), or, if an average useful life is not so set forth, then as estimated by the Board.

["(2) DEFINITIONS.—For the purpose of this subsection—

["(A) the term 'durable productive equipment' means machinery, tools, or other equipment which does not become a part of an end product acquired by any agency of the Government under a contract with a department, or of an article incorporated therein, and which has an average useful life of more than five years; and

["(B) the term 'subcontracts for new durable productive equipment' does not include subcontracts where the purchaser of such durable productive equipment has acquired such equipment for the account of the Government, but includes pool orders and similar commitments placed in the first instance by a Department or other agency of the Government when title to the equipment is transferred on delivery thereof or within one year thereafter to a contractor or subcontractor.]

"(2) *Definition.—For the purpose of this subsection, the term 'durable productive equipment' means machinery, tools, or other equipment which does not become a part of an end product, or of an article incorporated therein, and which has an average useful life of more than five years.*

"SEC. 201. (h) SAVINGS PROVISIONS.

"* * * 'but any court having on its docket a case to which the War Contracts Price Adjustment Board is a party, on motion or supplemental petition filed at any time within [two years] *three years* after the effective date of this section, showing a necessity for the survival of such suit, action or other proceeding to obtain a determination of the questions involved, may allow the same to be maintained by or against the United States.'"

The CHAIRMAN. Mr. McConnaughey, will you identify yourself for the record, please?

STATEMENT OF GEORGE C. McCONNAUGHEY, CHAIRMAN, RENEGOTIATION BOARD, ACCOMPANIED BY FRANK L. ROBERTS, JOHN H. JOSS, CHARLES F. MILLS, AND LAWRENCE E. HARTWIG

Mr. MCCONNAUGHEY. My name is George McConnaughey. I am Chairman of the Renegotiation Board.

Mr. Chairman, I would like to make a statement. Speaking on behalf of the Renegotiation Board, we appreciate your committee giving us an opportunity to appear before you to present our comments on H. R. 6287, with recommendations for such additions, deletions, or other modifications of such provisions as we consider desirable. In addition, in an appendix attached to our comments, there are submitted several technical provisions which we recommend as amendments to H. R. 6287 designed to promote the proper and efficient administration of the renegotiation function. As you realize, I have just recently been appointed to the Board, and I would appreciate your permission to have some of the members of the Board answer some of the questions which you may see fit to ask us.

Section 1 of H. R. 6287 provides for an extension of renegotiation for 1 year, to December 31, 1954. The Board considers such action necessary in the public interest.

The CHAIRMAN. Why?

Mr. MCCONNAUGHEY. Because of the continued large defense budget, it is believed that deliveries of defense materials in 1954 will be equally as large as they were in 1953, if not larger. Due to the long lead in contracts in 1950 and 1951, we are just coming into the main part of the impact of the defense effort, the war effort.

The CHAIRMAN. How are you going to work up to the present time?

Mr. MCCONNAUGHEY. Sir, we have approximately 1,750 of the 1951 cases yet to complete, which we have instructed our regional board members in January—when we had them in for a meeting—to dispose of by April or May, if possible. Then we have about 3,110 of the 1952 cases. The 1953 filings are just now coming in. Contractors have until April 1 to file for 1953. They are just in the process of coming in at the present time.

The CHAIRMAN. Do you consider that an efficient record?

Mr. MCCONNAUGHEY. I am speaking personally, now. I consider, in light of the fact that the act was not passed until March 1951, and no members of the statutory board were appointed until October of 1951, that the result was that the statutory board had to set up the regional boards. They had to select the men and train the personnel. They gave contractors until the following June of 1952 before they ever made their first filing.

So, in reality, the act has only been virtually in operation for a year and a half. I think they have done a very creditable job in the light of that. Particularly so in the last 6 months of 1953. Prior to that time, they were averaging about 195 cases per month processed. That jumped up to 456 cases in the last half of 1953, and we expect to maintain that record or better from now on out.

The CHAIRMAN. Tell us something about the flow of your work. Where do these cases originate, and how do they finally get to you?

Mr. MCCONNAUGHEY. We have a list of contractors, some 35,000 or 40,000 of them. They are sent notices to file. Then all their filings come into the main Board here.

The CHAIRMAN. They come directly here?

Mr. MCCONNAUGHEY. Yes.

The CHAIRMAN. Then what do you do with them?

Mr. MCCONNAUGHEY. Then we screen them out.

The CHAIRMAN. Meaning what?

Mr. MCCONNAUGHEY. The ones where, in the judgment of the screening committee, there could be no excessive profits are screened out and nothing more is done with them.

The CHAIRMAN. Do you give the quittance, or what do you give them?

Mr. MCCONNAUGHEY. It is called a letter of clearance. Then, on the balance of them, where there is a question, they go to the regional boards, one of the six boards. Those boards are in Boston, New York, Washington, Detroit, Chicago, and Los Angeles.

The CHAIRMAN. Do they hold hearings?

Mr. MCCONNAUGHEY. Yes, sir. Then they process the case. The accounting department checks the records of the contractor and then

a renegotiator checks into it and talks to the contractor. If they can come to an agreement, it comes before the regional board and that is what you call a bilateral contract.

The CHAIRMAN. Why do you call it a bilateral contract?

Mr. MCCONNAUGHEY. It is an agreement between the parties.

The CHAIRMAN. Bilateral is a fancy word for an agreement; is that right?

Mr. MCCONNAUGHEY. I agree with you; that is correct, but it is an agreement between the parties. As I understand it, at least 90 percent of the determinations are by bilateral agreements or clearances.

The CHAIRMAN. Do they all come here to you for final approval?

Mr. MCCONNAUGHEY. Yes; if they are above $400,000.

The CHAIRMAN. And below that, they are settled finally in the field; is that right?

Mr. MCCONNAUGHEY. That is correct.

Mr. JOSS. That runs about 2 to 1. Two out of three cases that go to the field are finalized in the field.

The CHAIRMAN. Finalized means finished; is that right?

Mr. JOSS. That is right.

The CHAIRMAN. That is another one of those words. All right, go ahead.

Mr. ROBERTS. The $400,000 distinction relates to renegotiable profits. If the renegotiable profits are $400,000 or less, the case is settled by a regional board. If they are more, it comes to the Board in Washington for final review and approval.

The CHAIRMAN. You have nothing to do with those that are lesser in amount?

Mr. ROBERTS. We make a post-audit review.

The CHAIRMAN. What does that mean?

Mr. ROBERTS. We examine the case they have completed to see whether the principles and policies that we have established have been carried out.

The CHAIRMAN. How lengthy a process is that?

Mr. ROBERTS. It varies with the case. It is not a lengthy process.

The CHAIRMAN. Go ahead.

Senator MARTIN. Mr. Chairman, might I ask a question?

The CHAIRMAN. Yes.

Senator MARTIN. Is that $400,000 the amount of the contract or is that profit?

Mr. MCCONNAUGHEY. Profit.

Mr. ROBERTS. Senator Martin, that is the aggregate of profits on all of his contracts delivered in that fiscal year.

Senator MARTIN. I wasn't sure which it was. Do all of them have to come here for approval or can some of them have final approval out in the field boards?

Mr. ROBERTS. Between two-thirds and three-quarters of them have final approval in the field.

The CHAIRMAN. Does the field give a clearance or do you give the clearance?

Mr. ROBERTS. The field gives the clearance in the two-thirds to three-quarters of the cases that I spoke of.

The CHAIRMAN. Do they hold up their clearance until you finalize the thing?

Mr. ROBERTS. They do not?

Mr. MCCONNAUGHEY. No, sir. If the contractor is not in agreement with the regional boards, then they can come to the statutory board in any case, no matter what it is.

The CHAIRMAN. How many of these regional boards do you have?

Mr. MCCONNAUGHEY. Six.

The CHAIRMAN. Where are their headquarters?

Mr. MCCONNAUGHEY. Boston, New York, Washington, Detroit, Chicago, and Los Angeles.

The CHAIRMAN. People from Denver go to Los Angeles; is that right?

Mr. MCCONNAUGHEY. People from Denver go to Los Angeles.

The CHAIRMAN. All the West Coast States go to Los Angeles?

Mr. MCCONNAUGHEY. That is correct.

The CHAIRMAN. Are there any complaints on that?

Mr. MCCONNAUGHEY. I wouldn't know.

Mr. JOSS. Not that we have heard of.

The CHAIRMAN. All right; proceed.

Mr. MCCONNAUGHEY. Section 2 raises the statutory floor from $250,000 to $500,000 for fiscal years ending on or after June 30, 1953. The Board considers such a change desirable, since it will eliminate the necessity of renegotiating many small cases at a relatively high cost to the Government in relation to the sales and profits involved.

However, in view of the lapse of time, the specified date should now be December 31, 1953. This will enable contractors with fiscal years ending on or after December 31, 1953, to make their filings on the new basis and will not affect filings already made.

The CHAIRMAN. Are you proposing specific amendments?

Mr. MCCONNAUGHEY. We are going along with what you propose, except for the time basis. Due to the lapse of time from June 30, 1953, it should be, in the light of the filings of the contractors, December 31. We are going along with what you recommend.

The CHAIRMAN. Will you later offer any amendments?

Mr. MCCONNAUGHEY. Oh, yes.

The CHAIRMAN. And you will offer them specifically in the form in which they are to be enacted into law; is that correct?

Mr. MCCONNAUGHEY. Yes, sir. Mr. Joss will discuss those with you.

Mr. JOSS. We don't have them all ready, but we could submit them very shortly.

The CHAIRMAN. All right.

Mr. MCCONNAUGHEY. Section 3 amends section 106 (a) (6) of the act, relating to mandatory exemptions, by providing that the Board shall consider as not having a direct or immediate connection with the national defense, contracts for furnishing materials or services to be used by the Government in the manufacture and sale of synthetic rubber to private persons for nondefense purposes.

The Board concurs in the desirability of this provision and, by the exercise of its permissive exemption powers, has already taken action consistent therewith. On October 29, 1953, the Board caused to be

published in the Federal Register an amendment of the Renegotiation Board regulations to exempt—

contracts with Reconstruction Finance Corporation for materials and services to be used in the manufacture and sale of synthetic rubber, to the extent that such materials or services are required for the manufacture of synthetic rubber for sale thereof to a private person or private persons for nondefense uses.

This regulatory provision, like the proposed statutory amendment, is retroactive to the effective date of the 1951 act.

Section 5 of the bill provides a mandatory exemption of prime contracts and subcontracts for so-called standard commercial articles in all cases except when the Board makes a specific finding that competitive conditions affecting the sale of such articles are such as will not reasonably protect the Government from excessive prices.

In writing this provision into the bill, your committee altered the House-approved provision which would have authorized the Board, at its discretion, to exempt such contracts and subcontracts if it found competitive conditions sufficiently protective of the interests of the Government.

The committee's attention is invited to the fact that the Board in renegotiation, depends primarily on information supplied by the contractor itself. Rarely could a contractor be expected to admit that it did not supply its product under competitive conditions. In the absence of any such admission, the contractor could not file a report on sales of articles which come under the very broad definition of standard commercial articles set forth in the Senate version.

Therefore, the precondition for Board action under your committee bill would be the development of new sources and means of obtaining information, with the probability that no determination could be made final except after extended controversy and costly litigation.

The administrative burden imposed under the mandatory exemption, as set forth by your acommittee, to obtain information as to the existence of competitive conditions, would be virtually impossible from an administrative standpoint. It should be pointed out that your committee's mandatory exemption and definition of standard commercial articles covers, according to our estimate based on studies made, 60 percent of all defense procurement.

Another serious objection to the proposed exemption is that it would exclude from renegotiation the large nunmber of cases in which sellers of standard commercial articles realize substantial excessive profits solely or chiefly as a result of their expanded sales for defense.

It is obvious that any substantial enhancement of sales of a given product, even if such product is one customarily sold by a contractor through its regular commercial channels in lesser quantities, will usually enable the contractor to realize substantially greater profits by reducing its unit production costs and spreading more widely its fixed charges and overhead. When this results from increased defense procurement by the Government, it is only proper that an appropriate benefit should be passed on to the Government.

While the House provision is less objectionable than that reported to the Senate, the Board does not recommend either of them, and believes that the just and equitable treatment of producers of standard commercial articles can be left to the Board by its proper application of the statutory factors presently contained in the Renegotiation Act of 1951.

The CHAIRMAN. Why does not commercial practice, where it exists, hold these prices within reasonable bounds?

Mr. MCCONNAUGHEY. It could or it could not. Let us assume such a mandatory exemption were put in as proposed in the Senate version.

In the first place, your contractors wouldn't file. They would all consider somebody was in competition with them. We will say that I am in business and I sell 5 million units in a year. Due to the Government business that jumps up to 20 million units. It is sold at the same price it is to everybody else. But due to the impact of the Government work, the overheads are lessened, the unit cost of production is obviously lessened in most all cases, and there are inordinately high profits.

The CHAIRMAN. Do inordinately high profits follow from what you have just said?

Mr. MCCONNAUGHEY. That is right; from the Government business.

Senator BENNETT. Mr. Chairman——

The CHAIRMAN. Senator Bennett.

Senator BENNETT. It also makes another interesting assumption, that the business is operating with a 20-million article capacity, at one-quarter of capacity. If you are going to step the production of an article up from 5 million to 20 million, I would say in most cases, or in practically every case except in the case of a business that was very seriously distressed, at a 5 million production, you have got to increase its capacity. I think it is begging the question to assume that the increase in capacity supplying new facilities automatically reduces unit cost, and I think while this may be the case in some situations, it doesn't automatically follow.

Mr. MCCONNAUGHEY. I agree with that, It doesn't always follow. You are exactly right. Basically, it is a sound principle that when you increase production, your unit cost drops and your overheads are spread.

Senator BENNETT. Sometimes you have to increase your overhead.

Mr. MCCONNAUGHEY. I agree.

Senator BENNETT. In order to multiply your business four times. You can't automatically absorb that, too.

Mr. MCCONNAUGHEY. That, as you well know, is taken into consideration in the factors in renegotiation.

The CHAIRMAN. What I am trying to get at is, assuming competition in the price of a commercial article.

Mr. MCCONNAUGHEY. Are you talking about a quantity discount?

The CHAIRMAN. I am talking about any commercial article where there is competition in commercial, standard-brand articles. Why should it be the subject of renegotiation?

Mr. MCCONNAUGHEY. Just for the reasons I have pointed out, that due to this defense effort, a tremendous amount of business is added.

The CHAIRMAN. I understand.

Mr. MCCONNAUGHEY. And profits quite frequently, in light of the Government business, are brought up to where they are excessive. Now, we are talking about two different things here. As I see this act, it is enacted in an attempt to avoid excessive profits. I don't see where pricing has anything to do with it if there are excessive profits, whether it is a standard commercial article or not.

The CHAIRMAN. Why won't competition take care of that?

Mr. McCONNAUGHEY. Competition does not take care of it if the Government impact increases that business many, many fold, and due to the Government business solely, you have profits that are inordinately high.

The CHAIRMAN. Aren't those who are in competition to supply that article not scaling their prices in order to get the business?

Mr. McCONNAUGHEY. At times, yes, and at times, no.

The CHAIRMAN. Doesn't the act give you leeway?

Mr. McCONNAUGHEY. Not under you version. We would have no leeway.

The CHAIRMAN. What does the act say?

Mr. McCONNAUGHEY. Under your version, it is a mandatory exemption, where the contractor doesn't even have to file with us. If he considers he is in competition, he doesn't have to file, and we never know anything about it.

The CHAIRMAN. Would you be entirely defenseless in that kind of case?

Mr. McCONNAUGHEY. We certainly would be entirely defenseless.

The CHAIRMAN. With no application of any kind?

Mr. McCONNAUGHEY. No, there is nothing we can do under your version. Our hands are tied.

The CHAIRMAN. Is that your objection?

Mr. McCONNAUGHEY. That is one of the basic objections. I would think that is fundamentally the objection, Mr. Chairman, that you would be exempting 60 percent of the business. The Government would obviously suffer, because there would be no check as to whether there were excessive profits. There would be no check at all on it.

The CHAIRMAN. If the check were provided, and if the prohibition against renegotiation on commercial articles were continued, except where you found that there was not fair competition, would that satisfy you?

Mr. McCONNAUGHEY. That wouldn't satisfy at all, but I would think that under the permissive version, the permissive exemption of the House, that it would be a lot more likely that the Board would be able to ascertain the facts.

The CHAIRMAN. I don't think you have yet answered. It seems to me unless you have a situation of connivance or monopoly or something of that kind, that assuming that the forces of competition operate, there is a desire among competitors to get the business and a desire to scale prices as necessary to get it. I would like to have an answer to that.

Mr. McCONNAUGHEY. I certainly can give you that. There would be no refund there at all.

The CHAIRMAN. No refund to whom?

Mr. McCONNAUGHEY. To the Government.

The CHAIRMAN. We don't have to secure refunds for the Government. The question is whether the Government has a just refund.

Mr. McCONNAUGHEY. There wouldn't be any just refund.

The CHAIRMAN. If you have complete competition in a field of commercial articles, and if that competition actually operates, the question is, why should the Government have what you call a refund?

Mr. Joss. Even in commercial practice, Mr. Chairman, where there is competition, if you are a very high percentage buyer of the man's

product—let's say you buy one-third of his product—I understand the normal practice to be that you get some sort of a discount.

The CHAIRMAN. Does that increase the price?

Mr. JOSS. No.

The CHAIRMAN. It decreases the price, doesn't it?

Mr. JOSS. Sure.

The CHAIRMAN. If you decrease the price, you are narrowing the field of profit, aren't you?

Mr. JOSS. Certainly.

Senator BENNETT. Mr. Chairman——

The CHAIRMAN. Senator Bennett.

Senator BENNETT. I was just going to make the observation that this is a Government where the right hand doesn't know what the left hand does. Under the Robinson-Patman law it is against the law to make any differentiation between purchasers on price. As a matter of fact, if we obey the Federal law in sales to ordinary commercial customers, the supplier very largely has to be careful to sell them all at the same price. That doesn't apply to the Federal Government.

The Federal Government can buy on the basis of a bid at any price, regardless of the price offered to the commercial customer.

Senator LONG. I am sure Senator Bennett doesn't make that statement with reference to the Louisiana Standard Oil case. I don't believe he has that in mind as a precedent.

Senator BENNETT. I just wanted to demonstrate the fact that you could not automatically assume that a large customer buying a substantial proportion of the output of a manufacturer would automatically get a better price than the other customer.

The CHAIRMAN. I am still confused. He gets a lower price.

Senator BENNETT. Not necessarily.

The CHAIRMAN. Well, that is the point of a quantity discount, isn't it?

Senator BENNETT. But under the Robinson-Patman law, quantity discounts are difficult things to defend.

The CHAIRMAN. But pass the operation of that act, which prevents the dilemma of which you speak, it seems to me that discounts of the type of which we speak narrows the field of profit. That is the purpose of them, isn't it?

Senator BENNETT. The purpose of it is to protect a small buyer against possible competitive advantages handed on to his larger competitor.

Senator LONG. I believe you would find, Senator Bennett, that even under the interpretation "most favorable to small business," under the Robinson-Patman Act, only an unjustifiable quantity discount is considered outlawed.

Senator BENNETT. It has to be deferred on the basis of actual differences in cost.

Senator LONG. Economies to be effected.

Senator FLANDERS. Mr. Chairman, I unfortunately have come in to this a little late, and I don't know just what points have been raised before. I would like to make an inquiry as to whether the intent of the changes proposed by the representatives of the Board in relation to commercial articles is to get prices lower than the private purchasers would get through renegotiation?

If so, why does the Government, in commercial articles, expect lower prices than private business would get under the same conditions?

The CHAIRMAN. The theory is that the emergency or the war causes a vast expansion of business. That, in turn, causes a vast expansion of unit production. The profits on such a vast expansion can be excessive. Am I correct in that; is that your theory?

Mr. MCCONNAUGHEY. Yes. That is true.

The CHAIRMAN. Never mind whether it is true. We are just discussing the theory.

Senator FLANDERS. Is it alleged that that condition exists at the present time?

The CHAIRMAN. That is what we want to hear about next. We have been told that people don't file and, therefore, there is a dearth of information. They don't know whether it exists or not.

Senator FLANDERS. Surely, our Government on the right hand can read the reports of business activity published by the Government on the left hand and come to some conclusions as to whether at the present time extreme activity is producing large profits.

The CHAIRMAN. One would think so. Tell us about that, please.

Mr. ROBERTS. Mr. Chairman, the chairman of the Board has asked me if I can respond to that. First, to the distinguished Senator, I would say we can read the reports of industry, and do.

Senator KERR. The Treasury could read the annual reports that General Motors sends out to its stockholders on how much it made and, therefore, eliminate the necessity for an income tax return.

The CHAIRMAN. Will you have an amendment to remedy that situation?

Senator KERR. I believe the chairman's questions are bringing that out.

The CHAIRMAN. Senator Flanders, will you state your disturbance again?

Senator FLANDERS. I was addressing myself to the question of commercial articles which are purchased in substantially the same manner by Government and private buyers. I was wondering whether in the suggested changes the Government was seeking through renegotiation to get lower prices than private buyers paid and if the suggestion was that the Government's orders so added to the total volume of orders of an industry that inordinate profits were arrived at; I was raising the question as to whether there was any present evidence of those inordinate profits from very high business activity.

The CHAIRMAN. Let's have an answer to that.

Mr. ROBERTS. The answer to that is yes, in certain situations. It is only to review those profits in those situations that we believe we should cover this field at all.

Senator FLANDERS. How do you pick the situations out?

Mr. ROBERTS. From the filings of the contractors.

Senator FLANDERS. Does the contractor say, in effect, "I have had so much private business and so much Government business, or that the Government business is big enough so that it will produce a profit which is much larger than I would otherwise have had"?

How does he lay himself open to renegotiation?

Mr. ROBERTS. He lays himself open by filing the material that we request, which shows the total volume of business that he had in his fiscal year, divided between business generated by the defense effort and business generated by commercial demand. Those three columns of figures are revealing on the problem that you spoke of.

Senator FLANDERS. Now, total business, defense business, and general business, those are the three columns?

Mr. ROBERTS. Yes, sir.

Senator FLANDERS. Do you then go into an analysis to see whether or not the total business, itself, is abnormally large for the particular industry, for the particular business?

Mr. ROBERTS. We do, yes, sir.

Senator FLANDERS. And you make some analysis as to the effect of that on profits?

Mr. ROBERTS. Yes, sir.

Senator FLANDERS. In other words, you do follow the line that if a company has good business from Government orders, it is not entitled to profits which it is entitled to if it has good business from private orders?

Is that the point of view?

Mr. ROBERTS. No, sir.

The CHAIRMAN. Tell us about that.

Mr. ROBERTS. me merely review the profits that result from the procurement of the Government, directly and indirectly for the defense effort. After weighing all of the facts, namely, the volume of business that a contractor has had in a historical period—sometimes we have to go back to 1936 and there is no limit to the extent of our search about that particular business—that will tell us whether or not the procurement of the Government has resulted in a substantial increase in the contractor's business.

Likewise, the profit figures will tell us whether or not the profit has risen.

Senator FLANDERS. Do you think that this is the view or the purpose of the Renegotiation Act as originally conceived. It seems to me like an act for the limitation of profit. My recollection of the original conception was that here were businesses taking contracts for new wartime products which had never been made before, and they made their best guess in making a bid as to how much they ought to charge without full knowledge on the part of both the Government and the business that they couldn't make a good bid and would have to protect themselves by a high one.

Both Government and business gladly and voluntarily subjected themselves to renegotiation under those conditions. It seems to me, sir, that the purposes of the original act are now lost. Perhaps they should be lost. I am not saying they should not be lost, but it seems to me they are lost in the alinement of policy which you are describing and now following.

Mr. ROBERTS. I do not believe so, Senator Flanders. I think what we have done in this discussion has been to segmentize industry. We have been talking solely about the commercial products that find their way into war materiel. The original act of renegotiation embraced commercial products that found their way into war materiel exactly as they do today. There is no distinction, no difference.

Senator FLANDERS. That may have happened very shortly after, but those are not the arguments on which the Renegotiation Act was sold. It may have been a result, but it was not the original purpose of the Renegotiation Act. I am very sure of my ground in saying that.

Mr. ROBERTS. I would like to draw your attention to the fact that when this committee, in 1943, considered the passage of the Renegotiation Act, this problem was given very careful consideration, and after that very careful consideration, no distinction was made as between these two classes of products.

The CHAIRMAN. What two classes of products?

Mr. ROBERTS. I was speaking of commercial products, Mr. Chairman, as contrasted with a tank, for example, or a bullet, or a piece of ammunition or an airplane.

Senator FLANDERS. It still leaves us with the assumption that it is national policy to allow volume to affect profit favorably in private purchasing, but not to allow volume to affect profit favorably in Government purchasing. That seems to be the principle, as you have enunciated it, and I wonder whether the principle is valid.

Mr. ROBERTS. I do not think the principle is valid, and I do not think we have enunciated it. I think what we have said is that we would like to review profits of contractors in this instance——

Senator FLANDERS. Why?

Mr. ROBERTS. To see whether or not there has been an inordinate increase in profit. We did not say that the company could not have a greater profit. I believe, sir, that the implications of your statement were that we would take all of the increased profit due to Government business.

Senator FLANDERS. Oh, no. I am interested in that term "inordinate profit." Is a profit resulting from volume from private orders ordinate, whereas if it comes from Government orders it is inordinate? Just why is the Government asking for this special consideration?

Mr. ROBERTS. Again, I think you are saying that we find any increase in profits inordinate, and I wish to make it clear that we do not.

Senator FLANDERS. If, however, the same profit had arrived from an increase in private business, would you still think the profit which you consider inordinate would be inordinate as a private operation? Do you put yourselves on exactly the same grounds so that you would question the profit from private business?

Mr. ROBERTS. If I were the head of a company and I were procuring from a supplier and I saw the situation of profits that you speak of, I would find them inordinate, just exactly as I would find them inordinate if it were Government business.

Senator FLANDERS. That is, you are prepared to pass judgment on private profits?

Mr. ROBERTS. No, sir; I didn't say that.

Senator FLANDERS. You are prepared to say that the same judgment should be passed on private profits by somebody.

Mr. ROBERTS. Oh, no.

Senator FLANDERS. As you pass on public profits.

Mr. ROBERTS. Oh, my, no, sir, indeed not, by no stretch of the imagination did I say that.

Senator KERR. If I might enlighten the distinguished Senator, I got the intimation from the witness, Mr. Chairman, that he said that if he were the head of a business that was going to be engaging in vast operations, that he might have an inclination to protect himself from being in the position of giving somebody inordinate profits on the business that he was making available and would do so by any legitimate means available to him.

Senator FLANDERS. May I compliment the Senator.

Senator KERR. I must say that I appreciate the compliment, although I didn't understand it and would hesitate to lean too heavily upon it. I gathered from what the witness said that his position was that the Renegotiation Act, either as originally conceived or as later developed through natural processes, was calculated to be an instrumentality of Government to protect Government from being the victim of inordinate profits on the part of those who were enjoying vast Government business, and that it had not been intended—and so far as the witness knows was not supposed—to apply to the profits made by commercial enterprise in their transactions in the field of private commercial enterprise. Is that somewhere near correct?

Mr. ROBERTS. That is exactly correct, sir.

Senator BENNETT. Mr. Chairman, my question probably should be addressed to the Chair. Was this question of separate consideration for standard commercial articles thrashed out at the time the original law was passed, and was the idea of excluding standard commercial articles definitely rejected, or is this a question that has just come into the discussion at this present time?

The CHAIRMAN. I will ask Senator George what his memory on that is.

Senator GEORGE. I think that, originally, we assumed that the standard commercial articles sold under competitive conditions would not give so much trouble. It was the new machine or the new equipment that was being contracted for on which there was no historical basis of its actual value. I don't remember that the original act dealt with standard commercial articles separately; however, my impression is that it did not.

Mr. ROBERTS. That is correct, with one exception. When the law was passed, in the 5 or 6 categories where the Board had permissive power, they were authorized, upon a showing that competitive conditions existed, to exempt from renegotiation some standard commercial articles.

Senator GEORGE. That was permissive?

Mr. ROBERTS. Yes, sir.

Senator GEORGE. And gradually, it evolved here into still a permissive——

Mr. ROBERTS. No, sir.

Senator GEORGE. Not permissive, but it is conditional. The Board must make certain findings before you could renegotiate those profits.

Mr. ROBERTS. Yes, sir. The point is, that under the bill reported out by your committee, the standard commercial article exemption is self-operating, and we wish to point out that we do not think that it is administratively feasible to carry on renegotiation if your provision is enacted into law.

Senator GEORGE. Isn't there an "out" in the amendment that we did pass?

Mr. ROBERTS. No, sir.

Senator GEORGE. Do we not say here that unless the Board makes a specific finding that competitive conditions affecting the sale of such articles are such as will not reasonably protect the Government from excessive prices?

Mr. ROBERTS. Yes, sir. Our point is that it is not administratively feasible. It is self-operating. It says unless the Board makes the determination. The Board's only source of information is that furnished by a contractor when he files, submitting his Government business. Under the Senate provision he would make a determination that he sold an article that was substantially identical to other articles, that it was let under a competitive prime contract, and all other conditions in your definition, and that, therefore, he would not file, and we would have no means of reviewing the amount of business that he did and the amount of profit he made on that business.

Senator KERR. You are saying that you are unable to get the evidence; you would be unable to justify the finding required by the statute?

Mr. MCCONNAUGHEY. We couldn't do it.

Senator KERR. In other words, we have given you a responsibility without giving you any means of meeting it?

Mr. ROBERTS. That is correct.

The CHAIRMAN. What does the law say about the filing?

Mr. ROBERTS. The law says that a contractor shall file on the first day of the fourth month following the close of his fiscal year, under conditions specified by the Board in its regulations.

Senator GEORGE. Hasn't the Board rather wide discretion as to what you could require him to show?

Mr. ROBERTS. I don't believe so, if this particular section is enacted into law.

The CHAIRMAN. Why not? Point out the language which would prohibit the wide discretion of the Board.

Mr. ROBERTS. This is an exemption.

The CHAIRMAN. Where are you reading?

Mr. ROBERTS. I am reading on page 4 of H. R. 6287, report No. 643.

Senator MARTIN. Which line on page 4?

Mr. ROBERTS. The third line:

> Any contractor or subcontractor making or furnishing a standard commercial article, unless the Board makes a specific finding that competitive conditions affecting the sale of such article are such as will not reasonably protect the Government from excessive prices.

Now that, I would like to point out, is No. 8 under the exemptions of Public Law 9.

The CHAIRMAN. What would prevent the Board from making the findings contemplated by that provision?

Mr. ROBERTS. The fact that a contractor who makes and delivers a standard commercial article is exempt from renegotiation unless the Board makes a specific finding that competitive conditions affecting the sale of that article are such as will not reasonably protect the Government from excessive prices.

The CHAIRMAN. How would you have it?

Mr. ROBERTS. If I had it, I would have it that in the Board's discretion, if the contractor could establish the fact that competitive conditions existed, that the Board would grant an exemption for his particular sale of standard commercial articles.

The CHAIRMAN. Would you be willing that that be mandatory?

Mr. ROBERTS. I don't understand that, Mr. Chairman.

The CHAIRMAN. Well, you are asking that the contractor establish the facts about free competition. If he establishes it, that includes renegotiation; is that right?

Mr. ROBERTS. In the discretion of the Board; yes, sir.

The CHAIRMAN. And what would the Board's discretion operate on? Would it be the mere proof of falsity of his charge?

Mr. ROBERTS. Yes; the establishment of the fact that competitive conditions were so operative as to prevent, again, inordinate profits on the Government section of the business.

The CHAIRMAN. And you would have to investigate that?

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. You would have to investigate under the law as it is written?

Mr. ROBERTS. Yes, sir.

Mr. JOSS. I believe, Mr. Chairman, that if something is mandatorily exempt, unless we do something, he is under no obligation to give us any facts and figures with respect to what is mandatorily exempt.

Senator GEORGE. Can't you require him to disclose that information? You got that authority under the act?

Mr. ROBERTS. Not if this provision is written in. We do not think so.

Mr. JOSS. We don't think so. We think there is at least substantial legal doubt.

Senator KERR. May I ask the witness a question?

The CHAIRMAN. Excuse me just a minute. What should be written in here that will preserve your power?

Mr. ROBERTS (reading):

Any contract or subcontract for the making or furnishing of a standard commercial article if, in the opinion of the Board, competitive conditions affecting the sale of such article are such as will reasonably protect the Government against excessive prices.

The CHAIRMAN. That puts the whole thing in the discretion of the Board and it removes the protection from the citizen, it seems to me. Is that what you are advocating?

Mr. ROBERTS. I am not advocating taking protection away from anyone.

The CHAIRMAN. We must deal here with effects, of course. I don't suggest that you do want to take protection away from anybody in a mendacious sense, but the effect of your argument would be the same thing by cutting my throat from ear to ear with good intentions, which leaves me just as badly off as if you did it with a malignant heart.

Senator KERR. As I understand the witness, Mr. Chairman, he is not asking that he be permitted to do that. I think he is asking that he not be required to permit that to be done to the Government.

The CHAIRMAN. I think we are driving at the point, why isn't the Board protected in snooping around and finding that here is a situation where there was not true competition and, therefore, the claim of

the contractor is false. Why hasn't the Board that power? Show us the provisions that take that power away from the Board.

Mr. ROBERTS. Well, in the first place, I do not think the Board wishes to snoop.

The CHAIRMAN. Let's strike the word "snoop," and substitute "investigate," "make inquiry."

Mr. ROBERTS. I appreciate that, Mr. Chairman.

The CHAIRMAN. Look around, and stick its nose into other people's business. Take whatever word you want.

Senator KERR. Mr. Chairman, I don't know why you would want a renegotiation board if it didn't have authority to investigate.

The CHAIRMAN. I think they have to have authority. We are trying to find out whether or not they do have it.

Senator KERR. As I understand the chairman, he was asking them to identify the law that prevented them from doing it.

The CHAIRMAN. That is what I want them to do, because they claim they are prevented.

Senator KERR. As I understand, they don't have that authority unless there is a specific legislative grant giving it to them.

The CHAIRMAN. They say they have no authority to protect themselves against the false claims of the existence of competition. I am trying to find out the basis of that claim. That is the heart of this question.

Senator KERR. When I get around to it I would like somebody to show me the authority or the statute which gives them the right to do that.

The CHAIRMAN. I am perfectly willing that they show that or show the lack of it, telling us one way or the other. You can put any adjectives on it that you want to.

Mr. ROBERTS. I like the word "investigate," Mr. Chairman.

The CHAIRMAN. All right.

Mr. ROBERTS. We think that the fact that this provision is mandatory relieves a contractor of filing information with the Board. If the contractor does not file information with the Board, we do not think that we would have the funds which would be necessary to make an investigation among the Government agencies or any place else we could find the information to determine whether or not that situation should be exempt from renegotiation.

The CHAIRMAN. Then you are not objecting to the principle that articles in free competition should be exempt. You are saying that this will preclude the filing of a report from which you can determine that. Is that your point?

Mr. ROBERTS. Exactly.

The CHAIRMAN. Is that your whole point?

Mr. ROBERTS. That is my whole point.

Senator LONG. Mr. Chairman, I would like to ask the witness the attitude of the Board with regard to common carrier transportation services by water.

It is my understanding that with the Shipping Act of 1916, section 15 requires that the rates be filed with the Federal Maritime Board for standard shipping services and that the Board is empowered to either disapprove, cancel, or modify any agreement if it feels that this rate is discriminatory or that the rates are too high, and that

further with regard to the space contracts issued by the Maritime Service, that the rate is about 40 percent below the usual commodity rate, and that since the outbreak of the Korean emergency these increases have been less than 10 percent, while the standard commodities, the wholesale index, is up substantially more than 10 percent and while the wage rate for seamen is up about 34 percent. In view of the fact that the Government does have some control over this matter and has seen fit to exempt the other common carriers, is there any reason why an appropriate amendment might not be supported by the Board to exempt common carriers in the foreign service?

Mr. McConnaughey. Senator Long, I can just give you my personal opinion and experience with the regulation.

I would say if the steamship companies are subjected to the same regulation as common carriers are with the Interstate Commerce Commission—which I do not know one way or the other—that they should be exempt.

I do not know.

Senator Long. The information I have on this subject indicates that there probably should be renegotiation on tramp steamers. I understand that those rates have increased anywhere from 150 to 200 percent. But with regard to the standard rates filed with the Maritime Commission by the shipping industry and the space cargo contracts, the overall increase is around 9 percent while the wage rate has gone up 34 percent in the industry itself.

That would certainly indicate that the Government regulation had been effective in seeing that there was no undue increase in the rate. I wondered if the board would know of any objection to exempting this particular type of contract.

Mr. Joss. Senator, I don't claim to be an expert in this field, but it is my understanding that the Shipping Act of 1916 is primarily for the purpose of protecting the shipping industry and not for the purpose of protecting the user of shipping space.

However, we do have an expert here by the name of Mr. Clarkson, who was formerly the head of a shipping company and who is presently our chief renegotiator on shipping. If you would care to hear from him we can call him forward.

Senator Long. I certainly would. The particular point I wish he would address himself to is whether the Government is adequately protected as it is. It is my understanding that the board makes the argument that renegotiation is not necessary except in cases where it is necessary to protect the Government in the existence of adequacy.

Already we have exempted, under the ICC, those transportation services that are under the ICC, and the best information I have is that the overall increase in the type of rates that I have in mind is only about 10 percent while the wage increase for seamen was about 34 percent, and further, that even though the act might not have been passed for the purpose of regulating the maritime cargo rates, nevertheless the Board has interpreted that act as giving it the power to reduce any unreasonably high rate or to reduce an unreasonably high rate level.

I wondered if there would be any objection on the part of the Board to amend to exempt the common carriers by water who engaged in foreign commerce.

The CHAIRMAN. You mean reduce it by way of renegotiation?
Senator GEORGE. To exempt it.
The CHAIRMAN. I mean exempt it. They have the power to establish rates for American carriage, but they can consider rates in connection with profits.

STATEMENT OF LEWIS CLARKSON, RENEGOTIATOR, RENEGOTIATION BOARD

Mr. CLARKSON. I say first that not all the rates are subject to even perfunctory regultion.
The operators are required to file with the Maritime Administration a schedule of what they call tariff rates.
The CHAIRMAN. Did you identify yourself for the record?
Mr. CLARKSON. Lewis Clarkson.
The CHAIRMAN. And what is your position?
Mr. CLARKSON. Renegotiator.
They are required to file tariffs for what is called package freight, which is covered by bill of lading shipments. The carriers are not required to file tariffs for space charters.
Senator LONG. Actually the space charter rate is negotiated by the Military Sea Transport Service to get it at a lower rate than the commodity rate, and the testimony is that those rates are 40 percent lower than the commodity rate.
Is that correct?
Mr. CLARKSON. I don't know what testimony you have had, but our actual experience in examining current reports filed by the steamship operators indicates that they are getting more per ton on the space charter rates for Government than they are getting on commercial business per ton. You must understand in the first instance that there is no equivalent for the space charter in commercial practice. That is a peculiar Government instrument. It is not used commercially at all.
So you have nothing with which to compare it. It is a matter of supply and demand. The rates will go up and down, just as they do on time charters. Time charters on liberty vessels went all the way from $1,300 to $2,200 a day due to supply and demand.
There was absolutely no control on those rates at all.
Senator LONG. I have a statement here to the effect that those rates—this is by Lt. Comdr. R. A. Call—to the effect that those rates you have in mind were approximately 40 percent below the established tariff rates.
Now, the Maritime Commission does have some control over those rates.
Mr. CLARKSON. There is no established tariff rate in commercial practice for Government space charter.
Senator LONG. Not for space charter, but for a commodity rate there is, is there not?
Mr. CLARKSON. A commodity rate is usually applied to package freight covered by a bill of lading.
The CHAIRMAN. Senator Long, so the rest of us can follow this, would you mind stating your point?

Senator LONG. Well, the point I have in mind is that with regard to the package rate and the commodity rate, the Maritime Commission requires that the rates be filed with the Government and that the Government have a right to reduce the rates if they are too high.

Now, it is true that there is another way that the Government does business with the common carriers, and that is by contracts for space rates. The testimony and the evidence I have indicate that the contract for space rate, which the Government cannot control, goes at a price 40 percent below the rate, on the average, that the Government can control.

Senator FLANDERS. May I inquire where the renegotiation board comes in to this?

Senator LONG. Because the board has the right to require that these contracts be renegotiated.

Senator FLANDERS. Which contracts?

Senator LONG. Those for ocean shipping, even though the Maritime Commission has the right to control the commodity rates and the rates which the Maritime Commission can't control are running about 40 percent below the commodity rates.

Senator FLANDERS. And they are subject to renegotiation?

Senator LONG. Yes.

Senator FLANDERS. They are lower than the Government's set rate but still subject to renegotiation, is that your point?

Senator LONG. That is correct.

Mr. CLARKSON. I think there is a little confusion as to the type of articles that you are talking about, as to what is being carried by transportation. To clarify it a little, I might say these commodity rates, as you call them, are what are commonly called tariff rates. They cover bill of lading shipments. The carriers are required to file tariffs with the Maritime Administration, but it is merely a perfunctory filing. I know of no cases of where the Commission has found it necessary to lower those rates.

In fact, I don't think they have ever acted in that capacity.

Senator KERR. Do they have that authority?

Mr. CLARKSON. They have the authority, but my understanding is that they only act when they receive a complaint of discrimination.

Then they may investigate it and find to correct any discrimination between one shipper and another. That is one type of rate.

The CHAIRMAN. Let me interrupt again, please. Is your point, Senator Long, that because of the regulation of these rates by some other agency, that the subject should be removed from the jurisdiction of the Renegotiation Board?

Senator LONG. That is my point, Mr. Chairman, that the Federal Maritime Commission takes the position that it has the power to regulate and control these rates. The Interstate Commerce Commission has the right to control carrier rates on all the railroads and therefore they are all exempt from renegotiation.

The Federal Maritime Board has the power to control the rates that I have in mind. I was raising the point that these should probably also be exempted from renegotiation. I say that the evidence tends to support that position because while the wage rate has gone up 34 percent the rates have only gone up around 10 percent.

The CHAIRMAN. What is the position of the board on this? Are you renegotiating Maritime contracts?

Mr. CLARKSON. We renegotiate steamship operations on all cargo carried for defense purposes.

The CHAIRMAN. Do you renegotiate those rates which are prescribed by some other governmental agency?

Mr. CLARKSON. I would like to clarify that point. In the first place, there is a distinct difference between the regulation of rates for railroads, as mentioned by Senator Long, and regulation of rates, so-called, under the Maritime Administration. In the case of railroads, they have a commission which determined the value of that property, its original cost, replacement value, and so forth. They determine the amount of assets usefully employed in that industry. In a rate case they will find what is a general overall return on that amount. Then, the rates are judged accordingly. For long hauls, the rates are adjusted lower. In the case of the steamship industry and the Maritime Administration, no such procedure is provided.

There are several types of rates. In the first instance, there is a little confusion, I think, on the part of Senator Long, in that he is confusing different rates. There is a tariff rate which is for bill-of-lading shipments. Then there is a space charter rate which is used exclusively by the MSTS in making defense shipments.

The CHAIRMAN. What is that?

Mr. CLARKSON. Military Sea Transportation Service, the entity that makes all the contracts for the shipment of defense materials. That space charter rate is not subject to regulation in any way, shape, or form by the Maritime Administration, because it is a type of contract that is peculiar only to the Government operations.

It is not used commercially. Therefore, the supply and demand for that type of space will determine what the rate shall be.

The CHAIRMAN. It is not determined by order of some board?

Mr. CLARKSON. No ratemaking board or any other body.

Senator LONG. If the Government wants to, it can use the bill-of-lading rates, can it not? If MSTS chose to it could use the bill-of-lading rate which is required to be filed with the Federal Maritime Board?

Mr. CLARKSON. Of course, if it is more convenient——

Senator LONG. I am only asking if the Government can use that rate if it wants to. That could be answered "Yes" or "No."

Mr. CLARKSON. You are speaking of the MSTS?

Senator LONG. Yes.

Mr. CLARKSON. MSTS endeavors to use the rate which will produce the most economical rate for the Government.

Senator LONG. Having explained that, will you answer "Yes" or "No," can or cannot the Government use the bill of lading rate if it wants to?

Mr. CLARKSON. I don't see the point of your question because, as I say, it wouldn't use the tariff rate if it could get the space charter rate lower.

Senator LONG. Now, will you answer the question "Yes" or "No"?

The CHAIRMAN. Just a minute, Senator. I think you can answer the question. I think you can answer "Yes" or "No," regardless of

what you think would be the wisdom of the Government's system. Can it do what Senator Long suggests?

Mr. CLARKSON. Certainly.

The CHAIRMAN. All right.

Senator KERR. May I ask a question there at that point? Is this MSTS charged with the responsibility of getting space as cheap as it can?

Mr. CLARKSON. You bet it is.

Senator KERR. Having ascertained that, would it under the law be permitted to pay a higher rate?

Mr. CLARKSON. The supply and demand——

Senator KERR. I say would it be permitted under the law to pay a higher rate than it had found that it could get in the discharge of its duty as prescribed by the law.

Mr. CLARKSON. It could. It has the authority to pay a higher rate.

Senator KERR. Then, if it has the authority to pay the higher rate, it would be just like another branch of the Government that was directed to do something on the basis of the lowest and best bid, and, having obtained it, turning around and giving it to the highest and worst. You are telling me than an agency charged with the responsibility of getting transportation as cheap as it can, after having gotten it on a basis that is 40 percent less than the published rate, would then be operating in accordance with the law if it paid the higher rate?

Mr. CLARKSON. But, Senator, it is not getting it lower than the 40-percent discount, because you are talking about two different things. One is a space charter rate and the other is a package rate.

Senator KERR. I will withdraw, Mr. Chairman. I was trying to help the witness.

Senator LONG. I can make my point very quickly.

The CHAIRMAN. Wait a minute. Give us a couple of illustrations of the difference between a package and a space rate.

Mr. CLARKSON. A package rate would be where a ship would call at a port and pick up half a dozen or more bill of lading shipments, each comprised of a small package. A space charter rate is where you will send to a certain depot for certain material where you want to get it all together and ship it all at one time. You will make a master contract with MSTS with the operator of that line, saying, "From time to time I will be called upon to ship material out of this port. I don't know the quantity because it depends on how we get our material together." So they will say, "We will agree to use 200,000 feet of space, and you will take it in the capacity which you can." Therefore, it becomes an entirely different type of operation than the tariff rate, the straight commercial rate.

The CHAIRMAN. Who makes those contracts?

Mr. CLARKSON. The MSTS.

The CHAIRMAN. According to their judgment of what best rates are?

Mr. CLARKSON. Supply and demand, availability of space on ships, and so forth.

The CHAIRMAN. There is no agency that says you cannot contract for more than so much per cubic foot?

Mr. CLARKSON. None that I know of.

The CHAIRMAN. It is a matter of renegotiation?

Mr. CLARKSON. That is right.

The CHAIRMAN. And they are supposed to protect the interests of the Government.

Mr. CLARKSON. That is right.

The CHAIRMAN. What is the difference in the judgment used in the package rate and the space rate?

Mr. CLARKSON. Difference in judgment?

The CHAIRMAN. Yes. You are the MSTS. You want to send some packages and on the other hand you want to reserve some space. What elements of judgment operate?

Mr. CLARKSON. The elements of judgment are that the MSTS may at the time send by the package rate because there may not be enough material there to make a major shipment or a space cargo shipment. It will not want to call out a gang of 10 men to put a few packages on the ship, so it will ship by the package rate, the regular tariff commercial rate.

The CHAIRMAN. It pays the regular rate in that kind of a deal?

Mr. CLARKSON. That is correct.

The CHAIRMAN. Who establishes that rate?

Mr. CLARKSON. That is a matter of negotiation. The package rate is the tariff rate.

Senator LONG. Here is the point I wanted to get to. The Government has the right to regulate the tariff rate. We will agree upon the term. The Government has the right to regulate the tariff rates. They must be filed with the Federal Maritime Board. The Federal Maritime Board takes the position that it has the right and power to regulate them.

Mr. CLARKSON. If it wishes to exercise it.

Senator LONG. Yes. The rate at which the Government is shipping by space contracts is, by the Government's estimation, about 40 percent below what the tariff rates would be. The Government has the right to regulate the tariff rates. The Government is actually shipping at a cost about 40 percent below that, according to the best information I have. I am relying upon Lt. Comdr. R. A. Call, who is director of the Water Transportation Division of MSTS, in a statement made November 17, 1952.

Mr. CLARKSON. It could be that he is getting a discount slightly below the regular tariff rate for space charter.

Senator LONG. Forty percent is more than slightly.

Mr. CLARKSON. I doubt that very much because I have had the experience, within the last several months, of examining a large number of steamship operators and I have received from the operators the tons shipped of the various categories. So far it indicates that in conjunction, per ton, comparing commercial cargo with space charter, Government shipments, the per-ton revenue for commercial shipments is lower than what they get for their space charter from the Government.

The CHAIRMAN. Do you renegotiate any contracts where the rate is established by a lawful agency in charge of that duty?

Mr. CLARKSON. Actually, Senator, while the Maritime Administration requires the filing of rates, I have not heard of any instances where they have gone into whether or not those rates are fairly established on a fair basis.

The CHAIRMAN. Answer my question, please. Do you renegotiate contracts where the rate is established by some governmental authority authorized to fix the rates?

Mr. CLARKSON. No.

Senator LONG. Is it your feeling that you should renegotiate the rates for common carriers where you have a tariff rate that is subject to control by the Federal Maritime Board?

Mr. MCCONNAUGHEY. That is not my position. I told you my position. If the Federal Maritime Board has the duty to regulate certain rates for steamship companies, I think it is their duty and should be exempted from renegotiation.

Senator LONG. In other words, if the commodity is being shipped at a rate below the rate the Federal Maritime Board has the right to regulate, it should be exempted?

Mr. MCCONNAUGHEY. I can't go that far.

Senator LONG. I would propose an amendment—and I have a copy of the amendment here, if you would like to see it—on the floor or with the chairman of the committee. I discussed this with the chairman about a year ago. I would propose that common carriers by water should not be subject to renegotiation where their rates are below the rates subject to control by the Federal Maritime Board.

Senator BENNETT. Might I ask Senator Long a question? Do you assume that space cargo rates which are not controlled by the filing of rates with the Maritime Board, when those space-cargo rates are below the rates set by the Maritime Board, then should not be renegotiated?

Senator LONG. Yes; that is the position I take, Senator Bennett. The reason I feel that way is that the same principle would apply to the railroads under the ICC. In this instance the Federal Maritime Board has the power to control these rates. Actually, the MSTS, of course, insists on getting rates below the rates filed with the Maritime Board, and I believe it is well that they should do so.

Senator BENNETT. Does the Maritime Board have the power to control space rental rates, or just commodity rates?

Senator LONG. They have the right to control the so-called tariff rate, which I regard as the commodity rate. They have the right to control that. That has to be filed with the Maritime Board.

Senator BENNETT. We have two types of rates here.

Senator LONG. What I am saying is that as long as the charge is below the charge that is subject to control by the Federal Maritime Board, that it should not be subject to renegotiation.

Senator BENNETT. Even though it is negotiated on a space rental basis?

Senator LONG. That is right. It is the same proposition, Senator Bennett, as you determining the rates for shipment by rail. If you find that you are getting your shipments below the cost that the Interstate Commerce Commission would fix as a rail rate, let us say by shipping in bulk cargo or making a contract for a lower amount.

Large amount of rail haulage, that it should not be subject to renegotiation.

Senator WILLIAMS. Isn't one of the differences in this that this tariff rate is more or less established on a local shipment rate, comparable to less-than-carload shipments with the railroads, whereas your contract

shipments or space shipments are where the Government will utilize the entire carrying facilities of that boat?

In other words, they would utilize a solid carload and rates would would automatically be lower on space shipments than on tariff rates, and the fact that they were lower would not mean that they were not too high.

Mr. CLARKSON. There is still another rate in there and another service which we have not mentioned yet. That is the time charter. That calls for the time chartering of the capacity of the entire vessel. The space charter will take one charter or one-half or some fraction of the carrying capacity of that vessel. As the Senator has mentioned, the space charter is equivalent to carload lot shipments, we might say, whereas the commodity rate that the Senator is talking about, Senator Long, is a less-than-carload rate.

So the two rates are not comparable at all. Neither is the rate for time charters, which is on a daily basis where the Government will hire the ship and pay so much a day. Let us say it would be $1,800 a day. That rate is not at all controlled by any agency. It is a matter of negotiation.

Senator LONG. Of course, I wouldn't propose to exempt the time charter.

The CHAIRMAN. Senator Long, let me suggest you submit your amendment to the members of the Board and let the Board give us a written memorandum of its approval or disapproval or any comments that it wishes to make so that we can get ahead.

Senator LONG. Yes. I have it here.

Senator FLANDERS. Mr. Chairman, may I pursue my inquiry a little bit further?

There is only one industry in the country with which I am intimately connected. That comes from 50 years of machine-tool building, lacking 2 months, when I came to this body. For the last of those years, I was the chief executive of that business.

During the years in which I was the chief executive, we established this principle: that we would make no quantity discounts for commercial products; that when we sold a single machine to a man beginning a new business we would charge him no more for the machine than when we sold a hundred machines to General Motors.

Is it fair for me to ask you, sir, whether you consider that enlightened business practice?

Mr. ROBERTS. I would say I do consider it enlightened business practice. I think that each company in this country has a God-given right, if you please, to charge any prices that its management so desires.

Senator FLANDERS. However, would you say that you would desire for the Government price privileges which we do not voluntarily give to General Motors or anybody else, the Government included?

Mr. ROBERTS. I would say, Senator Flanders, that if the Government was a purchaser of a substantial proportion of your output for a year, for use in the defense effort, it should have the right to review your profits based upon your prices, to see that you were not making an inordinate profit based upon your past history and based upon the contributions you had made in producing those machines.

Senator FLANDERS. Now, General Motors, in this case, would feel that the competitive situation protected them. They would not look at our machines alone. They would look at our competitors' machines and compare costs and output and various features and decide that competitively they would prefer to buy our machines at our price.

But there is nothing in that that is good business for the Government, I take it. General Motors feels that they are protected competitively. The Government does not.

Mr. ROBERTS. The Government doesn't feel that it is automatically protected; no, sir.

Senator KERR. Mr. Chairman, may I ask the witness a question there?

The CHAIRMAN. Yes.

Senator KERR. It is entirely possible that the Congress might feel that no matter how much influence General Motors has with the Executive, that its principles are not binding upon the Congress.

Mr. ROBERTS. I would agree with that, sir.

Senator FLANDERS. By the way, the Secretary of Defense got into a little trouble here lately because he awarded a contract to the lowest bidder.

Senator KERR. Are you complaining about it?

Senator FLANDERS. I am not, but there was quite an outcry that went up because the lowest bidder happened to be General Motors.

The CHAIRMAN. Let us assume complete fairness of competition. Let us assume that there is competition, that there is lively competition. Is it your contention that if what you consider to be an inordinate profit develops out of that kind of a field, that it is subject to renegotiation?

Mr. ROBERTS. Mr. Chairman, I would like to answer that by saying that I do feel that it is subject to renegotiation, but that does not imply that there will be a reduction in the price through a refund in renegotiation.

The CHAIRMAN. What, then, does that mean?

Mr. ROBERTS. It means that the Government has a right to review or renegotiate profits from the Government business in that instance.

The CHAIRMAN. Let me ask you this again. Assuming that there is full and free competition and a profit is made which you consider to be a comparatively large profit, do you consider that to be subject to renegotiation?

Mr. ROBERTS. Again, I say it is subject to renegotiation, but I do not wish to imply that under those conditions the board would find that it had to make finding of excessive profits.

The CHAIRMAN. Then, you do no quarrel with the contention that if the article is in free competition, genuine free competition, that it should be renegotiated?

Mr. ROBERTS. I do not, not since I understand you to mean being renegotiated, means to have a refund exacted.

The CHAIRMAN. I am assuming that out of an article in free competition, someone makes a large profit. Do you believe that that should be renegotiated?

Mr. ROBERTS. No, sir, not in the sense that I understand you to mean it.

The CHAIRMAN. Is that the feeling of the Board?

Mr. ROBERTS. I believe so, sir.

The CHAIRMAN. Then, we come back again to the proposition that what you are really fussing about is that you want the contractor to submit the data from which you can take a look at the picture and determine whether there has been free competition and other factors that you take into consideration?

Is that correct?

Mr. ROBERTS. That is correct.

Senator FLANDERS. Mr. Chairman, may I pursue this just a little further? It seems to me this raises a question as to whether any profit under free competition, if it happened to be large, is inordinate. That is a fundamental question. With free competition and a large profit, is that profit inordinate? Is it socially inordinate or is it inordinate from the Government's standpoint? Certainly it is there, and if the Government can reach its hand into it and bring some of it back, is that a good thing, when private purchasers are well content to pay the price under free competition which gives the so-called inordinate profit?

The CHAIRMAN. As I have understood the witness, in that case, assuming free competition, they would not be interested in renegotiating profits. That would be assuming free competition. Am I correct in that?

Mr. ROBERTS. You are, sir.

Senator GEORGE. May I ask a question? I hope it may be pertinent. Assuming a contract is let in a so-called distressed area at a price much higher than competitive bids for the same contract, what are you going to do with that?

Mr. ROBERTS. Fortunately, Senator George, the Congress has given us a law that is very flexible. It permits us to take into account all of the facts and conditions surrounding the production of the war materiel.

Senator GEORGE. I understand that, but I say, what are you going to do with that kind of contract? Are you going to renegotiate it?

Mr. ROBERTS. Yes, sir.

Senator GEORGE. Notwithstanding that it was made in a distress area?

Mr. ROBERTS. Yes, sir. I do not believe that a distress area means that a contractor can keep inordinate profits.

Senator GEORGE. Maybe it is not a practical question. Maybe the whole thing will be shortly a distressed area and it will be all right.

The CHAIRMAN. Let us get it clear in the record who at the present time is required to file an application.

Mr. ROBERTS. Any contractor who has contracts or subcontracts, as defined in our act, that has deliveries in his fiscal year from the aggregate of all deliveries of all such contracts in excess of $250,000.

The CHAIRMAN. He must file that information?

Mr. ROBERTS. Yes.

The CHAIRMAN. What do you call it?

Mr. ROBERTS. We call it a filing.

The CHAIRMAN. Go ahead with your statement.

Mr. MCCONNAUGHEY. Section 4 of the bill extends to prime contracts the partial mandatory exemption of subcontracts for new durable productive equipment, now set forth in section 106 (c) of the act. The

Board doubts seriously the merit and necessity of this provision. Your committee, in its report No. 643 to accompany H. R. 6287, said:

> The fact that many Government purchases of machine tools at the present time are for stockpiling purposes makes this amendment essential. By making sales of this type to the Government, the industry is, in effect, destroying the future market for its products because the eventual release of the Government stockpile will serve to satisfy normal demand.

The Board believes that it would be very difficult to successfully renegotiate other prime contracts if these prime contracts were partially exempted. The Board gives full recognition to the risk of postemergency saturation of the machine-tool market, so that profit margins considered appropriate for items of a less durable nature are not in any case considered relevant with respect to producers of durable goods. In some cases, the proposed exemption might sanction profits greatly in excess of any needed for "cushion" purposes. It would also apply to products which, although durable, are so specialized that they are of value to the Government only and so represent no threat to postemergency business of their manufacturer.

The CHAIRMAN. Senator Flanders, have you any comment on that?

Senator FLANDERS. Of course, I would not say I was instrumental, because we were all instruments, but I strongly backed this provision of the law when it was put in. The durable-goods industry is an unusual industry in that it is subject to feasts and famines, and the feasts and famines in the last 40 years have been generated by Government activity in purchasing for defense and then going out of the market. We could have pursued a business curve which would have more naturally resembled, we will say, the curve of the national production, had it not been for the fact that at times defense requirements required enormous production and then that has dropped off. This provision of section 4 takes that into account and endeavors to make some adjustment for it.

I think the adjustment is justified, particularly in view of the fact that in 2 wars the purchasing authorities of the Government have resolutely refused to think of the machine-tool business as anything but a private business seeking favors, until it suddenly discovered that it is impossible to carry the war on without them.

It has extremes of ups and downs. Our Government generated it and the cushion is necessary.

By the way, Mr. Chairman, at some appropriate point, I want to get back to my original questioning.

The CHAIRMAN. I think this is as good a time as any. Go ahead.

Senator FLANDERS. Let me make these inquiries. With regard to profits, inordinate or normal, and as to whether they are controlled by competition, if there is carried along with the Government purchases a large volume of 50 or 40 percent of private purchases, and if the private purchasers feel that it is a bargain to buy the machinery or other durable goods at that price, to what extent is that evidence of competition where there are no patents involved?

Mr. ROBERTS. I find that a very difficult question to answer. I think competition is not something that you can define in a broad statement. I think it applies in each situation. In your hypothetical case, you say, I believe, that private buyers are willing to pay the price established by that manufacturer.

Senator FLANDERS. They think it is a good bargain.

Mr. ROBERTS. And they, therefore, give him a substantial increase in business, did you say?

Senator FLANDERS. Well, they give him a substantial business under whatever conditions are in existence at the time during which the Government is also purchasing. It is good business for the private purchaser to purchase this product at the manufacturer's prices.

Mr. ROBERTS. I don't know how to answer your question, Senator. I am sorry. The individual situation of existence or nonexistence of competition is something that I think requires a little more study than I could give it in this time.

Senator FLANDERS. You would not, then, feel that the fact that there was a substantial private business indicated that competitively speaking the manufacturer was meeting competition? If it wasn't, we obviously wouldn't have that private business.

Mr. ROBERTS. Not unless it was not available from anybody else.

Senator FLANDERS. Let's assume there was plenty available from everybody else.

Mr. ROBERTS. With that assumption, I would agree with you. May I clarify my answer?

Senator FLANDERS. Yes.

Mr. ROBERTS. I would like to say that the mere presence of good business—and I mean by that large volume—does not automatically mean an absence of competitive conditions.

Senator FLANDERS. We are supposing, then, that an industry is not, as in wartime, full up with orders running 1 and 2 years ahead. We are supposing that there is available to any purchaser a dozen or 25 or 50 different types of machines in this particular field, but that a particular company from which the Government also purchases gets a substantial part of this private business. Is that or is it not prima facie evidence that the producer is meeting competition.

Mr. ROBERTS. Under the conditions you have outlined, I would say that it quite obviously was prima facie evidence that he is meeting competitive conditions.

Senator FLANDERS. Then, I wonder how that affects the standards for your deciding whether or not to renegotiate.

Mr. ROBERTS. It affects it a great deal because in the renegotiation process those facts are ascertained and become known and are given proper recognition.

Senator FLANDERS. Under present conditions with the industry not running full, the prima facie evidence would seem to exist in any case in which the manufacturer was receiving substantial private business along with the Government business, and that raises the question as to how much further than that you have to go.

Mr. ROBERTS. Could the assumption not be made that if the Government were taking a vast amount of that manufacturer's production, assuming that we all agree that he only has a hundred percent capacity?

Senator FLANDERS. During the war we run more than that. All you have to do is run 7 days a week, 24 hours a day, and bring people from a hundred-mile radius in buses. That is all you have to do to get 100 percent capacity. You are probably speaking of workers in a 40-hour week.

Mr. ROBERTS. No; I was speaking of conditions that might have existed last year, whereby second and third shifts were employed, more hours than in the regular 40-hour week were used, to produce badly needed machines, for example, for the production of war materiel.

Senator FLANDERS. Along with that might go the fact that the competitive condition was such last year that in deference to the Government's needs the business failed to take orders which private industry offered. That condition occurred, too. It seems again as though that was an evidence of meeting competition successfully in turning down those orders in large volume.

Mr. ROBERTS. That situation has existed and it is a very serious one, one that we give very careful consideration to because if a machine tool builder, for example, did not take commercial orders and did substitute Government business that was badly needed, he certainly is entitled to very great recognition.

We have a factor called contribution to the defense effort. We would say that was a material contribution and it would have a very decided effect on our decision as to whether or not profits were ordinate or inordinate.

Senator FLANDERS. I think I can end up this line of questioning, Mr. Chairman, unless some other bright thought occurs to me. I would not want to disclaim that possibility.

The general impression I get from this conversation we have had is that inordinate profits are pretty flexible and dubious things. The standards are difficult to set. I just simply want to leave in the record my conviction that under competition, certainly in my old line of business, large profits—which by the way we did not always have—are not inordinate. By definition they are not inordinate if they are gained under competitive conditions in which the industry as a whole is not running full or anywhere near it. That is my benediction, sir.

Mr. ROBERTS. Mr. Chairman, might I make one observation?

Senator FLANDERS. I may reply if you do.

Mr. ROBERTS. I would be glad to have you. The question of deciding on profits, whether or not they are inordinate, is a very difficult one. I think we should note the fact that contractors with whom we have dealt in only two instances have appealed from decisions of our Board to the Tax Court.

The CHAIRMAN. How many cases have you dealt with?

Mr. ROBERTS. 6,276.

The CHAIRMAN. And only two appealed?

Mr. ROBERTS. Two appealed to the Tax Court.

Senator FLANDERS. Mr. Chairman, that is a good record. I think we should say that is a good record. A year ago, and the year before that, there was more justification to be found for this renegotiation of commercial articles than under the present and ensuing business situation if our friends across the pit have their friends justified.

The CHAIRMAN. Now, let's come back to section 4. How do you think section 4 could be fixed up?

Mr. ROBERTS. Mr. Chairman, we do not think that it is necessary because we do think that under the provisions of the law which provide for consideration of all the factors, including the long life and

the saturation of future markets, that the Government procurement of machine tools should remain subject to renegotiation.

The CHAIRMAN. Is that all you have to say on that?

Mr. ROBERTS. Yes, sir.

Senator FLANDERS. In other words, they are against it.

Senator LONG. Do you feel that even in normal peacetimes that the Government procurement of machine tools ought to be subject to renegotiation?

Mr. ROBERTS. I do not, sir.

Senator LONG. Without a war emergency or anything of that sort?

Mr. JOSS. There shouldn't be any renegotiation then, at all.

Mr. MCCONNAUGHEY. There shouldn't be any such thing as renegotiation.

Senator LONG. I wanted to get that straight in my mind.

Mr. MCCONNAUGHEY. Section 5 is a lot more vital than section 4.

The CHAIRMAN. You say the Board gives full recognition to the risks of postemergency saturation of the machine tool market, so that profit margins considered appropriate for items of a less durable nature are not in any case considered relevant with respect to producers of durable goods. What have you been doing in these cases of machine tool manufacturers?

Mr. ROBERTS. We had a delay in that industry, as you will recall, because we had a different interpretation of the partial mandatory exemption put in by this committee. It necessarily delayed the filings. We have just begun to come up with renegotiation in this particular segment of industry.

The CHAIRMAN. Have you completed any cases?

Mr. ROBERTS. Yes, sir.

The CHAIRMAN. What have you done?

Mr. ROBERTS. We have completed 14 out of 33 that I have used as representative.

The CHAIRMAN. With what results?

Mr. ROBERTS. Of the 14, there have been 4 companies that have agreed to a refund of excessive profits under our negotiations with them.

The CHAIRMAN. As to the others?

Mr. ROBERTS. The others have been examined by the Board and we have found that competitive conditions existed and found that the Government did not have any refund coming to it.

The CHAIRMAN. You say it would also apply to products which, although durable, are so specialized that they are of value to the Government only, and so represent no threat to postemergency business of their manufacturer.

Is there much of that?

Mr. ROBERTS. I would hesitate to say how much of it there is. There is some. The wonderful machine-tool industry that exists in this country has developed machines that, for example, will profile a jet-engine blade. They will do many of them at a time. That machine is so special in character that it is not useful for anything else except profiling jet-engine blades.

The CHAIRMAN. Would it not be possible in the law to protect that kind of situation?

Mr. ROBERTS. We think we can protect it in renegotiation.

The CHAIRMAN. It is the difference between your operating as men and operating under the law. That is what I am talking about.

Mr. ROBERTS. Yes.

The CHAIRMAN. Why couldn't there be some provision in the bill giving you the right to renegotiate tools that are so specialized that they won't find their way into the general market in the future?

Mr. ROBERTS. I think it would be a very difficult thing to sort out. We might impose a greater administrative burden on industry than the benefit we might give them.

The CHAIRMAN. Could you do it by way of regulation?

Mr. ROBERTS. I don't know.

The CHAIRMAN. Frankly, I don't believe you have given very good reasons for objecting to the provision in the law as it is, and I am groping around to see whether there is some improvement that we can make.

Mr. ROBERTS. Mr. Chairman, to the best of my limited ability, I will try to do it.

The CHAIRMAN. Do it the best you can.

Mr. ROBERTS. The Government makes a purchase in wartime, as Senator Flanders has pointed out, of a great many billions of dollars worth of durable productive equipment. It buys it in normal situations. It is devoted entirely to the production of war materiel.

The CHAIRMAN. For the present?

Mr. ROBERTS. For the present. When their usefulness ceases or when the production program slackens, the present policy, as I know it—and I have endeavored to acquaint myself with it—is that they will be kept in Government standby facilities for use immediately should another emergency arise. I am saying by that that present plans do not call for selling them back to industry in any quantities or leasing them to industry in any quantities.

The CHAIRMAN. Of course, that can be changed overnight.

Mr. ROBERTS. Yes, sir; it can. That being true, the Government spends billions of dollars for this type of equipment and it is our opinion that we should have the right to review the profits on the sales to the Government rather than a fraction of the sale and profit.

The CHAIRMAN. Despite the fact that we have an enormous load of machine tools that the Government can put out on the market and destroy the people who made those tools?

Mr. ROBERTS. Yes, sir.

Senator FLANDERS. Mr. Chairman, I am willing to assent to the idea that there is a difference between standard and special machinery in this respect.

The CHAIRMAN. That is what I was getting at. I am wondering why you can't have some kind of protective provision there that would permit you to renegotiate the specialized stuff, drawing a distinction between the fact that that won't be put on the market and that this other stuff can be put on the market and probably will be put on the market.

Mr. ROBERTS. I wonder if Senator Flanders could help us by saying whether or not the industry could say, "This is a standard tool," and give us guide limits and quickly come up with a definition of a standard versus a special tool.

Senator FLANDERS. I think standard versus special applies particularly to this section of the act.

The CHAIRMAN. I should think a general definition would be possible in that case. A specialized tool obviously is a tool that can only be used for a special purpose.

Senator FLANDERS. There is one trouble, however, perhaps. You took the example, sir, of the milling machine for jet-turbine blades. Conceivably that can be used on other things too, but it is difficult to conceive of its other use. It does hang over the market if a sudden call comes for another expansion of airplane engine production. I don't know how pertinent that is in your thinking, but it stands ready and I think it should stand there ready and I think the Government should have it there to use. But it is a little bit off side of the standard, or quite a bit off side. I think probably, sir, if you asked me to come down and paid me a sufficient amount not subject to renegotiation for expressing my personal judgment on whether a thing was special or standard, I could express that judgment with satisfaction to myself. I don't know whether I could put it into the law.

The CHAIRMAN. Would you mind brooding on that subject, and brood with whoever is the amendment drafter here, to see if we can't agree on some common language.

Senator FLANDERS. I will brood on a limited number of eggs. This is just one egg?

The CHAIRMAN. Just one. There are many in the nest, but you have a broad coverage. See if you gentlemen can't figure out something and come up with some language and submit it to Senator Flanders. This is not the biggest problem in the world, to find appropriate language to distinguish between a specialized tool and one that is not specialized.

All right, let's get on to section 6.

Mr. MCCONNAUGHEY. I just wanted to say that the balance of the sections are technical amendments. We have no comment on that provision which extends for 1 additional year the time on war contracts. The balance are amendments which we can discuss later on. I think that just about covers it.

The foregoing recommendations of the Renegotiation Board have been cleared with the Bureau of the Budget.

The CHAIRMAN. Thank you very much for appearing.

Our decision was that we would hear the members of the Board and then, if the committee feels further hearings are necessary, we will hear others later on so we are through for the time being.

(The following were subsequently submitted for the record:)

STEPTOE & JOHNSON,
Washington, D. C., March 5, 1954.

HON. EUGENE D. MILLIKIN,
Chairman, Senate Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR MILLIKIN: The Synthetic Organic Chemical Manufacturers Association, whom we represent as general counsel, submitted a written statement to the Senate Finance Committee in support of H. R. 6287 as amended by the committee.

In the statement the association endorsed the mandatory exemption for standard commercial articles inserted in the bill by your committee. For this reason the objections to the standard commercial article exemption voiced by

the representative of the Renegotiation Board at the hearing on February 25, 1954, are of particular interest to us. We respectfully invite your attention to the enclosed memorandum which considers those objections and, we believe, shows them to be quite insubstantial.

Sincerely yours,

DONALD O. LINCOLN.

At the hearing February 25, 1954, on the bill to extend the Renegotiation Act before the Senate Finance Committee, the Renegotiation Board's spokesman stated certain objections held by the Board to the proposed mandatory exemption for standard commercial articles. Those objections are insubstantial as will be briefly shown.

The Board states that the administrative burden imposed by the exemption "to obtain information as to the existence of competitive conditions" would be virtually impossible. It contended that a precondition for Board action "would be the development of new sources and means of obtaining information" with the probability that no determination would be made final except after extended controversy and costly litigation.

These assertions are just not realistic in the light of the actual practice which would be contemplated by the committee's proposed mandatory exemption. The bill as drawn would constitute a finding by the legislature that sales meeting the criteria specified for standard commercial articles are presumed to be made under such conditions as reasonably protect the Government from excessive prices. This presumption, though rebuttable, in general requires no administrative attention on the part of the Renegotiation Board. If the contractor is of the opinion that certain of his sales to the Government fall within the criteria specified in the act, he simly would not include those transactions in his renegotiable sales. Since, as the Board concedes, nearly two-thirds of Government contracts would fall within the standard commercial article's exemption, the application of the exemption would result in many firms not being subject to renegotiation at all. Their total receipts and accruals, excluding the exempt transactions, would fall below the floor of $500,000 which would be established by the bill. Consequently, no attention by the Board would be required to the principles observed by the contractor in segregating renegotiable from norenegotiable sales. The Standard Form of Contractor's Report for Renegotiation in that event requires the completion of items 5 through 10 of the report form. These include a description of the methods used in segregating sales between renegotiable and nonrenegotiable business and a statement as to whether or not the aggregate renegotiable receipts were at or below the statutory floor for renegotiation.

The Renegotiation Board's regulations pertaining to methods of segregating renegotiable and nonrenegotiable sales (sec. 146.3 (a)) provide that sales exempted pursuant to section 106 (a) of the act (under which the standard commercial article exemption would fall if H. R. 6287 is enacted) be excluded from the contractor's determination of receipts or accruals subject to renegotiation. Consequently, no extensive statement in justification of such an exclusion is called for by the form. The submission of the report by the contractor subject to the criminal sanctions of the act is sufficient safeguard to warrant the Board's accepting the determinations of the contractor unless it is otherwise provided with evidence with respect to particular sales sufficient to reject the statutory presumption for the exemption.

A rather simple procedure is now available to the Board in cooperation with other Executive departments of the Government for developing information sufficient for the administration of this exemption. For example, at the time Government contracts are executed, the contracting officer has available to him all of the facts required in the formation of a reasonable judgment that competitive conditions affecting the item under procurement are abnormal. He could send a copy of contracts which he believed such abnormal conditions existed to the Renegotiation Board. The Board in those instances could notify the contractor that on the basis of the information in its possession, the Board considers the contract subject to renegotiation. The contractor, if he is of a contrary view, could then submit data to the Renegotiation Board setting forth any exemption on which he intends to rely with facts to support its application.

If the Board found that the facts submitted by the contractor were not persuasive for the application of an exemption, it would, of course, during renegotiation include in renegotiable sales the receipts of the contractor pertaining to the item under consideration. The contractor, as in the case of

all issues arising under renegotiation, would go all the way through the renegotiation process prior to resorting to an appeal to the Tax Court from the Board's determinations. Conceivably the contractor would be satisfied with the Board's determination of excessive profits, if any; or, weighing the relative costs of litigation in the light of the proposed refund, the contractor might be prepared to close out renegotiation for the year concerned without appealing the single issue concerning the exemption to the Tax Court.

With respect to contracts already in existence, the above procedure, of course, could not be followed. These contracts, however, can be rather easily administered by the Renegotiation Board through establishment of a procedure which would require contractors in submitting reports for renegotiation to identify the articles, contract agencies, and contract numbers on which the standard commercial article exemption is claimed. Listings of such information could periodically be prepared and submitted by the Renegotiation Board to the particular contracting agencies concerned. The procurement authorities of those agencies would be requested to examine the listings and to enter notations on any items upon which they then possess affirmative information indicating doubt as to the propriety of applying the standard commercial article exemption. The Renegotiation Board could then request the contractors concerned in those instances to supply supplemental information justifying the application of the exemption.

The Board's second objection to the standard commercial item exemption is that it would exclude from renegotiation cases in which sellers of such articles "realize substantial excessive profits solely or chiefly as a result of their expanded sales for defense." This objection appears to overlook entirely the essential fact that full effect to savings of this type is given in the procurement process itself. A contracting officer in negotiating the contract for standard commercial articles is armed with full knowledge of the firm prices which have been established through the forces of competition. He realizes at that time that large volume purchases by the Government may make possible substantial savings by the supplier in manufacturing the articles concerned. In the negotiation process he uses this information to advantage, requiring the competing firms to offer reductions from their established prices because of the volume considered. Where several firms are interested in securing the business, the obvious result is an actual reduction to the Government from the firm commercial price based upon the realization by the manufacturer or seller of the latitude for production economies based upon the volume involved. The same process is involved where the procurement is by formal bid pursuant to advertising. Where a number of firms are contending for the Government contract, their margin for price reduction is essentially premised upon their capacity for production economies consistent with the volume under consideration. The basic criteria of the committee in establishing the exemption is more valid than the Board's objection, because the former recognizes that the conditions affecting the sale of the article, including the volume of the article under procurement, the presence of a number of manufacturers contending for the business, and the operation of the normal forces of competition will be a sufficient protection for the Government from payment of excessive prices.

Any thought that the Government should be entitled to unusual concessions in price when it enters the market place under conditions of normal competition by suppliers for the Government's business should be rejected as inimical to the basic philosophy underlying the operation of the American economy.

COVINGTON & BURLING,
Washington, D. C., March 1, 1954.

HON. EUGENE D. MILLIKIN,
United States Senate, Washington, D. C.

DEAR SENATOR MILLIKIN: I should like to supplement my statement of February 13, 1954, about the bill (H. R. 6287) to extend the Renegotiation Act by commenting on certain developments which took place at Thursday's hearing on that bill.

As you know, the National Machine Tool Builders' Association strongly supports section 4 of H. R. 6287, which would eliminate the present discrimination between sales of machine tools to the Government and sales to private contractors for use in defense production. The Renegotiation Board does not directly oppose section 4, but in a prepared statement for your committee, the Board's chairman, Mr. McConnaughey, has said that he "doubts seriously the merit and necessity of this provision." Mr. McConnaughey's reasons were as follows:

"The Board believes that it would be very difficult to successfully renegotiate other prime contracts if these prime contracts were partially exempted. The Board gives full recognition to the risk of postemergency saturation of the machine-tool market, so that profit margins considered appropriate for items of a less durable nature are not in any case considered relevant with respect to producers of durable goods. In some cases, the proposed exemption might sanction profits greatly in excess of any needed for 'cushion' purposes. It would also apply to products which, although durable, are so specialized that they are of value to the Government only and so represent no threat to postemergency business of their manufacturer."

With deference to the Chairman of the Board, we do not believe his "doubts" about section 4 are well founded. It is hard to understand, for example, why "it would be difficult to renegotiate other prime contracts if these prime contracts were partially exempted." The "other prime contracts" referred to do not involve the sale of durable equipment which lasts and fills up the market for years to come. The present act contains a partial exemption for subcontracts for durable productive equipment, and no one would suggest, we believe, that it has led to any difficulties in the renegotiation of other subcontracts. In the absence of section 4, however, it will be practically impossible to renegotiate machine-tool builders having a predominance of prime contract business because they know that under section 106 (c) of the present act, competitors having a predominance of subcontracts are receiving more equitable treatment. Since, according to Mr. McConnaughey, the Board has only completed 14 machine-tool cases, the Board may not appreciate the formidable problem ahead, but the industry knows that it is very serious.

Similarly, we do not believe that the Board has as yet had enough experience in the 14 cases it has completed to know whether, as Mr. McConnaughey suggested, "the proposed exemption might sanction profits greatly in excess of any needed for 'cushion' purposes." We doubt very seriously the existence of any such case, and we should like to stress again that one of the principal purposes of section 4 is to eliminate an unwarranted discrimination between manufacturers who sell predominantly to the Government and those who sell predominantly to private contractors engaged in defense work.

Again, Mr. McConnaughey refers to the fact that the Board gives "full recognition" to the risk of postemergency saturation of the machine-tool market, and we know that this is the Statutory Board's intent. Unfortunately, however, it has not successfully communicated its intent to its renegotiators in the field. But more important, the Board's willingness to recognize "saturation" cannot eliminate or, in any event, has not eliminated the discrimination in the present act between manufacturers selling predominantly to the Government and those selling to prime contractors.

The last "doubt" expressed in Mr. McConnaughey's statement relates to "specialized" machines which "represent no threat to postemergency business." We do not believe that such machines have been purchased by the Government in any significant number, but in the few cases where it can be established that there is "no threat," Senator Flanders indicated that there may be some justification for a limitation of the application of section 4. We understand that the Board is to consult with Senator Flanders about the possibility of an amendment to section 4 relating to such "specialized" machines.

Finally, we should like to call your attention to Mr. Roberts' statement that the Board has thus far settled only four 1951 cases with refunds. This makes it plain that section 4 should be made retroactive to 1951 and 1952. No administrative difficulties can result from such retroactivity, and the discrimination inherent in the present act would be eliminated for those years as well as for 1953 and 1954.

Respectfully,

JOEL BARLOW,
Counsel for National Machine Tool Builders' Association.

STATEMENT SUBMITTED BY JOEL BARLOW, A MEMBER OF THE WASHINGTON LAW FIRM OF COVINGTON & BURLING, AS COUNSEL FOR THE NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION

As counsel for other companies and other industry groups I know they share the views I shall express on the overall problems confronting them in continued renegotiation. Only durable equipment manufacturers, such as machine-tool

builders, are concerned with the principal point of my statement—the enactment of section 4 of H. R. 6287, making it retroactive to 1951 and 1952.

As I believe the committee knows, the National Machine Tool Builders' Association represents virtually all of the country's manufacturers of machine tools. In view of the basic importance of machine tools in any war or defense production effort, the machine-tool industry has a vital interest in emergency legislation of every kind, and as I shall try to explain, it has a particularly vital interest in renegotiation legislation because of the unusually severe impact of this kind of law upon them and all other manufacturers of durable equipment.

The association has, of course, always favored legislation that will fairly and effectively eliminate excessive profits derived from war or other national emergency. I should like to emphasis that I am not here today to discuss the question whether renegotiation is an effectual instrument for eliminating such profits.

I should like to begin by pointing out that there is a distinction, and very important one, between renegotiation in wartime and grave national emergencies and renegotiation in a "guns and butter" economy. In wartime there is no considerable risk that renegotiation, like outright statutory profit limitation, will stifle the incentive to greater war and defense production effort. Moreover, in World War II, at least, renegotiation, although unfair in its impact on certain industries, was reasonably effective—principally because this difficult law was generally well administered and industry, for patriotic and other reasons, was willing to make real concessions with a war on. But it seems to me very plain that renegotiation should have no place in a peacetime economy and only the most limited role in a "guns and butter" economy.

There can be no doubt that the Renegotiation Act of 1951, in its present form and with its broad sweep of provisions affecting directly or indirectly practically all business related in any way to defense procurement, should not be extended. We believe that this committee and the House Ways and Means Committee have very wisely decided that with the return of more competitive conditions and with more knowledgeable procurement by the Defense Department the Renegotiation Act can be limited in its application if it must be extended at all. The President's recommendation that the law be continued does recognize, I am sure, that we must try to make it the kind of a law that can be administered fairly and will not discourage the most efficient and low-cost producers from taking Government contracts.

Thus we are concerned today with the exemption provisions which have very wisely been written into the bill to try to make it fair in its impact and to give some assurance that the cost of Government procurement will not be increased by driving away the most efficient and low-cost producers. The machine-tool industry believes this result can be achieved by the committee's proposal for an exemption for standard commercial items, the proposal to raise the statutory minimum from $250,000 to $500,000 of renegotiable sales, and the provision in section 4 of H. R. 6287 which would extend and expand the present partial mandatory exemption of new durable productive equipment.

The machine-tool industry is vitally interested in section 4 of H. R. 6287. Without it manufacturers of durable equipment simply cannot be fairly renegotiated on a basis comparable to other manufacturers. We do not want preferential treatment—only equal treatment.

As presently written, section 4 would be retroactive to years ending on or after June 30, 1953. We believe that it should be made retroactive to January 1, 1951, the effective date of the Renegotiation Act of 1951. It is already becoming clear in the few decisions made by the Renegotiation Boards in machine-tool cases that without a retroactive application of section 4, it will be impossible for them, as conscientiously as they may try, to do equity and avoid disparity of treatment as between companies and industries.

At this point, I should like to review briefly the history of the renegotiation of the machine-tool industry and especially the history of section 4. As many members of the committee know, the special problems of the machine-tool industry and other durable productive-equipment manufacturers in renegotiation have been brought before this committee and other committees of the Congress a number of times since the period of the first wartime Renegotiation Act, and section 4 must be read against the background of that history.

The basic, all-important fact about the renegotiation of the machine-tool industry is that it manufacturers itself out of business by producing large numbers of durable, long-lived machines in response to the exigencies of war or other national emergency. This is because machine tools last many, many years,

and this volume and surplus is concentrated in the renegotiable period. There are machines in service today which are 30, 40, and even 50 years old, and currently machine-tool builders are filling up their market for these machines for years to come. Of course, the older the machine the less precise its work becomes, and the older machines do not embody the more automatic features of recent models. But old machines nevertheless can be used for operations where high rates of production and close tolerances are not required, and a customer who buys a machine today may not be in the market for a similar machine for many, many years.

During World War II, the machine-tool industry produced more of these durable, long-lived, absolutely essential machines than it had produced in the last 40 years, and, as a result, the postwar machine-tool market was saturated and glutted. The saturation and the glut were of two kinds. First, many of the industry's private customers had many more fairly new machines than they knew what to do with. Such customers were not only out of the market for new machines, but they were quite willing to sell some of their used machines, at sacrifice or scrap prices, just to get them out of the way. But second, and for present purposes just as important, there was a great stockpile of Government-owned machines which was surplus to any foreseeable governmental requirement and which had a most depressing effect on the machine-tool market. Thousands of these machines were sold as war surplus at 10 to 30 cents on the dollar, and when piled on top of the machines in the hands of the industry's private customers, they had the effect of restricting the market for new machines to the barest minimum necessary for the survival of the industry's stronger members. In the resulting machine-tool depression, 38 companies (about 10 percent of the companies in the industry) were sold or liquidated, with a serious loss to the country of vital machine-tool capacity. Others survived only by entering other fields at the expense of their machine-tool capacity.

The irony of the postwar saturation of the machine-tool market is that the industry had predicted it during World War II and had suggested various remedial measures to the Government, including renegotiation exemptions similar to section 4 of H. R. 6287. Very few of its recommendations were followed, largely because it was then thought, as it is by some today, that the industry was unduly alarmed and seeking preferential treatment. But this postwar depression in the machine-tool industry is now a historical fact rather than a prediction, and I think you will agree with the unanimous view of the industry that it points definitely to the likelihood of a similar post-Korean depression in the industry. Actually the proof is here today. It can be seen in the rapidly declining machine-tool backlogs, orders and deliveries.

During World War II, as during the Korean emergency, the machine-tool industry and its members took the position before this committee and in their individual renegotiation cases that machine-tool builders should be allowed to retain their profits for use in tiding them over an inevitable postwar depression which would be directly attributable to their wartime production. This committee understood the problem, and it reported favorably on the so-called Walsh amendment, which provided a 100 percent exemption from renegotiation "for any contract or subcontract for durable machinery, tools, or equipment." [1] Unfortunately, there was a war on, time was of the essence in enacting the new law, and the Walsh amendment was lost in conference. Meanwhile, most renegotiation panels were renegotiating manufacturers of durable productive equipment on a basis not too dissimilar to that accorded manufacturers of mass production "expendable" items. The result was disastrously large renegotiation refunds which weakened the industry, multiplied the difficulties of the postwar depression, and placed serious limitations on funds vitally needed for research and development, all of which contributed to the machine-tool bottleneck which slowed down the defense production effort in the first stages of the Korean emergency.[2]

Actually, the postemergency outlook for the industry is in many respects even more bleak today than after World War II: (1) there is no section 124A telescoping provision for amortization of oxerexpanded plant facilities, and (2) ECA and MSA funds have brought into existence a competitive European machine-tool industry which has moved into established foreign and domestic markets.

[1] 90 Congressional Record 507 (1944); Minority Views of Senators Walsh, La Follette, Connally, and Lucas, S. Rept. No. 627, 78th Cong., 1st sess., pt. 2, 8–9 (1943).
[2] Hearings before a subcommittee of the Select Committee on Small Business, 82d Cong., 2d sess. (1952).

When the Renegotiation Act of 1951 was first before this committee, it recognized the situation I have been describing by reporting favorably on a partial mandatory exemption for new durable equipment. As you know, that partial exemption is contained in section 106 (c) of the Renegotiation Act, the section which would be amended by section 4 of H. R. 6287. As described in the committee report,[3] the exemption was designed to work "rough justice" by providing that certain defense contracts for the purchase of new durable productive equipment should be partly exempt from renegotiation according to a formula based on the ratio between an assumed emergency period of 5 years and the useful life of the equipment. But the partial mandatory exemption expressly excluded prime contracts made directly with the Government and subcontracts made for the account of the Government. At that time the industry did not press the point on prime contracts because neither it nor the Government realized that such a large proportion of machine tools would be bought directly by or on behalf of the Government. The pattern of procurement changed with the result that the Government was the principal purchaser of machine tools and the amendment therefore could not work even "rough justice." A company in New York, for instance, might have practically all prime contracts with no benefit from exemption, while a competitor, say in Michigan, might have the same defense volume but do less business directly with the Government and benefit from the exemption. The purpose of section 4 of H. R. 6287 is to remove this limitation and unreasonable discrimination and place all defense contracts and subcontracts for new durable productive equipment under the exemption. In other words, this long-lived productive equipment in the hands of the Government is, as your report points out, just as serious as in the hands of customers—and even more so since Government stockpiles not only overhang the market but will inevitably and increasingly be leased at low rentals and sold at low prices in competition with the industry.

As was the case at the end of World War II, these Government-owned machines will have just as much and (having in mind the second recurrence of emergency production within a space of 8 or 10 years) even a more depressing effect on the post-Korean market than privately owned machines. As I have emphasized, many of these Government machines will find their way into the commercial market at reduced prices, just as they did in 1946 and 1947. Although a national industrial reserve of first-class machine tools is an essential, the Government now has on hand many machines which will not be required in such a reserve, and the association does not advocate and does not believe that they will be or ought to be scrapped while in good working condition.

The Renegotiation Board may feel that by the recognition of the "saturation of market" factor in their regulations they can in some way ameliorate the unfair impact of the law on durable equipment manufacturers. But as hard and as conscientiously as they try, the evidence is all to the contrary. The law is difficult to administer at best, and where possible, there must be clear and explicit statutory provisions. Take the example I mentioned of the New York manufacturer who has, let us say, $1 million of regenotiable business on prime contracts with no exemption. His competitor in Massachusetts or Michigan may have $1 million of subcontracts, all subject to partial exemption, making his renegotiable sales $250,000. The Board cannot allow the New York manufacturer four times as much profit, nor can the Board without section 4 reduce his renegotiable sales to $250,000. The Board acknowledges this and even goes so far as to say that it cannot even try to correct the disparity of treatment under the statutory factors. They say it is just a plain question of segregation. Nor can the Board fairly renegotiate the New York company on $1 million of sales when another company, perhaps a competitor, with an additional $1 million of defense sales of "expendables," is not renegotiable at all because of other exemptions properly and necessarily included in the law and regulations.

As I have said, the pattern is clear in the few cases which have been decided for 1951 that the Board does not and, under present policy, cannot make up in allowable profit levels for the unfair impact of the statute on durable equipment manufacturers (1) who fortuitously, because of the procurement pattern, have an large proportion of prime contract sales, and (2) who face the same saturation of market problem because of defense produced surpluses.

The problem is further aggravated by the fact that despite the understanding the Renegotiation Board has tried to bring to bear on this difficult problem, the

[3] S. Rept. No. 92, 82d Cong., 1st sess., pp. 7–8 (1951).

regional boards have had to state categorically to contractors that no consideration whatever can be given the competitive disadvantage of the manufacturer with prime contracts, and no exemption. They have also said, despite plain evidence to the contrary, that they do not believe "saturation of market" is a serious problem for the industry. The only solution is the extension of the partial exemption formula to prime contracts as provided in section 4.

There is one further point involving the Board's present interpretation of section 106 (c) which will be cleared by the enactment of H. R. 6287 and the retroactive application of section 4 to 151 and 1952. The Board has taken the position in a ruling dated November 20, 1953, that lower tier subcontracts are not covered by the exemption if the "ultimate" purchaser of the complete machine is the Government. Although the ruling is broad enough to cover manufacturing subcontracts for parts, components or complete machines, it was directed at situations in which a machine-tool builder sells a machine to an independent distributor and the distributor resells to the Government. The machine-tool industry has taken the position that such a sale was covered by the exemption since the exemption only excludes subcontract sales "where the purchaser of such durable equipment has acquired such durable equipment for the account of the Government." The Board agrees both in this and in an earlier ruling that the distributor, considering the legal consequences of the situation, is purchasing "for his own account," but at the same time, by reference to the statute's legislative history, denies the exemption. It has ruled that the word "purchaser" in section 106 (c) (B) means "ultimate" purchaser, and that for this reason the exemption cannot apply when the machine ends up in the hands of the Government.

I have no thought of bothering this committee with the legal niceties involved in the Board's ruling, but I do wish to emphasize that the ruling will adversely affect nearly all the companies in the machine-tool industry. Almost every machine-tool builder sells to independent distributors, at least in some areas. And perhaps more important, the Board's ruling makes no distinction between builder-distributor subcontracts and the ordinary manufacturing subcontracts which have been so common in this emergency. If the Board persists in its ruling, it may have to go back over every case involving machine tools and other durable productive equipment and reexamine the segregation of sales. This would not only be an intolerable burden on the renegotiation process but the denial of the exemption would fall hardest on the smaller companies who sell a larger part of their output to distributors.

By enacting section 4 in its present form, the Congress could end this controversy for the years 1953 and 1954. And by making section 4 retroactive to January 1951, it could eliminate the controversy altogether. If this were done, there would be a very great savings in the time, trouble, and expense that goes into renegotiation cases, and a very considerable amount of litigation might be avoided.

I think the committee should have in mind that the Board's ruling on builder-distributor subcontracts is predicated upon the same testimony and the same portions of this committee's original report on the Renegotiation Act of 1951 as formed the basis for the Board's initial ruling on end-use segregation in machine-tool cases. It will be recalled that the committee disagreed with the Board upon its interpretation of this segment of the legislative history, and that the Board then issued an end-use regulation which conformed to the committee's views.[4]

This brings me to the necessary retroactivity of section 4 of H. R. 6287. All the points I have been making in support of section 4 apply to the entire period of renegotiation under the 1951 act, and implicit in the explanation in your report and in the House Ways and Means Committee report is the thought that if we had all been blessed with foresight, the partial mandatory exemption would have been written into the act itself with the amendments now contained in section 4. Since section 4 is a relief provision, there can be no question about the constitutionality of an amendment to H. R. 6287 making it retroactive to January 1, 1951, and the only question remaining, therefore, once we recognize the need, is whether such an amendment would present administrative difficulties and disrupt the orderly administration of the act. These questions are answered by the fact that, according to information available to the industry, only a very few 1951 machine-tool cases have as yet been finally settled by renegotiation refunds. The closed cases involve low-level profit clearances or cases in which the contractor

[4] See committee report on H. R. 6287, pp. 3–4.

decided to settle in order to avoid the time and trouble involved in prosecuting his case to a satisfactory settlement. The industry is still waiting in 1954 to find out what its profits will be for 1951. Under these circumstances, there can hardly be a valid objection to full retroactivity.

Finally, I should like to make one observation which relates to section 4 but bears principally upon the general administration of the act by the regional boards and the individual renegotiators in the field. Contrary to what we understand to be the policy of the Statutory Board in Washington, many individual renegotiators in the regional boards have been allowing manufacturers of durable productive equipment like machine tools lower margins of profits than those allowed in cases involving much less integrated manufacturers where "expendables," as distinguished from durable equipment, are involved. The theory is that the present limited partial mandatory exemption puts durable equipment manufacturers on a par with manufacturers of such expendables, and that the exemption is in effect a statutory substitute for the principle developed to some degree in World War II that durable equipment manufacturers such as machine-tool builders are entitled to retain higher margins of profit than manufacturers of expendables because of the relative complexity of their machines, their greater integration, the engineering services which they provide, their vital contribution and importance as the base of all defense production, the inevitable saturation of their postemergency markets, and similar factors. We believe that it would be very helpful to the Board in the administration of the act if the committee would write a statement into its report that section 4 of H. R. 6287 is not intended to be all inclusive or to obviate the necessity for recognizing under the statutory factors the serious risks faced by manufacturers of durable productive equipment because of the pattern of defense procurement resulting in Government-owned and industry-owned surpluses saturating future markets. You will recall that the committee wrote a similar statement on end-use segregation involving section 106 (c) into its report on H. R. 6287 made at the end of the last session.

I am very grateful for this opportunity to submit this statement to the committee.

KENNETH G. SMITH & ASSOCIATES, INC.,
Philadelphia Pa., February 24, 1954.

Hon. EUGENE D. MILLIKIN,
Chairman, Senate Finance Committee, Senate Office Building.
Washington 25, D. C.

DEAR SENATOR MILLIKIN: In presenting our recommendations for consideration by the Senate Finance Committee during its hearings on the Renegotiation Act of 1951, we believe that it is important to first establish ourselves as an authority on the subject.

Our president, Kenneth G. Smith, has had experience on renegotiation dating back to World War II, at which time he served as a Signal Corps Renegotiation Panel member for 2½ years. Following the war he worked on termination of war contracts with the Firestone Tire & Rubber Co., and then went into business for himself as a financial consultant.

This organization has prepared several hundred renegotiation reports for filing under both the 1951 act and the 1948 act. We believe this volume exceeds that of any other organization specializing in this field. We have ben consulted by accountants and attorneys, as well as by corporate officers, regarding renegotiation problems.

Mr. Smith has given talks on the subject from coast to coast and has written a number of articles dealing with renegotiation and termination questions and procedures. We publish a monthly report for the benefit of our clients, copies of which are enclosed. They contain many constructive recommendations for our clients.

We also enclose copies of some articles by or about Mr. Smith:

Renegotiation, Greater Philadelphia magazine.
How To Protect Yourself for Defense Contract Termination, Automotive Industries.
How To Protect Yourself for Renegotiation, Automotive Industries.
Renegotiation Needs Salesmanship, Automotive Industries.
Renegotiation Conferences, Automotive Industries.
Renegotiation Procedures, The Nor'Easter.
Prepare Now for Renegotiation, Metal Treating.
Sales Segregation, Special Charts.
Avoid Renegotiation Pitfalls, Distribution Age.

Renegotiation Round-Up, Distribution Age.
Renegotiation Meetings in Four Cities, Distribution Age.

After considerable discussion on this subject, not only with our clients, but also others concerned with the problem, we have concluded that the following five suggested changes in the 1951 act represent the views of a large number of concerns doing defense work:

1. Increase the floor

It is our opinion, after reviewing the files of many clients, that the $250,000 floor should be increased to $500,000. This step would greatly decrease the workload of small manufacturers, as well as decrease the Government's cost of administering the act.

In short, we believe that the Government stands to gain more than it loses by raising the floor to $500,000, and that many small contractors will be able to operate more efficiently with this extra financial and clerical burden eliminated.

2. Give prime contracts the same benefits as subcontracts under the durable productive equipment provision

It is our opinion that a sale of productive equipment, which is paid for by a governmental agency and classified as a prime contract, should receive the same consideration and benefits as a sale to a manufacturer engaged in defense work.

We have found in studying the records of many manufacturers that there is no difference in the end results so far as the manufacturer is concerned. The principal involved, which resulted in the inclusion of the provision pertaining to subcontract sales of durable productive equipment, applies with equal force to prime contract sales—the manufacturer's future market is oversold. Moreover, the Government will sell surplus equipment at a loss quicker than a normal commercial user.

By the adoption of this change a real service will be rendered to many equipment manufacturers who are greatly concerned with their future market, having in mind the sad experience of the industry after World War II.

3. Standard commercial article

Here again we have had considerable experience with a great many manufacturers who are engaged in the production of items classified as standard commercial articles. Their products are sold at standard competitive prices carrying their normal profit rate. In time certain sales find their way into the area of national defense end use—therefore become subject to renegotiation.

The exclusion of these items would reduce the workload of the Renegotiation Board and eliminate considerable business overhead, as well as cut down on Government expense.

4. Standard stock item exemption

In our opinion this exemption should be included as a mandatory exemption, not a permissive or discretionary exemption. During the entire life of the 1951 act the Board has consistently exempted sales considered to be purchased for stock. Thus we believe the Board has recognized the point we are making.

5. Profit margin on the first $1 million of sales

We are greatly concerned with the profit condition of small manufacturers on the first $1 million of renegotiable sales. It is our suggestion that your committee give serious thought to placing a floor on the profits earned on the first $1 million of renegotiable sales at a minimum of 10 percent. This would be a decided benefit to small manufacturers in permitting them to retain at least 10 percent before Federal taxes on the first $1 million of sales.

Although it may be true that in some cases less than 10-percent profit may properly be deemed excessive, however, in view of special circumstances, we believe that overall the amount of paperwork involved for both Government and business is not justified by the results obtained, including the practically unanimous feeling of businessmen, particularly small defense manufacturers, that recapturing a portion of profits which are under 10 percent is unfair.

Even the expiration of the excess-profits tax does not change the fact that profits under 10 percent are whittled down sufficiently by Federal income taxes without an additional cut being taken through renegotiation.

It should be remembered that most contractors engaged in defense work are also doing a considerable volume of general commercial business not subject to renegotiation. In many cases these contractors realize a greater percentage of profit on their commercial work even before renegotiation. It does not, in our opinion, serve the best interests of the national defense effort to penalize too

heavily the renegotiable portion of a company's sales, especially those small manufacturers who are heavily engaged in defense work. The return for their risk is very small.

We have not attempted to argue any of the above recommendations at length since we feel the committee is already cognizant of arguments on both sides of all these questions. Rather, we are offering these suggestions as being representative of the thinking of business, particularly small business, in various fields throughout the country.

In addition, we believe that the adoption of our suggestions would greatly reduce the Government's expense in administering the act.

We should be only too glad to be of any further service to your committee.

Respectfully,

ROBERT G. SMITH, *Secretary.*

CHAMBER OF COMMERCE OF THE UNITED STATES,
Washington, D. C., February 25, 1954.

Senator EUGENE D. MILLIKIN,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR MILLIKIN: The Chamber of Commerce of the United States believes that extension of the Renegotiation Act of 1951 without amendment would be undesirable.

1. The chamber concurs in the action taken by the Senate Finance Committee in amending the act (in H. R. 6287) to raise the minimum subject to renegotiation from $250,000 to $500,000.

2. We also agree with the committee that contracts and subcontracts for standard commercial articles should not be subject to renegotiation. However, the amendment made by the committee to section 106 (a) appears to repose too great responsibility in the Renegotiation Board for administrative determination of the extent of competition existing within industrial groupings.

3. As a further measure of improvement, the chamber believes that contracts which have been individually repriced under separate redetermination clauses should be expressly excluded from renegotiation.

4. The chamber also supports section 4 as reported by your committee at the last session. Section 4 is necessary to eliminate the unwarranted discrimination in the present law between—

(*a*) Manufacturers of new durable productive equipment who sell to the Government or to prime contractors acting on behalf of the Government; and

(*b*) Manufacturers who sell to Government contractors for their own account.

Without elimination of this discrimination, manufacturers of new durable productive equipment cannot be renegotiated on a basis comparable with other manufacturers.

During the past 2 years, application of the Renegotiation Act to contracts for many standard commercial articles, and the low floor on renegotiable income, were primarily responsible for accumulation of the current backlog of more than 6,500 cases awaiting action by the central Renegotiation Board and its regional boards.

Delay in disposition of these cases has placed many company managements in the unenviable position of not knowing how much of the income earned in recent years is actually theirs. Nor do they know whether they have followed sound dividend policies.

We can find no justification for applying the Renegotiation Act to standard commercial articles if the primary purpose of the law is still to prevent excessive profits. Almost all standard commercial articles have an established market price, and competition for contracts for these items is increasing daily. Therefore, opportunities for and the chances of excessive profits on such contracts are virtually nonexistent.

The chamber favors a floor of at least $500,000 on renegotiable income because it would permit the Renegotiation Board to concentrate on the larger contracts. This also would relieve many small contractors of the burden that renegotiation preparations now impose upon them.

The chamber recognizes that one of the virtues of renegotiation—especially to holders of numerous repriceable contracts—is the avoidance of contract-by-redetermination, especially for items still on the drawing board or in the experi-

mental stage. On the other hand, we can find no justification for pyramiding the two devices.

The chamber's position on this question has not changed since 1949, when the following policy declaration was adopted:

"Overlapping profit limitations, arbitrary in nature and application, including provisions for price redetermination, renegotiation, and application of the Vinson-Trammell Act, are harmful to the American enterprise system and to prompt and adequate procurement."

The normal goal of procurement policy should be close and firm initial pricing. This objective can best be attained by a progressive reduction in the incidence of the renegotiation process.

Renegotiation today discourages the low-cost efficient producer from taking Government contracts with the result that procurement costs increase because the Government must look more and more to marginal and high-cost producers.

An inevitable byproduct of continued easy reliance on retroactive review and adjustment of contract prices is careless and inefficient procurement.

I would appreciate it if you would make this letter a part of the record of your hearings.

Cordially yours,

CLARENCE R. MILES,
Manager, Legislative Department.

SYNTHETIC ORGANIC CHEMICAL MANUFACTURERS
ASSOCIATION OF THE UNITED STATES,
New York, N. Y., February 25, 1954.

Hon. EUGENE D. MILLIKIN,
Chairman, Committee on Finance,
United States Senate, Washington 25, D. C.

DEAR SENATOR MILLIKIN: The Synthetic Organic Chemical Manufacturers Association wishes to register its support for H. R. 6287 as amended by your committee, Senate Report No. 643, 83d Congress, 1st session.

This association represents 98 manufacturers of synthetic organic chemicals. Because of the extensive use of synthetic organic chemicals by other industries in the manufacture of military end items as well as the rather extensive use by the Government itself of products of our industry in its defense and defense-supporting operations, many of our members are Government contractors or subcontractors. Consequently, they have had experience with the renegotiation process both during World War II, under the 1948 act, and the Renegotiation Act of 1951.

We feel that the many costly hours devoted by the accounting and legal staffs of our members in preparing submissions to the Renegotiation Board and in defending the costs and profits reflected therein are an unnecessary burden upon the industry as well as upon the Government in the following respects:

1. The possibility of significant recoveries of excessive profits by the Government in those instances where the total receipts or accruals by a contractor or a subcontractor for a fiscal year are $500,000 or less is so slight in relation to the cost of the renegotiation process to industry and the Government in the aggregate of these cases that the renegotiation floor should be increased from $250,000 to $500,000 as proposed in section 2 of the amended bill.

2. Renegotiation finds its essential justification in the hazards encountered by the Government in periods of extraordinary procurement activity induced by war emergency or continuing international tension under circumstances which preclude the existence of firm pricing factors. Continuing tension in international affairs may justify the extension of renegotiation but it can be no sufficient warrant for placing procurement which is entered into by the Government with the benefit and experience of firm pricing in the same category as that in which excessive cost is unavoidable because of the pressure of sudden emergencies and the lack of pricing experience. Renegotiation is an emergency measure and should be limited in its application to the metes and bounds of the emergency which is its raison d'etre.

The paramount criteria from the Government's point of view should be the reasonableness of the prices paid to contractors and subcontractors rather than the profits earned by them. Since the early part of 1953 the economy has been functioning with prices largely being determined by the interplay of competitive forces in free markets. Government controls and restraints have been an absent or negligible factor. Actually throughout much of 1952 normal competitive

forces in the economy had been restored. It was common experience for prices on standard items to run below the OPS ceilings in 1952.

Under these circumstances the prices established in the market place for standard commercial articles are per se reasonable. The Government should look no further in those circumstances where the prices it pays have been determined through the free play of the forces of competition either in the commercial market place with respect to standard commercial articles or in Government procurement of other articles under full and free competitive bidding. For these reasons our association endorses the mandatory exemption for standard commercial articles and concurs in the definitions of the latter term contained in section 5 of the amended bill. We suggest, however, that subsection (B) (3) of the new paragraph (8) added by section 5 of the amended bill be amended by inserting the words "or subcontract" after the word "contract." This will extend the exemption to subcontracts entered into pursuant to competitive bidding and is consistent with the spirit of the definition otherwise set forth in the paragraph (8).

It seems to be generally understood that the gradual reduction in the level of defense expenditures, coupled with the moderate downturn of business activity in the Nation, makes it of exceptional importance that the industrial resources of the Nation be freed as far as possible from governmental restraints in seeking profitable outlets. The President's Economic Report makes it clear that the continued strength and expansion of the American economy is the most important factor to the strength of America and the free world. The amendments proposed by the Senate Finance Committee to H. R. 6287 as reflected in report No. 643 are fully consistent with these objectives. They give full recognition to the functioning of our free competitive economy by accepting as prima facie, reasonable prices established in the normal functioning of that economy. They are in full harmony with the tradition of renegotiation which looks solely to the protection of the Government's revenues in those areas where circumstance and the disappearance of free markets foreclose reliance upon prices paid in the pressure of the moment for essential Government supplies and services. They recognize that profits on standard items are the lifeblood of the manufacturer and leave to him full opportunity to utilize those profits for expansion, research, and high wages, which are the prime movers of the continued expansion and strength of our economy.

We urge the committee to adhere to its support of H. R. 6287 as amended.

Respectfully submitted.

SYNTHETIC ORGANIC CHEMICAL MANUFACTURERS ASSOCIATION OF THE UNITED STATES,
By S. STEWART GRAFF, *Secretary.*

WORCESTER, MASS.

Hon. LEVERETT SALTONSTALL,
United States Senate,
Washington, D. C.

H. R. 6287 will be considered by Senate Finance Committee Thursday February 25. Norton Co. and other manufacturers of durable productive equipment are vitally interested in the retention of section 4 of this bill which extends the partial exemption to all contracts. While we believe that renegotiation is no longer necessary under today's competitive conditions we urge your support of machine-tool industry's position that section 4 of H. R. 6287 should be made retroactive to 1951 and 1952 whether or not renegotiation act is extended to 1954. If manufacturers of durable production equipment are to be renegotiated fairly the partial exemption must be made applicable to prime contracts as well as subcontracts because it is unfair to renegotiate fully the sales of long-lived equipment which can and will be used for many years after defense effort requirements are satisfied. The case for section 4 is well explained in reports of the Senate Finance Committee and of the House Ways and Means Committee. In addition our association has filed a statement with each member of the Senate Finance Committee setting forth fully our reasons for this request. If you agree with, urge you to communicate to members of Finance Committee your support of our position, particularly that section 4 must be made a part of the 1951 renegotiation act regardless of whether law is extended to 1954.

NORTON CO.
E. M. HICKS,
Vice President.

THE PROPOSED EXTENSION OF RENEGOTIATION

A STATEMENT TO THE COMMITTEE ON FINANCE, UNITED STATES SENATE, BY THE MACHINERY AND ALLIED PRODUCTS INSTITUTE, CHICAGO, ILL., MARCH 9, 1954

Because of the far-reaching implications of the peacetime use of renegotiation and the highly technical nature of the subject, the Machinery and Allied Products Institute requested opportunity to be heard before the cognizant House and Senate committees last summer when H. R. 6287 was initially under consideration. At that time we pointed out that in view of the retroactive nature of renegotiation there was no need for hasty action on the part of Congress. Our request to be heard was repeated to the Senate Finance Committee during the present session of the Congress.

The views of the Machinery Institute have been guided by the conviction that the efficient functioning of free competitive markets is a fundamental condition of economic welfare. We have followed with interest and wholehearted support the actions of this Congress removing economic controls which interfere with the effective functioning of free markets. We have been pleased to observe how large has been the area of agreement between the thinking in Congress and our own thinking on appropriate public policy. When applied to renegotiation, the same fundamental principles which have been followed by Congress in the abandonment of other types of economic controls will demonstrate that renegotiation should also be terminated, and that its reenactment would be harmful to the efficient operation of our free-enterprise system and detrimental to the development of efficient practices for defense procurement.

As President Eisenhower stated in his economic report delivered to the Congress on January 28, 1954, "* * * Government must exercise great care to shape its policies so as to strengthen economic incentives, rather than to chill or frustrate them as has happened so often in the world's history * * *. Open markets and effective competition are the means of channeling productive efforts toward social purposes in a private-enterprise system." The extension of renegotiation at the present time, in a peacetime economy characterized by intensive and vigorous competition, would negate this philosophy in a most important area of industry-government relations.

The crucial issue before the committee is whether renegotiation should be reenacted in any form. In this statement we submit reasons for our position that renegotiation, having expired December 31, 1953, should not be reenacted. We review the basic goals of Federal procurement policies, discuss the relationship of renegotiation to those policies, and outline the contradiction between the two under normally competitive conditions. We also present a commentary upon the present situation of the American economy, and particularly of the capital-goods industries, which MAPI represents. In our judgment there clearly exists the vigorous and open competition which precludes the necessity of such a device as renegotiation.

THE ROLE AND LIMITATIONS OF RENEGOTIATION

The cost of renegotiation

Retroactive renegotiation of contracts is an extraordinary exercise of the powers of the Federal Government. Like other emergency powers, wherever employed, its use should be both selective in the scope of its application and limited in duration to periods of great emergency. As the institute has consistently pointed out,[1] there are five basic unavoidable faults of renegotiation, in addition to the grant of extraordinary power which it involves:

1. *Effect on incentives.*—Within the range of its application, renegotiation results in an almost total eclipse of financial incentives for economy and efficiency in the production of defense work. Although renegotiation is alleged to take into account, and to reward, efficiency of producers, the whole process is so inscrutable and the various determinations of what constitutes "excessive" profit so inexplicable that little incentive is left to pare costs and maximize productivity. We feel that this is inherent in the renegotiation process despite conscientious efforts on the part of the Renegotiation Board and renegotiators to overcome the adverse effects on incentive, and despite the insistence of the Senate Finance Committee upon spelling out standards in the law to the extent possible.

[1] Hearings of the Senate Committee on Finance on H. R. 1724, February 2, 1951; MAPI written statement to the Ways and Means Committee of the House of Representatives, July 9, 1953.

2. *Cost to Government and to the economy.*—A grant of such extraordinary power as is implied in retroactive renegotiation should be accompanied by significant advantages to the Government and to the economy. It is appropriate, therefore, to examine briefly the net recovery to the Government from renegotiation.

In fiscal 1953 gross receipts by the Treasury from renegotiation recoveries were about $22 million. It is estimated that the Treasury recovery in fiscal 1954 will be about $20 million. Taking into account the time lags involved, these $42 million in recoveries were mainly from profits received during the period of excess-profits tax when the rate of corporate profits taxes which would otherwise have been paid on these amounts ranged between 52 and 82 percent. Thus only 18 to 48 percent, or between $8 and $20 million, of the $42 million represented a net recovery to the Government—that is, recoveries which would not have been captured by corporate profits taxes. From this $8 to $20 million must be subtracted the roughly $10 million in expenses incurred by the Renegotiation Board, leaving a total net recovery by renegotiation of less than $10 million. There are no published estimates of potential recoveries for fiscal 1955 and later years.

3. *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 devoted to renegotiation proceedings in both industry and Government. The costs of renegotiation are passed on to the Government by individual firms, since they are allowed as an expense item for the purpose of computing both tax liabilities and renegotiable profits. The allocation of urgently needed management skills to these proceedings deprives the defense effort of some of its most essential resources.

4. *Arbitrariness of results.*—Despite the general standards written into the act, the determination of what constitutes excessive profits rests ultimately with renegotiation officials. Their probity and integrity we do no question. Yet the exercise of personal judgment that is involved must always remain incurably arbitrary, as must honest differences of opinion among the regional boards as to what constitutes excessive profits. An analogous situation would be the imposition of a 100-percent excess-profits tax by the Secretary of the Treasury, using his own unfettered judgment and the judgment of regional collectors in specifying what level of profits is considered excess. Government by law is inevitably weakened when substantive law is made from the personal judgments of myriad administrative personnel.

5. *Inducement to careless procurement.*—That pricing provisions in hastily executed contracts can be retroactively corrected has some advantages. However, by inducing an easy reliance on ex post facto recovery of mistakes, renegotiation can lead to careless procurement—on both sides of the negotiating table. Close pricing and well-conceived contracts should be the aim of procurement. Renegotiation tends to be an obstacle to this goal.

Renegotiation and competitive markets

Since renegotiation is a departure from our normal economic way of life, the proof of its necessity should rest upon those who would impose it. The Renegotiation Board has not sustained this burden of proof when it asserts without documentation that it considers extension of renegotiation "necessary in the public interest." (See testimony by Renegotiation Board Chairman George C. McConnaughey before the Senate Committee on Finance on February 24, 1954.)

Proponents of renegotiation have always attempted to justify the grave defects of renegotiation on the basis of the existence of emergency conditions. We feel it is clear that when defense procurement officials can make firm (that is to say, nonreviewable) contract prices at reasonable levels, renegotiation is unwarranted. The existence of economic conditions under which fair and reasonable prices can be determined at the time of contract placement is prima facie evidence that the need for renegotiation cannot be proven. It is crucial, therefore, to determine whether or not there is any general criterion of price reasonableness by which to judge the need for renegotiation in periods, such as the present, when we do not have all-out war but are faced with a limited mobilization program.

Basic criterion of reasonable prices.—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. 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, is consideration of renegotiation justified. This view of the role of renegotiation coincides essentially with the position taken by renegotiation and procurement officials during World War II, and with leading testimony on the Renegotiation Act of 1951.[1] It was repeatedly stated that the objective of the Government was to recapture overpayments to the contractor resulting from poor pricing; that such pricing was unavoidable under the pressure of the emergency and the inexperience on both sides of the bargaining table; that the goal of procurement policy was the development of experience and the perfection of techniques so as to widen the area of firm pricing; and that as that area widened, renegotiation would wither away.

It should be noted at this point that occasional distrubances of competitive markets in a limited number of areas are no justification for the maintenance of renegotiation, or of price and wage control, or of any other control device. Even a limited form of renegotiation during peacetime would require the creation or continuation of a Federal agency with power to decide by fiat which markets were competitive and which were not. But such decisions are not the province of the Federal Government except under the various antitrust laws. Consequently, the mere fact that the proponents of renegotiation can point to a few items of procurement for which alternate sources of supply are not available should not result in the enactment of renegotiation legislation. Such a philosophy would completely alter the very fabric of our social and economic system on which the arbitrary imposition of Federal control is a pattern suitable only for the gravest of military emergencies.

Having emphasized the existence of competitive markets as the major criterion for deciding whether renegotiation is needed, let us now turn to an analysis of the economic events since Korea to determine whether or not this criterion has been satisfied.

THE NATION'S ECONOMY SINCE KOREA

The 3½ years since the invasion of Korea have witnessed the maintenance of competitive conditions in a vast number of markets. In the remainder, competition has reemerged after a short-lived eclipse under the stress of heavy post-Korean contract placement.

As we have pointed out, the sole justification for considering renegotiation is the existence of a mobilization program of such magnitude as to prohibit the maintenance of normally competitive markets. A short review of the Nation's economic situation during the past year will suffice to demonstrate the generally competitive nature of industrial markets.

Economic report of the President.—Highlighted throughout the entire economic report of the President, transmitted to the Congress in January, is the increasingly vigorous competition prevalent throughout American industry. Large sections of the report are devoted to the current inventory readjustment and to the relative price stability achieved during 1953. The attention of the Federal Government has been increasingly directed toward the task of maintaining economic stability in the face of moderate downward movements in production and employment.

No careful reader of the President's report could fail to appreciate that the whole tone of the economy is intensively competitive and that the inflationary factors of the immediate post-Korean period have long been absent from the economic scene. This conclusion is reinforced by the report of the Joint Congressional Committee on the Economic Report, issued on February 26, 1954.

[1] Mr. Kenneth H. Rockey, Chairman, World War II Navy Price Adjustment Board. (Hearings before the Naval Affairs Committee, House of Representatives, 78th Cong., 1st sess., June 1943.) "The Renegotiation Act is purely a war measure designed to deal realistically with the troublesome problem of controlling prices and profits from production for war when time, quantity, and quality are of the essence in meeting the needs of one customer, the Government. The renegotiation law is the wartime substitute for the normal peactime controls and stimulates characteristics of free competition."

Mr. Maurice Karker, Chairman, World War II Price Adjustment Board. (Hearings on Revenue Act of 1943 before the Committee on Appropriations of the House of Representatives on June 1, 1943.) "Essentially renegotiation is a wartime substitute for peacetime competition."

Mr. Robert Patterson, former Under Secretary of War. (Senate Committee on Finance, 77th Cong., 2d sess.) "The threat of renegotiation to recapture the profits for peace periods frequently tends to undermine this incentive to a serious degree."

Production and employment.—During the last 2 quarters of 1953 the total output of goods and services produced in the Nation has fallen from $372 billion to $364 billion. Accompanying this modest dip in production has been a decline of about 2.5 million in employment, only about half of which was seasonal. As a consequence, the upward price pressures which are often used to justify the retention of renegotiation have been absent. Indeed we could, by employing labor and capital resources now idle, add about $15 billion to our present rate of output without putting any undue strain on our resources. Under such circumstances competition in industry for both civilian and defense business has been extremely keen. Alternative sources of supply for defense procurement are numerous, and indeed the Defense Department has found such sources in many cases too numerous—witness the cancellation of some defense contracts in order to concentrate remaining procurement among the most efficient suppliers.

Impact of the defense program less than original estimates.—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. Yet under these circumstances the official position of the former administration, as expressed in a letter to Chairman Doughton from Budget Director Lawton, foresaw no need "for broad-scale statutory authority providing for renegotiation of contracts [although] such legislation would help to round out authorities which should be exercised in the event of war or national emergency * * *" Even more explicit recognition of renegotiation as a standby device, not to be exercised immediately, was contained in similar letters from the Atomic Energy Commission and the Reconstruction Finance Corporation. An implicit endorsement of the same attitude may be found in the letter of the then Chairman of the Council of Economic Advisers, Leon H. Keyserling, reprinted in the hearings before the Committee on Ways and Means.

The defense program and the national economy.—We recognize that competitive markets can indeed be overwhelmed by a flood of defense contracts in an all-out mobilization, leaving procurement officials no option but to utilize any possible source of supply in an attempt to secure urgently needed armaments. In the peak years of World War II the Government was contracting for 35 percent of the total output of private industry, and for 100 percent of the production of some individual industries. Such conditions tend to limit severely the normal operation of competitive price making, which depends upon the availability to the Government of alternative sources of supply.

The past and prospective size of the current defense program, however, presents a far different picture. The actual extent of defense procurement has not attained the proportions originally estimated. Expenditures on national-security programs in the last months of 1953 amounted, at annual rates, not to $65 billion but to slightly over $50 billion. Declines in this level of defense expenditure have been programed for the period ahead, falling to $45 billion in fiscal 1955. If we subtract from this $45 billion the approximately $23 billion which will be allocated to pay services, and current operation of the Armed Forces and for the administrative expenses of the other national-security programs, we arrive at a figure of about $22 billion which will be spent for procurement and construction. This represents only 6 percent of the Nation's current $364 billion output of goods and services .

Since Korea, the output of our economy has increased by $88 billion, from $278 billion in the second quarter of 1950 to about $364 billion in the fourth quarter of 1953. Increased expenditures for national security have absorbed only $35 billion of this added output, leaving $52 billion for use by the civilian economy. Moreover, as noted above, currently unused resources could add another $15 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.

Trend of defense procurement turning downward.—The following brief review of the trends in military procurement indicates the declining impact of military procurement.

The volume of Department of Defense new major procurement contracts has declined from an average monthly rate of about $2 billion in the last half of 1952 to slightly over $100 million during the past 6 months. New spending authority for major procurement requested in the President's 1955 budget message was only $7.3 billion, in contrast to $20 billion in fiscal year 1953 and $29.5 billion in fiscal 1952. Expenditures for major procurement in fiscal 1955 are estimated at $14.5 billion, a decline of over 15 percent from fiscal 1954 and 10 percent from fiscal 1953. On the basis of the current rate of procurement obligations, it is

possible that actual expenditure reductions in fiscal 1955 may be even greater than the present estimates.

Viewed from any standpoint, the current and prospective level of defense procurement, in relation to a $364 billion economy, poses little threat to the existence of normally competitive markets.

Competition in capital-goods markets

The competitive tone which now characterizes American industry is especially observable in the capital-good industries represented by the Machiney Institute. The singularly limited impact of the current defense program is clear after even a cursory glance at the economic facts of life in these industries.

Orders and shipments.—At the peak of the post-Korean procurement boom, in the first quarter of 1951, new orders for machinery and equipment were about 75 percent higher than the current rate of shipments at that time. Since the first quarter of 1951, the volume of new orders has declined and the rate of shipments increased until currently the volume of new orders is almost 25 percent lower than shipments.

Defense business.—The peak of the defense retooling and facilities program has long since passed. Indeed, new prime contracts for production equipment directly placed by the Defense Department during the first 5 months of fiscal 1954 totaled only $53 million. This represents about one-third of 1 percent of the $14½ billion total new orders received and one-quarter of 1 percent of the $19 billion shipments made by the machinery and equipment industries during the same period.

The indirect impact of the defense program on machinery producers through the placing of subcontracts by defense prime contractors cannot be so precisely measured. It is significant to note, however, that the major concern of the Defense Department in the area of production equipment during the past 6 months has not been related to procuring new equipment but, rather, to the leasing or storage of equipment made surplus by the current decline in defense production. The existing procurement policy of reassigning defense production to a smaller number of more efficient producers has meant, of course, a corresponding decline in the volume of defense subcontracts for machinery and equipment. The productive capacity of the machinery and equipment industries dwarfs the small volume of direct and indirect defense procurement currently taking place in those industries.

Machinery production at its peak last summer was 155 percent of the pre-Korean level. This increase in productive capacity, coupled with the procurement developments outlined above, will provide alternative sources of supply for the overwhelming majority of procurement contracts or subcontracts in the long-range mobilization program ahead. The availability of several sources of supply normally guarantees the competitive conditions necessary to firm original pricing. In those cases where the developmental nature or novel design of the equipment purchased makes impossible originally firm pricing, various price redetermination clauses are available to protect the Government's interest. We submit that as a general rule, however, it is the responsibility of procurement authorities to secure firm and reasonable prices where competitive market conditions prevail, without the aid of costly and unnecessary retroactive devices which are frequently used purely for protectionist reasons.

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 manufacturing 183 percent, and construction costs 192 percent, machinery and equipment prices have increased only 78 percent. During the past 2 years, since December 1951, machinery and equipment prices have risen only 3.7 percent, despite increases of about 8.4 percent in average hourly earnings paid and a rise of about 5.3 percent in the prices of raw materials consumed.

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.

Profits.—As we have stated earlier, the ultimate goal of procurement policy, and of renegotiation when properly conceived, is the reasonableness of the price paid by Government. Despite this fact, 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 con-

nection between prices and profits, although profits are by no means the proper criterion of price reasonableness. Taking issue, 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.

Table 1 compares corporate profits earned in the quarter prior to Korea with profits earned in the third quarter 1953 [3] for all manufacturing industries and for the machinery industries. Insofar as the rationale of renegotiation lies in a mushrooming of profits, the facts belie the necessity for its continuation. Measured on equity or sales, before or after taxes, profits during the third quarter of 1953 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 for non-electrical machinery, before-tax profits on stockholders' equity were moderately below the quarter preceding Korea, while profits on sales were much lower. Profits on equity for electrical machinery industries were at approximately the same level as in the quarter before Korea, while measured against sales they were considerably less.

TABLE 1.—*Profits on stockholders' equity and on sales, all manufacturing industries and machinery industries*

	Profit on equity [1]				Profit on sales			
	Before taxes		After taxes		Before taxes		After taxes	
	2d quarter 1950	3d quarter 1953	2d quarter 1950	3d quarter 1953	2d quarter 1950	3d quarter 1953	2d quarter 1950	3d quarter 1953
All manufacturing corporations	24.8	23.3	15.6	10.5	11.8	9.6	7.4	4.3
Machinery (excluding electrical)	24.4	22.5	14.8	8.7	12.6	10.0	7.7	3.9
Electrical machinery	31.2	31.3	18.4	12.1	11.7	10.3	7.0	4.0

[1] Quarterly profits at annual rates.

Source: Federal Trade Commission and Securities and Exchange Commission.

It is significant also to observe that after-tax profits, measured against both stockholders' equity and sales, were half again as large in the second quarter of 1950 as in the third quarter of 1953.

In the face of the generally lower profit level before taxes during the third quarter of last year, and the plentiful indications that fourth-quarter earnings dipped even lower, any attempt to justify the need for a further recapture of profits through renegotiation is absurd.

Economic situation—summary

Viewed from whatever perspective one wishes to take, the economic situation of the Nation and of its capital-goods producers is characterized by normally competitive conditions. Production and shipments exceed new orders; order backlogs have rapidly declined; production capacity exceeds actual output with the result that there is stiff competition for the utilization of unused capacity; prices have remained stable in the face of wage increases; defense contracts are declining in volume; and, finally, profit rates reflecting these conditions are below pre-Korean levels.

RENEGOTIATION AND THE IMMEDIATE POST-KOREAN "PROCUREMENT BULGE"

We understand that one of the major arguments which has been offered as a reason for extending renegotiation is that defense expenditures in 1954 will include a substantial amount under contracts made during 1952 and earlier years. Consequently, the more competitive situation of the economy during the latter part of 1953, it is argued, is irrelevant in judging the need for extending renegotiation.[4]

There are two major considerations which negate the effect of this argument:

1. A very large proportion of procurement expenditures in 1954 will represent

[3] Latest date for which sufficiently complete information is available.

[4] See, for example, the committee reports of the Senate Finance Committee and House Ways and Means Committee on H. R. 6287, 1st sess., 83d Cong.

contracts placed in 1953 or later, or contracts placed earlier but with various price protective clauses incorporated in them.

2. Even in those cases where 1954 expenditures do represent fixed-price contracts placed earlier than 1953, such contracts by no means justify the extension of renegotiation. The general stability of the economy during 1952, in sharp contrast to the severe pressures of World War II and of the months immediately following Korea, offers little, if any, evidence of the disappearance of competitive markets. In the absence of such evidence, renegotiation is uncalled for.

The pattern of procurement expenditures

In fiscal 1955 (data availability makes it necessary to use fiscal year figures here), approximately $17.5 billion will be expended by the Defense Department for major procurement and operating supplies. Of this, about $3 billion will be expended for short lead-time operating and maintenance supplies and petroleum which either pose no problem insofar as renegotiation is concerned, or are of such short lead-time that they do not apply to the "procurement bulge" argument. Of the remaining $14.5 billion, about $9½ billion represents aircraft and ship procurement.

Of the $9½ billion aircraft and ship expenditures in 1954, about half will be retained by prime contractors, almost all of whom are subject to price redetermination of one kind or anotner. The remaining half of the receipts from aircraft and ship procurement will go to subcontractors. Some of these subcontractors will also be subject to price redetermination since the Air Force has increasingly required contractors to incorporate price redetermination clauses in many of their larger subcontracts. Additionally, since component and raw material lead time is usually shorter than end-item lead time, some part of the subcontracts has already been filled—the subcontractor thus being subject to renegotiation even though the prime contractor's receipts will occur after the demise of renegotiation. Finally, again because of shorter lead time, some of the subcontracting receipts from aircraft and ship expenditures in 1954 represent items on which subcontracts were made relatively recently and consequently within the highly competitive conditions of late 1953.

Thus, an analysis of aircraft and ship expenditures in 1954 indicates that less than half of these expenditures represents contracts or subcontracts placed prior to 1953 and not subject to any price protective devices. Of the remaining $5 billion procurement expenditures in 1954, a significant proportion will represent items on which contracts were made in 1953 or later.

In summary then, the assertion that renegotiation must be reenacted in order to cover receipts and accruals pursuant to contracts made during the post-Korean procurement bulge is a gross overstatement, since the majority of 1954 receipts and accruals will either have been priced in 1953 or will be covered by some form of price redetermination.

Competitive conditions in 1952

The great bulk of contracts which were made prior to 1953, and under which expenditures will be made in 1954, was undoubtedly placed sometime during 1952. It is pertinent, therefore, to examine the economic situation in 1952 to determine whether or not emergency conditions existed which swamped the normally competitive pricing system for Government procurement.

Aggregate stability.—Examining the economy as a whole, it is apaprent that upward price pressures, the straining of demand against resources, and the abandonment of normal price-making restraints which characterize emergency situations were not present in any overall sense. The prices of commodities at both the wholesale and retail levels actually declined slightly during the year, while basic raw material prices declined sharply. Average manufacturing profit rates, even before taxes, remained below pre-Korean levels. After-tax profit rates were far below pre-Korea. An examination of profit rates in the hard-goods industries, and, in particular, in those industries in which defense contracts were highly concentrated, fails to reveal any evidence of these extreme pressures of World War II or the immediate months after Korea which tend to defeat the normal limiting effects of competition. As we noted earlier (see p. 6), the "take" of military procurement from the total goods and services produced in the Nation was far below World War II levels and well under the amounts originally projected at the time the Renegotiation Act of 1951 was passed.

While it is true that an examination of aggregate economic activity does not preclude the possibility of abnormal pressures in some areas, this is by no means an argument in favor of renegotiation. No economy is perfect. Even

under normal conditions, consumers, investors, and Government sometimes make purchases at temporarily high prices because of the existence of monopoly or temporary scarcities. Even in periods when military procurement plays little part in determining the economic situation, certain areas of the economy expand, profitwise and pricewise, while others contract. A similar situation existed in 1952.

The year 1952 was basically a year of full employment, without price pressure and with no indications of widening in overall profit margins. Within this overall stability there were both upward and downward movements, generally of a modest nature. This is to be contrasted with the overall upward pressures which existed in World War II and immediately after Korea, when it may indeed be argued that competitive conditions in a number of markets were temporarily absent. If we are to postulate that renegotiation must be reenacted when a full employment economy contains a significant proportion of military procurement, despite the existence of general stability, then we alter completely the nature of renegotiation as an emergency device.

OTHER RETROACTIVE PRICING DEVICES

In the fiscal year 1952 approximately 51 percent of all negotiated contracts of the Department of Defense included price redetermination clauses which could be invoked to yield prices lower than those originally fixed. It should be noted that, in addition to this wide use of price redetermination in prime contracts, there is a growing practice on the part of procurement authorities to require by contract that prime contractors pass on redetermination provisions to their subcontractors. An additional 11 percent of all contracts let was placed by formal advertising in markets which were presumptively competitive. In other words, in the majority of contracts let, the Government, through competitive bids or through contractual arrangements, was amply protected without renegotiation.

It should be pointed out, however, that the Machinery Institute by no means recommends the adoption of price redetermination as a device for indiscriminate use by procurement officials. Firm initial pricing should be the goal of procurement policy. Indeed, the recent proliferation of redetermination clauses, in addition to its absurd overlap with renegotiation, is impossible to justify. As the defense program has advanced since Korea, and both contractor and procurement officials have become more "seasoned" in their knowledge of costs and reasonable prices, initially firm pricing should be applied increasingly.

SPECIFIC PROVISIONS OF PENDING RENEGOTIATION LEGISLATION

We have stated above the basic position of MAPI in opposition to reenactment of renegotiation beyond December 31, 1953. The following comments upon the specific legislative proposal now before the Senate Committee on Finance and on the Senate Calendar in no way change or modify this position.

Extension of section 106 (c) to cover prime contracts for durable productive equipment

H. R. 6287, now being considered by the committee, broadens the coverage of section 106 (c) of the Renegotiation Act of 1951 to include prime contracts and contracts for the account of the Government. The present law limits this provision to subcontracts.

You will recall that section 106 (c), as originally incorporated into law, restricts the renegotiability of receipts under subcontracts for durable productive equipment to a proportion of those receipts equal to the ratio between 5 years and the average useful service life of the equipment. It does not exempt such subcontracts. Whereas other materials enter fully and completely into the end items sold to the Government, the services of capital equipment are given up gradually over a period of years. The existing terms of section 106 (c) recognize that under subcontracts the life of the machinery and equipment is only partially used in producing defense commodities and is thereafter available for civilian production. Section 106 (c) does not, however, take account of the fact that the durable productive equipment purchased directly by the Government or for its account will also, in all probability, spend only a portion of its service life in the production of defense commodities. It is therefore appropriate to extend the application of section 106 (c) to cover all sales of durable productive equipment, under both prime contracts and subcontracts.

This is recognized by the Senate Committee on Finance in its bill and in its Report No. 643 which accompanies H. R. 6287. The broadening of section 106 (c)

as proposed in H. R. 6287 would accomplish this objective and afford a twofold benefit:

1. In the case of prime contracts or contracts for the account of the Government, the application of the section 106 (c) formula would, by exempting a proportion of sales equivalent to the excess of the service life over the presumed 5-year defense life, leave approximately one-third to one-fourth of such sales renegotiable, on the average. Thus, the broadening of section 106 (c) would grant part of the complete relief from renegotiation which the institute feels is now clearly warranted.

2. Secondly, the broadening of the section 106 (c) formula to equipment sold directly to the Government recognizes the fact that a large part of this equipment will not remain in Government use until its service life is exhausted but, rather, will be disposed of to civilian manufacturers.

It is significant in this connection to emphasize that the major concern of the Defense Department in the area of productive equipment during the past 6 months has not been with procuring new equipment but, rather with the leasing or sale of equipment made surplus by the current decline in defense production. This surplus problem has developed much earlier and to a larger degree than foreseen at the time of the passage of the Renegotiation Act of 1951 when section 106 (c) was made applicable only to subcontracts. In view of these developments, the broadening of section 106 (c) should be made retroactive to January 1, 1951. We understand that an amendment may be proposed to so provide.

The institute recognizes that in some cases equipment sold to the Government may remain more than 5 years in Government use. Nevertheless, in view of the fact that renegotiation in any form is unwarranted in the procurement of capital goods, the application of the 106 (c) provision to equipment sold directly to the Government errs not on the side of liberality but on the side of rigidity. It is a partial correction for the application of renegotiation to the capital-goods industries whose sales are made in a highly competitive market and whose long-lived products will be only partially consumed in defense production.

We do not agree that Renegotiation Board interpretations and administrative procedures, with respect to recognition of the risk of postemergency saturation and other factors, are sufficient to protect durable equipment manufacturers. It is precisely because such administrative measures have not been adequate that there is need for an amended section 106 (c). Experience with renegotiation and the inherently arbitrary character of the renegotiation process make definitive legislation imperative.

Standard commercial article exemption

The Senate version of H. R. 6287 provides for a mandatory exemption of standard commercial articles unless the Renegotiation Board makes an affirmative finding that competitive conditions of supply for such articles are "such that will not reasonably protect the Government from excessive prices."

The exemption of standard commercial articles from renegotiation is clearly called for under any conditions. As we have been at great pains to demonstrate in this testimony, the crucial factor upon which procurement policy should be built is the attainment of initially firm prices. The standard commerical article provision of the bill now before you grants at least partial recognition of this principle. The provision has the following advantages over the existing statute:

1. It plainly spells out in statutory language the fact that standard commercial articles are presumptively sold in competitive markets. Such a presumption is inherent in our free-enterprise system, and this provision places the burden of proof of demonstrating that markets are not competitive on the Renegotiation Board.

2. The provision spells out the definition of standard commercial articles. The previous history of the standard commercial article exemption demonstrates the wisdom of a congressional definition of terms. A similar provision, without the definitive wording of the present bill, was very narrowly construed during World War II to include only such items as iron and steel scrap, refined sugar, paper, flour, etc.—a scope far narrower than the broad range of products regularly sold as standard commodities and properly classifiable as "standard commercial articles."

3. The legislation now under consideration provides a mandatory exemption for standard commercial articles. The whole history of administrative exemptions from renegotiation confirms the wisdom of legislative mandates for exemptions wherever exemption is deemed desirable. By indicating that only through specific administrative designation can standard commercial articles be subject to renegotiation, Congress has clearly noted that the presumption is

in favor of firm pricing and nonrenegotiability for the large numbers of defense commodities which may be properly classified as "standard commercial articles."

4. The sum and substance of the "standard commercial article" provision is to place the renegotiation of the majority of defense commodities on the basis of specific affirmative designation by the Renegotiation Board. As we have argued at length in this testimony, renegotiation in any form now is unwarranted. If, nevertheless, some form of renegotiation survives through the action of Congress, the current economic situation dictates, at the very least, the inclusion of the standard commercial article exemption with the safeguards against administrative abuse now provided in pending legislation.

Increase in the minimum amount subject to renegotiation

H. R. 6287 raises the minimum amount subject to renegotiation from $250,000 to $500,000 with respect to fiscal years ending on and after June 30, 1953. It is obvious, of course, from the reasons we have advanced for complete termination, that in the event renegotiation is reenacted in any form, a minimum requirement would be a provision such as this eliminating renegotiation as to annual volumes less than $500,000.

Time limit on renegotiation proceedings

H. R. 6287 provides for the extension of renegotiation for 1 year. Under section 105 (c) of the Renegotiation Act of 1951, proceedings must be commenced within 1 year after the initial filing with the Board and completed within 2 years after such commencement. Since the initial filing date is 3 months after the end of the contractor's fiscal year, termination of renegotiation on December 31, 1954, would still leave many contractors subject to the doubts and uncertainties of renegotiation proceedings for at least an additional 3¼ years—or until April 1, 1958. By the use of so-called "voluntary" waivers, this date can be extended even further.

In order to prevent the perpetuation of renegotiation proceedings interminably into the future on appeal from the Board with reference to workload and backlogs, the Machinery Institute strongly urges that should any extension of renegotiation be enacted, the accompanying committee report should instruct the Board to complete proceedings with the utmost speed. The doubts and uncertainties with regard to profits and cash position engendered by long-drawn-out renegotiation proceedings are too serious a detriment to sound business operations to be allowed to continue any longer than absolutely necessary.

Statement of congressional intent

The Machinery Institute has, throughout this testimony, firmly opposed the reenactment of renegotiation. Should the Congress nevertheless enact such extending legislation, we urge that Congress make it abundantly clear that such extension is not the first in a series of 1-year extensions. The committee report should include language to this effect, pointing out that the December 31, 1954, termination date is final, and that it is not merely a way station on the road to an indefinite continuation of renegotiation.

CONCLUSION

Reenactment of renegotiation is unwarranted. This extension of direct Federal wartime profit control into a period of peacetime completion is completely contrary to the philosophy of private enterprise upon which our present industry-Government relations rest. The current trend of economic conditions and the lessening impact of military procurement have created a situation in which the Federal Government can obtain reasonable prices by normal procurement methods. The continuation of renegotiation under these conditions would reverse the administration policy of removing Federal controls over private business.

We have also commented upon certain of the provisions of H. R. 6287 now before the committee. It is evident that the provisions we have discussed, namely, the broadening of section 106 (c), the introduction of a mandatory "standard commercial article" exemption, and exemption from renegotiation of annual volumes of $500,000 or less, would alleviate some of the inequities of the Renegotiation Act of 1951. Nevertheless, these provisions are no substitute for the course which present circumstances clearly demand—renegotiation, having expired on December 31, 1953, should not be reenacted in any form.

(Whereupon, at 12:10 p. m., the committee adjourned.)

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