ECONOMICS OF MILITARY PROCUREMENT

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ECONOMY IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETIETH CONGRESS

SECOND SESSION

NOVEMBER 11, 12, 13, AND 14, 1968

PART 2

[Thursday, November 14, 1968]

Testimony of Vice Admiral H. G. Rickover, U.S. Navy

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

22-490 O WASHINGTON : 1968

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price $1.00

[The testimony herein was presented to the Subcommittee on Economy in Government of the Joint Economic Committee by Vice Adm. Hyman G. Rickover, U.S. Navy, in executive session, Thursday, November 14, 1968, and was subsequently ordered to be printed for public distribution.]

FOREWORD AND SUMMARY

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

Approximately 25 percent of the total Federal budget is spent by the Department of Defense for military equipment. An additional enormous amount is spent for other military purposes. Many observers have in recent years pointed to instances of waste and mismanagement in defense contracting. It was the increasing concern over this that prompted the Subcommittee on Economy in Government of the Joint Economic Committee to hold hearings on profits and cost control in defense procurement.

On October 31, 1968, in announcing the hearings Senator William Proxmire, chairman of the Joint Economic Committee said:

> The need for a comprehensive investigation of military procurement has existed for some time * * * Military contracts total $44 billion a year and serious waste or inefficiency in this massive program has burdensome consequences for every American.

The subcommittee asked Admiral Rickover to testify in order to get the benefit of the knowledge he has gained in his many years of Government service. For the past 20 years, in particular, he has headed the Naval Nuclear Propulsion Program, where he is responsible for design, development, procurement, installation, and maintenance of nuclear propulsion plants for naval ships. Although his job is primarily technical, this broad responsibility has necessitated his considerable interest in procurement. As he explains, "I have had to get into the details of Government contracting in order to get my work done efficiently and on time."

Admiral Rickover is a particularly valuable witness for two reasons: first, as an official having operational responsibilities he is daily witness to the practical results of Defense Department procurement policy decisions; second, in his unique position he deals with the procurement policies of both the Defense Department and the Atomic Energy Commission.

Admiral Rickover's testimony provides a broad perspective on today's problems in defense procurement. He believes the fundamental faults in present Defense Department policies affect all aspects of procurement. To correct these faults, the Admiral urges a comprehensive overhaul of procurement policies and regulations. In summarizing the latter point, he says:

> The laws and regulations concerning defense procurement are loose and outmoded. They contain many loopholes that industry is able to exploit. Defense procurement rules need drastic overhaul and tightening.

He cites numerous examples from his own experience to illustrate each of the problems he discusses, emphasizing that these are symptomatic of fundamental deficiencies which pervade defense procurement. He argues for a comprehensive study of defense contracting by the General Accounting Office. He reiterates his conviction that the most serious defect in the procurement regulations is the lack of uniform accounting standards for defense contracts. He has been the leading proponent of uniform accounting standards for a number of years. His testimony on this subject last spring resulted in Public Law 90–370 which directed the Comptroller General of the United States to study the feasibility of uniform accounting standards. Admiral Rickover predicts that uniform standards would lead to impressive savings in time, money, and manpower.

As the second major point of his testimony, the Admiral cautions against the influence of industry on defense procurement policies. He states:

> In procurement matters the Department of Defense is too much influenced by the industry viewpoint. Procurement rules are interpreted to benefit industry rather than to protect the American public.

He explains that the industry viewpoint in the Department of Defense stems from two main sources: first, from top-level Pentagon officials who are appointed from private industry and return to industry after a relatively brief period in Government; second, from industry advisory groups working closely with Defense Department officials. He cautions that if the partnership between Government and industry becomes too close the latter may become "a fourth branch of Government * * * but without political or legal responsibility."

Since in a democracy "rights and duties are correlative," Admiral Rickover argues that, having won the rights of citizens under the law, corporations have a duty of civic responsibility. Moreover, he points out that—

> In the matter of abuse of privileges it is industry, not Government, that has the most to lose. The Government tends to obstruct the moment it interferes. If industry takes too much advantage the Government will be compelled increasingly to obstruct.
>
> The threat is to industry itself; the danger is that it will destroy its integrity and credibility and its full value to society. Industry has the choice of freedom to seek its goals without special privileges, or the enjoyment of special privileges without the freedom to act it now has.

The third main point of the Admiral's testimony is that congressional action is necessary to improve the situation. He says:

> Congress will have to take the initiative in correcting the deficiencies in defense procurement. Neither the Department of Defense, nor the Department of Commerce, nor the General Accounting Office will do it. It should not be left to a self-interested defense industry to decide what is best for the American people.

He discusses situations from his own experience in which the Defense and Commerce Departments have been unwilling to use the statutory authority given them. He states that the General Accounting Office has not placed enough emphasis on major issues—those where principles are involved. If the General Accounting Office is to

carry out its responsibility as the "conscience of Government," that office should undertake comprehensive studies and work toward fundamental improvements.

Admiral Rickover's testimony stands as one of the most comprehensive critiques of defense procurement ever presented to the Congress.

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ECONOMICS OF MILITARY PROCUREMENT

THURSDAY, NOVEMBER 14, 1968

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:15 a.m., in room 2311, New Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire.

Witnesses: Vice Adm. H. G. Rickover, accompanied by M. C. Greer.

Also present: Richard Kaufman, economist; Douglas Frechtling, minority economist; and Howard A. Cohen, legislative counsel to Representative Rumsfeld.

Chairman PROXMIRE. The subcommittee will come to order.

Admiral Rickover, we are delighted and honored that you have come to testify before us. You are particularly welcome because you are an expert in defense matters. As you know, we are holding hearings on defense procurement. We are trying to determine what we can do to keep the cost of the Federal Government down and how we can provide an opportunity for a healthy and vigorous defense industry that will be eager to compete for contracts. We also want to be sure that the taxpayer is protected.

We are delighted and honored that you have come to testify before us, not only because you are an expert in defense matters, but because of your reputation for frankness and honesty. I realize that when testifying before Congress, you are required to support the official position of the Department of Defense. However, I understand you are permitted to give us your personal views if you are requested to do so. I am asking you to do so. We have already heard testimony from Department of Defense officials responsible for defense procurement. It is your views we want today. I hope you will feel completely free to give us your personal views regardless of what they may be and regardless of whether or not they agree with official Department of Defense positions. If the Congress is to carry out its proper legislative role, it must have all views, not just the official views of the executive department concerned.

You are particularly well qualified in an area in which it is very difficult to get answers. Defense procurement affects groups that have great political and financial influence and power, and it is most important that the Government get as full and complete and accurate a record of the elements that make up this procurement as is possible.

I believe you will be able to shed considerable light on the problems that concern us, based on 50 years of experience in the Navy and your

outstanding record as head of the very successful Naval Reactors Program, which is a joint program of the Department of Defense and the Atomic Energy Commission. I understand that you have headed that program since its inception, over 20 years ago, and that you have designed and procured the reactor plant for every nuclear warship this country has. I asked you to appear before this committee because you have held a unique position in Government from which to gain firsthand knowledge of the effectiveness of Department of Defense procurement practices.

You know what a heavy burden we have on the American taxpayer. A great deal of this burden is because of our national defense effort, and something like $44 billion of the Defense Department's budget each year goes for procurement. Many of us are concerned, and I am sure you are, about what we can do to keep the cost of defense procurement down as much as possible. This is an area in which I particularly want your personal views.

I would like to begin by asking if you have a prepared statement?

Admiral RICKOVER. No, sir; I do not. As you know, I learned about this hearing yesterday afternoon. I was not in Washington, and I did not have time to prepare a statement. However, I am familiar with the issue and I will attempt to answer your questions.

Chairman PROXMIRE. We tried to reach you, as you know. You were at sea, as I understand it.

Admiral RICKOVER. Yes, sir.

Chairman PROXMIRE. You were in a submarine and it was hard to get in touch with you because of the bad weather.

Admiral RICKOVER. Yes, sir. This past weekend I conducted sea trials out of Quincy, Mass., of our latest nuclear-powered submarine, the U.S.S. *Sunfish*. I attempted to get off the submarine by helicopter following the trials, but the seas were too high and the visibility poor. I had to remain aboard the *Sunfish* until the weather abated enough for me to leave the ship.

Chairman PROXMIRE. Under these circumstances, Admiral, I think it would be very helpful to the subcommittee, and appropriate, if you feel free to add to your testimony this morning and if you would also reply to questions that we might want to send you.

BASIS FOR TESTIMONY

Admiral RICKOVER. I will be happy to do so, sir. I am sure you are aware of my deep respect for and appreciation of our Congress. It is an honor to appear before this committee. I will try to help in any way I can.

I feel deeply my obligation, when asked, to give my views to the elected representatives of our people. The views I express are my own. I have no personal aspirations.

I can only hope that these views will be of some assistance in seeing to it that the public's business is carried out in a proper manner.

You know of my concern about defense procurement. I think the American public is entitled to have its business done prudently and economically. In my judgment our military procurement often falls short of this ideal.

Chairman PROXMIRE. The testimony of several witnesses earlier this week confirms that judgment, Admiral.

Admiral RICKOVER. Perennially, for the past several years, in testimony before various congressional committees, I have pointed out serious and fundamental deficiencies in defense procurement practices. My testimony on the policies of the Department of Defense has earned me disfavor among some of my superiors. They seem to think it is improper for a military officer to criticize their actions. They think of criticism as idle mischiefmaking designed to distract men from their tasks. Not wishing to be against openness of opinion, they cry out for "constructive" criticism, by which is commonly meant, "Admire us, don't complain."

All measures benefit by criticism, because all are capable of improvement. The modern world changes so rapidly that any formula right for yesterday is apt to be wrong for tomorrow. Adjustment to change is essential. But how to bring change to large institutions, institutions which are usually unaffected by competition, is the difficult problem. Criticism does for the large institution what competition does for the individual or for the small business.

To lay bare what is wrong is not an idle exercise in ex post facto faultfinding. Rather, it is an act of rectification. If it is not performed and accepted, faults, undiscovered and uncorrected, are bound to produce new difficulties. These may differ from the present ones, but are bound to be just as detrimental.

That is why I feel a duty to speak out when I see a fault in the system—even if the system has been designed by my superiors. I have refused to allow propaganda or ideology or a narrow loyalty to administrators to deny the evidence of my own senses as well as of the facts. I do not shade my work to appease administrators or to gladden the hearts of bureaucrats. Nor do I believe in the diversion of intellect to the justification of departmental policy.

Those who know segments of Government operations have an obligation to see that their knowledge is not lost. My particular experiences have given me a unique opportunity to assess this issue, and I have no alternative but to confront it.

Chairman PROXMIRE. In this regard, Admiral, I want to emphasize how grateful we are that you, and all the witnesses we have had at these hearings, recognize the obligation to share your expertise with this committee.

Admiral RICKOVER. Thank you, Mr. Chairman.

But I must warn you not to expect, just because testimony in these hearings shows reform to be necessary, that it will come without much additional effort, or that it will come soon. Despite my testimony over the past several years and the reports of various congressional committees, the situation remains unchanged. But at least the problem is now more precisely defined. I am disillusioned but not discouraged.

In assessing the situation that exists today, I have attempted to sort out some guiding principles, based on my own experience in Government, my deductions from observing how others in Government operate, and my analysis of history. What I say is empirical and practical, and not a search for a system of government philosophy.

If you agree, I will briefly describe some of the things that concern me. Then, if you wish, we can discuss them in more detail, sir.

Chairman PROXMIRE. Go right ahead, Admiral.

Admiral RICKOVER. I have three main points.

THREE BASIC POINTS OF TESTIMONY

First, the laws and regulations concerning defense procurement are toothless, loose, and outmoded. They contain many loopholes that industry is able to exploit. Defense procurement rules need drastic overhaul and tightening.

Second, in procurement matters, the Department of Defense is too much influenced by the industry viewpoint. Procurement rules are interpreted to benefit industry rather than to protect the American public.

Third, Congress will have to take the initiative in correcting deficiencies in defense procurement. Neither the Department of Defense, the Department of Commerce, nor the General Accounting Office will do it. It should not be left to a self-interested defense industry to decide what is the best for the American people.

EXAMPLES SHOW DEFECTS IN PRESENT PROCUREMENT RULES

Let me give you some specific examples to show how defense procurement is being conducted under present procurement rules. Specific examples are frequently an extremely useful tool to cut through generalities.

Recently, a Department of Defense official refused to approve one of my contracts—a $50 million contract—because he thought the contractor should get a higher profit than the latter had previously agreed to accept.

Another Department of Defense procurement official told me I had no business negotiating a profit lower than that suggested by Department of Defense procurement regulations.

In still another case, I found that one supplier was charging the Government $8 an hour for design work while he charged commercial customers only $6 an hour for the same work. The Department of Defense decided that this procedure was proper under "generally accepted accounting principles." At my request the General Accounting Office looked into this contract and concluded that the Department of Defense had been overcharged $5 million.

Another case: For several years the Navy paid more than the Atomic Energy Commission for the same work at two Atomic Energy Commission-owned laboratories. I first pointed this out in 1964, but the Department of Defense did not correct the situation until 4 years later. During these 4 years the extra cost to the taxpayer was $1.5 million.

Another case: I found a major defense contractor not complying with the requirements of the Truth-in-Negotiations Act 6 years after its enactment. During those 6 years he had received about $1.2 billion in defense contracts.

Another case: Department of Defense procurement regulations do not have accounting principles for fixed-price-type contracts even though three-fourths of defense procurements are in this category.

Another case: Department of Defense officials claim they have "no evidence of excessive profits," yet they have no knowledge of the profits being made on more than 50 percent of their contracts.

Chairman PROXMIRE. This is shocking; this is really shocking.

Admiral RICKOVER. What is so shocking about it, sir? It has been going on for many years.

Chairman PROXMIRE. I didn't know it had been going on for many years. I say it is shocking to me that people in the Department of Defense, whose responsibility it is to keep costs down, are acting this way.

Admiral RICKOVER. It is a sad fact that there is no sustained, serious, informal, specific criticism of the Defense Department by those in the Department itself. Instead of checks and balances, there are checks and imbalances.

There is a tendency for anyone who is in power to keep his own mistakes secret, and thus exempt himself from criticism. But there is no greater recipe for disaster than a persistent refusal to face unwelcome facts, to believe that what you are doing needs no improvement.

HIGHER PRICES IMPAIR NATIONAL DEFENSE

Last May I testified that uniform accounting standards alone could save as much as $2 billion a year on defense procurement. However, if all defense procurement regulations were properly tightened up, my estimate of $2 billion would be low. More than $2 billion could be saved if the laws and regulations governing defense procurement were given a thorough overhaul. Compare this to $800 million, the total amount appropriated for Navy shipbuilding in the Appropriations Act for fiscal year 1969, and you can appreciate the importance of this issue.

We are not able to buy all the equipment we need. Paying more than we should prevents us from having many items we need to defend our Nation.

Chairman PROXMIRE. So this has an adverse effect on our defense as well as on the taxpayer's pocketbook. It means we don't get the ships we need.

Admiral RICKOVER. Yes, sir. That is an important point. Beyond any ethical or political considerations, excessive prices militate against the defense of the United States.

SUMMARY OF PREVIOUS TESTIMONY

Let me briefly summarize some of the major points I have made in my testimony to Congress over the past several years:

Point 1. The lack of a uniform standard of accounting is the most serious deficiency in Government procurement today. Without such a uniform standard, it is virtually impossible to discover what it costs to manufacture defense equipment and what profit industry makes in producing it—unless months are spent reconstructing suppliers' books. Without such a standard, the Truth-in-Negotiations Act and the Renegotiation Act cannot protect the public against excessive profit on defense work because contractors are able to allocate costs to Government contracts in almost any manner they choose. Defense contractors should be required by law to keep their books in a way that will provide meaningful information on their costs, and to base their proposals for contracts on an accounting system that meets Government standards.

Point 2. The Department of Defense in the past few years has taken it upon itself to increase profits on negotiated defense contracts by an average of 25 percent. Industry and the Defense Department claim

that profits are too low; in my judgment, they may be too high. The profit levels on defense contracts should be reviewed to determine whether or not they are higher than they should be and whether the Government derives any benefit from these higher profits. In my opinion, the Government does not.

Point 3. The Department of Defense profit guidelines should take into consideration the extent of contractor investment in plant, facilities, and skilled personnel needed to perform the work. Under the Department's weighted guidelines method of profit analysis, profits are based primarily on estimated costs so that contractors who have little invested in Government work get the same profit as contractors with a substantial investment in such work.

Point 4. Defense contractors should be required by law to provide a certified report of costs and profit upon completion of each contract over $100,000 so the Government can tell what it costs to manufacture the equipment and how much profit industry made producing it. Criminal penalties should be provided for false or misleading reports.

Point 5. The Armed Services Procurement Regulation has become a device to protect industry rather than an aid to help Government contracting officers charged with protecting the Government in the procurement of military supplies and equipment. The Regulation should be revised to make clear that its profit provisions are intended to be upper limits for Government contracts and to encourage contracting officers to obtain the most favorable terms for the Government.

Point 6. All defense contracts should require prior Government security clearance of all advertising so that technical information regarding this country's military capabilities will not be given away to potential enemies. Further, the Armed Services Procurement Regulation should be modified to prohibit reimbursement of advertising costs on any negotiated contract.

Point 7. Uniform patent rules for all Federal agencies should be established by law. These rules should require that the rights and title to inventions financed by public funds be retained by the Government for the American people whose taxes have paid for them.

Point 8. Current Department of Defense policies regarding use of Government-owned machine tools tend to perpetuate their retention and use at contractor plants. Decisions involving use of Government-owned machine tools on subsequent contracts should be subject to the same reviews as decisions to provide machine tools in the first place.

Point 9. The Government should adopt a uniform policy on how much home office general and administrative expenses should be paid for work at Government-owned, contractor-operated plants.

Point 10. Department of Defense procurement procedures should be strengthened to insure prompt closeout of contracts following completion of work in order to protect the public against large, after-the-fact, contractor claims.

Point 11. The Department of Defense is too much influenced by an industry viewpoint, particularly in Government contracting where the opposite should be the practice. Therefore, Congress will have to take the initiative to correct the deficiences in defense procurement; the Department of Defense will not act of its own accord.

What I am suggesting is that Congress should reexamine its rights and duties under the Constitution, and not let them lapse. Congress is not merely an advisory body. It is the agent of the people. There is no one else to look after their interest. Good intentions will not protect people; laws are needed, not wishes.

All bureaucracies have the tendency to distort the record to show themselves to good advantage. Facts are as vulnerable to manipulation as any other form of power. Bureaucracies ceaselessly strive toward the state of pure nonaccountability, but it is not the purpose of the American Government to insure the comfort of our appointed officials. Nor must the servants of the Pentagon become our masters. Some of those in the directing stratum appear to believe that beautiful phrases will rescue them from vicious facts. Statistics can be used to confuse and oversimplify. When the reader—or the writer—does not know what they mean, the result is semantic nonsense.

For example, Defense Department officials have issued glowing public statements on economy and cost reduction. You will find many Potemkin demonstrations in the Pentagon—as elsewhere—of people trying to convince you of the perfection of their standards, their qualities, their accomplishments. The practice of the Department of Defense has been to boast so loudly at the slightest accomplishment that the sheer decibel count gives the satisfying illusion that a revolution is going on. They claim to have "saved" so much money in the past few years that were this true, we would need to build several large repositories to house the "savings." But from what I have seen their actions contradict their statements.

GOVERNMENT HAS TWO MAILING LISTS

I have come to the conclusion that there must be two separate mailing lists for distributing instructions to Government personnel. On one list, you get instructions to be economical; don't waste Government funds; the President urges you to cut down costs, and so forth. On the other list, you get instructions to pay higher profits; spend more money than you need to; look out for industry because industry is not capable of looking out for itself. My problem is, I am on both mailing lists.

Chairman PROXMIRE. When you say mailing lists, are you talking about specific letters that you get? Specific instructions?

Admiral RICKOVER. Yes, sir. There are specific directives. Being a simple person with a single track mind, I am confused because I don't know whether to comply with what the President and the Congress say about being economical or to carry out the orders of some of my superiors to spend more than I need to. Maybe I need some psychiatric help to understand it, or maybe they need some. [Laughter.]

Chairman PROXMIRE. Admiral, I would like to go into the subject of profits on defense contracts.

Last April, before the House Banking and Currency Committee and again on May 1 before the House Appropriations Committee, you testified that profits on defense contracts have increased by about 25 percent over the past several years.

I quote you: "Far from being too low as claimed by the Department of Defense and industry, they may be too high."

Why do you suspect that they may be too high?

Admiral RICKOVER. Mr. Chairman, you should understand that today there is no way of knowing whether defense contractor profits are too high or too low.

First, the Department of Defense does not get reports of costs and profits under firm fixed price contracts. These contracts account for over half the total Department of Defense procurement.

Second, there are no uniform standards of accounting for costs under defense contracts. As a result, you cannot tell how much profit industry really makes, even when contractors report costs and profits.

In the absence of comprehensive, factual information on profits realized on defense contracts you are forced to develop your own conclusions based on available information. I will tell you why I think defense profits may be too high.

PRICES OF MILITARY EQUIPMENT RISING STEEPLY

For one thing, prices of military equipment have escalated in the past several years much faster than the Bureau of Labor Statistics indexes for items in the civilian economy. The Bureau of Labor Statistics Wholesale Price Index for manufactured goods shows an increase of only about 1.5 percent a year since 1959.

Chairman PROXMIRE. Department of Labor showed 1.5 percent a year?

Admiral RICKOVER. Yes, sir; 1.5 percent per year or about 15 percent since 1959. However, prices for military equipment have gone up 30, 40, 50 percent and more.

Chairman PROXMIRE. Over what period did this 30-, 40-, 50-percent increase occur?

Admiral RICKOVER. In some cases, it has occurred just in the last 2 or 3 years. For example, the price for the propulsion turbines and gears for the nuclear-powered aircraft carrier *Nimitz* was about twice as high as the propulsion turbines and gears for the *Enterprise* although the equipment is nearly identical. That is an increase of nearly 100 percent in 8 years.

Chairman PROXMIRE. How much did the price of the equipment increase?

Admiral RICKOVER. The price increased from $5.5 to $10 million, sir.

Chairman PROXMIRE. To what do you attribute the higher price?

REASONS FOR INCREASE IN PRICES

Admiral RICKOVER. The intense competition for available industry capacity is one reason. In addition, average profits on defense contracts are 25 percent higher now than they were during the 1959–63 period. Labor and material escalation also contributes to the higher prices. However, I believe much of the increase stems from suppliers' ability to charge questionable costs to defense work, and from outmoded defense procurement regulations. Defense procurement rules are written on the assumption that competition is the rule rather than the exception. This results in loopholes that contractors are able to exploit at the expense of the taxpayer.

Chairman PROXMIRE. Would you please explain that, Admiral?

Admiral RICKOVER. Back in 1809 Congress passed a law requiring—

"That all purchases and contracts for supplies or services which are or may, according to law, be made by or under the direction of either the Secretary of the Treasury, the Secretary of War, or the Secretary of the Navy, shall be made either by open purchase, or by previously advertising for proposals respecting the same * * *."

Under the formally advertised procedure, the Government publicly announced what it wished to buy and everyone was given an opportunity to bid on the work. Contracts were awarded to the low bidders. In those days, military supplies were relatively simple: wagons, rifles, cannon, ammunition, food, clothing, horses. Many firms could provide these items and new suppliers could easily enter the market.

The requirement to procure by means of formal advertising was continued by subsequent legislation through the Armed Services Procurement Act of 1947, the present legal authority for defense procurement regulations. This act continues the basic rule that defense equipment should be procured by formal advertising. However, it provides, essentially, that if equipment cannot be procured through formal advertising, it may be procured by negotiation under the authority of one or more of 17 exceptions to the rule requiring formally advertised procurement. These are called negotiated procurements. Currently, only about 11 percent of defense procurement is formally advertised—all the rest is negotiated under one or more of the 17 exceptions.

In negotiated procurements competition is limited. Over half the Defense Department's negotiated procurements are sole-source. Defense equipment is much more complex today than it was even a few short years ago. The majority of defense procurement dollars go to the large corporations that can muster the scientific, engineering, production, and financial resources required to perform multimillion-dollar defense contracts for very complex equipment such as aircraft, missiles, ships, electronic equipment. Among these corporations there is little real competition. The firm that receives the first order has a substantial advantage over its competitors for subsequent orders. Further, in today's market, under the pressures of a rapidly expanding civilian economy and the Vietnam war, there is a high volume both of commercial and defense work. There is plenty of work to go around, so that industry can shop for the contracts it wants to take.

COMPETITIVE PROCEDURES FOR NONCOMPETITIVE PROCUREMENT

Despite this situation of limited competition, defense procurement regulations are primarily oriented toward competitive procurement. The problems arise when the rules and reasoning of formally advertised, competitive procurement are applied to negotiated procurements where competition is limited.

The Department of Defense has developed a concept of competitive, negotiated procurements under which it can select which firms may bid on the order and then award the contract based on the bids received, as if in a formally advertised procurement. I call this the "competitive, noncompetitive" or the "non-negotiated, negotiated" procurement procedure.

Adding up these procurements, the Department of Defense contends that more than half are competitive. Its procurement rules have been developed as if this were really the case. In fact, however, true competition in defense procurement is the exception, not the rule. I believe that steps should be taken to establish appropriate pricing safeguards.

The competitive negotiated procurement provides the simplicity of formally advertised procurements but eliminates the safeguards that protect the Government in noncompetitive procurements. In the competitive, negotiated procedure, contractors do not have to reveal their cost estimates. There are virtually no pricing safeguards; they are exempt from the Truth-in-Negotiations Act.

That is what I mean when I say that defense procurement regulations are outmoded. They try to fit the noncompetitive procurements of today into the mold of yesterday's competitive procurements. The resulting loopholes lead to higher prices. I am concerned that the Government does not receive corresponding additional value for the higher prices paid.

Chairman PROXMIRE. Would you agree with Mr. A. W. Buesking—he is a former Pentagon procurement expert now teaching at the University of Southern California. He was with the Pentagon until last August and he said yesterday, as I recall, that costs are 30 to 40 percent higher than they would be under competitive conditions, that is on defense contracts where you have negotiations with the sole source and do not have competition. Do you agree with that?

Admiral RICKOVER. His estimate is a conservative one. Does that answer your question, sir?

Chairman PROXMIRE. Yes; it does. Please go on.

Admiral RICKOVER. Every indicator I have seen shows that profits on defense contracts have increased substantially in the last few years. Companies are asking higher and higher profits. Large defense contractors are reporting record high profits to their stockholders.

Suppliers of propulsion turbines are insisting on 20- to 25-percent profit as compared with 10 percent a few years ago.

Several nuclear equipment suppliers are requesting 15 to 20 percent profit.

Profit percentages on shipbuilding contracts have doubled in the past 2 years.

One division of a large company recently priced equipment to a Navy shipbuilder at a 33-percent profit.

There are other indications of high profits. The examples I just gave are only a few I have seen in the course of my recent work.

GENERAL ACCOUNTING OFFICE CONFIRMS 25-PERCENT INCREASE IN PROFIT

As a result of my testimony in 1966, the House Appropriations Committe asked the General Accounting Office to ascertain what effect the Department of Defense weighted guidelines method of profit computation had on profit levels. The General Accounting Office confirmed what I had said. They found that negotiated profits had increased by 25 percent. Here are their findings:

NEGOTIATED PROFIT RATES ON DOD CONTRACTS

[In percent]

Type of contract	Profit on cost		Percentage increase
	1959-63	1966	
Firm fixed price	9.0	10.6	18
Fixed price incentive	8.9	9.8	10
Cost plus incentive fee	6.0	8.2	37
Cost plus fixed fee	6.2	7.6	23
Average for all types	7.7	9.7	26

DEFENSE WORK MORE PROFITABLE THAN COMMERCIAL

As you know, Dr. Murray Weidenbaum of Washington University at St. Louis conducted a study comparing profitability of defense and nondefense work. He concluded that the gap between defense and nondefense profits has indeed widened over the past decade—in favor of defense business.

His study compared six firms whose Department of Defense and National Aeronautics and Space Administration contracts were estimated to make up over three-fourths of their total sales, with six nondefense firms having a similar sales volume. Here is a summary of his findings:

COMPARISON OF DEFENSE- AND NONDEFENSE-ORIENTED CORPORATIONS

	Average of sample of defense firms		Average of sample of industrial firms	
	1952-55	1962-65	1952-55	1962-65
Profit margin on sales (percent)	3.0	2.6	4.5	4.6
Capital turnover per year	6.1×	6.8×	2.9×	2.3×
Return on net worth (percent)	18.6	17.5	13.0	10.6

Chairman PROXMIRE. Admiral, it appears obvious from what you say that this matter of profits on defense work should be of great concern to Congress. However, the Department of Defense does not agree there is any need for such concern.

DEPARTMENT OF DEFENSE ARGUMENTS UNCONVINCING

Admiral RICKOVER. Both the Department of Defense and industry contend that defense profits are low. They quote Renegotiation Board figures and a recent Department of Defense financed study made by a private research corporation, the Logistics Management Institute, to support their argument. I find their arguments unconvincing.

First, the profit figures from the Renegotiation Board are unreliable for determining overall profits on defense contracts. The annual report of the Renegotiation Board specifically cautions against use of such figures for generalizations about the profitability of defense business as a whole or even the profitability of the renegotiable sales the Board has reviewed. When you take into consideration the exemptions allowed under the Renegotiation Act, you will recognize why the Renegotiation Board makes this statement. Despite this warning, the Department of Defense continues to use Renegotiation Board figures to support its claim that there is no basis for concern that contractors are making high profits on defense contracts.

Second, the Logistics Management Institute's study of defense profits and costs, upon which the Department of Defense places great weight, was based on unverified and unaudited information volunteered by defense contractors who elected to participate in the study. Forty-two percent of the contractors who were approached provided no data. The costs and profits reported were not based on any uniform standards of accounting.

It seems to me that firms that could actually "show" a low-profit figure on defense contracts would be eager to participate in such a study because their figures would then support a case for higher profits on defense work, while firms with high profits would naturally be reluctant to furnish such information.

DIFFERENCES BETWEEN REPORTED AND ACTUAL PROFIT

Further, it has been my experience that the data reported by contractors are generally quite different from the actual data found on Government audit. Let me give you a comparison which shows the difference between profits reported by five contractors and the actual profits determined by Government audit:

COMPARISON OF REPORTED AND ACTUAL PROFITS

[In percent]

Contractor	Profit reported	Actual profit by Government audit
A	4.5	10.0
B	12.5	19.5
C	11.1	16.9
D	[1] 2.0	15.0
E	21.6	32.7

[1] Loss.

In short, the approach used by the Logistics Management Institute does not appear to provide a sound basis for determining the profitability of defense contracts.

The Department of Defense admits to a 22-percent increase in profits on defense contracts under its weighted guidelines method of profit computation, but argues that this increase is only in the negotiated or "going-in" profit. It contends that contractors generally incur higher costs than they originally estimate when pricing the order and as a result, actual, or "coming-out" profits are much less. However, I find that the only factual information the Department of Defense possesses on profits—its in-house profit review system—indicates that contractors actually do realize their "going-in" profits. I have a table which compares average *negotiated* profit and average *earned* profit on defense contracts totaling about $11 billion between July 1, 1958, and December 31, 1963, based on information in the Pentagon's in-house profit review system:

COMPARISON OF NEGOTIATED AND ACTUAL PROFITS

[In percent]

Type of contract	Average negotiated profit	Average earned profit
Firm fixed price	(1)	(1)
Fixed price redeterminable	9.3	8.6
Fixed price incentive	9.3	9.2
Cost plus incentive fee	6.4	7.2
Cost plus fixed fee	6.4	6.1

[1] Data not available.

The earned profit figures in the table are based on costs the contracting officer agreed to accept—not necessarily those shown on the contractor's books or those determined by the Government auditor. You can see from this table that on a comparable basis contractors are, for the most part, realizing their negotiated profits. And please note that the Pentagon's in-house profit review system has no information on firm fixed price contracts.

After the Department of Defense again this year claimed that defense profits are low, I did some checking. I found that in fiscal year 1967, 35 defense contractors accounted for 50 percent of the dollar value of Department of Defense procurement. These 35 contractors had, during this period, a 12-percent higher return on investment than half of the top 500 U.S. industrial firms as identified by Fortune magazine. This is one more indication that profits on defense contracts are not as low as the Department and industry would like us to believe.

The Department of Defense weighted guideline method of establishing profit was supposed to discriminate among contractors so that those who performed well or took more difficult contracts would receive higher profits than those who performed poorly or took less difficult contracts. As near as I can tell, the only result has been that the Department of Defense has increased profits paid on defense contracts by about 25 percent and, as it turned out, without regard to the nature of the contract or to contractor performance.

Chairman PROXMIRE. Yes, we had testimony on this point earlier this week that there is no correlation between performance and profits. We had testimony earlier this week that contractors are not penalized with lower profits for poor performance.

Admiral RICKOVER. That is what I have been getting at, sir. Everyone gets more profit. Like rain, it falls equally on the just and the unjust. And higher profits can substantially increase the cost of defense contracts.

People tend to think of profits on defense contracts as only that amount of profit being paid to the prime contractor. Often they fail to recognize that a large percentage of the prime contractor's costs represents profits of subcontractors. The total amount of profit paid to contractors on a defense contract is often considerably greater than the profit of the prime contractor himself, because profits may be compounded through several layers of subcontractors.

To illustrate, let me tell you what can happen in a typical situation when a shipbuilder procures a component to be installed in a ship. I will use a motor-driven pump as an example. The shipbuilder buys the motor-driven pump from a pump manufacturer; the pump manufac-

turer buys a motor for the pump from a motor manufacturer; the motor manufacturer buys certain parts for the motor from a parts supplier.

Suppose it costs the parts supplier $100 to make the parts. To this he adds 10 percent for profit. He then charges the motor manufacturer $110 for the parts.

The motor manufacturer who bought the parts builds the motor. He adds a 10 percent profit to his manufacturing costs; he also adds a 10 percent profit to the cost of the parts he bought. So, in his total price to the pump manufacturer he includes $121 for the parts—the $110 he paid the parts supplier plus $11 profit.

The pump manufacturer manufactures the pump. He adds a 10 percent profit to his cost of manufacturing the pump; he also adds a 10 percent profit to the cost he paid for the motor. In his total price, the pump manufacturer charges the shipbuilder $133 for the parts used in the pump motor—the $121 he paid in the price of the pump motor plus a $12 profit.

The shipbuilder buys the completed motor-driven pump and installs it in the ship. He charges the Government 10 percent profit on his installation costs; in addition, he charges a 10 percent profit on the cost he paid for the motor-driven pump. Thus, in his price to the Government, the shipbuilder charges $146 for the parts used in the pump motor—this includes the $133 he paid in the price of the completed motor-driven pump plus a $13 profit.

In this example, the firms involved would make the following profits on the $100 worth of parts used in the motor:

Parts supplier	$10
Motor manufacturer	11
Pump manufacturer	12
Shipbuilder	13
Total	$46

Of the $46 in total profit, only $13 would be visible to the Government as "profit"—the remaining $33 would be included in the shipbuilder's "costs."

Please note that in my example the shipbuilder makes more profit on the parts than the parts supplier. Please note also that I have not shown the profit the pump manufacturer made on the work done by the motor manufacturer nor the profit made by the shipbuilder on the completed motor-driven pump delivered to him. The shipbuilder would, in addition to the $13 profit he made on the material, also make 10 percent or more on the work performed by the motor manufacturer and the pump manufacturer. That is another issue that should be looked into—the question of how much profit a contractor should get on subcontracted work.

The point I want to make here is that when the Department of Defense increases profits 25 percent, as it did in establishing its weighted guidelines method of profit computation, the cost to the Government is increased substantially. For example, suppose each firm in the previous illustration increased its profit from 10 percent to 12.5 percent, an increase of 25 percent. Although you might think the total cost to the Government would increase by $3.25—25 percent of the shipbuilder's $13 profit—actually the total cost would increase of $14 because of the compounding of profits through the tiers of sub-

contractors. An increase in profits on other costs, such as labor, would increase the total cost to the Government in a like manner.

Frequently, defense contractors are able to pay large profits to other divisions of their own company by subcontracting portions of the work to them and then treating the profit made by other divisions as "cost" under the contract, so that these extra profits will not be visible.

For example, several years ago we were negotiating with a large, multidivisional firm—I will call it Company X—for complex equipment for which competition was limited. We were dealing with Division A of Company X. Division A indicated a 15-percent profit in its cost breakdown. However, in looking at Division A's cost breakdown for material and subcontracted work we found that much of the materials and parts were to be provided by Divisions B and C of Company X. Division A, in its bid, included the prices quoted by Divisions B and C without checking the estimates used in these quotes and without getting competitive bids from other firms. We found that Division A's material "costs" included substantial profits for Divisions B and C. Thus, although it appeared that this contract would provide a 15-percent profit, in fact, Company X would receive a much greater profit.

Chairman PROXMIRE. This indicates, Admiral, that in some cases a large prime contractor may benefit by limiting competition in awarding subcontracts.

Admiral RICKOVER. Yes, sir; especially on fixed-price contracts. There are some regulations to prevent this on cost-type contracts, Mr. Chairman, but not on fixed-price and fixed-price-incentive-type contracts which together account for over 75 percent of defense business.

Chairman PROXMIRE. And these awards sometimes go to other divisions of the large company rather than to other firms or small businesses?

Admiral RICKOVER. Yes, sir. I don't think the large corporations are as concerned about small businesses as you are, Mr. Chairman.

BUSINESS HAS RESPONSIBILITY TO THE PUBLIC

The primary purpose of a business is to make a profit. I am not against industry making a reasonable profit on Government business, nor am I interested in having the Government dictate how industry should run its affairs. Economist Milton Friedman wrote:

"Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for the shareholders as possible."

But business, in the conduct of its affairs, does have a responsibility to treat the general public and the Government fairly. I think some businessmen tend to forget this responsibility in their push for higher profits. This is indicated in a report submitted by a Government official who attended a recent defense-industrial forum:

"This industry forum group made six speeches and asked questions for 3 hours. Not once did an industry representative mention customer satisfaction, quality of product, or engineering expertise. The entire thrust was corporate profit, excessive Government surveillance, and inadequate contract performance. The dinner speaker pounded

the same anvil for 47 minutes. * * * The speeches of industry representatives provided a very clear perspective of the arena in which * * * Government managers must grapple with industry."

The Government is constantly concerned about the health of industry; shouldn't business be concerned with the health of Government?

Chairman PROXMIRE. Admiral, you mentioned that the Armed Services Procurement Regulation does not require consideration of return on investment in establishing profit levels.

LOW PROFIT PERCENTAGE CAN BE MISLEADING

Admiral RICKOVER. Normally, the Department of Defense only considers profits as a percentage of cost, so a low profit *percentage* is automatically deemed a low profit. This can be misleading. For example, in the late 1950's the U.S. Tax Court upheld two Renegotiation Board determinations of excessive profits upon appeal by the contractors involved. The Tax Court determined that the amount of excessive profits was greater than even the Renegotiation Board had determined. In one case, the contractor realized profits, before taxes, of about 120 percent of its invested capital; at the time 99.6 percent of its total sales were to the Government.

In another case, a contractor had contracts with the Air Force. Figured as a percentage of the contract price, the profits on these contracts appeared reasonable—7.5 to 9 percent. But when the Tax Court investigated, they found that the contracts provided 612-percent and 802-percent profit on the contractor's investment in 2 successive years when 99 percent of his business was with the Federal Government. So, what may appear to be a nominal profit as a percentage of *cost* may be exorbitant when you consider the contractor's investment. That is why contractor investment should be an essential consideration in evaluating profitability of defense contracts.

CONTRACTORS WHO INCREASE EFFICIENCY MAY LOSE PROFIT

When competition is limited, as it is in the defense industry, the contractor who increases his efficiency may, in the long run, under the present system of determining profit as a percentage of estimated costs, actually lose profit. For example, if it costs $100 to do a job and the contractor gets a 10-percent profit, he earns $10. If he reduces the cost to $90, he will get only a $9 profit. In defense business, the higher the cost, the more profit he makes. So he has no incentive to invest in new machine tools and in other facilities which would make defense work more efficient and less costly. Thus, from the taxpayers' standpoint, the present system provides exactly the wrong incentive to contractors.

UNIFORM STANDARDS OF ACCOUNTING

Chairman PROXMIRE. Let me ask you, Admiral, you said that profits may be too high, and—you are guarded, and I think properly so—that costs may be excessive. Now, one of the difficulties is, of course, it is very, very hard to get at these costs because of the variety of ways in which they are handled.

Admiral RICKOVER. Yes, sir.

Chairman PROXMIRE. You have been the primary advocate of uniform accounting standards. Will you please give us your views on this, how practical it is, and so forth. I wish you would speak to some of the arguments that have been made by the accounting profession that this is too difficult.

Admiral RICKOVER. Mr. Chairman, it is not too difficult to establish uniform standards for accounting. I would use the very same systems which companies use internally to find out what profits they are making on their contracts. They know whether they are making money or losing it. They know it very well, but when it comes to dealing with the U.S. Government, it suddenly become an impossible task to obtain this information.

Chairman PROXMIRE. We had some very able people testify before the Banking Committee in the Senate earlier this year that there is no reason in the world why you couldn't have a uniform accounting standard. You imply that it is a matter simply of disclosure rather than a matter of providing uniform principles. Are you saying they can do this if they wanted to do it? All they have to do is use their present accounting systems.

Admiral RICKOVER. That is part of it. I believe that much of the information the Government needs could be made available with little or no change in their present accounting systems.

Chairman PROXMIRE. The General Accounting Office seems to agree with you. They say this information is available. Is this a matter of the Defense Department not going after it?

Admiral RICKOVER. The Defense Department doesn't want to go after it. The biggest problem, however, is that the information you get isn't meaningful. You have to thoroughly understand the peculiarities of the contractor's accounting system to know whether or not the information is meaningful. Further, he can change his accounting system at will. We need to establish requirements that costs be recorded in a certain manner and in a common language so that the Government and contractors can communicate meaningfully regarding costs and profits.

Chairman PROXMIRE. To get that common language, you must get common accounting principles.

Admiral RICKOVER. That is exactly the point, sir.

Chairman PROXMIRE. I was getting the impression that it was not a matter of arriving at uniform accounting standards—just a matter of going and getting the costs. You don't mean that, as I understand it. You feel that there should be principles that are agreed upon; don't you?

Admiral RICKOVER. Yes, sir. Exactly.

Chairman PROXMIRE. So there is no shifting in depreciation, shifting of R. & D., and that kind of thing?

Admiral RICKOVER. That is right.

Chairman PROXMIRE. And you can save billions of dollars?

UNIFORM ACCOUNTING STANDARDS COULD SAVE MORE THAN $2 BILLION

Admiral RICKOVER. I estimate that uniform standards of accounting could save at least 5 percent of the defense procurement budget. That means that more than $2 billion could be saved each year.

For years I have been pointing out that the biggest loophole in Government contracting is the lack of uniform standards of accounting. Such standards are essential if Government contracting is to be placed on a rational basis.

Uniform standards would help place Government contracting officers on a more equal footing with industry, and would enable them to understand the basis for the prices they have to negotiate.

The Government must have uniform standards of accounting before laws such as the Truth-in-Negotiations Act and the Renegotiation Act can be effective.

Such standards are needed so that the Department of Defense, Congress, and the public can determine what profit industry really makes on defense contracts, and what defense equipment actually costs to produce. I am not talking about rules for bookkeepers or clerks. What is needed are standards from which contractor costs can be evaluated and measured. As it is now, actual profits can easily be hidden by the way overhead is charged, how component parts are priced, or how intracompany profits are handled. Companies are able to report as *cost* what is actually *profit*.

Some believe that lack of uniform standards of accounting is no impediment to sound procurement; that it is possible to determine costs readily without them. I would like to illustrate some of the problems I have encountered in trying to do Government business without uniform standards of accounting.

First, contractors can overload costs on Government contracts with consequent benefit to their commercial work.

SHIPBUILDER'S ACCOUNTING METHODS LEAD TO OVERCHARGES

A problem I ran into several years ago, which took 7 years to settle, illustrates this. We were dealing with a large shipbuilding company that was very successful in competing for merchant ships. I shall refer to him as Shipbuilder Y.

Shipbuilder Y was often the low bidder for merchant ships. Yet in bidding on naval ships, he was usually higher than other commercial shipyards for the very same type naval ship—as much as 10 to 20 percent higher. Despite his higher prices, he was able to obtain contracts to build naval ships because, at that time, factors such as geographical dispersal, distressed labor areas, and labor differential between shipyards often determined where the Navy built its ships.

This disparity kept bothering me. How could he be competitive on one type of ship, yet not be competitive on another type built at the very same yard and with the very same workmen?

So I sent two of my people to look into this anomalous situation. After a cursory review, they reported that Shipbuilder Y was charging the Navy more for its design and other work than he was charging others for the same type work on commercial contracts. For example, the Navy was being charged $8 per hour while for commercial work the charge was only $6 per hour for exactly the same type work.

They also reported that the shipyard accounting system, as approved by the Navy, was allowing the shipbuilder to make charges to overhead and to Navy work in such a manner as to result in lower costs for the commercial work. Costs such as supervisors' salaries, overtime, and premium time were being charged as direct costs on Govern-

ment contracts while similar costs on commercial contracts were being charged to overhead and allocated to all work, Government and commercial.

My people found this system of accounting had been in existence for many years and that Government auditors had accepted these costing methods because they considered that the system conformed to "generally accepted accounting principles."

I wrote to the Comptroller of the Navy giving him the facts I had found and asking him to look into the matter. His reply informed me, in essence, that I didn't know what I was talking about, that I should mind my own business and I could rest assured that his auditors were seeing to it that the Government was being treated fairly. That was tantamount to telling you, when your mother is in danger of falling off a cliff, not to warn her until she has fallen over it.

I persisted. The Comptroller finally had his auditors look into the matter. They concluded that nothing was wrong; everything conformed to "generally accepted accounting principles." The audit was an exercise in self-justification, a facade for inactivity.

A man who has bought a theory often will fight a vigorous rearguard action against the facts. If you do not argue the case as it is, and take refuge in previous decisions and in systems of your own devising, it is possible to justify almost anything.

I finally managed to get the General Accounting Office interested in this case. In 1962, they verified my charges and issued two reports. These reports showed that Shipbuilder Y's accounting practices had resulted in unjustified payments of over $5 million by the Government. Only then did the Navy begin to question these shipbuilding costs. By September 1962, the Navy took action to recover about $6.5 million in costs previously paid the shipyard under Navy contracts, primarily in areas I had questioned.

Four years later the Government finally recovered about $3 million of the $6.5 million originally disallowed, and the case is now closed. It is unlikely any money would have been recovered if I had not been able to get the General Accounting Office to take an interest in the case. I believe the Navy could have saved far more than $3 million had it faced the problem objectively, rather than defensively, when I first pointed it out.

ILLUSTRATION OF NEED FOR UNIFORM ACCOUNTING STANDARDS

Let me give you another example of how a contractor may use his accounting system so the Government cannot tell whether it is paying for only what it gets.

A leading defense contractor maintains a large product engineering group that works primarily on developing design and manufacturing improvements for its products. The company charges this group as an overhead expense to all work, both commercial and Government. In 1964 the cost of the product engineering group at just this one corporate division was about $6.3 million, a substantial sum. The cost is prorated to the company's Government and commercial work.

Government contracts with this company usually involve very little product engineering, whereas their commercial orders involve extensive work of this type. Yet, the contractor collects the entire cost of this group in one lump sum and then prorates these charges to all work,

Government and commercial, so that Government and commercial customers share the cost of this group.

As a result of my testimony in 1965, the General Accounting Office looked into this particular case. The Comptroller General advised the Secretary of the Navy that he could not determine whether the product engineering cost and expenses assigned to Government fixed-price-type contracts were reasonable. He further pointed out that the contractor's engineers sometimes charged portions of their workday directly to certain Government cost-contracts, but charged the remainder of the workday to the product cost and expenses overhead pool which was then allocated to both commercial and Government work in a ratio of the estimated production cost. Thus the Government often paid the full cost of engineering work performed on its contracts and, in addition, absorbed a share of the cost for commercial development work.

The General Accounting Office recommended that the Navy consider some other way of contracting with this company so the Navy could be assured that it bore only an equitable portion of the product engineering costs and expenses. However, the contractor would not provide the Navy a breakdown showing the proportion of the time the product engineering group worked on items that would benefit the Government in contrast to the effort spent on items that would benefit primarily commercial work. After much difficulty, the Navy obtained from the contractor a listing of the general development projects on which the product engineering group was working. The Navy then decided to accept a pro rata share of the cost of this group on Government contracts because the projects appeared to be generally applicable to Navy work.

The Navy never did find out whether the proportion of the product engineering group effort devoted to Navy-type projects was commensurate with the costs charged to its contracts.

EXPERTS DISAGREE ON "GENERALLY ACCEPTED ACCOUNTING PRINCIPLES"

Even Government accounting experts often disagree on how particular costs should be handled under "generally accepted accounting principles."

For example, I have been involved in a case concerning several multimillion dollar contracts dating back to 1958. At that time, there was no Truth-in-Negotiations Act. However, on certain procurements for nuclear propulsion components, cost breakdowns were requested so that the Navy could test the reasonableness of price levels established through negotiations.

In response to these requests for cost breakdowns, the contractor submitted figures that indicated his price included a 10-percent profit.

About 4 years later, in 1962, the General Accounting Office found that the contractor made actual profits of about 45 to 65 percent on these contracts, and that he knew, or should have known at the time he submitted his cost breakdowns, that he would realize these higher profits rather than the 10 percent he represented to the Government.

Chairman PROXMIRE. Can you tell me what firm that was?

Admiral RICKOVER. I would prefer not to identify particular firms or individuals, Mr. Chairman. I use examples in my testimony to

illustrate fundamental deficiencies in defense procurement. I only use examples from my own experience, and it would be unfair to the firms I deal with to single them out when many other companies are undoubtedly doing the same things.

As I was saying, the General Accounting Office investigated these contracts.

The General Accounting Office considered that, under the circumstances, the contractor was not entitled to these excessive profits. The Navy and the Department of Defense agreed with the General Accounting Office. In July 1962, the Navy withheld payment to the contractor of about $4 million, to recover the excess profit. In November 1964, the Navy auditor, after an extensive and thorough review, formally determined that the $4 million was not reimbursable under the Government's contracts. In January 1965, the contractor appealed the Navy auditor's decision. This appeal was ultimately turned over to the Defense Contract Audit Agency and, in February 1966, the defense auditor responsible for auditing this contract issued a preliminary decision substantiating the Navy's action in disallowing the $4 million. In June 1967, the contractor again appealed the case to Defense Contract Audit Agency headquarters.

The General Accounting Office had concluded from a review of the contractor's cost estimates that the contractor knew, or should have known, his price would provide for a profit of about 45 percent of estimated cost. The Defense Contract Audit Agency supported this position until 1968. Then they suddenly reversed their position and proposed to release the money to the contractor.

The Defense Contract Audit Agency, using the same facts that the General Accounting Office used, but a different method of assigning costs, arrived at a different conclusion. The Defense Contract Audit Agency evaluation indicated that the contractor should have expected to realize a profit of only 20 to 27 percent of cost when he submitted his cost breakdown. On that basis, they were proposing to release the money, which would give the contractor a 45-percent profit, until I got into the issue.

Currently, the Navy, the General Accounting Office, the Defense Contract Audit Agency, and the contractor are in dispute over how certain costs should be charged. Should the stated profit have been 10, 20, 27, 45, or 67 percent? In principle, I do not see any difference in misrepresenting costs and profits by a factor of 2 or by a factor of 4.

In cases such as the one I just mentioned, I cannot accept that there should be so many different profit figures, given the same set of facts. Six years after the first General Accounting Office report on these cases, the two foremost accounting groups in Government have not yet agreed on how the costs should be treated. Each believes its method to be correct.

When a corporation submits a price or cost breakdown to the Government, I believe the corporation and the officials involved should be held responsible for its accuracy. Since the corporation has won the rights as a citizen under law, why, then, shouldn't it and its officials have the corresponding obligations and responsibilities of a citizen? In a democracy rights and duties are correlative. It is time for corporations to begin assuming the same morality as individuals rather than an independent, nonhuman outlook. It is one of the glories of

Anglo-Saxon jurisprudence that every official is responsible for his acts. It was not the corporation but its officials that gave the Government this information. However, it appears that they may now be excused for their actions.

In the matter of abuse of privileges, it is industry, not Government, that has the most to lose. The Government tends to obstruct the moment it interferes. If industry takes too much advantage the Government will be compelled increasingly to obstruct.

The threat is to industry itself; the danger is that it will destroy its integrity and credibility and its full value to society. Industry has the choice of freedom to seek its goals without special privileges, or the enjoyment of special privileges without the freedom to act it now has. This is not to suggest that the freedom of a corporation in its capacity of "citizen" should be less than that of a human citizen. It is, however, to make a distinction between the role of corporation officials as individuals and that of the corporation whose servants they are.

GENERAL ACCOUNTING OFFICE REPORTS SHOW DISAGREEMENT

Other General Accounting Office reports indicate some of the problems encountered under the Armed Services Procurement Regulation cost principles. In one case, the General Accounting Office reviewed the cost of bidding and related technical efforts charged to Department of Defense and National Aeronautics and Space Administration contracts. Let me read some excerpts from the General Accounting Office report:

"Paragraph 15–205.3 of Armed Services Procurement Regulation defines the bidding costs * * *. However, if the contractor's established practice is to treat bidding costs by some other method (than defined in ASPR 15–205.3), the results obtained may be accepted only if found to be *reasonable* and *equitable*."

"Although the cognizant (Government) auditor has questioned a significant portion of the bidding and related costs claimed * * * in recent years, the Government negotiator has allowed virtually all such costs."

"DOD has not provided auditing and contracting officials with specific guidelines for implementing the *bidding cost* provision, and these officials, as well as contractors, must interpret the 'bidding cost' provision only by the general terms of the 'reasonableness' provision (of ASPR)."

In another case, the General Accounting Office reviewed selected overhead costs charged to Government contracts. Let me read some statements from that report:

"The Armed Services Procurement Regulation generally requires that allowable indirect costs in cost-reimbursable-type contracts be reasonable * * *."

"The ASPR offers no specific guidelines covering the allocation of plant maintenance and occupancy costs."

"The allocation of building maintenance and occupancy costs on the one-roof basis is only one of several acceptable accounting practices. In our opinion, however, this method is not acceptable when it results in costs being assigned to operations to which they are not applicable and, particularly, where an alternative method would produce a more equitable cost distribution."

In another case, the General Accounting Office also reviewed reimbursement of certain overhead costs under cost-type contracts. The following are excerpts from the contractor's reply to this report:

"The report states that (the contractor) was improperly reimbursed for certain overhead costs incurred during 1959 and 1960 in the amount of $95,000. The report considers that these costs were not allowable under the applicable cost principles in the Armed Services Procurement Regulation. Specifically, the report holds that the Air Force should not have approved the payment of $36,000 of administrative costs related to the contractor's advertising department, $48,000 of administrative costs associated with the contractor's participation in certain exhibitions, and $11,000 of costs associated with the financing of the contractor's operations."

"We believe that your findings and conclusions as set forth above are not correct. You imply or state that the costs in question were unallowable under the applicable ASPR cost principles. The fact of the matter is that the applicable ASPR provisions were silent as to the specific allowability of these costs and hence were subject to consideration under the general ASPR principles of reasonableness and allocability. This being the case, the treatment of these costs were a matter of judgment for the duly authorized Government official; namely, the administrative contracting officer at the * * * plant * * *."

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES CALLED "ELUSIVE AND VAGUE"

Others who have to cope with so-called "generally accepted accounting principles" are beginning to recognize the need for a uniform basis for determining costs. Recently, the Armed Services Board of Contract Appeals heard a case involving a contractor who had certain costs disallowed under Government contracts. The contracting officer did not think they were pertinent to the Government work.

The contractor, of course, defended his accounting method as being in accordance with "generally accepted accounting principles" and appealed the disallowance to the Armed Services Board of Contract Appeals—the Board that settles contract disputes between the Department of Defense and its contractors.

The Board found that generally accepted accounting principles were of little assistance in settling this dispute. Expert accountants gave conflicting testimony. It finally agreed with one of the experts and ruled in favor of the Government. The Board stated in its formal decision:

"Except insofar as the ASPR (Armed Services Procurement Regulation) cost principles themselves reflect generally accepted accounting principles, it is difficult for the Board or the parties to cost contracts to govern their determinations by *such an elusive and vague body of principles* (italic supplied). Yet, accountants apparently persist in talking in terms of generally accepted accounting principles, concepts, standards, or practices. (See Acountants' Handbook, Wixon, 4th edition, 1.13.) In the absence of specific contractual or ASPR coverage, we shall often have to rely on expert opinion evidence from the accounting profession to resolve issues as to what is or is not to be considered acceptable in a given case. In this case, we have no dearth of

accounting opinions. While the witnesses for both parties who furnished the opinions were highly qualified, their opinions were equally conflicting."

Widely differing opinions are commonplace in accounting for work under defense contracts. I had a situation several years ago where Navy and General Accounting Office auditors conducted extensive audits over a period of about 1 year to determine one supplier's actual cost in making equipment for the Government. Altogether there were seven reports containing 11 differing estimates or evaluations of supplier's costs, not counting the estimates made by the supplier himself. These various reports showed estimates of the supplier's costs differing by as much as 50 percent. Thus, while accountants may tell you they have no real problem determining costs, getting accountants to agree on costs in a specific situation is quite difficult.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES CALLED "MEANINGLESS"

An editorial from the October 15, 1966, edition of Forbes magazine illustrates the problem:

[From Forbes magazine, Oct. 15, 1966]

UNACCOUNTABLE CPA'S

"Unaccountable CPA's—It's past time certified public accountants were called to account for practices that are so loose that they can be used to conceal rather than reveal a company's true financial picture. The owners of public companies and the analysts who recommend purchase or sale of their securities used to think they could rely on the honesty of financial statements certified by a reputable outside auditing firm. But in some very spectacular situations, it has turned out that such certification was not of the value or meaning or importance that the public thought. All these certifications usually bear the phrase: 'According to generally accepted accounting principles,' as a phrase which is now coming to be generally accepted as damned meaningless. When the Westec situation hit the fan, it developed that the Ernst & Ernst certification was so 'liberal' as to warrant a less flattering description. Then, not long ago, there was the *Yale Express* case. In Forbes' last issue, Leonard Spacek, chairman of Chicago's CPA firm of Arthur Andersen & Co., urged the establishment of an official Government 'court,' appointed by the President, with jurisdiction over not only CPA's but also Federal agencies like the Securities and Exchange Commission, Federal Power Commission, and Interstate Commerce Commission, to rule on accounting principles.

"With firm rulings from a Government group, Spacek reasons, CPA's will not be subject, as they presently are, to client pressure. Does he think the uproar over Westec's accounting practices will help bring about sweeping reform? Spacek shakes his head. 'No, not unless the public demands it, as they did of the auto companies over the safety issue.'

"We do.

"Before Government action is taken, the stock exchanges, industry groups, and CPA's themselves ought to get together to establish accounting standards that will be standard, and a method of enforcement that will be enforceable."

So you see, anyone who tries to tell you they have no trouble determining costs should be required to do some explaining.

Let me give you another example of how contractors can benefit from an inadequate accounting system. Several years ago the Navy was procuring pumps from one division of a large corporation. Since the price for these pumps was rising, the Navy asked for a Government audit to determine what the actual costs had been on prior orders.

The contractor's accounting records indicated profits between 45 and 65 percent on the prior orders. But the contractor claimed his accounting records did not show the actual cost of performing the work and that his actual costs were higher than his books showed. The Government auditor agreed that the contractor's accounting system did not accurately record incurred costs. He pointed out, however, that the contractor had repeatedly refused to modify his accounting system so that it would show actual costs incurred. Thus, there was no way to tell whether or not the equipment was overpriced.

All I am saying is that on Government contracts we should have some ground rules for costs—and use these ground rules on all contracts, not just on some of them. I am not advocating large, new expensive systems which would be a burden on small business. But I believe it is wrong to keep on awarding contracts totaling hundreds of millions of dollars to the same firms year after year, and still be unable to tell how much the equipment costs or how much profit they make. In 1967, 30 percent of all defense procurement, about $12 billion, went to just 10 large firms. Of the top 25 defense contractors, 23 were among the 100 largest defense contractors 10 years ago. Isn't it reasonable to expect that the Department of Defense should know how these firms spend the Government's money?

I consider that for any contract over $100,000, the Government ought to have a uniform set of accounting standards and ought to require the contractor to account for and report his costs in accordance with that standard. It was Lord Kelvin who said:

"When you measure what you are speaking about, and express it in numbers, you know something about it; but when you cannot measure it, when you cannot express it in numbers, your knowledge is of a meager and unsatisfactory kind."

COST PRINCIPLES NOT APPLIED TO FIXED-PRICE CONTRACTS

Chairman PROXMIRE. Admiral, I thought the Armed Services Procurement Regulation specifies cost principles for Government contracts. Would you please explain this?

Admiral RICKOVER. The Armed Services Procurement Regulation cost principles apply only to cost-reimbursement-type contracts. These cost principles deny certain costs, such as advertising expenses and bad debt expenses that have been determined as a matter of Government policy to be inappropriate for Government contracts. However, these principles do not apply to firm-fixed-price and fixed-price-incentive-type contracts, which together constitute more than 75 percent of defense procurement. The Armed Services Procurement Regulation states that its cost standards are only "guides" in fixed-price contracting. Contractors interpret this to mean that all costs are allowable under fixed-price contracts. Dr. Howard Wright, in "Accounting for

Defense Contracts," states specifically: "No cost is unallowable under fixed-price contracts."

BOOK ILLUSTRATES LOOPHOLES IN REGULATION

Dr. Wright participated in the development of the present Armed Services Procurement Regulation cost principles. He was therefore well qualified to write a book which illustrated some of the loopholes in these cost principles. This is tantamount to preparing a code of ethics and then writing a book on how to beat the rules and still be assured of salvation.

Let me read some of his suggestions from a section entitled, "Ten Ways To Maximize Profits."

In "Maximizing Selected Cost Elements," he states:

"Bidding expense. If these are proportionately greater on Government work, accumulate separately and charge directly to the contracts. Do not allocate all bidding costs to all business.

"Use accelerated methods of depreciation.

"If normal repair and maintenance work cannot be done because of intensive equipment use during contract performance, be sure the contract price covers the cost (if fixed-price contract) or that an advance agreement provides for reimbursement (cost-type contract).

"Price intracompany transfers at transfer prices."

Mr. Chairman, this last point made by Dr. Wright is the profit-on-profit loophole I explained earlier. Although the procurement regulation has some rules to cover this situation, they apply only to cost-type contracts. There are no real rules to cover this situation on 75 percent of all Department of Defense contracts.

To continue:

"Identify and recover precontract and starting load costs that are disproportionate on Government work. For example, heavy recruiting and training costs and abnormal costs of defective work should be 'direct costed.' "

In "Review Unallowable Costs," he states:

"No cost is unallowable on fixed-price contracts.

"For cost-type contracts determine if alternate treatment of item may permit it to be allowable. For example, some entertainment costs might more accurately be classified as travel or employee morale expense."

In "Make Decisions in Light of Section XV, Armed Services Procurement Regulation." he states:

"Contributions to educational institutions are unallowable. However, if the purpose of the contribution is to underwrite losses incurred by the institution in offering courses to the contractor's employees, a lump-sum contract with the institution will accomplish the same objective and will be allowable.

"Avoid stock options and deferred compensation devices. Substitute higher salaries and fringe benefits that are allowable."

In "Prepare Termination Claim on Most Advantageous Basis," he states:

"Use total cost claim where preparatory and starting load costs are heavy and contract is far from complete.

"Use total claim where costs have been higher and profits lower than expected.

"Use inventory claim to protect higher than expected profits on completed portion of the contract."

In "When Preparing Termination Claim on Inventory Basis," he states:

"Include all unrecovered costs in the inventory: materials and components, work in process, unbilled finished goods, plus unrecovered starting load and preproduction costs that may not be recorded anywhere in the inventory."

I hope I have not unwittingly contributed to a run on Dr. Wright's book by Government contractors because of the "nuggets" I have quoted.

Chairman PROXMIRE. I can see why there might be.

NO REQUIREMENT FOR MEANINGFUL ACCOUNTING RECORDS

Admiral RICKOVER. I mentioned earlier that a contractor can change his accounting system at will. This is another major loophole in defense procurement regulations—the absence of definitive requirements that contractors maintain meaningful accounting records. Generally, contractors are only required to maintain an accounting system conforming to the vague standard of "generally accepted accounting principles."

The General Accounting Office has the right to examine the books and records pertaining directly to performance of any Government contract over $2,500 for a period of 3 years after completion of work. However, there is no requirement that contractors' books and records show the cost of this work. This is tantamount to having a season ticket to a theater where the curtain never rises.

The Department of Defense requires that contractors maintain books and records to show the cost of performing certain types of orders, but this requirement does not pertain to firm-fixed-price contracts—55 percent of defense procurement.

These loopholes confront the Government with an endless variety of accounting systems for allocating costs to Government work. The Government has neither the time nor the personnel for full investigation of costs.

Let me give you some examples.

SUPPLIER REFUSES TO KEEP ACCOUNTING RECORDS EVEN AT GOVERNMENT EXPENSE

I am involved in a situation with a sole source supplier of special units for naval nuclear propulsion plants. The supplier refuses to keep accounting records that show the cost of manufacturing this equipment and he will not reveal his manufacturing process. He certifies his cost estimates as required by the Truth-in-Negotiations Act. However, there are no accounting records to back up these estimates. Thus, there is no way to determine whether the prices he quotes are reasonable.

To avoid delaying ships, the Navy released part of one order on his terms and offered to pay him to collect cost information under that order so the basis for pricing future orders could be established, since requirements for these units could amount to several million dollars over the next 2 to 3 years. The contractor answered that he was busy building these units and he would let us know later on whether he could accommodate our request. The first order is now nearly complete and the supplier still has not agreed to set up adequate accounting records. As a result, we will not be able to determine a reasonable price for subsequent orders.

The Navy is pursuing this matter, but since there is no requirement that contractors maintain adequate accounting records, we have no leverage in the negotiation. I doubt we will succeed in getting this supplier to keep meaningful accounting records.

Obviously, controversy abounds when Government contracting officers and auditors are told to use the Armed Services Procurement Regulation cost principles as a "guide" for fixed-priced contracts and contractors contend that these cost principles are not applicable. This conflict accounts for much of the frustration, anxiety, and delay contractors associate with Government business. I do not know why a particular cost, such as a bad debt expense or interest expense should be allowed on one type of Government contract and disallowed on another. Hence my constant request for uniform standards.

Since there are no firm standards for costs on fixed-price contracts under present defense procurement regulations, each Government contracting officer, in effect, determines Government policy with regard to what costs should be reimbursed. They make this determination on a case-by-case basis simply because the Department of Defense is unwilling to make the decision. As a result, one contracting officer might, under a fixed-price contract, allow a cost that would be specifically disallowed under a cost-type contract. Another contracting officer might take the opposite position. Decisions regarding what costs to recognize under fixed-price-type contracts are influenced more by the relative bargaining positions of the parties than by equity. Large contractors are bound to have an advantage over smaller contractors in such situations.

I believe steps can and should be taken *now* to close this loophole.

First, the Department of Defense should immediately make the cost principles in Armed Services Procurement Regulation Section XV mandatory for all types of contracts. This would provide a basis for measuring costs until the General Accounting Office completes its study of uniform accounting standards. Application of Section XV to all contracts would be just a start, however, since other standards are needed in such areas as assigning costs to Government work.

Second, defense contractors should be required to report, upon completion of each order over $100,000, the actual costs incurred and the actual profit realized on the order. Until a uniform standard of accounting can be developed, contractors should be required to calculate costs and profits in accordance with existing principles in Section XV of the Armed Services Procurement Regulation. They should be required to certify these reports and to have them verified by a Government auditor or perhaps a certified public accountant.

Third, contractors should be required to keep adequate accounting records to show the cost of any contract over $100,000.

These three changes would result in an immediate and substantial improvement. Besides providing a sounder base for evaluating costs and profits, they would simplify contract pricing.

GOVERNMENT COULD RELY MORE ON PRIVATE ACCOUNTING FIRMS

With a definitive and uniform standard of accounting and with criminal penalties for improper certification, there is no reason why the Government could not rely to a greater extent on certified public accountants to verify contractor cost information. This could lead to significant savings in cost and time.

Much of the time consumed in the procurement process is not in negotiations. It is lost in the extensive factfinding process, in trying to determine supplier costs and in evaluating them based on the limited information the Government may have at hand. Once uniform standards of accounting are established; once contractors are required to maintain records and to submit a report of actual costs computed in accordance with such standards upon completion of each order; and once contractors are required to submit cost estimates and pricing proposals in accordance with such standards, defense procurement can be conducted economically and rapidly on a rational and coherent basis.

So far I have talked primarily about loopholes in Department of Defense procurement regulations. There are also serious loopholes in the laws Congress has passed to safeguard the money spent for defense procurement. Neither the Truth-in-Negotiations Act nor the Renegotiation Act effectively protects the public against excessive costs and excessive profits. As you know, the real protection in this world comes not from people's good intentions, but from laws.

Chairman PROXMIRE. Please elaborate, Admiral.

FUNDAMENTAL DEFICIENCIES IN RENEGOTIATION

Admiral RICKOVER. There are four fundamental deficiencies in the renegotiation process. First, much of the work most profitable for industry is excluded from renegotiation because of the exemptions which were included in the act as a result of the efforts by special-interest groups.

Second, the Renegotiation Board is not sufficiently staffed to do its job. It has fewer than 200 people to watch over $45 billion of defense procurement, while in 1953 it had 742 people to look after $32 billion of defense procurement.

Third, the Board has no basis for determining actual costs and profits on defense contracts. It has adopted Internal Revenue Service rules which have nothing to do with the way costs are assigned between Government and non-Government work or between contracts that are subject to renegotiation and those that are exempt. Renegotiation cannot be effective when there is no standard for measuring costs and profits on contracts. Internal Revenue Service rules are inadequate for this purpose.

Fourth, contractors are able to average out their profits and shift them from year to year to conceal excess profit in any one year.

Contractors report aggregate Government sales subject to renegotiation and aggregate costs related to these sales. The difference between these two numbers is profit for renegotiation purposes. Obviously, the

manner in which contractors allocate costs among Government and non-Government contracts determines what profit they report. Since contractors have great flexibility in accounting for costs, they have equal flexibility in reporting profits.

Let me read you an excerpt from an article that appeared in the press earlier this year. It quoted a statement by the president of one of the Nation's largest defense contractors, and it illustrates the leeway contractors have in reporting their level of profits:

"The situation in connection with * * * is somewhat different, the president said. There is no question of anticipated losses. The question is one of how much profit to book in a given year. He explained that the company had decided to slow the rate of profitbooking. He added that he wanted to make it clear that the amounts were definitely less than we believe we should—or will ultimately—earn."

As long as the contractor is able to avoid showing a high profit in any one year, he is safe from renegotiation. That does not mean he did not overcharge the Government on defense contracts.

RENEGOTIATION ACT DOES NOT PREVENT OVERPRICING

Large firms have a significant advantage in being able to average their profits. They can overcharge the Government on contracts where competition is slight in order to bid low, perhaps at a loss, to obtain other Government orders in more competitive markets. A company might make excessive profits in one division to compensate for low profits in another division. Since the Renegotiation Board deals in average profits, high profits on one order or in one division of the company can offset low profits on other orders or in other divisions.

Thus, Government may be subsidizing the entry of a large corporation into new markets at the expense of small business. The Renegotiation Board would never know, because the individual transactions are hidden in averages. The analogy is the case of the nonswimmer who thought he would be safe in a river because he had read that the average depth was only 5 feet.

Representative Gonzalez has tried to strengthen the Renegotiation Act by making it permanent legislation. He proposed to eliminate the so-called 35-percent rule. Under this loophole, any item for which 35 percent of the sales was in non-Government markets was automatically exempt from renegotiation. Representative Gonzalez also proposed including construction contracts, machine tools, durable production equipment, and sales to the Tennessee Valley Authority under the act, and lowering the level of reporting from $1 million to $250,000.

RECOMMENDATION FOR ADDITIONAL CHANGES TO THE RENEGOTIATION ACT

I agreed with these recommendations, and made additional recommendations to further tighten the Renegotiation Act. I recommended that industry be required to report cost and profits on every defense contract over $100,000 on a contract-by-contract basis, and that these costs and profits should be reported in accordance with uniform standards of accounting that would prohibit costs not appropriate to Government contracts, such as advertising, bad debts—costs of the type specified in Section XV of the Armed Services Procurement Regula-

tion. I recommend that an authorized senior company official be required to certify such reports, that criminal penalties should be provided for filing false or misleading data, and that such officials or firms not be allowed to plead nolo contendere in these cases. I also recommended that the Renegotiation Act provide for renegotiation of contracts within individual commodity groupings, such as the groupings prescribed by the Federal Supply Catalog, rather than by total company sales.

Representative Gonzalez' proposal to make the act permanent was defeated. However, the 35-percent rule for exemption of standard commercial articles was strengthened somewhat, so that an article will now qualify for exemption from renegotiation if 55 percent of its sales are in commercial markets.

Chairman PROXMIRE. Admiral, you know that we enacted the Truth-in-Negotiations Act to put Government on a more equal footing with industry in negotiating defense contracts and to protect the taxpayer against overpricing. Some Members of Congress and others have argued that with the Truth-in-Negotiations Act we don't really need the Renegotiation Act.

TRUTH-IN-NEGOTIATIONS ACT DOES NOT PREVENT OVERPRICING

Admiral RICKOVER. Congress, the General Accounting Office, and the Department of Defense place great faith in the Truth-in-Negotiations Act as a protection against overpricing. Yet, the Truth-in-Negotiations Act does not and cannot adequately protect the Government against excessive prices. There are several reasons for this.

First, the Truth-in-Negotiations Act assumes that costs and profits can be measured. Without uniform standards of accounting, this is not possible. Suppliers can inflate costs so that it becomes almost impossible to tell what costs are included in the price and what profit a contractor expects to realize on the order.

Second, contracting officers may bypass the Truth-in-Negotiations Act by determining that competition is adequate, even in negotiated procurements, where usually there is in fact little or no competition. The Truth-in-Negotiations Act does not apply when a contracting officer determines that there is adequate competition. In these cases the contracting officer does not obtain or evaluate supplier cost and pricing data in establishing the price. Nor does the contractor have to reveal the basis for his cost estimates; or certify that his price was based on current, complete, and accurate cost information. Once a procurement is judged to be competitive by the contracting officer, the Government assumes full responsibility for high profits and overcharges.

REQUIREMENTS FOR COST DATA ARE WAIVED

Third, requirements for cost data under the Truth-in-Negotiations Act can be waived. Surprisingly, such waivers are granted to many large defense contractors.

Chairman PROXMIRE. Can you give us an example or two?

Admiral RICKOVER. Yes, sir.

The requirement for cost data was waived for a procurement of propulsion turbines, although the price was substantially higher than for similar equipment on a prior order and even though the contractor

himself admitted his price included a 25-percent profit. The contractor argued that he considered his bid was based on competition; therefore, he would not provide cost data. The Government waived the Truth-in-Negotiations Act.

Manufacturers of large computers needed by Government for its research and development programs refuse to provide cost data on orders for new design computers. The entire computer industry takes this position, so the Government has waived the Truth-in-Negotiations Act. Each of these large computers costs the Government $6 to $7 million or more so the procurements are substantial; such procurements amount to over $3 billion each year.

Material suppliers such as steel mills, nickel producers, and forging suppliers usually do not provide cost data.

Chairman PROXMIRE. Why shouldn't it be made mandatory?

Admiral RICKOVER. It should be. This is what I recommend.

As you know, the requirement for cost data under the Truth-in-Negotiations Act does not apply if the contract is judged to be "competitive" or "based on standard catalog prices." Contracting officers generally prefer to judge the procurement to be "competitive" or "based on standard catalog prices" rather than suffer the delays inherent in a head-on confrontation with a large firm that is unwilling to provide cost breakdowns. It seems that the bigger the firm or industry which is unwilling to provide cost breakdowns, the more likely is it that competition will be held to be "adequate."

The determination of competition is one of judgment by the contracting officer. This judgment is difficult. It requires analysis and assessment of many complex factors. These factors are often subjective and intangible, and not susceptible to precise evaluation. Rarely do our contracting officials have the experience and judgment to understand all the factors involved. Yet the decision that competition exists, once the contract is awarded, is final and the Department of Defense does not then or thereafter review supplier books or records, so it can never know when these judgments are wrong.

By deciding that competition is "adequate" the Government contracting officer and the contractor save considerable time and effort because cost data does not have to be obtained or reviewed. Otherwise, the contracting officer must obtain cost breakdowns, have the cost estimates audited, and then negotiate with the supplier, documenting the results. Because there are no uniform standards of accounting this task is difficult, often requiring months of effort by technical personnel, by auditors, and by the contracting officer. Should a contracting officer attempt to analyze the volumes of detailed information involved and overlook some critical point, he may be accused of negligence. He also faces a difficult problem if his review of suppliers' costs indicates the price should be lower than he is able to negotiate.

In large complex procurements it is, therefore, very tempting for a contracting officer to take the easy route and determine that there is "adequate" competition.

Chairman PROXMIRE. Is this done frequently?

Admiral RICKOVER. Yes, sir, I think so. Let me give you an example to illustrate the problem.

PROCUREMENT OFFICIALS RELUCTANT TO NEGOTIATE

Earlier this year, the Navy solicited bids from two companies on a contract covering many millions of dollars. Only these two firms were capable of performing the work. The low bidder's price was significantly lower than his competitor's; however, it was still substantially more than the Government estimate based on experience for similar work. The difference in the production facilities of these two companies gave the low bidder a substantial advantage over the other firm. A comparison of the low bidder's proposal with prior contracts for similar work indicated many areas where his proposal had been unreasonably inflated.

Navy procurement officials looked at the two bids and concluded that competition was adequate. They said they were convinced that both firms wanted the contract. The procurement officials recommended accepting the low bid and awarding the contract immediately, without obtaining and reviewing the supplier's cost breakdown and without negotiating. This is the normal procedure for handling competitive bids.

I told the procurement officials I thought they were wrong. I showed them areas where it was obvious the contractor's price was substantially higher than actual experience on prior orders. I pointed out that, once accepted, this inflated bid would establish a new pricing level with resultant higher prices on subsequent orders.

I told them if they did not get the cost down to a reasonable level before they awarded the contract, the contractor would have no incentive to control his costs and run the job efficiently.

The procurement officials were still not convinced. This was the way they had been awarding contracts. They had decided that under Department of Defense procurement procedures this could be awarded as a competitive contract. They suggested that my only interest was in trying to keep the contractor from realizing enough profit.

I was finally successful in obtaining approval from higher authority for the Navy to obtain the supplier's cost estimates and negotiate the price. As a result, the base price was reduced through negotiations by about $27 million. The contract now falls within the scope of the Truth-in-Negotiations Act, so that all subcontracts placed under this prime contract are subject to the provisions of that law. This probably would not have been the case had the contract been awarded on the basis of "competition."

I believe the Truth-in-Negotiations Act is violated even more in the award of subcontracts than it is in the award of prime contracts.

Chairman PROXMIRE. We asked some of our earlier witnesses to comment on the matter of subcontracting. Apparently, there is little information available on this subject. We did ask about subcontracts, and they had some information regarding small business set-asides and things of that kind, but nothing else. Any information you can provide on subcontracts would be helpful.

SUBCONTRACTING IS THE HIDDEN PART OF THE ICEBERG

Admiral RICKOVER. Subcontracting is the hidden part of the procurement iceberg. About half the work under large defense contracts is subcontracted. From what I have observed this is an area that may be full of procurement abuses.

Chairman PROXMIRE. Yes, it is enormously important as you indicated. We want very much to get at that. Our hearings wouldn't be complete without it.

Mr. COHEN. Admiral Rickover, when these prime contractors bid for sophisticated weapons, and they have a number of subcontractors, have they already had to go to these subcontractors to get some idea of prices and capacity to perform a certain job? On the prime contract, do they delineate who will be their subcontractors?

Admiral RICKOVER. Sometimes they do, but it is not necessary that they do so. It is the Government's choice. If, for technical or other considerations, it is necessary that a certain part of the work be subcontracted to a particular firm, the contracting officer may include a contract requirement to that effect.

However, if you have a competitive contract, the contracting officer will generally not place any restrictions on subcontracting.

Chairman PROXMIRE. Suppose you don't have a competitive contract?

Admiral RICKOVER. Even then, contractors are seldom bound to a particular subcontractor by terms of the prime contract, except where necessary from a technical standpoint. The Department of Defense pays little attention to subcontracting.

I am currently involved in several large Government contracts where I have arranged to review and approve subcontracts prior to placement of the contract. Normally in the Navy—and I suspect elsewhere in the Department of Defense—it is not the practice to review these procurements on a case-by-case basis. Rather, Department of Defense personnel review and approve the contractor's purchasing system, and rely on the approved system to assure reasonable prices for the Government. With a Government-approved procurement system, the contractor is no longer required to submit subcontracts for Government approval.

The procurements I have seen indicate that Government-approved procurement systems often result in unreasonable prices for the Government.

I found that, in actual fact, nearly all procurements are treated as "competitive." Shipbuilders generally do not obtain supplier cost or pricing data from their suppliers. I have seen procurements recommended as competitive when only one supplier could physically perform the work.

CONTRACTORS FAIL TO COMPLY WITH LEGISLATION

I found that one large defense contractor had not implemented the requirements of the Truth-in-Negotiations Act *6 years* after its enactment. During that period he had received about $1.2 billion in Navy contracts.

Chairman PROXMIRE. Why couldn't we have a study made by the General Accounting Office of the enforcement of the Truth-in-Negotiations Act? Where it is being used; where it is not. They should be able to do that easily.

Admiral RICKOVER. Yes, sir, and to find out why it isn't being used.

I found that some major subcontractors have never provided the cost data required by the Truth-in-Negotiations Act. The prime contractor simply concluded that competition was adequate so he could

place the order without the delay of requesting a waiver to the Truth-in-Negotiations Act and without a major confrontation with the supplier.

Just this week I sent a letter to the Assistant Secretary of the Navy for Installations and Logistics about the Navy's ship procurement practices. I listed specific examples I had encountered.

In one case a shipbuilder received only one bid and it was substantially higher than previous prices for similar equipment. The proposed price was $311,000, about $75,000 more than the shipbuilder paid several months earlier for the same type units for another ship. The bid price was about $152,000 more than similar units bought in 1964 for the same type ship. The shipbuilder recommended this procurement as a competitive deal because he had requested the bids from several companies. Even though only one company bid, the shipbuilder did not obtain and evaluate the supplier's cost and pricing data as required by the Truth-in-Negotiations Act.

I rejected the shipbuilder's recommendation and insisted that he obtain and review supplier cost and pricing data as required by the Truth-in-Negotiations Act. As a result, the price was ultimately reduced by about $85,000 through negotiations. The final price still provided a substantial profit to the supplier.

In another case a shipbuilder requested approval for a procurement which provided for about a 33-percent profit on the supplier's estimated costs. In recommending approval of this procurement, the shipbuilder pointed out that the profit had been negotiated down from 46 percent.

I disagreed with this procurement and asked the shipbuilder to obtain a Government audit. The auditor pointed out further areas where the supplier's estimated costs were higher than could be supported by his books, so there was potential for even higher profit than we thought. The shipbuilder subsequently advised us he was unable to negotiate a lower price but that the supplier was submitting a new cost breakdown to show higher cost and lower profit, but the same price. In his recommendation the shipbuilder stated:

"In view of the competitive nature of this procurement, our evaluation of the reasonableness of the total price quoted and the urgent necessity for early placement of the order, we recommend that the contracting officer give us his consent to procure these sets from * * * at the total price of $518,488 as well as the stock components at a total price of $161,409 without waiting for the revised cost breakdown or the final audit report from DCAA. Attention is again called to the [supplier's name] position that the total price for these sets will not be reduced."

In another case, a shipbuilder recommended approval to place a $216,000, sole-source subcontract for equipment. Initially, the supplier refused to provide the cost data required by the Truth-in-Negotiations Act. I insisted that the shipbuilder obtain the cost data. Eventually, the supplier acquiesced. The cost breakdown he provided indicated a 25-percent profit on his estimated costs and, in addition, numerous unsubstantiated contingencies that could provide him a potential profit in excess of 50 percent. Nonetheless, the shipbuilder recommended this procurement at the bid price.

The overcharges I have been talking about do not seem large, individually. However, you must remember, sir, these examples are but

a small fraction of 1 percent of all procurements in this category. You can easily imagine the hundreds of millions of dollars that could be saved if the Department of Defense required its contractors to obey the Truth-in-Negotiations Act.

Chairman PROXMIRE. I am interested in seeing your letter to the Assistant Secretary. Will you provide us a copy?

Admiral RICKOVER. Mr. Chairman, I cannot release the letter without prior Navy approval.

Senator PROXMIRE. If there are any difficulties in obtaining release of this letter, I would like to be informed.

(The letter follows:)

DEPARTMENT OF THE NAVY,
NAVAL SHIP SYSTEMS COMMAND,
Washington, D.C., November 13, 1968.

Memorandum for the Assistant Secretary of the Navy (Installations and Logistics).

Subj: Need for improvements in ship procurement practices.

Encl: (1) Examples of Recent Procurements Recommended by Shipbuilders but Which Were Overpriced.

1. The rising cost of naval ship construction has been a matter of considerable concern to the Navy. I believe that a large portion of the price increase in the Navy's shipbuilding program results from poor contracting practices.

2. There is little or no real price competition for shipbuilding contracts or for complex equipment that shipbuilders buy. However, for many years, the Navy has awarded shipbuilding contracts, and shipbuilders have awarded subcontracts, on the basis of "adequate competition".

3. Early this year, Navy procurement officials recommended awarding the DLGN 36–37 ship construction contract without negotiating because they considered the competition obtained from two bidders adequate, even though NAVSHIPS technical and project personnel found numerous indications that the low bidder's price was excessive. Ultimately, NAVSHIPS obtained permission to negotiate the price. Through negotiations, the low bidder's base price was reduced by $27,000,000.

4. Enclosure (1) contains several recent examples of shipbuilder procurement that indicate the inadequacy of the Navy's present procedures for ensuring reasonable prices for the Government under shipbuilding contracts. These examples were discovered because I require specific NAVSHIPS review and approval of major subcontracts for equipment under my technical cognizance. Normally, the Navy does not review subcontracts on a case-by-case basis. Instead, the Navy approves a shipbuilder's procurement system and then relies on the approved procurement system to obtain reasonable prices for the Government. From what I have seen, this procedure has not been effective.

5. Because competition for major ship construction contracts is limited, ship prices are influenced more by historical costs than by competitive market pressures. Since shipbuilders base their quotes on subcontractor bids, they have little incentive to negotiate lower prices after they receive a contract. In the long run, higher cost bases will

generate higher profits, since profits are generally established as percentages of estimated cost.

6. I believe that the Navy should face up to the lack of true competition in the shipbuilding industry and among the suppliers of shipboard equipment. Competition in this field is the exception—not the rule.

7. I recommend that you initiate a review of shipbuilding procurement practices, placing particular emphasis on the lack of true competition available, both at the prime contract and subcontract levels and on the depth of contractor and government review being performed on these procurements. If carried out effectively, such a review should lead to improvements that could save the taxpayer many millions of dollars each year. Pending completion of this review, I recommend that you require specific Navy review and consent to all subcontracts in excess of $100,000 under cost reimbursement and incentive type contracts.

8. If I can be of further assistance, please let me know.

H. G. RICKOVER,
Deputy Commander for Nuclear Propulsion.

EXAMPLES OF RECENT PROCUREMENTS RECOMMENDED BY SHIPBUILDERS BUT WHICH WERE OVERPRICED

I. MAIN CIRCULATING SEA WATER PUMP PROCUREMENT

On May 17, 1968, Shipbuilder A requested NAVSHIPS approval to procure main circulating sea water pumps from the only bidder of seven companies solicited. The proposed price for these pumps was $311,000—about $75,000 more than Shipbuilder A paid in Feburary 1967 for similar pumps used in construction of another type ship and about $152,000 more than was paid for pumps bought in 1964 for the same type ship. Shipbuilder A recommended the $311,000 price as reasonable based on increased technical requirements and known price escalation. He did not obtain and evaluate the suppliers' cost and pricing data as required by Public Law 87–653.

NAVSHIPS disapproved the proposed subcontract and asked Shipbuilder A to obtain and evaluate the supplier's cost data to insure that the price was reasonable. This data showed that the price of $311,000 would provide the pump supplier a $43,000 profit on direct labor costs of $4,707, subcontracts and materials totaling $213,387, and other costs. including sales expense, G&A and interest, totaling $50,694. Based on the suppliers' cost data, Shipbuilder A negotiated a price of $228,000 which was about the same price paid for similar pumps purchased eighteen months earlier. The negotiated reduction of about $85,000 consisted of a reduction in price, including profit, of about $45,000 and a reduction of about $40,000 in resolution of technical requirements. However, the reduced price still provided the pump supplier a profit of about 10% on his total costs and about 45% on his "in-house" costs. Without special review by NAVSHIPS, Shipbuilder A would have placed this order as a competitive deal and the cost to the Government would have been $85,000, or about 35% higher.

II. MOTOR GENERATOR SET AND VOLTAGE REGULATOR PROCUREMENT

On 14 August 1968, Shipbuilder A requested NAVSHIPS approval to place a firm price contract for motor generator sets and voltage

regulators at a price of $513,488, including $122,500 for the voltage regulators. The supplier's cost breakdown indicated that the price of $122,500 for voltage regulators included a 33% profit on cost—a profit two to three times higher than would normally be paid under ASPR guidelines. In their submission to NAVSHIPS, Shipbuilder A stated this profit was considered reasonable since the items were "high risk" and the profit had been negotiated downward from 46%.

NAVSHIPS disapproved the proposed procurement. Shipbuilder A was requested to initiate an audit of the supplier's cost breakdown and negotiate a more reasonable price. Shipbuilder A subsequently advised NAVSHIPS that the preliminary audit report indicated questions relative to labor and material man hours. However, Shipbuilder A recommended placement at the price originally offered by the supplier since the supplier had indicated his total price was final and not subject to further negotiation. With respect to the high profits, Shipbuilder A indicated that the supplier was submitting a new cost breakdown to show higher costs, lower profit and the same price. On this basis, Shipbuilder A stated:

> "In view of the competitive nature of this procurement, our evaluation of the reasonableness of the total price quoted and the urgent necessity for early placement of the order, we recommend that the Contracting Officer give us his consent to procure these sets from * * * at the total price of $518,488 as well as the stock components at a total price of $161,409, without waiting for the revised cost breakdown or the final audit report from DCAA. Attention is again called to the (supplier's name) position that the total price for these sets will not be reduced.

This procurement is still pending.

III. MAIN SEA WATER PUMP PROCUREMENT

Shipbuilder B recommended that NAVSHIPS consent to a $216,000 subcontract for main sea water pumps for which there was only one source.

Initially, the supplier refused to provide the cost data required by Public Law 87–653. NAVSHIPS insisted that Shipbuilder B obtain the required cost data. The supplier finally acquiesced. A Government audit of the supplier's cost breakdown showed the following:

1. A 25% profit on his estimated costs.
2. His cost estimate included $34,000 of other costs the Government auditor considered questionable. He had added a 20% factor to material costs, factory labor, and factory overhead costs to provide an allowance for possible defective work. A 10% factor was then added to each cost element for possible cost increases during the two-year period of contract performance. A 20% factor was then applied to the total cost less general and administrative expenses to compensate for the risks of Government inspection. The Government auditor could not obtain data to support these mark-up factors.
3. The price included a $68,000 subcontract with another division of Shipbuilder B's parent corporation. This firm declined to furnish cost and pricing data to the pump supplier, the shipbuilder or the Government because the procurement was less than $100,000. Although this procurement was less than $100,000, the Navy's

aggregate procurement of such motors from this firm, either directly or as a lower tier supplier, constitutes a very large sum since this firm is the Navy's leading supplier of quiet pump motors.

Shipbuilder B has been told to continue negotiations in order to obtain a more reasonable price and to obtain and provide data necessary to justify the reasonableness of the price. This procurement is still pending.

Admiral RICKOVER. You must further understand that the Truth-in-Negotiations Act does not insure reasonable prices in noncompetitive situations. This was illustrated by a large machinery procurement in which I was recently involved. Originally, there were two suppliers of this type machinery. Both competed for a $5.4 million lead order. The unsuccessful bidder withdrew from the business. When I went to procure a second set of machinery from the remaining supplier, he increased the price from $5.4 to $8.4 million. When the Navy tried to negotiate a more favorable contract, he raised his price to about $9 million.

I thought he would have trouble certifying cost data to support his price as required by the Truth-in-Negotiations Act, since his cost estimates were obviously inflated. He had no difficulty at all. Whatever numbers the contractor could not support, he carefully labeled as his "best judgment" so that he could not subsequently be accused of misrepresenting any facts. The Government had to accept his price since he was the sole-source supplier. This contractor will not have to worry about any future price adjustment under the Truth-in-Negotiations Act. He protected himself well. Nonetheless, I believe that the contract was overpriced.

CONTRACTORS SAY "TAKE IT OR LEAVE IT"

Chairman PROXMIRE. Do companies often give you "take it or leave it" propositions with regard to cost?

Admiral RICKOVER. Yes, sir; but often in a subtle manner.

They include unwarranted contingencies in their estimates and defend them as real costs that simply do not show up on accounting records for previous orders. Then they refuse to negotiate these "costs."

Sometimes, contractors submit a "courtesy bid." A courtesy bid is a bid so high as to insure that the contractor will not get the order. It is a more graceful way to tell the Government that he is unwilling to perform a particular order.

As in the case of the Renegotiation Act, the establishment of uniform standards of accounting would go far to make the Truth-in-Negotiations Act more effective. It should be strengthened to prohibit its being waived for contractors who do large amounts of negotiated defense work, say $1 million or more annually. I also recommend that the Truth-in-Negotiations Act be revised to require that Government agencies obtain, and that contractors provide, detailed cost and pricing data on all procurements that cannot be awarded based on advertised competitive bid procedures.

GOVERNMENT SUBJECTED TO VOLUMINOUS CLAIMS

The Government's procurement problems do not stop when a contract is awarded. Contractors often submit claims for additional

remuneration for extra work they allegedly performed beyond the requirements of the contract. Some contractors retain law firms that specialize in presenting these claims and who become very proficient in finding loopholes in contracts. I am sure you know that such law firms are endemic in Washington.

Some have large staffs that begin preparing and documenting claims the day the company starts work on a contract so that at time of contract completion, the claim can quickly be submitted with voluminous backup.

Usually, backup information for claims is quite detailed and the legal arguments extensive. The actual costs of performing the contract, however, are seldom supported by the accounting records. The contractor explains that his accounting system does not separately identify the cost of changes or of extra work. Therefore, he prepares a so-called independent estimate which is usually inflated to give him room to negotiate an overall settlement that will be satisfactory to him. The contractor then submits the claim and waits.

On the Government side, the claim arrives in the midst of other more urgent problems involving day-to-day operations. The Government is not adequately staffed, as is the contractor, to undertake the research and fight these claims. Please bear in mind that frequently the work of preparing claims and fighting the Government is charged to the contractor's overhead costs—which the Government pays. The Government people devote as much time to evaluating the claim as they can afford without jeopardizing other urgent Government business.

Usually, the effort concentrates on whether the legal arguments have merit. Once the Government concedes partial liability, the contractor is in the driver's seat in negotiating the cost for that item, since there are no accounting records to substantiate the claim. The Government seldom knows what it is really paying for in claim settlements.

Many claims result from contract changes. Because much defense equipment is complex and requires a long time to build, the Government often has to make technical changes during the life of the contract. Although most Government people try hard to keep these changes to a minimum, they are often necessary to take advantage of operating experience or of new developments. Some changes are of an urgent nature and have to be authorized before the work can be priced, to prevent a contractor from proceeding with unnecessary work in areas affected by the change.

Once a large unpriced change has been made, the door is open. These changes are often very complex, requiring a lengthy period to prepare the necessary estimates and negotiate the price. Frequently, a large backlog of unpriced changes develops, and this backlog is still pending at the time the contract is completed. The contractor can then combine these changes with whatever other claims he is able to develop, valid or not, and submit a single large claim against the Government.

In these circumstances, it is usually not possible to determine the cost of the individual changes for which the Government is responsible. The Government is forced to negotiate a lump settlement. It is here that the contractor has the Government at a great disadvantage.

Contractors are very careful not to account for change orders sep-

arately. There is no requirement that they do so. Thus, contractors can use change orders as a basis for repricing these contracts. They have almost unlimited freedom in pricing change orders because their accounting system will never show the cost of the work. The Government can never really evaluate the amounts claimed or check up to see if it paid too much.

Contractors know that their chances of success on a contractual claim increase as the claim grows older. The case drags on, Government personnel familiar with the original contract and the claim move to other jobs. The new Government representatives do not have time to learn all the details in the backlog of claims. Rather than dispute the claim in ignorance, the Government negotiates a lump-sum settlement. Contractors take this into consideration in preparing their claim. The claim is made sufficiently large so they will still win their desired settlement, even though there is the appearance of compromise.

In a recent case, a contractor submitted a $70-million claim on a $70-million fixed-price contract. The contractor's supporting documentation filled dozens of file cabinets. The Government simply did not have enough people to review the claim in detail, much less analyze the supplier's voluminous backup material in order to arrive at a proper basis of settlement on the individual items. Actually, extra people would not have helped much because this contractor's accounting system does not identify the cost of changed work or the cost of resultant delays. This claim was settled on a lump-sum basis, at about 90 percent of the amount the contractor claimed.

TWO-MILLION-DOLLAR CLAIM ON ONE-MILLION-DOLLAR CONTRACT

In another case, a construction contractor submitted a $2 million claim on a $1 million contract awarded him in 1961. In view of previous unfounded claims by construction contractors which had been settled in their favor, my staff devoted considerable effort in originally writing this contract to protect the Government against unfounded claims. We provided that no changes could be authorized except in writing by a specifically designated Government representative. The contract specified that change orders had to be priced out before the contractor could proceed with the work. We carefully prepared the specifications in such a way as to leave no uncertain areas and we warned the contractor, in writing, exactly how the contract was to be administered to avoid unwarranted claims. The contractor was given the opportunity to withdraw before he signed the contract if he did not wish to perform on the basis we proposed. He did not withdraw.

The contract was awarded 7 years ago; the work was completed over 6 years ago; but the claim resulting from this contract is still not settled. The claim was denied by the contracting officer, but the contractor appealed and was upheld by a Government Contract Review Board. The contracting officer, doubting the legality of payment, requested a decision from the General Accounting Office prior to paying the claim. The lawyers representing the contractor then argued that the General Accounting Office did not have the right to review the claim. However, in 1966, the General Accounting Office ruled in the Government's favor and disallowed the entire claim.

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The contractor's lawyers then brought suit in the U.S. Court of Claims. Since that time, there have been motions and cross-motions, briefs and counterbriefs. The most recent development is an offer by the contractor to settle if the Government would pay him only $1.5 million rather than the $2 million he originally claimed. Of course, this offer should be rejected. The Government owes him nothing.

To fight his claim we have had to expend thousands of hours of the time of our technical people whose services are required on urgent defense work.

Even more frustrating is that this very same contractor is able to repeat these tactics again and again because there is no Government-wide system to alert other Government agencies of his performance.

The Government continues to do business with contractors regardless of the time and effort it must spend fighting and paying unfounded claims.

ODDS FAVOR CONTRACTOR IN CLAIMS AGAINST GOVERNMENT

Once the contractor wins a settlement on one of these claims, he is apt to submit claims on other Government orders. He knows that the odds are in his favor; he has nothing to lose if the claim is disallowed. The Washington claims lawyers generally work on the basis of getting a percentage of what they can get out of the Government. Some manufacturers submit claims—valid or not—almost as a matter of course on their Government contracts. One way to deal with this problem would be to identify contractors who are taking advantage of the claims procedure, and to consider this in determining their suitability to perform other Government work.

In this regard, I believe the executive branch should maintain contract experience records which reveal such matters as original and final prices of contracts, the amounts of unfounded and exorbitant claims submitted by contractors, and the amounts of excessive profit, so that this information can be considered by all Government agencies prior to awarding subsequent contracts.

GOVERNMENT REIMBURSES CONTRACTORS' ADVERTISING COSTS

Chairman PROXMIRE. Admiral, in your testimony before the House Appropriations Committee, you stated that the Department of Defense is paying for advertising costs on defense contracts. I thought this was prohibited under defense regulations.

Admiral RICKOVER. No, sir. This is another major loophole in Government contracting.

I first testified on this subject before the House Appropriations Committee in 1961. Senator Howard Cannon, at about that time, testified before the Senate Appropriations Committee on the same subject.

As a result of this testimony, Congress included a provision in the fiscal year 1962 Department of Defense Appropriations Act prohibiting reimbursement for advertising costs of defense contractors except for (1) the recruitment of personnel required for performance of the contract; (2) the procurement of scarce items; or (3) the disposal of scrap or surplus materials. It was clear that Congress expected contractors to pay for advertising out of corporate profit, except for the

three items I just enumerated. I again testified on this subject in May 1967 before the House Appropriations Committee. Congress reiterated its position by including a prohibition against the Government paying advertising costs of defense contractors, in the fiscal year 1968 Department of Defense Appropriations Act.

These provisions were incorporated into the cost principles in section XV of the Armed Services Procurement Regulation. But, as I explained earlier, these cost principles do not apply to fixed-price and fixed-price-incentive-type contracts which account for three-fourths of all defense contracts. Contractors can charge advertising costs to these contracts despite the congressional prohibition.

It is clear that the intent of Congress is to insure that Government funds are not spent on advertising regardless of the type of contract. I have no reason to think that Congress wanted these costs disallowed under cost-type contracts only.

Yet to this day, I do not believe the Department of Defense has made any effort to insure that defense contractors are not reimbursed for advertising costs.

This is a real danger in a bureaucracy. You establish a rule and you think the problem has been solved, but the rule is then interpreted in such a way that the purpose is defeated. That is why hearings of the kind you are conducting are important. Congress constantly has to check; it constantly has to make certain that the laws and regulations are being carried out in accordance with the intent of Congress.

SECURITY INFORMATION AVAILABLE IN ADVERTISEMENTS

What also disturbs me is that many defense contractor advertisements are inimical to the security of the United States. A vast amount of technical information regarding this country's military capabilities is being given away through advertisements. I am not talking about classified information, whose publication is prohibited. I am referring to the large amount of unclassified information pertaining to manufacturing techniques and the capabilities of military hardware, all of which is valuable to potential enemies.

A recent statement attributed to a former Communist spy says, in effect, that the Soviet military attaché's office in this country is able to acquire openly and without subterfuge 95 percent of the material it needs to meet its intelligence objectives. It was stated that in most other countries Soviet-bloc agents spend 90 percent of their time in clandestine efforts to obtain information which can readily be found in American publications.

Let me give you some recent examples of what I am talking about. The November 1968 issue of *U.S. Naval Institute Proceedings* contains 36 pages of advertising by defense contractors. The October 1968 issue of *Armed Forces Management* magazine devotes 98 of 162 pages to advertising by defense contractors. Information is disclosed on the following:

Solid-state weapons control radar used on the F–4E Phantom.

Superjet aluminum used in C–5A.

Reducing weight of the C–5A's high-frequency communications system by 26 percent.

Description of fire power of CH–53 helicopter.

Shipboard missile radar fire control system.

A–7A Corsair II jet.

AS–12 missile which has the destructive power of a 155-millimeter high explosive projectile at ranges up to 6,500 yards.

One-man tank stopper weighing only 27 pounds and superior in range and accuracy to a 90-millimeter recoilless rifle.

New OH–6A convertible helicopter.

New ASW aircraft P–3C Orion.

A new radar unit to aid ballistic missile defense.

Tactical radar for pinpointing enemy mortar locations.

Navy's SQS–26 sonar for detecting enemy ships.

There are many magazines of this kind. The items being advertised are Government property. Neither the Government nor the public derives any benefit from such advertising. Only the corporations involved in creating a good image—it helps sell their stock and other products—and potential enemies of the United States derive benefit from such advertisements by defense contractors.

I am not even convinced that this advertising achieves its goal of creating a favorable image of the advertiser. The American public is not as gullible as Madison Avenue sometimes likes to believe.

Chairman PROXMIRE. In this connection, you may be interested in the reaction of Mr. Don Maclean of the *Washington Daily News*. He wrote the following in his column on June 4, 1968:

"We were sitting in the Embassy Theater here the other evening when in addition to the regular feature, we were treated to a short subject. It was in praise of the F–111 (TFX) which has had an unfortunate career in combat and is not thought to be too airworthy by those who must buy it. On the screen the F–111 flashes by while a deep voice says, 'This plane can fly nonstop across the Atlantic Ocean!' (So could Lindbergs's). The voice continues, 'This plane can drop bombs from low altitudes: this plane * * * et cetera, et cetera.' (The short subject is truthful to the extent that nowhere does it assert that the F–111 can do any of these things very well.) I assumed that the short was cranked out for propaganda purposes by the Defense Department, but at the end I saw that the producer was [name of contractor]. Judging from the film, the F–111 seems capable of marvelous maneuvers when it manages to stay airborne for any length of time."

RECOMMENDATIONS CONCERNING DEFENSE CONTRACTORS' ADVERTISING

Admiral RICKOVER. I believe specific actions can and should be taken to curtail advertisements of this type and also to insure that the Government does not pay for these or other advertisements.

Here is what could be done:

First, Congress should require the General Accounting Office to determine whether the Department of Defense has complied with the provisions of the Defense Appropriations Act specifically prohibiting reimbursement of advertising costs.

Second, the Department of Defense should be required to modify the present Armed Services Procurement Regulation provisions to prohibit reimbursement of advertising costs as an element of cost on any negotiated contract. Advertising costs would have to be paid from profits.

Third, a mandatory clause should be included in all defense contracts requiring prior Government security clearances for all adver-

tising relating to military hardware. I have such a clause in each of my contracts. It requires that the company must obtain Government approval prior to release of any information relating to work under the contract. Were you to read any of these magazines you would find no advertisements or technical data about naval nuclear propulsion plants.

GOVERNMENT-OWNED TOOLS IN CONTRACTORS' PLANTS

Chairman PROXMIRE. You have testified on excessive use of Government-owned facilities in contractors' plants. We have made some progress in getting the Department of Defense to improve its regulations in this area. Do you have any further recommendations on this subject?

Admiral RICKOVER. Yes, sir. This is another significant loophole in the Armed Services Procurement Regulation.

Department of Defense policy requires that contracting officers put Government-owned machine tools in possession of contractors to the greatest possible use in the performance of Government contracts or subcontracts, so long as this does not confer a competitive advantage on the holder. I believe this policy causes machine tools to be kept in suppliers' plants much longer than necessary.

My experience has been that Department of Defense contracting officers routinely authorize use of Government-owned machine tools, even after the contracts for which the tools were originally provided have been completed. As a result, the Government incurs considerable additional cost; these machine tools are not available for bona fide needs, and suppliers' incentive to invest in their own machine tools is sharply reduced. In addition, this policy inhibits competition.

Initially, there is probably a real need for the Government to place Government-owned tools in a particular supplier's plant. But after a few years, this need generally passes. However, as other contracts are placed with the supplier, Government contracting officers automatically keep on authorizing him to use the Government-owned tools on the new orders, the theory being that once the Government has had to buy tools it should use them extensively to make it look like a good investment. It is not a question whether the Government-owned tools are actually needed to do the work, or whether authorizing their use on new contracts will keep the tools at the supplier's plant longer than necessary, but whether the supplier is willing to use them on other Government work.

These decisions perpetuate the retention and use of Government facilities in suppliers' plants, whether or not this is in the best interest of the Government.

Contractors naturally like this policy. It is to their advantage to retain the Government tools as long as possible because they get extra production capacity with no investment or risk.

The Department of Defense policy states that Government-owned tools should be used on other Government work in the factory so long as this does not confer a competitive advantage on the holder. Obviously, any contractor who holds Government-owned machine tools has a substantial competitive advantage. If these tools did not provide such an advantage, he would not be so interested in getting and keeping them.

I have always followed the policy that contractors should provide their own machine tools to perform my work. To get them to do so, I have established a firm requirement that they must use their own machine tools for nuclear work. For the most part I have been successful in achieving this objective. In a few exceptional cases I have been forced to resort to use of Government-owned machine tools.

Several years ago, I had to provide a contractor with Government tools in order to get an important job done. It would not otherwise have been possible to get it done on time. Despite the large number of machine tools the Government owns, I was told that these tools were not available and that the Navy would, therefore, have to buy new tools. The ones I needed were common, general-purpose machine tools. It seemed preposterous that there were not excess machine tools in the Department of Defense inventory which I could use. But I was told that all were in use and that I would have to buy new ones. I decided to check into the matter further. I screened the tools supposedly in use, and soon found suitable ones that could be made available for my work. This saved more than a million dollars on the particular contract. More important, it indicated to me that serious deficiencies existed in this area of Government procurement.

I testified to the House Appropriations Committee in May 1966 concerning this matter and recommended that Congress ask the General Accounting Office to look into the way the Department of Defense administers Government-owned machine tools; I suggested the General Accounting Office determine how much the Government has invested in machine tools which are unnecessarily tied up in suppliers' plants. I also recommended that Department of Defense procedures be strengthened to make certain that decisions to authorize the continued use of existing Government-owned facilities at suppliers' plants be reviewed to the same extent as the decisions to provide the facilities in the first place.

The General Acounting Office carried out a review of Government-owned equipment in contractor plants. As you know, they found significant deficiencies. You and your committee were instrumental in focusing public attention on these deficiencies. Since that time, some improvements have been made. However, I have seen no effort by either the Department of Defense or the General Accounting Office to change the existing policy of routinely authorizing use of existing Government-owned equipment on subsequent Government contracts.

I again recommend that you ask the General Accounting Office to check into how many Government-owned machine tools remain in contractor plants after completion of the program for which they were originally provided, determine the level of Department of Defense management at which these decisions are made, and review the controls in effect to insure that Government-owned equipment is not left too long in supplier plants because of routine perfunctory authorizations by contracting officers.

GOVERNMENT AGENCIES HAVE A "GIVEAWAY" PATENT POLICY

Chairman PROXMIRE. Admiral, I know that you have expressed concern about the patent policies being followed by the Defense Department. Professor Weidenbaum also mentioned patents briefly in his testimony the other day. Could you give us your views on this matter?

Admiral RICKOVER. Mr. Chairman, I have been disturbed for many years at the patent policies followed by most Federal agencies, particularly the Department of Defense. Except for the Atomic Energy Commission and the National Aeronautics and Space Administration, most Government agencies have adopted "giveaway" patent policies under which the Government normally retains only a nonexclusive royalty-free license for itself, granting title and principal rights to contractors, even when inventions are developed at public expense under Government contracts.

In June 1961, I testified at length on this subject before the Senate Committee on the Judiciary, with Senator John L. McClellan presiding. Senator Russell Long, among other Senators, was also present. He has performed a major service to the Nation by bringing this matter to public attention. As a result of the attention focused on the problem by Senators Long and McClellan, as well as my testimony and that of others, the executive branch conducted a review of patent practices within the various agencies as they affect the disposition of rights to inventions made under contracts with industry. Upon completion of this study, President Kennedy, in October 1963, issued a "Memorandum to the Heads of the Executive Departments and Agencies on Government Patent Policy."

Basically, the President's memorandum, which is not an Executive Order and has no basis in law, encourages, but does not require, the Government to acquire the principal rights to inventions, where the nature of the work to be undertaken or the Government's past investment in the field of work favors full public access to resulting inventions. On the other hand, the policy states that the public interest might also be served by according exclusive commercial rights to the contractor in situations where he has an established nongovernmental commercial position, and where there is greater likelihood that the invention would be worked and put into civilian use than would be the case if the invention were made more fully available.

"TITLE" POLICY VERSUS "LICENSE" POLICY

The President's memorandum attempted to strike a middle ground between a "title" policy and a "license" policy. The "title" policy is based on the precept that since the research leading to the invention was carried out with public funds, the rights to the invention must be taken by the Government and dedicated to the free use of the public. The practice of permitting such rights to rest in the hands of a private corporation endangers the public interest by further concentrating economic power, to the detriment of a freely competing economy.

Conversely, the "license" policy provides the Government with only a royalty-free, nonexclusive license under the patent, with all other rights being granted to the contractor. The contractor is permitted to patent and market the invention as though it were an ordinary commercial item developed at his own expense. The proponents of this policy argue that the public interest is best served by providing incentives of exclusive rights to those who invent or discover. They feel that a practice of making the creative efforts of Government contractors freely available for the use of everyone does not benefit the public interest or carry out the intent of the patent law.

A patent, you must remember, is a grant of certain rights by the Government to an inventor. The grant lasts for 17 years. During this time it gives the inventor, or someone to whom he assigns his patent, the legal right to prevent anyone else from making, using, or selling the invention. The patentholder thus has a property right which, in effect, is a monopoly. He may sell or assign the patent itself. He may also grant licenses to manufacturers and sell the invention, practice the process, or carry on any other activity in connection with the subject of the patent. Or, he may choose to practice the invention exclusively for his own profit. If his patent is infringed, he is protected by law. He may receive damages for any economic injury sustained.

The President's memorandum specifies three categories of procurement that result in different treatments of patent rights: Category I—Title in the Government, category II—License in the Government, and category III—Disposition of rights deferred. It is categories I and II that I want to discuss.

The Government "normally" acquires title—that is, the principal or exclusive rights—to inventions made in the course of, or under, a Government contract in four situations:

One, when the contract is for the development of products or processes specifically intended for commercial use by the general public, such as an improved fertilizer, or when its use will be required by governmental regulation, such as an aircraft safety device. Such contracts are relatively rare in the Department of Defense.

Two, when the contract is for the development of products or processes directly related to the public health, not items of purely military application. Situations like this could be found in the Department of Defense, as in contracts for the development of drugs and medical instruments, but more likely would be found in contracts of other Government agencies such as the Department of Health, Education, and Welfare.

Three, when the contract is in a field of science or technology in which there has been little or no significant experience except for work funded by the Government, or where the Government has been the principal developer. The best example here is the field of nuclear energy where the Government financed all early research and development work.

Four, when the contract is in one of the following two fields of nonpersonal service; either for operating a Government-owned research or production facility, or for coordinating and directing the work of others.

In every other case, that is, category II—the Government grants the patent rights to industry. The policy words are dressed up a bit so that they do not appear so black and white. Granting such rights to a contractor is supposedly intended to best serve the public interest—"by encouraging the contractor to direct his highest quality personnel, know-how and experience toward solving the Government's research problems; by recognizing the contractor's equities in the technical field; and by leaving the invention in the control of an organization qualified to further develop it into a commercially usable product in the shortest possible time."

Regardless of the niceties of the word engineering, it all boils down to the fact that valuable patent rights are being given away to industry—rights that belong to the American taxpayer.

What does the executive branch's generosity get the taxpayer? I know of no case where companies charge more to do research and development if they are not permitted to keep proprietary or commercial patent rights. The contracts with these companies are nearly all cost plus, and the fees are about the same throughout the Government. Conversely, I know of no case were a contractor has offered to accept a smaller fee if he is permitted to keep the proprietary or commercial patent rights that result from his Government-financed research and development.

Nor do I agree with the statement frequently made that unless patent rights are assigned to industry, their employees will not work assiduously. I have never seen anything of the sort. A man who has an idea in his mind, if he is worth his salt, will want to get it out. He will fight all obstacles to get it out; it really makes no difference to the individual engineer or scientist one way or another because the company gets to own the patent rights anyway.

INDUSTRY HAS A DUAL STANDARD FOR PATENTS

Now, the companies take a different stand toward their Government than they do to their own employees. Generally, their own employees must sign an agreement providing that the company takes title to the patents they develop. Apparently, the companies desire better treatment from the U.S. Government than they accord their own employees. This is a classic refutation of the proverb, "what's sauce for the goose is sauce for the gander."

Thus, when defenders of the giveaway patent policy argue that contractors have a right to patent inventions made under Government contract, they demand for themselves different rights than they are willing to give their own employees and subcontractors. Mass production and the virtual disappearance of the independent inventor have changed the original intent of the patent law which was to encourage individual inventiveness. Patents do not generally belong to the inventor; they belong to those who employ him.

Statistics show that only 24 percent of the patents issued for inventions in 1967 were issued to individuals, 73 percent to corporations, and 3 percent to the U.S. Government. Comparable figures for the period 1946 to 1950 show that individuals received 41 percent of the patents issued, corporations were granted 58 percent and the Government 2 percent. Since 1950, the percentage of patents issued to individuals has been steadily declining. By depriving employed inventors of any right to the products of their inventive brains, industry has morally precluded itself from making a valid claim to inventions paid for by Government funds. Once you disregard the claims of talent, know-how, and personal effort in favor of the fact that patent rights lodge entirely in whomever pays for the research that produces inventions, there is no merit in arguments that somehow there should be a different law governing private and public research investment.

It is interesting to note that a recent study concerning industry ownership of patents resulting from Government-financed research and development work revealed that between 87 and 93 percent of the patents have never been commercially used by the companies holding them. I mentioned earlier that one of the prime reasons advanced by proponents of the "license" policy for vesting in industry title to

Government-financed patents is to develop it further into a commercially usable product, and in the shortest possible time. Supposedly, this allows the incentives of the patent system to operate for the ultimate benefit of all. No mention, of course, is made of the benefit accruing to the company's stockholders.

The defenders of the "license" policy frequently point out that the amount of remuneration received on most patents is small in comparison to overall company sales. I do not doubt this. However, for every patent that proves to be a "dud," there is always the possibility of finding a "diamond in the rough." Two examples come to my mind. They have been publicly reported so I am not divulging any privileged information.

The Massachusetts Institute of Technology acquired a computer patent in the course of research paid for by the Navy. Litigation shows this patent to be worth many millions of dollars. MIT's patent covers a memory core unit that is essential in virtually all high-speed digital computers. The International Business Machines Corporation agreed to pay MIT $13 million for use of the patent in an out-of-court settlement. According to the New York Times, the Radio Corporation of America also obtained a license arrangement to use the patent providing royalties were paid.

The Department of Health, Education, and Welfare was involved in an even more striking case. A test kit that detects one form of mental retardation in newly born infants was developed by the University of Buffalo under research and development work sponsored by the Department. The university granted an exclusive license to Miles Laboratories to put the kit into mass use. Ultimately, the Department of Health, Education, and Welfare nullified the Miles license agreement and took title to the invention because the price charged by the company for the kit was out of line with the costs incurred by the inventor for the kits—$262 compared with $6.

Large corporations have tremendous financial resources. Do we need to concentrate even more economic power in their hands? The Government's patent policy does exactly this. One-half of the patents acquired by contractors as a result of Government-financed research and development work are owned by 20 large corporations. These are the very same companies that receive the lion's share of contracts. But are they so poorly reimbursed for their efforts that the American taxpayer has to pay them a bonus?

You know how concerned I am that the industry viewpoint is widely accepted in policymaking circles of the Government. Two agencies—the Atomic Energy Commission and the National Aeronautics and Space Administration—are required by statute to take Government title to inventions developed in the course of contracts, subject to waiver of rights by the Government.

Yet, in one case, even the Atomic Energy Commission, which has one of the better patent policies, was granting one of my prime contractors patent rights on inventions and discoveries resulting from work done for my program. When I discovered this, I had my staff conduct a review. We found that up to that time, 100 patents had been granted as a result of inventions and discoveries made at one of the Atomic Energy Commission-owned, contractor-operated laboratories. The Government had retained all rights in about one-third of these patents, the contractor being granted a royalty-free, nonexclusive

license in each case. In the remaining 67 patents, the contractor was granted rights greater than a royalty-free, nonexclusive license. In fact, in some 28 instances, the Government retained for itself *only* a royalty-free, nonexclusive license and granted *all other rights* to the contractor. In addition to building an advantageous patent position from these 67 patents, the contractor realized royalties from patents granted on inventions totally financed by the Government. This contractor had received a fee totaling many millions of dollars for operating the Government laboratory. There is no need to grant him rights to patents resulting from inventions and discoveries made in this Government-financed laboratory.

When I pointed this situation out to the responsible Atomic Energy Commission officials, they took steps to require that I be consulted on the disposition of rights to patents resulting from work under my cognizance. So far as I know, the contractor has not been granted title to any patent resulting from work done for my program since that time.

I believe if you look into the practices of the National Aeronautics and Space Administration you may find that they, too, give away many patent rights by administrative determination.

The basic concept involved in my patent testimony is that the Government is entitled to get its money's worth for its research and development procurements as for every other procurement. This is not the case under our present "giveaway" patent policy. Individual firms realize benefits on Government research and development contracts far out of proportion to the work they have done.

NEED FOR PATENT LEGISLATION TO PROTECT THE PUBLIC

A matter of broad national policy is involved here. I feel there is a compelling need for definitive legislation that will protect the public interest in this area. At present, instead of Congress providing direction and control over the Government's patent policy, each agency is proceeding on its own in a different direction. I do not believe Congress should abdicate its constitutional rights and duties to the executive branch. By perpetuation over a period of years, these rules have become precedents which may ultimately assume the force of law.

I urge Congress to enact legislation which will establish uniform guidelines for all Federal agencies—guidelines requiring them to retain for the American people the rights and title in all inventions financed by public funds.

Chairman PROXMIRE. Professor Weidenbaum said that contractors could get patents from Government work and that this reduced the amount of competition in defense industries.

Admiral RICKOVER. He is right, sir.

Chairman PROXMIRE. This would have a very adverse effect on our economy. The great strength of our economy is its competitive force.

Admiral RICKOVER. It is having a greater effect on what our people think of their Government.

Chairman PROXMIRE. Admiral, this is a pertinent issue. I would like to ask the staff to include a copy of Admiral Rickover's testimony before the Senate Judiciary Committee for the record.

(Admiral Rickover's June 2, 1961, testimony before the Senate Judiciary Committee appears in this volume as App. I. See p. 99.)

Chairman PROXMIRE. Admiral, you stated that in your opinion the Department of Defense is too much influenced by an industry viewpoint.

Admiral RICKOVER. Yes, sir. This viewpoint is most pronounced in Government contracting, where exactly the opposite should be the case. Here, the viewpoint should be strongly pro-Government in order to protect the interests of the public. Industry has a plethora of employees to protect its interests.

There is much interchange of personnel between industry and Government; this brings to the Government many able men. In some cases, this exchange of personnel has resulted in situations where Government officials now represent the contractors with whom they formerly did business, and contractor officials represent the Government in dealing with their former companies. The problem is that during a lifetime of working in a given field, these men usually acquire a viewpoint that parallels the philosophy and the practices of their business organizations.

Chairman PROXMIRE. Are you saying that the philosophy is to protect the companies in the industry and not the taxpayer or the Federal Government?

Admiral RICKOVER. Well, I would put it this way. When a man has been practicing a given religion all his life, it is very difficult for him to change late in life. For example, Mr. Charles Wilson, who had been president of General Motors, became Secretary of Defense. You remember his statement, "What's good for General Motors is good for the country"——

Chairman PROXMIRE. Yes, indeed.

Admiral RICKOVER. Mr. Wilson was a man of integrity, but he had been in business all his life. What he said was what he thought and believed, but his was a business-oriented philosophy. Today some people in positions of great authority in the Defense Department hold a similar viewpoint. I do not mean to intimate that they are not sincere or that they do not try to do their best. But what *they think* is right for the Government and what is *actually* right for the Government may be two different things.

The problem is not only economic. Consider the effect on the morale of a career civil servant or military employee who watches men from industry come into policymaking positions for short periods of time, and go back to industry after 2 to 3 years, sometimes less. In some cases, they will then be dealing with the very people they supervised during their tour in Government.

Career men in Government may feel that some of these appointees are simply acquainting themselves with the inner workings of Government so they will be more effective in dealing with the Government when they return to industry. Can you expect them to be committed wholeheartedly to their work in this environment? A man experienced in private industry may contribute much to the Government, but I would require that, as a minimum, he stay 5 years.

If I met an intelligent young men who aspired to be a business leader, I would advise him to get a job with an industrial concern and work his way to the top. If a young man aspired to be a leader in the Defense Department or the Navy, I would give him the very same advice,

because the top people in the Department of Defense are appointed from private life. It is little wonder that we have trouble attracting competent young people into Government service and keeping them.

The tendency to the industry viewpoint in the Department of Defense shows up in various ways. Presently, an important concern in Department of Defense contracting circles appears to be that contractors should get enough profit.

I previously mentioned a case where Navy procurement officials proposed to award without negotiation a multimillion-dollar contract that was obviously overpriced. When I objected to this award, I was accused of trying to keep the firm from making enough profit. The procurement officials were convinced that the contractor was not making enough profit. Yet, the firm had been realizing record sales, nearly all of which were on Government contracts for which there has been little or no price competition.

This particular contractor is well equipped to look after himself. He has plenty of accountants, estimators, and lawyers looking out for his interests. The Navy officials should have been concerned with the taxpayers' interest rather than the contractor's.

Another case involved a design contract for a new submarine. There was almost no contractor risk in this contract, and negligible investment. Because of this, and because of the experience he would gain in the performance of the contract, the contractor agreed to accept a 5-percent profit.

The Navy contracting officer refused to approve the contract because the profit guidelines in the Armed Services Procurement Regulation "allowed" a profit of 8 to 10 percent. He told me I was breaking the rules by not paying 8 to 10 percent profit. I told him, "Fine, you write a letter to Congress and to the newspapers and tell them Rickover is breaking the rules by saving Government funds. See what the public reaction will be."

He finally agreed to the contract at 5-percent profit on condition that the contractor revise his proposal so the record would show that the contractor himself had requested the lower profit. In this way he could not be criticized by his superiors for paying a profit lower than "allowed" by the regulations.

Chairman PROXMIRE. You mean that there are officials in the Navy who have attempted to force you to give a higher profit to companies?

"THE NICKEL LETTERS"

Admiral RICKOVER. Yes, sir. I call a recent experience with this type of thinking "the nickel letters." In August of this year the Navy proposed to place a $50 million contract with a company at a profit of 2.29 percent.

Chairman PROXMIRE. Let me understand the 2.29-percent figure. Was that the percentage of profit to sales or to cost?

Admiral RICKOVER. It is 2.29 percent of estimated cost. That may sound like a low profit——

Chairman PROXMIRE. It does indeed. In testimony yesterday, the Department of Defense witness said that the average profit on defense work was about 9.4 percent.

Admiral RICKOVER. Actually, it was quite adequate under the circumstances. The contract involved no risk for the company and almost

no investment, and the Navy has been working on the same terms with this company for many years.

In any event, because of the amount of this contract, it had to be approved by higher authority. When I submitted the contract for approval, I received a formal letter stating the contract was disapproved because the profit was too low.

Chairman PROXMIRE. Who sent you the letter?

Admiral RICKOVER. A Navy procurement official. I replied the next day. I said that I thought my job as a Government agent was to obtain services for the Government at the lowest possible cost. However, in order to have this contract approved, I said I was willing to increase the fee on this $50 million contract from $1,147,023 to $1,147,023.05—an increase from 2.29 percent to 2.2900001 percent. I thought it was worth a nickel of Government funds to avoid delaying the contract any further.

The procurement officials were not satisfied with my response. Since then a whole series of letters—six, I think—has been exchanged on this issue. The procurement officials have tried to defend their attempt to require me to pay a higher profit. I insist that they were wrong to require higher fees than necessary. They have never admitted their error. After the "nickel letters" experience, I can better understand the frustration that prompted Cromwell to say to the representatives of the Church of Scotland: "I beseech you, in the bowels of Christ, to think it possible you may be mistaken."

In the end the contract was let on the terms I originally proposed and I am happy to report that the Government did not have to pay the extra nickel.

Chairman PROXMIRE. May we have copies of those letters for the record, Admiral?

Admiral RICKOVER. I will have to get clearance from the Department of Defense to give them to you.

Chairman PROXMIRE. Admiral, I would like you to do so. I would be very interested to see the specific details of this example. I find it incredible. Please let me know if you have any difficulty in obtaining clearance for the "nickel letters." My staff will help if you like.

Admiral RICKOVER. Yes, sir.

(The information follows:)

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., August 22, 1968.

From: Chief of Naval Material.
To: Commander, Naval Ship Systems Command
Subj: Cost-Plus-Fixed-Fee Pre-Negotiation Business Clearance SS 12,918 [Contractor *Z*].
Encl: (1) Original of subject Business Clearance

1. Subject business clearance covers the procurement of (classified, matter deleted) of nuclear reactor plant components (classified matter deleted) for use in nuclear powered submarines, and the furnishing of associated components, repair parts, stock components, associated technical data, engineering services, reports, replacement reactor plant components and refueling components.

2. Work is scheduled to complete in November 1973—over five years in the future—and the estimated cost is $50,808,394 plus a fixed fee of $1,147,023 (2.29%) for a total of $51,227,387.

3. The contractor proposed a 5% fee but the negotiating team proposes to reduce this to 2.29% based upon their utilization of the weighted guidelines method set forth in ASPR 3–808. The result of their application of the weighted guidelines is as follows:

Input	Recognized costs	Weight range (percent)	Assigned weights (percent)	Fee, dollars
Subcontracts	$46,654,877	1 to 5	1.75	$816,460
Labor	1,472,972	9 to 15	12.5	184,122
Overhead	1,952,545	6 to 9	7.5	146,441
Total	50,080,387			1,147,023
Composite weight			2.29	
Risk (CPFF contract)		0 to 1	0	
Performance		−2 to +2	0	
Selected factors		−2 to +2	0	
Total, weighted guidelines			2.29	1,147,023

4. Paragraph 7 of subject clearance states that all of the components are subcontracted and are the responsibility of the prime contractor, a responsibility that will continue for over five years. This Office cannot agree that this responsibility is worth only a 1.75% assigned weight as shown above, with a zero assigned weight for contractor's risk below the line. Nor has it been shown that the contractor's request for a 5% fixed fee is an unreasonable one.

5. Enclosure (1) is returned approved with respect to the pre-negotiation position on costs but disapproved with respect to a fixed fee of 2.29%. A higher fee is authorized.

Signed/——— ———
(By direction).

(The letter was signed by Director, Procurement Contract and Clearance Division, Office of Naval Material.)

DEPARTMENT OF THE NAVY,
NAVAL SHIP SYSTEMS COMMAND,
Washington, D.C., August 23, 1968.

Memorandum for Chief of Naval Material.

Subj: Chief of Naval Material Requirement That NAVSHIPS Pay Higher Fee On Proposed Contract With [Contractor Z]

Ref: (a) Naval Material letter MAT 022/GWR; Ser: 03195 dated 22 August 1968

1. Reference (a) returned a Naval Ship Systems Command (NAVSHIPS) request for Chief of Naval Material (CNM) approval of a pre-negotiation business clearance for a contract with [Contractor Z] involving the procurement of reactor components for nuclear ships. The contract is estimated to cost $50,808,394 for which NAVSHIPS proposed to pay a fixed fee of $1,147,023 (2.29%). Reference (a) disapproved the fixed fee of 2.29% as being too low.

2. I am at a loss to understand the rationale of reference (a) which would require NAVSHIPS to pay a higher fixed fee. It has been my understanding that Government officials are obligated to obtain services at the lowest possible cost. For many years I have been exhorted

to do so by innumerable documents issued by the President of the United States, the Director of the Bureau of the Budget, the Secretary of Defense, the Secretary of the Navy, the Chief of Naval Material, and the Commander of Naval Ships Systems Command. I have been able to obtain these very same services from [Contractor Z] and others for many years at the 2.29% or a lower fixed fee.

3. Reference (a) states that CNM cannot agree that the contractor's risk in this procurement is zero, but no reason is given to show that there is any risk. I hereby reaffirm that the contractor's risk is and always has been zero—period.

4. In order not to delay award of this contract, I will comply with your requirement that a higher fixed fee be paid. I am therefore recommending to NAVSHIPS Division of Contracts that the fixed fee on this $50,808,394 contract be increased from $1,147,023 to $1,147,023.05 or from 2.29% to 2.2900001%.

5. In view of my compliance with your request I consider this matter to be closed.

H. G. RICKOVER.

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., August 26, 1968.

Memorandum for Vice Adm. H. G. Rickover (NAVSHIP–08).
Subj: Pre-Negotiation Business Clearance SS 12,918, [Contractor Z].
Ref: (a) CNM ltr MAT 022/GWR Ser: 03195 of 22 Aug 1968 to NAVSHIPS;
(b) NAVSHIPS Memo for CNM of Aug 23, 1968.

1. Reference (b) has misinterpreted reference (a). No direction was provided to increase the fee under subject contract. The rationale presented in subject pre-negotiation clearance was insufficient as well as inconsistent to justify the negotiation position in accordance with the weighted guidelines set forth in ASPR, Section 3–808.3. Review with members of the negotiation team failed to elicit further information.

2. The action proposed in paragraph 4 of reference (b) is disapproved and by copy of this memorandum the Commander, Naval Ship Systems Command is requested to provide in the post negotiation clearance sufficient information to logically justify the fee negotiated.

Signed/——— ———,
Chief of Naval Material.

SEPTEMBER 11, 1968.

Memorandum for the Chief of Naval Material
Subj: NAVSHIPS contract N00024–69–C–5101 with [Contractor Z] for nuclear propulsion plant components.
Ref: (a) NAVMAT memorandum Ser 03195 dtd 22 August 1968;
(b) VADM H. C. Rickover memorandum to the Chief of Naval Material dtd 23 August 1968;
(c) Chief of Naval Material memorandum for VADM H. G. Rickover dtd 26 August 1968.

1. In reference (a), the Naval Material Command (NAVMAT) disapproved a Naval Ship Systems Command (NAVSHIPS) pre-negotiation business clearance to contract for nuclear propulsion plant components. The contract was estimated to cost $50,808,394 for which

NAVSHIPS proposed to pay a fixed fee of $1,147,023 (2.29%). NAVMAT approved the NAVSHIPS pre-negotiation position on costs, but disapproved the proposed fixed fee of 2.29%, stating that "a higher fee is authorized".

2. In reference (b), I informed you of my recommendation to the NAVSHIPS Division of Contracts that the fixed fee on this $50,808,-394 contract be increased from $1,147,023 to $1,147,023.05, or from 2.29% to 2.2900001%, thereby complying with the NAVMAT directive that a higher fixed fee be paid.

3. Reference (c) stated that I had "misinterpreted" the August 23 NAVMAT memorandum, reference (a), and that:

> "No direction was provided to increase the fee under the subject contract. The rationale presented in subject pre-negotiation clearance was insufficient as well as inconsistent to justify the negotiation position in accordance with the weighted guidelines set forth in ASPR, Section 3–808.3. Review with members of the negotiation team failed to elicit further information.
>
> "* * * the Commander, Naval Ship Systems Command is requested to provide in the post negotiation clearance sufficient information to logically justify the fee negotiated."

4. Subsequent to the above memorandum, NAVMAT approved the award of this contract at the fixed fee originally recommended by NAVSHIPS, namely, 2.29%, thereby negating the NAVMAT directives in reference (a) and (c). The contract has now been awarded to and accepted by [Contractor Z.]

5. I would like to make two points relative to award of this contract:

a. I consider that reference (a) was quite clear in requesting that NAVSHIPS pay a higher fee on this contract. Reference (a) stated:

> "Paragraph 7 of subject clearance states that all of the components are subcontracted and are the responsibility of the prime contractor, a responsibility that will continue for over five years. This office cannot agree that this responsibility is worth only a 1.75% assigned weight as shown above, with a zero assigned weight for contractor's risk below the line. Nor has it been shown that the contractor's request for a 5% fixed fee is an unreasonable one.
>
> "Enclosure (1) is returned approved with respect to the pre-negotiation position on costs but disapproved with respect to a fixed fee of 2.29%. A higher fee is authorized."

b. In reference (c) you stated that the NAVSHIP'S rationale for a 2.29% was "insufficient as well as inconsistent to justify the negotiation position in accordance with the weighted guidelines set forth in ASPR, Section 3–803". Please note that NAVMAT has reviewed and approved prime contracts for nuclear component work at levels of 2.29% or less for the past several years.

6. In sum, NAVMAT's contribution to the negotiation and award of this contract was:

a. A directive that NAVSHIPS pay a higher fixed fee than NAVSHIPS considered appropriate, and higher than the supplier was willing to acept.

b. A recision of that directive.

c. A delay of 20 days in obtaining a contract.

H. G. RICKOVER,
Deputy Commander for Nuclear Propulsion.

22–490 O—69—pt. 2——5

DEPARTMENT OF THE NAVY,
HEADQUARTERS NAVAL MATERIAL COMMAND,
Washington, D.C., September 26, 1968.

Memorandum for Vice Admiral H. G. Rickover (NAVSHIPS–08).
Subj: [Contractor Z] Procurement for Nuclear Reactor Components.

1. I have reviewed your letter of 11 September 1968. I believe it appropriate to indicate that the material provided my staff on 27 August 1968 regarding the [Contractor Z] contract should have been set forth in the pre-negotiation clearance submitted by NAVSHIPS. In addition, if the "weighted guidelines" method of profit determination was not considered appropriate, the basis could have been set forth in the pre-negotiation clearance and a waiver requested to the appropriate ASPR provision.

2. I mention the above two points to indicate my concern that in our acquisition process there is required a mutual exchange of information, such that our recent exchange of correspondence on this matter would be unnecessary. I hope that I may have your personal support to the end that our staffs will freely review proposed contractual actions well in advance so that we can achieve our mutual goals of rapid and businesslike procurements of maximum benefit to the Navy.

Signed/——— ———,
Chief of Naval Material.

DEPARTMENT OF THE NAVY,
NAVAL SHIP SYSTEM COMMAND,
Washington, D. C., October 16, 1968.

Memorandum for the Chief of Naval Material.
Subj: [Contractor Z] Procurement of Nuclear Reactor Components.

1. Your memorandum of 26 September 1968 is the latest in the series of correspondence concerning the fixed fee paid to [Contractor Z] on a recent NAVSHIPS contract for nuclear reactor components. Your memorandum implies that this problem arose because NAVSHIPS rationale for paying proposed fixed fees was not properly documented. You asked for my personal support so that proposed contractual actions will be freely reviewed well in advance and mutual goals of rapid and businesslike procurement of maximum benefit to the Navy can be achieved.

2. Documentation has nothing to do with the issue I raised. The point is, in my opinion, NAVMAT procurement officials should not be directing NAVSHIPS to pay higher fees.

3. My records indicate your office has reviewed 27 contract actions totaling about $449 million for work under my technical cognizance during the past four years. All these contracts provide for fixed fees of about 2.29% or less. I do not think NAVMAT approved these contracts without understanding the basis for these fixed fees. The nature of these contracts has been discused in great detail on several occasions by the members of our respective staffs; specifically, with Admiral ——— and his staff on August 14, 1964, with Admiral ——— and his staff on July 10, 1967, and again with Captain ——— and his staff on August 27, 1968. Other discussions have been held from time to time. In each case, the decision has been made to proceed with the procurement as recommended by NAVSHIPS.

4. You can be assured of my support in the future, just as in the past, in achieving rapid and business-like procurement of maximum benefit to the Navy.

5. I trust this issue is now settled.

H. G. RICKOVER,
Deputy Commander for Nuclear Propulsion.

Admiral RICKOVER. Legislation has been enacted and rules adopted to help protect the Government's contractual interests. However, the industry lobbies and industry-controlled advisory groups have an impressive record of watering down these laws and rules so as to lessen their impact. Moreover, industry has found there is no real penalty for refusing to comply with these laws and rules. The Truth-in-Negotiations Act, requiring certified cost and pricing data from suppliers in noncompetitive situations, is now 6 years old. Yet, as I stated, I found that a major contractor, with over a billion dollars in Government contracts, is not complying with the requirements of the act. The act is, to all intents and purposes, a dead letter.

I also mentioned that all major computer manuafcturers regularly refuse to provide cost and pricing data on multimillion-dollar computer contracts. The Government departments and, I believe, the General Accounting Office are aware of this situation, but the manufacturers continue to withhold this cost data with complete equanimity.

COMMERCE DEPARTMENT RELUCTANT TO USE AUTHORITY OF DEFENSE PRODUCTION ACT

Chairman PROXMIRE. I understand you have had difficulty in obtaining assistance from the Department of Commerce in getting companies to manufacture defense equipment.

Admiral RICKOVER. Yes, sir. The Defense Production Act of 1950 was passed to assure that the Government could obtain necessary defense equipment. By this law, the Department of Commerce is authorized to direct a manufacturer to accept contracts essential to national defense. The basic assumption of this law is that the national defense should come before the private interests of business concerns.

The act has not been a strong tool because the Department of Defense and the Department of Commerce have been reluctant to use the authority the law gives them. Their great power, as contrasted with their small actions, is as if Prometheus had become manager of a match factory.

Chairman PROXMIRE. Admiral, last spring you testified before the House Banking and Currency Committee about a case in which the Department of Commerce would not issue a directive after a supplier had refused to accept and perform a contract for submarine propulsion plant equipment. As I remember, the supplier had a considerable amount of commercial business, and he said he could not spare the engineering personnel necessary for the defense work.

Admiral RICKOVER. Yes, sir.

The contract was crucial to development of the new design submarine, so the Navy asked the Department of Commerce to direct the firm to perform the order under the Defense Production Act. At first, Department of Commerce officials promised to help but when they

learned that the contractor would resist the directive, they backed down and announced they would not issue it.

Department of Defense headquarters soon got involved. The first question they asked was: "Why couldn't the Navy hold up the submarine for a year or two so that the manufacturer could finish his commercial contracts?"

Chairman PROXMIRE. Did this firm have enough engineers to do this job?

Admiral RICKOVER. The work involved about one-thirtieth of 1 percent of his total business. He had many contracts that dwarfed this order. He is doing the job now; we are satisfied with the number of engineers assigned to the job and the speed with which they were assigned once the contractor agreed to do the work.

NAVY FORCED TO ACCEPT REDUCED RIGHTS IN CONTRACT

Chairman PROXMIRE. How did you finally get a contract if the Department of Commerce refused to issue a directive?

Admiral RICKOVER. The Department of Defense would not back the Navy's effort to obtain a directive from the Department of Commerce. The Navy was told to resume negotiations with the firm. By that time, the firm had decided to accept the contract in order to avoid unfavorable publicity. However, in order to get the contract the Navy had to give up several standard contractual rights to which it would have been entitled had a directive been issued under the Defense Production Act.

This case drew considerable congressional interest. Subsequent to my testimony, on May 7, 1968, the Commerce Department sent the chairman of the House Banking and Currency Committee, Representative Wright Patman, a three-page apologia rationalizing its actions. This letter, written by a high official of the Department, is another example of the industry viewpoint in Government. The official stated his interpretation of the Defense Production Act as follows:

"It was not the intent of the Congress in enacting the priorities powers to create in the executive branch the power by regulation or directive thereunder to compel a private manufacturer to accept and perform a Government contract upon the Government's own specified terms."

His letter was forwarded to the Atomic Energy Commission for comments—which I provided. I wrote:

"It is my understanding that the intent and purpose of the Defense Production Act is to insure that the Government can obain defense equipment from contractors capable of producing such equipment despite any preference they might have for nondefense work. The act is worthless if prior agreement from a contractor is a prerequisite to directing his acceptance and performance of defense work under the Defense Production Act."

Chairman PROXMIRE. I would like the staff to get copies of this correspondence for the record.

(Materials referred to follow:)

U. S. DEPARTMENT OF COMMERCE,
BUSINESS AND DEFENSE SERVICES ADMINISTRATION,
Washington, D. C., May 7, 1968.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency,
House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: I appreciated the opportunity of appearing before the Committee on Banking and Currency on April 10, 1968 in connection with its consideration of H.R. 15683, a bill to renew the Defense Production Act, as amended.

During the course of my testimony I stated that: " * * * there have been no serious examples of rejection of a rated order when the rated order is placed properly and the company accepting it or to which the order is directed has the capability of producing the order in the time frame needed * * * "

According to the hearing transcript a later witness criticized this Department's exercise of the priorities powers under Title I of the Defense Production Act in connection with certain cases submitted to this Agency for directive or other action. This criticism impels me to offer a few further observations on these particular cases and in general on the matters which were the subject of criticism.

It was not the intent of the Congress in enacting the priorities powers to create in the Executive Branch the power by regulation or directive thereunder to compel a private manufacturer to accept and perform a government contract upon the government's own specified terms. Such action would amount to a taking of property which might have been appropriate, if at all, under Title II of the Act (Requisition and Condemnation), which, however, was terminated by the Congress in 1953.

As the agency to which responsibility for the exercise of these powers is delegated by the President, we have consistently as a matter of sound administration sought to avoid the issuance of a directive seeking to compel performance of a defense contract by a person whom we felt to be physically incapable of fulfilling its requirements. We see little advantage in a vain directive. We concluded that such was the case in the Contractor A situation only after repeated conferences with representatives of both the Navy and the company, and upon written documentation of their respective positions. [Doubt as to that company's capability of timely performance of the Navy's contract requirements because of the highly technical and difficult problems involved was well founded. The chronology published at page 130 of the Committee's Hearings indicates that efforts to negotiate for the performance of the development and design work involved had been a matter of protracted discussion between the Navy, its prime contractor (Contractor B) and various possible subcontractors. (Contractor C and Contractor A, and perhaps others) commencing as early as November 1965. This was some 16 months before the Navy even sought to invoke priorities assistance to meet its requirements.]

The assertion at page 96 of the Hearings that priority assistance in most instances consists of the issuance by BDSA of a directive to the supplier, ignores the fact that the mandatory use of priorities is accepted by industry as a matter of routine com-

pliance with the BDSA regulations. These regulations require, at all levels—from the prime contractor to the most remote subcontractor or supplier—the prompt acceptance and performance of contracts or orders which are identified by a defense rating symbol. The system is self-administering and enjoys a high degree of acceptance and adherence by industry. In a limited number of cases, however, because of delays or other impediments caused by conflicting priority orders, production capacity problems, facility limitations, and other types of production bottlenecks, directives are resorted to by BDSA to supplement the effectiveness of the priorities system. Directives are issued only after full consultation with the parties affected, both government agencies and private suppliers.

At pages 96 and 97 of the Hearings it is stated that the Department of Commerce directed delivery of a reactor core component at a date later than that required by the prime contractor and later than that promised by the supplier. On August 22, 1967, in a letter to BDSA the Atomic Energy Commission requested that a directive be issued to the supplier involved, Contractor D. This letter transmitted a request for "Special Priorities Assistance on Form BDSAF–138 prepared by the prime contractor, Contractor E, which had been submitted to the Procurement Assistance and Mobilization Planning Branch, Division of Construction, U.S. Atomic Energy Commission. Section 8(a) of that form showed the shipment date required by the prime contractor as June 21, 1968. On August 23, 1967, in response to the Atomic Energy Commission request, BDSA issued a directive to the Contractor D directing the shipment of the specified reactor core component on or before June 21, 1968. The supplier accepted receipt of this directive on August 28, 1967, but did not indicate that he would be unable to meet the directed shipment date.

At no time did Contractor E or the AEC request BDSA to issue a directive requiring delivery of the item involved by April 14, 1968, nor was BDSA ever informed that the supplier's current delivery promise was June 14, 1968, as alleged on page 97 of the Hearings

On February 26, 1968, AEC informed BDSA by telephone that the supplier, Contractor D, had reported slippage in its production of the core component. BDSA immediately contacted the supplier and was informed that a delay of six weeks in delivery was anticipated because the company was exceeding its estimated machining time. This information was immediately reparted to AEC who requested the issuance of an amended directive calling for a change in the required delivery date from June 21 to August 3, 1968. Accordingly such an amended directive was issued on February 28, 1968.

On March 13, 1968, AEC requested BDSA to withdraw the amended directive because it had been informed that delivery closer to June 21, 1968, could be achieved by Contractor D by expanding its work week. Pursuant to this request, on March 14, 1968, BDSA cancelled the directive calling for delivery by August 3, 1968, and directed Contractor D to make shipment by June 21, 1968.

The foregoing is submitted to assist the Chairman and the Committee in evaluating the testimony presented at the April 10 and 11, 1968 Hearings.

Sincerely yours,

A. A. Bertsch
(S) A. A. BERTSCH,
Assistant Administrator, Industrial Mobilization.

JULY 5, 1968.

Hon. JACK BROOKS,
Chairman, Government Activities Subcommittee,
Government Operations Committee,
House of Representatives.

DEAR MR. BROOKS: Your letter of May 23, 1968, forwarded a copy of Department of Commerce comments on Admiral Rickover's testimony of April 10, 1968, before the House Banking and Currency Committee. Since the points raised in the Department of Commerce letter relate to matters in which Admiral Rickover was directly involved, we requested his reactions to the Department's letter. Admiral Rickover's response to the issues raised by the Department of Commerce is attached.

The facts involved in the two situations described by Admiral Rickover in his testimoney on April 10, 1968, appear to us to be the types of procurement actions in connection with which the authority to compel acceptance by contractors properly should have been exercised.

We shall be pleased to make available any further information you may require.

Sincerely,

E. J. BLOCH,
Deputy General Manager.

MEMORANDUM

JUNE 28, 1968.

To: R. E. Hollingsworth, General Manager.
From: H. G. Rickover, Director, Division of Naval Reactors.
Subject: Comments on Department of Commerce letter concerning administration of the Defense Production Act.
Symbol: NR:D:HGRickover H# 7011.

In a letter dated May 23, 1968, to the Deputy Controller, Congressman Jack Brooks requested comments on a May 7, 1968 letter from the Business and Defense Services Administration (BDSA) of the Department of Commerce to the Chairman of the House Banking and Currency Committee. The Department of Commerce letter takes issue with my testimony before the House Banking and Currency Committee with respect to the manner in which the Defense Production Act is being administered.

I testified that with regard to Naval Reactors programs, the manner in which the Defense Production Act and its implementing regulations have been applied by the Department of Commerce has been of little, if any, help to me. In fact, I noted in my testimony, in some instances, Department of Commerce "help" has been detrimental to programs for which I am responsible.

In commenting on my testimony, the Department of Commerce letter includes statements that are factually incorrect, along with statements that were apparently intended to justify their action, or lack of action, in connection with two cases involving the Naval Reactors Program discussed in my testimony.

Since their uncorrected statements contradict my testimony, I request that my comments on the letter be included in the AEC's reply to Congressman Brooks and that a copy of the AEC reply be sent to the Chairman of the House Banking and Currency Committee.

My comments are as follows:

"a. *Department of Commerce criticism of my testimony regarding their failure to assist the Navy in obtaining equipment for a new design submarine.*"

The Department of Commerce letter states:

> "It was not the intent of the Congress in enacting the priorities powers to create in the Executive Branch the power by regulation or directive thereunder to compel a private manufacturer to accept and perform a Government contract upon the Government's own specified terms."

It is true that Congress apparently did not intend to permit the Government arbitrarily to dictate its own terms and conditions for performance of an order under the Defense Production Act. However, Congress also emphasized that vendors were not to be permitted to discriminate against defense orders by imposing different terms and conditions from those normally used for generally comparable orders and contracts. (See Section 707 of the Act and BDSA Reg. 2 Sect. 10.) The fact is, the terms and conditions of the proposed contract were not in issue during the time when we were seeking Department of Commerce assistance. The Navy did not insist that the manufacturer accept the Government's own terms. The Navy's sole, urgent purpose was to get the supplier to agree to undertake the work and to start performance as soon as possible. The Navy was willing to, and later did, make a general, letter-type contract which left the detailed terms and conditions to be negotiated between the parties. The Navy was also willing to place the order on the basis of the supplier's "regularly established price and terms of sale" for the equipment involved—as contemplated by the regulatory requirements of the Business and Defense Services Administration of the Department of Commerce.

As it developed, since the Department of Commerce would not assist the Navy by issuing a directive to perform the urgently needed work, the Navy was compelled to accept less favorable terms and conditions than customarily used in comparable procurements from the manufacturer in order to obtain its agreement to undertake the work. These terms and conditions were discriminatorily adverse to the Government's interests. Thus, what I believe to be the truly essential underlying intent of Congress in enacting the Defense Production Act was substantially thwarted; that intent was, I believe, accurately portrayed in the following passage from Report No. 1455, dated May 23, 1968, of the House Banking and Currency Committee:

> "The priorities and allocations authority of Title I is intended to assure that materials and equipment are available at the time and place they are needed to meet military and other essential production. The system is supposed to assure that defense orders

take priority over performance under any other contract or order. This authority also intended to assure that essential production orders are filled promptly, including the extensive research and development activities of the Department of Defense, the Atomic Energy Commission, and the National Aeronautics and Space Administration."

The Department of Commerce letter states:

"* * * we have consistently as a matter of sound administration sought to avoid the issuance of a directive seeking to compel performance of a defense contract by a person whom we felt to be physically incapable of fulfilling its requirements. We see little advantage in a vain directive. We concluded that such was the case in the Contractor A situation only after repeated conferences with representatives of both the Navy and the Company, and upon written documentation of their respective positions. Doubt as to that company's capability of timely performance of the Navy's contract requirements because of the highly technical and difficult problems involved was well founded. The chronology published at page 130 of the Committee's Hearings indicates that efforts to negotiate for the performance of the development and design work involved had been a matter of protracted discussion between the Navy, its prime contractor (Contractor B) and various possible subcontractors, (Contractor C and Contractor A, and perhaps others) commencing as early as November 1965. This was some 16 months before the Navy even sought to invoke priorities assistance to meet its requirements."

A chronology of events leading to the Navy's March 30, 1967 request for Department of Commerce assistance may be summarized briefly as follows:

In November 1965, the Navy's prime contractor, Contractor B, requested proposals from both Contractor A and Contractor C to conduct design studies for the main propulsion equipment and ship's service turbine generators for a new submarine. The equipment was to be similar in design to equipment previously developed for the Navy by Contractor A.

In December, 1965, Contractor A replied that they were unable to quote on the work because of prior technical commitments and that a minimum of one year would be required before they would be in a position to do so. Further, Contractor A stated they would be willing to undertake this work *only* if they were the only logical manufacturer and if there were some material urgency for this equipment. Since Contractor C was willing to perform the work, Contractor B contracted for the initial design studies with that company. These studies were completed in a timely manner on February 4, 1967.

Thus, up to this time there was no issue with Contractor A.

On February 9, 1967, Contractor B requested bids from Contractor A and Contractor C for the design and manufacture of the equipment needed for this project.

On March 3, 1967, Contractor A notified Contractor B that they would not be submitting a proposal on this equipment because of a lack of technical manpower.

On March 6, 1967, Contractor C advised Contractor B that they could not submit a proposal to provide the ship's service turbine generators because of lack of sufficient technical information. As stated above, the basic design of these units was developed originally by Contractor A for another Navy project.

During the period March 8–14, 1967, during various telegraphic and telephonic exchanges between Contractor B and Contractor A officials, and between Navy and Contractor A officials, Contractor A stated on four separate occasions that they would not bid on the Contractor B proposal.

On March 17, 1967, Contractor B officially requested Government assistance in obtaining propulsion plant equipment for this project.

On March 20, 1967, the Navy concluded that Contractor A was the only supplier that could provide the equipment to meet its requirements.

On March 30, 1967, the Chief of Naval Material forwarded Contractor B's request for Government assistance to the Department of Commerce.

The above chronology shows that actually less than one month elapsed between Contractor A's refusal to bid on March 3, 1967, and Navy's official request to Commerce on March 30, 1967, for priority assistance. During those 27 days strenuous but unsuccessful efforts were made both by Contractor B and Navy officials to persuade Contractor A to reconsider its declination to bid. Thus, it is obvious that the Navy did not delay 16 months in requesting priority assistance, as implied in the Department of Commerce letter. On the contrary, the Navy moved with dispatch befitting the increasing urgency of the situation in seeking such assistance.

The Department of Commerce letter of May 7, 1968 indicates that issuing a directive to Contractor A in this case would have been in vain because Contractor A was physically incapable of fulfilling the Navy's requirements. However, in my view, the facts did not and do not support the Department of Commerce conclusions that Contractor A was incapable of fulfilling the Navy's requirements.

As reasons for its refusal to accept an order, on May 8, 1967 Contractor A wrote the Department of Commerce stating that at least two technical breakthroughs were required for successful completion of this project and that, because of a shortage of qualified engineers, they would not be in a position to review the design specifications until about April 1968—about a year later than the Navy requested. The Navy did not agree with Contractor A that any "technical breakthroughs" were required, nor that Contractor A could not make available sufficient qualified engineers for this work.

To clear up any questions regarding the need for "technical breakthroughs", a meeting was held on May 23, 1967 among technical personnel from Contractor B, the Navy, Contractor A, *representatives of the Department of Commerce* and the staff of the Joint Committee on Atomic Energy. At this meeting, Contractor A withdrew their statement that "technical breakthroughs" were required and stated that Contractor A did not question and had never intended to question the basic technical feasibility of the job. This is reflected in the minutes of this meeting which were issued by the Department of

Commerce on June 8, 1967 to participants of the May 23 meeting. Thus there was no basis on technical grounds for the Department of Commerce to refuse to issue a directive.

With regard to the availability of qualified engineering personnel to perform the job, the Navy, in a letter dated April 28, 1967, pointed out to the Department of Commerce that the engineering work related to this equipment was estimated to comprise only about 10 to 15 percent of the total price and that it was inconceivable that Contractor A, one of the Nation's largest defense contractors could not provide the modest technical resources needed. This job involved a fraction of one percent of its total annual business. Contractor A has thousands of engineers. Only about 10 to 15 engineers were required for this job. At the very same time Contractor A was telling the Department of Commerce that they did not have the necessary engineers, Navy personnel found that engineers experienced in this type of Navy work were listed in the firm's telephone directory as being assigned to commercial work.

In August 1967, the Navy was finally able to obtain a contract with Contractor A. Once Contractor A agreed to accept the order, they promptly assigned the necessary engineering personnel—about 9 months earlier than the date of April 1968, which the Department of Commerce previously accepted as the earliest feasible date. Had the Department of Commerce issued a directive in March 1967, as the Navy requested, work could have started immediately.

The Department of Commerce appears to interpret the Defense Production Act and its implementing regulations to require prior agreement from a contractor as a prerequisite to directing acceptance and performance of defense work under the provisions of the Act. I do not believe that Congress intended this to be the case. Rather, I believe that Congress intended that the Act provide authority for the Government to require contractors to accept and perform contracts for defense work even though the contractors would rather do commercial work.

The Navy never received an official response from the Department of Commerce to its request of March 30, 1967 and a later one, on April 28, 1967, for Department of Commerce assistance. The Department of Commerce letter of May 7, 1968 to the Chairman of the House Banking and Currency Committee is the first official statement of the Department of Commerce position I have seen. However, the reasons why the Department of Commerce would not issue a directive in this case are still not clear to me.

"b. *Department of Commerce criticism of my testimony with regard to their failure to assist the AEC in obtaining timely delivery of certain reactor core components.*"

The Department of Commerce letter comments on another case of their "non-assistance" cited in my testimony. Their letter states:

> "At no time did Contractor E or the AEC request BDSA to issue a directive requiring delivery of the item involved by April 14, 1968, nor was BDSA ever informed that the supplier's current delivery promise was June 14, 1968, as alleged on page 97 of the Hearings."

Our review indicates that, contrary to the statement of the Department of Commerce, Contractor E did submit a request for priority assistance which indicated the supplier's shipment promise of June 14, 1968. This request was forwarded through channels to the

Atomic Energy Commission on August 15, 1967. On August 21, 1967, the Atomic Energy Commission advised the Department of Commerce of the required date of April 15, 1968, and of the supplier's delivery promise of June 14, 1968. After a telephone discussion with the supplier, the Department of Commerce advised the Atomic Energy Commission that a June 21, 1968 delivery was the earliest date the supplier would accept in a directive. Based on the Department of Commerce determination that June 21, 1968 was the earliest delivery date which the supplier would accept in a directive, the Atomic Energy Commission, on August 22, 1967, revised the requested date to June 21, 1968 and submitted a formal request to the Department of Commerce for issuance of the directive. This case again points up their practice of obtaining the contractor's acquiescence as a condition precedent to issuance of a directive under the Defense Production Act.

The Department of Commerce letter states:

> "The assertion at page 96 of the Hearings that priority assistance in most instances consists of the issuance by BDSA of a directive to the supplier, ignores the fact that the mandatory use of priorities is accepted by industry as a matter of routine compliance with the BDSA regulations. These regulations require, at all levels—from the prime contractor to the most remote subcontractor or supplier—the prompt acceptance and performance of contracts or orders which are identified by a defense rating symbol. The system is self-administering and enjoys a high degree of acceptance and adherence by industry."

This statement sums up quite well a point I made in testimony to the House Banking and Currency Committee. The Defense Material Priorities System does certainly appear to be "self-administering."

A Department of Commerce publication entitled "Keeping Defense Programs on Schedule", 1961, reprinted 1966, at page 28, states that the "directive" feature is intended as a mandatory priority mechanism to be used in circumstances where the so-called "self-administering" aspects of the priorities program do not accomplish the desired results. My experiences is that the Department of Commerce will not issue a directive without the contractor's prior agreement. Thus, by their practices, including their measures to avoid "vain directives," the Department of Commerce avoids any difficulties with industry, but provides virtually no assistance to the Government agency requesting help within the spirit of the Defense Production Act. This, in my opinion, is the reason for the "high degree of acceptance" by industry.

I can speak only from my own experience—I do not speak for others. My experience is that the Department of Commerce is unwilling or unable to use the authority Congress provided them in the Defense Production Act. In my opinion and based on my experience with the way the Department of Commerce is administering the Act, the Government is no better off than if there were no Act. It is not clear to me whether the Department of Commerce represents industry to the Government or the Government to industry.

I appreciate very much the opportunity to review the Department of Commerce letter of May 7, 1968. In my judgment it fully supports my testimony regarding their lack of help to my program in administering the Defense Production Act.

H. G. RICKOVER.

(End of inserted material.)

Chairman PROXMIRE. In your opinion, Admiral, why are these officials unwilling to use the authority of the Defense Production Act?

Admiral RICKOVER. Government officials have been swayed by industry, Mr. Chairman. In this case, the manufacturer convinced them that the private interests of his company were more important than our national defense requirements. Men constantly seek maximum realization of their interests by means of maximum utilization of their powers. Manufacturers and their advisory groups can be very persuasive. They have sold many Government agencies on the idea that the prerogatives of industry must be preserved. This explains why high-ranking Government officials often seem more interested in placating industry than they are in protecting the Government's rights. This is evident in the way new policies are implemented. The Department of Defense tends to trade away something for each new procurement policy it implements. Its preoccupation appears to be in making the policy palatable to industry.

For example, last year the Department of Defense announced it would obtain contractual rights to audit suppliers' books during and after completion of a contract. This could have been a valuable tool for contracting officers to use in checking actual profits and costs on defense contracts. Such information would have been useful for negotiating costs and profits on later contracts. However, a most high official in the Office of the Secretary of Defense ruled out this possibility in a letter to the Army, Navy, and Air Force. The letter said, in part:

"I wish to make it clear that the purpose of any postaward cost performance audit, as provided herein, is limited to the single purpose of determining whether or not defective cost or pricing data were submitted. Access to a contractor's records shall not be for the purpose of evaluating profit-cost relationships, nor shall any repricing of such contracts be made because the realized profit was greater than was forecast, or because some contingency cited by the contractor in his submission failed to materialize—unless the audit reveals that the cost and pricing data certified by the contractor were, in fact, defective."

Copies of this letter were distributed to contractors. In my opinion, the Department of Defense, by this action, gave away a fundamental right the Government should have retained. In the very nature of things, bureaucratic policies run where preferences lead.

The feeling of responsibility for the welfare of industry shows up in other ways, too. I believe it is caused to a large extent by the influence of industry advisory committees, lobbyists, and former industry officials who, although they have taken positions in Government, nevertheless, retain an industry viewpoint. The bargaining between the Department of Defense and industry representatives in establishing Government procurement policies often requires the Government to accept less than it should in order to obtain industry agreement with the Government policy.

When the Department of Defense decides to make a change in the Armed Services Procurement Regulation, it conducts a prior check with industry to make sure that the change does not impinge too greatly on the latter. Sometimes it sends proposed changes to manu-

facturers and advisory groups for comments. This leads to a situation in which the Department of Defense negotiates with private industry over each of its own regulations.

In the case I just mentioned, the Department of Commerce chose to negotiate with the firm rather than exercise its legal authority, even when it had become obvious the firm was unwilling to negotiate.

Whatever legislation may be enacted as a result of these hearings, the authority should not go to the Department of Commerce. That Department is an industry-promotion agency. Dealing with it is, as President Kennedy said of the State Department, like dealing with a foreign power.

The General Accounting Office and now the Department of Defense have authority to examine contractors' books and records. However, when you mention a study of profits on defense contracts, both agencies turn to non-Government groups to collect the information so that industry will not be offended.

Another reason for the protective attitude toward industry simply arises from familiarity. Harold Nicolson in *Peacemaking 1919* points out the danger of familiarity in his vivid description of the negotiations at Paris leading to the Treaty of Versailles:

"* * * Nothing could be more fatal than the habit (the at present persistent and pernicious habit) of personal contact between the Statesmen of the World. It is argued, in defence of this pastime, that the Foreign Secretaries of the Nations 'get to know each other'. This is an extremely dangerous cognisance. Personal contact breeds, inevitably, personal acquaintance, and that, in its turn, leads in many cases to friendliness: there is nothing more damaging to precision in international relations than friendliness between the Contracting Parties. Locarno, not to mention Thoiry, should have convinced us of the desirability of keeping our statesmen segregated, immune and mutually detached. This is no mere paradox. Diplomacy is the art of negotiating *documents* in a ratifiable and therefore dependable form. It is by no means the art of conversation. The affability inseparable from any conversation between Foreign Ministers produces allusiveness, compromises, and high intentions. Diplomacy, if it is ever to be effective, should be a disagreeable business. * * *"

What he said about the danger of familiarity among statesmen is equally true about those in Government who buy and those in industry who sell.

You know how it is in the State Department. They have what they call "country" desks. Pretty soon the official in charge of the Lilliputian desk or the Brobdingnagian desk begins to feel that he is responsible for the welfare of "his" country. I have no doubt that some of our giveaway programs have had their inception in this feeling by "desk" officers. Instead of constantly bearing in mind that his sole function is to take care of the interests of the United States, he instead becomes a judge, seeing to it that justice prevails between the United States and "his" country. And when one becomes a judge he no longer is answerable to any earthly authority; he is answerable only to God.

INDUSTRY WANTS TO NATIONALIZE LOSSES BUT PRIVATIZE GAINS

Industry would very much like to nationalize its losses and privatize its gains. Every major company has a staff of highly trained, well-paid officials to represent it to the Government. Industrial firms retain contracting officials and lawyers whose sole job is to see that the company is granted every conceivable advantage from the Government. They have set up advisory groups and lobbies to give themselves a say in the making of Government policies. Thus, executives and advisers, lawyers and lobbies are protecting industry quite adequately. They need no assistance from Government officials. Rather, Government officials should be concerned with protecting the *Government* and the people.

It is here apropos to contrast the expertise and rationality of business when it does its own purchasing as compared with the obfuscation that often surrounds their decisions and actions relating to those who purchase from them.

You will remember that in 1913, Woodrow Wilson said Washington was so full of lobbyists that "a brick couldn't be thrown without hitting one of them." He added:

"It is of serious interest to the country that the people at large should have no lobby and be voiceless in these matters, while great bodies of astute men seek to create an artificial opinion and to overcome the interests of the public for their private profit. It is thoroughly worth the while of the people of this country to take knowledge of this matter. Only public opinion can check and destroy it.

"The Government in all its branches ought to be relieved from this intolerable burden and this constant interruption to the calm progress of debate. I know that in this I am speaking for the Members of the two Houses, who would rejoice as much as I would, to be released from this unbearable situation."

The situation today is no different. Congress must remain ever alert to protect the public from pressure groups that would act counter to the public interest.

PROTECTION AND ENCOURAGEMENT FOR GOVERNMENT PERSONNEL

Chairman PROXMIRE. What we are trying to do is to make it so that the cards are not stacked against these governmental purchasing agents. One of the most useful bits of testimony we had in all these hearings was from Mr. Beusking and Mr. Fitzgerald on the difficulty of providing protection and encouragement for people who will do a good job of trying to keep contractors' costs down. It is difficult to do it. As Mr. Fitzgerald put it, it is "antisocial" behavior and it is behavior that often results, as they both testified, with people not staying in the Pentagon very long. Mr. Fitzgerald did testify that the Air Force is now trying to work out a method of protecting these people and giving them some kind of encouragement from the Secretary of the Air Force and so forth, but we haven't had a chance to see whether this is going to be effective or not. It seems to me this is something that is well worth recognizing, and if you have any views in this area I would appreciate hearing them.

Admiral RICKOVER. I believe you will find, Mr. Chairman, that top management in the Department of Defense does protect and encourage subordinates—as long as they hew to the party line.

Chairman PROXMIRE. Let me ask about the difficulty of talking out. The Congress and the people deserve and should have the facts on this kind of thing as frankly as possible. Yesterday we had a case where I had requested Mr. Fitzgerald to provide a statement for the committee; he failed to do it. He told us that he was ordered not to do it, and I am deeply concerned about this. I think that if we do not have an opportunity to determine what the experts in the Pentagon think about this, and what their information is, it means that the democratic process just isn't working. I would like to get from you, Admiral Rickover, what you think about the difficulty of speaking out.

Admiral RICKOVER. It is not difficult to speak out in the Department of Defense. It is not difficult at all for a military person to speak out, provided he is prepared the next day to receive orders to a duty station 12,500 miles from Washington.

CONGRESS CAN CHAMPION THOSE WHO SPEAK OUT

Chairman PROXMIRE. What can Congress do?

Admiral RICKOVER. In obvious cases, Congress can champion unpopular critics. You are familiar with my own case; had it not been for Congress I would have been out of the Navy many years ago.

Similarly, I think Mr. Fitzgerald will be protected from any repercussions for testifying against the wishes of the Department of Defense. Since you have exposed the attempt to stop Mr. Fitzgerald, he is in the public eye for the time being and many will be watching for evidence of reprisal.

The problem is that not every knowledgeable subordinate in the Department of Defense has the opportunity to present his views before a congressional committee. For many imaginative people in the Defense Department and the three services, the only forum for new ideas is the Pentagon's chain of command. The working-level person who develops a new proposal must send it through innumerable strata of reviewing authorities. There may be 15 or more tiers of administrators separating him from the Secretary of Defense. This means that 15 groups must all approve his suggestions, but any one of the "decision-makers" can summarily dismiss it.

Therefore, anything Congress can do to require the Department of Defense to thin out its thicket of "managers" would enhance the condition of working level people throughout the Defense Establishment.

Chairman PROXMIRE. I am interested to hear you say this, Admiral, because I am concerned about the tendency of the Department of Defense—and some other executive agencies—to suppress information that might show them in a bad light.

Admiral RICKOVER. Mr. Chairman, a thought has just struck my mind that might have some relevance here. Congress is the only body which has the power and willingness to obtain all of the information not otherwise available to the public; where public issues can be fully illuminated; where the interests of the American people can be properly protected.

Today this congressional committee is inquiring into the activities of the most powerful arm of the executive branch. At this hearing, as well as at other congressional hearings, it is possible for citizens of our country to speak out publicly, to express views on how the Govern-

ment is conducting its affairs—even a military man such as myself is able to critically discuss his own department, his own superiors. What more is needed as a living demonstration of the glory of our form of government, of its resiliency, of the faith we have that wrongs can be corrected, that even the most powerful individuals in our Government can be called to account by the representatives of our people? Where else besides the United States and a handful of other countries is this possible?

In ancient times the proud boast *some* men could make was "*civitas Romanus sum*"—it was at that time the apogee of personal political privilege to be a Roman citizen. I submit it is a far greater privilege to be an American citizen. We have done something more admirable than admit into our polity everyone living and working in this country. We permit *every* American to judge his Government.

I just wanted to say that I am proud to be here, proud to be allowed to participate in my Government, proud that in my country no man can be truly silenced if he desires to speak out. This is, perhaps, the greatest privilege of American citizenship.

We have all heard of cases where Government personnel were apparently "punished" for speaking out against the policies of their superiors. I do not mean the spectacular punishments that might be meted out to a dissenter in other countries; but there are subtle methods of reprisal that have been brought to bear against subordinates who publicly refuse to toe the agency line.

I think it would be wise for those who would "punish" their subordinates in this way to remember that they themselves have the same privilege; they themselves are protected from injury in the same manner as is the lowliest witness. While they might protect themselves from the embarrassment of criticism by silencing a critic, they will be contributing to the erosion of a privilege that is the birthright of every American.

Chairman PROXMIRE. I wish to thank you, Admiral, for the thoughtful remarks you just made. I share your views. Those who would lightly change our system of government because of an occasional lapse should bear in mind that the liberty we now hold was not easily won by our forebears; it cost countless lives and great hardships and devastation.

CONGRESS MUST TAKE THE LEAD IN CORRECTING CONTRACTING DEFICIENCIES

Chairman PROXMIRE. Admiral, you stated that Congress will have to take the lead in improving Department of Defense procurement procedures.

Admiral RICKOVER. Yes, sir. Leadership of the type being practiced is not leading to solutions of problems: there are only responses. My experience is that you, the Congress, will have to force the issue. The Department of Defense will not. They have a fixed opinion on every subject and insist at all costs that they are right—even at the cost of being wrong. It has never occurred to them to say that they were unsure or even perhaps they didn't know. To have done so, I suppose, might have been taken as a sign of weakness.

The General Accounting Office will not. Industry will not, because it is not to its advantage to do so.

I know that Congress has attempted to help the executive branch do its job by providing the legal authority to protect the Government's interests through legislation—through the Armed Services Procurement Act, the Defense Production Act, the Renegotiation Act, the Truth-in-Negotiations Act—all of which are designed to help the military get its job done in an economical manner.

It has been my experience, unfortunately, that those in positions of power do not take the initiative to correct obvious deficiencies. They become protective of the status quo. They appear unwilling to use the authority Congress has provided them. That is why I am convinced that if anything is to be done about this matter, Congress will have to do it.

Each year since 1963, in testimony before the House Appropriations and other committees, I have given my views on how Government contracting might be improved based on what I have observed in conducting the naval nuclear propulsion program. Each year I pointed out specific deficiencies in defense procurement and have made specific recommendations for improving these procurement practices. But my statements are like hammers with no anvil, since the Department of Defense does not respond. It seems to believe I have no business criticizing its contracting or other practices—that if any criticism is warranted it will come from its own officials whose job descriptions require them to take care of such matters.

On occasion, the Department of Defense has disagreed publicly with my testimony. For example, in 1963 I testified to the House Appropriations Committee that I thought profits of large defense contractors were fairly high despite what might be heard to the contrary. In response, the Department issued a press release stating that I was "sailing on the wrong tack" and indicating that I did not know what I was talking about.

At House Appropriations Committee hearings this year, I again testified that defense profits may be too high. I cited specific examples and numerous indications which led me to that conclusion. I recommended that uniform accounting standards be established for all defense contracts. Following my testimony, legislation was introduced calling for a General Accounting Office study to establish uniform accounting standards.

On June 17, 1968, 6 weeks after my appearance before the House Appropriations Committee, the Department issued a public statement announcing they had found no basis for concluding that defense profits were too high; in fact, it again expressed concern over the "downward trend" in defense profits. On the same day, the Department of Defense, in a letter made public by the Senate Banking and Currency Committee, opposed the proposed study to establish uniform standards of accounting for defense contracts.

The letter stating that there was no basis for concluding defense profits to be too high was widely disseminated to industry by means of a Defense procurement circular—so that contractors would know where the Department stood on this issue. The letter was also published in the Defense Management Journal for the Department of Defense cost reduction and management improvement programs, which also receives wide distribution throughout Government and industry.

Mr. Chairman, on July 18, 1968, you wrote to the Department of Defense, pointing out that the profit data cited by the Department of

Defense in their letter was unreliable. You asked the Department to establish a system to find out what profits really are. That, in my opinion, is exactly what is needed. However, Mr. Chairman, and with due respect to you, I must say to you that your public relations program is not as persuasive as that of the Department of Defense. You do not have as many minnesingers to chant your praises. "Whose bread I eat, his song I sing." Your letter was not printed in the Defense procurement circular or in their Cost Reduction Journal. I suggest you ask for equal space so that the readership can become equally aware of your concern in the matter.

Chairman PROXMIRE. You have a point there, Admiral.

DEFENSE DEPARTMENT MEDIA REFLECT INDUSTRY VIEWPOINT

Admiral RICKOVER. Their use of these media for propaganda purposes contributes to the industry attitude of contracting officers throughout the Department. They hear the industry propaganda at the negotiation table and then read the same story from their Defense superiors in the house-organ literature. I doubt they ever hear the other side of the argument. They must feel that since the Department of Defense and the contractors hew to the same party line, it must, by dint of repetition, be true.

In the United States, the prestigious word "image" has now achieved eminence. Every Government organization conceives it to be fashionable and in accordance with the latest concept of "management" to create an "image" for itself. This is why Federal agencies need such huge public relations staffs, and why they keep on grinding out propaganda. The news media can be friendly one moment and hostile the next. The job of a public relations staff therefore is to put its agency's best foot forward. Their job, as far as they can, is to present to the public only the information favorable to their side. Have you ever seen a press release by a Government agency that was actually critical of itself—that did not resort to delicate wording intended to blunt the actual situation?

The Department of Defense has shown almost unlimited capacity for absorbing protest and externalizing blame, for confusing and dividing the opposition, for "seeming" to appear responsive to legitimate protest by issuing sophisticated and progressive statements and studies that are poorly implemented, if at all.

COST-REDUCTION MEASURES MAY BE FALSE ECONOMY

The Department of Defense apparently believes that the solution to poor procurement practices is good public relations. When criticized, it usually responds with a press release, denying anything wrong and stating how much money has been saved through its vaunted cost-reduction program. Their words on saving money always sound splendid in speeches and public relations documents, and in house organs, but how much reality do they have?

I see the other side of the story. I will give you an example. The Department of Defense claims large cost savings through reduction of inventories. It claims to have eliminated large excesses of stocks on hand, and claims that the inventories are now managed on the basis of "cost effectiveness."

However, the past several years I have received an increasing number of complaints from ships telling me of difficulties encountered in obtaining parts and equipment from the supply system. Looking into this, I found that supply effectiveness for most repair parts required to support shipboard mechanical and electrical equipment has been reduced from about 90 percent several years ago to about 60 percent today. This means that for every 100 requests for parts that come in from the fleet for repair parts and equipment, 40 cannot be filled from stock. It appears the primary reason for this reduced supply effectiveness is the Department of Defense decision to reduce the amount of funds for spare parts.

Lower investment in inventory sounds like a fine idea. In fact, it may be false economy. Savings in inventory can be more than offset by higher costs to purchase needed parts on a crash basis.

It has been estimated that hurried "spot buys" of repair parts cost the taxpayer about 25 percent more on the average than a normal competitive procurement of the same item for stock. Sometimes the item simply cannot be obtained when needed.

I find that under present Department of Defense policies, 25 percent of the Navy's operating ships have equipment out of order which reduces their capabilities. Availability of required parts is quite often the limiting factor in restoring this equipment to service. Thus, we may pay more in the long run, and have less effective weapons when equipment is out of commission for lack of spare parts.

A similar problem exists in the manner the Department of Defense manages its weapon acquisition programs. Its financial and systems analysis personnel have caused significant program delays and cost increases by their decisions to suspend or to defer weapons programs in order to conduct cost effectiveness studies.

The Russians do not appear to have this problem. Once they reach technical decisions, their programs are carried out without administrative disruption. Their programs are not subjected to constant reanalysis and rejustification on grounds of cost effectiveness. It is high time that we recognize the consequences of unwarranted delays in technical programs. In the Department of Defense, administrators and systems analysts hold up funds specifically appropriated by Congress for important military projects while they study and restudy the project. They are attracted to studies like mice to a granary. The Navy has been particularly plagued by decisions to delay the nuclear shipbuilding program and by the ensuing studies and counterstudies that have now become a way of life. However, the problem is not unique to my own program.

The Department of Defense decisions are nearly always tentative; they analyze and decide—then reevaluate, redecide, on and on. The military services are required to respond with their own studies at the expense of their primary functions. It is like being required to compose a sonnet while fighting a duel.

Their myriad administrators have assumed great powers, and powers once acquired are seldom relinquished. "No winter shall abate this spring's increase."

Their decisionmakers have generally tended to follow the advice of young economists with their magnificent theories which reduce the complexity of the real world to the simplicity of a model. The concept appears to be that military matters are simple matters which can

be learned easily by any college freshman. I regret to say that some of the Department of Defense cost-effectiveness decisions made in recent years smack of this sort of "sheepskin economics." The military is thought of as a bunch of unimaginative cowboys. It may be that our military leaders do not have accurate foresight but the actions of the cost effectiveness analysts have demonstrated that they have none at all.

Take the case of nuclear-powered naval ships. The Department of Defense has constantly criticized their high cost. But decisions, or lack of decisions by the Defense Department have delayed and interrupted nuclear shipbuilding programs—a significant factor in the cost increase. You cannot start a program, then stop it or delay it, and then resume it without incurring additional costs. Those who make administrative decisions which lead to program interruptions and in lengthy delays in releasing appropriated funds must bear much of the responsibility for cost increases and program delays resulting from such decisions.

It is of course possible for those with original imaginations to discuss highly complex matters intelligently with each other, but administrators and systems analysts should not pretend to understand every mystery of science and engineering; they should act as administrators.

They consider engineering, in particular, rather vulgar, as sort of plumberlike and unimaginative—the domain of technicians. Therefore engineering problems can be readily resolved by anyone in authority; it is their right to debate it, sit in judgment, lay down the law, while others do the work. They think it is simply a matter of sitting at the center of an information web and, on the strength of bits of data collected by others, acquiring superior capacity to judge and direct complex technical processes.

To see the absurdity of this assumption one has but to translate it into the parallel where an administrator with no medical education sits in judgment and lays down the law to a surgical team. Let me assure you that the technical expertise required of a nuclear submarine designer is every bit as closed to the lay mind as is surgery.

Despite all the new systems analysis, computer techniques, game theories, and alleged sociological "scientific insight," the kind of expertise which only the professional man with long experience possesses is still required. For all the world, what the current situation reminds me of most is the concept of hereditary monarchs, that they had some divine capacity to rule on every matter within their realm.

Chairman PROXMIRE. I understand that recently in testimony before the Joint Committee on Atomic Energy, you responded at length to questions concerning the reasons for this problem in the Department of Defense.

Admiral RICKOVER. Yes, sir. In the July 25, 1968, hearings concerning advanced design submarines.

Senator PROXMIRE. I would like to ask the staff to insert in the record the questions Admiral Rickover was asked and the answers he gave.

(The information follows:)

Question: As you know, the committee is deeply concerned about the way the Department of Defense delayed the high-speed submarine and is delaying the electric drive submarine. Would you provide the committee with your views to why this is happening?

Answer: I have given this much thought over the past several years and I have expressed my ideas at length before committees of Congress [1]—this committee, the House Armed Services Committee, the Senate Preparedness Subcommittee, the House Appropriations Committee, and most recently the Senate Foreign Relations Committee. If I talk about a matter not within my assigned area of responsibility, this should be attributed to affection for my country rather than presumption.

What is basically wrong with the Defense Department, in my opinion, is the excessive size of its headquarters, its civilian general staff, which has grown at such a prodigious rate in the last 8 years that it has now reached what in an atomic bomb is called a "critical mass." As you know, when a critical mass is reached, the bomb "take off"; it is out of control. The DOD headquarters staff has become so vast that it has gone out of control of its own leaders.

There are so many layers of administrators that they constitute a thicket impeding action on vital matters for which DOD approval must be obtained. At numerous points there are barriers—often manned by relatively minor administrators—which check progress. In consequence, almost nothing can now be decided without inordinate delay. It is bad enough to make wrong decisions but infinitely worse to make none at all—as happened with the aircraft carrier *John F. Kennedy*. By simply refusing to act on the request of the Armed Forces and of Congress that the carrier be nuclear powered, the civilian general staff killed the project and got its wish to have it powered by conventional fuel. Currently, the building of the electric drive submarine is being held up possibly with the hope for the same result. This is a dangerous game. Our enemies will not politely hold their hand while still another study is made by the Defense Department.

Obsessed with the fallacy that the decisionmaking process can be made "scientific," the civilian general staff has built a complex apparatus for the evaluation of military hardware requested by the Armed Fores. The deciding criterion has been "cost-effectiveness," a

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[1] Related testimony by Vice Admiral Rickover before various committees of Congress are—

1. Hearings before the Joint Committee on Atomic Energy:
   (*a*) June 21, 1968, nuclear submarines of advanced design.
   (*b*) Feb. 8, 1968, naval nuclear propulsion program, 1967–68.
   (*c*) Mar. 16, 1967, naval nuclear propulsion program, 1967–68.
   (*d*) Feb. 16, 1966, AEC authorizing legislation, fiscal year 1967.
   (*e*) Jan. 26, 1966, naval nuclear propulsion program.
   (*f*) Feb. 8, 1965, Mar. 18, 1965, Apr. 8, 1965, pts. 2 and 3, AEC authorizing legislation, fiscal year 1966.
2. Hearings before the Committee on Armed Services, House of Representatives:
   (*a*) June 13, 1968, No. 56, hearings on military posture, 1968.
   (*b*) Apr. 18, 1967, No. 8, hearings on military posture, 1967.
   (*c*) May 2, 1966, No. 64, hearings on military posture, 1966.
3. Hearings before the Preparedness Investigating Subcommittee of the Committee on Armed Services, U.S. Senate:
   (*a*) Mar. 13, 1968, U.S. submarine program.
4. Hearings before the Subcommittee on the Department of Defense of the Committee on Appropriations, House of Representatives:
   (*a*) May 1, 1968, pt. 6, Department of Defense appropriations for 1969.
   (*b*) May 1, 1967, pt. 6, Department of Defense appropriations for 1968.
   (*c*) May 11, 1966, pt. 6, Department of Defense appropriations for 1967.
   (*d*) May 12, 1965, Department of Defense appropriations for 1966.
5. Hearings before the Subcommittee on Public Works of the Committee on Appropriations, House of Representatives:
   (*a*) Apr. 24, 1968, pt. 3, public works appropriations for 1969.
   (*b*) Apr. 26, 1967, pt. 2, public works appropriations for 1968.
   (*c*) Apr. 20, 1966, pt. 2, public works appropriations for 1967.
   (*d*) May 5, 1965, pt. 3, public works appropriations for 1966.
6. Hearings before the Committee on Foreign Relations, U.S. Senate:
   (*a*) May 28, 1968, Defense Department sponsored foreign affairs research.

social-science concept that gives inadequate weight to the factor of military effectiveness, which cannot readily be quantified and fed into computers.

Men without the necessary technical training and practical experience hold positions of authority within the civilian headquarters organization, positions that permit them to decide technical and operational matters. Lacking the hard experience of those who must solve complicated technical problems, who daily come up against the difficulty of getting anything concrete accomplished in this world, the administrators and systems analysts of the Defense Department make little allowance for technical expertise in their "scientific" decision-making process. They have little if any comprehension of the elusive attribute of exceptional personal perception and ability that anyone involved in a new technology must possess if he is to succeed. They customarily substitute "method" for "substantive knowledge."

This is typical of the social-science approach which at present permeates the civilian headquarters of the Defense Department where social scientists hold high position. In education, it has led to the dogma of the progressive educationists that knowing how to teach is more important than knowing what to teach. In management, it fosters the delusion among high-ranking administrators that the position they hold of itself invests the holder with competence in all areas of his domain.

That the Defense Department is a huge and costly institution bound by inordinately involved and time-consuming procedures is self-evident and fairly well known. Not so well known and potentially more dangerous is the fact that, by virtue of sheer power and blinded by their own propaganda, those in charge consider themselves competent to engage in actual design of complex technical equipment and in the detailed direction of military operations.

Some examples: A very high DOD civilian official used to conduct weekly design meetings with a contractor during which the design of a most complex weapons system was evaluated in detail. Another high civilian DOD official held meetings attended by other leading civilians of the headquarters staff and by military line officers where the design of the complex equipment of a new submarine was evaluated. None of those present was experienced in the relevant technology. On other occasions, the DOD general staff has bypassed the Navy Department and gone directly to subcontractors to obtain technical and financial information. The financial information was requested on a contract then under negotiation by the Navy's contractor. The result may be an increase in cost.

What is forgotten by those who set up these elaborate decisionmaking processes is that the military is an operational organization with specific technical tasks to perform, and that these require a high degree of specialized technical knowledge and experience. They are tasks which are not amenable to purely management techniques. They lie in two different areas of human competence, and are not interchangeable.

Different elites disagree with each other. The problems with which administrators deal spill over into areas where they are not specialists, and they must either hazard amateur opinions or ignore larger issues—which is even worse. We have created a form of organized disorganization because the chief administrative goal of the Department of De-

fense appears to be the exercise of control in areas where their staff is not expert. This is why their dream of total efficiency through a new "science" of management has so often been shipwrecked on the hard rock of reality.

The vast organizational structure built up by the civilian general staff is out of proportion to the administrative work that needs to be done. It is designed to serve two additional purposes—neither of them contributing in any significant manner to military effectiveness. First, it gives play to the theoretic concepts of the social scientists and to their postulates on how decisions should be arrived at. Second, it offers "proof" to the uninitiated public that the job is getting done. This is accomplished by complex charts and lengthy "word-engineered" organizational descriptions. The civilian general staff can point to these and to its large number of administrators as "proof," as uncontradictable authority that everything necessary is being done. And all of this is expounded and celebrated by the DOD public relations staff—its propaganda arm. They will "prove," when profits on military contracts increase, that in fact the Defense Department is "saving" money. They will counter congressional questioning of Defense Department decisions by "proving" that a highly scientific decisionmaking process is at work and Congress need entertain no doubts or misgivings.

Their anonymity and their control of a vast public relations staff—paid for by the American taxpayer—protects high-level administrators who commit errors. They should not thus place themselves above public criticism. Other public officials are judged by their performance, by the results they achieve. A simple measure of the efficiency of the civilian management of our Military Establishment is the leadtime it requires to produce new military weapons. On this point, let me quote from a press conference held October 27, 1959, by Chairman John A. McCone of the Atomic Energy Commission, on his return from a visit to Russia:

QUESTION. I wonder if you could tell us from the administrative side whether you found that their administration is perhaps abler to put policies into practice a little bit faster than we are? What comparisons you might draw on the administrative side.

Chairman MCCONE. We were quite surprised with the speed with which they could accomplish certain specific objectives. Their plan of organization, under which their institutes which correspond to our laboratories are operated by their Academy of Science, seem to give them a facility for mustering and directing their scientific and technical talent in such a way that they get things done in remarkably short time.

QUESTION. Does this business of expedition in making decisions and mustering their financial and brainpower have any application in this country? Is this something that we have to improve on?

Chairman MCCONE. I think that is right.

I mention these comments of Chairman McCone because, if anything, they are even more pertinent today than when he made them in 1959. What I call the "administrative timelag" has grown immeasurably in the interval. I believe there is a direct relation between this increase and the vast expansion of the Defense Department's civilian general staff in the last 8 years. There is a saying that no one can be called a great economist who causes an economic disaster. By the same token no one engaged in managing our Military Establishment can be called a great administrator when, under his administration, our own competitive position vis-a-vis a potential enemy deteriorates.

Recently I testified that we may find ourselves in the midst of elaborate cost-effectiveness studies when our opponents demonstrate they have outproduced us in the sinews of war. But so strong is the civilian general staff's enthrallment with studies, that even when actual proof is presented that the Soviets are outdistancing us in submarines, it is impossible to break the spell—the studies must continue.

Lack of funds cannot be used to excuse the DOD's delay in authorizing new design submarine construction. Congress has not only made the necessary funds available but has repeatedly urged that the new type submarines be built without delay. Further, the Navy has offered to provide funds from other Navy programs for the increased cost.

The manner in which the electric drive submarine has been handled by the Department of Defense is far more important than the specific issue of the submarine itself. If this manner of doing business—where the highest levels of civilian and military administration in the Department of Defense become involved in details of warship design, including submarines—is indicative of the way other Department of Defense projects are being handled, we are in serious trouble.

I believe it is incumbent on those of us who are familiar with the fundamental principles involved in the issue of the electric drive submarine to express our deep concern.

Question: Would you provide your recommendations on what needs to be done in the Department of Defense to correct this situation?

Answer: I believe what I have just said leads to some obvious simple remedies.

First, I would require the DOD headquarters—the civilian general staff—to be drastically reduced in number. As an immediate step I would require that it be reduced to the level of numbers and of high-level positions it had in 1960.

Second, I would return to the three Services the right to run their own departments—and not remain the servants of the vast defense headquarters civilian directorate.

The DOD has become unmanageable because of its huge size. This would be equally true of any other centrally controlled organization with similar responsibilities and with many billions of dollars to spend. The immense growth of recent years was never the intent of Congress, and it is Congress that can and should require immediate return to the basic concept of the Defense Department. The Lord hasn't created people with sufficient wisdom to run these vast organizations. The corrective judgment of the legislative process must therefore be used.

The Military Establishment should, of course, be managed by a civilian headquarters staff, but the staff should set policy and not engage in detailed administration and operation, and in the design of military equipment, as it now does. In a homely manner of speaking, the Department of Defense is constipated; it must be purged or it will become increasingly torpid.

I well know the reluctance of the legislative branch to interfere with an agency of the executive branch. But after all, Congress does have the constitutional authority to "raise and support" our military forces. Surely this means more than merely appropriating funds. As the representative of the people in whom all authority ultimately resides, the Congress has the responsibility of "oversight"—of making certain that the taxes paid by the people are spent wisely and in the public interest.

Should we ever lose a war, to what avail would it then be to say: It was not the business of Congress to meddle in affairs of the executive branch.

One of the reasons you do not have a full picture of what goes on in the Defense Department is that you permit witnesses to use "meta-talk"—the diplomatic language which is expressive of bureaucratic caution. It is highly serviceable for fending off questions one does not wish to answer. It is effective because it takes advantage of and plays on the courtesy of congressional committees who try not to embarass witnesses.

Lately, I find myself thinking of the commission set up after the end of World War I by the Weimar Republic to study and report on the causes of Germany's defeat. The commission found that a major cause of this defeat was the amount of paperwork required of the armed forces. Toward the end, they were literally buried in paper.

I hope we will never have to appoint a similar commission.

(End of inserted information.)

Admiral RICKOVER. Mr. Chairman, I think it is important you understand that procurement policies are only one aspect of the overall problem of the high cost of operating the military. Your committee should not be unaware that the factors listed in my replies to the Joint Committee on Atomic Energy also result in technical and economical inefficiencies.

Chairman PROXMIRE. That is good advice, Admiral. We will explore this aspect further.

DEPARTMENT OF DEFENSE OFFICIAL REQUESTS "FACT SHEETS"

Admiral RICKOVER. Recently I had the first intimation of Department of Defense interest in my testimony—that is, aside from their public statement in December 1963 in which they contended I did not know what I was talking about. On August 22, 1968, the Deputy Assistant Secretary of Defense for Procurement requested individual fact sheets on each specific fact covered in my testimony before the House Appropriations Committee. He stated he desired the information on the specific circumstances of these facts and the rationale used to support statements I had made to Congress "for the purpose of his own analysis and to respond to congressional inquiries."

I responded that it was a mystery to me why the Department of Defense first makes public statements that my testimony is incorrect and then, later on, requests me to supply them the facts. I told them that I could not see what purpose this information could serve on an after-the-fact basis.

Chairman PROXMIRE. You mean to say you had to provide fact sheets on each specific example you used in your testimony?

Admiral RICKOVER. Yes, sir. I prepared and forwarded fact sheets on each of nine specific examples covered in my testimony. I forwarded them to my superiors with my comments.

Chairman PROXMIRE. Could we have a copy of your response, Admiral?

Admiral RICKOVER. Senator Proxmire, again I would have to request Department of Defense clearance.

Chairman PROXMIRE. I wish you would do so. Again, if my staff can do anything in this regard, please tell me.

Admiral RICKOVER. I shall, sir.

(The correspondence appears as Appendix II, this volume. See p. 166.)

NEED FOR COMPREHENSIVE PROFIT STUDY

Chairman PROXMIRE. Admiral, we have been pressing the General Accounting Office to make a comprehensive and complete study of contractors' profits. We feel that until we have that information it is going to be very, very hard to get action in a lot of areas. We want to have them make a study of the realized profits. Mr. Staats himself testified on Monday that nobody has made that kind of a study—no congressional committee has made that kind of a study, no agency of the Government, no foundation, no university has.

Admiral RICKOVER. May I interrupt, sir?

Chairman PROXMIRE. Yes.

Admiral RICKOVER. The question is why hasn't the General Accounting Office done so? Who has stopped them?

Chairman PROXMIRE. Well, they are reluctant to make it. Of course, they will do it if they are directed to do so.

Admiral RICKOVER. That is just the point. They have a charter. It is a broad one. I have an extract of it here:

"The Comptroller General shall investigate at the seat of Government or elsewhere, all matters relating to the receipt, disbursement, and application of public funds, and shall make to the President when requested by him and to Congress at the beginning of each regular session, a report in writing of the work of the General Accounting Office, containing recommendations concerning the legislation he may deem necessary to facilitate the prompt and accurate rendition and settlement of accounts and concerning such other matters relating to the receipt, disbursement, and application of public funds as he may think advisable. In such regular report, or in a special report at any time when Congress is in session, he shall make recommendations looking to greater economy or efficiency in public expenditures."

Now, I would think that $45 billion in defense procurement would elicit great attention from the General Accounting Office. This is 25 percent of the entire budget of the Federal Government. They ought to be very much concerned with how well and how efficiently Government procurement is carried out. But they have apparently waited for somebody to tell them what to do. By failing to take the initiative they are, in my opinion, not carrying out their primary function.

Congress has charged the General Accounting Office with a great responsibility, and Congress should be able to depend on them to take the lead.

GENERAL ACCOUNTING OFFICE IS CONSCIENCE OF GOVERNMENT

The General Accounting Office is, in a sense, the conscience of our Government. It should study the *entire* subject of defense procurement in depth, not because everything bad is in the Defense Department, but because the major part of the Federal budget is being spent by this one Department. Whatever principles and rules are evolved there—what you learn from that particular Department—will be applicable to the National Aeronautics and Space Administration, to the Atomic Energy Commission, and to other Government agencies.

Chairman PROXMIRE. As you say, of course, they make some very useful studies which enable us to save substantial sums here and there, but not the comprehensive kind of study that would be most useful to us.

There is no doubt we need more information. The Comptroller General testified Monday about all the audits they are conducting. The General Services Administration was paying about $1.5 million too much for light bulbs. One Air Force base paid too much for propane gas. Cape Kennedy spent more than it should for a fire department. Of course, these audits all lead to substantial savings, but we still do not have a comprehensive picture of Government procurement. I had great difficulty Monday morning determining the Government-wide implications of these findings.

Admiral RICKOVER. The General Accounting Office has apparently been reluctant to take the initiative on these broad, basic issues. I have told the Comptroller General and his officials that they are missing a great opportunity to save the Government very large sums. They should be taking on a few major issues where important principles are involved and then evolve Government-wide procurement rules based on their findings.

In my opinion, the General Accounting Office should be conducting broad investigations into fundamental aspects of Government contracting operations. It is not enough simply to have a charter of responsibility for a job; the job must be worked at and kept meaningful in relation to the existing situation. Many of our present-day regulatory commissions were set up in the 1930's, during the Roosevelt administration, to correct the abuses prevalent at the time. But once the major abuses were corrected and the public economic welfare improved, many of these commissions acted as if their job was finished without concern for new abuses that were introduced.

No problem can be solved once and for all. This is so because men, being endowed with free will, continually alter the condition of life.

Industry quickly learned to live with these new commissions and to accommodate itself to them. Often the membership of these commissions was comprised of people from the very industries or organizations they were intended to regulate.

More important, industry soon learns how to achieve its ends within the existing rules. Seldom do rules keep pace with events. New abuses crop up, and new rules must be continually devised to cope with the changing situation. For example, Congress found widespread abuse in charges for consumer loans and passed the truth-in-lending bill. Senator Hart recently pointed out abuses in the insurance industry. It is a role of Government to search out these abuses and to change the rules and procedures to prevent them. It is a constant, reiterative process.

The point I am making is that the General Accounting Office, like any other organization, must constantly examine its operations to insure that it is in fact carrying out its charter, and not just doing the same old things long after the situation has changed. I do not think Congress wants the General Accounting Office to preoccupy itself with investigating relatively minor matters when there is an overriding need to look into the fundamental issue of how the Government does its contracting.

The General Accounting Office, in my opinion, if it is to perform its primary function, would start using its talents to conduct a thorough review of how the Department of Defense does business, not only the profits it pays, but the whole way it goes at it, what rules it uses, and so on. Let the GAO compile a "Who's Who" of contracting officers and their relations with industry. What interchange have they had with Government and with industry? Who are the members of these various groups such as industry advisory groups? What is their background?

Chairman PROXMIRE. We heard some interesting testimony, for instance, on the Logistics Management Institute and some of the other advisory groups they have set up.

Admiral RICKOVER. One of the most influential of these groups includes in its membership officials from industry and the Department of Defense. This is the Industry Advisory Council—it used to be called the Defense-Industry Advisory Council before the term "defense-industry" acquired the connotation it has today.

The Industry Advisory Council has considerable influence on Department of Defense procurement policy. This group of high-level industry and Department of Defense executives meets regularly to discuss procurement policies and other matters concerning weapons acquisition. It is one of industry's most effective forums for influencing defense procurement policies. I believe this group has more influence on defense procurement policy than the Department of Defense's Armed Services Procurement Regulation Committee itself.

Industry is represented on the Industry Advisory Council by the chief executives of many large defense contractors. The Department of Defense is represented by Secretaries, Assistant Secretaries, and top-level military officials. In contrast, the Armed Services Procurement Regulation Committee is comprised of lower level Government officials who have considerably less influence.

There are problems in such an arrangement. Let me read comments from the September 1967 issue of *Armed Forces Management* on the Defense Industry Advisory Council:

"* * * it would be naive to assume the DIAC discussions can remain entirely free from partisan views. By the very nature of the corporate structure, it is the management philosophy of a given corporate head that permeates that particular organization and forms the basis for positions adopted by that organization. With this premise, often a top manager's evaluation of a given subject area must be redolent of a position that might be taken by his own firm or association.

"* * * The DIAC meetings are kept as informal as possible and are conducted without public record other than a general summary of minutes for the benefit of the membership. While both Defense officials and the Council recognize the inherent danger of negative reaction in not making the DIAC proceedings public, it is nonetheless felt this type of 'free climate' is conducive to the most candid and straightforward exchanges.

"There can be not question that the DIAC discussions, to date, are making a major contribution to defense-industry relationships."

Please note that no public record of these meetings is made. It is open to question whether such meetings at which Government policy for business is formulated should be conducted without such a record.

I believe that for most high-level Government officials the Industry Advisory Council is their only real contact with the procurement world. As a result, their viewpoint is influenced by what they hear from industry executives during these meetings. Doubtless, these Government officials would have a much different outlook on defense procurement problems if regular meetings were held with working-level Government contracting officers, Government auditors, and technical personnel who have to deal with industry on a day-to-day basis.

The problem of industry's influence on Government actions through "industry advisory groups" is not a new one. You may remember, Mr. Chairman, an issue in 1955 and 1956, when the Antitrust Subcommittee of the House Judiciary Committee inquired into the operations of the Department of Commerce Business Advisory Council. That Council included many prestigious business leaders, including representatives of the Government's major defense contractors. Its meetings were not open to the public, nor did the Commerce Department release full minutes of meetings. The Secretary of Commerce refused to provide the records of the Business Advisory Council to the Antitrust Subcommittee.

At that time the chairman of the subcommittee made this statement:

"While there may be many substantial reasons justifying the existence of the Council, no good reason for hiding its operations from the public has ever been suggested."

That reasoning applies equally today to the defense and industry advisory groups which have a great influence on procurement policies.

When the subcommittee was finally able to obtain information on the Business Advisory Council, it found a number of practices it considered questionable. For example, the operations of the Council were being financed by industry contributions. The salary of the Executive Director of the Council was paid from these contributions. In addition, the subcommittee found that the Council was paying for a study of the Government's antitrust laws at the very time the Department of Justice was taking legal action against several of its members for violation of these laws. The subcommittee also found that members of the Council were being given access to Government records not available to the public, or even to Congress.

After their hearings were concluded, the subcommittee issued an interim report calling for rules for business-Government advisory groups. These rules included

—That such groups receive statutory authority before they are established.

—That meetings be held under the direction of Government-paid officials.

—That complete minutes of the meetings be kept and made available to Congress and the public.

I don't know what happened to these recommendations. They seem sensible to me. I don't know why they were not adopted.

The Business Advisory Council continued to function until 1961, when Luther Hodges became Secretary of Commerce. He pressed for changes in the operations of the Council, including meetings open to the public and the addition of academic, professional, and small business representatives to its membership. The members of the Coun-

cil would not accept these changes, and in July 1961, it severed connection with the Department of Commerce. Today the group operates as a private organization under the name of "the Business Council."

Chairman PROXMIRE. I think a comprehensive study on the impact of such industry advisory groups on defense procurement policies would be very helpful to us. It seems to me that the Industry Advisory Council has great influence on defense procurement policy, and I do not see how a review of defense procurement could be comprehensive without a critical evaluation of the activities and functions of this group. Under any circumstance, public records of the meeting should be made. Perhaps the General Accounting Office should look into this as part of an overall review of defense procurement.

Admiral RICKOVER. I believe the General Accounting Office should be required to take the lead in such reviews. With our large population, with the huge sums of money we are spending, with the vast bureaucracy—which essentially has gotten out of control of Congress and, therefore, of the people—the General Accounting Office can perform one of the most important functions in Government. It can look at these issues broadly and make recommendations to Congress for basic changes. It can provide an invaluable service to the Congress and to the country if it would but take the initiative. It is the only office in Government both authorized and staffed to examine such issues.

Chairman PROXMIRE. You mean a study of profits and a more general study of the entire procurement operations?

Admiral RICKOVER. Yes, sir, the entire procurement operation. If it does not take the initiative itself, I think Congress should direct it to make a comprehensive study.

Chairman PROXMIRE. Congress directed them to make the feasibility study of uniform accounting standards.

Admiral RICKOVER. Yes, sir. But that is only a start. There is a Chinese proverb that the man who eagerly awaits the arrival of a friend should not mistake the beating of his own heart for the thumping hooves of the approaching horse. Congress will have to stay on top of that study so we can be sure to get something of value out of it.

ARGUMENTS AGAINST UNIFORM ACCOUNTING STANDARDS NOT VALID

Contractors will tell you that it is too difficult, or too costly, to establish uniform accounting standards; that such standards would impinge on management prerogatives; that industry could not live with uniform standards; that they are unnecessary.

We have heard all these arguments before. When it became apparent that we needed more stringent production and quality control standards for manufacturing reactor plant components for nuclear warships, we were told that industry could not work to such strict standards. But tight standards were necessary to insure safety of the crews and reliability of the powerplants. We stopped worrying about whether it could be done—we just did it.

Industry usually overdramatizes the difficulty of change. However, once we are committed to make the change, many of the difficulties disappear. Recently, *The Economist* described an arrangement the British Government worked out with industry to accomplish the same sort of function our Renegotiation Act is supposed to perform. Appar-

ently British industry objected to certain features of the system; nevertheless, the new rules go into effect next year. Return on investment figures, which have been adopted as the measure of profitability, will have to be based on the Government's accounting standards. The article states:

"After all its posturing over the last 3 years, the Confederation of British Industry has probably now found that post-costing and equality of information are not such painful injustices as it once seemed to be arguing. However, the Government has succeeded in introducing these two principles without damaging industry's incentive to seek higher efficiency and pocket some of the proceeds."

Thus I am skeptical when people say how difficult it will be to establish uniform accounting standards. I do not see how these standards can be any more difficult to establish than are standards for design and manufacture of complex military equipment. Further, it may be less onerous to accept standards for accounting than it is to have numerous Government auditors, contracting officers, and technical people at the contractor's plant trying to reconstruct his books to find out what it costs him to manufacture the equipment. It is also very difficult for the Government to tax our people $2 billion extra each year when that sum could be saved by use of uniform accounting standards.

Chairman PROXMIRE. The General Accounting Office gave us a long list of people they are working with. Many of them, or their representatives, testified before the Banking Committee earlier this year against the uniform accounting study. I think it most important that the General Accounting Office get your views because you are so highly respected and because you have a view that this can and should be done.

CONGRESS MUST FOLLOW FEASIBILITY STUDY CLOSELY

Admiral RICKOVER. I will be happy to give my views to the Comptroller General if he requests them. I think it is important that Congress keep an eye on this study, Mr. Chairman, so that we can be sure that the question of feasibility will be obtained in an objective manner.

I am concerned that the General Accounting Office study may turn into an academic exercise for the benefit of professional accountants. The other day I read a speech given by the Department of Defense audit representative to the General Accounting Office study group. Let me read from the conclusion of his speech:

"Looking ahead to the completion of our task and the aftermath, it seems to me that our major contribution will lie in the information and data which we shall have been successful in accumulating, analyzing, and reporting, and our related efforts to motivate and assist in the development and improvement of cost accounting principles as a useful communication medium among all interested elements in our society. To state it in another way, if the results of our study are considered productive, and perhaps even 'generally accepted,' I would think that it would be more because we succeeded in advancing the state of the art than because of any specific conclusions we reached as to whether or not uniform cost accounting standards are feasible."

Now it seems that this person is concerned more with advancing the state of the accounting art than with developing a sound basis for

Government procurement. With that attitude, nothing constructive will be done.

Chairman PROXMIRE. Admiral, I raised that point specifically with Mr. Petty, the Director of the Defense Contract Audit Agency, when he testified Tuesday. He and Mr. Malloy, the Deputy Assistant Secretary of Defense for Procurement, assured me that the Department of Defense was approaching this study with an open mind.

Admiral RICKOVER. Of course, they would say that. What else could they say? Advisers from industry and the accounting profession will also say they have an open mind, but I question just how openminded they really are. These groups have a vested interest in the status quo. The logic may be faultless in its own terms but the terms fall short. That is why Congress will have to follow this closely. The public interest is at stake, yet the public will not be represented in this study except to the extent that their elected representatives take a hand. Congress cannot just turn this study over to the General Accounting Office and forget about it.

Chairman PROXMIRE. Admiral, did the General Accounting Office contact you yet regarding the feasibility study?

Admiral RICKOVER. No, sir.

Chairman PROXMIRE. They intend to. They testified at the hearing they will do so. We made a point of that. We said: "We want you to contact Admiral Rickover on this." They have a questionnaire they want to send out.

Admiral RICKOVER. I will be happy to do everything I can to help them, sir.

CONGRESS MUST BE THE PUBLIC'S SAFEGUARD AGAINST SPECIAL-INTEREST GROUPS

Mr. Chairman, I have explained why the Department of Defense and the General Accounting Office will not on their own volition correct the deficiencies in defense procurement. Industry, of course, has no interest in seeing these deficiencies corrected. In many cases, the existing loopholes, such as the exemptions in the Renegotiation Act, are the direct result of industry efforts. Other loopholes are the result of influence on defense procurement policy exerted by industry advisory councils, industry associations, and private firms. There are many examples indicating that those with vested interests cannot be relied upon to act against their own interests.

You have this very same problem with automobile insurance. Senator Hart and others are trying to devise a more workable system that would eliminate much of the litigation inherent in the existing system. At present, half the customer's premium goes for administrative and legal expenses. With the reforms advocated by Senator Hart a larger portion of insurance premiums would go to policyholders in payment for actual damages. Yet, the insurance firms oppose the change; the some 20,000 or more lawyers in the industry oppose the change; the multitudinous number of accountants and claims personnel oppose the change. All of them have a vested interest and consequently have no incentive to change. But who, other than Congress, will protect the public in situations of this sort?

The patent situation is similar. Patent lawyers are considered the acknowledged experts, and it is they who have influenced our present

patent policies. As a result, the system of administering patents is cumbersome and requires extensive legal assistance—to the benefit of the 6,000 private patent lawyers. Here also, the patent lawyers are alined with industry in maintaining the status quo.

In this connection, you will remember the opposition of the automobile industry to Federal safety standards, and the opposition of the accounting profession to the establishment of accounting standards.

With the exception of Mr. J. S. Seidman, of the New York accounting firm of Seidman & Seidman, the accounting profession, and industry, even the Department of Defense, were unanimous in opposing uniform standards of accounting. Their opposition was successful in persuading the Senate Banking and Currency Committee to require only a study of uniform cost accounting standards rather than the establishment of such standards as provided in the House version of the bill.

Today some leaders in the accounting industry are beginning to recognize the inadequacies of the present accounting system. Thirty years ago the accounting profession recognized the need to develop accounting standards. But they have procrastinated, perhaps because they thought it not in their interest to develop such standards. Nor will they, I feel, take effective action until someone forces them to do so.

I could give many other examples but the point is, I think, obvious. Congress is the public's only safeguard in areas such as defense contracting where all the so-called experts have vested interests. For this reason, Congress has the obligation to take the initiative in these matters.

Chairman PROXMIRE. I intend to watch this area very closely.

Admiral RICKOVER. Mr. Chairman, you represent the State of Wisconsin—a State which has been identified with what has been called "progressive conservative" political movements. For this reason I believe you will be interested in what Henry L. Stimson, who was Secretary of War from 1911 to 1913 and Secretary of State from 1929 to 1933 in Republican administrations, and Secretary of War from 1940 to 1945 in a Democratic administration, has said. It is germane to the issue you are considering today. I will quote from "*On Active Service in Peace and War*":

"Responsibility could not be divorced from authority. Men began to think irresponsibility was a direct result of scattered authority and divided power; fear of too much government had led to untrustworthy government. The elected officials must have more power, not less—only so could they be held accountable for success or failure.

"It was in this stream of thinking that Stimson had found himself in January 1911, when, at Theodore Roosevelt's request, he made a speech to the Republicans of Cleveland, Ohio:

" 'Which one of you businessmen would assume the presidency of a great enterprise under pledge to conduct it to a successful conclusion, if you were limited to 1 or 2 years for the task; if you could not choose your own chiefs of departments, or even your legal adviser; were not allowed full control over your other subordinates; and if you were not permitted freely to advise with and consult your executive committee or your board of directors?'

"Having appealed to the common sense of his largely Republican audience he returned to his main theme: 'So long as our Nation remained young and hopeful, so long as our problems were simple, we could scrape along even with happy-go-lucky inefficiency. And we have done so.

" 'But this condition of national simplicity remains no longer. The giant growth of our industries, the absorption of our free land, the gradual change of our Nation from a farming people to one living largely in cities, with needs far more diversified than those of their fathers, have brought us face to face with the most acute problems of modern democracy. Side by side with our helpless officialdom has grown up the tremendous structure of modern incorporated business. There is nothing inefficient in that development. Its wealth is limitless and increasing, its organization has the perfection of a military machine, its ministers spring to their tasks endowed with the best specialized training that science can give them. The result of contact between the two could have but one issue. So long as they occupy any ground that is common, so long as business has any relation to the public, one or the other must control. And it is not difficult to see, under present conditions, which that one must be.'

"Business had grown big, but this in itself was no sin. The crime was simply in the failure of Government to keep pace—'one or the other must control,' and control should rightly belong *only* to Government."

Certainly Mr. Stimson cannot conceivably be classed as having radical views on economics or anything else. He was a corporation lawyer for a good part of his life. The term "pragmatic radical" might be a good description of him.

The issue, as I see it, Mr. Chairman, is "who is going to be in control, the Government or industry?"

OVERPRICING EXISTS TODAY

Many Department of Defense procurement officials, and even some Members of Congress are not too concerned about defense profits because they believe the Renegotiation Act protects the Government against overpricing. That is a serious mistake. History is replete with examples of how industry has used loopholes in Government policies to its advantage. Overpricing might not be as obvious today as it was in the past, but I have no doubt it still exists. Government regulations have made modern companies and their accountants very sophisticated in how they show the profit picture.

During the Civil War there were no statutes to regulate profiteering. As is well known, contractors reaped unconscionable profits on military procurement, and they had little or no reason to hide these profits.

In the Spanish-American War, Congress tried to control profits on armor for naval ships by setting a maximum price for armor plate. Contractors united to defeat this move by refusing to sell to the Government at the specified price.

During World War I, the Government acted to limit defense profits. It used cost-plus-a-percentage-of-cost contracts in World War I. Contractors simply inflated costs with consequent increases in profits. In pegging raw materials costs, the Government found it

had to set prices quite high to enable it to find enough firms willing to sell to the Government at the pegged prices. As a result, low-cost producers were able to make excessive profits by selling to the Government at the high, pegged prices.

In 1934 Congress passed the Vinson-Trammell Act which limited profits to 10 percent of the contract price for naval vessels and aircraft. Again, contractors simply drove up costs and thus increased their total profit. Further, a profit of 10 percent of costs could still result in exorbitant profits from a return-on-investment standpoint.

Excess profit taxes were established during both World Wars, but they were only partially effective. These taxes did not apply if a contractor could show that his profits, no matter how high they might be, were not appreciably higher than his average prewar profits. Thus, how industry accounted for costs became a significant factor.

During and after World War II, the Renegotiation Acts of 1942 and 1943 introduced the present system of contract renegotiation. Under contracts covered by these laws, contractors submit statements of costs and profits to the Renegotiation Board each year. The Board in turn evaluates the reasonableness of the profit claimed in context with other considerations such as the contractor's efficiency, his type of business and the degree of risk assumed by him. By means of additional legislation, the renegotiation system developed during World War II has been extended through the present time. Under renegotiation, the contractor has to be more sophisticated, but there remain serious loopholes which tend to defeat the act's purpose.

Mr. Chairman, I am sure you are aware that concern over the large profits being made by industry is not confined to Members of Congress. It has been of longstanding concern in our history and has led to many investigations and to the enactment of legislation intended to be remedial.

But the situation today is graver than it has ever been. With an annual military procurement of some $45 billion and little likelihood it will decrease in the foreseeable future, large profits have become an issue gnawing away at the faith of our people in their Government, at the way the defense business is currently being conducted.

A democracy is a delicate and fragile human construction. For it to exist, the people must believe in their Government and in their institutions. When any special group, as for instance a business minority takes advantage of the Government, the faith of the people is undermined. That is a very serious matter. I believe this is now happening; I think those in the executive branch ought to recognize that unless the situation is remedied our democratic form of government is in jeopardy.

Ours is the finest Government that has ever been devised. Gladstone, the British statesman, referred to our Constitution as "the most wonderful work ever struck off at a given time by the brain and purpose of man." I would like to see us go back to the principles of the Founding Fathers. We have departed from some of these principles. Today, pressure groups and special interest lobbies exert influence on public policy disproportionate to their proper role and responsibility in society, and not always in the public interest. This is a basic moral and political issue that calls for solution without undue delay.

Our people are unable to understand the logic of having their sons drafted to fight a distant war at the risk of their lives, while at home the Government permits large corporations to make high profits from the supply of war materials.

We should not underestimate this feeling among the mass of our people. I believe those responsible for permitting this—both in industry and in Government—are doing a great disservice to industry as well as to Government. Inevitably there will be repercussions which will increase the power of Government and limit the freedom now possessed by industry. Perhaps it asks too much of the officials of a corporation that they take this factor into account. The head of a corporation and his chief officials are, in essence, judged by only one criterion—the profit the corporation makes. It is unrealistic to expect them to do otherwise than try to make the highest possible profit. If they fail to do so, others will take their place.

For this reason the Congress must constantly bear in mind the growing autonomy of the Federal bureaucracy, the increasing lack of control by the Congress, and the bureaucracy's tendency to make accommodations with industrial corporations. If a close partnership between Government and industry is actually necessary, then a great responsibility rests on the Congress and on the executive branch to see to it that these giant organizations do not become, in effect, a fourth branch of Government—a fourth branch, but with men exerting power without political or legal responsibility. It will be necessary to check and control them.

Given this situation, Government must and should intervene. If it does not—especially in the case of military equipment—it will continue to lose the confidence and faith of our people.

KNOWLEDGE OF HISTORY LIBERATES US

A knowledge of history liberates us from the restrictions of our time and our place, and gives us valuable knowledge with which to face modern problems. History repeats itself. This fact is a testament to human stupidity. Insofar as problems are not purely technical they have to do with human beings, and men do not change as much as is often thought, merely because they have more gadgets.

In anything concerned with human behavior we must still depend on wisdom—a term expressive of man's cumulative experience—sifted through an observant and intelligent mind. The wisdom of ordinary, even illiterate people over the ages has been quite remarkable. This is why the common folk sayings, and the words of the Bible, even though they originated in preindustrial societies, remain valid today—despite the vast advance of technology and its effect on our environment.

One bit of wisdom that has struck me as having eternal value is that man cannot live by bread alone. A human being whose sole nourishment comes from the pursuit of material gains is a defective person. Such persons must be regarded with caution because their judgment is impaired. For this reason, it is important that their activities be kept under scrutiny so they may not unduly harm the body politic. Conservatism cannot take honest root in a situation where the criteria for success or failure are ruthlessly materialistic.

Henry L. Stimson, the "pragmatic radical" I mentioned, once said the people were like a behemoth that every once in a while turns over and completely reverses itself. I believe our people are now in the process of turning over. It would be the better part of political and business wisdom to recognize this and to conduct our affairs so as not to cause the turning over to be so great and so rapid as to cause too many unpleasant consequences.

INDUSTRY ONLY WANTS A FAIR ADVANTAGE

While we have gradually been evolving a basic set of laws to protect the Government, industry has been developing a complex set of accounting devices by which it can circumvent them. As industry becomes more sophisticated in finding and exploiting loopholes in the law, Congress must become more diligent in closing them. Industry will fight this effort; they will come here and testify as if they were entitled to a few loopholes in any legislation that affects profits. They will tell you that they don't want much, Mr. Chairman. All they want is a fair advantage. [Laughter.]

Today, in a world that knows no peace, inefficiency in this area of the Department of Defense's responsibility courts serious difficulties. It takes time to spend money. When more money is spent than is absolutely necessary, military equipment is delivered late; it will often be obsolescent because of time wasted. You have a good case here where an action with a clearly beneficial purpose in one area—saving money—would have tangential effects of benefit to another area—efficiency.

Chairman PROXMIRE. The statement you just made that by spending too much money we can actually create inefficiency is not understood by most people. It is a throughful observation.

I wonder whether you have any thoughts on the recent announcement by the Defense Department that it will engage in forms of social work—that it will use its money and talents for social welfare. This issue has relevance to the work of the Joint Economic Committee because it concerns allocation of funds among the Government departments. Should defense funds be used for this purpose?

Admiral RICKOVER. I have always felt, and I have previously testified that the great danger for any bureaucracy is to extend itself into areas which are not its direct concern, where it therefore usually has no special competence. The defense effort of the United States is so vast and so complex that it is almost impossible of accomplishment. For it to achieve even a modicum of efficiency requires the full-time devotion of all its people.

There are other organs of Government that can perform social functions better and with greater efficiency than the Defense Department. This is not its primary task. I can see no special competence for social work in the Department of Defense, for engaging in "a fertility of projects for the salvation of the world." In sum, I would say in a quite general way that the assumption by the Department of Defense of *any* function outside its specific task of the military defense of the United States is deterimental to its proper and primary purpose.

Chairman PROXMIRE. Admiral, this committee has been very interested in your testimony, and especially in your specific recommendations for congressional action to correct the problems you have enu-

merated. I think it would be helpful to the committee and the other Members of Congress if you would summarize your main points.

Admiral RICKOVER. I will be happy to do so, sir.

The essence of my testimony, Mr. Chairman, is that defense procurement policies must be tightened if the public interest is to be protected. I have used specific examples to illustrate many of the deficiencies and loopholes in present defense procurement policies. I have tried to show that prevailing attitudes within the Department of Defense are not conducive to objective evaluation of these policies because the Department of Defense has been greatly influenced by the industry viewpoint. In the course of day-to-day compliance with existing procedures, no one there seems to have stepped back and taken a critical look at the overall defense procurement process. The General Accounting Office also seems reluctant to get into this area in depth.

RECOMMENDATIONS FOR CONGRESSIONAL ACTION

For these reasons I believe that Congress will have to become an active protagonist in overhauling the defense procurement process. This is a large and difficult task, I realize. However, it is important that it be started promptly. Therefore, I recommend the following course of action for the Congress in the area of defense procurement:

First, make every effort to insure that uniform standards of accounting are established as quickly as possible so there will be a sound basis for contracting, so the Government can readily identify actual cost and profits. Since, under the terms of Public Law 90–370, the General Accounting Office has been required to look into this matter, Congress should insure that the feasibility study conducted by the General Accounting Office is objective and that in this study the public interest is kept foremost—above the interests and the opposition that can be expected from industry and from many in the accounting field. Until this study is completed and until uniform standards have been established, the Department of Defense should be required to adopt the cost principles in section XV of the Armed Services Procurement Regulation as mandatory for all types of contracts, including fixed price contracts, and for the reporting of cost and profit information.

Second, the Department of Defense should be required to revise the Armed Services Procurement Regulation so that procurement policies reflect the real situation wherein competition in defense procurement is the exception and not the rule. The rules of noncompetitive procurement should apply to all contracts that are not formally advertised procurements. The Armed Services Procurement Regulation should be changed to indicate that it prescribes an upper limit for contracting officers on matters such as profits, allowable costs, use of Government facilities, and the like. Whenever possible, they should obtain the best deal for the Government.

Third, Congress should insist that the Department of Defense develop an effective self-appraisal program in the area of procurement. The numerous examples I have mentioned and the many others brought to light by other congressional hearings and in the press indicates that the Department of Defense appraisal program has not been effective.

Fourth, Congress should require the General Accounting Office to undertake a comprehensive review of defense procurement. Such a re-

view should include a critical look at the fundamental basis and assumptions of defense procurement. The General Accounting Office should get into major issues from which general principles can be developed for Government-wide improvements in procurement. This comprehensive review would be in lieu of the fragmentary approach that has often characterized its efforts.

Fifth, the General Accounting Office should study the impact of the Industry Advisory Council and other industry groups on defense procurement policies and whether the interest of the public requires additional safeguards in such arrangements. The General Accounting Office should look into the interchange of personnel between industry and Government to determine whether legislation is needed to restrict the ability of procurement officials to represent Government and industry alternately.

Sixth, defense contractors should be required to report costs and profits upon completion of each order in excess of $100,000. Such reports should be submitted in accordance with the uniform accounting standards and should be certified by an authorized official of the company. Criminal penalties should be provided for those who submit false or misleading data.

Seventh, defense procurement regulations should be revised so that return on investment is considered in establishing profits.

Eighth, uniform rules that would preserve for the American public the rights to all inventions developed at Government expense should be established for all Federal agencies.

Ninth, present Department of Defense rules should be revised to discourage use of Government-owned machine tools on orders for which their use is not required, so that the Government's investment in such tools can be reduced and so that contractors cannot rely on Government-owned tools to perform other work. The Armed Services Procurement Regulation should provide that decisions to authorize use of Government-owned machine tools on orders other than those for which the tools were originally provided should be considered and approved at the same level and under the same criteria as required to provide them to the contractor in the first place, whenever such authorization would extend the period of time the Government tools are left at the contractor's plant.

Tenth, defense procurement rules should specifically prohibit reimbursement of advertising costs on any negotiated contracts. Government security clearance should be required for all advertising related to defense contracts.

Eleventh, a central Government file should be maintained on contractor experience, showing for each contractor such items as his actual delivery performance, exorbitant or unfounded claims he has submitted, the difference between original and final price of each contract performed, and the amount of excessive profit he has realized on Government work.

Twelfth, the Renegotiation Act should be strengthened by making it permanent, by reducing the level of reporting from $1 million to $100,000 and by eliminating the exemptions for commercial articles, construction contracts, durable equipment, and the Tennessee Valley Authority. Congress should take steps to insure that the Renegotiation Board is adequately staffed to carry out its responsibilities.

Thirteenth, the Truth-in-Negotiations Act should be strengthened by requiring contracting officers to obtain, and contractors to provide, cost data on all contracts in excess of $100,000 unless such contracts are awarded as formally advertised procurements. Congress should prohibit waiver of the Truth-in-Negotiations Act for contractors doing in excess of $1 million of business with the Government annually. These contractors should be required by law to provide cost and pricing data.

Fourteenth, the Defense Production Act should be strengthened to require certification by contractors that rated orders receive priority over nonrated orders; inspections of contractor plants to insure that priority is actually given to the rated orders; and annual reports identifying instances when assistance, as requested by military departments, was not provided. The authority for administration of the Defense Production Act should be reassigned from the Department of Commerce to another agency.

Chairman PROXMIRE. Admiral, you have been a most refreshing witness and your testimony has been illuminating. I particularly appreciate your use of specific examples and your specific recommendations. Many people testify before congressional committees complaining about things that are wrong but few have specific recommendations on how they can be remedied.

I appreciate the time you have taken from your important technical duties to testify here today. It is not often we get the benefit of advice from a person of your experience. Too often we have to rely on the testimony of people who have little direct contact in day-to-day procurement matters. Usually they are at the policy level and seem so ingrained with the present system and so remote from actual events that they are not objective. That is why your testimony is so important to us. You are intimately familiar with the procurement system but not officially a part of it. As a successful program manager for many years, you are in a unique position to evalate the procurement process in terms of its impact on the nuts and bolts of getting the defense job done. I can well understand why you are so interested in this field.

Admiral RICKOVER. I have to be interested, Mr. Chairman.

REASON FOR INTEREST IN CONTRACTING

As you know, my training is in engineering. I have never raised contracting issues out of simple academic interest. I have had to get into the details of Government contracting in order to get my work done efficiently and on time.

I have been made painfully aware of these issues in the course of my technical duties. They affect my ability to do my job since they require that I take much time from my technical duties and devote it to matters which should be the direct responsibility of the large number of officials as listed on the organization charts.

There is no way to determine the ultimate cost to the Government when scarce technical and project personnel are diverted from their primary responsibilities because of administrative deficiencies. The cost is more than just the time of the technical people involved; important technical projects are unnecessarily delayed.

Since technology builds on work performed rather than on work contemplated, on construction rather than on systems analysis, delays impede our technological growth. You lose 6 months here and 6 months there while contracts are being negotiated, while audit reports are being submitted, while those who have authority are deciding whether or not they will exercise it. When you add these delays all together over a 10-year period, 2 or more years may be lost in terms of technological advancement. In today's environment and with today's problems, we simply cannot afford such slowdowns. I only wish our potential enemies were hampered with these problems created for us by overadministration.

As long as young men have to go to war, I firmly believe we should give them the best weapons we can build. I only wish it were possible for older people such as myself to go to Vietnam. I would be happy to do so. I have lived my life, but the young men we are sending there have not lived theirs. It is not proper to draft young boys, send them out to fight and take the chance of losing their lives, while at the same time defense contractors are making large profits.

There has been an aversion among the "decisionmakers" in the Department of Defense to take specific action on specific problems. They have a persistent urge to seek universal formula with which to justify particular actions. They dislike to discriminate. They want to find some general governing norm to which, in each instance, appeal can be taken so that individual decisions can be made, not on their particular merits, but automatically. They resort to directives that are more useful in protecting those who write them than in instructing those who receive them.

The administrative agencies we have set up in some cases have become thickets that prevent ideas from getting through, rather than agencies to encourage them.

I have an abiding concern for the success of our democratic form of government and for a quality of life which some present-day practices tend to destroy.

What is needed is that Congress act when others have defaulted in carrying out their responsibilities. If economy in government is what you want, sir, then what I have recommended seems to be an effective way to achieve it.

Chairman PROXMIRE. Admiral, you know the deep feeling we in Congress have for you. You can be sure we will give your advice and recommendations the most careful consideration. You have done the Nation a great service by coming here today and giving us such frank and detailed advice. Thank you very much.

Admiral RICKOVER. Thank you, Mr. Chairman. Many who appear before Congress have done more, but few have been treated better. It has been an honor to be here, sir.

Chairman PROXMIRE. The hearing is adjourned.

(Whereupon, the Subcommittee on Economy in Government of the Joint Economic Committee, adjourned, subject to call.)