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Statement of

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before the

Commerce, Consumer, and Monetary Affairs

Subcommmittee of the Committee on Government

Operations, U.S. House of Representatives

on

[~~the~~ Administration of the Federal Government's

Anti-inflation Program]

Testimony

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Mr. Chairman and members of the Subcommittee:

We are here today at your request to present our views and other information on the Federal Government's anti-inflation program, with particular emphasis on the use of Federal contracts as a device to foster compliance with the President's wage and price guidelines.

Inflation is a serious national problem and the goals of the President's program certainly deserve everyone's support. As you know, industry and labor have been requested to voluntarily limit their wage and price increases to levels established by the Council on Wage and Price Stability. The Council is monitoring compliance with the voluntary standards.

The Office of Federal Procurement Policy (OFPP) has issued regulations which provide that beginning on February 15, 1979, companies must certify compliance with the standards to be eligible for Federal contracts in excess of $5 million. The names of those companies which are found to be in noncompliance by the Council will be placed on a public list. They will not be eligible to receive such Federal contracts unless the head of a procuring agency grants a waiver.

Since these procurement provisions are mandatory and the Council's legislation does not authorize the use of mandatory controls, the Council seeks to maintain a

"separation" from the procurement provisions. Therefore, in its monitoring, the Council will not consider which companies are Government contractors.

Mr. Socolar has commented on the legal ramifications of the Federal contract provisions. But, even assuming that the President has the legal authority to take the steps announced, there are serious questions about the potential effectiveness of using the Government procurement dollar to compel compliance with the guidelines. Specifically, it is our opinion that a careful and objective analysis of the program structure will lead to the conclusion that it is primarily a psychological device to focus attention on the wage and price spiral. Whether intentional or not, it seems designed to spotlight the possible deviations of a very small number of Government contractors who, as a group, would probably have minimal impact on the overall trend of the economy. We base these conclusions on the following:

--The threshold established--contracts in excess of $5 million--results in a small universe of between 1500 and 2000 contracts.

--Within that universe, the largest dollar contracts will probably have to be exempted from control. I refer to sole-source major weapons contracts, which are likely to receive waivers for reasons of national security.

--The monitoring efforts by a small Council staff will necessarily be largely based on limited data furnished by contractors. It does not seem to us, based on years of observing the procurement process,

that debarment or default action can be taken--and sustained--on the basis of the limited data that will be available.

I would like to point out that our reservations pertain to the use of the Government contract as an effective tool to fight inflation. The positive side of this program is that the potential adverse publicity for major corporations and labor unions has to have some beneficial effect.

I would like to now discuss, in some detail, the specific points raised in your request.

Procurement Data

You asked us to consider the number of Federal agencies and Federal contract actions which would be effected by the procurement provisions of the anti-inflation program, considering the $5 million threshold.

There is no reliable data now available on how many Federal agencies have individual contract actions in excess of $5 million dollars or how many contract actions or different contractors are involved. However, OFPP has estimated that at least 17 agencies are likely to make awards of that size:

--The twelve cabinet departments,

--the Tennessee Valley Authority,

--the National Aeronautics and Space Administration,

--the Veterans Administration,

--the U.S. Postal Service, and

--the General Services Administration.

DOD, which maintains fairly good procurement statistics, estimates that over 1400 of its contracting actions are valued over $5 million each, for a total value of about $27 billion annually. Projecting the DOD data Government-wide, OFPP officials estimated that there are probably no more than 2,000 such transactions in excess of $5 million totaling about $40 billion each year. The number of contractors and contract actions that will be covered under the anti-inflation program will depend on how the Council rules on various exceptions and exemptions.

There is no available data that breaks down the procurements over $5 million for the contract categories mentioned in your letter--new contracts, orders under existing contracts, and supplemental agreements to existing contracts.

Monitoring

The Council intends to monitor compliance with the wage and price standards with as small a staff as possible and without assistance from other Federal agencies.

The Council will limit its monitoring efforts primarily to the Nation's 500 largest industrial companies

and the 200 largest non-industrial companies based on the opinion that these companies have the greatest impact on the economy, the largest numbers of employees and the greatest discretion in establishing their prices.

The Council generally will not ask companies for information on current year pay or price changes unless noncompliance is suspected. The monitoring will involve no in-depth checking of companies' source records or visits to company offices. Determinations of companies' probable noncompliance will be based almost entirely on staff analyses of Government economic indexes, trade journals, and other summary data or reports.

Even in cases of probable noncompliance, the Council anticipates looking at only minimal company furnished information. It will assume the data to be correct and only review the logic and assumptions. The Council believes that this method will provide sufficient opportunity for each company to justify its position and an adequate basis for the staff to determine whether the company is noncompliant. If found noncompliant, a company may request a reconsideration of the Council's decision. However, a hearing on reconsideration will be held only if the Council, in its discretion, deems it to be advisable.

The Council feels that if it monitors companies merely because they have Government contracts, such action would blur the "separation" it wishes to maintain between its

voluntary anti-inflation program and OFPP's mandatory program for Federal contractors. The lack of such separation, the Council believes, would make the program more vulnerable legally. Therefore, according to Council staff, they will not consider whether or not companies monitored are Federal contractors.

Procuring agencies and prime contractors will be required to use the Council's list of noncompliant companies to determine which contractors and subcontractors are not eligible for Federal contracts in excess of $5 million in accordance with OFPP procurement provisions.

As a result of this approach, inequities could arise because some Federal contractors that are among the top 500 industrial and 200 non-industrial companies will be monitored, while those not among these top 700 firms--even if they have substantial amounts of business with the Government--will receive little or no attention from the Council.

We believe that it is reasonable to assume that there are a substantial number of contractors with less than $350 million in annual sales (the approximate cutoff point for the top 500 industrial companies) that are awarded Federal contracts valued at $5 million or more.

This matter takes on special importance because the Federal procurement portion of the anti-inflation program--unlike the non-procurement portion--involves the severe

sanctions of ineligibility for Federal contracts and possible termination for default. The Council's planned monitoring approach restricts the application of the mandatory compliance requirements and the accompanying penalties for noncompliance to the larger Government contractors discussed previously.

In our view, the Council's planned monitoring approach provides little assurance that it will know whether companies are in compliance with the standards.

Penalties For Noncompliance

You requested that we discuss the range of possible costs and consequences to the Government as well as the likely impact on the Federal procurement process of contract terminations or debarments under the anti-inflation program. These penalties, as well as the provision for contract price reductions, are provided in the OFPP policy letter issued on December 27, 1978.

The use of these penalties will depend on how the program is actually implemented. For example:

(1) Considering the Council's limited staffing, its planned cursory methods of monitoring compliance, the difficulty of validating company data to source records, and the complexity of the standards (as well as the almost

certain challenges by the affected parties), the number of determinations of noncompliance made by the Council is likely to be limited.

(2) Only a relatively small number of the Government's contracting actions are valued at more than $5 million and, therefore, subject to the certification requirements.

(3) A large share of the covered contracting actions, such as defense weapon systems, may qualify for waivers from the certification or termination for default requirements.

There is no logical way to estimate or project possible costs to the Government resulting from application of penalties under this program. For example, we have no way of knowing how many penalty actions will actually occur. Second, each action will be separate and distinct from all others and the circumstances of the procurement (status, level of investment by contractor, extent of administrative and legal controversy) all have an impact. We can, however, discuss this subject in general terms.

There are, of course, the two possible penalties, debarment and termination for default. In the case of debarment, there are no direct contract costs to the Government. There exists the possibility of substantial indirect costs for appeals and/or legal actions. There is also the possibility that debarment of a particular contractor could result in a contract award to a higher cost producer. This leads to a Catch-22 type of situation where application of anti-inflation steps increases the procurement costs to the Government.

The more complicated penalty is termination of an existing contract for default. Procurement regulations provide that the right to terminate a defaulted contract is discretionary with the Government and appropriate officials must use judgment in exercising that right. Above all, contracts are to be terminated only when such action is in the best interest of the Government.

Depending on the type of contract involved, the rights and liabilities of the contracting parties in a termination action can be quite different. Generally, in a situation involving a fixed price contract, the Government is not liable for any costs on undelivered work and is entitled to repayment of any advance or progress payments made. The contractor is liable for any excess costs incurred in the reprocurement of the product or service and liquidated

damages accrued or, in the absence of liquidated damages, the actual damages suffered by the Government.

These rules generally apply when a contractor defaults by failing to deliver the prescribed product or service in accordance with the contract terms. Whether the courts would similarly protect the Government from liability when the default is due to failure to meet wage and price guidelines is, in our opinion, highly conjectural.

On the other hand, if a cost reimbursement type contract is terminated for default, the Government has to reimburse the contractor for his allowable costs in accordance with the contract provisions.

It is important to note that the contractor is not liable to the Government if the failure to perform, as anticipated under the contract, was beyond his control and without his fault or negligence.

The primary consideration in agency decisions to terminate a contract for default appears to be the availability of the product or service from other sources and the time needed for reprocurement. In other words, care is taken to avoid disrupting an ongoing procurement program.

A contract for common usage items, such as office supplies, could readily be terminated for default because such items are available from other sources on relatively short notice. A contract for a made-to-order item, such as a weapon system, would be less likely to be

terminated for default because of the complexity of the production process and generally the difficulty of getting another contractor to produce a satisfactory item.

Although we were unable to readily obtain information on actual case experience, the increased costs to the Government resulting from a termination for default could involve a very large sum.

As you can see from this brief discussion, termination for default is a complex subject. Given the added burden of default for a non-performance related matter, the problem is greatly magnified.

The contract clause required by the OFPP regulation also contains the proviso that "* * * should the Government determine that termination for default would not be in the public interest, the contractor agrees that he will accept an equitable reduction of the contract price or cost allowance and profit or fee, as appropriate under the circumstances." A question arises as to the basis on which "an equitable reduction" will be calculated. In light of the severity of the termination for default option, this provision could become very important. We believe OFPP should develop additional guidance on this subject for the contracting agencies.

The OFPP regulation contains provisions for granting waivers of the certification requirements and the termination for default and contractor debarment penalties. These

waivers may be granted only by the agency head involved and only after thoroughly exhausting all reasonable alternatives. Although the procurement provisions have not yet become effective and their outcome is still only a matter of speculation, there is a possibility that numerous waivers will have to be granted by the procuring agencies to avoid severe impacts on their operations.

Staffing

It is difficult to estimate the number and types of Federal employees required to administer the procurement provisions of Executive Order 12092. The Federal Government has no experience with this particular approach to the control of inflation. The difficulty of administering these provisions will depend on the extent of voluntary compliance with the wage and price standards.

The most important administrative feature of the wage and price standards is that they apply to firms and bargaining units, not to specific goods or services. This places most of the administrative burden on the private sector and means that the standards can be interpreted and monitored by a relatively small number of Federal employees. Phase III of the Nixon Administration's Econmic Stabilization Program required approximately 3,000 Federal employees, 1,000 on the staff of the Cost of Living Council and the remainder primarily in the IRS.

The Council is currently operating with a staff of approximately 35 permanent employees and 50 detailees from other Federal agencies. Originally, it planned to reach a maximum staffing level of 143 permanent employees by October 1, 1979. However, because it has received an unexpectedly large volume of requests for interpretations of the standards, the Council decided it needs to add 90 more permanent positions for a total of 233.

The Council considers a large staff unnecessary because of the voluntary nature of the wage and price standards and undesireable because it might raise the specter of mandatory controls. Nevertheless, the high degree of business and labor interest reflected in the large number of inquiries indicates that the Council's workload could continue to grow, requiring more staff in the future.

The Council intends to do almost all of its work in Washington, D.C. As I indicated earlier, it will not request the assistance of any other Federal agencies, such as the Internal Revenue Service, the Defense Contract Audit Agency, or the General Services Administration, in monitoring compliance with the standards.

Since the Council will not specifically monitor Federal procurement, little of its staff resources will be dedicated to monitoring Federal contractors, per se, and none to enforcing the procurement provisions of Executive Order 12092. Even if the $5 million threshold for covered Federal contract

actions is lowered at some future date, no additional staffing is contemplated.

Views of Business and Labor Representatives

We met with officials of a contractor association and eight corporations or companies having Federal contracts in excess of $5 million during 1978 to obtain their views on the program. The companies that we met with are: General Motors, Boeing, Raytheon, Burroughs, Goodyear Tire and Rubber Company, GTE-Sylvania, Hewlett-Packard, and Williams Research. We also met with officials of the International Brotherhood of Teamsters and the United Auto Workers.

The representatives of almost every business and labor organization we spoke with stated that they were having problems in getting a clear understanding of the Council's wage and price standards or how they should be applied to their situation. The standards were repeatedly called vague and the Council's staff was criticized for giving differing and inconsistent interpretations.

Company and contractor association officials we spoke with were also concerned about the methods that the Council would use to monitor compliance. Some officials emphasized that detailed audits of compliance with the wage and price standards would result in a large bureaucracy and the danger that confidential business data could be disclosed to the public or competitors. As long as Federal monitoring of

compliance was consistently applied and was restricted to the kinds of methods the Council plans to use--checking summary reports and assumptions--the program was seen as acceptable.

Company officials also expressed concern that

--use of the profit margin limitation would encourage cost increases, promote inefficiency, and discourage productivity,

--waivers might cause significant delays in Federal procurement because they can only be granted by agency heads, and

--the program is mandatory for covered Federal contractors and only voluntary for others.

SUMMARY

In summary, we must conclude that that aspect of the anti-inflation program that envisions penalties against Government contractors who fail to meet the President's wage and price guideline will have relatively little impact. Its coverage, in terms of number of contracts, contractors, and total dollars will be limited. Further, legal and administrative problems inherent in debarment and default procedures will preclude any significant number of such actions.

It must be recognized, however, that this effort is part of a larger program of voluntary compliance. We

believe the voluntary program deserves everyone's support. As in past efforts to control wages and prices, there are important values in the disclosure of proposed wage and price increases and the knowledge that the Government is actively engaged in trying to slow the rate of inflation.