



# **FEDERAL PROCUREMENT PRINCIPLES**

**A Proposal  
in the National Interest**

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in the National Interest**

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# PROPOSED FEDERAL PROCUREMENT PRINCIPLES

The procurement of goods and services by federal agencies from private enterprise is a significant factor in the national economy and contributes substantially to the economic growth and world leadership position of the United States. To foster the continued growth and strength of the nation, it is declared in the public and national interest that certain principles be set forth defining the fundamental relationships between the public and private sectors of our society in all federal procurement actions. These principles shall have precedence unless otherwise barred by law:

\_\_\_\_\_ • \_\_\_\_\_  
The Government favors the use of and will procure to the maximum extent from private enterprise to fulfill its needs for goods and services.

\_\_\_\_\_ • \_\_\_\_\_  
All Government procurement actions, including those resulting from actions of sovereignty, shall be based on a doctrine of fairness and equity.

\_\_\_\_\_ • \_\_\_\_\_  
The Government shall abide by the same business principles that govern others in the field of commerce.

\_\_\_\_\_ • \_\_\_\_\_  
The Government, when its procurements comprise the sole or dominant share of a market, shall recognize and avoid the use of its monopsonistic leverage to exact unfair or inequitable contractual arrangements or conditions.

\_\_\_\_\_ • \_\_\_\_\_  
The opportunity to earn a reasonable profit shall be fostered in government procurement commensurate with the risks assumed and comparable to similar commercial endeavors.

\_\_\_\_\_ • \_\_\_\_\_  
Government procurement shall acquire the benefits of competition through the use of either formal advertising or negotiation.

\_\_\_\_\_ • \_\_\_\_\_  
The Government shall pay fair prices for goods and services by accepting all ordinary and necessary costs, consistent with accepted commercial practices.

\_\_\_\_\_ • \_\_\_\_\_  
The Government shall issue procurement regulations as required to establish equities and protect the public interest while at the same time assuring that regulations are not excessive, conflicting or impose undue costs.

\_\_\_\_\_ • \_\_\_\_\_  
Formal criteria for the content, development and approval of all procurement policies, regulations and procedures shall be established by each agency, be common among agencies where possible, and be consistent with these Federal Procurement Principles.

\_\_\_\_\_ • \_\_\_\_\_  
The Government recognizes and shall protect the rights of affected parties to participate in the procurement regulatory process and to seek independent review of such regulations for amendment or repeal based on these Federal Procurement Principles.

## CHAPTER 1

# THE CONCEPT

This is a public proposal, presented in the national interest. It hopefully will generate dialogue among and action by those directly involved with government contracting. The proposal also should be of interest to all concerned with its impact on our society.

The importance of this proposal is found in the fact that government procurement involves a major segment of the national economy, large numbers of public and private institutions, and all taxpayers. As a proposal, it is offered with full recognition that promulgation is the responsibility of others and that acceptance of its suggestions will depend on the viewpoints of many.

***The proposal, simply stated, is to enact into law a set of Federal Procurement Principles which will establish the framework for governing, with fairness and equity, the fundamental contracting relationships between the Federal Government and the private sector.***

No such set of explicit principles currently exists. This void is believed to be an underlying reason for many of the troublesome problems being experienced in government contracting and for serious inefficiencies in the economy which, in the national interest, should be corrected.

Government contracting with private enterprise has been called the world's largest business. This may well be. Federal expenditures for goods and services currently amount to about \$100 billion per year,<sup>1</sup> which is three times greater than the entire budget for Great Britain and comprises almost one-half of the U. S. national budget. Such expenditures have become a towering force and a major element of our economy. By way of further comparison, such expenditures today are 5½ times higher than in 1950. They have doubled in just the last ten years and by 1975 will probably exceed the equivalent of the entire federal budget of only five years ago.<sup>2</sup> Yet no clearly defined

<sup>1</sup> "Special Analyses, Budget of the United States Government", 1971.

<sup>2</sup> Based on National Planning Association projection data.



set of principles exists to provide guidance and long-term national direction for such an overwhelming economic undertaking.

What does exist are over 4,000 statutes which directly or indirectly affect such transactions; scores of Executive Orders and Circulars; hundreds of Board and Court decisions; thousands of policies spread among the various agencies; and innumerable procurement regulations, procedures, management systems, and reporting requirements—all developed and administered largely in piece-meal fashion and often conflicting and duplicative.

Within this mass of paper, initiated by and residing in offices throughout all levels of government, some principles can indeed be found. But more often than not they are only implicitly stated and were generated from different viewpoints for different needs at different times. This is not an indictment but rather recognition that government contracting has grown fitfully and rapidly, and without benefit of a strong and explicit foundation.

Stresses and problems associated with government procurement are legion and appear to be growing even more rapidly than expenditures. The symptoms of cost growth and cost overruns, growing numbers of Court cases, more and more red tape, and charges of waste and inefficiency, clearly indicate that national policy on government procurement has become an increasingly critical public issue.

Recognition of the growing importance and complexity of procurement problems, and broad public concern about them, led the Congress to establish in 1969 the Commission on Government Procurement to review all aspects of federal contracting. Such recognition is also the reason this proposal is being offered at this time. It appears that the nation is in a period where such fundamental guidelines can be established based on broad experience and should be established based on obvious need. The future form, efficiency and well-being of the national economy will in many ways be dependent upon whether this need is met and how well it is met.

As important as developing and installing such a sound foundation for the future may be, the task will not be easy. Widely acceptable Federal Procurement Principles will have to take into account not only the best of the past but also the realistic requirements of today and the needs of tomorrow.

They will have to be forged with recognition of our traditional concepts, institutions and values and with understanding of the underlying nature of current social, economic and political trends. They will have to take into account the complex factors of conflicting goals and objectives and such issues as public interest vs private independence, political exigencies vs national long-term needs, and sovereign powers vs equity, among many others.

The challenge to both government and private enterprise will be considerable, but it is earnestly believed that this proposal will provide a good starting point for the job to be done. Its validity is believed to be substantial on at least two counts. First, it addresses fundamentals which, by their very nature, exclude subjective bias or selfish interest. Second, it represents a set of standards comprising the essentials of sound and enduring business relationships, developed over the long history of commercial jurisprudence.

Assuming that the need is recognized and the concept is accepted as worth exploring, this paper is dedicated to a broad examination of government procurement and a search for clear statements of basic principle. Key factors are identified ranging from statutory, economic, legal and philosophical to related principles from which our society has developed. Much is drawn by way of example from defense procurement because of its size and influence on the practices of other federal agencies. Each chapter examines major aspects of government procurement and, through analysis and synthesis and with an eye to the future, proposed Federal Procurement Principles are set forth.

**Chapter 2** reviews the basic and essential roles and responsibilities of the Federal Government as they

relate to procurement by its agencies, and of private enterprise which serves to fulfill government needs. The evolution of government contracting is discussed and key historical events and their implications are cited. The emphasis is on only the most significant and fundamental factors and the perspective is on the broad framework of government and industry relationships. Seven proposed principles are derived.

**Chapter 3** looks at the regulatory aspects of federal procurement. The need for regulation is reviewed as well as the scope of regulatory actions and the magnitude and nature of their impact. Receiving particular attention are the costs of regulation to both

the public and private sectors, and both in monetary and in broader terms. Underlying deficiencies in the regulatory system are identified and possible solutions examined. Three proposed principles are derived.

**Chapter 4** recognizes the challenges and difficulties in moving a proposal of this magnitude from concept to promulgation and suggests alternative approaches.

**Chapter 5** provides a composite set of all Federal Procurement Principles being proposed, preceded with an appropriate legislative preamble.



## CHAPTER 2

# THE BASIC FRAMEWORK

### **The Constitution**

The Federal Government has bought equipment and services it needs from private industry since its earliest days. The Constitution, however, contains no direct delegation of power to the Federal Government for such contracting. Thus, although the Constitution enumerates many powers, such as “to raise and support armies” and “to provide and maintain a navy”, there is no explicit guidance for the relationship between the Federal Government and the private sector in the course of any resultant procurement.

It has therefore been accepted that the power of the United States to contract is incident to the general powers granted by the Constitution.<sup>3</sup> Accordingly, one must look elsewhere for guidance on such matters as the relative rights of the contracting parties, whether federal or private sources are to be utilized, the use of sovereign power, protections against abuses, regulatory authority and similar basic guidelines.

### **Early Laws**

The first 100 years of the nation's development provide few helpful clues in this regard, and understandably so. Life was comparatively simple and needs were largely met in either the open marketplace or by the government's own yards and arsenals. In 1809, a rudimentary system of procurement was established by statute, and except for subsequent limitations on actions of government officials to prevent abuses in the letting of contracts, little of contemporary significance is found in the law until 1875.

At that time the Supreme Court, in what must be considered a landmark case, addressed the question of limitations on sovereign power when the government contracts with private enterprise. The Court's decision stated that when the government “comes down from its position of sovereignty and enters the domain of commerce, it submits itself to the same

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<sup>3</sup> U.S. vs Tingley, 30 U.S. 114 (1831); U.S. vs Allegheny County, 322 U.S. 174 (1944).

laws that govern individuals there.”<sup>4</sup>

While subsequent decisions have upheld this basic premise,<sup>5</sup> certain exceptions have been made in recognition that the same government agent must sometimes perform functions and acts in both a sovereign and contractual capacity. In such cases, for example to terminate a contract for convenience of the government, basic sovereignty is considered paramount. Also related is a limitation placed on the private sector in that a contractor is not to gain a better position than in the commercial marketplace by virtue of having contracted with the government.<sup>6</sup>

On balance then, it would appear that the Courts over time have recognized and endorsed a basic concept of the government adhering to the same rules and practices of the commercial marketplace as an individual, except where clearly necessary to protect the sovereign interest. This suggests a good starting place for the development of a set of Federal Procurement Principles, in that a fundamental definition of the relationship between the government and private sector can be derived. The proposed principle would be that:

*The Government shall abide by the same business principles that govern others in the field of commerce.*

### **Sovereign Powers**

Such a principle would not clear up the matter of when and how sovereign powers should be exercised, which is an area requiring clarification. The question is not only important, but most difficult. Actions taken in the name of sovereignty, and more particularly in the elusive cause of “public interest”, unfortunately are too often self serving.

This is at least partially due to the competition

among and within agencies for funds, authority, control and so forth, which often result in actions more in the agency interest than in the public interest. Further, the environment of public contracting provides strong incentives for the natural inclination of sincere and dedicated people to find and use every advantage which sovereign power provides. Acts purportedly based on sovereignty, when such is not absolutely clear and obvious to all, are more apt than not to land on the wrong side of fairness and equity.

Such powers, by their very nature, are readily available to those in the lower tiers of bureaucracy where the bulk of contracting decisions are made. Their positions, far from the seats where power is checked and balanced and perspectives are broader and farther ranged, are nevertheless close enough to borrow added strength when this is deemed useful or necessary. This is not to suggest malicious intent, but rather to recognize human behavior and the sheer size and complexities of managing what, in the Department of Defense alone, amounts to about 10 million procurement actions per year. It is also recognition that it is very easy to assume mistakenly that an agency’s needs and desires are synonymous with the “public interest.”

This gray area in which, somewhere, sovereignty ends and normal business relationships begin is not only elusive but probably the cause of much of the stress and strain between government and private enterprise. The courts are not too helpful. They have usually found acts to be in a sovereign capacity where they:

- Are public and general, not directed to the contractor;
- Would equally affect dealings of private parties;
- Have an indirect rather than direct effect on the contract;
- Are in the public interest.<sup>7</sup>

<sup>4</sup> Cook vs U.S., 91 U.S. 389, 398 (1875).

<sup>5</sup> U.S. vs Allegheny County, 322 U.S. 174 (1944); In Re American Boiler Works, 220 F2d 319 (1955).

<sup>6</sup> Horowitz vs U.S., 267 U.S. 458 (1925).

<sup>7</sup> Government Contract Principles, A Manual of the U.S. General Accounting Office, November 1970.



The first three conditions are very broad and would not affect a particular contract to the exclusion of others. "In the public interest", of course, brings us full circle as it is in the main indefinable except in specific cases. Vague and general as the concept may be, nevertheless it is broadly supported by almost all citizens and is central to sovereign functions.

How then to provide clarity and reasonable restraint without creating undesirable effects on matters truly in the public interest; to provide beneficial improvements without impairing necessary responsibilities?

If this is not possible with a single statement of principle, it can probably be achieved through a composite of several and their resultant interaction. Part of the job could be done by adopting a principle which would be an article of good faith while providing accommodation to actions based on the recognized changing needs of the government, whatever their source. It would also provide a basic guideline to the thousands of government employees far from the top councils as they weigh their countless decisions. It could read like this:

All Government procurement actions, including those resulting from actions of sovereignty, shall be based on a doctrine of fairness and equity.

While certainly a step in the direction of ensuring balance in procurement actions and benefiting further by openly subscribing to accepted tenets of our society, this simple statement is inadequate alone.

Since government procurement is such an important element of our economy, more can be added by considering the theories and laws of the economist. Two areas appear worth exploring: Monopsony and the question of direct government competition with industry to provide goods and services.

### **Monopsony**

Monopsony is the opposite of monopoly. In a mo-

nopoly the single seller can warp the market price to his advantage unless his leverage is controlled. In a monopsony, the single buyer has commanding leverage over the seller unless, again, control is maintained. Both conditions are considered by the economist to be extremes of imperfect competition and undesirable imbalances for an ideal marketplace.

The undesirability of monopolies has long been recognized by the government, which has long controlled and prevented monopolistic advantage to protect the public.<sup>8</sup> Curiously, monopsony has escaped more than casual examination and almost totally avoided formal controls to prevent abuses. Since monopsony is just as subject to abuses as monopoly, this lack of attention would appear odd until one realizes that the government itself is virtually the only monopsonist of significance in existence.

This situation comes about because the government is virtually the sole market for products such as space vehicles and defense systems, and the dominant share of the market in many other areas. Nevertheless, government or not, this unique market is a monopsony and, to prevent abuses, should be controlled.

How does monopsony power relate to sovereign power in the government marketplace? The best explanation may be that it is an extension. Both are special powers, neither is clearly distinguishable as it moves away from the absolute condition, both are interrelated. Who can say with certainty that the reason a price or contract term is more advantageous to the government is because the customer is the sovereign, or because the customer is a monopsonist? But one can ask whether or not government contracts should be let with inequities, regardless of the source of power. The answer, in all fairness, should obviously be no. What then has occurred to blur the obvious?

Years ago, when federal contracts affected a much smaller sector of society, the answer could be ig-

<sup>8</sup> 15 U.S. Code Sec. 1-7; 15 U.S. Code Sec. 12-27.

nored, at least politically. Before such a major share of our national resources was devoted to serving the government's needs, human and capital, the need for attention may have escaped the economist. Further, there is an economic law which says that as long as an enterprise can exit a particular market and enter another, no harm is done. The market will automatically correct itself and the balance between buyer and seller will be restored. The lawyer had little basis for concern because government contracts are contracts of adhesion and if one does not like the terms, he does not have to sign the contract.

These viewpoints may partially explain why monopsony in the government marketplace has not raised undue concern. The lawyer and the economist agree, but for different reasons; one advises not signing the contract and the other advises entering another market. Unfortunately, these are no longer viable options to many companies. As they have grown they have had to tailor themselves to the government's particular requirements. Thus, in large part, there is no other market to enter as long as the capability to fulfill large scale, complex defense, space and other advanced technology needs of the nation is maintained.

Regardless of history or rationale, in principle the only proper answer has to be that the government errs when it permits its power to be used to exact undue contract terms. Too much is at stake for the nation, its taxpayers and its society, today and tomorrow. The national economy must move forward if it is to continue to provide jobs for an increasing population. It must move forward to raise the levels of its citizens' well-being. It must remain competitive internationally. It can do none of these well, or even adequately, if significant segments of the private sector are exposed to monopsonistic leverage which saps their vitality and erodes their independence.

In the evolution of government procurement, the time has come to recognize the presence of monopsony, measure its effects carefully, and control it as necessary. The following procurement principle would provide an initial step.

*The Government when its procurements comprise the sole or dominant share of a market, shall recognize and avoid the use of its monopsonistic leverage to exact unfair or inequitable contractual arrangements or conditions.*

While this principle gives proper direction, by itself it is still not enough to control adequately the possible misuse of monopsonistic advantage. Two major related areas directly susceptible to monopsony power are prices and profits. These should be examined further and, while profit is a function of price, they can be considered separately. Their criticality lies in the fact that both relate directly to the long term viability of a firm, and in the composite, to the nation's economic well-being.

### **Contract Prices**

In an ideal market—that is, a market where both buyers and sellers have equal powers—prices tend to meet the level at which the buyer gets a product at a fair value and the seller gets a fair profit. The market is in equilibrium and both share attendant benefits equally. In imperfect markets, equilibrium is lost. In the case of a monopoly the seller can exact an unfair price and dictate terms to his advantage. In a monopsony the buyer can force low prices and inequitable contract terms.

These pressures have become commonplace in government procurement and the trend is increasing. One prime example is the unilateral shift of risks to contractors without commensurate opportunity for profit.<sup>9</sup> Another is the refusal by many agencies to reimburse contractors for certain costs necessarily incurred in the performance of a contract, as well as certain ordinary costs of doing business. This means that these government agencies are using their monopsonistic leverage to get advantageous prices by

<sup>9</sup> F. Trowbridge vom Baur, "Shifting the Risk to Government Contractors—and the Flight of Capital," *NCMA News Letter anthology*, Vol. No. 1, pp. 23-26.

"Cost Disallowances: Causes and Effects," AIA, May 1971.



not paying for all ordinary and necessary costs the contractor must incur in delivering the product.

In the case of the aerospace industry, the impact of this trend has quadrupled in DoD contracts in just the past eight years to reach the equivalent of 30% of before-tax profits. Examples of such unaccepted costs include interest on loans, independent research and development, leasing and patents—all costs which are included in the product price in the commercial marketplace, and paid in full by the buyer.

Why should the government, for example, not accept interest charges incurred necessarily to produce its product, just as it pays for that interest charge when it buys “off the shelf” from the commercial market? To do otherwise is to declare for itself preferential treatment, and to reduce arbitrarily the fair price it should have paid. Such should and would be prevented with adoption of this principle:

*The Government shall pay fair prices for goods and services by accepting all ordinary and necessary costs, consistent with accepted commercial practices.*

### **Profits in Government Work**

The profit opportunity is an integral and vital element of the free enterprise system which drives our capitalistic society. Profit, if not the engine of our economy, is the fuel on which it runs. Adequate profits are just as essential for work conducted in the public marketplace as for work in the private marketplace.

Most would agree completely with the first two foregoing statements, yet the third is questionable in the minds of some and even rejected by others. The reasons, the effects and the facts are worth examining.

Government procurement has become too important in too many ways to be unduly saddled with either myths or values of bygone eras. Yet, to a degree, such appears to be the case regarding profits in government work.

The act of doing business with the government has often been portrayed as synonymous with profiteering. The past has indeed seen isolated horror cases but these are neither of recent vintage nor in sufficient numbers to draw a sweeping and lasting indictment. Yet the myth lingers on and is raised periodically, usually successfully, and often for journalistic sensation or political gain. Successfully, that is, if measured in terms of keeping profit levels as low as possible.

There is no doubt that some opportunists made excessive gains out of wartime exigencies from the time of the Revolutionary War through World War I. After World War I, however, such became a matter of top attention in Congress and a series of statutes and amendments followed, starting with the Budgeting and Accounting Act of 1921. Further protection was built into law in 1934 with passage of the Vinson-Trammel Act.<sup>10</sup> The first allowed for an examination of all claims and accounts and the second set profit ceilings on various types of procurement. Later, a Renegotiation Board was established to determine whether excess profits may have been made.<sup>11</sup>

Today, the protections in statutes and regulations are so formidable that in fiscal 1970 out of the 4,400 contractor filings required with the Renegotiation Board, 1,029 showed that a contractor had sustained a loss—a total of \$461 million worth. This compares, in the same period, with only 123 where a determination was made of excess profits, which totaled \$33 million.<sup>12</sup> Yet the myths remain.

The effect of this attitude about profits and what it portends for the future are important issues. Several recent studies have verified that profits in defense work and in other contracts with the government are not only on a dangerously steep declining curve, but are well below the average of commercial business. The trend is in its sixth year and has reached the

<sup>10</sup> Act of March 27, 1934, Ch. 95, 48 Stat. 503.

<sup>11</sup> The Renegotiation Act of 1951, as amended.

<sup>12</sup> “Fifteenth Annual Report,” The Renegotiation Board, 1970.

point where after tax profits in 1970 were only 1.75 percent of sales.

The inadequacy of such levels can be readily seen when compared in the same year to the 3.4 percent average for all manufacturing, or the 6.5 percent average for the 50 top regulated utilities. Something obviously is wrong. If anything should be clear in this complex field it is that the future viability of this sector of private enterprise is in jeopardy unless sound and long-lasting improvements are made. If not accomplished, serious and widespread degradation of vital national capabilities in this important segment of our economy can be expected. Unfortunately, too many either do not recognize or choose to ignore the vital role of profit in our capitalistic economy.

What should be the profit levels for work done for the government? Again there is no simple answer for such a complex subject, but there can be a principle.

It is a generally accepted investment rule that profits should be in reasonably direct relation to the extent of risk involved. This economic principle is straightforward and has worked well and long: the higher the risk, the higher should be the profit potential. If this rule is not followed, the consequences also are straightforward. Inevitably available capital will move to ventures which provide a better balance between risk and profit opportunity. If capital deserts an enterprise, it is equally inevitable that the deserted business will suffer, though the effects may be slowly felt. Such is the path of much government business today.

Proof? Not neat and clean and precise; such is seldom the case. Indicators? Numerous. The profit trend is one. Another is a recent poll<sup>13</sup> of top financial and business leaders from the 500 largest U. S. manufacturing companies and the 50 largest banks. The statistics are revealing. The survey found that 83% of manufacturing executives interviewed were not interested in seeking additional defense con-

tracts and 48% of these considered defense business as in their line of work. In the case of the bankers, 72% were not interested in increased involvement in financing defense work.

The answer and equity, then, must lie in the direction of tying profit levels to the relative values the government contracting market must provide if government is to continue to use private business to meet its procurement needs. Correct as this appears to be, tools to measure these values precisely are not yet in hand. While some theoretical work has been done, little has been accomplished, unfortunately, in the area of empirical measurement. This means, simply, that no one today in government, industry, or the academic world can show that a given contract is, for example, 3.2 times as risky as another and should therefore have 3.2 times the profit opportunity.

Lacking precision, one is limited to coarse measurements such as "low" or "high," and facing uncertainty, is emotionally drawn to a safe evaluation. Add monopsonistic leverage or let the situation seek its own level and it is not surprising that destructively low profit levels result, even though much higher levels in areas expressly subject to government regulation are currently authorized.

A solution, not in absolute terms but at least in direction, would be to adopt a principle which would recognize the degree of risk in the profit equation and temper imperfect judgments by tying profits in government work to a sound base which would clearly express recognition of the necessity of adequate profits in maintaining free enterprise as a viable institution, e.g.:

*The opportunity to earn a reasonable profit shall be fostered in government procurement commensurate with the risks assumed and comparable to similar commercial endeavors.*

#### **Government vs Private Enterprise**

The discussion of monopoly and how to cope with it to meet tests of fairness and equity have been

<sup>13</sup> Opinion Research Corporation, Caravan Survey, November 1970.



lengthy but necessary. Another basic subject, mentioned earlier, is whether government should contract with private enterprise for needed goods and services, or perform the work itself.

History does not prove useful if pursued beyond the turn of this century. Circumstances prior to the industrial age make comparisons relatively meaningless. Suffice it to say that the trend toward more dependence upon the private sector was slow but sure and accelerated rapidly in times of war.

Meaningful developments in terms of contemporary policy can be considered as beginning midway between World Wars I and II. Starting in 1932 and periodically since then, the Congress has formally endorsed the concept of government reliance on the private sector as being beneficial to the public interest and integral to our free enterprise economy. Further, practical experience with the lower economic efficiency of arsenals hastened their virtual demise. Although the government still maintains certain facilities and levels of capability in selected areas, experience has made it abundantly clear that the government arsenal is no match for the efficiency, economy, diversity and dynamism of profit-motivated private enterprise.

The Executive Branch issued its first firm policy in this area in 1955 by stating: "The Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary channels."<sup>14</sup> Four years later the policy was restated almost verbatim and strengthened with this elaboration: "Because the private enterprise system is basic to the American economy, the general policy established a presumption in favor of Government procurement from commercial sources. This has the twofold benefit of furthering the free enterprise system and permitting agencies to concentrate on their primary objectives."

Unfortunately, such clear words of purpose have not found their way into statutes so as to provide

legislative intent to this particular vital area of government-industry relationships. As a result, increasing erosion has gradually taken place in both policy<sup>15</sup> and practice. In addition, during times of budget reductions and economic slowdown government agencies retain more work "in-house" in lieu of contracting with private firms.

Competition by government with industry also has been unduly complicated and confused by permitting justification of government operations on the basis of cost comparisons which, by their very definition, favor the government.<sup>16</sup> General Accounting Office interpretations have added to the "in-house" bias to the further detriment of the private sector.

The erosion of private enterprise in favor of a growing government bureaucracy is not in the public interest. There is clear need for a principle that would provide for government operations where absolutely required, yet clearly state a preference for the use of the private sector. Such a statement of principle should provide that:

*The Government favors the use of and will procure to the maximum extent from private enterprise to fulfill its needs for goods and services.*

### **Industry Competition**

Competition by government with the private sector in fields of commerce is not compatible with our economic system, but competition among firms most certainly is. Commercial competition has long been fostered as the spark that kindles the fires of innovation and assures fair prices in the marketplace. The Federal Government, particularly in the Congress, has long recognized the need for and the benefits of competition, especially for military procurement.

In 1809 the first federal statute appeared<sup>17</sup> requiring advertising for bids to promote competition

<sup>15</sup> OMB Bulletin A-76, as amended.

<sup>16</sup> For elaboration, see CODSIA letter to The Director, Office of Management and Budget, dated March 5, 1971.

<sup>17</sup> Act of March 3, 1809, 2 Stat. 536.

<sup>14</sup> Bureau of the Budget Bulletin 55-4.

among suppliers (though it gave equal standing to purchases on the open market). Subsequent statutes during that century developed specific ground rules for advertised bidding, including "award to the low bidder." An 1860 statute<sup>18</sup> subsequently set the basic pattern for all government procurement until World War II. It provided, in pertinent part, that: "All purchases and contracts for supplies or services, in any of the Departments of the Government, except for personal services, shall be made by advertising a sufficient time previously for proposals respecting the same, when the public exigencies do not require the immediate delivery of the articles, or performance of the service."

Thus advertised bidding to assure competition became the norm for government procurement, with the two noted exceptions. A third exception soon followed, which recognized that the existence of only one competent source precluded the need for advertising. This pattern prevailed for the next eighty-five years except during wartime.

Negotiated procurements were authorized, to varying degrees, during such periods from the time of the Civil War until World War II. At that time the War Powers Act of 1941 waived all existing provisions of law in order to meet the national emergency. Soon afterward, an Executive Order<sup>19</sup> was issued which went further and prohibited formal advertising, unless specially authorized. Advertising had to give way to get the job done. The great bulk of military procurement during World War II was conducted through negotiation.

At the close of World War II, a study was conducted by a special committee of the War Production Board to consider the lessons of wartime procurement experience, which had coped with more complex and sophisticated requirements than ever before known. The result was a proposed Bill which was finally enacted as the Armed Services Procurement Act of 1947. This Act, still governing defense

procurement as amended lists 17 exceptions where authority is granted for negotiations rather than formal bidding. It would serve little purpose here to review the background and reason for each exception—that has been done by others<sup>20</sup>—but each is based on sound economic reasons.

About \$14 billion worth of negotiated procurements were made by the Department of Defense alone in FY 1970. Does that mean that formal advertising as a competitive tool is extinct? Not if the fact that 498,339 DoD contracts were formally advertised in the same year is an indication. It means only that experience has proven that high cost, sophisticated products and services cannot be wisely and effectively procured except through negotiation, and that the bulk of smaller and commercially available goods is still amenable to formal bidding procedures.

The main point is that even though the world has moved on, and the experience of over thirty years and of billions upon billions of dollars worth of contracts has proven the necessity and value of negotiated procurement, another federal procurement myth lingers on. That myth, simply stated, is that the presence of negotiation means the absence of competition.

Because the notion is so deep-seated, policy makers are continually forced into a defensive posture over the use of negotiated contracts, as countless pages of Congressional testimony will attest. The press often builds up such reactions, if only to add punch to their stories. Even the General Accounting Office shows a measure of addiction to the myth.

All of this, of course, inevitably affects the attitudes of those responsible for government contracts, and their decisions. Attitudes are important but fragile commodities; positive ones, which cannot be based on doubt or mistrust, are vital to success. If a sound framework for all future federal procure-

<sup>18</sup> Act of June 23, 1860, 12 Stat. 103-104.

<sup>19</sup> No. 9001, December 27, 1941.

<sup>20</sup> For example, Statement of February, 1960, before the Procurement Committee of the Senate Armed Services Committee by the then Assistant Secretary of Defense (Supply & Logistics) E. Perkins McGuire.



ment is to be established, the myth that negotiated procurements are not competitive should be dispelled.

This problem has long been recognized and a correction recommended by many.<sup>21</sup> It is simply to raise the stature of competitive negotiation to a position equal with formal advertised bidding in the law, rather than relegate it to an exception. This would readily and appropriately recognize that the benefits of competition are what is important and desired, rather than preference for one procedure over another to attain them.

As anyone with personal experience will attest, negotiated contracts can be not only highly competitive, but in many ways are superior to advertised bids. In fact, negotiation has been partially adopted in the advertising system in what is called "Two-Step Advertising" where the first step is to conduct negotiations prior to advertising for bids.

It is also broadly known that private enterprise favors negotiation in its own procurements.<sup>22</sup> It seems self-evident that free enterprise, which can choose any method, would prefer negotiation only if the results in terms of better products at better prices are superior to those of other methods.

As a practical matter there is no effective alternative to negotiated contracts for the development of sophisticated technological products, because of their complex nature. While this has been recognized in law even before enactment of the original Defense Procurement Act, what has not been generally recognized is the degree of additional competition that has been achieved in negotiations through administrative action.

Even less recognized is the fact that such a high degree of competition exists today in negotiated

contracts that all of it is not necessarily beneficial. For example, the term "reverse auction" has come into being as a result of intensive rounds of concurrent negotiations among competing contractors. The fact that so descriptive a term exists is a disturbing testimonial to the government's misuse of monopsony power. Further, one need only consider the increasing problem of contractors in meeting the terms of negotiated contracts to understand the detrimental impact occurring.

The fact, not the myth, is that negotiation can realize the full benefits of competition just as well as can advertising. The recommended principle is that:

Government procurement shall acquire the benefits of competition through the use of either formal advertising or negotiation.

The purpose of this chapter has been to address those principles which would establish the basic framework for the procurement relationships between private enterprise and the Federal Government. Every attempt has been made to hold to that which is truly basic, to discard the superfluous while retaining the important, whether for traditional, philosophic, legal or economic reasons. It has not been felt necessary to cite existing laws against criminal actions as these are supported fully by all of good intent and should remain on the books for all who are not.

Thus, principles are proposed which would define the basic government-industry procurement relationships as to:

- When government will procure from private enterprise;
- How government will conduct itself when it does;
- How the benefits of free enterprise can be fostered and preserved.

The next chapter will turn to regulatory matters which are perhaps more administrative than structural, but nevertheless of basic importance.

<sup>21</sup> For example, "Task Force Report on Procurement", 1955, by a study group of the "Hoover Commission", and "The Armed Services Procurement Act of 1947 Should be Reformed", Robert B. Hall, *NCMA Journal*, Vol. 3, No. 1, Spring 1969.

<sup>22</sup> Testimony to this effect has been provided Congress as far back as hearings to amend the Armed Services Procurement Act of 1947.

## CHAPTER 3

# THE REGULATORY PROCESS

Federal procurement has become the most heavily regulated business in the American economy. Many believe that Defense procurement is seriously over-regulated and that many other agencies are headed that way, some with dismaying speed. If current trends continue, the future is bleak indeed in terms of greater inefficiency and unnecessary costs to the taxpayer.

By way of example, today it takes more than 3,000 pages to record the Armed Services Procurement Regulation (ASPR), and that is only the tip of the iceberg. In addition, having equal force and effect of law when required by contract, are hundreds of directives, instructions, procedures, manuals, reports, management systems and data requirements.

Surmounting all of these, in terms of hierarchical relationships, are over 4,000 Federal Statutes either directly or indirectly applicable. Under them, usually four to five layers deep, are reams of "flow-down" documents which interpret and expand higher-level requirements. All of this paper and the tiers of bureaucracy required to administer it are more than just worrisome to those who must comply with it; the problem is central to their ability to perform well, or not.

In this critical area, it would appear that four hard and important questions need to be faced today for the benefit of tomorrow. If addressed at the level of fundamentals with the knowledge of experience, the details can be left to others. If not faced squarely and soon, the inevitable result will be severe atrophy of the federal procurement process. This is because the vast bulk of current regulations has come about in the last twenty-five years and most of the complexity and seemingly endless details in the last ten. The four underlying questions are:

- Is all this regulation necessary, or even desirable? If not,
- What is the proper level?
- What caused the excesses?
- What basic corrections are needed to achieve and stay at a proper level?



All of this, of course, presupposes that regulations are needed and are integral to the federal procurement process. This as well as the four other basic questions will be the main topics in this chapter.

### **The Need for Regulations**

Procurement by government agencies, as has been shown, constitutes in many ways a special, even unique marketplace. In many instances it comprises the sole market for a particular product; because of the size of purchases, it often may dominate or at least greatly influence the timing, prices or nature of the market. Insofar as a special marketplace is created, some regulations are undoubtedly needed to substitute for natural forces inherent in the open marketplace. An example is the establishment of rules for competition. A major void in this category, as noted earlier, is control over undesirable monopolistic advantage.

A second category of need for procurement regulations arises from the fact that the government customer, unlike its commercial counterpart, has reserved special rights for itself. It can be sued, for example, only with its consent. Thus, regulations are required to alert the potential seller to such limitations on his ability to protect his rights.

A third category of government needs derives from its role as sovereign. Included are such obvious necessities as statutory implementations, the right to decide what is required and when, to unilaterally cancel or change requirements to meet changing needs, and rules to account for the federal budgeting process, including auditing of expended funds. This category also covers regulations made "in the public interest."

As noted in Chapter 2, it is in this last area where valid sovereign need gradually disappears and monopoly appears, but under a more noble banner. This is becoming of great concern due to increasing misuse. It is a rare public servant who will not almost automatically defend any regulation, old or proposed, as being in the public interest. This is a convenient,

even warming reason, but not necessarily a correct one. It is also a virtually endless road.

The fault, however, lies less with people than with a system which does not provide specific, objective, criteria for evaluation of what should be, but depends instead on subjective application of detailed rules and procedures, justified on what vaguely is deemed good for the distant and largely uninformed public.

Procurement regulations are needed for good and valid reasons. But so, too, is protection against excessive regulation and overly zealous or self-serving application. Such protection is also solidly in the public interest. A principle recognizing both needs would declare:

*The Government shall issue procurement regulations as required to establish equities and protect the public interest while at the same time assuring that regulations are not excessive, conflicting or impose undue costs.*

Here again, a single principle cannot cope with all significant aspects of a situation; excesses from other causes must be further discussed.

### **The Costs of Excessive Regulation**

Procurement regulations are seldom viewed by legislators as important enough to warrant more than cursory attention. The general view is that they are obviously needed, the needs are being satisfied and responsibility lies elsewhere. If a particular problem surfaces, a new law or amendment to fix it is hammered out and the subject of regulations is set aside again.

The attitude toward regulations among Executive Branch policy makers is much the same. An exception sometimes occurs following changes in Administration when policy changes often are announced, but too many times without substantial penetration down into the standing bureaucracy. At these high levels an attitude of unconcern is perfectly reasonable if the system below is functioning well. If it is

not, abuses are bound to occur. What has been and is happening?

By way of primary example, let us turn again to the Department of Defense, though the situation is generally the same in other agencies, differing only in degree. And let us take a broader view of procurement "regulations" than usually taken, because such is necessary to place the real problems in perspective. In the case of DOD, the Armed Services Procurement Regulation is automatically thought of as the DOD regulation system. It is central, but it is far from being the sole source of procurement regulations. The correct perspective is to consider, as well, every DOD policy, management system, report, procedure, etc. that bears on the DOD procurement system and upon the contractors serving it. It is only from this perspective that the total impact can be seen.

The multiplicity of players can also be seen more clearly. They are not just the nine men on the ASPR Committee or those participating on ASPR subcommittees. They include, at the level of the Office of the Secretary of Defense, the many offices involved with procurement documents under the Assistant Secretaries for Installations & Logistics, Comptroller and the Director of Defense Research & Engineering, as well as special joint offices. They include those in the offices of each Service Secretary and many others in the several functional offices serving them.

Principal contributors to the regulatory network are also found within each of the Services at each command and lower offices. The pyramid grows geometrically until it reaches its base, the program managers and contracting officers who must comply with all the regulations, however titled, and finally at the level of the contractor who also must comply. The government employees in the chain number in the thousands. Given this perspective, the effects can be seen more clearly.

Witness a hypothetical but representative case for illustration. A fourth-level employee in an office of the Defense Comptroller is assigned the job of pull-

ing together a periodic report never before requested. Looking at what is readily available, he finds that much of the data he needs is not at hand or is not in the form in which he needs it. He determines that it must be obtained directly from DOD contractors. In the process he also decides that if some additional management requirements were set forth in the same general area, a problem in subordinate offices that had been brought to his attention earlier on two or three contracts also could be solved.

Three months later a draft of a new management system is routed for coordination. It is readily "signed off" since it does not appear to affect other offices much, if at all. It is issued and a new procurement requirement is born. It may comprise two pages, or 200. When placed in contracts it will have the same authority as an ASPR clause. It must be followed. It is a control. It will cost money to comply with. Contractors will be audited for compliance. It is a procurement regulation whatever its title.

From this single example, here are the typical effects. Since it is issued from the Office of the Secretary of Defense, every subordinate office will be required to implement it, more than likely by rewriting it within 90 days to tailor it to their formats or missions, down through at least three levels—in each Service, not just one.

In the process, other requirements as well as greater amounts of detail are often added. By the time it reaches the bottom of the chain there will be at least a dozen and perhaps two dozen formally issued versions among the three Services and other components, their several subordinate echelons and various procurement branches. Sometimes the document is handed down without rewriting it, but this is not the general pattern. It has now reached the procurement and contractor level. The costs already incurred are significant, but pale in comparison with what is to come.

Since the document is from the top of the pyramid and requires data from all DOD contractors, it can be placed on all applicable future contracts.



Within a few months it may well involve one hundred prime contractors and ten thousand subcontractors.

Because the data to be reported is not likely to be available to each contractor in the form required, he must rearrange his data collection method, or develop a new one. This may mean changing his manuals, information flow, paperwork—possibly adding people or departments. Not one contractor, but all 10,100 contractors are involved. As the data is gathered, it will then wend its way upward, being reviewed, approved and re-reviewed at each higher office until it reaches the initiator. Cost? Who can say with certainty? But the multiplier effect on costs resulting from one small effort by one man can be staggering, and it can last for years.

Unfortunately, hard data on costs attributable to procurement regulations are impossible to obtain. Little research actually has been conducted. The impact on overhead costs, however, both within government and among defense contractors, has to be tremendous. For instance, it is commonly known that defense contractors usually try to physically separate defense from commercial operations because of the inordinately high overhead costs of defense work—largely attributable to government procurement requirements.

Perhaps the best estimate available<sup>23</sup> is that for management system costs alone: \$4.4 billion in DOD Fiscal Year 1969. This does not, presumably, include a single dollar attributable to the ASPR or the many other categories of regulation.

Some lessons can be drawn from this example which are important to the future. They certainly would include:

- The term “procurement regulation” must be viewed in its broadest context, and administered the same.
- The establishment of regulations is not centrally controlled, is fragmented, and often dic-

tated from narrow perspectives with excessive detail.

- There is no set of formal criteria that regulations must meet, which is particularly detrimental in such areas as compatibility with other policies, ascertaining actual needs, assessing effects and weighing costs against benefits.
- The decision to impose new regulations is unilateral and without adequate means provided for challenge by those affected.
- The dispersion of initiating points and lack of principles, criteria and central control result in conflicting, duplicatory and inequitable rules, and excessive and unnecessary costs.
- Poor regulation and over-regulation are inescapable so long as major reform is not initiated.

Other detriments also must be considered and may in the long run be even more important than dollar costs. Perhaps the most important is rigidity. Over-regulation and excessive detail combine to tie the hands of management in government and industry alike. Industrial managements find traditional prerogatives eroded or eliminated; their work force is saddled with imposed methods, efficient or not; their overhead costs creep ever upward, prejudicing or hampering their ability to be competitive in other fields. Flexibility to meet new opportunities and to overcome new problems is the victim.

Government management is affected similarly. The huge, structured bureaucratic machine is at times almost impossible to change, and increasingly so as it grows. It keeps moving in the ways and directions it has built for itself, and a new policy desired by management often bogs down by the time it filters just a layer or two down from the top. Pentagon managers lament that it usually takes three to five years for a policy change to be fully implemented at the bottom. Many never make it at all. Again, flexibility, the ability to meet new demands and chal-

<sup>23</sup> Blue Ribbon Defense Panel Report, Appendix E, July 1970.

lenges, is the victim.

The costs of rigidity are severe. The price—of substituting rules for judgment, of sustaining bureaucratic growth by allowing it to create its justification through issuance of ever spiraling requirements, of smothering innovation with needless details, of blocking new business opportunities by creating inefficiencies—is too high a price for all, including the nation.

Another major detriment is attributable to the lack of stability of regulations. This factor adds substantial dollar costs, but more important, it produces constant and unnecessary turmoil. This not only makes planning difficult but also requires excessive involvement of managerial talent that could better be used in other pursuits. Some brief illustrative examples will show the extent of this induced problem.

At the level of top policy, the pendulum has made several swings in recent years. While the current swing seems better, strains and problems caused by earlier swings are still being felt. One example is the use of prototypes in development programs. Prototypes were largely abandoned a few years ago in favor of analysis and paper designs. Created by policy were not only 20 to 30 thousand page weapon system proposals<sup>24</sup> with attendant costs, but increased frequency of technical surprises as hardware development proceeded.<sup>25</sup>

The unhappy results have been headlined in the news. Today, changes in policy are again recognizing the value of prototypes and graduated levels of advanced development work. Another example, related to the first, was the turn away from dependence on management judgment in the name of management science. This led to a massive proliferation of complex and rigid management systems in just a few

short years.<sup>26</sup> Recent policy changes indicate a return to recognition of the value of experienced people exercising good judgment. Accompanying this has been some reduction in the number of management systems, but too many big, costly ones still remain.

Stability appears to be foreign to the ASPR system as well. Over 200 changes are processed each year on the average.<sup>27</sup> The possible impact of just one such change has already been shown. Over 200 changes in the approximately 230 working days available each year tells its own story, but a more specific example may be useful.

Section XV of ASPR is entitled "Contract Cost Principles and Procedures." The use of the word "principles" in the title relates very well the original purpose and intent of this ASPR section. Yet through a process of piecemeal and constant conversion, this section has undergone a ten-fold growth in wordage and has become a set of rigid rules for cost disallowances rather than principles and guidelines for determining allowability. It appears that even where principle has been established, the insatiable appetite for detailed regulations frustrates the goal of reasonable stability.

It is worthy of note that none of the above examples (and hosts of uncited ones) is basically grounded in either sovereign or practical need. Essentially, they demonstrate how monopsony power proliferates when not controlled. The belief, so often found at the top, that the foundation of the procurement system is adequate and that the regulatory store is running well, is obviously not in keeping with the realities. Costs in both direct and indirect terms are excessive and are sapping vital strengths unnecessarily.

So it would appear entirely reasonable to answer the first question, posed earlier,

<sup>24</sup> "Study of United States Air Force Requests for Proposals, Critique and Recommendations," Aerospace Industries Association, December 1969, Reprinted May 1971.

<sup>25</sup> "Essential Technical Steps and Related Uncertainties in DOD Weapon Systems Development, Phases I and II", Aerospace Industries Association, May 1968-September 1968.

<sup>26</sup> "Final Report of the Advisory Committee for Management Systems Control," Department of Defense-Council of Defense and Space Industry Associations, March 1968.

<sup>27</sup> Speech before the American Bar Association by Assistant Secretary of Defense (I&L) Barry J. Shillito, July 14, 1971.



- Is all this regulation necessary, or even desirable?  
with a resounding “No.” Much of it is not desirable by any reasonable measure, and in fact is counter-productive. Of the rest, certainly more is due to desire or whim than to necessity. The amount of current regulation deemed to be necessary by a demanding, objective judge would, more than likely, be a very small percentage of the whole. The second question,
- What is the proper level?  
should be governed by the principle recommended earlier suggesting that the proper level is the minimum level—enough to protect the public interest adequately and to define the process and its limits, but not so much as to stifle private enterprise or the process itself. Only through such a guideline can a proper level be achieved and maintained. The third question,
- What caused the excesses?  
has been partially answered by the examples but a deeper look should be taken to answer it better, as well as the fourth question,
- What basic corrections are needed?

### Regulation Criteria

One of the basic factors contributing to excessive amounts of regulation mentioned earlier is amenable to correction through adoption of a principle. It is the lack, anywhere in government procurement circles, of a formal set of criteria against which to test a proposed or existing regulation. This void, even more than in the case of principles, is hard to understand or sanction by anyone who considers it more than momentarily. It seems axiomatic, for instance, that every proposed regulation should be made to stand the test of need. If it is not truly needed, or only marginally needed, it should never be allowed to be imposed.

Costs have been discussed as being another im-

portant factor. Even if a need is shown and accepted, a regulation supporting it can take many forms with varying impact. Cost impact should be a key criterion and total costs, not just the labor of the crew developing the regulation. Costs of implementation, costs of audit, costs of compliance, costs of transmission and reviews, indirect costs, management costs, costs of alternative approaches—all such costs should be considered. Given these, then how important is the need? Is it really worth it, or has it become a luxury? This is a fitting and necessary test, but apparently too seldom used.

Other criteria also are important. Does the regulation conflict with others, or with policy? Obviously it should not, but, with the possible exception of ASPRs, many do because nothing demands a review to make sure. Is there too much procedural detail or would a broad statement of what is needed rather than how to do it be more appropriate? Such would obviously fit more situations, cause less disruption and leave more room for management flexibility.

Then there is the criterion of stability. Has the new concept and its rules been proven fruitful by adequate test before imposing it broadly by regulation? Or, is this particular revision so important it cannot wait until the whole section is reviewed and updated? The examples could continue on and on, but the job of designing criteria can be done later. What is needed first is something to cause the criteria to be formed and used. Also, it should be noted that this basic deficiency is not only common to all agencies, but the solution as well can apply commonly among agencies. The principle could read:

Formal criteria for the content, development and approval of all procurement policies, regulations and procedures shall be established by each agency, be common among agencies where possible, and be consistent with these Federal Procurement Principles.

## Checks and Balances

A second fundamental problem also is caused by a void in all government procurement today. In essence, it is the absence of an adequate check and balance system in the establishment of procurement policy, regulations and procedures. Admittedly controversial, it is nevertheless a basic problem to which a solution must be found if fairness, equity and reasonable efficiency are to be achieved and maintained.

The check and balance concept is fundamental to our form of government. It is absent in the main in the government marketplace. Some lawyers will disagree and cite existence of the contractual "disputes clause" and the Board of Contract Appeals and the Courts. While it is one form of check and balance, the "disputes" procedure and recourse to the Courts are both too narrowly limited in their applicability to have any significant influence on the mass of procurement regulations. Further, it has become common practice for government agencies to expressly and effectively neutralize a Court or Board decision favorable to a contractor<sup>28</sup> by changing the regulation involved. Others will cite the legal "contracts of adhesion" argument and economists will point to the protection provided by exiting the market, but these recourses have been shown in Chapter I to be inadequate in the existing environment.

The argument of government's sovereign rights has applicability as a defense against a sound check and balance system but its limits should be recognized. Few will quarrel with actions taken in the name of sovereignty and most will support them as long as they are clearly in that category. The danger, as noted before, is using that good defense to sanctify a poor action or rationale, otherwise indefensible. Its use needs to be further tempered when the line gets vague between sovereign rights and monopsony power.

Another argument is sure to be put forth because

it has gained the favor of the Administrative Conference of the United States and is currently proposed as legislation. Over simplified, it is that great good would come if currently exempt government regulations were brought under the Administrative Practices Act (APA) and its procedures. Such proposals are not new and have long received strong opposition from the agencies, a cool reception from industry and general indifference from the private bar. Though arguments in support have been made publicly on both practical and legal grounds,<sup>29</sup> two practical points would seem to make such a solution substantially less than effective.

The first is the matter of definition mentioned earlier. A procurement regulation is not always called a regulation and therefore would continue to escape the screen of scrutiny, including the APA screen. An educated guess would be that there are ten to twenty times more procurement regulations called something else than are labeled as such, measured by sheer bulk of number of pages. In practical terms, the well-intentioned blow would miss by a mile.

The second point is more telling in that such a change would result materially only in the exchange of one procedural system for another, rather than in curing underlying problems. Some gains might accrue to broader public notice, but the benefits would probably be more cosmetic than real. The APA system is simply not designed to provide an adequate check and balance, particularly against monopsony.

What then is needed to help solve monopsony problems and ensure fair and equitable treatment to both public and private interests? The answer must be two-fold.

First, all parties to be affected by the regulations, public and private, should be afforded adequate opportunity to participate in the regulatory process. Government agencies may claim that this is not only

<sup>28</sup> Letter to Deputy Secretary of Defense Packard, AIA, November 6, 1970, (P&F 70-405).

<sup>29</sup> John J. Grossbaum, "Procedural Fairness in Public Contracts: The Procurement Regulation", *Virginia Law Review*, March 1971.



done today but that the coordination process already takes too long. Industry responds that little opportunity exists in the early stages when potential problems are most easily identified and preventable and that experience indicates most coordination time is consumed within the agencies. Both views have substance, yet the problems remain and are ever growing. A clear mandate resolving this dilemma must be expressed.

Second, and perhaps of paramount importance, is the need for some means to be provided for the regulated to seek amendment or repeal of rules set forth by the regulator. Some mechanism must be instituted that is preferably short of the courts but beyond the bias of the originator. A full judicial process would be too formal, too lengthy and too costly to cope adequately with the need. Achieving an objective review by definition removes it from the hands of the regulator.

What is needed to bring order out of what is approaching chaos is an independent, quasi-judicial body where the unfair and inequitable procurement rule can be challenged, along with the unnecessary and undesirable. Such a review would not only surface the real intent, need and rationale for a dubious regulation or change, but its very existence would be of inestimable value in preventing the development or implementation of such in the first place.

It is not the purpose here to provide a proposed de-

sign or even to argue the merits of alternative structures.<sup>30</sup> It is hoped that opportunity will come. Just as with the other proposed principles, the details can be worked out if a sound principle is adopted. What is needed is the principle:

*The Government recognizes and shall protect the rights of affected parties to participate in the procurement regulatory process and to seek independent review of such regulations for amendment or repeal based on these Federal Procurement Principles.*

This brings the basic concept to a conclusion. Just enough detail has been provided in the way of justification to make the proposals understandable for the non-expert yet keep them relevant for the policy maker. Enough is here for the expert as well to show the way for elaboration, based on his own experience. The next chapter will look at ways to move this proposal forward from concept to reality and at some of the difficulties of so doing.

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<sup>30</sup> There have been several thoughtful proposals in this area. One of the more notable is found in a speech by John Lane, Jr. to the National Contract Management Association, August 1970, which also expresses a highly constructive critique of the existing regulatory process.

## CHAPTER 4

# THE CHALLENGE

The foregoing chapters were designed to set forth in summary form the primary subject areas where clear statements of procurement principles would provide the greatest long-term benefits for the nation. Others may see the need for additional principles or for refinements in those proposed. Such constructive review is welcome and can only prove beneficial.

On the other hand, because government contracting has become an exceedingly complex subject, it is recognized that some will either decry the possibility that acceptable principles can be unwoven from all the details, or use the details to argue against those proposed. Such attitudes should not be permitted to prevail for the need is too great and potential future benefits too important to permit negativism to prevail.

From the perspective of history, the tremendous growth in government procurement, both in impact and complexity, has been relatively recent. The growth in the next few years is apt to be even more astounding, and, it can be reasonably assumed, the details more complex and the problems much greater. The time to provide a solid foundation of principles is now, when there is adequate experience but before the problems become insurmountable and the task impossible.

If the concept of establishing a set of Federal Procurement Principles is deemed sound and endorsed, two important questions remain: Where should such principles be embodied? Who should provide the leadership to bring them to fruition? Some observations may be helpful.

The proposed principles are intended to be applicable to all federal agencies for the procurement of all goods and services from all sectors of private enterprise. They should serve the functions of providing a national procurement philosophy and defining basic government-industry relationships in this unique marketplace. They would be the standards upon which to judge the soundness of existing and future policies and regulations and to prevent the establishment of inequitable or unnecessary ones.



For such purposes, their value would appear to be diminished to the degree that their applicability is limited or their definition restricted or specialized.

Thus it would appear that, to meet these purposes, the proposed Federal Procurement Principles should be embodied in a statute designed to provide precedence in the field of all government procurement. While no such document exists today, one may well result from the ongoing efforts of the Commission on Government Procurement. At least such could conceivably be a major recommendation resulting from this comprehensive effort.

Alternatively, such a Bill could be introduced before the Commission completes its work and be justified solely on the basis of need and growing public concern. Or, administrative steps could be taken to adopt the principles, preferably with multi-agency coordination and agreement. Several routes would appear feasible; one should be identified and broadly supported.

The question of leadership in establishing principles may prove more difficult but it seems reasonably clear, under whatever leadership, that both the federal and private sectors should be fully engaged in the proceedings. This view would seem to give an edge to the Commission on Government Procurement since it is comprised of a mixed constituency,

but certainly other options are possible. For example, several governmental groups in both the Legislative and Executive branches have mechanisms to involve private interests, as well as the responsibility for taking action in the public interest. Industry groups, on the other hand, would appear to be limited in their ability, individually or collectively, to assume leadership because of the appearance of self service. This should not limit their ability to support a particular government group, however, nor their interest in doing so.

So while the answers are not perfectly clear, the best options appear to be in the direction of legislation fostered by a quasi- or purely governmental body. The real answer, of course, can be provided only by an individual who will take the leadership; one with requisite authority and responsibility who will accept the challenge and provide the platform and initiative. Only then will the job get done.

For the purpose of providing a starting point for such action, all the proposed principles, as developed earlier, are set forth below. They are preceded by a preamble as might be found in typical legislative language of intent.

Finally, they are offered as an open proposal in recognition of national need and in the spirit of public interest.

## CHAPTER 5

# PROPOSED FEDERAL PROCUREMENT PRINCIPLES

Set forth below are all Federal Procurement Principles proposed in this study, arranged in a logical sequence. They are preceded with a preamble which describes their intended purpose and use as might be embodied in enacting legislation.

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The procurement of goods and services by federal agencies from private enterprise is a significant factor in the national economy and contributes substantially to the economic growth and world leadership position of the United States. To foster the continued growth and strength of the nation, it is declared in the public and national interest that certain principles be set forth defining the fundamental relationships between the public and private sectors of our society in all federal procurement actions. These principles shall have precedence unless otherwise barred by law:

- The Government favors the use of and will procure to the maximum extent from private enterprise to fulfill its needs for goods and services.
- All Government procurement actions, including those resulting from actions of sovereignty, shall be based on a doctrine of fairness and equity.
- The Government shall abide by the same business principles that govern others in the field of commerce.
- The Government, when its procurements comprise the sole or dominant share of a market, shall recognize and avoid the use of its monopsonistic leverage to exact unfair or inequitable contractual arrangements or conditions.
- The opportunity to earn a reasonable profit shall be fostered in government procurement commensurate with the risks assumed and comparable to similar commercial endeavors.
- Government procurement shall acquire the benefits of competition through the use of



either formal advertising or negotiation.

- The Government shall pay fair prices for goods and services by accepting all ordinary and necessary costs, consistent with accepted commercial practices.
- The Government shall issue procurement regulations as required to establish equities and protect the public interest while at the same time assuring that regulations are not excessive, conflicting or impose undue costs.
- Formal criteria for the content, development

and approval of all procurement policies, regulations and procedures shall be established by each agency, be common among agencies where possible, and be consistent with these Federal Procurement Principles.

- The Government recognizes and shall protect the rights of affected parties to participate in the procurement regulatory process and to seek independent review of such regulations for amendment or repeal based on these Federal Procurement Principles.



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1725 DE SALES STREET, N.W., WASHINGTON, D.C. 20036