WAR PROFITS AND LEGISLATIVE POLICY

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JUST as inveighing against sin is spasmodically a popular pastime, so too is inveighing against war-profiteering. With the latter, considerable success has been experienced in the last two years, and it seems doubtful that, as a result of this success, post-war investigations will reveal anything like the scandals which shocked the public during the two decades following World War I.

From its earliest days this country has been confronted with attempts on the part of merchants and vendors “to avail themselves of the difficulties of the times, and to amass fortunes on the public ruin.” A condition which our people have faced in every one of their wars—and which other people have faced in their own wars—is perhaps best described by the Father of his Country in a letter dated March 31, 1779. It is worth quoting in extenso.

Our conflict is not likely to cease so soon as every good man would wish. The measure of iniquity is not yet filled. . . . .

Speculation, peculation, production, engrossing, forestalling . . . . affording too many melancholy proofs of the decay of public virtue . . . . and too glaring instances of its being the interest and desire of too many who wish to be thought friends, to continue the war. . . . .

Cannot this common country America possess virtue enough to disappoint them? Is the paltry consideration of a little dirty pelf to individuals to be placed in competition with the essential rights and liberties of the present generation, and of millions yet unborn?

Shall a few designing men for their own aggrandizement, and to gratify their own avarice, overset the goodly fabric we have been rearing at the expense of so much time, blood and treasure? And shall we at last become the victims of our own abominable lust for gain?

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† George Washington, in a letter to the President of Congress dated August 16, 1777.
Forbid it heaven! Forbid it all and every state in the Union! By enacting and enforcing efficacious laws for checking the growth of these monstrous evils, and restoring matters, in some degree to the pristine state they were in at the commencement of the war.

Our cause is noble, it is the cause of mankind! And the danger to it is to be apprehended from ourselves.

The hopelessness of General Washington's position, his impotence to cure or even deal with "speculation, peculation, production, engrossing, forestalling," is akin to the difficulties which he had in maintaining his armed forces, whose personnel was wont to take off for home on the slightest whim.

This letter is worth quoting because it indicates the extent to which our groping for a solution to the problem of curbing war-profiteering has advanced. In each of our wars adventurers have sought "to amass fortunes upon the public ruin." But in the present war such attempts are being dealt with effectively.

The problem is threefold—material, fiscal, and moral—with political over-tones. Adequate appreciation of this triple nature of the problem is essential to an understanding of the history of attempts to meet it. For if attention is paid to the tone of only one or only two tines of the tuning fork, the results may be highly discordant.

PRICE OF ARMOR PLATE IN SPANISH AMERICAN WAR

The most important of the threefold aspects of the problem is the material. For to an increasing extent, wars have become matters of matériel. The point is illustrated by attempts by the Congress to control the price of just one item of matériel—armor plate—prior to and during the Spanish American War. During the early nineties, the Navy had paid from $574 to as high as $671 for armor plate. In the belief that such prices were unreasonable, the Congress took action, and on March 3, 1897, a statute limiting the price of armor plate to $300 a ton was approved. Fiscal and moral considerations may have motivated such action, but that material considerations were not amply weighed is indicated by the ineffectiveness of this legislation. Manufacturers simply refused to accept contracts at the lower price. To avoid its having dire results in the prosecution of the war, the Congress had to raise the ceiling to $400. Notwithstanding this experience, the Congress subsequently

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2 Hensel and McClung, Profit Limitation Controls Prior to the Present War, 10 Law and Contemporary Problems 187 at 191 (1943).
tempted fate by reducing the ceiling once more to $300, with the result that manufacturers again refused to bid. Finally despairing, the Congress gave the Secretary of the Navy authority to procure armor "at a price which in his judgment is reasonable and equitable." Thus, the Congress finally succumbed to the material aspect of the problem—the most important of the three.

Price and profit control must be so finely governed that the material requirements of a war will be satisfied. This means that, under the capitalistic system to which we are committed, there must be incentive to produce and to produce quickly in large volume. In peacetime competition provides this incentive, and as soon as competition kills it, production ceases. The fittest survive. But in wartime the production of the least fit may be just as essential as the production of the fittest, so that prices and profits must be such that both have an incentive to survive. If the material aspects of the problem are not given sufficient weight, the question of the moral and fiscal aspects may become academic through the loss of the war which is being fought.

PRICE AND PROFIT CONTROLS IN WORLD WAR I

Attempts to control prices and profits of war contractors in World War I proved futile. Indeed, as in the case of the Spanish American War, they boomeranged—but for a different reason. The material aspect of the problem was over-emphasized by the adoption of cost-plus-a-percentage-of-cost contracts. These were designed to underwrite the contractor, inducing him to turn to war production because by such underwriting he escaped risk, and at the same time inducing him to produce rapidly in large volume. But by the very nature of these contracts, he was actually induced to increase his costs, for the ratio between profits and costs remained constant and the higher the dollar costs the higher the dollar profits. Thus, a fiscal fallacy entered into the adoption of this kind of a contractual arrangement. It should have been evident at the outset, but in this as in so many aspects of pricing, hindsight is superior to foresight.

Another fiscal error was made when attempts to limit war profits were supplemented by relatively high excess profits taxes.


As Bernard Baruch has stated, high excess profits taxes standing alone aggravate war evils.

However lofty may have been the motives of the country, the Congress, and the procurement agencies during World War I, however much they may have had their eyes on the material and moral prongs of the tuning fork, they failed to tune in with the third—the fiscal. While, unlike the experience of the Spanish American War, legislation did not in itself hamper satisfaction of the material considerations or discourage production, while attempts to limit profits satisfied lofty moral concepts, these attempts were abortive because insufficient attention was given to the fiscal aspect of the problem. Not only did cost-plus-a-percentage-of-cost contracts fail to curb war-profiteering; they aggravated it. Not only did high excess profits taxes fail to prevent war-profiteering; they made for inflation.

Of the 168 bills and resolutions introduced into the Congress between the 1918 Armistice and the fall of France for the purpose of coping with the problem of war-profiteering, few were adopted and none recognized the threefold nature of the problem. Of those that were adopted, all were failures because they considered only the moral aspect of the problem. The only important piece of legislation of this nature was incorporated in the Vinson-Trammel Act, passed in 1934 and subsequently amended three times—in 1936, 1939 and 1940. By limiting profits on naval vessels (subsequently extended to apply to military and naval aircraft) to a percentage of the contract price, the Vinson-Trammel Act prescribed what, in effect, was not very alien to the cost-plus-a-percentage-of-cost contracts of World War I. The main difference was that the contract price rather than the cost was the base. While superficially this difference might appear to be great, in actual practice, it could be almost meaningless. Thus, because it did not give sufficient cognizance to the material and fiscal aspects of price control and profit limitation on war contracts, the Vinson-Trammel Act was ineffectual. More than that, in some instances the act discouraged shipbuilders and aircraft manufacturers from entering into contracts, and thus delayed the defense program.

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6 American Industry and the War 415 (1921).
12 See debate on 1940 Excess Profits Tax, 86th Cong. Rec. 11,243, Aug. 29, 1940.
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POLITICAL OVERTONES

During the '20s, the question of regulation of prices of war contracts and limitation of profits thereon became increasingly important from the political standpoint.

One of the most potent forces was the American Legion, whose political influence was growing rapidly. In 1920 it launched a campaign for what it termed "Universal Service."³

In 1924 the two major political parties each included a plank calling for the close control of the munitions industry in time of war.

The Republican plank⁴ read as follows:

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

The Democratic plank⁵ read as follows:

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

Apparently both major political parties felt that with the adoption of these two planks in 1924 the matter had been disposed of, for future party platforms ignored the subject. In view of the extensive newspaper publicity and general public preoccupation with the question of control of war profits that developed as the years went on, it seems strange that neither political party made an issue of the matter. Nor is it reasonable to explain this omission of the question from the party platforms by the fact that it was receiving so much attention in the Congress. The omission may be set down simply as a political phenomenon.

During the '30s, with World War II drawing nearer, agitation for a complete ban on war profits grew apace. Thus, a majority of the Senate Munitions Committee on June 18, 1936, recommended the nationalization of naval shipbuilding and manufacture of certain arms used by the Army and Navy.⁶ The minority report of the committee expressed the

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³ This was a three-way program designed to: "(1) Promote peace, (2) Take the profits out of war, and (3) Strengthen the National Defense." Note that the American Legion's second point was to "take the profits out of war"—not some of the profits, but by implication, all of the profits.

⁴ See Republican Campaign Text Book of 1924 at 85.

⁵ See Democratic Campaign Text Book of 1924 at 39.

⁶ Baltimore Sun, June 20, 1936, Associated Press dispatch from Washington.
belief that "rigid and conclusive munitions control would be more effective than nationalization in promoting peace, defense and economy." The majority recommendation was based on the conclusion, drawn from two years of investigation, that regulation of arms manufacture "is easily evaded."17

On June 22, 1936, the Women's Committee on Suggestions for the Democratic platform recommended by unanimous adoption that the best way to preserve peace was "by passing stronger neutrality legislation and taxing the profit out of war."18

Three months earlier, in one of the first polls conducted by Dr. George Gallup, Director of the American Institute of Public Opinion, the people of the country had gone on record as strongly favoring manufacture by the Government of its own war materials. In the nation-wide poll the vote favoring this change was 82 to 18 out of every 100, with about the same proportion of members of both political parties favoring the change.19

It was this agitation that, in part, led to the strengthening of the Vinson-Trammel Act of June 27, 1936.20

The political crescendo reached in regard to war profit control occurred in 1939 and 1940 when twenty-five bills were introduced in the Congress to deal with the subject more effectively than it had been dealt with theretofore. With war brewing and finally developing in Europe and with production of munitions mounting rapidly in this country, it was only natural that insistence upon adoption of some form of control should increase. None of these numerous bills, however, was adopted, for the Congress was tending more and more to the belief that the problem could be dealt with by a high excess profits tax.

Still clearly uncertain as to how to cope with the problem, the Congress side-stepped the issue in the Revenue Act of 1940. Finally, however, on July 1, 1940, shortly after approval of the Revenue Act of 1940, the President addressed a strong message to the Congress directing its attention to the National Defense Program and to the duty of the Congress to see that the burden of the program was equitably distributed "according to ability to pay," and recommending the enactment of a "steeply graduated excess profits tax, to be applied to all individuals and all corporate organizations without discrimination."21

As a result, both Houses finally adopted a highly complicated measure involving a combination of the theories of "average-earnings" and "invested-capital" which represented a not very happy compromise. The provisions for excess profits taxes were subsequently amended in 1941 and again in 1942.

**SIXTH SUPPLEMENTAL NATIONAL DEFENSE APPROPRIATION ACT**

An uneasy feeling that the high excess profits taxes did not wholly accomplish the purpose of controlling prices and profits on war production continued to prevail in the Congress. During discussion of the Sixth Supplemental National Defense Appropriation Act in April, 1942, Congressman Francis D. Case, Republican from South Dakota, introduced into the House a measure to limit the profits on war contracts to six per cent. While it was not specifically stated, it is to be presumed that this six per cent was on a basis of "before taxes," following the precedent established by the Vinson-Trammel Act. The measure passed the House by a vote of 70 to 8.

As it went to the Senate, however, the procurement agencies along with the War Production Board pointed out that this arrangement would place a profit strait jacket on business and provide for the realization of excessive profits by companies which in the best of peacetimes were accustomed to making no more than two per cent on sales, while at the same time it might force heavy industry companies into bankruptcy by not allowing them sufficient return. In other words, while the aim of the Case amendment was laudable, again the question of practicality was overlooked.

Meanwhile, recognizing that unprecedented volume of production was leading to excessive profits already indicated by 1941 corporate reports, the War Department had conducted a number of price renegotiations with prominent war contractors. Therefore, when asked by the Congress to suggest an alternative to the Case amendment, Lieutenant General Brehon Somervell, Chief of the Army Service Forces, presented a substitute on behalf of the procurement agencies. It was based on the theory that if every contract price could be re-examined by the parties in the

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26 Ibid. at 3231.
light of actual experience under the contract, it should be possible to eliminate the bulk of excessive profits.27

Appearing before the Senate Subcommittee on Appropriations, Robert P. Patterson, Under Secretary of War, gave the following reasons for opposing a set profit limitation:

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

(2) Uniformity: In the second place, a flat percentage limitation does not really achieve its prime objective of uniformity of treatment. Although it allows a fixed uniform per cent of profit on gross sales, this will be most unfair as applied to the diverse types of business engaged in war work. It takes no account of the fact that in different lines of business the same volume of sales may require widely different amounts of capital, skill, and work, depending on the rate of turnover.28

This can be regarded as a perfect summation of the practical aspects of control of prices on and profits from war contractors.

As for political aspects, the startling revelations as to extraordinary salaries and bonuses paid by Jack & Heintz, Inc., as brought out in hearings before the Naval Affairs Investigating Committee,29 crystallized in the public mind the extent to which war profiteering might lead. Public reaction, as reflected in newspaper comment and letters to the Congress, was immediate and intense. Under the leadership of Senator Kenneth McKellar, Democrat of Tennessee, the Senate Appropriations Committee adopted the principle of contract renegotiation in the form of Section 403 of the Sixth Supplemental National Defense Appropriation Act.30 Thus, politically, this final approach to control of war profiteering had its active sponsorship from a Republican in the House and a Democrat in the Senate. The 1924 party platforms had been fulfilled.

ANTI-RENEGOTIATION CAMPAIGN

But the matter had not been fully resolved with enactment of the Sixth Supplemental National Defense Appropriation Act and its Section 403. Perhaps because there had been no debate in the Senate or the House

28 See testimony of Under-Secretary of War Patterson at hearings before Senate Finance Subcommittee on Sec. 403 of Pub. L. No. 528, 77th Cong., 2d Sess. (1942) 3.
29 Hearings before House Naval Affairs Committee on H. Res. No. 162 (vol. 1; Mar. 23, 1942) 77th Cong., 2d Sess.
on this section, some contractors subject to it took the position that it had been ill-considered and that it was designed to "ruin" American business.

In August of 1942 the campaign to repeal or emasculate renegotiation was launched by John B. Hawley, president and sole owner of the Northern Pump Co. of Minnesota, when he circularized the Congress and businessmen with a silver-covered 42-page brochure captioned *Dictatorship over United States Industry under Public Law 528* and sub-captioned *Sabotage of Production, Development and Expansion—towards Losing the War.* This was only one of a series of mailings sent out by one of the relatively few aggressive opponents of renegotiation—an excellent producer, it must be said, as are most of the other vocal business opponents. At about the same time a financial magazine carried an article by a prominent writer condemning renegotiation and basing his argument almost wholly on a theoretical case coinciding interestingly with Northern Pump.31 This article, displaying a wide misconception of what renegotiation is all about, was subsequently reprinted in condensed form in *Reader's Digest.* The battle was on.

The Departments engaged in renegotiation agreed with some of the more reasoned objections to the law which were voiced by businessmen of a less sensational stripe than Hawley, Jack, et al. Indeed, as the administrators began to work with the act, it became apparent that it did contain a number of minor flaws relating chiefly to mechanics. This was inevitable since adoption and application of the principle of renegotiation represented pioneering. Certain recommendations for changes in renegotiation were adopted administratively by the Departments and subsequently incorporated as amendments to Section 403 in the Revenue Act of 1942,32 jurisdiction for renegotiation having been transferred from the Appropriation Committee to the House Ways and Means Committee and the Senate Finance Committee where it has continued to remain.

A summary of some of the other changes effected through the Revenue Act of 1942 will indicate the manner in which the practical aspects of profit control were now commanding an increasing degree of attention—the moral, fiscal and political aspects having been satisfied by the adoption of the principle embodied in Section 403.

One amendment provided for final agreements. When a contractor or subcontractor renegotiated in good faith for a specified period and agreed to eliminate excessive profits for that period, it was clear that he should


be entitled to assurance that the matter would not be reopened at a later
date. The original statute did not provide expressly for any final clearance
for liability for excessive profits. This amendment specifically authorized
such final agreements for a specified past or future period.

Another change was embodied in two provisions affecting a statute of
limitations on renegotiation. The first of these prohibited renegotiation
after one year from the close of the fiscal year in which the contract or
subcontract was completed or terminated. The second authorized a con-
tractor to file financial and cost statements for prior fiscal periods and
obtain clearance under the statute, unless the Secretary should begin
renegotiation within one year thereafter. Few contractors availed them-
selves of this privilege.

Under the original law, when a contractor or subcontractor held a num-
ber of war contracts or subcontracts, the boards had found it desirable to
renegotiate with him to eliminate excessive profits on these contracts or
subcontracts as a group, or on an overall basis, instead of individually.
Section 403 authorized renegotiation of contracts individually. In view of
the boards' practice of considering contracts as a group, the group renego-
tiation was formalized as part of the statute.

By one of the amendments, too, the Treasury Department was brought
into the field of renegotiation, while other changes were largely of a
technical and relatively minor nature.

CONGRESSIONAL INVESTIGATIONS

Politically, the next important step affecting renegotiation was an in-
vestigation by the Special Committee Investigating the National De-
fense Program (Truman Committee) begun in the early part of 1943 under
the direction of Senator Carl M. Hatch, chairman of a special subcom-
mittee on renegotiation. A report\textsuperscript{33} issued by this subcommittee under
date of March 30, 1943, in general endorsed the principle of renegotiation
in no uncertain terms, praised its administration and made a number of
recommendations designed to lead to further improvement in both the act
and the administration.

Led by a small minority of businessmen, the attack on the principle of
renegotiation became increasingly vocal as the year 1943 progressed. Thus
it was that several score of industrialists thoroughly opposed to renegotia-

\textsuperscript{33} Additional Report of the Special Committee Investigating the National Defense Pro-
gram pursuant to S. Res. 71 (77th Cong.) A Resolution Authorizing and Directing an In-
vestigation of the National Defense Program, Renegotiation of War Contracts, March 30
(legislative day, March 23), 1943.
tion appeared before the Naval Affairs Investigation Committee during its hearings on the subject in June, 1943. Also before this committee, on the other hand, appeared a number of contractors who favored the principle and the administration of the Renegotiation Statute. The transcript of these hearings is embodied in a 1300-page document, which was supplemented on October 7, 1943, by a report of the committee itself. The majority of this committee followed in the steps of the Truman Committee by strongly endorsing both the principle and the administration of the statute. The minority endorsed the principle, praised the Government representatives in the price adjustment boards but averred that renegotiation had served its purpose and should be repealed as to contracts made after December 31, 1943.

With attacks by certain business groups rising to a higher pitch, the House Ways and Means Committee—as part of its job in preparing the Revenue Bill of 1943—began hearings on renegotiation in September, 1943, which continued off and on during the month. This testimony ran 1100 pages. The committee's report outlined provisions for a new renegotiation act based on Section 403 of the Sixth Supplemental National Defense Appropriation Act. To the amazement of business interests, the renegotiation provisions prescribed by the House Ways and Means Committee continued renegotiation in the main as it had been conducted for nearly a year and a half. Major changes—including provision for court review of unilateral determinations and exemption of contractors having renegotiable business less than $500,000 a year—had been either recommended or endorsed by the administrative departments.

When the Senate Finance Committee had completed its hearings on renegotiation early in December of 1943, however, it soon became apparent that the majority of the committee was determined to make such changes in the House bill as would leave only an empty shell. The form would be preserved but the substance destroyed. All over the country newspapers reflected the public reaction to this attempted emasculation.

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34 Investigation of the Progress of the War Effort; Hearings before the Committee on Naval Affairs, House of Representatives, 78th Cong., 1st Sess. (Renegotiation of War Contracts), Vol. 2, June 10 through June 30, 1943.


Such a champion of private enterprise as David Lawrence at one extreme and such a “leftist” as PM at the other extreme sprang to the defense of renegotiation. Said the former:

Undoubtedly there have been some injustices and these ought to be revised by the Tax Court, or even some special court. But when a man like James Forrestal, Undersecretary of the Navy, whose peacetime job is investment banking in Wall Street, cries out against the efforts to emasculate the renegotiation law, other business men will want to ask themselves whether their tactics may not lead to a reaction and another wave of radicalism and antibusiness legislation when the servicemen come back home, and get all the facts about wartime profits.38

Another advocate of private enterprise, Mr. Arthur Krock, in commenting on the attempt to amend renegotiation out of existence, said:

If the Renegotiation Act is amended to the extent favored by the Congressional committees, war corporate profits will reach levels that, when spotlighted after the war, as they are sure to be, may infuriate the country. produce a reckless and destructive backswing against industry and start all over again the cycle of pacifism and “merchants-of-death” propaganda that helped so profoundly to send this nation unprepared into desperate war.39

The preservation of private enterprise is certainly one of my chief concerns. Any legislation that would destroy or hurt it would be inimical to such a concern. Believing that renegotiation was not only in the general public interest but was of specific benefit to industry itself and convinced that any emasculation of renegotiation would be a serious blow to both the country as a whole and industry as an important segment, I presented on behalf of myself and Senators La Follette, Connally, and Lucas a document called Minority Views.40 The response to publication of these views, which attacked certain of the provisions of the Senate bill that seemed to me to emasculate renegotiation, was instantaneous and dramatic. Newspaper editorial writers and commentators throughout the country, presumably reflecting a good cross-section of public sentiment, made it clear that the public would not stand for renegotiation emasculation. It became crystal clear that the country would not tolerate a return to World War I profiteering and that it regarded renegotiation as the only sound preventive measure so far developed.

As a consequence, the Senate and House conferees, composing their

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38 Washington Star, December 14, 1943.
differences, presented to the Congress what the *Washington Post* described as "a testimonial to the legislative process of study, discussion and compromise. It is," continued the *Post*, "a sound, workable law, acceptable to the executive agencies which must administer it and responsive to the rights of the contractors who must submit to it." 

In short, after long trial and error, the fundamental trio of considerations—material, fiscal, and moral—had been satisfied by successful legislative processes for the reasonable control of wartime profiteering.

No doubt, as time goes on, new flaws will appear in both the legislation and the administration. But as it now stands, the Renegotiation Act itself is the best solution of a difficult problem which human ingenuity and experience have been able to contrive.