June 17, 1953

Honorable Homer E. Capehart
Chairman, Committee on Banking
and Currency
United States Senate
Washington, D. C.

Dear Senator Capehart:

In the letter of April 4, 1953, from your Committee, an expression of opinion by this Administration was requested as to the merits of S. 133, a bill, "To encourage the making of contracts with the United States by requiring the inclusion of an escalator clause to provide adjustments for approved price and wage increases."

The subject bill would require that every contract entered into by the United States after the date of enactment and prior to the expiration of the Defense Production Act of 1950 include an escalator clause to permit adjustments of the contract price to be paid by the United States for articles, materials, supplies or other work to be performed under the contract so as to reflect:

(1) Changes in the cost of labor and personal services utilized in the performance of the contract, occurring after the bid date of the contract and attributable to increases in wages and salaries approved under the Defense Production Act of 1950 or permissible under such Act without approval; and

(2) Changes in the cost of materials used in performing the contract, occurring after the bid date of the contract and attributable to changes in the price to the contractor of such materials approved under the Defense Production Act of 1950 or permissible under such Act without approval.

The result of this legislation would be to cause additional costs to be incurred, which the Government would be obligated to pay, and at the same time to reduce the incentive for the contractor to seek lower costs of operation.

It would, in effect, eliminate a substantial risk normal to fluctuating business conditions which presumably the contractor considers and reflects in the bid price which he offers to the Government. The likelihood is that removal of this business risk would not be reflected in lower prices bid to the Government but rather that the additional costs involved would be superimposed upon prices already being bid.

The escalation provisions referred to in the bill as presently drafted, do not contain a maximum price limitation proviso. With an unlimited escalator clause generally in effect in all contracts, the cost of supplies could readily be increased beyond available appropriations, there being no
practical method to estimate in advance the maximum liability of the Government in such instances and to commit appropriated funds accordingly.

In general, a major objection to the use of escalator clauses in Government contracts, even where a maximum price limitation has been provided, is that they necessitate the tying up of appropriated funds to the extent of the maximum potential liability of the Government, whether such funds are used or not for that purpose, thereby depriving the Government of use of the appropriated funds for other necessary purposes.

Escalation clauses should, if used at all, work downwards, as well as upwards so that in the event of declining markets for labor, personal services, and cost of materials, the Government would receive the benefit of any savings resulting from such declines.

The proposed bill apparently contemplates only upward escalation since it refers to adjustments for approved price and wage increases, although it is vague with regard to the nature of the adjustments required because of changes in the cost of materials used in the performance of the contract. In addition to the objectionable feature of one-way escalation, the cost of administering such contracts in time and personnel required would be prohibitive.

Additional personnel such as accountants would be required to assist contracting officers to police contracts and to examine into the merits of multitudinous request for price adjustments which would grow to flood proportions in the course of a period of active fluctuation in business conditions. The operational costs in connection with the procurement of supplies would thereby be increased to an unjustifiable extent.

In view of the fact that there already exists within the authority of the contracting officer the right in appropriate cases to insert escalation provisions into particular contracts, provided that maximum limitations which define the extent of the Government's risk for appropriation purposes, are similarly inserted, it is felt that the need for additional legislation with regard thereto, is not present.

It is further felt that the indiscriminate use of escalator clauses in all contracts would seriously hamper the procurement program of the Government, and in general, be harmful to its interests. The procurement which this Administration engages in involves short term as well as long term contracts for both real and personal property, and escalation provisions are not appropriate to all the situations which arise in day to day purchasing.

The policy of this Administration has been to restrict the use of such provisions to extraordinary instances, which have been found to be few in number, and accordingly, can be appropriately treated on a case by case basis. It is believed that this policy is in the interests of the Government and should be continued.
For the foregoing reasons, this Administration is strongly opposed to the enactment of this bill.

The Bureau of the Budget has advised that there is no objection to the submission of this report to your Committee.

Sincerely yours,

/s/ EDMUND F. MANSURE
Administrator