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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-178205

MAY 22 1975



The Honorable Mike McCormack
House of Representatives

Dear Mr. McCormack:

In response to your request of May 7, 1974, and subsequent discussions with your staff, we have completed a study on the effects of oil price increases on small business contracts.

We examined 10 contracts awarded to small business concerns during fiscal years 1973 and 1974 to identify problems that small businesses were having that could be related to oil price increases and to estimate to what extent contractors' profits or their ability to perform under the terms of the contracts were affected by such increases.

We believe that the inflation experienced during fiscal years 1973 and 1974 has had an impact on profit and that the rate of inflation has been affected by the increase in the price of oil and oil-related products. We were unable, however, to isolate oil-related increases from other price increases that contributed to the inflation rate.

Your office directed us to study the effects of oil price increases through a profitability/performability assessment of a limited sample of Department of Defense small business, firm fixed-price contracts.

Initially, we reviewed four contracts and found these contracts were not oil-related to the point where increased oil prices would affect profitability or performability. One contractor stored Government-owned fuel and made the fuel available as needed. A second contractor designed and manufactured missile test stands; a third manufactured magnetron tubes for the Air Force; and a fourth contractor manufactured target tracking control systems.

Because it appeared that these contractors would not experience profitability or performability problems related to oil price increases, we selected six more small business supply contracts for review. These contracts were for fuel to be delivered to the Government.

Each of the six supply contracts contained clauses that permitted the contract price to be adjusted periodically as the market price of certain base items in the contract fluctuated. These clauses are intended

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to protect the contractor and the Government against major economic fluctuations in labor and material costs or to provide for adjustments in the event of changes in the contractor's established prices. We believe that the contractors involved in the six contracts did not incur any economic setbacks because the unit prices for the contract items increased as the price of fuel products increased. We also found no instance where these contractors were unable to provide the services called for in the contracts because of the increase in fuel product prices.

In addition, we held discussions with small business representatives from the Defense Fuel Supply Center and General Services Administration. These representatives said they did not know of any specific case in which a small business had been seriously damaged by increased oil prices. They conceded, however, that some small businesses with fixed-price contracts might have experienced profit reductions or losses due to inflation.

We noted that the Department of Defense issued Defense Procurement Circular 120 in March 1974. This circular clarified and updated an armed services procurement regulation provision. The circular covers escalation clauses and permits upward and downward revisions of contract prices, when such clauses are included, based on certain economic factors and other contingencies. In addition, the General Services Administration issued Procurement Letter 105 in January 1974, which permitted economic price adjustment in fixed-price Federal Supply Service contracts when escalation clauses are included.

1, 2 On January 23, 1975, your office requested that we inquire at the Department of Defense and the General Services Administration on the availability of data showing the extent to which the economic price adjustment clauses were being incorporated into small business contracts. 5, 17

The Department of Defense said that, from July to December 1974, there were 24,123 active fixed-price, small business defense contracts with a total dollar value of approximately \$1.8 billion. Of these contracts, 2,242, or 9.29 percent, contained economic price adjustment clauses. The total dollar value of these contracts was \$494 million. From July to December 1973, there were 23,531 active small business contracts of which 1,044, or 4.43 percent, were fixed-price contracts with economic price adjustment clauses.

Procurement officials at the General Services Administration said statistical information on the number of small business fixed-price contracts containing economic price adjustment clauses was not readily available and could be obtained only through a detailed analysis of files in their various procurement offices.

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We did not obtain official comments from the Department of Defense, the General Services Administration, or the contractors visited.

We do not plan to distribute this letter further unless you agree or publicly announce its contents.

Sincerely yours,



Comptroller General
of the United States

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