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January 10 The problems of cost determination; by Prof
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Business Administration

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DISCUSSION FOLLOWING PROFESSOR SANDERS' LECTURE

"THE PROBLEMS OF COST DETERMINATION"

1/10/36

Captain Cheever I was very glad to have the opportunity to hear Professor Sanders and in my discussion tomorrow morning, particularly in regard to the adjusted compensation contract, I shall endeavor to discuss more in detail how the rules he has brought up are applied to those contracts. I was very much interested in one remark and that is that anyone who belittles the allocation of burden shows his inexperience-but at the same time we should not advocate control of our Government contracts. We do have a difficult problem but it is not insurmountable.

Q - How do you feel about the theory of the Nye Committee regarding price fixing on M day?

A - I am afraid I am not acquainted with that theory.

Q - The idea is to freeze the prices of the basic materials, at least, as of the market price on the first day of mobilization.

A - I see now, I have read of that but did not recognize it by the name. I think it is impossible as a practical matter as long as the Treasury is following the kind of financial policies to which I have referred. If Senator Nye can control the policies of the Treasury in such manner that there will be no inflation during the war period and before that period of rising prices then he can freeze prices, but not otherwise. An attempt to freeze prices during a period of inflation would simply create another of these nation-wide bootlegging situations. I speak plainly as a private citizen.

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Q - You don't think it is possible any more than prohibition was?

A - Exactly that - and it is not due to the cussedness of our citizens. They would be squeezed between the upper and nether millstone and the contractor and manufacturer would be squeezed in between.

Q - It appears that in time of war it will be necessary for the Government to make certain contracts in which it will be vitally interested in the cost of production - the cost plus contract. Would it be possible, in your opinion, for the War Dept., in conjunction with cost accountants and industrialists, to prepare some sort of manual of cost accounting procedure - a general manual which could be applied to fit any part of industry or would it be necessary to enter into great subdivisions - prepare one manual for one section, etc? Could one be devised to cover industry as a whole?

A - I would suggest that you would not try to cover industry as a whole. It would make more difficulties than it would solve. I had thought of the other alternative - of obtaining manuals for the major industries. You know that most of our large manufacturing companies have manuals for their internal purposes. They are sometimes willing to loan them or give them to innocent college professors whom they regard as harmless. They might sometimes furnish them to the Government service. If you could make a collection of such manuals they would be a great aid. Many industries have uniform accounting and cost systems for their industry. There were 600 cost accounting systems for 600 industries. I would not want to be bothered with a cost accounting system for the ceiling wax industry, but many of the basic industries would interest

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you. However, the problems of the different industries are so different that it would make more trouble than if you would endeavor to make a uniform manual for all industries. But you have published and already available such manuals and the industries have entered upon them in good faith and for their own financial purposes.

If I might return to the previous question for a moment more -- I would not like to leave any misapprehension on this point. As a citizen and an economist, I would favor all the measures which the Treasury and the Government might take to avoid these inflationary conditions because they make for such hazards as depressions. If the Government will restrict the quantity of bonds issues - take the first measures toward the financing end - prices will automatically freeze. I am not in favor of that kind of treatment but you can't let your financing and prices run wild and then expect the Government to freeze them.

Q - The present policy of the War Dept. and the Navy Dept. is to get their supplies of non-commercial items through allocated facilities and there are some ten or twelve thousand of them. The plan is to use ordinarily 50% of the capacity of each plant. In connection with the cost accounting which has to be done in connection with the negotiated contract, considering the personnel required to check those contracts as they go through, do you think it is advisable or considered feasible to check them afterwards through audits?/

A - Cost accountants among themselves - the National Association of Accountants - when they ^{have} gotten together during the past few years, have increasingly placed emphasis on the desirability of checking the cost

currently and in advance The object is to obtain efficiency and keep down the cost, and I think that the emphasis should be placed on trying currently to supervise and control costs so that they do not get away from us, rather than simply find out afterwards If, in such a case industry should say it is impossible, then you could point to a vast body of literature in which the whole emphasis has been laid on that point of view. In other words, that effort is still worth making and you stand to accomplish a good deal.

Q - How about the number of people trained - are there sufficient now trained to carry out that inspection or how are we going about getting them?

A - There, of course, is quite a problem. In war-time there comes a scarcity of everything. You^{would} have to ally yourselves with what public bodies as there are and seek their aid. This National Association of Accountants is worthy of consideration. It has some six or seven thousand cost accountants all over the country and it would be a good idea to seek their cooperation. It would be a good start, in any case. The American Institute of Accountants is a national body representing the C.P.A. fraternity. These associations are sometimes looked upon askance as representing the interests of their clients but as a matter of fact there are a great many public spirited and honest men among them. I agree that there would be a scarcity, but that would be the direction in which to look.

Q - What about the increase in price due to scarcity. In time of peace we use sulphuric acid but in war we use nitric. Nitric acid should increase in price. What about that?

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A - Just what is the point of the question - as to whether the Government should absorb the increase? It could not be done in the freezing of prices.

Q - How are you going to adjust that increase due to scarcity?

A - It seems to me that whatever the cost, or the increase in price, if there is one, the Government has to take it, - not the private citizens.

Q - Will the closing of commodity exchanges prevent speculative prices?

A - No. the exchanges provide means for temporary running up and down but long basic movements of commodity prices are independent of exchanges.

Q - Have you ever discussed that with Mr. Baruch or could you give us any idea why he was so strong in his statement that it was absolutely necessary to fix prices?

A - He may have had in mind advocating a financial policy which would make it possible and I have tried to indicate that if you can get the Treasury to adopt a financial policy to make it possible, then all well and good. There would be tremendous pressure on the Treasury to make it easy for the nation. The way to make it easy is to inflate.