

# The Foundations of Government Contracting

Contracting professionals would do well to understand not only their position in the structure, but their place in the cycle as well, and how that cycle came to be.

BY SANDY KEENEY

## The Beginnings of American Public Procurement

Every contracting professional at some point is faced with the question, “But why is a contract with the United States so different than a contract with Wal-Mart?” The answer can be varied and prolonged, but ultimately lies in the very roots of our nation. To fully understand the profession of contract management, every practitioner would benefit from an exploration of its history. Conversely, any student of U.S. history would do well to have at least a passing understanding of federal contracting; the government is irretrievably interwoven into the national fabric. Government spending in this country has always been a primary—if sometimes unintended—driver of economic, industrial, social, and scientific development.

The interaction among the public, its government, and its contractors has evolved through the years, and the process makes a fascinating study. The relationship among them, however, has not always been friendly. The cycle of waste, fraud, and abuse on the part of both contractors and government employees has echoed down the years since colonial days. Abuses and the ensuing public scandals produce an increasing maze of government regulation. The tangle of red tape has caused responsible contractors from colonial

farmers to modern industrial suppliers to refuse to do business with the government. As one new government employee said, when first exposed to the morass of regulations, “Who in their right mind would subject themselves to this?” (Trossbach) This conundrum has threatened the success of more than one war effort in our history.

The roots of the U.S. procurement system lie in England, as does much of the rest of the U.S. legal system. Modern U.S. civilization began partly as an English separatist religious movement, but also as a safety valve for English social and political upheavals. In the wake of the Protestant reformation, English society was undergoing radical changes. On the religious front, an increasing number of church congregations wished to establish their independence from the Church of England and elect their own clergy. In the socio-political arena, more and more of the English middle class was becoming educated; but the England of the seventeenth century had few places

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to employ these ambitious young people (Cruden, xvii-xviii). The church was no longer the path to power it once was, and an officership in the military was, for the most part, open only to younger sons of the nobility.

One road to riches for unlanded but educated young men was that of government civil service. Samuel Pepys, best known for his description of the great London fire of 1666, used his connections to land a position as a clerk of the Royal Navy, equivalent to a modern contracting officer. It was an unpaid position, but Pepys soon became wealthy from the kickbacks he received from contractors. At the time, there was nothing unethical or illegal about this practice. On the contrary, it was the expected means of compensation for civil servants in a day when government budgets were neither as huge nor as regulated as today's (Siri, 1; Miller, 3). For those without the connections to land a government job in London, the New World represented an opportunity for land and profit.

The English colonists brought with them English common law, and with it, the English system of military procurement. In the mid-eighteenth century, a British field army was responsible for obtaining its supplies locally. The commissary general was responsible for the acquisition of foodstuffs and related items, while the quartermaster general was responsible for transportation, construction, and other supplies. Both of these officers had the authority to contract with local farmers and merchants. In the slightly modified American system, these officers not only were responsible for purchasing, but also for storage, shipping, and distribution. The British system was necessarily decentralized, since the central office was back in London. When the Americans adopted the same system, they adopted its problems as well—most notably a lack of a central executive authority (Nagle, 23; Huston, 3, 6).

## Running a Revolution

The Continental Congress's policy was to coordinate, not to command, the colonies. Having just thrown off one tyranny, Congress was not eager to replace it with another. In addition, the colonies had a long-standing tradition of mutual distrust—no Virginian wanted to trust his fate to any Pennsylvanian. Congress, therefore, could not tax, could not pass laws binding on all the colonies, and could not regulate commerce. Congress

was hamstrung. It did make valiant efforts to find a way to supply its troops, but it had no comprehensive, well thought-out plan (Nagle, 20-21). Trial and error was the order of the day. It soon became evident that logistics and supply would be one of the biggest battles of the war.

Congress tried to run the war through a series of committees. One of the notorious "secret committees," the Secret Committee of Trade, was established in 1775 during the English trade embargo to be responsible for military supply (Nuxoll, 1). However, under the committee system, weeks were lost in debate, and when a decision was finally made, Congress did not have the power to enforce it. Congress later appointed several general officers to be in charge of various kinds of purchases, but there was still no central oversight and the officers often worked at cross purposes. In 1779, the officers were brought together under the Board of War, but were still separated by discipline (Huston, 8).

Congress organized and re-organized the administrative system every few months, trying to find a workable process. As a result, the purchasing departments became confused and demoralized. Several quartermasters general resigned in frustration within a few months of their appointments. Some were reappointed by Congress, only to resign again. Some resignations were refused by Congress, whereupon the quartermaster simply sat down and did nothing. Disorganization and mismanagement caused the Valley Forge and Morristown debacles of starvation amidst plenty (Huston, 10-11; Nagle, 34).

While the office of quartermaster general was unpopular and difficult to fill, the position of local purchasing agent for the military was a much sought after position. The purchasing officers appointed by Congress were not military men, but businessmen. Congress deliberately chose merchants, reasoning that business acumen was required for effective acquisition. In accordance with the business practice of the day, the purchasing agent had wide authority: he could buy, sell, insure, ship, and incur debt in his client's name. The agent was paid on commission, usually a percentage of the gross value of the shipment. Most of the agents acting for Congress tried to act with integrity, since their livelihoods depended on their good reputations; but as may well be expected, some did not. In addition, the commission system left no incentive for the agent to get the best possible prices and so led to higher costs. The public came to view the position of government

officer as a path to wealth—just as it used to be in old London (Nagle, 40). Furthermore, an agent usually had both commercial and public clients, and it was not considered unethical to blend the interests of the two. Instances were recorded, however, in which agents used public money to finance private ventures, only paying the money back if the private investment was successful (Nagle, 24-26).

Nepotism and favoritism were common means of awarding contracts. Quartermasters regularly gave inside information on upcoming bids to cousins and colleagues (Nagle, 27). In a way, this practice could be justified with the arguments that the quartermasters were familiar with these peoples' past performance and so could be sure the government would be getting best value; and, that in the interest of getting supplies to the troops as quickly as possible, advance information was distributed to people the quartermaster knew in order to speed up the process. However, modern eyes will still look askance at it, especially as the quartermasters did not come away from the deal empty-handed.

Of course, not all of the shady business was coming from the government side. As Benjamin Franklin put it, "There is no kind of dishonesty into which otherwise good people more easily fall, than that of defrauding the government," (qtd. by Miller, x). Deliveries of spoiled meat, axes without heads, one-quarter size blankets, and shoes and saddles that fell apart were commonplace (Nagle, 19). Congress tried to eliminate fraud through regulation, but the resulting red tape was so burdensome and complex that it paralyzed the system.

Profiteering has been a problem in conflicts throughout history, and the American Revolution was no exception. Speculators bought up every sort of commodity from foodstuffs to arms, and held them off the market to drive up prices. As the war dragged on, inflation grew into one of the major problems facing the Continental Congress, driving the currency to the brink of extinction.

## Arms Manufacturing and the Federal Arsenal System

Many manufactured items were in short supply even at the outset of the war. The British had always discouraged colonial manufacturing, an example being the Iron Act of 1750, one of the British Navigation Acts which set ceilings on iron production ("History of the USA", 205). The colonies had

to ship their raw materials to England for manufacture into goods, which were then shipped back to the colonies at a good profit. When the British Parliament shut down arms export to the colonies in 1774, a number of colonies immediately set up public arms factories. Other colonies, however, believed in-house manufacture to be too expensive, and turned to private contractors instead—the make-or-buy debate that continues to this day. During the 18 months preceding the Declaration of Independence, Congress also established federal armories, one in Pennsylvania and one in New Jersey (Huston, 21).

After the war began in earnest, other arsenals sprang up around the country, founded both by the individual states and by Congress. Of particular note was the arsenal built in Springfield, Massachusetts, in 1777 (Huston, 33). Eventually this depot became the most important general supply depot and munitions factory in the nation. Several factories grew up around Springfield to supply the depot. Over the next decades, the Northeast became the center for the Union industrial strength that turned the tide of the Civil War some 80 years later.

Manufacturing in the 1770s, however, was still done largely by hand, by skilled craftsmen. A musket had to be created by a gunsmith, who assembled each individual weapon. Production was limited, then, to the speed and capability of the gunsmith; the best could only turn out 20 muskets a month. The shortage of arms remained a problem throughout the war, especially since returning troops liked to take their guns home with them (Kiely; Huston, 21-22).

Contributing to the shortage of manufactured goods was the shortage of labor to run the factories. Craftsmen and skilled labor were lost to military service. Some classes of labor were periodically exempted from the draft, but these exemptions were only temporary, as the army was also shorthanded. Sometimes creative sources of labor were found—Pennsylvania used prisoners of war to cast shot—but when labor was not to be found, some foundries simply ground to a halt (Nagle, 18; Huston, 23).

## Supplying the Troops

Feeding the troops was another matter. Food does not require specialized plants or highly skilled labor to produce. Food, however, does not have a long shelf life, and storage and transportation become the chief issues. Congress at various points in the war tried to coordi-

nate food supplies among the 13 states as an attempt to control spiraling prices, but ran into trouble. Each state had different systems and different definitions of a “ration,” so the commissary general could not accurately determine requirements. Congress had other problems as well. Because of the lack of hard currency and the farmers’ lack of confidence in its ability to pay, Congress could not purchase direct at the federal level. Farmers sold to the British rather than sell to Congress; the British had cash. Civilians and British soldiers had plenty to eat, and American soldiers were starving (Nagle, 18; Huston, 26).

Early on, when the war appeared to be just a skirmish to get King George’s attention, each colony was required to raise its own militias in support of the cause. Following the British example of requiring troops to purchase their own uniforms, the militiamen had to bring their own clothing, muskets, and blankets (Nagle, 16). Congress continued this practice when it began raising federal troops. The quartermaster genera five percent, to be paid for by payroll deduction. The five percent was used to finance the quartermaster general’s department. By October 1776, when the terms of enlistment of the first batch of recruits were expiring and the men were going home in droves, the system of self-supply was replaced by one in which Congress offered a suit per year for men who enlisted for the duration (Huston, 25). The states, however, were still supplying their own militias as well. As a result, suppliers to the military found themselves with 16 bidders: the British, the Continental Congress, and 13 individual states, along with the Tories, who bid up prices to devalue the Continental currency (Huston, 21; Nagle, 16-17). The ensuing bidding wars contributed to the cycle of inflation.

Domestic shortages drove buyers to seek supplies overseas. While protectionist interests frowned upon such activity, it was impossible for domestic factories to keep up with demand. Getting past British blockades was a dangerous proposition, but privateers and merchants in search of fortune made the attempt. The French provided a major source of import; even though two-thirds of the direct shipping was captured by the British, the remaining third got through. In addition, the Dutch-owned island of St. Eustatius in the West Indies became a clearinghouse for goods destined for the new United States. In exchange for American produce, Dutch ships loaded with powder and arms disguised as tea and rice set sail to supply Washington’s

armies (Huston, 19). American privateers supplied an appreciable amount of American equipment by raiding British ships and British colonies. It was a booming business. From Boston alone, 365 ships carried letters of marque, and other ports up and down the coast had fleets as well. The effort was so successful that “the Americans carried on the first two years of the war largely at British expense” (Huston, 20).

In view of the chronic shortages of both goods and currency, unit commanders had to get creative to keep their troops in the field. One such commander, General William Smallwood, in frustration with the performance of a supplier of leather goods, decided on a do-it-yourself approach: he started up a shoe factory and ran it with his own troops. Other soldiers resorted to private sources, writing home and asking their families to buy for them such commercial goods as socks, blankets, candles, and paper (Nagle, 20). And, there was always the option of impressment.

Impressment, or the direct seizure of goods for the support of the military, was, of course, highly unpopular. The idea of the pre-eminence of individual rights was deeply ingrained in colonial society, dating back to the religious separatists in England who wished to elect their own clergy. Thomas Jefferson enshrined the idea in the Declaration of Independence. When it came to running a war, though, it was sometimes a choice between individual rights and disbanding the troops for lack of supply.

General Washington found himself in an awkward position: to solve the immediate supply problem, he would have to compromise the long-term objectives of the Revolution. He would win the war but lose the peace. Washington was therefore always extremely careful to show the utmost respect for civilian authority, as is evident in all of his correspondence with Congress and the various state legislatures. Indeed, Congress at one point felt Washington was so respectful he was endangering his army. In December 1777, Congress adopted a resolution taking him to task, calling his “delicacy...highly laudable in general, [but] may on critical exigencies prove destructive to the army and prejudicial to the general liberties of America” (qtd. by Huston, 28). Congress had a right to be frustrated. Washington’s constant deferral to civilian authority, however, became one of the reasons the American Revolution is one of the few in history that did not pass into dictatorship.

Washington did sometimes use impressment, but only as the very last resort. When impressment was

necessary, Washington made sure that his officers followed due process: an impressment warrant would be issued, and the citizen could then present this document to the nearest government agent, to be paid for according to a schedule—assuming, of course, that cash was available to pay for it. When cash was not available, the government agent paid in nearly-worthless scrip (Huston, 36; Nagle, 19).

## Financial Crisis

Money was a critical problem during the Revolution. Many of the states did not impose taxes, and those that did were sketchy in their enforcement. After their experience with the British, citizens were wary of taxation in any form. Congress did not have the power to tax, but relied on the states for funding (Huston, 66). Congress also did not have an established procurement system, and what procedures it did have were being continually reorganized. The supply system became more and more ineffective because of the country's financial problems and the resulting lack of faith in Continental currency. By 1780, the crisis was at its peak.

Troops were in a state of mutiny over lack of food and clothing, an ever-increasing amount of wages in arrears, and the decline in purchasing power of those wages (“History of the USA”, 214). In an effort to shore up their salaries, army officers began selling off military stores, already in short supply. The army had no cash and no credit. Washington was in despair, writing to the Executive Council of Pennsylvania, “...all our operations are at a stand...our affairs must soon become desperate beyond the possibility of recovery...I have almost ceased to hope” (qtd. by Huston, 65).

Congress set up a plan whereby the states were to provide “specific supplies” to the Continental Army, establishing quotas for each state. In effect, Congress was organizing a barter system. It seemed like a good idea. Congress, however, did not have the power to pass binding legislation, and relied on the states to cooperate. States that could not collect taxes passed by their own legislatures could not be expected to follow through on a supply system passed by Congress. Administration of a program involving 13 separate governments turned into a bureaucratic nightmare. The “specific supply” system soon collapsed. With the army's survival at stake, the French minister prevailed upon a group of Philadelphia merchants to form a bank to extend credit to the government (Huston, 67–68).

Driven to their wits' end, Congress finally surrendered to the obvious solution of centralized purchasing authority. The Act of February 6, 1781 again reorganized the government, this time with three executive departments: Treasury, Marine, and War, with Treasury to be headed by a superintendent of finance. Congress elected Robert Morris to fill that position. Morris, a wealthy Philadelphia merchant and banker who later became widely known as the “patriot financier,” at first refused the job. After some persuasion, Morris accepted, on the condition that he could keep his private business interests. Congress was reluctant to accept these terms, concerned about the potential conflict of interest; however, when Morris made it clear that he would not accept otherwise, Congress agreed (Huston, 70).

Morris has been a controversial figure in the history of the Revolution. Some historians portray him as the ultimate profiteer, using the war to finance his mercantile house of Willing & Morris (Miller, 72–77). Others go to the opposite extreme, claiming Morris disguised his government purchases as part of the operations of Willing & Morris “both for security reasons and to reduce the inflated prices that merchants routinely charged the government” (Nuxoll, 1). The truth probably lies somewhere in between. In any case, the fact remains that after Morris took over the Treasury Department, the Revolution's financial condition began to improve immediately.

One of Morris's improvements was the overhaul of the contract system. He put in place a system that would be very recognizable to today's contract professionals. Invitations for bids would be put about to “respected business people” (“Construction Contracting”, 1–2), remaining open until a specific date. The bids would then be opened, negotiated, and awarded. Morris had two evaluation criteria: the bidders must be “men of substance and talents,” and the terms must be “most beneficial to the public” (qtd. by Nagle, 49, 50). To put this in modern terms, the bidders must be responsible and must present the best value to the government by offering the best combination of price and payment terms. Morris's contracts put responsibility for storage and transport back onto the contractors, and also included provisions for dispute resolution and quality assurance inspections (Nagle, 48, 50).

While Morris's system was far from perfect—fraud was still a problem—it was a vast improvement over the previous arrangement. With someone in charge, the

United States began to look like a slightly better credit risk, and foreign governments anxious to unseat British control in the Americas became more willing to send money. Large loans from France and Holland in particular carried the American army through the end of the war (Huston, 70).

## Post-revolution Reorganization

After the British surrender, demobilization did not take long. The country was tired of war. Many citizens felt a large standing army was a threat to states' rights and individual liberty, so the army was almost completely disbanded and responsibility for defense was returned to the state militias. In the years between the Revolution and the War of 1812, the U.S. Army was never more than four regiments (Huston, 100, 102).

The commissary general and the quartermaster general were honorably discharged, as these posts were considered staff positions only necessary during war. In 1785, Congress replaced Robert Morris with a three-man Board of Treasury, which was to be responsible for military stores. The secretary of war would be responsible for transportation, storage, and distribution. A network of contract agents assigned by geographic area did the actual buying. The Board of Treasury continued Morris's system of formal advertisement, with contracts containing clauses for arbitration and inspection. Contractors were paid five percent of expenses, payable every six months. These procedures worked fairly well, but the government still had financial problems and periodically had to abandon contracts for lack of funds. In addition, there was no system of accountability for the agents and their assistants, and as a result, large property losses were incurred (Nagle, 55–56).

The old distrust between the states soon led to the disintegration of the Articles of Confederation, and in 1787, the U.S. Constitution established a strong central government to stand in the place of the English sovereign ("History of the USA", 217). Among other powers given to the federal government, Article 1, Section 8, of the Constitution granted the authority to "provide for the common defense and general welfare of the United States," "to raise and support armies," and "to provide and maintain a navy." In an effort to keep this power under control, the Constitution also provides that "no appropriation of money to that use shall be for a longer term than two years." Case law has interpreted this limitation to refer to consumable items

such as food and clothing, but not to "means for attack or defense" such as weapons (McDonald, II–1).

Congress busily began to form a government. In 1789, the Department of War was formed under Henry Knox, with jurisdiction over the army and navy, and the Department of the Treasury was established under Alexander Hamilton (Nagle, 60; Huston, 86). Neither department had a formal mandate to supply the troops, so they both did. Formal advertisement was still the preferred method of contracting, but Hamilton put in place a system of advance payments to enable more contractors to bid on government work (Nagle, 60–61).

This system was adequate until the nation faced its first test—the 1790 Native American uprisings in Pennsylvania and Kentucky. The campaign was a complete disaster. Bad communications resulted in suppliers unable to find the troops they were supposed to supply. Advance payments were made to contractors who kept the money and provided no goods. State militias called up to assist the regular army were untrained and undisciplined, and unwilling to serve under federal commanders. Finally, in November of 1791, with the supply system in collapse and the troops in disarray, Native Americans won their biggest victory in history over the U.S. Army, with more than half of the U.S. force killed (Matloff, 112). The debacle triggered the country's first Congressional investigation, the results of which produced another reorganization of the procurement system. Advance payments were prohibited, and military procurement was brought under the exclusive control of the Treasury Department; the secretary of war no longer had the authority to purchase, but had to send supply requisitions to the Treasury Department (Nagle, 65). Military purchasing reverted to the War Department in 1798, however, with Treasury retaining audit authority (McDonald, II–1; Huston, 89).

## Early Procurement Practices

From 1798 into the new nineteenth century, many now-familiar contracting practices came into being. The first requirements contracts were put in place to address the difficulties of supplying troops on the Western frontier. The distances involved, over bad roads or no roads, with dangers from wild animals, bandits, and hostile Native Americans, made troop supply very expensive. Contracts required contractors to supply the post with rations for a specified number of months. If

the troops moved, the government would move the supplies; but the troops could move without notice, leaving the contractor with unneeded supplies on hand. The government gave “good faith” estimates, but no guarantees—the requirements contract—and if the contractor failed to deliver, the government could re-procure and charge the contractor (Nagle, 69).

Government-furnished material was first used when uniform contractors could not deliver on time because they could not get enough cloth. The government began purchasing their own cloth, and then contracting with tailors to make the finished uniforms. The tailors were paid only if the uniforms passed a quality inspection (Nagle, 69). Uniform quality improved markedly under this system.

The oldest procurement regulation still in existence was passed by Congress in 1808. Legislators had long been in the habit of securing contracts for friends and relations, or for businesses in which they had interest. The “Officials Not to Benefit” statute prohibited members of Congress from benefiting directly or indirectly from a government contract. Over the years, the statute was brought forward into the *Armed Services Procurement Regulations* and then into the *Federal Acquisition Regulation* under FAR Clause 52.203-1. It was removed from Part 52 in 1995, and incorporated into the procurement integrity sections of FAR Part 3 (Federal Register). It is codified in Title 18 USC §431.

Congress’s first effort to regulate the procurement process with a statute that applied equally to all agencies of the government was the Act of March 3, 1809. This act required the use of formal advertising, which prior to the act had only been used by Robert Morris’s precedent. The act also established an early version of a contracting officer, who had both purchasing and payment authority. Since this officer had more or less total control over the entire purchasing process, the act required that the officer be bonded, must be appointed by the president with the consent of the Senate, and must submit his accounts to audit by the Treasury Department (Nagle, 71).

Congress began venturing into the employment practices of its contractors in 1799, by declaring that only “free white” persons could carry the mail. This unfortunate statute also carried the first rewards for whistleblowers: persons found guilty under this statute were to be fined \$50 per violation, with half going to the government and half to the person reporting the violation (Nagle, 72).

## Expanding the Defense Industry

The “military–industrial complex” that Dwight Eisenhower was to warn against in the mid-twentieth century was, in the late eighteenth century, rather simple. Colonial manufacturing was very limited, and during the Revolution domestic manufacturing could not keep up with demand. After the war, Alexander Hamilton in his role as secretary of the Treasury began advocating the use of the new Constitutional powers of the government to encourage the development of a domestic arms industry. His 1791 “Report on Manufactures” caused an uproar at the time (Huston, 93), but over the years many of its recommendations were adopted. In 1794, Congress expanded the national armory system, including one at Harpers Ferry, Virginia, and in 1798, began once again contracting with private arms manufacturers.

The armory in Springfield, Massachusetts, had become the hub of a large manufacturing region. One of the oldest companies in this country has its roots in this area. E.I. du Pont de Nemours & Company was founded in 1802 in Wilmington, Delaware, to manufacture gunpowder. DuPont has been a defense contractor ever since (“DuPont Heritage”). Other weapons producers in the Northeast at the turn of the nineteenth century included pistol and sword makers in Connecticut, two musket manufacturers in Massachusetts, a rifle factory in Pennsylvania, and the Whitney Armory in Mill Rock, Connecticut.

In 1798, Eli Whitney of cotton gin fame needed money. The textile business was suffering a downturn. To tide him over the hard times, Whitney sent a letter to the secretary of the Treasury, offering to manufacture muskets for the government. Whitney had never made guns, but he was familiar with some advances in mass production being made in French factories, and he had some theories of his own that he wanted to try. On the basis of his “skill in mechanic” (qtd. by Nagle, 76) Whitney won a two-year contract to produce 10,000 muskets. It took him 11 years to deliver. When he was finished, Whitney had revolutionized gun manufacture.

Whitney’s innovation was the use of jigs and dies to produce standardized parts, any of which could be assembled to produce a standard weapon. Before Whitney, guns could only be produced by a skilled gunsmith. After Whitney, quality weapons could be produced by ordinary factory labor in a fraction of the time and at a fraction of the cost (Huston, 95). Field repair was also much simpler, as spare parts did not have to be filed down to fit individual weapons.

The American defense industry was off to a good start, but it was still in its infancy. Most of the factories of early nineteenth century America were small shops run by a single owner or a group of partners, and were susceptible to failure. Many early contracts had to be terminated for default. When the War of 1812 came along, domestic manufacturers still did not have the capacity to outfit the army, and the perennial make-or-buy debate reappeared.

### The Battle of Whitney and Irvine

The new commissary general of purchases, Callendar Irvine, did not like contractors; he thought they were all crooked and greedy, paying “slave wages” to produce inferior goods and increase profits at the public’s expense. Irvine wanted to bring all public manufacture under public purview, “under the superintendence of one judicious and independent man” (qtd. by Nagle, 92). One may assume that he meant himself to be that man. Others in the government were not convinced of the benefits of in-house manufacture, but Irvine began to implement his plan in the making of uniforms. Abandoning the practice of issuing government-furnished fabric to master tailors who supervised assembly, Irvine hired men to cut out the uniforms, issued the pieces directly to those who made them, and paid the assemblers a fair wage (Nagle, 89). This was the first government attempt to set wage standards, a precursor of today’s Walsh-Healey, Davis-Bacon, and Service Contract Acts.

Irvine was an irascible crusader against contractors, campaigning to void their contracts whenever possible. He never minced words when they complained of “having a hard bargain,” accusing “these gentry” of never having intended to perform, but only to “get possession of the public money.” He wrote to the secretary of war, “The Govt. [sic] has been trifled with long enough, in all conscience, by these contractors” (qtd. by Nagle, 91, 92).

Some businessmen surrendered under Irvine’s attacks and simply got out of the government business. Eli Whitney came out fighting. Whitney, admittedly slow to get out of the blocks on his first contract, was now an established producer of muskets. Irvine tried to terminate Whitney’s current contract on the grounds that his muskets were inferior because they did not incorporate the latest technology. Whitney’s contract specified producing muskets patterned after a

specific, established model. Whitney replied that he was following his contract, stating, “From this standard, I consider myself as having no right to deviate” (qtd. by Nagle, 92). He stated further that the muskets met specifications to the satisfaction of the government inspector, and if the government had wanted different specifications they should have said so in the contract. A hot exchange of letters ensued, with Irvine demanding a return of the government’s progress payments with interest and declaring the contract “at an end,” and Whitney replying, “I cannot comprehend how one party can have a right to revoke the contract, which does not equally appertain to the other party” (qtd. by Nagle, 93).

The dispute raged for several months, during which Whitney continued to produce his muskets. Irvine refused to send an inspector to his plant, claiming that the contract had been terminated. At last Whitney appealed directly to President Madison. Madison consulted with the secretary of war, who sent the chief of ordnance out to Whitney’s factory. After he inspected the guns, the chief of ordnance wrote to the secretary, “I think his arms as good, if not superior, to those which have in general been made anywhere else in the United States” (qtd. by Nagle, 94). Whitney’s contract was reinstated over Irvine’s protests, and Irvine was warned that suppliers should not be driven out of business; the nation needed them. With the 1812 war with Britain at its height, the United States had to buy a quarter of its supplies overseas—although this was not due entirely from lack of industrial capacity. Many domestic suppliers simply refused to do further business with the government. Farmers even sold their produce to the British rather than to the Americans, because they were easier to deal with.

### Arms Manufacture and the Industrial Revolution

After the war, the government began to adopt policies that would nurture domestic production. In an effort to keep private arms manufacturers in business, the government introduced an early version of option years by renewing a contract if performance was satisfactory and the price was at least as good as other bids received. This policy, however, had its good points and bad points for both sides. For the government, it ensured an additional source of supply and promoted a “spirit of cooperation” (Huston, 117); but the government was receiving some guns that many considered to be inferior to those made

by the armories, at a higher price. From the contractor's point of view, the new policy guaranteed business as long as he adhered to the contract; but since he often had only one customer, he was at the mercy of that customer's shifts in policy and notorious inertia.

The make-or-buy argument has been around since the Revolution, with a modern iteration in the *Circular No. A-76*, from the Office of Management and Budget. Through the first half of the nineteenth century, opinion shifted back and forth as to the best combination of public and private manufacture. The national armory system was expanded again in the years after the War of 1812, as they were a cheaper source of supply: private manufacturers typically had higher prices and cost more to administer because they had to be inspected. Private manufacturers were more likely to experiment and innovate with new methods and materials, however, and the armories could serve as a price check to curb gouging (Huston, 114, 117–118).

The 1815 Ordnance Department Act, signed just before the end of the war, authorized the drafting of regulations for the “uniformity of manufactures of all arms” (qtd. by Nagle, 109). This system of uniformity among manufacturers, both public and private, would have a profound impact on American industry. The regulations put in place as a result of the act allowed innovations to be dispersed among all manufacturers, both public and private. Even patents obtained before a contract award could be included—one contract signed in 1818 included a stipulation that a method of motive power patented before the war could be used by any manufacturer working for the government (Nagle, 82).

One process that fell under these regulations was Eli Whitney's method for standardization and interchangeability of parts. Initially the armories resisted the new process, claiming interchangeability was convenient but unnecessary and the tooling changes required were too expensive (Huston, 114). Eventually, the process was adopted throughout the industry. The Springfield armory built further on the technique, developing a method of gauging that was forced on all manufacturers. Now parts were interchangeable even between guns made by different factories (Nagle, 110). Since the armories were open shops, anybody could come in and get plans and drawings for whatever processes were in use. New manufacturing skills that had begun in France and were improved by Whitney spread rapidly through civilian industries and inspired further development, taking the U.S. into the Industrial Revolution.

## Abuse and Regulation

Contracting procedures were evolving right alongside manufacturing techniques. New structure and formalization was being put in place, often in response to abuse of the public treasury. Prior to 1820, for example, heads of departments could enter into contracts before having available funding. After one disastrous contract in which the contractor presented a bill far beyond what was originally anticipated, Congress added an amendment to the 1820 Military Appropriation forbidding government officials from contracting without fiscal authority. As Congressman McCoy of Virginia put it, “Contracts should not be made in anticipation of appropriations because circumstances might arise...that would prevent Congress from appropriating the funds,” (qtd. by Nagle, 108). Modern contract managers will recognize this as an ancestor of the Anti-Deficiency Act of 1982.

In 1821, the General Regulations for the Army only specified what was to be purchased, not how. The regulations issued in 1825 contained a detailed procedure for sealed bidding, with contractor bonding requirements and payment instructions. The trend for tightening regulations continued throughout the years leading up to the Civil War. The 1857 General Regulations of the Army were the tightest yet, and were imposed on all government agencies in 1860, by an amendment offered by then-Senator Jefferson Davis (McDonald, II–2). The straitened structure of government business now required detailed record-keeping, multiple copies of standard forms, and strict accounting procedures. Formal advertising was also required for all procurement, with only two exceptions—(1) personal services, or (2) when “immediate delivery or performance is required by the public exigency” (qtd. by Nagle, 167). The Civil Sundries Appropriations Act of 1861 further solidified the regulations, and became the primary procurement procedure used during the Civil War. This act, upon revision and amendment in the 1870s, became Revised Statute 3709, which stayed in effect until replaced by the Armed Services Procurement Act in 1947 (McDonald, II–3).

As might be expected, increased regulation resulted in increased disputes. Before the 1850s, a contractor's rights were limited by the principle of sovereign immunity. The 1855 Tucker Act established the Court of Claims to “render judgment upon any claim against the United States founded either upon the Constitution, or any act of Congress

or any regulation of an executive department, or upon any express or implied contract with the United States..." (28 USC §1491(a)(1)), thereby waiving sovereign immunity in these instances. The act has been revised by Congress and clarified by case law (in particular, *Cooke v. United States* in 1875), but is still current today (Nash, Cibinic, O'Brien, 863).

## An Explosion of Chaos and Rampant Fraud

With contracting procedures in 1861 structured for accountability and competition, the process was somewhat less prone to fraud, but much more cumbersome. The coming of the Civil War almost immediately overloaded the infrastructure.

As is often the case, initial public enthusiasm was for raising troops, not raising supplies. As Lincoln stated in his address to Congress on July 4, 1861, "...one of the great perplexities of the government is to avoid receiving troops faster than it can provide for them" (qtd. by Huston, 161). At the beginning of the war, the federal government was in disarray. Many long-term civilian employees left Washington to serve Richmond; those who were left were unsure who was in charge of what, since nowhere was the division of duties clearly spelled out. In any case, large federal armies were still regarded with suspicion by the public, and loyalties to the states were still stronger than loyalties to the nation. In addition, the states were better able to raise supplies than Washington, being closer to the sources, less regulated, and fully staffed. Early mobilization, therefore, relied more on state militias than on the regular army (Huston, 164).

Early procurement in the Civil War was disorganized and chaotic. William LeDuc, a merchant who volunteered for the quartermaster corps, noted that he went "from the steady going ways of civil life into the very vortex of the cyclone of army life" (LeDuc, 68). In the heat of the emergency, citing the "public exigency" exception in the Civil Sundries Act, formal advertising requirements were thrown to the wind, and purchasing officers launched a bidding war. Agents for both Washington and Richmond, agents from both Union and Confederate states, and private individuals on both sides all tried to purchase the same goods, thus driving prices up and quality down (Nagle, 176). Soon all pretense of procedure was abandoned and a free-for-all ensued. Previously

honest businessmen became "rapacious profiteers" who, according to one official, "hurried to the assault on the treasury, like a cloud of locusts" (qtd. by Nagle, 177).

Profiteering and fraud were the hallmarks of government business during the Civil War. Hasty mobilization, loose enforcement, large-scale emergency buys, and lack of coordination at the federal level led to a situation very attractive to people looking for a quick fortune (Huston, 180). J.P. Morgan was one example among many. In 1861, before hostilities broke out, the government auctioned off 5,000 obsolete and dangerous guns. Morgan, through an agent, bought them for \$3.50 each. He then turned around and sold them as new to General Fremont in St. Louis for \$22 each. When soldiers tried to fire them, they exploded as often as not. When the government refused to pay, Morgan sued in the Court of Claims. Morgan won the suit; even if it had gotten a bad deal, the court said, the government had signed the contract (Nagle, 193).

Other rifles delivered on contract were equally bad, even if they really were of new manufacture: stocks made of raw, unseasoned wood shrank until the fittings fell off; hammers broke; parts came off at a touch; barrels burst during target practice; bayonets bent or broke off during drill (Nagle, 192). Shoes were made of "leather composition," a material that looked and felt like leather but fell apart when wet (Nagle, 198). Shoe soles were found to be filled with chips. One soldier complained that the Southern gravel was very sharp, and cut right through the "contract-made shoes" that he was supplied (LeDuc, 123).

Uniforms, however, were of such poor quality that they became a byword. The cloth was made from "shoddy," a trade term for fabric made from scraps of material that had been ground up, respun, and rewoven. Like leather composition in shoes, shoddy looked and felt like good cloth. But, after a little wear or a little rain, it fell apart in rags. "Shoddy" came to be synonymous with poor quality (Nagle, 198).

Political favoritism was a widespread problem in all levels of the government. In the chaos of 1861, the secretary of war bypassed the regulations and appointed friends and loyal republicans into vacant purchasing offices. One particularly incompetent appointee spent \$21,000 on linen pantaloons and straw hats for the troops because summer was coming on (Nagle, 184). The pantaloons may have held up better than shoddy, anyway, and certainly

would have looked sportier.

In July of 1861, public outcry against fraud launched an investigation led by a Congressional committee chaired by Charles H. Van Wyck of New York (Huston, 180). After a year-long inquiry, their report compared contractor behavior to outright treason, and demanded further regulation. As Huston notes, “Fear of fraud has always been one of the major causes of government red tape” (181). Others in the government argued that more legislation would only bog down the process. New laws were enacted over the protests, however, as Congress had to be seen to be doing something. In 1862, legislation was passed requiring all contracts to be written out in full, signed, and filed in a central office together with all bids, proposals, and advertisements. The contracting officer was then required to execute affidavits attesting to the authenticity of the contract file. This presented a particular encumbrance to those quartermasters who were using the new telegraph to speed up acquisition, such as the one who sent a wire to the Colt Patent Firearms Manufacturing Company in May of 1861, reading only, “Deliver the 500 pistols to major Thornton at NY Arsenal. For further orders, wait mail” (qtd. by Nagle, 177). Under the new law, such expediency was illegal. Opponents of the new rules pointed out that anybody who wants to steal will do so, and will do whatever paperwork is necessary to cover the trail (Nagle, 195–196). Later in 1862, Congress also extended army regulations—up to and including court-martial—to apply to anyone supplying the army.

Most of these regulations were only loosely enforced and soon of necessity went by the wayside. One that has endured to this day, however, is the False Claims Act. Enacted in 1863 at the height of the war, it imposed criminal and civil penalties for submitting a false or fraudulent claim for payment to the government. The act awarded to a citizen reporting such a claim 50 percent of the amount recovered, which could run up to triple the amount of damages (31 USC §3729 (a)(7)).

## The Role of Industry in the Civil War

Despite the persistent recurrence of fraud, not all contractors were dishonest. American arms manufactured by Colt and Remington, among others, were world-famous and were regularly supplied to troops. During the years before the war, foreign delegations often visited the United States to tour munitions plants, and at the 1851 World’s Fair in

London, American rifles won a number of medals (Nagle, 171). While American manufacturers increased production tremendously after the war began, they still could not keep up with demand, and early battles proved that more weapons were needed immediately. Therefore, agents from both the North and the South flooded into Europe, buying up guns previously bought from the United States. Here the North fell victim to the shortsighted optimism that characterized much of the early Union strategy. Union agents bought up only existing weapons with no consideration for long-term needs, sometimes paying exorbitant prices for old, obsolete weapons. Confederate agents, on the other hand, contracted with the best factories in England for the coveted British Enfield rifles, and so were at least briefly better supplied than the Union (Huston, 179).

The Civil War was the first truly industrial war in U.S. history. Even though the Union was graced with a number of incompetent generals, in the long term the strength of its industrial base won the war. The South lost because its economy was based on a one-crop agricultural system, and it could not support a protracted war (McDonald, II–2). Fully aware of its limits, the Confederacy hoped to win a quick and decisive victory and avoid that protracted war. Jefferson Davis acted quickly to solve the initial supply problem after his election as president of the Confederate States in February 1861. He authorized agents to go north and buy as much ammunition, firearms, and machinery as they could, and bring back as many skilled armorers and machinists as they could find. Large quantities of powder were ordered from DuPont, the country’s main producer; DuPont shipped the orders until Fort Sumter fell in April. After the company cut them off, the South seized all of DuPont’s Southern warehouses (Nagle, 187). The arms embargo imposed by the North later that month cut off other shipments, but the South had already had six weeks’ worth of deliveries. When Confederate troops raided Harpers Ferry Arsenal that spring, they captured its rifle-making machinery and destroyed the armory, thereby eliminating one-half of the existing government-owned small arms manufacturing capacity (Nagle, 178–179).

When the quick and decisive victory they hoped for was not forthcoming, the South began to have many of the same problems as the North in regards to fraud and profiteering, along with some problems left

over from the Revolution: a weak central government with a weak currency and a poor financial system; and plenty of raw material but not enough factories and labor to convert it into goods. Government-sponsored incentives for building new plants fell short of the goal, especially as manpower began to dwindle. When existing taxes did not raise enough funds, the Confederate government simply printed more money instead of raising taxes; the result, as in the Revolution, was runaway inflation. By 1863, when the Union was finally hitting its stride in production, Confederate manufacture was declining, with shortages increasing everywhere (Woodworth, 1). As Davis had feared, a long war meant a long slide into oblivion.

No other war in American history, even World War II, can match the proportions of the Civil War. The Union Army expanded over 62 times, from 16,000 men in 1861, to over one million in 1865. Union expenditures expanded over 45 times, from \$23 million to over \$1 billion; the Confederacy also spent over \$1 billion (Huston, 175; Woodworth, 1). In addition, society looked completely different after the war. Mass production was now the standard instead of the exception, with factory methods introduced across the civilian market.

In the defense market, however, industrialization has its consequences. More complex weapons are more expensive, and fewer companies can produce them. Barriers to market entry are high. Mobilization will therefore take longer, and a war effort can no longer be mounted from a standing start. Larger standing armies must be maintained during peacetime, and we then have the military-industrial complex about which Eisenhower warned us.

## Lessons of History

In government contracting, history presents itself as a series of cycles: the country faces a big emergency such as war, or a major task such as landing a man on the moon; industry steps up to the task; as initial public enthusiasm wanes and the task settles in to performance, complaints about quality and cost ensue; fraud is unearthed and scandal follows, resulting in increased regulation; competition is reduced as companies leave the business; regulations are streamlined to bring competition back. Certain debates recur in each generation as well, and each generation tries to find their own balance: make or buy, protectionism or free trade, strict regulation or ease of administration,

appropriate ethical standards, and fair profits.

The basic difference between contracting with Wal-Mart and contracting with the U.S. government is this: when Wal-Mart signs a contract, it is only guarding its own interests. When the United States signs a contract, it is guarding the public's interest. With a long history of abuses behind it, the government is understandably cautious of getting burned again; hence, the rigid purchasing structure that tries to contain the fire. That rigid structure also protects the contractor to some extent, for as Callendar Irvine was shown, industry is in the public's interest. William LeDuc, the merchant-turned-quartermaster from the Civil War, remarked, "War is business, and the best business capacity, backed by the longest purse, is sure to win" (65). Contracting professionals would do well to understand not only their position in the structure, but their place in the cycle as well, and how that cycle came to be. *JCM*

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