

Benefits of the Contract Method to County Highway Programs

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INTRODUCTION

The other day, former Gov. Harold Handley made a talk to the 18th Annual Purdue University Management Conference and he had some sage remarks about how we should accentuate our push for free enterprise.

He said: "American business must promote the value of the free enterprise system or face continued bureaucratic erosion. It's time to sell, market, and promote the one most important commodity we have in America today—the free enterprise system."

Governor Handley's comments are timely and are certainly germane to this paper. This is true because the free enterprise method of construction by contract after competitive bidding—where it is in the public interest—is in keeping with the American economic system.

Most everyone will agree that it fosters ingenuity consistent with sound business practice. Our highway system in America constitutes an outstanding example of the American free enterprise system in action. Although highways are public property, administered by governmental highway departments, they are practically all built by private contractors.

The results speak for themselves. Our country has the finest highways in the world and we are making them better and safer than ever.

The debate over the advantages of public works construction by private contract or by a county's own forces is an old one. Certainly it has been waging for as long as I can remember and it will probably go on for as long as anyone can forecast.

Sometime somewhere—hopefully in this area—we will see an end to unjustified government competition with private business.

Contract Versus Force Account

Force account is construction done by county or city employees using county- or city-owned equipment. Oftentimes, it is called day-

labor construction. The opposite of this method of construction is the contract method where a county, in effect, hires a private contractor to build a bridge or a road on the basis of his proposal to do the work at a certain price—a price which is determined after open competitive bidding. The difference between the two methods is, in short, a matter of government competition with private business.

Many will agree that any appraisal of force account construction of public works must recognize that such activity is actually government in business. Force account—in its truest sense—depends pretty much on the same philosophy that guides the most ardent socialist in his preaching for government ownership and control as a panacea to all industrial ills.

This is not to condemn force account construction by simply calling it socialism. On the county highway level there are certain kinds of jobs that in the public interest can be done better by force account than by construction by contract. Maintenance work for example, or jobs that can be pursued without the necessity of investing heavily in expensive equipment. I do contend, however, that no industrial operation can survive indefinitely if it is based on rules directly contrary to sound economics and normal human behavior.

History of Contract and Force Account Construction

History records that force account construction came about largely because, at the time the country was very young, contract construction was limited to a small field of contractors willing to bid upon such work because of its uncertainties.

Because of the small number of private contractors, public agencies proceeded to organize construction units and started to build their own streets and roads. This type of construction continued until the same public agencies became aware of the rapid development of the private construction industry and were receiving bids lower than the costs they were experiencing.

During the mid 1930's, an experiment was conducted by the Bureau of Public Roads when 53 highway projects were selected for force account construction operations. These projects were picked after bids from private construction firms had been received and opened. The purpose of the experiment was to document the work cost when performed by day labor and compare it with what it would have cost if let to contract. Since the choice of these particular projects was made by chance, no slanting of bid figures by contractors was possible.

The costs secured and the dates of completion of the projects under force account construction left no doubt concerning the economical

advantages of the contract method of doing such work. In fact, total costs of the projects in the experiment averaged 18 percent above the bids of private industry, with several jobs going as high as 85 percent above the contractors' quotations.

The standard of living here in the United States has been built upon a free economy made possible by our particular type of government and implemented by an open competitive market. Widespread construction of public works by contract became a possibility both by reason of this freedom of individual effort and the rewards attainable from such efforts.

This has been made possible by American individualism rather than European collectivism. There may be critics of our economic practice of free competition, but I submit that no one speaks against the standard of living it has made possible.

The Associated General Contractors of America, along with several other trade associations and private business groups, is one of the leading proponents of the contract method for public works construction. And the AGC has overwhelming evidence to answer the argument that there are advantages in having a municipality's construction work performed by the county's own forces.

The battle against day labor by governmental agencies, starting in about 1918, was aimed primarily at the Corps of Engineers and the Bureau of Reclamation, both of which handled nearly all their new construction projects on a force account basis.

Today, these agencies perform more than 98 percent of their construction work by contract. In addition, the greater part of work done for state governments is let to contract.

In spite of the odds, many municipalities insist on doing their own construction work. I mean big jobs—like bridge construction and the building or reconstruction of long stretches of roads. Why do they do this? What is the big attraction they see that private industry does not?

Governments often say they do force account in order to provide a cost yardstick by which the county can measure bids submitted by private contractors on jobs the county has done by contract.

This, of course, can and should be done by the engineer's estimate of the job. Moreover, the accounting methods used by counties and by contractors differ so widely there can hardly be a fair comparison for yardstick purposes.

Some county governments also say that many of their jobs are too small to bother with writing up detailed specifications and asking for

bids. It is contended by some officials promoting force account construction that such work frees the county from contractor's profit and that the county will be further exempted from the many taxes the contractor normally assumes.

Savings such as these, however, are small indeed and are completely washed out when organizational competition and individual initiative is considered. Observations of industrial progress have shown repeatedly that progress does not flourish without competition and that when individual initiative is removed from the work, it is replaced by mental, physical and moral indolence. This normal human behavior is the basic reason for the success experienced in construction by contract. The lack of initiative can lead only to a dead-end street.

ADVANTAGES OF CONTRACT WORK

Consider now some specific advantages of contract work. First, the contractor undertakes to carry out the work at his bid price. He accepts all insurable risks and liabilities from injuries sustained on the job. His bid is guaranteed by approved sureties. Thus the cost of a project is known with reasonable certainty *before* construction starts. Since the contractor hopes to earn a profit from the job, the county can be assured that his bid figures represent the real cost of the job.

In addition, the contractor's very existence depends in a large part on his equipment. His profit or loss reflects in no small measure on his equipment. It must make money for him. Due to accelerated depreciation rates and longer operating time on his equipment, his operating costs are lower. I understand that the depreciation policies now being followed by the Internal Revenue Service have a tendency to favor the contractor who follows a consistent policy of upgrading his equipment. Recent tax changes help him through quicker tax write-offs and investment credits.

Contrast this with the usual public agency's method of depreciation. Here there is no tax policy involved, only the process of writing off the initial investment. Write-offs are usually either a straight yearly depreciation or a percentage of the residual value.

Whatever method employed, a public agency usually extracts the last full measure of devotion from a piece of equipment. To be competitive, the contractor has to have up-to-date, efficient, automated equipment. Examples of some of this equipment are the automated concrete batching plant and the central mixing plant. Better equipment, specialized equipment, automated equipment give better results and also aid in lowering the costs.

I recall some time ago asking a county highway engineer the cost of a certain project. "Practically nothing," was his reply. "We own our gravel pit, so the aggregates cost us nothing. All the equipment is ours, so that's free. Our men work by the year, so we don't have to charge them to this project. Our only cost is for the asphalt we used."

If the cost of any project is figured on such logic, then it will be a little more expensive to contract the work. But when a *true* cost accounting procedure is used in which direct labor charges, direct equipment charges, all material costs, all engineering charges, fringe benefits, and all overhead are carefully accounted, then the price of contract work is more favorable. In many cases, contract work is lower.

Through long experience, contractors become specialists in one or more particular fields of construction. They know their sources of supply; they know the capacity of their machines and the capability of their men. When a contractor prepares his bid, he devotes much thought to the problem of devising the best and most economical manner of doing the work. His specialized knowledge and experience may be instrumental in saving money on the job.

When a contractor agrees to do a certain job under contract, he must agree that the project be completed on a prescribed date. He cannot receive final payment or the release of money that is retained while the work is progressing until the job has been completed to the satisfaction of the county or the city. In addition, the contractor sometimes is made subject to heavy penalties for each day of work over the stipulated time of the project. This factor, plus his own office overhead, gives assurances to the county that the job will be completed on time.

Third, the quality of workmanship and materials is guaranteed by the contract system. The materials which go into the project are prescribed in detail in the specifications and are subject to the approval of the county engineer. If, in the engineer's opinion, the workmanship or the materials are not satisfactory he can reject the work and order it redone at the contractor's expense.

It is the practice of some counties to require the contractor to maintain the project in good condition for a period of time after completion. It is therefore to the contractor's interest—and to the importance of maintaining his reputation—that the quality of his work measure up to the prescribed standards.

Fourth, the contractor provides centralized responsibility for the job. This involves devising construction schedules, organizing work forces, purchasing materials and arranging for delivery, operating

equipment, hiring and coordinating subcontractors, and insuring responsibility for the work, the men, and third parties against all insurable risks arising from the work.

An extra benefit of the contract system is the incentive a contractor has for doing a good job. His financial interests are at stake. Since his profit is directly dependent on the degree of efficiency which he can bring to the job, a loss is a personal penalty. He is spurred by the knowledge that under the competitive conditions of the construction industry the alternative to maintain a high degree of efficiency is being forced out of business.

By way of summation, then, contract construction :

1. Establishes definite costs,
2. Sets firm completion dates,
3. Insures quality workmanship and material,
4. Provides undivided responsibility,
5. Relieves the county of liability for injuries on the job,
6. Safeguards public funds,
7. Supports free enterprise,
8. Assures lowest cost possible.

The superiority of the contract method is demonstrated by these statistics:

1. About 98 percent of the federal government's construction work is by contract.
2. About 99 percent of the work of the Bureau of Reclamation is contracted.
3. Comparison tests by the Bureau of Public Roads have shown that force account projects run, on an average, 18 percent above contractor's bids. Several test projects ran as much as 85 percent more than contractor's bids.

DISADVANTAGES OF FORCE ACCOUNT WORK

What about force account work? I am not referring here to county maintenance projects but, rather, large jobs such as bridge construction or long stretches of road construction.

One disadvantage of force account work is that it eats up taxes. It needs taxes to exist but it gives none in return. It produces no wealth but many times perpetuates a political machine.

It wastes manpower. Construction often requires a large number of employees at the start of a project, which may have peak-and-valley work cycles throughout its duration. Contract construction takes the guesswork out of maintaining a staff of sufficient size at all times.

Force account work is often shoddy. A contractor specializes in certain types of construction. He and his men are professionals. They must be to compete for jobs and be able to do the work at the lowest possible cost. A county's forces are not likely to be the best men available and they are not restricted by the price of a contract.

Force account operations many times allow public officials to build a political fortress. Those counties which do most of their work by force account have officials who can control the purse strings of the county's treasury. Because of an ill-advised electorate, they can, in time, get out of hand.

And last—force account practices undermine private enterprise. As I have emphasized here, private enterprise cannot function properly unless businessmen can compete freely and openly for jobs and customers and profits. Without these, the incentive to go into business is lacking. Force account directly blunts this incentive.

CONCLUSION

As businessmen we all must realize the danger of government going into any kind of business. Private contractors have demonstrated their capacity to do public works construction better, more efficiently, and at less cost. Instead of competing, government should encourage the businessman. By so doing, government will be benefitting not only the contractor, but the taxpaying public as well.