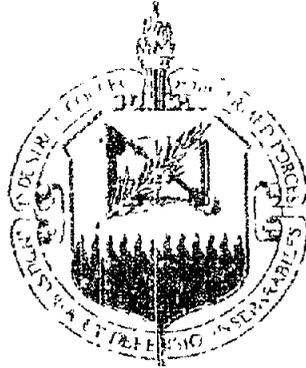


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## MANAGEMENT OF THE DEFENSE INDUSTRY

by Colonel William G. Wood

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INDUSTRIAL COLLEGE OF THE ARMED FORCES  
WASHINGTON, D. C.

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**MANAGEMENT OF THE DEFENSE BUDGET**

**5 October 1955**

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**Reporter: R. W. Bennett.**

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## MANAGEMENT OF THE DEFENSE BUDGET

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**GENERAL HOLLIS:** It would be unnecessary to elaborate to this group on the importance of the budget of the Department of Defense as it affects our economy or as it affects the operation of the military service. It is probably the biggest single budget in history. This prodigious responsibility rests primarily on one man, the Comptroller, the Assistant Secretary of the Department of Defense, who is our speaker this morning. He has served under all of the secretaries of defense during the history of our country, and yet with those responsibilities he has found time somehow to come year after year and speak to the Industrial College of the Armed Forces.

It is an honor and a great pleasure to present to you this morning the Honorable Wilfred J. McNeil.

**SECRETARY McNEIL:** General Hollis, members of the class: It is always a pleasure to meet with you. I always look forward to the last half of your program, because I can expect to get some rather penetrating questions. I have to have a little of this business in order to keep up with the spirit, I think.

General Hollis mentioned that I have been around for a while, and mentioned a little about experience. It reminds me of a little story I heard last night about the school of experience. This school of experience is all right, but the trouble with it is that its graduates are usually too old to work.

I was discussing that very important pronouncement with Walter Williams and he came out with another one. He said he had a little motto that used to hang on the wall over his desk in the Pentagon reading: "Blessed be those that run around in circles, for they shall be called wheels." No longer am I careful who I call a big wheel.

I think, General Hollis, that with your permission I will discuss first, in connection with the subject which you outlined, the general philosophy of our approach to the problem. Then, if there are questions that you want to ask specifically about some of our current problems, we can deal with them in the discussion period.

It certainly is encouraging to all of us to see the work which this school is doing. The graduates are for the most part destined for staff positions. In thinking about this job of being Secretary of Defense, Mr. Wilson thought it would take some time before we could start to work. It is not a revolutionary but more an evolutionary process. A very important factor in this evolutionary process is certainly the period that you gentlemen spend together. And certainly as you go back to staff or command or other duties, you will be much better able to work with your brother in uniform.

We are getting some real benefit from just that one fact, that you do work together. I don't mean to discount in that the importance of the curriculum or studies in themselves. But a very important part is concerned with your ability to understand the other fellow and to work with him in harmony and somewhat as a team. The school, I

think, is doing a grand job in contributing in that respect.

But, of course, I am going to deal with just one facet of your studies--the subject of Management of the Defense Budget. That is the reason I took the liberty of asking General Hollis if I might discuss some of the basic philosophy, give you some idea of how we approach the problem, as I mentioned a moment ago, and then try to fill in on any specific questions that you might have a little later.

"Budget" is a funny term in a sense, because to me it connotes dealing with figures. It is that in a sense. But, as we have said many times, even in this group in this school before, it is merely a dollar tag on a series of plans and programs.

So then even on the financial side alone the budget goes much beyond doing computing work, including figuring out some calculations. I think we have to regard financial management in the broader sense. That covers, of course, a multitude of things. It certainly includes the collection and interpretation of facts. Rightly or wrongly, quite the frankly, only reason the work we do becomes interesting is because this happens to be about the only place in the Army, Navy, Air, or Defense where all plans and programs come together. Perhaps that isn't right. Maybe it is not the right way to organize a business, but nevertheless that is what happens.

Take in the Senior Staff. They deal with force levels, general degrees of adequacy of mobilization reserves, standards of training, and all those things. But the interpretation of those things into the

present three thousand different programs, which are very important in themselves, is a very important part of their business. Later they are translated into requirements of material and people, and into dollars. And in the budget shop, if you want to call it that, the three service divisions of Defense are about the only place that they will come back to get it.

One of the jobs, as we see it, where a contribution can be made to this whole machine is an effort in the examination of these plans and programs to see that they are geared together.

I recall--this may be an unusual circumstance, although it comes up hundreds of times during a period such as from now to December--a service that had in 1947, for example, a training program for 1840 pilots, as I recall it. That came from one compartment. That is one of our problems--that compartmentation. I went to the outfit which had the responsibility of assigning aircraft for the training of pilots. Their request for aircraft maintenance personnel for aircraft would have provided sufficient aircraft for three thousand. But their facilities, which came from still another compartment, would have supported six thousand.

When, let us call it, an analysis was made, when that was discussed with the Senior Staff, they very happily changed the pilot training rate to 1800 and adjusted the equipment so they had to cope with 2100 with facilities for 3000. It couldn't be completely brought into reasonable balance in this total program, because the policy was to use 45 million

dollars that year when it was originally thought necessary to handle 40. I would call that a good decision. Whatever mechanism it takes to bring about a reasonable balance when the program is geared together, to my mind--there I am selling my own wares--might or should make some contribution to either better defense or better defense at a little lesser cost.

I could go on with examples of that kind, but this isn't a horror story type of session. But I want to add one word there.

Not a single one of the people in these various compartments is trying to chisel or steal something from someone else. Each is interpreting his broad directives as best he can. Perhaps he hasn't gotten his assignment clear enough. But you will probably never get sufficiently detailed any annual aircraft plan to be clearly interpretive, so it can be translated into the some three thousand different programs, made up in different parts of the world and different parts of this town.

So any mechanism that will speed that up, that will help give us a well-rounded plan for each service or for the Department, will be a contribution. So I think it is necessary in financial management to use a broader term than we usually think of as "budget."

This is probably an old story to you, but I think we have to think of it a bit, because the size and character of our organization depends a great deal on how it has to be organized and be managed. First, we know it is big. At present the assets of the Department of Defense are running something over 150 billion dollars, or more than

the assets of the five hundred biggest corporate enterprises in this country. That gets to be a rather big machine, even when we think of General Motors as being very large. When we take the military and civilian people together, we have four million people. That is an old story to you. But again it is the largest enterprise and it emphasizes the kind of organization that has to be set up, and the kind of skills and talents that have to be used, to attain the job.

But this doesn't tell the story. Size is only one thing. It is the fact that we are engaged, rightly or wrongly, in almost everything known to man. We have grocery stores as big as the A & P. That doesn't mean much in itself. The Navy has shipyards greater than the rest of the shipbuilding industry in the country at the moment. The Army arsenals have large capacity. Certainly the overhaul and repair shops of the Air Force and of Naval Aviation have capacity for that type of work greater than industry has today.

Then there is the training job, the school part of the defense effort, because essentially the whole military machine must continue to go to school. The courses that are taught in the military schools just run the whole gamut of business and every other facet of other schools. I don't know whether you teach art in your schools, but I wouldn't be surprised to find a little of that somewhere.

All I am trying to say by that is that when you are engaged in almost everything, it certainly complicates the problem a bit, so that if goes beyond mere size. When it gets scattered around the world,

it does get a little complex. At times I think this complexity is in proportion to the cube of things rather than the square or just by ordinary multiplication.

Now, another factor that we have to organize for, I think, or plan for, and which makes our planning a many-sided picture, is the fact that we have to be ready to do things on a moment's notice that we didn't expect to do yesterday. Korea was an example, certainly. There is no question but that it came suddenly. It required effort throughout our place entirely different from what had been thought of the previous December or even on June 24th. We have to be ready to take advantage of these things. We have to be flexible, which means that we have to organize to be flexible if we are to do the job correctly.

One of the complications--and I won't continue that line any longer--is that we are always coming out with something new, whether it is weapons, or methods of using such weapons. That adds a bit to the complications. And yet we are expected to manage this business as efficiently and economically as possible.

I just want to set the stage on that a little bit, if I might. Certainly I think we have to come to the conclusion that there isn't a managerial job in the world, except for the Presidency, that approaches in scope or complexity or size that of the Department of Defense. I touched on that a minute ago, but I would like to emphasize the fact that, with all these complications and complexities and size and scattered around the world, we have to operate in a goldfish bowl, where

our operation is about as visible as, maybe more visible than, any other similar or comparable operation. And that means you always have to plan ahead to be sure you are doing things as efficiently as possible. It just means, I think, that we have to do a little bit better job than just organizing it and taking care of it.

Now, in connection particularly with the financial part of the management problem--I mean the management problem as it is particularly related to the financial side--I have tried to think out some groupings of the things we do in order to get a better feel of how we have to finance it and organize it from that standpoint.

You people, each of you, may have different ideas. But, in the first place, on the financial side, on the budget side, you cannot handle every single bit of the various things we do in identically the same way. I am running face on right now into the American Institute of Accounting. They have an idea that you can set up a global accounting system to do this job. It isn't practical. It wouldn't be even if we could find the people in the United States and the rest of the world who could understand it. It would be unwieldy in action. So I have tried to figure out what might be the best method of budgeting and financing our activities. The result of my sorting out is something like this:

First, I would set aside or identify those things which are difficult to measure as end products. You might call them the administrative or military type activities. I don't mean you can't have certain standards by which to measure the skills of certain units. That is all right.

But certainly you can't put it in the market, put a price tag on it, and expect a customer to come and buy it.

The first group I would set aside is the combat and combat-support type units, which are capable of momentary redeployment without loss of operational effectiveness. Certainly you don't want the burden of handling 38 potential combat units with the same type of cost accounting that we would expect to find in a manufacturing plant in the center of the United States. It is a different kind of animal. People understand it, I am sure, quite well. But we do have trouble with the Hoover Commission in getting that idea across. Such units are certainly unique and have no counterpart in ordinary business activities.

We have another group in the same general classification which can be financed, I think, on the same general pattern, although with the combat units I wouldn't carry the detailed cost accounting to the same degree. That is the operation of posts, camps, stations, or bases, which I would call an administrative type of activity. Surely it is military, but the end product of the activities at Fort Bragg or Bolling Field is a little difficult to measure. You can't put it in the market, you can't put a price tag on these things; and yet you want some measure of the requirements for financing and for supporting that type of thing, some measure of what they are doing.

I think a very similar class would be the operation of our wholesale supply depot system.

Another group with a strict administrative function would include departmental headquarters, perhaps command headquarters, and procurement and inspection offices, security offices, recruiting offices-- things of that kind. There are probably about 12 to 13 thousand in number of that kind of activity. I am going to deal with them in just a minute. Certainly the method of budgeting and financing there is or should be different than it is in a manufacturing concern. General Motors has an office with about twenty-eight hundred people up in New England. Their method of approving their operating budget, at least of providing the resources for their operations, is certainly different from what you would use in financing the budget of a command headquarters. That is the type of thing that I think can fall into one general pattern of budgeting and financing after the money is made available for making these resources available to the local commanders to operate.

Another broad classification certainly is the handling of our inventory. The method of handling it is a little different, because handling inventory is different from taking care of today's consumption needs. We have to be ready to do something unusual, which means we have to have some mobilization reserves. So we divide our inventory into two broad classes and try to find the best method of financing and managing the budget for each. There, I think, we have to have two different methods of financing and managing that class in our effort.

First I would take capital or semi-capital type items. They are those where the local commander has little voice in what is bought, in

whether we buy or don't buy. Certainly over at Anacostia or at Bolling Field the commander of that base has no real influence on whether they buy an F-100 or a 9F-11 or something like that. That is done somewhere else.

Next is the incurred liability to spend money. That has an effect on the daily operations of the Army, Navy, and Air Force, and some effect on their future operations. When you have incurred liability, you will have expenditures following for ships, tanks, mobilization reserves of ammunition, aircraft engines, and things of that nature.

But there is another class of material which would generally fall into the class of consumption-type material. I know of no way to properly finance that except the way we do on any capital investment. That is to appropriate the money, incur the liability, spend the money, then take it into your system at the time you get it ready for use.

You have a different problem with consumption-type material. There I think we have made great progress in the past several years, even in the past few months. I think that type of material can be financed properly only with a revolving fund. We call it a stock fund. That is a name that we took over because there was such a fund running for fifty years before the legislation authorizing it was passed; and it is easier to sell an old name than to create a new one.

Once these materials are carried, financed, budgeted for, there comes the question of procurement. When they are budgeted for from a revolving fund, it means that we have created a situation where it is easier to apply, to the extent practicable, smart merchandising

principles. It is a method whereby automatically you can get an almost perfect measurement of the consumption or the cost of consumption. It is the type of article which can be handled best by the man literally on the ground. Whether it is a recruiting station or a big air base is immaterial. Any other method is difficult, because of the great deal or great volume of material consumed. Therefore I think that is a fact to be taken into consideration in financing and planning the way you budget for that type of item.

There is another group, and this is a pretty broad classification. I have included in this a rather long list of things that we do which are quite identical with what is done in private business. Certainly the operations in our shipyards, in the manufacturing arsenals, and the large overhaul shops of the Army, the overhaul and repair shops of the Air Force and of Naval Aviation, are certainly almost assembly-line type operations. They are certainly job shops. They have end products that you can measure. You can come up with a price tag on them. You can improve your system. You can create a much more manageable machine for the local commander. You automatically get cost conscious without the benefit of directives from the QA&M people running around and making studies. You just automatically are.

In other words, by establishing, let us call it, a corporate-enterprise financing method, capitalizing the material on hand at working prices, providing working capital to pay its bills, permitting it to adapt to a financing and accounting structure almost identical with that in the best-managed private business, we can get all the financing they

need and at the same time get the flexibility that we have to have. It is a much better way to measure. At the same time we solve a lot of our budgeting problems. There is no longer really any budget of the pencil-and-paper type. You do like they do in an industrial establishment. All you do is to budget one thousand engines at seven thousand dollars each and you have a complete budget for that whole category, whether you have it inside or outside the place. That commences to make this business a little bit understandable to all of us.

I won't deal with these categories too much longer. But another type of capital-type item, of course, is the construction of public works. There again I think the normal Federal method which provides the money for specific programs is all right. It is exactly the pattern that private business would follow when allocating one hundred million dollars to build a manufacturing plant, like that of U. S. Steel at Trenton. I see no real difference. But we can improve our method of administering this above what we do now, and I think we are in motion on that. All I am trying to point out is that we can identify the effort and divide it into several broad classes, each of which requires, I think, a different method of approach in the budgeting and financing.

We have another problem, and this gets to be a touchy subject. But this is something that we have now, and certainly we must expect to live with it for a long time to come. We have people who are managing various elements of our business who are not CPA's. I can say that because I am not one. But we expect our troop commanders, our

navigators, our gunnery officers, ship commanders, marine commanders to do what is really a very special type of managing. We expect them to have a type of skill far above that which you can find anywhere in the field. We expect them to sit at a desk and manage their office with all of a bookkeeper's experience and skill somewhere else in civil life. We expect them to be experts on some single facet, whether it be steel, automobiles, textiles, or what-not.

So we have to go a little bit further than the average in private business in making machinery. We have to develop the instruments on the dashboard so as to make them easier to read. I am not too much afraid of the decision to be made by our senior military people if they see both sides of the coin at the time the decision has to be made. It doesn't worry me a bit to get on an airplane and fly across the pond. I kind of figure that the Air Force or Navy pilot sitting in the seat is pretty competent in reading instruments. Somehow or other we have to get this organization and information, whether it is financial or otherwise, in a readable form to the guy that has to make the decision. I am not too much afraid of what he is going to do in flying the machine. That is why we try as desperately as we can to develop some system which will provide that information on the dashboard for the fellow that has to fly the machine. But it is one of our problems. It is a problem that is much more serious and difficult to solve than that, I think, even of a large private business.

We have to accept some facets of that. One is that frequently

you get things like Hoover Commission reports that are not complimentary. I am not damning the Hoover Commission reports. I just find a few little quirks in them. But just take what they say about the "terrible military approach to things." They imply sometimes that there is something sinister in it. But there isn't.

To me it probably gets back to this: It is what a man is hired to do. I think you will find that ninety-nine times out of a hundred or more, he is going to do a pretty good job of what you and I as taxpayers hire someone in uniform in a command position to do. This may be perhaps an exaggeration, but we as citizens are hiring people in uniform to have enough in any place in the world to meet any unforeseen circumstance. That may be an exaggeration, but I think the emphasis should be on that rather than on having a commander spend all his time worrying about efficiency and economy. I certainly can understand it.

So I think in that situation we will have certain financial requirements that we probably never will be able to support. I am not critical in the first instance that that kind of comment is written down. It doesn't bother me a bit, so long as the organization is there to bring it into reasonable balance, so we can get all the facets together, all the different plans and programs, and see that some are not way out of line with another facet to which it should be geared.

Now, I want to touch on just one more requirement for what I think we have to develop to do. That is that anything we organize or develop has to be something that can change overnight. We do have

too many changes of our own making. We change our plans and upset everybody from top to bottom. But we have to be geared to plans which are capable of changing because of what somebody else does.

Let us go back to Korea. I don't think for a moment that we were organized as well as we could be to take care of a thing like Korea. Certainly we can be better organized than that all the way around, and especially on the financial side. It is one thing we have to keep in mind in setting up a financial budget. It has to be able to be in a position where, if something happens this morning, it will be able to change overnight.

Now, we have in mind, and we are in process of doing, several things. First, in the past budgets have been thought of as something that the three services generally made up at their local field activities. Major commands have spent months preparing their budget for a year or a year and a half hence. Even departments have started in January to translate the details of their personnel requirements into money as early as 15 or 18 months prior to the beginning of an operating year.

Practically all of that is unnecessary, to my mind. I think we are moving toward a change, and making some progress in changing. I don't think we will ever have a situation where we will be able to deliberately submit a budget to Congress later than the opening of the year. We have for several years past submitted it in March or April. Congress usually doesn't get it done until July or August. So let us say that January is more or less a date to shoot at. It is something over which we

have <sup>a</sup> little control. But if we get our business organized on the financial side a bit better, there is no reason why, if we start in September or October, we cannot do a complete job and spend Christmas at home.

It does mean, however, that we have to do a little bit better job than what we are doing today. Let us call it accounting if you want to-- knowing what it costs to do certain things. Our factors are not good. They are better than they were, yes. But if you have to budget for the overhaul of aircraft or ships or engines by each little piece, you have to start eighteen months ahead and you don't get it done before Christmas. But if that is a Federal budget and you just budget for fifty-eight ships of the destroyer class to be overhauled, and we have had good experience and know that it costs about \$150,000 for the normal overhaul of a destroyer on the average, we have a very good budget. And it is all on one line, or on thirty lines if it covers thirty classes. We can use it for aircraft, ships, tanks, or two and a half ton trucks.

The minute we get our overhaul facilities bidding on the work on the capital industrial basis, and our relationships with our own industrial facilities are those of placing an order, a contract, without the Walsh-Healey Act, all the boiler plate, so it is <sup>a</sup> simple, let us say, one-page contract, settling our account by getting a bill out of that place for that overhaul job, we have the best support in the world for our budget. Two decisions only are necessary. Did they use cost experience, and is that cost experience generally good? Is that about the right number that <sup>will</sup> require overhaul or attention next year? If you

do that, you have the best possible budget. You have one that will stand up under any kind of experience.

You could shorten the time. There is no reason why, with proper information to back them up on the overhaul of engines, they should spend the next year in Air Force and Navy making up that budget. They could do it in twenty-four hours and come up with a very good one. I am exaggerating there perhaps, because first we have to have a plan. But if after a good analysis, the plan makes sense, shows that these two thousand of this type of engine are desperately needed for the reasonable support of the task forces, and if you have adequate cost experience--which we do not have at the moment--you have a good budget.

I can't emphasize that too much. In the past we have had that all in little compartments. We have had to deal with little pieces of this overhaul job. It simply is unmanageable, unworkable, one of the most wasteful things, I think, that we do.

You people could get in on that. Maybe in your past duties you have run into some of these problems. Maybe you have talked about, maybe screamed about, them. When you leave this school, you are going to be in a better position to help do something about it.

Now, I mentioned a minute ago on the budgeting side that we would like to get a Congressional budget that we can go ahead with. I had in mind by that that we shouldn't expect the details to be made up at the senior commands. It is good sense for the person who is going

to operate the plan to be in on the plan, but there is no reason why an air base or a recruiting station should be expected to give us their detailed requirements for the next year. That presupposes that eighteen months ahead of time they present their idea of the requirements, that they know exactly what we are going to do; and that never happens.

One little factor type of the thing I am talking about may be illustrated this way: It is a dreamed-up example. At each little Air Force or Navy Aviation command today they have two, three, half a dozen, aircraft. How many of those are going to operate next year somewhere in the world? The Air Force or the Navy doesn't know that. But they know that they have so many F-100s altogether that are going to be assigned to units. Where, they probably don't know. But the flying hour cost is practically the same in Texas as it would be in Florida or in Honolulu or in France. Therefore if we know the number of aircraft of each type that are going to fly somewhere in the world, we have a very good flying hour cost. We have a very good budget for anybody, because Langley Field probably doesn't know when they will get what type aircraft in what month, or perhaps exactly what units may be stationed there. There are too many changes in the plans.

What I am trying to say is that in all this planning, in dealing with very large forces, spread out through the world, with changes in ships and deployment, it just is not feasible to make up budgets in the way we have done it in the past. We can, however, know by the end of this next month the forces that we are going to have. In fact,

we won't even know the manpower strength that will be approved by Congress until some time in October. We don't have the Joint Chiefs of Staff propositions in. Informally I know what they are. We kick them around, but there has been no formal submission.

The way the budget work is being done by Army, Navy, and Air is that they are going their best. They are guessing. And yet we do have a decent accounting structure. We can take the result of that and apply it to any ordinary reasonable force structure. As to changes that might come about, no one anticipates any except very minor ones. In general these can be taken care of quickly right at headquarters.

Next spring it is quite possible that the Army's repair depot will know about how many two-and-a-half-ton trucks it will be asked to overhaul. It doesn't know that now. Therefore in the budget on that thing they can make only a limited contribution to the whole package.

That is the general type of approach to the construction and evaluation and submission of the Federal budget to Congress that we want to get. We want to get it further along. We hope that by next spring, certainly by a year from now, when for the first time that activity or field command actually gets into the serious business of budgeting, they will along about April or May commence operating the job. At that moment they will have a pretty good idea of what their own work load is going to be. At that time they can make a very vital contribution. In all this procurement, of course, we have reasonable flexibility in our total plans. We have already gotten over that hurdle with

the Congress.

I will digress a bit to touch on that. If you examine the appropriations for our current structure today as compared with five years ago, you would find little similarity. The Army money five years ago came from Congress in 149 different compartments. Even then there was some limitation of amount in some of these. Today, except for Reserves and the Guard and three or four minor items like Alaska communications, essentially all of the Army's money is in three pools. That is a far cry from being circumscribed legislatively by statute in every little type of activity. You now get your money in a reasonably large pool, so you can have some flexibility between programs. You have to have that particularly in operating the big machine that we are in these days. That program has already been bought by Congress. That was one of the difficult hurdles. It is perhaps one of my minor satisfactions, because I feel that our boys have done a good job in getting that done.

Now, we are going to have to manage our business pretty carefully. It means we are going to have to go back to the old practice of providing a limit for some of the guessing that we do. Whenever we get increased flexibility, increased latitude, it means that that increases very greatly the responsibility of all of us down in our place to do a pretty good job of running our business.

That gets down to the point of saying that in running our business we have to emphasize what we have. We have to know where we are

going, where to spend what we have. Unless we do that, we haven't  
of  
much of a chance/setting a good course for the long-range or the near  
future.

So far, although I have jumped around a bit, I have touched on  
the need for gearing the various plans together and getting a pretty  
solid package. I have touched briefly on a couple of different approaches  
that we are trying to install now in the budget process. But the budget  
is affected by outside influences. We don't control everything in connec-  
tion with the budget. It is not viewed in isolation. If it were, it would  
be considerably simpler. We run constantly into the question of how  
much of the national resources will be devoted to defense.

Now, we might think that if our plans call for more than we  
have the money to pay for, there is only one thing to do--that somebody  
has to borrow the difference or raise it from taxes. But we are cert-  
ainly affected by the consequences of that. If we continue to borrow  
every year for the next ten or fifteen years, what will happen to the  
value of the currency? What inflationary effects will it have? To what  
extent will it affect the economy? We are affected by those considera-  
tions very intimately.

We get the taxes. It is an easy thing to say, "We will increase  
think  
the taxes ten percent or twenty percent." We might find that is not our  
responsibility. But it is, a little bit, because we are certainly affected  
by it.

In my opinion--and I think some college people will disagree--

I think that in periods of very good times, when we have very high employment, high national income, we must pay our way in this country. I think that has to be done.

Now, that wouldn't be too bad. But it wasn't in the basic policy, which has been adopted for the defense of the United States, which says that we are going to stay reasonably strong for as long as we are in trouble in this world. Therefore it is easy to see that this is going to be a reasonably heavy burden for ten years, perhaps twenty years. I don't think anyone knows. Certainly the policy that has been adopted--that we are going to keep reasonably strong, in a state of partial mobilization, that we are going to stay that way until the sky has cleared, is a good thing for us in budgeting, since for the first time it gives us a chance to get this machine on a reasonably stable level and do a good job of managing and running it. Certainly we can do it more efficiently and economically if we don't have the old peaks and valleys.

But, if we are going to maintain our strength over a rather indefinite period--and I agree with Humphrey on this and with your Chief as well--I think we must pay our way in good times. That automatically gives you some limiting factors, because the tax rates certainly have to be geared to the economy, to whether they will restrict expansion in our economy or lower it, or whether they will encourage it. I don't know the answer to that.

I remember being called up with Charlie Wilson to testify before

the Ways and Means Committee a few years ago in connection with the excess profits tax. I am not an economist. I do think I know a little about how some of these things affect me as an individual, as a member of society, and how these things affect individuals cumulatively. So we testified at the time, after two or three days of huddling and trying to get answers and getting all the advice we could, that the high tax rate, which was at that time running 72 percent, on corporate income could be continued for three years without damage to the future of industry, and perhaps four years, that no one could measure this thing accurately; but that if you kept that 72 percent tax on corporate earnings indefinitely, you certainly would restrict future private investment in expanding plant and expanding employment.

Whether 58 or 52 percent or 47 percent would be better I don't know, because when you get in that small range, I don't know how you can guess it. I think the general guess is that 50 percent or thereabouts tax rate on corporate earnings is about the point at which you would create an atmosphere for the greatest expansion of the economy and at the same time have a chance gradually to increase your revenue or at least maintain it.

Is the tax rate on personal incomes right or not? I think again I am not competent to answer that. Certainly you are faced, I think, with the fact that on the political side there will have to be some probably minor reductions. The reductions of three years ago, or two years ago, have, I believe, been some encouragement to the present level

of business activity. I don't know whether they are solely responsible, but certainly they contributed to it.

I would guess that you will find, as we lower the rate on corporate income and lower the rate on personal income, with the higher velocity of turn-over in business, that the total Federal income will be almost as great with the lower tax rate as it was with the higher. I don't think you could prove some of these things, but that was the result some years ago when the same tactic was followed as is happening now.

That doesn't mean that a further cut in the tax rate is going to give you any commensurate increase in business levels. But that does affect the Department of Defense. You may have read in the papers a complete misunderstanding about Humphrey coming over to the Budget Bureau, after talking with the President, and asking us to reduce our expenditures by three percent, because he thought if we would do that, the budget could be balanced this year.

Presumably, I think anybody would agree that we could reduce our budget three percent if we really applied ourselves, without cutting out anything essential in Agriculture, Commerce, or Interior--any of these things. We could find three percent somewhere in our outfit. You probably noticed that very excellent decision that Hughes announced about reducing our contract expenditures to 33 billion dollars. Well, immediately we had speeches criticising us for cutting down our defense. But it was also said that that reduction was only fiscal

responsibility. So I don't know. I guess we are probably on the beam, because we are catching it from both sides.

So there is some truth to the press report that the proposal was made that we cut expenditures three percent throughout the whole Federal Government. I might say that there is a commitment from other agencies to cut theirs two percent. We have a little different kind of problem. We have put a 34 billion dollar level on expenditures. I think it is to the best interest of all that we try to do something about it, whether it means a little less travel, a little less light, a little less something else. Actually, however, following last year's budget, an estimated expenditure of 34 billion dollars was an optimistic figure-- on the low side. In other words, we didn't know quite where we would get that without changing some programs.

During the spring Congress made a few changes in our budget. Darned few, I might say. They gave us authority to use German marks without reimbursement to the Treasury. That helped us some 300 million dollars on our reporting of expenditures. It didn't change our program at all. Our original 34 billion estimate included the cost of the German marks. Congress reduced our budget a little bit.

But during the spring we added some things. You all know that the B-52 was accelerated, and the 101 and 104 were accelerated, because it looked as if they were going to be pretty decent aircraft. We added 150 million for family housing. We increased the research a little bit. Congress provided money to increase the Marine Corps strength.

Perhaps it is going to be 198,000 and Air about 125,000. So we added about 700 million dollars in identifiable items that we knew about last December. So the few things like the German marks didn't make any difference except they were a little hard to handle when we were doing them without reimbursement. So we upped the budget about 250 million or 300 million, right in that range.

We just in going over this thing at Humphrey's request--and I don't quarrel with him for trying or asking--we came out with this: There is going to be no change in the basic elements of the military program. A few items have been accelerated. The IGI program is going forward as planned. We are going to have to tighten our belts, do a lot of things on the administrative side, to stick to our present estimate of about 34 1/2 billion dollars. I just want to tell you there isn't any basic change in sight except that we will have to tighten our belts and do a couple of little things that are not basic elements of strength.

I want to add that, regardless of the newspaper stories about the fusses between Charlie Wilson and Humphrey, they are wrong. Humphrey talks about it, but he is going to support every essential military program.

Now, George is going to do better than he thought he was, because revenues are going to be up above his estimates. You might wonder how I would know that. Our policy is to keep an eye on what the other boy is doing. Perhaps they keep an eye on what I am doing. We just made a little less on corporate earnings last year. But A. T. & T. is up a little bit, and General Motors is up a little bit. So is Chrysler. Their earnings

look pretty good. You can go down the list--U. S. Steel, Bethlehem, and the rest. I can't help but think that George Humphrey is going to get a little more money next March than he thinks he is. So it wouldn't surprise me if the Federal budget is going to be balanced or come awfully close to it even though we are spending a little more than was hoped for.

I have tried to make a reasonably orderly presentation, but some of it was not so orderly, because I wandered off the course. I want to save some time to answer questions.

I just want to emphasize one thing, however, and that is that unless we can get this job done, difficult as it may be, I don't think we are going to accomplish this basic policy, which I think is good, and that is, how we are going to keep the confidence of the people so that over a long period they will support us in a strong defense so long as this world is in trouble.

I look for some good questions in a few minutes. So if you want to take up any programs or anything, I will be glad to answer your questions.

**CAPT GERWICK:** Secretary McNell is ready for questions.

**QUESTION:** Secretary McNell, you said you are interested in simplifying the budget preparation by using industrial practices. Why wouldn't a memorandum from the Comptroller's office posing this as an objective be appropriate in accelerating that process?

**SECRETARY McNEILL:** It has been issued, sir, and I can

make several copies of it available to the class. It covers the whole plan. Would that be helpful?

**STUDENT:** Yes.

**SECRETARY McNEIL:** It is 180 pages long, but the best part of it, I think, is in a couple of pages. But it covers every facet of budgeting--accounting, reporting, evaluation, etc. It covers 180 pages. It is an attempt to put into one package a rather complete outline plan which I hope to get adopted completely next March. Then we will all be on the same level in what we are trying to accomplish. I will try to send down several copies if anyone is interested.

May I ask this: If any of you do glance at it, and if you have any questions or any comments or criticisms, constructive or destructive, I would certainly appreciate them, because I would like to have as workable a package as I can for the budgeting in headquarters and commands, for the fellows who have to do the operating. That is what we are trying to get. We will appreciate everything in the way of comments that anyone wishes to offer.

**QUESTION:** Mr. Secretary, I understand that the Department of Defense is considering, or possibly has already considered, the supply manager concept, whereby one of the departments would be assigned the complete responsibility for a particular commodity. Is that concept being considered primarily for finance management reasons or for other reasons?

**SECRETARY McNEIL:** It is not being considered primarily

for financial reasons. As a matter of fact, I don't believe in it.

I hate to make a mealy-mouthed statement like that. That came from the Hoover Commission, and there will be an effort in four categories of supplies to make a real test--and I mean a sincere test--of it. These four groups of supplies that were initially proposed about a month or so ago were food, clothing, petroleum, and medical supplies.

I hate to attribute the sponsors' enthusiasm for it to political pressure, but I am certain it was there. In other words, I think they thought they had to satisfy a Hoover Commission and public-press demand for what I think a lot of people believe is a much more economical and better supply system. They think if you didn't have but one system of doing it instead of three, it should save money. That has been discussed heatedly.

I believe now, in fact, we have been discussing it for the last month, that the single manager concept will probably be limited to food. In food it might work. One reason it might work is because there the question of mobilization reserves is a very minor factor. Generally the amounts on hand are for consumption purposes.

Another reason is that the source of supplies is to a large extent local. There is a great deal of local purchasing. As far as Army's relationship with Air, it has been running for a long time. But I think the big part is the fact that the mobilization reserves consist to such a high percent of local purchases.

I think it is a little different in the case of petroleum. I think that is an entirely different problem, because there really isn't any

such thing as a wholesale depot level storage of petroleum. That is not exactly a correct statement, but for a big part of it, all the reserves we have of petroleum are pretty generally stored at the places where they will be used. Let's call it the retail or user's level. Therefore you don't have the problem of a single manager for both the wholesale and the individual service management at the retail level, which was the single manager idea when it was presented.

I think that after discussing the clothing thing, it will be dropped, because while there are 34,000 items of clothing, there is only a little number of items in the 34,000 that are identical; and what benefit do you get if they are not identical?

I do think we are going to have to do something with this supply thing to satisfy both the real and the fancied criticisms of our supply systems in the past. While it has been my thought that the percentage of waste has been small, yet when it does exist, it is of the management character. When a Navy recruiting office in Denver requisitions desks on Oakland which come from Grand Rapids, Michigan, you are going to get quite a story because of the cross hauling and so forth that does on. I don't think we can excuse ourselves for that. We have to have a system where if the Air Force or the Army has a depot or the General Services Administration has a depot in an area, we can send a truck over and get it and at the end of the month, pay our bill, and it is all done. That will avoid the cross-hauling of supplies.

What that gets into is the effect on the common-use supplies.

I think we will probably have to come to what I would call mandatory cross-servicing in the continental United States or in certain rather well-settled areas. It is my view that if we do that, we have eliminated practically all sources of valid criticism.

What does it take to do that? It takes a revolving fund type of ownership of supplies in each of the three services, so that we can do business with each other without all the ordinary government red tape, so that trucks from Governors Island can back up to the big medical supply depot of the Navy in New York, get what they need, and pay for them at the end of the month. Then we will have just a clean job.

So with that in mind, in the medical field they are trying to work out a plan for a single manager, where each service will own its own mobilization and operating stock. I can't think that it is going to make any real contribution.

I do think, however, to be charitable, that the raising of these issues by the Hoover Commission in their last report rather forcefully might force us to do some things that I think we should have been doing for a long time. It is just about what I described. I don't think we have any excuse for sending to the central depot of the Marines if there is a depot of another service close by. That is where financial management comes into it--the kind of financial structure that permits one service easily to do business with another. I think that system will work.

Under the old system, which existed some years ago, even six

years ago, if the Army sold something to Air or vice versa, the proceeds were unusable again by the selling service. That created a condition which made impossible any cross servicing. It didn't stem from the financial side of the house. It stemmed from the other side. The financial side of the house, I think, has the job of creating whatever is necessary to make a sound system work. And again I don't think that the single manager system is the right answer. I don't know in the medical thing how a supply corps captain in the Navy can manage the mobilization reserves and operating stock down through the bowels of the Air Force and Army. It just isn't in the cards.

Now, I think--to make one more statement--that if three rather clean and well-managed supply systems, let us say, on medical supplies cannot be operated with about the same amount of material on hand for operating stocks and mobilization reserves, assuming we take care of this cross hauling problem, as theoretically could be accomplished with a single system, that means that somebody in the field has demanded the responsibility of permitting excess stock to exist in the aggregate in mobilization and in operating stocks. So to my mind, three clean and well-managed systems, with ability to deal with each other, and taking care of this cross-hauling problem, entirely separate and apart from the purchase side, can work.

Let me add one more point. Their idea of the fourth service of supply theoretically could work if it had ownership of all stocks and if it carried the supply system down to the point of consumption. But

that would add another step. I don't believe that is quite in the cards. There are too many places in the world, such as out at sea in the Pacific, where a supply ship of the Navy is there and the fourth service is not there. Somebody has to be there. In North Africa, except for Port the Air Force has practically the only forces there. Should we create a separate service to operate those Air Force bases there? I don't see any real gain.

Some of the proponents of the idea have said: "Well, the single manager would handle only the depot stock. Each service will handle the retail level." But that doesn't answer the question entirely, because, speaking of those areas, there are intermediate levels where you issue from bulk U.S. stock, and it is going to some distribution points in North Africa, to one of the 45 air bases. So there will be another distribution retail level there.

I really think that the obligation to clean out the problems that have existed has been pointed out quite forcefully. I think we could, if we wanted to, solve the problem instead of depending on the what I would call another echelon or layer--getting more people outside the chain of command mixed up in the command.

I wouldn't have elaborated as much on that except that I feel very heatedly on the subject.

QUESTION: Sir, I believe you stated that it was your hope that eventually the services would come in with a budget with one line of items. I think that is something with which everybody certainly agrees.

I am sure the departments would agree with you. We would like to have that. But doesn't the Staff with its item approval force the services to go the other way and submit their items in detail to the F. D. ?

SECRETARY McNEIL: I won't say that some requests for unreasonable detail have not been made. I wouldn't say that, because I think it has happened. I know it has. I believe generally it would stem from the fact that it doesn't come that way at the moment. The figures to support an item just won't balance out, mathematically or judgment-wise. When they won't, you try to get enough to prove the point.

If we have the type of material which is bought on the outside, there is no problem there, because there we have an actual current price and it is simple to get it. But when you get to some function which is hard to evaluate as to its net worth or contribution, but it has 1480 people and 7 million dollars of support-type costs, and is measured in just those terms, then you get into details and I don't know how you can help it, when you try to find out what elements make up that total of 1480 people and 7 million dollars of support costs. When you do that, so frequently we find that the thing is a guesstimate from the beginning.

Now, in the whole field of overhaul and purchase, if you have anything that can give you a good feel as to the cost of that article, if during the year we have proved our cost, or the previous year we have carried the material cost into the training of electronic personnel, if you have that, we are going to buy it. Sure, you might quarrel in the year before or two years with an element of cost; but once you have fixed on it, then everybody can use that as the criterion. But until we

have it, we are going to constantly have this effort, some of <sup>it</sup> necessary, some carried on by perhaps some enthusiastic individual, to get into too much detail.

That may not be a satisfactory answer to that question, and some day I wish you would come up and let me show you in practice what I mean by that.

CAPT GERWICK: Mr. Secretary, there are a lot more questions, but our schedule has caught up with us. On behalf of the Commandant and the rest of us, we thank you very much.

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