

ADVANCE COPY



## THE DEFENSE BUDGET

Honorable Charles J. Hitch

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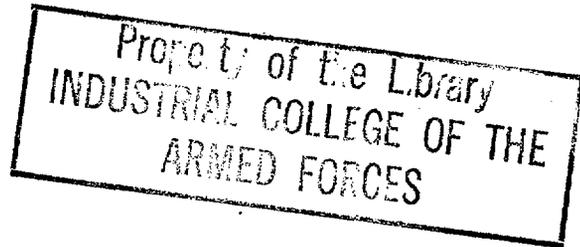
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THE DEFENSE BUDGET

23 October 1963

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Reporter--Grace R. O'Toole

Publication No. L64-49

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ADMIRAL ROSE: Gentlemen: With slightly different talks on slightly different days at the two schools in the last few months we have been concerning ourselves with national security policy--what it is, how it is formulated, who is involved in its formulation, the machinery through which policy is made, and some of the means by which policy is carried out.

It is quite obvious that the formulation of policy and national security programs is only half of the job. The programs must be carried out, and to do so requires resources--lots of them.

This is our consideration this morning, the problem of allocating resources to carry out the security programs for which the Department of Defense is responsible.

I can think of no one more capable of discussing this matter with us than our speaker this morning. This is his job.

It is a great pleasure to present the Honorable Charles J. Hitch, Assistant Secretary of Defense, Comptroller. Mr. Secretary, it is good to welcome you back.

MR. HITCH: Admiral Rose, General Griswold, Gentlemen: I welcome this opportunity to meet again with the students of the National War College and the Industrial College, the two senior professional colleges of the armed services. This group represents a cross section of the best minds in the military establishment, and it is always a welcome duty to appear before you.

As I did last year, I would like to discuss two separate but related

topics--first, the intermeshing of defense and economic policies, and, secondly, the functioning of the new planning, programing, and budgeting system in the Department of Defense. Both are concerned with the allocation of resources, first, within the Government as a whole, and, second, within the Department of Defense.

I know you recognize that today in the Defense Department we are rarely confronted with what might be called a purely military decision. Defense is now so completely interwoven in the daily operations of our Government that virtually everything we do affects some other part, some other policy, some other program of the Government. Indeed, defense is now and has for many years been a very important factor in the economy of the Nation, and changes in the size of the Defense Program or even in its composition can and do have important impacts on the economy.

The close interrelationship of scientific, military, and political policy and planning has long been recognized by everyone concerned with national security affairs, but this interrelationship is equally important in the economic and fiscal areas. Because the Defense Program is so large a part of the total Federal Budget, it is by far the single most important element which has to be considered in the determination of the Government's fiscal and budgetary policies.

The Department of Defense, for its military functions alone, will spend about \$50 billion during the current fiscal year, more than one-half of the total Federal Budget. If defense-related activities such as military assistance and atomic energy are added, the broader category of national defense amounts to about \$55 billion, or more than 55 percent of the total. In total, national

defense programs take about one-tenth of the Nation's gross national product, and certain major industries, such as aircraft, ordnance, shipbuilding, and electronics, are heavily dependent on defense work, amounting, in the case of the aircraft industry, to about 90 percent of its total output.

Moreover, the economic health of many communities is closely related to local ~~expenditures~~ expenditures generated by military installations.

Sharp changes in the rate of defense expenditures or even contract placements can have an important influence on the business cycle, particularly at the turning points. The prime example of this is the sharp curtailment in defense expenditures and contract placements. In the summer of 1957, just when the economy was at such a point, this curtailment certainly contributed to the business recession in that year. Conversely, the upward trend in defense expenditures and contract placements during the last three years has undoubtedly contributed to the <sup>rise</sup> economic activity during that period.

Not only does the Defense Program have an important impact on the economy but what happens to the economy also has an important impact on the Defense Program. Just as military policy can never be divorced from foreign policy it can never be divorced from economic or fiscal policy in peacetime or in wartime.

In wartime this relationship is quite direct and therefore readily apparent. The physical capacity of the economy in itself is the limiting factor on the size of the war effort. In peacetime the relationship is more complex and less obvious but nevertheless just as real.

Defense policy must be harmonized with tax policy, credit policy, debt management, international payment policies, and so forth, and all of these aspects of the economic fiscal policy are themselves closely inter-related.

There are some who argue, correctly, that the U. S. economy today could support an even larger Defense Program than we now have. This is undoubtedly true, but the argument misses the point. The real problem confronting the President is to strike the proper balance between military-foreign policy on the one hand and economic-fiscal policy on the other. While this Administration has clearly demonstrated that it is determined to provide all the defense required by the international situation--and without recourse to arbitrary budget ceilings--it is by no means insensitive to the need for harmonizing military policy with economic and fiscal policy, and no Administration ever can be.

Among the many economic and fiscal problems confronting the Government, two are of particular importance at this time--the rate of economic growth internally and the adverse balance of the international payments. And the Administration's efforts to solve both of these problems will continue to have an important bearing on the size and character of the Defense Program.

Let us consider, first, the balance of payments problem. The United States in every year since 1950, except 1957, has paid out to the rest of the world more than it took in--that is, in each of these years the United States had a deficit in its international balance of payments. But prior to 1957 these annual deficits amounted to only about \$1 to \$1.5 billion. Moreover, some redistribution of international monetary reserves was necessary

and desirable in any event, since the United States during and immediately prior to World War II had acquired a highly disproportionate share of such holdings. After 1957, however, in the four years, 1958 through 1961, the deficit in the balance of payments averaged well over \$3 billion a year, and totaled more than \$13 billion over this period. As a consequence, our gold reserves were depleted by nearly \$6 billion while at the same time the short-term dollar assets held by foreigners increased by \$7.5 billion. For the first time in over 22 years our gold reserves fell below \$17 billion, while at the same time the potential claims against them increased substantially.

Actions taken by the Government, including particularly the Defense Department, succeeded in reducing the deficit in 1962 to about \$2.2 billion, a significant but still inadequate improvement. Our gold reserves in that year declined by almost another billion dollars, to \$16 billion.

I know that you are familiar with some of the measures taken by the Defense Department to cope with this problem. For example, we increased the degree of preference to be accorded to U. S. sources for the purchase of supplies to be used by our forces overseas. Military construction overseas has been curtailed and prefabricated buildings produced in the United States are being used wherever possible. A voluntary program to reduce expenditures by Defense Department personnel overseas has been in effect for 2-1/2 years. Perhaps most important of all, through a series of agreements--the most important being with Germany and Italy--our allies have been induced to increase their purchases of military equipment and services from the United States. In fact, Germany has agreed to offset U. S. Defense dollar outlays in Germany,

amounting to \$700 million a year, by purchases from the United States.

Notwithstanding these efforts, the deficit in the balance of payments during the first half of 1963 again increased alarmingly to an annual rate of more than \$4 billion. Most of this increase stemmed from a rise in private long-term foreign investment. This net outflow of long-term capital during the first half of 1963 reached an annual rate of \$3.8 billion--\$1.3 billion higher than the already substantial outflow in 1962 and nearly double the rate experienced in the year 1959 through 1961. And, of the total increase, most was in the form of new foreign borrowing in U. S. money markets.

Thus, still more has to be done. The Defense Department on its part has undertaken in the last few months a new series of measures to reduce its dollar outlays abroad. These include the further curtailment of U. S. activities at certain bases overseas, the transfer of other activities to the host country, and some minor redeployments of forces to the United States somewhat earlier than originally planned. They also entailed a further tightening up on contractual services, petroleum procurement abroad, and construction abroad. We hope that through these and the measures taken earlier we can reduce our dollar expenditures abroad by approximately \$300 million a year--from about \$2.7 billion in fiscal year 1963 to \$2.4 billion in fiscal year 1966. Any greater reduction in our expenditures overseas would have to be achieved through major redeployments. Our growing airlift capacity, the prepositioning of heavy and bulky equipment overseas, and the increased range of the newer tactical fighters may, in time, make such redeployments feasible. As you are no doubt aware, a number of exercises are planned during the next

several months to test our ability to move whole divisions together with their tactical air support to Europe, the Near East, and the Far East.

But the measures taken by the Defense Department alone will certainly not be enough. This is not a problem that can be solved by the Defense Department. To meet the problem of the short-term capital outflow, the Government has adopted a policy of maintaining short-term interest rates at a competitive level with money markets in other countries. Thus, 90-day Treasury bills which yielded 2.5 percent in mid-1961 now yield nearly 3.5 percent, quite a significant increase. This policy was reinforced in July when the Federal Reserve System raised its discount rate from 3 to 3.5 percent.

To meet the problem of long-term capital outflows, the Administration has proposed an interest equalization tax on purchases of foreign securities by Americans from foreigners. This tax is designed to discourage foreign borrowing in U. S. money markets which, as I indicated earlier, was the major factor accounting for the deterioration of our balance of payments in the first half of this year. It is ironic that even countries enjoying substantial surpluses in their balance of payments also borrow in U. S. capital markets. They choose to do so because long-term funds are cheaper in the U. S. and more readily available as a result of the more efficient organization of our money markets. There are already signs that these two policies are having beneficial effects and it is hoped that the deficit in our balance of payments will be considerably reduced in the second half of this calendar year. Solution of this nagging problem is of great importance to the Defense

Department, because continuing large deficits could, over the longer run, have a disastrous effect on our overseas deployments and on our whole defense posture.

Despite the short-run improvements anticipated from the new measures taken and proposed, a fundamental improvement in our international position still depends upon our ability to achieve greater industrial efficiency, to utilize more of our savings at home, and to maintain price stability. Although the rash of recent price increases is becoming worrisome, our overall price performance over the past five years has been very satisfactory. The U. S. price position relative to other leading industrial countries has improved, because price levels elsewhere have been increasing more rapidly than our own, substantially more rapidly. But even this so far has not been enough to solve our balance of payments problem. Investment of funds, both domestic and foreign, in the U. S. must be made more attractive. This, of course, is one of the important objectives sought by the President in the comprehensive tax reduction program proposed last January.

The other important reason for the tax cut relates to the more fundamental problem of economic growth. Although the gross national product has increased from \$518 billion in 1961 to an estimated \$585 billion for 1963, unemployment has only declined from 6.7 percent of the labor force to about 5.6 percent, and our industrial plant is still working well under optimum capacity. Thus the growth in gross national product is largely the result of increases in the labor force and in productivity, rather than reduction of unemployment. The President's Council of Economic Advisers estimates that

gross national product would have to be about \$30 to \$40 billion higher to reduce unemployment to about 4 percent of the labor force, or, conversely, that the reduction of unemployment to 4 percent would produce an increase in GNP of \$30 to \$40 billion. Thus, to speed up the rate of economic growth, alleviate the problem of unemployment, increase the efficiency of the American economic system, and make investment of capital in the U. S. more attractive, the Administration is pressing the Congress to enact the tax-reduction program.

Of course, a tax cut of the magnitude proposed by the Administration will, initially, significantly reduce Federal revenue. But past experience has shown that the economic stimulation afforded by a tax cut can, within a few years, create a tax base sufficiently larger to more than offset the revenue loss. It is estimated that, even under the proposed lower tax rates, the Federal Government's revenue would be increased by one dollar for each three or four dollars of increase in GNP. Using a ratio of one to four, a \$40 billion increase in GNP would yield the Government about \$10 billion in extra revenue. This, together with the normal growth in GNP, could produce a balanced budget within two or three years--provided that the growth of Federal expenditures can be held in check. And this constraint will be one of the most important connecting links between economic and fiscal policy and the military program in the years immediately ahead.

The urgent national need for a tax cut at this time does not relieve the Government from the necessity of bringing the Federal Budget into balance within a reasonable period of time. This Administration subscribes to

the view that it is not only unnecessary but also unwise to attempt to balance the Federal Budget in each and every year. To do so would contribute to making recessions worse and inflationary booms higher and would have a destabilizing effect on the national economy. But by the same token it is also necessary to have a surplus in years of high economic activity and full employment when the potential inflationary pressures are greatest. Thus, the achievement of full employment and a balanced budget are still the twin objectives of the Administration. But the balanced budget is to be achieved by an increase in economic growth and not by a sharp reduction in Federal expenditures which would be self-defeating.

All of this imposes on the Federal Government and, because of its size, particularly on the Defense Department a special responsibility for the utmost restraint in its demands for additional resources. Total Federal expenditures have increased from \$76.5 billion in fiscal year 1960 to an estimated \$98 billion in fiscal year 1964, an increase of about \$5 or \$6 billion per year.. During the same period, Defense expenditures, excluding military assistance, will have increased from \$41.2 billion to over \$50 billion, and expenditures for space research and technology from \$.4 billion to \$4.2 billion. Thus, of the total increase in Federal expenditures of about \$21 billion, defense and space account for about \$13 billion, or about \$3.25 billion per year.

The reasons for the rapid increase in expenditures for these two programs are well known to you. But the greatest part of the increase in both programs is now behind us. With respect to the Defense Program, the very large investments which we have been making over the last three or four years will not be required during the next few years and a leveling off of defense expenditures

can be anticipated.

We have this problem well in mind as we go about the task of preparing the fiscal year 1965 Defense Budget. Although it does not seem likely that defense expenditures in fiscal year 1965 can be brought below the level of the current year, now estimated at about \$50 billion (compared with the \$51 billion originally estimated in the budget presented last January) we should be able to hold the increase to a modest amount. While we will have to absorb about a half-billion dollars of pay increases in 1965 as compared with 1964, we estimate that the Congress will cut our 1964 budget request for military functions by about \$2 billion, mostly in longer lead-time items for which we would have spent substantial sums in fiscal year 1965. This rather substantial cut, from about \$52 billion to \$50 billion, is a very clear signal from the Hill that the going will be tougher from here on out. We will have to have an extremely good case for any further increases in the level of the Defense Budget.

But it was clear to us even two years ago when we had completed our review of the first Five-Year Force Structure and Financial Program which covered the period 1963 through 1967, that defense expenditures would tend to level off at about \$50 billion a year. I recall telling the National Tax Conference on National Defense and Taxation two years ago, in December 1961:

"...Defense expenditures for our own military forces over the last five years averaged about \$40 billion per annum. Although we are still wrestling with the 1963 budget, it is quite possible that Defense expenditures over the next five years will average \$50 billion per annum."

Now I would like to take a few minutes to discuss the allocation of resources within the defense establishment. Here the problem is one of

choosing doctrines, forces, weapon systems, etc., to obtain the most defense out of any given level of available resources, or, conversely, to achieve any given level of defense with the least amount of resources. In this respect it is essentially a problem of economic choice--of relating military worth or effectiveness to the costs, in terms of resources, of alternative ways of achieving our national security objectives. This, you will recognize, is the traditional concern of economics--the allocation of resources to achieve maximum economy or its mirror image, efficiency.

I assume, I hope not rashly, that you are all familiar with the planning-programming-budgeting system which we have been developing in the Pentagon during the last 2½ years to assist the Secretary of Defense in solving this problem of resource allocation. Previously, the annual budget process had been the principal tool for the allocation of resources in the Department of Defense, and indeed for the making of major program decisions. The budget was the one place where at least once a year all our varied programs and activities were brought together at one time, permitting each program to be weighed against all the others in terms of their costs and, in a very general way, their military worth. Moreover, the budget was, and in this sense still remains, the principal mechanism through which management controlled the execution of the program.

But the Defense Budget was, and still is, oriented along functional lines. Its subdivisions, you know, are military personnel, operation and maintenance, procurement, construction, RDT&E, etc. This grouping is still one useful way to look at the Defense Budget and, indeed, it is still the

pattern in which the Congress appropriates funds and in which we manage certain areas of our activities. However, this arrangement, which permeates the entire financial management system, is not very helpful in the key decision-making areas which are the principal concern of top management in the Defense Department, namely, the sound choice of military forces and major weapon systems in relation to military tasks and missions. Nor does this system produce data in the form needed to relate the cost of programs directly to their military effectiveness. Furthermore, the time horizon of the budget is too limited, generally only one year, so that the full time-phased costs of proposed programs are not disclosed and the data needed to assess properly the cost and effectiveness of alternative programs are not available.

Accordingly, the new programming function has been introduced to serve as a connecting link between military planning, which is performed in terms of forces projected several years into the future, and the budget, which is developed in terms of functional categories projected only one year ahead. This new planning-programming-budgeting system links missions to forces, forces to resources, and resources to budget dollars, and thus permits us to relate budget requirements directly to missions. By projecting forces, programs, and dollars at least five years into the future we can get a better appreciation of the full cost implications, present and future, of alternative program proposals. By "full cost implications," I mean not only the cost of researching and developing a system or of that in procuring it, but the entire cost of developing, acquiring, and operating the system over its useful life.

I really cannot see how the Secretary of Defense can intelligently decide among alternatives without having such data in hand and, in fact, neither does he.

Thus we now have a three-phase interlocking system of planning, programming, and budgeting comprising: 1) the planning and review of requirements, 2) the formulation and review of programs extending five years into the future, and 3) the development of the annual budget estimates.

The first phase, military planning and requirements determination, is a continuing year-round operation involving the participation of all appropriate elements of the Defense Department in their respective areas of responsibility. What are involved here are not merely requirements studies in the traditional military sense but rather military-economic studies which compare alternative ways of accomplishing national security objectives. We have been making in the Department extensive use in these studies of what is sometimes called systems analysis or cost-effectiveness analysis.

Systems analysis has turned out to be a rather controversial area of activity. Yet it is exactly the kind of analysis that has to be done in one form or another in all situations calling for the allocation of resources, whether it be the family unit, a private business enterprise, or a government agency. Obviously, the techniques used can vary from a rough sort of intuitive judgment based on experience to an elaborate analysis involving the use of computers. It is our contention that many of the problems we face in the Defense Department are both too complex and too novel to be solved on the basis of anyone's unsupported intuitive judgment.

There is no conflict between good systems analysis and the appropriate

use of military experience and judgment. Quite the contrary, I have consistently maintained that systems analysis is essentially a method of getting before the decision-maker the relevant data, organized in a way most useful to him. It should incorporate any relevant sound and experienced military judgment. And, indeed, most of the systems analysis or operations research work is performed in the Department by or for the services and the Joint Chiefs of Staff organization.

I believe that the value of systems analysis is now well recognized and accepted throughout the defense establishment. The current argument concerns its proper position in the organizational structure. Here again I would like to suggest that it should be used at all echelons where it can contribute to the decision-making process, including the Office of the Secretary of Defense. Because so many of the important problems of defense cut across service lines, they can be resolved only at the OSD-JCS level. It is interesting to note in this connection what the Air Force Magazine had to say about this problem in January 1961, the month in which we took office:

"The predominance of service influence in the formulation of defense planning and performance of military missions must be corrected. At present, defense planning represents at best a series of compromised positions among the military services... There is a clear need for defense interest rather than particular service interest." The article concluded: "No longer can this nation afford the luxury of letting each service strive to develop in itself the capability of fighting any future war by itself...We cannot afford such waste..."

To deal with the vast quantity of data that is involved in the

decision-making process the Secretary needs a staff of his own to put the data into a form most useful to him. And this is the principal role of the systems analysis group in my office. Where the group itself conducts--as it occasionally does--a cost-effectiveness study, comments and criticism are solicited from other appropriate elements of the defense establishment, particularly the Joint Chiefs of Staff. In fact, under the new planning-programming-budgeting system, the Joint Chiefs of Staff are more intimately involved in the entire decision-making process than they ever were before--in the military planning and requirements determination phase which has always been the traditional province of the JCS, but also now in the programming phase and in the budget phase, the latter of which has been traditionally the province of the Comptroller organization.

Another area of misunderstanding which has grown up around the systems analysis function is the false dichotomy sometimes drawn between costs on the one hand and military effectiveness on the other. Yet both are inseparable parts of the same problem. It has long been my view that the job of economizing, which some would delegate to budgeteers and comptrollers, cannot be distinguished from the whole task of making military decisions. The question, "Should we buy another 200 MINUTEMAN missiles in fiscal year 1965?" cannot be answered without examining: 1) the additional target-killing capability which the 200 missiles could contribute to the already-planned forces, 2) the additional costs, both investment and operating, which the 200 missiles would incur, and 3) the military worth of using those same budget dollars in other ways. Thus, the military effectiveness of any proposed program,

be it an increase in numbers of weapons or in their performance, cannot logically be evaluated standing alone but must be considered in relation to the cost and--in a world in which resources are limited--the alternative uses to which the required resources could be put, either within or outside the military establishment.

The second phase, the formulation and review of programs, is now well established. We do continue to encounter some problems in the program-change system. As long as the budget process is tied to an annual cycle, which it will always be, we are bound to get a peaking of program-change proposals prior to the annual budget review. And, indeed, it is desirable to review major program-change proposals by the services concurrently, because many of them are so interrelated. But the piling up in change proposals in the late summer created last year and is creating again this year a bottleneck in the review process at the OSD level, and it has resulted in an undesirable overlap of our program and budget reviews. We have under consideration several proposals designed to cure this situation. Those of you from the Industrial College, who will be hearing Dr. Asher from my office later this morning, will learn more about this problem from him.

The third or budget phase of the planning-programming-budgeting process is proceeding much as it has in the past, except that, being tied to the program, the budget review is no longer the vehicle for major program decisions. The estimates for the fiscal year 1965 budget were transmitted by the services to my office on schedule and they are now under joint review by my budget staff and that of the Bureau of the Budget. Of course, it is

during this budgeting phase that the exact numbers of missiles, aircraft, tanks, guns, and so forth, to be funded in the next annual budget are determined. And it is in this phase that the detailed shipping lists, production schedules, lead times, activity rates, personnel grade structures, prices, status of funding, and all the other facets involved in the preparation of the annual Defense Budget are scrutinized.

By and large, I believe it is fair to say that the new approach to defense planning-programming-budgeting has proved its worth. For the first time it has been possible to assemble and focus the vast quantities of information involved in the formulation of requirements, programs, and budgets on the principal areas of decision-making in the Defense Department. Although much remains to be done in the way of further refinement, the system has greatly assisted the Secretary of Defense in reaching decisions on major weapon systems and forces in context with the principal missions they were designed to perform.

Gentlemen, in conclusion, let me repeat what I said here last year. I have no illusions that the planning-programming-budgeting process will in itself make the hard decisions easy or the complex problem of formulating the National Defense Program simple. What these innovations will do, I hope, is facilitate the rational analysis of national security problems. They will make us aware of the full cost implications of the policy and program choices we make. They will permit us, in a shorter time and with greater accuracy, to cost out the various alternatives available to us so that we can develop a program which provides the greatest amount of defense for the resources

consumed. And that is the heart of the resource allocation problem in the Department of Defense.

Thank you.

COLONEL NORMAN: Mr. Hitch is ready for your questions, gentlemen.

QUESTION: Sir, who has overall staff responsibility at the OSD level in relating programs to requirements? In other words, what are your responsibilities as compared to the other Assistant Secretaries in general, particularly on TERD, installations, and logistics?

MR. HITCH: I think that this is the answer to your question: Whenever a program-change proposal is made by one of the services or by any other component of the Defense Department--and the vast majority of them are made by the services--that program-change proposal comes to my programming office. The programming office designates an office within the OSD which will have primary action responsibility on that particular program-change proposal. If it is a program-change proposal which primarily involves research and development, the office of primary responsibility will be the Office of Defense Research and Engineering. If it primarily affects logistic support, it will be I&L, and so forth. In addition, offices within the Office of the Secretary of Defense which have any interest at all in this program-change proposal, not just within the Office of the Secretary of Defense but anywhere within the Department, including always the JCS, and including in a good many cases other services which have an interest in this service's proposal, will be sent the program-change proposal and will comment on it, will have an opportunity to comment on it, to the office with primary action

responsibility. The office of primary action responsibility will write a consolidated memorandum for the Secretary of Defense in which will be stated the views of all components of the Department which have an interest in this program-change proposal. The office will lay out alternatives for the Secretary of Defense and will, as a rule, as the office of primary action responsibility, make a recommendation.

It is on the basis of this material and also the original submission by the service or other component that the Secretary will make his decision.

QUESTION: Sir, would you care to comment on the element of cost effectiveness as it pertains to this recent decision on the nuclear carrier? It appears from press reports as though the additional combat capability which the nuclear power plant would seem to provide might have been regarded as only goldplating.

MR. HITCH: No, I don't think anybody regards it as just goldplating. Well, there may be some people who do. But I don't think that the Secretary's view is that it is just goldplating. This, of course, is a decision which he has not yet made. He transmitted to the Navy a tentative decision and had a reclaimer from the Navy which he still has under consideration.

It wasn't that the nuclear power was just goldplating. I think that the Secretary recognizes very clearly that, if you were comparing one nuclear-powered carrier with one conventionally powered carrier, you would, on the basis of effectiveness, choose the nuclear-powered carrier. The real question is whether it is worth that much more--the additional cost. The original investment cost in the carrier alone will be at least \$125 million, and

possibly more. Associated with that there will also be the much higher cost, proportionately more, of the escorts for the carrier, because, proportionately, the cost of adding nuclear power is higher, the smaller the ship. You do not get the full advantages of a nuclear carrier if it has conventionally powered escorts.

So, what the Secretary is trying to learn is whether the increase in effectiveness, the increased endurance--because it is essentially that--of the nuclear carrier and the nuclear task force is worth the very substantially greater cost of the nuclear carrier and the nuclear task force.

I think that in principle this is the right approach to the problem. If the nuclear task force is going to cost, over the long run, say, 20 percent more, is it 20 percent more effective, or more than 20 percent more effective, or less than 20 percent more effective?

His position, as I understand it, on the FY 1963 carrier is simply that the Navy has not been able to produce anything that convinces him that it would be more than, say, 20 percent more effective.

QUESTION: Contrasts in thoughts on what you might call inter-service competition between the Symington Report, in which Mr. Gilpatric participated, and your book, ~~xxx~~ seem to be quite marked. Would you comment on current thinking at the OSD level on the single-service concept, pro and con?

MR. HITCH: I think you are referring to some comments that I made in my book on the value of competition in research and development. This could be inter-service competition or there are other ways in which you can get competition in research and development. I still believe in a good deal of

competition in research and development. I think that that competition has to be pretty much confined to the earlier stages of research and development. I don't think that it can be extended, except in very exceptional cases, to the competing development of operational systems by different services. I don't think I said anything in my book to the contrary.

The Symington Report, as I recall it, was really addressed to the question of the management organization of the Defense Department, the role of the services, and particularly of the service secretariats in relation to the Secretary of Defense, and the need for the service secretariats.

This is an entirely different question. It is an organizational question. It is a question on which I am certainly not an expert and one with which I did not deal in my book.

QUESTION: Sir, there is a conflict in the news as to whether Exercise Big Lift has demonstrated a capability for augmentation or for replacement. Can you tell us which it is?

MR. HITCH: Augmentation or replacement?

STUDENT: I think the situation is that the Germans feel that we intend to withdraw our forces.

MR. HITCH: That's right. Well, the primary purpose of Operation Big Life is to test and try out and exercise our ability to deploy rapidly. There is no question in my mind that one of the effects will be to demonstrate whether or not we can effectively deploy units of this size rapidly, and this could certainly affect our thinking, and, I would hope, the thinking

of our allies abroad, about possible future redeployments of our forces, associated with the leaving of heavy equipment abroad and the leaving of bases abroad.

QUESTOEM' Mr. Hitch, are the decisions on this year's PCP's being formulated with a view toward holding the total annual cost of defense programs to a level more nearly approximating the expected annual budget?

MR. HITCH: No. However, I think it is perfectly clear that the factors that I discussed in my talk this morning and the very apparent atmosphere that these factors have created, both on the other side of the river in the Executive Department and on the Hill, are influencing the Secretary. They are very important factors in the back of his mind in making decisions on particular PCP's as they come across his desk.

QUESTION: Mr. Secretary, have you found that the data converted from the appropriation structure to the program structure are accurate enough for your decision-making and control purposes, or do you foresee a need to change either the appropriation structure or perhaps the program structure to make them more compatible one with the other?

MR. HITCH: I see no need to change the appropriation structure for this purpose, and I think there are very considerable advantages in the appropriation structure as it has developed during the 1950's and 1960's.

We certainly need better cost estimating in connection with our programming activities which support our requirement studies, but I think that we don't achieve better cost estimating by making adjustments in the appropriation structure. We have to tackle this problem directly. It is primarily a problem for the individual services, a problem for them to

develop better cost-estimating techniques. We are, in Dr. Asher's office, attempting to assist as best we know how in the development and application of these techniques, working with the services.

There have been many unfortunate cases in the past where decisions were based on cost estimates that turned out to be just completely wrong, not wrong by a few percent but wrong by factors of 2 and 5 and even more in cases where we were dealing with weapon systems in the early stages of their development.

Now, I don't think that we are ever going to be very good at making cost estimates of weapon systems in the very early stages of their development, particularly weapon systems that really extend the state of the art. But I think we can certainly do much better than we have done in the past. I think that many of these cost estimates on which decisions were based were just obviously away out of line on the basis of previous experience. I think we can develop techniques which will show us in most cases those which are away out of line. Unless we do we are just kidding ourselves when we attempt to base decisions on this kind of analysis. It's one of the most important problems facing the whole programming and decision-making procedure.

QUESTION: Mr. Secretary, a previous speaker on the balance of payments problem has indicated that a certain amount of a balance of payments deficit is in fact desirable, that, with the growing economy in the United States, the current balance of payments problem will right itself, and that any precipitous action we might take might shake confidence in the dollar and

in fact might cause foreign bankers to make a run on the dollar. Mr. Secretary, would you comment on this view?

MR. HITCH: Yes. The principal comment that I want to make is that economists and everyone else who have attempted to forecast what is going to happen to the balance of payments in the future have made very bad estimates and have shown that this is a kind of forecasting that is beyond the state of the art.

I recall, immediately after the war, in the late 1940's, when we were running very large surpluses in our balance of payments, that practically everyone, both here and abroad, looked upon these surpluses as being a chronic problem for all future time. The great problem that faced the world economy was thought to be the dollar shortage, resulting from these surpluses. There were all sorts of theories that this dollar shortage fed upon itself and would get progressively worse. Instead, beginning as soon as 1950, we started to run deficits.

As I pointed out in my talk this morning, these early deficits were really desirable. We had cornered most of the monetary gold of the world in Fort Knox, and it was just necessary, in order to finance international trade, for these reserves to be redistributed and for dollars to be available to other countries for the financing of world trade. These dollars were made available, in effect, by the balance of payments deficit that we ran during the 1950's.

However, enough is enough. We have provided a lot of dollars. Most of the other leading industrial countries are now well supplied with monetary reserves in the form of gold and dollar holdings. There is a long-run problem facing the world economy which is, as international trade

continues to increase: How are we going to increase the reserves of all the participating countries as trade increases, because our monetary gold reserves are not increasing that rapidly? This does create a problem and it does threaten the stability of the international system.

It is also true that, if we suddenly reversed our balance of payments deficit and started running surpluses, we would create a new dollar shortage and reserve shortage problem throughout the world, which has been using these dollars as part of their reserves. We would be taking them back, which would lead to severe difficulties in other countries and might precipitate an international monetary crisis.

I have been hearing ever since we took office from various officials of the Treasury and other optimists outside official life that our balance of payments troubles are temporary and that they are going to correct themselves, that the real problem is this year and next year will be better. We have recently had a report, a very good report, prepared by the Brookings Institution, in which they forecast that our balance of payments deficit will right itself by 1967 or 1968, mainly because prices and costs are rising more rapidly in other advanced countries than they are here. Maybe they are right, but I'm just not sure. If we run deficits in the order of \$3 billion for another 2 or 3 years even, our reserves are going to be drawn down to a point where we will be extremely vulnerable to a run on the bank.

QUESTION: Mr. Secretary, I have a related question. As you know, on current commercial accounts the United States earns a surplus in balance of payments. In your talk you stated that, if our balance of payments continues

on the overall accounts to be negative, this will have serious implications for our deployments abroad. Why is it that you don't take the position that these continued balance of payments deficits will have serious implications for tourism and for the capital market? More broadly put, how is your activity on the programming side related systematically to the structure of our foreign policy?

MR. HITCH: I was about ready, but that last sentence threw me. This is the way I would do it. I would certainly let tourism go before I would let military defenses go. I would certainly put a stop to this excessive overseas investing and use by foreign countries of our money markets before I would give up our defense deployments, any necessary defense deployments. I would hope that that would be the position taken by this Administration or any future Administration.

All I said was that, unless the balance of payments problem is solved, our defense deployments are going to be put in jeopardy. Now, there are other possibilities. I know that the Administration has been thinking hard about various ways to curtail tourism. It's very hard to think of good ways to curtail tourism. If anybody here has any good suggestions I would welcome them.

Let me add just one more word. The Administration, of course, has taken what has so far proved to be a very effective measure to reduce the use of our money markets by foreign borrowers. It may prove to be less effective after it is enacted--assuming that it is enacted--than the anticipation of it has proved to be, but I welcome this step, and I think it may be desirable

and necessary to take further steps along this line.

It is hard, however, because most of the things you can do to stop the flow of particular investments are very easy to evade unless you have complete foreign-exchange controls, and this is something that this Administration and I think any Administration will shy away from just as long as possible.

QUESTION: I am under the impression that the Defense Department is trying to encourage NATO and certain foreign countries in which we provide foreign aid to introduce a system similar to your program control. Would you comment on this?

MR. HITCH: Well, I think we would be happy if NATO, and particularly the more important NATO countries, would develop something comparable to our programming system which would facilitate the relating of their budgets to the forces that they are supporting either within or outside of NATO.

This is a very delicate matter, of course. What we have done is to brief the NATO Council on our programming system, and we have responded to requests from the British, the Germans, and the Belgians to brief their respective Ministries of Defense.

It's very hard to transplant a financial management system from one country to another, because the basic governmental structures, the budget structures, the history, the parliamentary systems are so completely different. But we think that there are some elements of what we have done here that could usefully be used by other NATO countries. If they did use them, it would facilitate NATO planning and NATO defense.

COLONEL NORMAN: Mr. Secretary, on behalf of both Colleges, thank you very much for discussing this most important subject with us this morning.