



## FINANCING NATIONAL SECURITY

Honorable David E. Bell

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Reviewed by: Col J. H. M. Smith      Date: 3 Jan 1963

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

FINANCING NATIONAL SECURITY

17 October 1962

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Reporter--Grace R. O'Toole

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

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ADMIRAL ROSE: Gentlemen:

Even in our own personal day-by-day affairs money is important. The size of the national budget is important because it also takes the amount of money we have left over to buy things at home.

You have already heard from several of our speakers about the fact that they were submitting estimates and defending things for the 1964 Budget.

The man who has to put all of this together in one document, explain it to the President, get his approval, and then carry it from then on is the Director of the Budget.

It is my great pleasure to present Mr. David E. Bell, the Director of the Budget.

Mr. Bell.

MR. BELL: Thank you very much, Admiral. Gentlemen:

I am very pleased to have this opportunity to talk with you this morning. We share common interests of considerable dimensions. As you all know, the Federal Budget at the present time is totalling expenditures of something over \$90 billion, of which the national security amount is estimated for the current fiscal year to be around \$58 billion, including Defense proper, the Atomic Energy Commission, our space activities, and our international activities. This is over 60 percent of the tax dollar that all of us pay.

You are here in part, I suspect, because you have demonstrated a considerable capacity for management and top leadership in your various agencies and services. You will be going on from here to positions of major responsibility, some of you to the highest that the Executive Branch offers.

We have in the United States what I think is a very good system of combining in commanders and in agency heads both administrative responsibility and financial responsibility, so that, as you have already learned in your previous capacities and as you will continually experience in your future assignments, you have to bear a share of the financial responsibility for what is to be spent by the United States Government. It is particularly because of this aspect of your present situation and your future careers that I regard it as a real opportunity to be here with you today.

The subject I have been asked to discuss, Financing National Security Policy, is a very large subject. I won't attempt to cover it all. I propose to concentrate in the remarks I'll make before the break on what seems to me to be a series of questions that reach to the heart of the subject in an analytical sense. How do we decide how much of our national resources we can and should put into national security purposes? How do we balance our plans for spending funds in one aspect of our security position as against another aspect? How do we balance the requirements of security against the requirements of other aspects of the National Government's activities in civilian fields, such as education or highways? How far can we answer questions like this in a rational, quantitative, arithmetic manner, and how far do we answer them by judgment or by the seat of our pants, and, if so, what are the

logical consequences of these facts?

These are the questions that I would like to talk with you a little bit about before the break. I will be at your disposal after the break for different types of questions if you so desire.

In order to avoid any possible misunderstanding, I should make one preliminary observation. I suspect this is not news to any of you here. Like most of those in this Administration, I do not regard the matter of financing national security policy as a different thing, a different set of decisions from deciding what that national policy ought to be. In this Administration we have all stressed very strongly that we do not make policy decisions independent of their cost. On the contrary, we make policy decisions in the light of and while we are well aware of what their costs are. You do not have a plan if you have decided to do something but have not decided to pay for it. You only have a plan if you have both decided you want to do it and are prepared to pay the cost associated with it.

The only reason for stressing this, which is a very obvious and elementary point, is that it has not always been true in the past in the United States Government. Sometimes there have been occasions on which it has been said that we had a national security plan or policy to accomplish a certain set of objectives and then the annual budget did not support that plan or policy at all. We are trying to avoid any such circumstance in the present Administration. As you probably know, the Comptroller of the Defense Department refers to a combination planning, programing, budgeting process. I personally think of it this way also. Everything I say this morning should be understood to rest on that assumption.

Let me first raise the question: Is there a financial limit to what we can or should put into the national security of the United States? Some of you will recognize that I put the question in that form deliberately, as a straw man. I don't think there is any such limit, at least within any reasonable relationship to the level of spending that we have at the present time.

You sometimes--well, not just sometimes but frequently--hear a good deal of discussion, if you read a good deal of discussion in the newspapers, you hear it in the Congress and among commentators, <sup>to the effect</sup> that the cost of government is rising, very drastically, that this is a danger to the national interest and the national welfare, that if the cost of government continues to rise we could be in very serious difficulties, and for that reason we should put a clamp, a limit, a ceiling on the outlays that we are proposing to make for national security purposes and for other purposes in the budget.

The logical defense, insofar as ~~this~~ position has a logical defense, seems to run along one of two lines; first of all along the line that we should not spend more than we take in, we should not spend beyond our revenues. This argument shades very easily into the implication that we should be limited in our spending plans in the Federal Government to the amount of revenues which will be yielded by the tax system that happens to be on the books at any given time.

Put in that way I think you can see immediately that there is no essential logic to that point of view. The tax laws that are on the books are there as the result of historical circumstances. They were written by men who felt that those tax laws reflected an appropriate demand on the taxpayers at the time they were prepared.

But there is nothing sacred about them. They can and should be changed from time to time. If we need to spend more than we are spending we should obviously be prepared to pay for it, but the tax laws can be changed upward as well as downward. The question is not What do the tax laws give us? but What level of taxation do we wish to impose and do we feel it necessary to impose?

Furthermore, there is a different argument about the level of revenues which can be very awkward and, I think, personally, very misleading. You have seen this argument debated considerably in the last year or two. This is the argument as to whether we should try to match our expenditures in any year to the revenues that are going to be available in that year.

I think that economists in the United States would agree at least 99 percent that this argument would be a very dangerous one to accept. This point of view would be a dangerous one to accept because it overlooks the fact that we have business cycles, business recessions and booms in the country and, if we were to try to match our expenditures to the revenues that would be collected under a particular set of tax laws in a year of recession, this would require us sharply to cut back government expenditures to match the revenues that were going to be coming in in that particular year, quite regardless of the needs that might be met through those expenditures.

Furthermore, if we did this, we would be contributing to a worsening of the economic situation and not a betterment of it. If we cut back our expenditures sharply in a year of recession, this would mean cancelling government contracts, firing employees, and in general taking a series of restrictive actions which would

contribute to the economic downturn which is already characteristic of a recession period.

So to the economist it is an open-and-shut case that we should not try to match expenditures to revenues in a recession year. Indeed, we should regard a government deficit as an instrument against recession and should deliberately increase the deficit either by reducing taxes or by increasing expenditures, if that can be calculated and times in a way which would contribute to bringing us out of the economic recession.

Under these circumstances the fiscal policy which economists propose, and which in large part is adopted as accepted by this Administration, as it was by the preceding Administration, is that we should plan our overall revenues and expenditures not to match each year but to be related to the economic circumstances that we foresee in the next year or two.

This does not mean, obviously, that we should not match revenues and expenditures over a period of time. By and large we accept the desirability of doing that. I might note in passing that there is an argument among economists, which you may hear some echoes of during this year, and may see some echoes of as you read newspapers and scholarly journals, for any of you who do, that we have been in the United States for the last several years in a condition of continuing under-employment. Ever since 1957 the unemployment rate in the country has been averaging around 6 percent, whereas most people think that it ought to be averaging around 4 percent or less, if we were to fully use the human resources the country has.

There are economists who say that a way, one of the methods, by which we can push the economy from this continuing level of underemployment to a full employment level would be to deliberately run government deficits every year, varying in size, obviously, with the circumstances of the time, but nevertheless deliberately planning to run deficits over a series of years. That point of view has not been accepted by the present Administration. It is not the basis for our present policy-making. Nevertheless there are very respectable, honest economists of both parties who believe that this is the case in the United States circumstances of today. I suspect the discussion of this point of view will come increasingly to the fore if, as seems likely, we are going to continue to be in this state of uncomfortably high unemployment steadily over a period of time. The main point I am making, obviously, is that it is not a satisfactory basis for determining how much of the Nation's resources we should put in the national security, and simply to say, "Well, we are limited by the revenues which are coming in." Revenues are flexible just as expenditures are.

The second argument which is made to support this point of view that there is some sort of financial ceiling which we should put on national security outlays is simply the argument that there is an awful lot of money going into security and going into the Federal Budget as a whole, and that amount of money is rising steadily. This year it is \$93 billion; last year it was \$88 billion; the year before that it was \$82 billion, and so on. You can carry the progression back; the figures are all available. They show quite correctly that the absolute size of expenditures in the Federal Budget has been rising very steadily in the last 10 years. There was

kind of a bulge in the early fifties at the time of the Korean War. If you look back beyond that to the end of World War II you see the same trend of rising expenditures. It carries back that far.

Is this indeed a cause for alarm? Is it something we should regard as evidence of approaching doom? I think by and large the answer is clearly no. If you look not at the absolute figures but at the relationship between Federal Budget expenditures and the national output of goods and services you do not get a rising relationship but a stable one. Today the budget expenditures, as I have quoted them, are running around 16 percent of the gross national product. If you look back for the last 10 years you will find that that is virtually the same figure every year. It was slightly higher during the Korean War and slightly lower in the late forties. But, basically, if you look at this trend line since the end of the war it is flat and not rising.

This is simply to say that the proportion of national resources we have been putting into our Federal Budget has been relatively stable since the end of World War II. In consequence, it is very hard to make a case that rising government outlays are in and of themselves any kind of a danger. During the period since the end of World War II the country has expanded. The economy of the country has expanded rapidly and the standard of living has risen very sharply. We are individually and as a nation vastly better off over this past 15 years, and the improvement, by any welfare standard, is continuing.

Moreover, if you ask, "Why 16 percent?" the answer seems to be that this is roughly where the conflicting judgments and attitudes came to rest. I think myself

it's a little suspicious that it is so stable. It doesn't seem to me that this is illustrative of the flexible judgment one ought to make. I don't think the national requirements have been that stable. But that's the way the figures show up when you look at them in a statistical sense. I think this probably indicates that we are a little overly rigid in our patterns of making decisions on budgets of both revenues and expenditures size.

Nevertheless, the main point I am making is that there is nothing to the argument that, since the Federal Budget has been rising, we must be approaching some kind of a limit beyond which it would be unsafe to go. The Federal Budget as a national proportion of the/output of goods and services has not been rising.

If you look ahead, the implication is quite clear. The GNP is going to continue to grow, which makes room, if it is desirable, for the Federal Budget to continue to grow. About a year ago now, in the closing days of the first session of the 87th Congress, Senator Byrd, who holds views on most of these matters, I am sure you know, quite different from mine, said that he could foresee, if present trends were not reversed, a Federal expenditure budget in 1965-6-7--I have forgotten--5 years from whenever he was talking--of \$106 billion, \$108 billion, or something like that. At that time we were spending in the middle \$80 billion dollar level. This was played up in the newspapers like a horrendous figure. If you calculate what the GNP is likely to be at the time of which he was speaking, you will find that his figure, again, is 16 percent. If it came true, it would imply no increase at all in the relative share of the national output of goods and services going for Federal Budget purposes.

Having said all this, I would like to emphasize that in my opinion there is nothing whatever that is magic about 16 percent. If it is necessary for us to spend more, it seems to me we could easily do so. During World War II, the largest proportionate share of the GNP that was taken through the Federal Budget was about 45 percent. We reached level in fiscal years 1943 and 1944. That was exceptionally high. At the same time, if you will recall, there was the remarkable economic fact that all through World War II the civilian standard of living by and large was rising, not falling. What we did to finance World War II essentially was to bring into production tremendous resources of manpower, plant capacity, and so on which, through the thirties and even into the late thirties, had not been used--were idle. So our gross national production could be suddenly increased to a large extent.

That would not be true today. If we were to jump the budget take, the share of national resources to be devoted to Federal Budget purposes, presumably for national security reasons, if that were to rise sharply, we could not do so without cutting back somewhat on the resources that go to satisfy civilian wants. However, none of us would argue, I think, that civilian wants are being met at a level of scarcity or austerity, and there is plainly a tremendous share of the national resources which could be devoted, if it were necessary, to national security purposes without significant damage to the national welfare.

In consequence, I personally conclude that there is no reasonable prospect of a financial limit to what we could put into national security if it were necessary, anywhere near the range of what we are now using. At the same time it also seems

to me that the basic pattern of values that we all share indicates that we should spend less if we possibly could. There is no advantage to it. It is not a contribution to the national welfare in the personal sense to spend money for security reasons or many other aspects of the Federal Budget. So that if possible I think that all of us would like to see that 16 percent cut down, so that we could have more of the national resources left to us as individuals to spend.

Now, if I am correct, and if we are not constricted by some kind of financial limit, what, then, should be the basis for determining how much of the national resources should go into security? There's another way by which this question is sometimes approached by some military officers and others who feel very deeply and very strongly on the subject of how important the national security is. This argument you will frequently hear, and it runs essentially that we should give some kind of absolute priority to security outlays, we should spend whatever is necessary to insure the Nation's security, we should look at the requirements, and whatever they are we should finance them.

This would be fine. It may be a satisfactory philosophical position. I have not myself seen any way in which it can be an operational position. There is no such thing as absolute security under today's conditions, and I assume that there never was, though I am no military historian. We can spend virtually any amount and add to our security. There is no way by which we could say that if we only spent \$60 billion it would finish the matter off and we would be absolutely secure, that we need not spend \$61 billion, that \$60 billion is enough, and we can guarantee security to the country. I don't think it's that kind of a problem. It seems to me it

is a problem of relative risks, whatever level of outlays is determined to be necessary. You can, and should, presumably--and I think this is probably the heart of the process--judge, make evaluations of the relative increase in security which will be obtained by a particular increase in security outlays of one form or another.

This is the kind of logical judgment which needs to be made, But that's a different thing from saying that there is some sort of absolute level to which we can push our security expenditures, and should push them, and that will end the matter.

Consequently, I don't find, either on the side of financial availability or on the side of security requirements, any absolute answers. I think we find only relative answers. I think analytically, therefore, we are driven back to the proposition that we must make judgments on the relative advantages of different activities in the security field, weighed against the cost that will accompany them, weighed against the alternative uses of those same resources for other national purposes, private or public.

That's a general statement of the logic that is involved. It is not a statement of an operational method. Let me discuss now for a few minutes the extent to which this can and cannot be turned into an operational set of ideas. I don't think myself that we have a very sophisticated set of analytical tools. Therefore, I am not bringing you a revelation from on high here today. I will in large part be indicating what seems to me to be an agenda for further thinking, further research, and unsolved problems.

Let's look first to the discipline of economics. There are, I think, some ideas from economics which are usable in trying to reach judgments as to the relative values of different possible levels of security expenditures in comparison with their cost.

First of all, most of economics is irrelevant. Most of economics deals with a market system, and we are not concerned here with something that can be weighed and measured in a market sense. We don't buy national security in the economists' kind of market. So that a good bit of very advanced, careful, intelligent work that economists have done over the last 150 years to develop models of pricing mechanisms, cost mechanisms, allocation systems, and so on, which revolve around the idea that it all works through an impersonal market where different forces come together and give you allocations and prices which represent the tastes and desires of the community, -all that set of ideas, -by and large is inapplicable to what we are dealing with.

But there are some logical points which have come out of the work of economists which are applicable. There is first of all the idea of measuring and comparing the relative gains and the relative costs of particular actions. This is an idea which is not limited to market situations. We use it very widely in budgeting. Throughout the Federal Budget there are activities where, in one way or another, you can assess what benefits you will receive from applying resources to a given purpose, and you can measure what it is going to cost you.

The principal difficulty you encounter is in those situations, and many aspects of national security are of this kind, in which the benefit you receive is not

quantifiable. You can't measure it. Particularly, you can't measure it in dollar terms. Sometimes you can't measure it in any terms we have yet invented. Now, some of the areas in which this statement would have been true a few years ago are yielding to quantitative analysis. The relative value of education, for example, is one such area. Economists have been working now for the past several years, a number of able economists, quite hard on the question of what is the value of education to individuals and to a society. Some of them, notably Professor Schultz of Chicago, who is a very distinguished economist indeed, and a past president of the American Economic Association, would now say that we have come far enough so that we can attach some quantitative values to investment in education in the United States or in any other country. In consequence, we should be in a position soon to be able to make more quantitative judgments about the value, in relation to the cost, of various kinds of educational outlays, at the local level, the State level, and the national level, and possibly at the level of those of us as individuals in trying to plan our own family budgets.

This is an illustration of the possibility that some of the areas to which we have not yet been able to apply quantitative analysis may yield to such analysis in the future. The logical process is clearly one which we should try to apply to the national security issues. What is the advantage to us of 600 Minute Men in place ready to go at a particular point in future time as against 500 Minute Men in place ready to go at the same point in future time? It's a quantitative question. In part it can be given a quantitative answer even today, not in market terms but in terms of what those Minute Men can do in relation to what we think the potential enemy

can do. The relative value in relation to the relative cost of those Minute Men we are beginning to be able to grope our way toward analyzing.

There is a second idea that comes out of economics which I think is quite useful as we try to wrestle with this problem. This is the idea of measuring and comparing at the margin. You noticed how I phrased the question about the Minute Men. What are 600 Minute Men worth in comparison to 500? What value have those last 100 Minute Men in comparison to the last squadron of B-52's? If you have another million dollars to put into defense, is it more valuable to put in into another Army division or into another 50 Minute Men? These are questions asked as economists have learned to ask them in marginal terms, and they sharpen up the issues. The essential response may still have to be one which depends on judgment and not on quantitative comparison. I think in large part today that is the case. Nevertheless, to ask the question in marginal form may itself be a very useful and helpful aspect of the logical approach to these things.

Finally, in recent years economists have come forward with a set of ideas built around the theory of gains. What is the likely response of an enemy to a particular set of decisions on our part? If we do this will he do that, which will negate it and will require us to readjust our own plans, and so on? Rather than thinking simply of the enemy's position as something that is independently established, consider the interplay between his and ours. This is an idea which really grew originally out of thinking about market situations in which there were few sellers or few buyers. Hecht's obviously has to consider the effect and the repercussion on Woodie's of what they may do.

This idea has been developed to its greatest extent, I think, by Professor Tom Schelling of Harvard. He may be one of your lecturers this year--I don't know. He has worked extensively in the field of the economics of national security and he stresses very heavily this particular aspect.

I am suggesting that there are at least these three aspects of logic which come out of economics--the notion of comparing relative gains and costs, the notion of working at the margin, and the notion of applying, so far as possible, strategy and gamesmanship.

Now, I would not overemphasize the degree to which this permits us to answer questions of resource allocation to defense as a whole or among defense alternatives. I think they do give us some notion of what we are trying, some idea of what the right questions are. I think we are a long way from being able to answer them in a particularly handsome or clean-cut, quantitative manner. I think they give us a better basis at the present time for working within the field of defense than they do in enabling us to compare between defense and other kinds of activities that need to be financed through the Federal Budget.

I have been very impressed myself by the degree to which it has been possible to make quantitative analytical judgments on the questions of the different forms in which we can put together strategic forces, Comparing Polaris and Minute Men and B-52's you can really go quite a long way in trying to derive quantitative comparisons. You can go less far, it seems to me, when you are working on a question like missiles versus divisions. You can go less far even than that when you are working on questions of how much to the Defense Department and how much to education

in the Federal Budget. On these questions we are still flying pretty blind.

Moreover, even in the cases where we were beginning to be able to apply quantitative ideas, we are still in such a primitive stage that we must rely, it seems to me, very heavily on judgment.

This takes me to the second and last point I want to make, as far as what I have prepared to say goes. If judgment is involved, and I think it has to be, there are important questions of whose judgment it is. Here we have some ideas that derive essentially from the study of government and political science. If you look at the development of proposals and their disposition in the field of national security, you start, of course, with the service element involved and come up through the service department to the Secretary of Defense. The judgments are invoked at each of these stages. Then they come up to the level of the President.

An interesting thing is that at that level the President is the first man, among all of those who have made judgments and reached decisions on these questions up to this point of what I have said, who has to stand for election. The judgment that he makes is going to be put on the line in a political sense. The judgment the rest of us make is not. His judgment, then, of course, is put before the Congress in the form of budget recommendations, and they have to stand for election on the disposition they make of his recommendations.

Now, this means that the system we have is basically one that means that national security decisions are going to be settled in a political context. People are frequently very frightened at this. It seems somehow un-American. Politics is something that is sort of grubby, faintly distasteful, and not a clean-cut, logical

way to decide issues of national security.

I read, I remember, a year or so back an article by an economist at the University of Virginia who argued that it was impossible to expect good decisions on national security in a political context because people would always vote for what they would see as their short-run interest, and they would always vote for comfort and against sacrifice.

If this were in fact the case I think we would all be in a pretty parlous state. I think there is some reason to feel a little more comfortable about it than that fellow did. We have evidence in recent years of the country doing things that have not been too comfortable and easy. Many of you were here, as I was, when Mr. Truman took us into the Korean War. This was a dirty, painful, irritating, distant affair. I suppose the final verdict of the historians is not in on it. It seems to me that this was a tremendous act of the application of U. S. power in a crucial situation and that it was extraordinarily important to the security of the Nation that we do that. We did it. We were reasonably successful within limits that the situation imposed. This was a factor in the election of 1952, but I imagine it would be agreed that it was not the only and not the most decisive factor in that election, and the incoming Administration did not change the basic security policy which had been enunciated by the previous Administration but continued it, not only in the sense of continuing our position in Korea but continuing the various other elements of the foreign policy of the United States and backing it up through the budget in national security terms. All of these matters since the war have been irritating, uncomfortable, distant, painful, and costly, and yet they have been continued.

A series of Presidents have sustained them, and the public opinion obviously has backed them up regularly.

You can make even a stronger argument. There was an element in the campaign of the present President which was related to his feeling that by and large the security interests of the country had not been adequately supported in the late fifties, just before the election of 1960, and to some extent he campaigned on a pledge of increasing the allocation of resources to the national security, which, of course, has been done. The recent budgets have very substantially increased the resources devoted to national security.

This, I am sure, is not a simple case, that he argued that and was elected and therefore the people of the United States rendered their verdict. It was one element in a very complicated situation, but it was one element and a very clear one.

So that it seems to me the basic conclusion one comes to, considering the political element of decision-making in the national security field, must be that with adequate leadership it is possible to expect a reasonable decision for the country in terms of both the long and the short-run interests of sustaining national security through the budget allocation process.

Now, I wouldn't by any means argue that we can't improve the process. The Budget Bureau can improve it to some extent simply by contributing to better education of the country on what issues are involved. All of you will be in the process of doing the same thing from your various positions. The degree of public education on the meaning of our national security and what we must do to pursue it

is certainly less than it ought to be. This is made most evident every year when the annual fracas over foreign aid takes place. Everyone who has studied the matter within the Government on a sophisticated basis, including, I am sure, all of you, knows that all of the last three Presidents have in general concluded that a reasonable, certain volume of outlays for assistance, both economic and military, to foreign countries is as important an element of our national security outlay as any other element of that outlay, and the expenditures for foreign aid are as important to our national security as expenditures directly for the defense services.

This is not the attitude, obviously, that is displayed in the Congress, nor is this attitude, I am sure, widely understood and shared in the country. This is an evidence of a lack of understanding on the part of public opinion in the United States which may yet cost us very dear. If we do not carry through a strong foreign aid program and as a result some of these countries are lost to the free world, it would seem quite obvious and evident that we would have to pay a good deal more in a direct sense for increasing our direct military defense outlays.

So that this is very much an unsettled question and one that will be with us for several years. Furthermore, the process by which these various judgments are made that we have been talking about, while it has been refined and improved, I think, quite extensively in the Executive Branch in recent years, has not been correspondingly improved in the Congress. The congressional process of dealing with these basic budget issues is not one that seems as logical as one could devise, even recognizing the basic natural characteristics of a legislature which cannot be changed. It is a body of men who must reach a collective judgment through a

necessarily complicated and time-consuming process of mutual accommodation. That's what it is there for. You can't fight that part of the problem. But you certainly could devise ways by which members of Congress would be better informed and ways by which they could organize themselves and their time, and provide themselves with staff assistants which would be far better than those that are in existence today.

So that, even though I have personally some feeling of confidence that we need not all quit and go home in despair at the thought that in the last analysis these decisions on national security budgeting are going to be passed on in the political process, it seems to me that this opens up a different and a new agenda for improving that process and the education of everybody from the general public to the members of Congress who are involved in it.

There is no reason, I think, for me to make any long summary of what I have said here today. I shall simply stress that I think there are no rules of thumb which give us an easy way to arrive at decisions on financing our national security policy. I think we have to face instead a series of hard, difficult questions of judgment which can be approached in a logical sense by asking about the relative advantages and the relative costs of different alternatives. You can make comparisons frequently at the margin which will sharpen up the questions. You can ask about the response in the national security field-- what your actions are going to do others and how they are going to respond, and what that will make you do next, and so on.

These, I think, are ways of approaching the problem more intelligently.

Nevertheless, it is still going to rest on judgment as far ahead as we can see, to some extent improved and replaced by direct quantitative comparisons. The judgments that are involved are those of people like ourselves in the Executive Branch but also people like the President and the members of Congress who are participants in the political process. There too, there are possibilities for improving the intelligence and the rational basis for the decisions that are made.

I take it this is the time we are supposed to have a break.

CAPTAIN BRYCE: Gentlemen, Mr. Bell is ready for your questions.

QUESTION: Would you please discuss your views regarding the gold-flow problem, as well as the alternatives you see to solve it?

MR. BELL: Yes, I will be delighted to. First of all, the balance of payments of the United States, meaning the total payments outward from our economy to other countries, in relation to the total receipts of our economy from other countries, has been in deficit for the last several years. It was in deficit over \$3 billion a year in 1958, 1959, and 1960 calendar years. In calendar year 1961 it was about \$2.5 billion. This year Secretary Dillon has said he expects it to be under \$2 billion. It is still in deficit, however.

As settlement for those deficits, foreigners, foreign banks, foreign individuals, and foreign companies, do hold claims against the United States to the extent of the deficits, and in consequence their claims against assets in the United States have risen in recent years. Some of those claims have been settled by their taking gold in settlement for their claims. Others have not. Others simply exist on the books as debts of one kind or another that we owe to people abroad.

It would be a mistake to concentrate too sharply on the gold flow that is involved. The gold flow is simply a part of the settlement process. Many people who have claims in the United States have no reason to collect on them. They do not want to obtain assets from us. They are quite willing to have the claims stay here. They have investments in the United States of one kind or another. Nevertheless, if the complete claims that are outstanding against the United States were collected all at once, they would exceed the amount of gold that we have available to pay them.

On the other hand, we also have claims on other countries. We had been running balance-of-payments surpluses for many years before the middle fifties, and we have assets abroad substantially greater than the assets that foreigners have in the United States. If we collected all of the assets that we have abroad we could bring back to the United States much more gold than there is in the world.

So that these hypothetical full collection calculations, while interesting, are not particularly realistic as immediate possibilities.

Now, the fact that gold has been flowing out of this country to a lesser extent than the deficits in the balance of payments, nevertheless steadily, is significant from several different points of view. In one sense it has served to establish a much stronger and healthier relationship between the reserves of other countries and those of the United States. For many years we were practically the only nation in the world that had any substantial gold reserve. There is no particular reason why this should be the case or why it should continue to be the case. Insofar as other countries, other governments and central banks have required gold reserves

makes for a wider distribution of the gold backing for monetary systems around the world. This is not a bad thing at all. At the same time, we have a law on the books in the United States which requires that our currency, according to the technical definition in the law of what currency is, which is principally Federal Reserve notes, must be backed 25 percent by gold.

There is nothing magic about 25 percent. The law could equally well say it must be backed 5 percent by gold, or 100 percent by gold. It happens to say 25 percent. In fact, the currency in the United States is not valuable because it is backed by gold. It is valuable because it will buy something, and it will buy something because the internal monetary system and the economy are so organized and managed that the currency remains valuable.

This is a problem of inflation and the price level and the sensible management of the national economy and of national monetary affairs, all of which are very important questions but have virtually nothing to do with gold. We could, without real damage of any type, apart from the psychological impact, abolish or forget about gold, seal it up in Fort Knox, and never talk about it any more, and run a monetary system and an economy that was equally as stable, or unstable if you like, as the one we now have.

The fact of the existence of gold in a real economic sense is a historical anachronism. Internationally it remains convenient to have some arbitrary standard such as the value of gold to measure the convertibility of currencies. But the international value of currencies is not set by what a country says its currency is worth in gold. It is set by what the country's currency will buy. This is the reason for

the International Monetary Fund and for devaluation and revaluation, and so on.

Any of you who have studied economics, I think, will recognize all this as a very commonplace comment. Therefore, to a large extent the problem of the gold outflow is, in a technical sense so far as it affects the United States monetary reserve, what we make it, and no more than that. However, the problem of the balance of payments, apart from the gold flow, is a real problem and a very significant one, and one that we need to devote very serious attention to.

This is the problem of, What is the significance of these continuing deficits? By and large they signify that, if you take the balance of payments apart and look at it in pieces, we have been running a substantial excess of commercial exports over imports, continuing right through these recent years. We've had several billion dollars of favorable balance of trade on commercial accounts. Simultaneously, however, we have been spending money abroad, first for private investment to the tune of \$2 or \$3 billion a year, second to pay for our tourists who go abroad to the tune of around a billion dollars a year, and thirdly for the financing of national activities involving expenditures abroad, of which the largest is, of course, the existence of the military forces in Germany and Europe and around the world, which has been costing us in the neighborhood of \$3 billion plus each year.

In addition we have been spending for foreign aid, lending money or giving it to foreign governments in the interest of their development programs, that money then being spent by those countries in Europe, Japan, or some place else, to buy the commodities and equipment that they want. The net balance of payments effect of the Foreign Aid Program is about \$1 billion a year.

We have been earning foreign funds from the tourists who come here and from providing certain other services. The net effect of all these different transactions is the overall deficit that I have been speaking of.

Now, it is clearly undesirable for us to run a substantial deficit indefinitely. It is not necessarily economically undesirable to run some deficit for quite some period of years. We would prefer not to. But certainly we want to have the feeling that the balance of payments position is under control. For the last several years the deficit has been too big to allow us to feel comfortable about that.

In consequence there are a series of policy actions which have been taken and are under way now which are aimed at, first of all, increasing our exports, which involves a whole lot of things, from a larger sales effort through stressing the maintenance of level prices and costs in the United States. Increasing exports obviously is the best and simplest way to improve the balance of payments position.

In addition measures have been taken to limit the impact of Federal activities on the balance of payments. To offset the military expenditures abroad we have attained agreement from Germany that the Germans will buy here approximately as much in the way of military equipment as we spend in Germany to maintain our troops there, and discussions have been held from time to time with France and Italy as well.

We have obtained prepayments from some of those countries on loans that we made to them back in the Marshall Plan days. We have had several hundred million dollars of prepayments from Germany, France, and Italy in the last couple of years. This has helped in the situation.

In the foreign aid field, since late 1959, I believe it was, there has been a policy in effect under which by and large we do not give money to foreign governments--we provide them with goods purchased in the United States. This, of course, has no direct impact on the balance of payments. We are simply giving them products of our own factories, farms, and so on.

In consequence, and to sum up, I would say that the balance of payments problem is a significant and serious one in measuring the relationship between our own economy and foreign economies, and we have a series of policy measures under way to improve that relationship. The gold flow itself is largely a problem in psychology and historical legislation. We are bound to a considerable extent by past attitudes on this. Obviously legislation reducing the requirement for gold covered behind our currency would encounter a great deal of opposition. That opposition would in an economic sense be nonsense, but it would be there, it would be real, and it would be highly controversial action for the Congress to take. So far neither President Eisenhower nor President Kennedy has made any such proposal.

QUESTION: While I realize that you don't believe in running a deficit indefinitely, for ever, it is my impression that in bad times we should not cut down expenditures and we should run a deficit for fear of making bad times worse, and in good times I always hear that this is not the time to balance the budget. No one yet has explained what happens at the end of this process. Will you comment?

MR. BELL: Yes, I will. So far as the position of the Administration is concerned I should emphasize that, while we have not yet had a chance to put it into

practice, it would be our attitude that in good times, in boom times, the Federal Budget should be planned to be in surplus, not so much for long-term effect on the debt but for short-term effect on the stability of prices. The corollary of the proposition, that in times of recession the Federal Budget should be in deficit as a contribution toward limiting the recession and getting the country out of it, is the proposition that in times of boom the Federal Budget should be in surplus, in order to <sup>take</sup> purchasing power out of the private economy and reduce the inflationary pressures which otherwise might result not in increasing national output but simply increasing the national price level. This would be exceptionally important in the present period of time because of the balance of payments difficulties that I spoke of earlier. It is extremely important at the present time to hold a stable price level.

We have been doing pretty well on this for the last five years. The wholesale index in the United States has been essentially stable while the price indexes in Europe have been steadily rising. This has improved regularly and steadily our competitive position in the European markets. Now, nevertheless, your question is a very legitimate and proper question. What is the long-run prospect if we follow this kind of fiscal policy which I have described, which the CED calls a stabilizing budget policy, and which by and large this Administration has accepted as correct, like the preceding Administration? Does this mean that over a period of time we would in fact increase the national debt? It depends on how strongly you think the private economy will respond. The view that the Administration takes is that, if we got to full employment the demand would be sufficiently strong so

that private investment would be considerably larger than it is today and, with the process of growth in the population and improvement in technology and a continuing level of full employment, we could indeed expect that the private economy would be essentially self-sustaining. The Federal Budget could oscillate to handle short-run recession and boom situations and you should not have over a period of years a net addition to the national debt.

This would be the policy. Now, as I indicated during the course of my talk, there are economists who differ with this and who say that at the present stage of the structural development of the United States economy you could not expect that to take place, and that you will have to have steady deficits in the Federal Budget.

How do they meet the question you have just raised? They say that the degree or the amount of the deficits that would be involved in the increase in the national debt is not significant enough to cause anyone long-run concern. They point to the fact that since the end of World War II the Federal debt has risen about 11 percent. During the same period of time corporate debt has risen 250 percent and personal or private debts of families, borrowings on installment accounts, automobiles, and so on have risen 300 and some percent, the total amount of family debts. The debts of State and local governments have gone up over 300 percent. During this period of time, they say, as you look at the economy as a whole, the Federal debt has been extremely conservative, the Federal Budget has been handled in an extremely conservative manner, and the debt has risen by a very small amount.

Moreover, this is a comparison of the absolute amount of the Federal debt at the end of World War II and today. This means that relatively the Federal debt has been steadily declining. At the end of World War II the Federal debt was approximately 130 percent, if I remember correctly, of the gross national product, in 1946 or 1947, or whenever it was. Since that time the Federal debt as a percentage of the GNP has been steadily falling. Today the Federal debt is only about 50 percent of the GNP. In consequence, in thinking of the Federal debt in relation to the capacity of the country to pay for it, so to speak, it has been a steadily declining burden.

They therefore argue that as long as the Federal deficits were calculated moderately, so long as you assumed any substantial private investment response to increases in demand, any conceivable program of stimulating the economy by a series of deficits over a series of years would not raise the Federal debt enough to cause anybody serious concern about our ability to carry it.

Now, I repeat, this is not the position that we are arguing in favor of. I am quoting to you the arguments of economists who do take this point of view and who are responsible people, concerned over the finances of the country.

To come back to the position we do take, which is that we see no reason why it should not be possible to balance the Federal debt if the economy is running at reasonably full employment--balance it over a series of years--this is essentially the position of the CED. They say our policy should be to balance the budget at high employment, that we should calculate our tax system to cover the expenditures that we want to make if the economy is operating at about 4 percent unemployment. If the economy operates below that we would run a deficit. The CED would say we

should accept that deficit under those circumstances.

This is approximately where we are today. This assumes that, if we get to and oscillate around full employment, we will not be adding to the debt over time. It implies, however, that the debt would stay at approximately its present level for quite some period into the future, and it would not be gradually paid off.

What does this mean? It means essentially that we will sustain a debt of approximately the present size, or would under these assumed circumstances, for some time to come. We would have to pay the carrying charges. The carrying charges are now running around \$10 billion a year. This is a substantial sum of money. It is not, of course, enormous. It is one-tenth of the Federal Budget. It is 10 out of 600, one-sixtieth of the GNP. I would personally very much like to see us reduce it. I have not been able to see any way by which we can make plans in the immediate span of years we are in, this 2 or 3 year period we are in, to reduce the national debt and have a budget policy which would contribute toward keeping the economy reasonably fully employed.

This I think was the conclusion of the preceding Administration. I think Arthur Burns would answer this question just about the way I have answered it. During the 8 years of the Eisenhower Administration the net increase in the Federal debt was around \$18 billion, as I remember. They were confronted by essentially the same conditions that we are. Most of this increase came in the second term, during the period of time when we were not able to get the economy back up to full employment. We are still in that period of time. We still face the same essential difficulties. We still, I think, have to assume that we are going to

be running relatively small but nevertheless significant budget deficits , at least in the present year. We ran one last year. We ran a smaller one the year before. In 1959, of course, we ran a big one, over \$12 billion, the biggest one to date, which was simply a reflection of the recession of 1957-58.

I think, therefore, that the attitude we should have toward the debt is that nobody is desirous of increasing it, we are desirous of reducing it. We have not been able to reduce it under any Administration since the War. It has not, however, risen by amounts which need to be regarded as alarming. It appears likely to me that the present span of years may show similar results. If they do, then it seems to me we should continue not to be alarmed. In relation to the power and strength of the economy, the Federal debt has been falling and not rising. This, I think, is probably the single most significant fact to look at when we are trying to assess the meaning of the Federal debt to us.

**\* QUESTION:** Sir, has the new mission-oriented and program-backing budgeting system of the Department of Defense received the approval and support of the Bureau of the Budget?

**MR. BELL:** It certainly has. We were very pleased to see it developing last year, and we have tried to use it as the figures have become available. We regard it as the single most illuminating and valuable method for presenting the programs of the Defense Department in financial terms. ✓

This does not mean that the other methods of looking at the Defense Budget have been abandoned either by the Office of the Secretary or by ourselves. Appropriations to the various services will continue to be made, and the classification of ✓

Defense expenditures by type--that is to say by operation and maintenance, construction, procurement, personnel, and so on--also remains a useful set of figures which we are continually working with. ✓

The mission-oriented budget presentation was used, of course, by Secretary McNamara in his presentation of the Defense Budget to the committees on the Hill this past year. I understand that they, too, found it a very illuminating and useful method for looking at many of the important aspects of the Defense Department Program. They, too, of course, did not regard it and are not apt to regard it as a substitute for the prior systems which were still available and are still available. ✓

So far as our approval is concerned, I think it is probably the least important aspect of the matter. We are an advisory body to the President. The questions really are: Is it useful to and liked by the President? I think the answer is clearly yes. Is it useful to and liked by the Congress? I think the answer is yes there also. ✓

**CAPTAIN BRYCE:** Mr. Bell, speaking for the audience, thank you for a most excellent addition to our courses of study. ✕