

THE ECONOMICS OF NATIONAL PRIORITIES

HEARINGS
BEFORE THE
SUBCOMMITTEE ON
PRIORITIES AND ECONOMY IN GOVERNMENT
OF THE
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JUNE 1, 2, AND 4, 1971

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THE ECONOMICS OF NATIONAL PRIORITIES

TUESDAY, JUNE 1, 1971

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN
GOVERNMENT OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire and Representative Conable.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; Ross F. Hamachek, Richard F. Kaufman, and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowski, research economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. This is the third consecutive year that the Subcommittee on Priorities and Economy in Government has conducted hearings on the subject of national priorities. In the present inquiry we hope to highlight what we consider to be the more important economic issues and to conduct an intense examination of the composition of the Federal budget. It is clear that whatever is said about national priorities must be measured against what is actually done in the budget.

To obtain a reordering of priorities a major change has to occur in the allocation of resources. The administration claims this has been done, that our priorities have been changed dramatically in the past 2 years. A close look at the budget indicates otherwise.

For one thing, there can be no shift from a wartime to a peacetime economy while the Nation is still burdened with a wartime defense budget. Two years ago the defense budget was about \$80 billion. This year the administration is once again requesting an \$80 billion defense budget. Even taking inflation into account, such an enormous outlay for military purposes is not consistent with the claim that we have successfully managed the transition from war to peace.

In this year's annual report of the Joint Economic Committee the concept of defense was expanded to include all expenditures related to national security, whether funded through the Department of Defense or not. The national security budget was then totaled for the years 1965 and 1968 through 1972. What we find is a most disturbing picture.

The national security budget went from an already high level of \$71.6 billion in 1965 to \$103.6 billion in 1968 and then to \$106.1 billion in 1969. Since 1969 national security outlays have fluctuated between \$105 and \$107 billion and now promise to resume the upward climb. Requested budget authority for 1972 is \$111 billion.

Perhaps a peacetime economy is no longer an attainable goal, given the state of military technology and the international environment. Personally, I do not believe this to be the case. But if the administration believes it, then the American people ought to be told.

An analysis of the major changes in overall budget outlays for fiscal year 1972 suggests that the administration is moving at glacial speeds, if at all, to reorder national priorities. Of the \$22 billion available for shifting in 1972—over and above what is required to continue funding programs established in prior years—\$12 billion is being used for programs that cannot be controlled through the budgetary process, such as pay increases, social security, and previous commitment and contracts for housing subsidies and urban renewal.

That leaves only \$10 billion for programs that can be controlled through the budgetary process. Of this amount, \$1.5 billion has been earmarked for the Department of Defense, \$4 billion for revenue sharing, and the remainder for welfare reform, school desegregation and contingencies.

Our witnesses this morning are eminently qualified to discuss these matters. Indeed, they have already done so in brilliant fashion in the study entitled, "Setting National Priorities, The 1972 Budget." The coauthors of the book, Charles L. Schultze, Edward R. Fried, Alice M. Rivlin, and Nancy H. Teeters, are all distinguished and well-known economists who have served in public office and are presently on the staff of the Brookings Institution.

I have your statements before me, and I am of course familiar with your book, so why don't you proceed from left to right with your introductory remarks.

STATEMENT OF CHARLES L. SCHULTZE, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. SCHULTZE. Thank you, Mr. Chairman.

All of us are pleased to have the opportunity to discuss with you this morning our recent study of national priorities, centered around the President's 1972 budget proposals. With your permission, it might be most helpful to the committee if each of us spent 5 to 10 minutes summarizing particular aspects of our study. We would then be prepared to answer questions on the points covered in our testimony or on any other matters discussed in the study.

Mr. Fried will cover the area of foreign policy and national defense; Mrs. Rivlin, the area of human resource programs; and then Mrs. Teeters, the areas of housing policy and social security.

I would like to lead off with an overall summary, relating the problem of setting priorities to the budgetary situation, both the short run and the long run.

Necessarily the President's budget describes only one set of alternatives: those the President is recommending. To make intelligent

choices, however, the Congress needs to review a wider spectrum of alternatives. There are alternatives with respect to the objectives the Nation should pursue, there are alternatives with respect to how much resources should be devoted to each objective, and there are alternative ways of trying to achieve those objectives. In our study of setting national priorities we have not attempted to construct a set of budgetary proposals as a single alternative to those recommended by the President. Rather we have sought to identify the major choices which the President is asking the Congress and the American people to make; to describe some alternative choices which might be made; to analyze the more important consequences, both short and long run, of accepting one or the other alternative; and finally to spell out some of the criteria which should be considered in choosing among the various alternatives.

Several major features emerge from an analysis of the 1972 budget:

First, its overall fiscal impact on the economy is perhaps best described as natural; it provides approximately for a balanced full employment budget in both 1971 and 1972.

Second, like budgets of recent years, a significant fraction of the growth in expenditures—about \$12 billion, as the chairman mentioned—from 1971 to 1972 will reflect built-in escalation, due to rising prices and wages, growing numbers of beneficiaries on social security and public assistance rolls, rising workloads, and similar factors.

Third, income maintenance programs of all kinds have become the largest single element of Federal expenditures, growing at about \$10 billion a year in the past 2 years, as a result of built-in growth factors, sizable increases in social security benefits, and the adoption by the administration of an income maintenance strategy as the chief instrument in the war on poverty.

Fourth, budgetary savings from Vietnam withdrawal continue in 1972 to be eaten up by the impact of rising wages and prices on the defense budget and to a lesser extent by increasing support and procurement costs for the baseline (non-Vietnam) forces.

Fifth, the bulk of the 1971 to 1972 expenditure increases, not absorbed by built-in growth, is devoted to three major areas: Revenue sharing, social security benefit increases, and non-Vietnam defense programs including the first step toward a voluntary army. The other major new initiative—the family assistance plan—will not have a major budgetary impact until 1973.

We have attempted to look further ahead by projecting the budgetary outlook through 1976. Revenues were projected on the assumption of a return to full employment sometime before 1973, and the continuation of existing tax laws. The expenditure projection estimates the future costs of existing programs and of those proposed by the President in his 1972 budget. It allows only for built-in growth due to such factors as rising wages and prices and growing numbers of beneficiaries on social security and public assistance rolls. It does not allow for the substantive expansion of existing programs or for the introduction of new ones. It is, in other words, an estimate of the future costs of existing and Presidentially proposed programs and policies.

The difference between revenues and expenditures so projected is the "fiscal dividend"—the excess of revenues yielded by existing tax laws over expenditures necessitated by existing and Presidentially proposed programs. It is an estimate of the net amount available from economic growth and Vietnam withdrawal which can be available for undertaking new Federal activities, for cutting taxes, or for holding as a budget surplus.

On the basis of our estimates there will be no fiscal dividend between now and 1974—that is, the growth in expenditures under existing and currently proposed programs will equal the growth in revenues and the savings from Vietnam withdrawal. In the subsequent 2 years, between 1974 and 1976, revenues will rise modestly more than expenditures, so that by 1976 there may be a \$17 billion fiscal dividend.

But this \$17 billion is only slightly more than 1 percent of the then projected gross national product. While the Federal Government in total will be absorbing more than 20 percent of GNP, only 1 percent out of the 20 percent will be available for new initiatives, and even that small amount won't begin to appear until at least 2 years have gone by.

The fiscal dividend which would emerge after 1974 is not only small, it is very "delicate," in the sense that it may easily disappear and not be available for high priority uses. Practically all of the fiscal dividend in 1976 will show up as a surplus in the social security trust funds. If, as has often happened in the past, the Congress seizes upon the growing surplus in the trust fund to increase the level of social security benefits by more than cost-of-living increases warrant,¹ the social security trust fund surplus, and hence the fiscal dividend, will be reduced or disappear.

These projections lead to several implications. First, over the next 4 years, the combination of tax reliefs granted in the 1969 Tax Reform Act and expenditure programs already on the books or proposed in the President's 1972 budget will use up almost all of the resources becoming available in a relatively painless manner through economic growth and the winding down of the Indochina war.

Major new Federal initiatives to meet high priority national objectives will have to be primarily financed either through tax increases or through reductions in spending on existing programs.

Second, to the extent that the current high levels of unemployment call for additional budgetary stimulus this year, measures should be chosen which do not imply either a permanent reduction in tax revenues or a long-term increase in spending, unless the items selected for spending are of such very high priority that we are willing to see them eat into the very slim fiscal dividend projected for the mid-1970's.

On the basis of these criteria, permanent tax reductions such as depreciation liberalization or expenditure programs such as accelerated public works—which result in added outlays only after a substantial time lag—are very poor choices.

In conclusion, let me mention findings of our priorities study in specific program areas which my colleagues will not cover in their testimony.

¹ The projections already allow for increases in social security benefits to match cost-of-living increases.

With respect to water pollution control programs, we point out that current Federal policy, and most of the proposals, but not all, currently under consideration by the Congress, emphasize the setting and judicial enforcement of standards and the provision of grants for municipal waste treatment plants. But these policies and programs neglect almost completely the development of economic incentives to induce industrial polluters to reduce the pollution content of their waste discharges. Evaluations of past performance in this area, and projections of the future magnitude of water pollution problems all emphasize industrial pollution as the major problem. The levying of a tax on polluters, proportional to their waste discharges, would provide a powerful incentive for them to minimize pollution. Yet such a highly effective approach is seldom given much of a hearing by those devising pollution policy.

Our priorities study also cites the results of an independent projection of water pollution wasteloads over the next 30 years. This projection shows:

First, that with present technology, wastes generated will grow alarmingly over the period.

Second, that secondary treatment of wastes could sharply reduce this wasteload.

Third, that the cost of uniform secondary treatment of all wastes would be very expensive indeed, reaching \$28 billion per year in 1980 and \$55 billion annually by the year 2000. This emphasizes, again, the priority which should be given to providing incentives to industry to change their internal processes to generate smaller wasteloads.

In the area of Federal transportation policy our study brings out one major point. The highway trust fund generates about \$1 to \$1.5 billion more in revenues each year than is needed to complete the Interstate Highway System and to carry out other federally aided highway programs at the rate contemplated when the trust fund was established.

What should be done with this annual "surplus" in the trust fund? Should it be automatically utilized for increasing the annual rate of highway construction, or should some means be found to make a conscious priority decision about the purposes to which these revenues should be directed? Only through a deliberate review of the highway trust fund program can the Congress come to grips with this question.

In our view, there is no good argument for automatically allowing a major increase in highway spending to occur, simply because the trust fund revenues exceed current expenditure levels. A conscious priority decision should be made.

If I may, Mr. Chairman, I would like to turn it over to Mr. Fried who will discuss the area of foreign policy defense budgets.

Chairman PROXMIRE. Fine.

Mr. Fried, will you proceed, sir.

Mr. FRIED. Thank you, Senator.

STATEMENT OF EDWARD R. FRIED, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. FRIED. Mr. Chairman and members of the committee, this year's defense budget is the first to reflect force structure decisions arising

out of two major foreign policy developments: The judgments flowing from the Nixon doctrine and the influence of the strategic arms limitation talks with the U.S.S.R.

We have tried, therefore, in the priorities study to outline the foreign policy outlook associated with the defense budget as well as other defense policy considerations that have gone into the administration's review of strategy and force levels over the past 2 years.

The results of that review, at least as they are reflected in the fiscal year 1972 defense budget, can be summarized as follows:

For strategic forces, the maintenance of a diversified strategic deterrent composed of sea-based missiles, ABM-protected land-based missiles and bombers along with the continued installation of new weapons systems to increase the capability of the deterrent. Other advanced systems are under development but the decision to procure them is left open.

The cost of this force is fairly stable—roughly one-fifth below the pre-Vietnam level of expenditures for strategic forces, as measured in dollars of constant purchasing power. Whether we move toward a more rapid pace of modernization—and of course higher strategic budgets that would go with it—will depend in part on the results of the SALT talks.

For baseline or peacetime conventional forces, a significant cutback of three divisions, two carriers, and five Air Force and Navy wings from the pre-Vietnam level. This change—the result of a reassessment of strategy—means in effect a reduction in forces maintained for Asian contingencies. Despite this sizable reduction in combat units, however, the estimated cost of general purpose forces is slightly higher than the pre-Vietnam level—again measured in constant dollars.

For Vietnam, the prospect is for a continued decline in the cost of the war. Savings from the further withdrawal of troops will be offset only in part by increased military assistance in Indochina. In terms of national priorities, the important point is that two-thirds of the savings from Vietnam are already behind us.

We cannot look to the phasing down of the war as a major future source of funds to finance other programs. If there is to be a major shift of expenditures from defense to nondefense needs—or indeed the reverse—it will depend for the most part on how we assess future requirements for peacetime forces and on the efficiency with which we meet those requirements.

As part of the projection of the budgetary outlook and the fiscal dividend, we have attempted to price out the current defense posture over the next 5 years, along with some alternative defense budget options. We do not claim great precision for these estimates: They are at best rough approximations. Their purpose is solely to clarify the choices that lie ahead.

These projections indicate that the cost of the current defense posture would rise from \$79 billion (in total obligational authority) in 1972 to \$88 billion in 1976, in current dollars. In other words, the remaining savings from ending the war would be more than offset by pay and price increases, by the additional cost of the volunteer service, and, by implication, the cost of new weapons. At that level, the defense budget would be about 6 percent of GNP compared to 7 percent today.

This is not a prediction of present probabilities—but merely the projected cost of current forces, excluding the additional forces created specifically for the Vietnam war.

For comparison we have outlined two alternative defense budgets—one lower and the one higher than the current defense posture. They by no means represent an extreme range—to the contrary, each would be consistent with differing interpretations of the Nixon doctrine. Considerably lower as well as higher budgets could be derived from the wider alternatives spelled out in the book for both strategic and conventional forces.

The low budget option by 1976 would be approximately \$76 billion, or roughly 5 percent of GNP at that time. Essentially it would be consistent with an austere interpretation of the Nixon doctrine. It would finance a diversified strategic deterrent—with retention of warning and detection systems and continuation of measures to protect land-based missiles and bombers. The significant changes would be the elimination of the existing air defense system, postponing procurement decisions for new systems to the late 1970's, and phasing in replacements during the 1980's.

For conventional forces, this budget would support a more literal interpretation of the one and one-half war strategy—that is, a further reduction in forces for Asia and greater reliance on Europe-oriented forces to deal with any crises in the Asian region. It would require a further reduction of perhaps three Army divisions, two carriers, and seven Air Force and Navy wings. The pace of weapons modernization would have to be reduced from present levels.

The high budget option, on the other hand, would come to \$96 billion by 1976—which would mean continuing defense expenditures at the current ratio of roughly 7 percent of GNP. It would finance a more rapid phasing in of new strategic systems and a faster pace of conventional weapons modernization—particularly for the Air Force and Army.

A further issue worth noting is the changing relationship between combat and support forces and the important implications this could have for defense spending—over and above the budget options noted above. What seems to be happening is that the support base or the defense overhead is not going down commensurately with the reduction in combat units. The consequences can be seen for each of the services in the relationships between total manpower and total budget costs on the one hand, and the number of force components on the other.

In each case, the implied budget cost of an army division, or a ship, or an active aircraft, in dollars of constant purchasing power, is considerably higher in 1972 than in 1964. Also in each case the total manpower associated with each force component is higher, and this, of course, is a fundamental reason why budget costs are up.

The indices are crude and the implications oversimplified, but the budgetary consequences seem to be significant. The stickiness of overhead costs, for example, could be an important reason why the cost of the baseline conventional force did not go down despite the reduction in combat units. In part, the explanation may lie in the difficulty of moving very fast in pruning the defense structure in a situation

where military manpower is being reduced by almost one-third in the space of 3 years.

Nevertheless, it flags an important problem—the need to keep close watch on the defense overhead as the Vietnam pipeline dries up and related adjustments are made in military manpower needs.

Finally, a few conclusions may be worth noting regarding foreign assistance programs, which are also examined in the international affairs section of the priorities book. We estimate the total foreign assistance requested this year at \$7.5 billion, of which almost \$4.5 billion is for security assistance. The bulk of this security assistance is related to the war and financed in large measure in the defense budget.

A surprising fact regarding foreign assistance programs is the degree to which they have stayed in a range of between \$6 and \$8 billion a year—measured in 1972 dollars—over more than two decades.

What has shifted dramatically has been the distribution as between security and development assistance. During the Marshall plan period and during the first half of the 1960's, the emphasis of the program was on development assistance. During the 1950's and following active United States involvement in Vietnam during the 1960's, the stress has been on security assistance. My personal bias is reflected in the hope that over the 1970's we will once again see the need to accord priority to development assistance, both as a means of promoting security in the broader sense and as an appropriate way to conceive of United States responsibilities in a troubled world.

Thank you.

Chairman PROXMIER. Thank you, Mr. Fried.

And now Mrs. Rivlin.

Will you proceed, please.

STATEMENT OF ALICE M. RIVLIN, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mrs. RIVLIN. Mr. Chairman, these few pages will attempt to summarize briefly for the committee the major questions raised in the chapters of "Setting National Priorities: The 1972 Budget" that deal with revenue sharing and with human resource programs (chapters 6-11). The emphasis in these chapters is not on the relative priority to be attached to various overall goals—such as health versus welfare, or defense versus alleviation of poverty. Rather, it is on the choices among means of achieving such widely accepted goals.

If there is a theme running through these chapters, it is the great difficulty of designing public programs when several objectives are sought at once. It is difficult, for example, to find a way of transferring funds to State and local governments when one objective is to increase the ability of these governments to fill locally perceived needs and another is to insure that national priorities are met.

It is difficult to design an income maintenance system when one objective is to help the neediest and another is to encourage work. It is difficult to design a health financing system when one objective is to improve the access of individuals to needed medical care and another is to hold down the cost of care for everyone.

The following are some of the questions that must be discussed and debated by the Congress and the public before the particular set of programs proposed in the 1972 budget can be accepted or rejected.

The first question is: Is general revenue sharing the best way to aid State and local governments?

The budget proposes earmarking a proportion of Federal revenues for distribution to States and localities—no strings attached. The question at issue is not whether State and local governments should receive additional Federal funds, but whether we need this new mechanism. The book examines three arguments for general revenue sharing. The argument that general revenue sharing is necessary to meet a general and continuing State and local fiscal crisis is found weak.

Unless they raise their tax rates further, State and local governments in the aggregate seem likely, by 1976, to be short about \$10 billion needed to pay for likely expenditures. But this gap is of modest proportions (less than 4 percent of expected State and local expenditures) and could be filled by a variety of means.

Aggregates can be misleading, of course. Some State and local governments, especially big cities, are in much deeper trouble than others, but general revenue sharing is not obviously an appropriate means of channeling Federal revenues to meet the special needs of big cities. The current pressure on State and local budgets caused by the combined impact of recession and inflation is undoubtedly severe, but again the revenue sharing device is not easily adapted to alleviating these short-run cyclical problems.

The argument that revenue sharing would return "power to people" and give local governments more control over their spending is a separate argument whose persuasiveness depends partly on the weight given to local as opposed to national priorities. It is also argued by the proponents of general revenue sharing that revenue sharing would help redistribute resources toward needy areas and needy people.

The validity of this argument depends on what is seen as the alternative to revenue sharing. Compared with a cut in Federal taxes of equal magnitude, revenue sharing is likely to result in more public services in poorer areas financed from less regressive taxes. But if revenue sharing is seen as an alternative to increases in other Federal grants, the answer is not so clear. It depends on what is given up and how the revenue sharing funds are distributed. Several alternative formulas are considered in the book.

The second question: Is special revenue sharing the best way to reform the Federal grant system?

The budget proposes consolidating 130 separate grant programs into six grants for broad purposes like "education" and "transportation." There is no question that the Federal grant system needs reform. There are now far too many grants. Many are obsolete and the whole structure is complex and expensive to administer. The administration could have recommended pruning out and consolidating superfluous grants or giving State and local governments flexibility to transfer some funds from one category to another so long as they met the requirements of the programs they selected. In fact, the special revenue sharing proposal goes much further.

State and local governments would have far more discretion than they do now over the use of Federal funds. Indeed (with the exception of education where considerable specificity is retained), the six purposes are so broad that special revenue sharing seems unlikely to differ much from general revenue sharing except that some of the six formulae would favor cities, others would favor small towns.

Hence, enactment of the special revenue sharing proposals might have important effects on the congressional process and the role of lobbies and interest groups. Congressional appropriation decisions would become less important in determining what the funds were spent for and would tend to focus far more heavily on where the money was spent.

The third question: Can we design an income maintenance system that is equitable, helps the needy, and encourages work?

There is general agreement that the present welfare system meets none of these criteria adequately. Payment levels are unconscionably low in many States; there are major inequities (equally needy people are treated differently in different places and the working poor are not covered at all); and those who are covered have little incentive to work. The family assistance plan proposed in the 1972 budget moves a small distance toward equity and adequacy. It does not improve incentives to work appreciably, because benefits would be reduced sharply as an individual's earnings rose. The difficulty is that lowering the rate by which benefits are reduced as workers earn more is expensive and the extra money this requires would not all go to the neediest.

The book explores the implications for the future of moving to a system of the same general type as the family assistance plan, with guarantees of higher levels. It makes the point that such systems are expensive. The net cost of a FAP-type plan with a \$3,600 level (for a family of four) would be about \$25 billion, and that of a \$5,500 level would be about \$71 billion.

Moreover, such plans whose benefits rise with family size would necessarily entail considerable transfers from small to large families at the same income level. Middle income families with a large number of children would be receiving benefits while small families at the same income level would be paying income tax. Such a situation might be regarded as antisocial, as well as inequitable, by those concerned with excess population growth.

The fourth question: Do we need to create public service jobs and, if so, what kind?

Even if income maintenance programs are designed to encourage work: the poor cannot work if no jobs are available. The book explores the potentialities and costs of job creation programs—even though such programs are given almost no attention in the 1972 budget. The problem of reconciling conflicting objectives also arises in job creation programs. If the objective is simply to create jobs for the unemployed, a given number of people can be employed most quickly and cheaply in low-skill dead-end jobs. If the objective is to perform useful work or to provide new skills and career opportunities for the employees, then the cost per job created is necessarily higher and the programs tend to attract people who would have been employed anyway rather than the "hard core" unemployed.

The fifth question: Social security: Should we finance a universal pension system by a regressive tax?

The rapid growth of social security benefits and tax collections dominates the domestic side of the budget and seems likely to do so in the future. The social security payroll tax is now the second largest Federal tax source and payroll tax rates are scheduled to rise while income tax rates are scheduled to fall. One question to which the Congress should give urgent attention is the desirability of financing such a large portion of Federal expenditures from a tax which falls heavily on low-wage earners and, unlike the income tax, provides no personal exemptions to reflect ability to pay. Mrs. Teeters will discuss this question in somewhat greater detail.

The sixth question: Can we provide everyone with needed health care without escalating the rise in health care prices?

The problem of conflicting objectives is nowhere more evident than in health financing. There is general agreement that we want a financing system that insures good quality care to all who need it and at the same time promotes efficient use of health resources. There is also general agreement that we do not have such a system now.

Unfortunately, measures to broaden health insurance to cover more people and include more services increase the pressure of demand on supply and tend to accelerate the rise in medical care prices, while efforts to hold down costs by increasing the share of the bill paid by the consumer tend to exclude those who need care from obtaining needed services.

New forms of health service delivery—such as health maintenance organizations—sound promising, but little evidence is available to show that they will actually hold down costs without impairing quality. The book compares two major health financing proposals—that of the administration and the Kennedy-Griffiths bill—and raises questions about whether either contains workable mechanisms for insuring efficient use of health resources.

Chairman PROXMIRE. Thank you, Mrs. Rivlin.

Mrs. Teeters, please proceed.

STATEMENT OF NANCY H. TEETERS, RESEARCH ASSOCIATE, THE BROOKINGS INSTITUTION

Mrs. TEETERS. Mr. Chairman, I appreciate the opportunity to appear before this committee with my colleagues to discuss setting national priorities. I will address myself to the areas of social security and housing.

The social security programs, old age, survivors, and disability insurance, are the largest of the income maintenance programs. They represent a major investment in human resources. The appropriateness of providing adequate benefits to persons eligible for old-age, survivors, or disability insurance is not questioned.

The people of this country clearly support these programs that provide income to millions of workers and their dependents who have reached retirement age or who have become disabled. The provisions in pending legislation that assure adjustment in benefits for increases in the cost of living make explicit the commitment to protect the benefits from the effects of inflation. However, we are concerned about the method of financing those benefits.

With some exceptions the expenditures for social security cash benefits are completely financed from payroll taxes. When the total size of the program was relatively small and the payroll tax was low, few people questioned using payroll taxes for this purpose. However, the expenditures for social security benefit programs are now the second largest expenditure in the Federal budget and the payroll taxes are the second largest source of receipts. As long as the benefits are predominantly financed by payroll taxes, the aggregate volume of expenditures will determine current and future payroll tax rates.

Consequently, when benefit provisions are revised, the tax rate schedules, both in the near term and for the future, have been increased. Until recently, the near-term tax rates appear to have been set so that the revenues and expenditures were approximately equal, with the tax rates needed to keep the system in actuarial balance scheduled for the future. However, in recent years the combined employer-employee tax rate has been in excess of the cost of the program and rather sizable current surpluses have accumulated in the trust fund.

A nationwide social security system is not like a private insurance plan. It cannot, by accumulating a surplus, investing that surplus in government securities, and using the interest on those securities to pay future costs, transfer any of the real costs through time. The interest on the government securities held by the trust funds is also a government expenditure and taxes must be levied to pay it.

If the large trust funds that are projected were to materialize, their existence would only alter the extent to which future generations are taxed by way of the payroll tax or through general revenues to support the retired population. Either way each working generation is taxed to support the currently retired population.

Because social security is essentially a tax and transfer system, current tax rates should again be set so that current revenues and expenditures are roughly equal. To avoid an overall loss in Federal revenues, it may be necessary to raise other tax rates. In addition, other reforms of the tax would be desirable. The payroll tax is regressive. Because of the wage ceiling, the payroll tax is a larger proportion of earnings below the ceiling than it is of those above. The payroll tax is paid by all employees in covered employment, with no exemptions or adjustments for family size or the number of workers in the family. Thus, a family with more than one wage earner with combined earnings above the ceiling pays considerably more taxes than does a family with the same income earned by one person.

Several proposals for reform have been made. The burden on low-wage earners could be reduced by introducing personal exemptions or providing for a refund of the taxes paid on income below a certain level. In addition, more of the costs of financing the benefits could be shifted to general revenues. A more frank recognition of the fact that social security is only partly an insurance system and that it is also a mechanism for redistributing income would help to develop a more rational and equitable method of financing benefits.

In another section of the book, we examined the national housing goals. We asked three questions: First, do we need 25 million new housing units of which 5 million are to be subsidized units for low- and moderate-income families? Second, are that many housing units likely to be built? And, third, is subsidizing the purchase or rental

of new housing units the most efficient way to provide decent housing to low- and moderate-income families?

We found the question of how many new housing units are needed difficult to answer. A very substantial number of new housing units—between 11 and 13½ million—will be needed to accommodate the expected increase in the number of households. Beyond accommodating the increased number of households, the need depends on desirability of replacing unsatisfactory existing housing units and increasing the number of vacant units to reduce upward pressure on rents.

The housing goals call for construction of 2.5 million units a year, which is between 1.1 and 1.4 million units a year in excess of average rate of household formation expected. The number of new housing units constructed has exceeded household formation over the past 20 years, but by far less than the amount called for in the housing goals. There is some danger that the vacancy rates implicit in the housing goals could reduce incentives for the private market to build new houses.

To estimate whether 25 million housing units are likely to be built, projections were developed based on past relationships between housing starts and demographic and economic factors. Under the most favorable conditions that it seemed reasonable to assume, total new housing starts, including mobile homes, for the 10-year period in our projections, totaled 23.4 million units, 1.6 million units below the housing goals. But this lower volume of housing production would still permit removal of approximately the same number of undesirable existing units as called for under the national housing goals.

The subsidy program that is part of the housing goals apparently assumes that most low- and moderate-income families eligible for the subsidies live in substandard housing and that new housing units must be built for them. Data tabulated from the 1966-67 Survey of Economic Opportunity give new information about the distribution of substandard housing.

They suggest that the chief problem of the poor in urban areas is not so much substandard housing as it is high rents relative to their incomes. The urban poor pay a very large fraction of their income in rents. The data suggest that it may be more efficient to give housing allowances to poor and moderate-income families to allow them to live in decent housing without having to spend a large proportion of their incomes on rent. A housing subsidy which seeks to provide new housing for the poor may be addressing the wrong problem and is very expensive. Subsidizing the 5 million new units and 1 million rehabilitated units planned for in the housing goals is estimated to cost eventually between \$5 and \$6 billion a year on an average or \$800 to \$1,000 per unit per year. The annual budgetary cost of a housing allowance that reduces the rental or homeownership costs for the poor to live in existing, as opposed to new housing, would be less expensive—about \$3 billion a year.

In order to keep rents from rising rapidly under a program of housing allowances, it would be necessary to pursue policies that encourage overall residential construction or that reduce restrictions, such as racial discrimination, that make it difficult for people receiving such allowances to live in decent older homes.

In addition, housing allowances could be part of the family assistance program. One of the problems involved in reforming the welfare system is variation in the cost of living between regions and between urban and rural areas. Rent apparently accounts for a large part, but not all, of these variations in the cost of living.

The welfare payment could be in two parts, a uniform minimum payment as the first part with a second part to cover the cost of housing. The second part would vary from area to area. Although such a system would not compensate for all variation in cost of living between areas, it could be a part of a system that integrated various forms of welfare assistance.

Chairman PROXMIRE. Well, thank you very much. This has been a most enlightening and helpful panel. I think that the book and the efforts made by Brookings is one of the most useful contributions that I have seen in the years I have been in the Senate. I only regret that there is not some way of calling broader attention in the Congress and in the country to it. I hope that this committee can do that, and I intend to do all I can by speeches on the floor and talking to my colleagues in the Senate, calling their attention to this, because I think it is a most helpful contribution.

Now, from this morning's discussion I find very little cause for optimism. Maybe I am wrong.

First, I would like to get a response to the general question that I raised in my opening statement. Has there been a dramatic shift of national priorities in the past 2 years? Has the administration successfully managed the transition from a wartime to a peacetime economy?

First, Mr. Schultze.

Mr. SCHULTZE. Well, maybe I can start to answer that. When you ask the question have we shifted priorities, you have to ask, "from what?" And this question is a little bit like the young man who was just married and one of his friends asked him how he liked his wife and he said, compared to what? So the question is a shift in priorities from what?

If you look at it in terms of the absolute levels of dollars spent, there has been a shift, but I do not think it has been very large. If, on the other hand, you measure the defense budget as a proportion of GNP, there has been a significant reduction in the proportion of GNP devoted to the defense budget, as two things have happened.

No. 1, reduction in Vietnam costs, and No. 2, a growth in the GNP while the overall defense budget in current dollars over the last 3 or 4 years has not grown.

In my own view this is not the best way to measure a shift in priorities. There is no absolute percentage or absolute dollar volume that is relevant. I think we still have to ask the question, what are we getting for the last \$5 billion or the last \$10 billion we are spending in defense compared to what we might get somewhere else, and it seems to me rather than asking the question of what percentage change has there been as a proportion of GNP, we need to continue to look—as I think this committee has—at what are the dollars going for, and are we getting what we ought to get out of defense spending and where else might we use some of those dollars and would that be a higher priority.

Chairman PROXMIRE. Would you like to comment, Mr. Fried?

Mr. FRIED. Just one brief comment. I agree with Charlie Schultze's statement. I think if you look at the specific question of Vietnam and what has happened to Vietnam savings—as I indicated, two-thirds of them are behind us, not ahead of us—you get some paradoxical views. One is that since the peak period of Vietnam expenditures in 1968, there has been a decline of roughly \$15 billion.

Chairman PROXMIRE. Let me just interrupt to say that I think your statement that two-thirds of the savings from Vietnam are behind us is a startling and interesting statement. I have not heard that from anyone else. I have heard people estimate maybe half but they have not done it on the basis of analysis, just a guess. In view of the fact that we have not withdrawn half of our troops yet—we are close—and in view of the fact that we still seem to be spending a tremendous amount over there, how do you calculate that two-thirds of the savings are behind us?

Mr. FRIED. I am sorry. The figure—that assumes the \$8 billion cost of war in the 1972 budget. The rest of the savings are already in the 1972 budget.

Chairman PROXMIRE. Oh, you are talking about prospectively?

Mr. FRIED. Yes, with the cost of war at roughly \$8 to $8\frac{1}{2}$ billion, as reflected in the 1972 budget, which assumes continued withdrawals at roughly the past rates and that we would have 100,000 troops in Vietnam by June of 1972. On that basis, we estimated the incremental cost of Vietnam in the 1972 budget at $\$8\frac{1}{2}$ billion. Fairly recently Secretary Laird of the Defense Department said that he estimates it at about \$8 billion, so we are fairly close.

But that part of the savings that occurs this year is already reflected in this budget, in this year's spending priorities. If you look ahead, there is about roughly \$8 billion left.

Now, to get back in terms of peak expenditures in 1968, there has been a reduction of about \$15 billion in Vietnam costs; from \$23 billion in 1968 to \$8 billion in the 1972 budget.

At the same time our estimate is that non-Vietnam defense costs would suggest that much of the Vietnam savings went into increased expenditures for non-Vietnam purposes.

On the other hand, during this period, the defense budget absorbed substantial increases in both military and civilian pay and in prices, increases which we estimate at about \$15 billion. So that it depends on how you look at it. If you assume that the defense budget and the defense establishment should be expected to absorb all or most of pay and price, well, a lot of war savings went into the non-Vietnam defense budget but that is a pretty stiff assumption. In real terms the savings from Vietnam went into some other programs or in the tax reduction.

Chairman PROXMIRE. Mrs. Rivlin, do you want to comment?

Mrs. RIVLIN. No, I believe not.

Chairman PROXMIRE. Mrs. Teeters.

Mrs. TEETERS. No.

Chairman PROXMIRE. I would like to ask one other question to any member of the panel who would like to answer. The current budget for fiscal 1972 has been described as neutral. I think that Mr. Schultze

used that term neutral. Incidentally, it seems to me that if you put this in terms of the national income account, it is restraining rather than neutral. There would be a surplus. And most of the economists who have testified called it a budget that is exercising restraint although it is hard to fault you on that because restraint is very limited.

In your judgment is this both a proper and the most desirable course for the Federal Government to take now in view of the critical unemployment problem that now faces us? What steps would you advise Congress to take to improve the unemployment outlook?

Mr. SCHULTZE. Well, while this is not something on which we offer a nice firm judgment in the book, I will offer my own moderately firm opinion, which is that the Congress in considering this problem has a tricky problem in front of it. From the point of view of the overall national economy, it would be most desirable to have a more stimulative budget this year, a budget which ran some level of full employment deficit.

Chairman PROXMIRE. You are talking about consolidated budget rather than—

Mr. SCHULTZE. Unified budget. That is right. Whatever way you want to measure the balance in the budget, either with the national income accounts or the unified budget, that the balance in the budget should be reduced, i.e., there should be a lower surplus or if you are using a unified budget, a deficit.

As I indicated, however, the problem in doing this it seems to me is to select those instruments of policy which will have their desired effect relatively quickly, will lose revenues or add to expenditures, over the next 18 months without at the same time building in permanent revenue loss or a permanent expenditure increase on what would otherwise be deemed relatively low priority programs—because if you look down the road 2 or 3 years from now, you may be in quite the opposite situation.

Chairman PROXMIRE. That fits right in with your assertion which I think is again very significant, that between now and 1974, you do not foresee any fiscal dividend at all on the basis of present programs if we do not start any new programs at all, and that in 1975 and 1976, the dividend will be extraordinarily limited?

Mr. SCHULTZE. Right.

Chairman PROXMIRE. Now, I think that is one of the most significant facts that almost all of us in the Congress have ignored and we ignore that to our peril. But if we follow the recommendations you have made to us just now of temporary stimulants, it would seem that we have to follow a tax reduction, at least move the 1972-73 tax cuts into 1971, that would be temporary and stimulative. At the same time it would not be meeting some of the needs of our most urgent and desperate domestic needs for our society in the areas that Dr. Rivlin and Dr. Teeters spoke about so well. It would not help us in welfare, it would not help us in some of these other areas.

Mr. SCHULTZE. To a point I think that is quite right, Senator, and it is a dilemma. I think one, however, ought not to underestimate the national welfare implications of a more rapid return to full employment. If one looks at unemployment among teenagers, among blacks, if one looks at individuals at the low-income end, and for example the

possibility of their buying a house, go on down the line in almost every area of welfare you are talking about, I would certainly put very high on the list a return to full employment as something which helps. That does not solve many of the public needs of the country over the longer run but I think it is terribly important nevertheless.

Chairman PROXMIRE. Mrs. Rivlin, would you settle for that?

Mrs. RIVLIN. Not for very long. I guess I would agree with the tax cut, acceleration of already proposed programs of tax cuts, as a useful quick way of getting stimulation if one thought that one could not increase expenditures for other high priorities like welfare very quickly.

Chairman PROXMIRE. Would you like to comment, Mrs. Teeters?

Mrs. TEETERS. Just to point out that at present time the fiscal position of Government is somewhat more stimulative than when the budget was sent up. The social security benefit increase that is being paid this month will result in a more stimulative budget than originally planned.

However, it will be offset next year when there will be increased taxes as well as benefits.

Chairman PROXMIRE. But if Congress goes to the January 1 increase, to balance the benefits, then that would as you say tend to make the budget more stimulative?

Mrs. TEETERS. In the short run because the major impact of the stimulation is in this year.

Chairman PROXMIRE. My time is up.

Congressman CONABLE.

Representative CONABLE. Thank you, Mr. Chairman.

I would like to welcome Mr. Schultze back to the committee. I think it is very pleasing to all of us that his talents are still available to use here in Washington and I want to welcome your colleagues also that you brought with you from the Brookings Institution, a very constructive group.

You know, everybody walks this tightrope here when they come before this committee. They all want to talk about how in the short term we have got to have more stimulus but in the long term it is obvious we are going to have restraint because restraint is implicit in the figures available to us. And it is a pretty frustrating thing to a group of politicians who are laymen to try to strike this balance because obviously the specialists and experts who appear before us feel they have got to strike the balance, too.

Let me ask you about tax policy. There has been a suggestion here that we should speed up the tax cuts. Do you feel, Mr. Schultze, that the tax cut mode that we have adopted here, increasing the personal exemption, is a desirable one?

Mr. SCHULTZE. Well, if you had asked me that question in 1969 I would have said absolutely no. Not so much on grounds of the particular nature of the cut but that there should not have been that big a tax relief given.

My answer to Senator Proxmire was postulated on the point that that tax cut is on the books. As far as I can see it is not about to be repealed. We built it into our calculations for 1974, 1975 and 1976, and as long as it is there, it seems to me you might as well get the

stimulative benefit out of it now and it will not cost you anything several years down the pike since it is already on the books.

Representative CONABLE. Let us assume you are not a politician and you are looking at this from a pure viewpoint. Do you think it is desirable to go the route of a Federal tax cut at a time when we are inevitably going to be shifting an increasing portion of the burden onto the regressive taxes at the State and local level?

Mr. SCHULTZE. I suspect in effect you are asking me how I would like to restructure the tax system.

Representative CONABLE. That is what I am asking you, yes, sir.

Mr. SCHULTZE. I think my answer would be I would like to have a little more time to think about it. It seems to me first you point out quite appropriately that with a series of cuts in the personal income tax, accompanied by a series of increases in the payroll tax, that we are taking a Federal tax system which has some elements of the progressivity.

Representative CONABLE. And reduce——

Mr. SCHULTZE. And reduce that progressivity, and it seems to me that is bad. I am not sure where I would put, without some more thought, highest priority on Federal tax reform but I think the direction you are pointing in is clearly one of the highest priority, namely, somewhat less reliance on the payroll tax, and that is going to mean inevitably, it seems to me, some way of using general revenues to finance part of the social security system.

Representative CONABLE. Now, let me ask you this. There have been some very strong suggestions made by the administration that some restructuring of the executive branch could result in a fiscal dividend of some sort. Do you, from your vantage point, again not as a politician but as an economist, a man who studies these things very deeply, do you see any possibility of fiscal dividend there assuming the Congress wishes to respond to Presidential initiatives in ways in which it has not shown any great acuity up to this point?

Mr. SCHULTZE. Well, with respect to the Government reorganization, I find myself in what for me is a rather anomalous position being an administration witness for the reorganization plan, and if you are basically talking about restructuring in that manner I am all for it.

Representative CONABLE. Is there realignment along functional parts is what I am talking about.

Mr. SCHULTZE. Correct.

Representative CONABLE. Are there substantial fiscal dividends to be gained there?

Mr. SCHULTZE. No.

Representative CONABLE. Why not?

Mr. SCHULTZE. I am for it because I think it will make for more effective government. There may be undoubtedly some efficiencies in the narrower budgetary sense, but I think the biggest gain is going to be in terms of spending the dollars we are going to spend more effectively. I do not really believe one can look forward and think there will be big dollar gains with it.

Representative CONABLE. Isn't that the way with fiscal dividends? Aren't they going to be spent rather quickly as they are available rather than pile up as a visible pile of cash that we then can decide to cut up after the fact?

Mr. SCHULTZE. I agree with that but I do not think that is what is going to happen out of reorganization. I do not think it will give us a reduction in spending. I do think the existing programs that are being carried on will be carried on more effectively.

Don't get me wrong. I am for it. I think it is great, but I do not really think you can look for a large savings. I am not saying there should not be some savings in overhead. There undoubtedly will be as you consolidate seven departments down to four but I do not think these are large magnitudes. I think really it is that the Government might become somewhat more responsive. The bureaucracy might become somewhat more flexible, controlled for national purposes, and I think that is all to the good, but I personally would not look forward to big kinds of straight efficiency savings in the narrower sense that we will be spending less money on a given program than we otherwise might.

Representative CONABLE. I take it that other things being equal, you would like to see a tax increase here at this time, but that because of the stimulative impact or antistimulative impact of such an increase, that you are striking a balance which says that probably a decrease would be preferable provided it did not get us locked in for the long run.

Is that a summary of your position?

Mr. SCHULTZE. That is a good summary; yes, sir. That is a summary of my position. I do not want to speak for all my colleagues.

Representative CONABLE. Yes; do you assume that we are going to be able to survive this decade without a tax increase ultimately?

Mr. SCHULTZE. I am not sure.

Representative CONABLE. Nobody likes to advocate a tax increase.

Mr. SCHULTZE. I am perfectly willing to. You ask me a slightly different question, whether we could survive the decade without one?

Representative CONABLE. Yes.

Mr. SCHULTZE. Oh, I think somehow we will survive but I—

Representative CONABLE. Wouldn't the short-term considerations gobble us up if we do not eventually go to greater tax resources for these pressing problems we have?

Mr. SCHULTZE. Oh, don't get me wrong, I think we need it and I am trying to get a judgment whether we will get it or not. If push came to shove I would say the odds are better than 50-50 we would but here is where clearly I am not enough of a political analyst to want to make to hard a forecast on it.

Representative CONABLE. Well, I am not sure that the politics of it is what we are interested in your telling us about really here in this committee. And that is one of the things that kind of bemuses me about the testimony we have here. Everybody is testifying to the politics of economics and it makes me wonder if the two are distinguishable, economics and politics, because everyone is talking about what is possible, not what is desirable.

Mr. SCHULTZE. Well, let me make one more comment.

Representative CONABLE. This balancing of long term and short term is a very confusing thing to me.

Mr. SCHULTZE. I think that is not any question of politics. My view on it leads me to not a political but a substantive conclusion that right now, we need in effect less taxes and 2, 3, 4 years from now we very likely need more and that is my substantive conclusion.

Representative CONABLE. But let me ask you as a statistician now, hasn't the percentage of our gross national product taken in taxes declined in actual dollars recently?

Mr. SCHULTZE. I do not think so.

Representative CONABLE. Has it been because of the Federal tax system?

Mr. SCHULTZE. Two things have happened. On the State and local side, they have grown as a percentage of GNP and grown fairly steadily over the last 15 years. Federal revenues have fluctuated fairly narrowly around 20 to 21 percent. You have had a combination of a number of things happening.

On the one hand, the personal income tax is progressive. We have lowered it and offset part of the progressivity impact. We have had continuing tax increases and wage ceiling increases in social security and that has tended to raise the proportion picked up through social security taxes. So that the tax cuts on the one hand could balance the progressivity in the Federal.

Taking Government altogether, Federal, State and local, the tax take has grown over the past 15 years.

Representative CONABLE. I have been interrogating you too much. I wonder if I have raised some points the other members of the panel would like to respond to?

Mrs. TEETERS. I would like to point out that three tax rate increases are currently scheduled for the decade of the 1970's in existing legislation under the social security law.

Representative CONABLE. Social security and that goes up to until 1980, isn't that right?

Mrs. TEETERS. The tax rates under OASDI rise until 1975. The overall tax rate goes up beyond that because of the Medicare.

Representative CONABLE. But the only tax increases you are talking about are social security tax increases?

Mrs. TEETERS. That is correct.

Representative CONABLE. Do you think that is a desirable element, the extent to which we are putting pressure on this comparatively regressive tax?

Mrs. TEETERS. No, I do not. I think it is really changing the whole tax structure in a very undesirable way.

Representative CONABLE. That has to be balanced, of course, against the impact of any change in the mode of financing on the philosophy of social security. Many of our people feel that they have an investment in that that they cannot afford to monkey around with.

Excuse me, my time is up.

Chairman PROXMIER. Well, I would agree wholeheartedly that you can make a strong case for tax increase but I think it is very, very hard to bring it off and I think you are perfectly right in indicating that this is required and you have to deal with realities whether you are an economist or a politician. Except in wartime, it has been hard for us to increase our taxes and it is hard to argue that you do it to stem inflation because, of course, the taxpayer has to consider his taxes as part of his cost of living. It is very hard to sell social programs, it seems to me, to the taxpayer. It has been in the past. An imaginative and vigorous President perhaps could do that under some circumstances, but it is very, very difficult to do.

Nevertheless, Mr. Fried, you put your finger on what is at least a possible consideration. You did it very well I thought because it gives us some kind of a choice.

You pointed out that there was a kind of triple choice; a moderate high defense budget and a moderate low defense budget and then one in between the two, of course. The difference is about \$20 billion by 1976, \$96 billion for the high and \$76 billion for the low. The low as you say could be lower. That is about the level at which we are spending now but it is recognized it is lower in real terms because of the projected inflation which would be substantial over the next few years. But here is a difference of \$20 billion. This would substantially increase the fiscal dividend available to meet our domestic programs, increasing it from \$17 to roughly \$27 billion, falling far, far short of the need in many of these areas, health, family assistance, but at least it is a substantial amount and even if we cannot increase taxes, or increase them enough, it seems to me this would be very helpful.

Is this a correct reflection of what you—the implications of what you say?

Mr. FRIED. Well, with one qualification. The current posture of \$88 billion, the current posture which we estimate would cost \$88 billion in 1976—

Chairman PROXMIRE. Current meaning no more—not in Vietnam. It is over, et cetera.

Mr. FRIED. Right. It is the current forces, current procurement plans, plus the additional cost of the volunteer service, which we estimate at \$2 billion, which might be low.

Chairman PROXMIRE. I think that is low.

Mr. FRIED. That is right, but this is the additional cost.

Chairman PROXMIRE. I think it is even low for additional.

Mr. FRIED. One and a half billion dollars for the volunteer service is already in the 1972 budget. That plus the \$2 billion we have allowed for—\$3½ billion may be low. We have also allowed \$1 billion for any residual military or economic aid program in Indochina. These costs have gone into the \$88 billion estimated cost for the current defense posture in 1976 and now that number has been built into the \$17 billion fiscal dividend. So with what we call the low budget option of \$76 billion, there would be a saving of \$12 billion, rather than \$20 billion.

Now, that is on strategy grounds.

In addition there is the point I tried to make and which we elaborated on in the priorities study—the use of manpower in defense as an area worth looking at. I pointed out that it is a bit surprising that with the fairly significant cutback in forces that took place in this year's budget as a result of the reassessment of strategy, there was no reduction in the cost of conventional forces as compared to 1964 and as measured in constant dollars.

One possible explanation is that the defense overhead is higher. Let me just give you a figure which appears in the book which is very rough and based on crude data but which indicates the kind of stakes that may be involved. If we supported the current peacetime force at the support and manpower levels of 1964, the cost of these forces in today's dollars would be somewhere between \$10 and \$15 billion less.

Now, that is obviously a very very high figure.

Chairman PROXMIRE. Let me try to get at those two points quickly. One is as far as manpower is concerned, do you assume in the low budget that we can withdraw some of our troops from Europe?

Mr. FRIED. No.

Chairman PROXMIRE. Even in the low budget you do not make that assumption?

Mr. FRIED. Not if the low budget option is to be consistent with the Nixon doctrine, which is the way we described it.

Chairman PROXMIRE. You are the first witness I have heard who claims to understand the Nixon doctrine. Most witnesses say they do not know what he is talking about.

Mr. FRIED. The general objectives of the doctrine are clear enough. What I said was you could have different interpretations of that doctrine and that is the basis for the three different budgets.

Chairman PROXMIRE. At any rate, one interpretation is that we have the same amount of manpower in Europe.

Mr. FRIED. Yes. You put priority on forces in Europe.

Chairman PROXMIRE. Five years from now we still have 310,000.

Mr. FRIED. We may or may not. Senator Proxmire, but the important point is how many troops should we maintain for European contingencies, wherever the troops may be. The heart of our defense posture, the forces that drive the total conventional force budget, are the forces we maintain for European contingencies.

Chairman PROXMIRE. I understand somewhere in your remarks you made some assumptions about other countries able to provide manpower, taking some of the burden. It seems to me if that can be done anywhere it should be done in Europe. They have the manpower. They have more men than they have in Russia. They have the economic strength.

Mr. FRIED. Well—

Chairman PROXMIRE. So if you are not going to do it there, it seems to me that is rhetoric.

Mr. FRIED. I think that Europe clearly has the capacity to do more in its own defense. The issue really is whether it will and what means one uses to negotiate better arrangements.

I want to get back if I may, Senator—

Chairman PROXMIRE. I beg your pardon.

Mr. FRIED. The reduction in the defense budget that would be consistent with at least one interpretation of the Nixon doctrine—and is explicit in our low budget option—would be a further reduction in forces maintained for Asian contingencies.

Now, with that kind of force reduction plus a somewhat less conservative strategic posture and somewhat lower levels of force modernization, we could save roughly \$12 billion. That is a substantial amount.

Chairman PROXMIRE. I think superficially the case can be made very strongly against the increased overhead. But I am wondering in view of the fact that this is a situation in which we expect to have kind of a standby defense capacity, with the 10 to 20 percent of its full war capacity, under these circumstances to expect to be able to reduce overhead may not be realistic and may be extraordinarily difficult.

Isn't it true that when you have a standby situation prepared to act and prepared to flush it out in the event of war, that your overhead under those circumstances is extraordinarily hard to reduce without just knocking out your capacity to quickly mobilize and quickly respond?

Mr. FRIED. I think that is right. I would never assume that we would expect support costs or overhead costs to go down in strict proportion to combat forces. There is obviously a fixed element in these overhead costs and you are right in pointing to them. But that still does not say that substantial reductions could not be made in the logistic systems, in commands, in bases, in training facilities. The issue is how much.

I think it is important to point out that the problem is particularly difficult at a time when military manpower is being reduced pretty rapidly. Nevertheless my own feeling is that it is terribly important to watch very carefully the use of manpower in defense, particularly as the cost of that manpower is rising.

Chairman PROXMIRE. Do you assume in your calculations that overhead would be proportionately reduced or did you assume it would continue to be disproportionately high as you cut back your forces?

Mr. FRIED. I would assume that some reduction should be made in overhead in support, not proportionately to the total reduction in combat forces but significant reductions should be made.

Chairman PROXMIRE. How did you figure that \$4½ billion of foreign military assistance? We had hearings on that in this committee earlier in the year and the budget had said \$545 million for foreign military assistance. We discovered the Comptroller General said over \$4 billion, we ended up concluding it was \$5 billion to \$7 billion. Nobody knows how much it is. One of the most shocking failures is to tell Congress where our money is going and I am chairman of the Appropriations Subcommittee on Foreign Operations. We have jurisdiction over half of that, half the military assistance and all the economic assistance, and we are just having a tremendously difficult time getting the information on it. So how did you base your projections of \$4½ billion especially as you say this has been tending to usurp much of the money that you said used to go to economic assistance?

Mr. FRIED. Well, we included in military assistance the following. First, the very large sum of \$2.2 billion that is funded in the Department of Defense budget, plus the MAP program, grants at \$705 million and foreign military credit sales of \$510 million. I did not allow for surplus military equipment which I gather this year may be somewhere in the order of \$500 or \$600 million, but which does not require an appropriation.

Chairman PROXMIRE. In the next few years when we start giving away that Vietnam equipment, that is going to be a very big item, isn't it?

Mr. FRIED. That is right.

Chairman PROXMIRE. Because we have a fantastic amount that is going to have to be disposed of.

Mr. FRIED. We allow for it in the tables but did not put a value on it because of the issue of what value you use, whether you use acquisition value or utility value, but it is there. I have listed it here at \$600 million but did not add it into the total.

Then we added the \$778 million request for supporting assistance, \$100 million for Public Law 480 under the common defense grant program which goes to Vietnam and Korea, and \$100 million for the President's contingency fund. That comes to roughly \$4.4 billion without allowing anything for the utility value of the surplus stocks.

Chairman PROXMIRE. You are not really tying in what so many people implied was really the heart of the Nixon doctrine, we spend more money abroad in military assistance, provide more equipment but less troops, that we would substitute assistance for manpower. And if that principle is pushed in the next 5 years it would go far beyond \$4½ billion perhaps.

Mr. FRIED. We might, Senator, but really it depends on what sort of post-Vietnam world one should project.

The Defense funded \$2.2 billion going to Indochina alone is a lot of military assistance. If one thinks of countries that might be potential recipients, it would be pretty hard to spend sums of that magnitude each year over a sustained period.

Chairman PROXMIRE. Well, I would hope we would eliminate the whole thing in 3 years and I will do my best to do it.

Mrs. Rivlin, why would special revenue sharing, not general, but the special revenue sharing, which as I understand it would eliminate the categorical grants, very largely, and provide for much broader allocations, why would that result as you say in Congress focusing more on where funds were spent instead of what for? You make that statement and then you do not have a chance in your brief remarks to expand it.

Mrs. RIVLIN. Well, if the Congress really enacted what is proposed and did consolidate these particular categorical programs into very broad categories like education, transportation and rural community development, these categories are so broad that I think it would become evident fairly quickly that they were not constraining the States and localities very much.

These are items for which States and localities are going to spend something anyway, and the States and localities would fairly quickly realize that it was in their interest to lobby for the program that brought the most money into their area, regardless of the ostensible label on it. I think this might change the way things looked in Congress. A Congressman would tend to concentrate his efforts on getting more money to the special revenue-sharing formula that would benefit his district most, rather than concentrating so much on what the money would be spent for after it got there.

Chairman PROXMIRE. I take it it could, then, have a perverse effect on the way Congress distributed money. Instead of inquiring as to whether or not this served a meritorious national purpose, whether you could justify it on the basis of the merits, there would be a tendency of saying, well, my district, my State is not getting as much as the other State and if we can move from one category into another we can do well in education, not as well as in some of the other categories. So you tend to press—is that what you are getting at? You tend to press for whatever would provide for funds in your district rather than what would serve in the view of the Congressman or Senator the national interests?

Mrs. RIVLIN. Well, any decline in the Congress, specificity about what money is to be spent for would be likely to have that effect. The Congressmen have to worry about their own districts in some way. And the effect of special revenue sharing would be to reduce the amount of congressional control over exactly what the money is spent for. That is the purpose of special revenue sharing.

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Thank you, Mr. Chairman.

Mrs. Rivlin, I take it you feel there is no crisis of financing in State and local government, is that correct? You say in your testimony the revenue gap of State and local is of modest proportions in the light of expected State and local expenditures, and this gap can be filled by a variety of means?

Mrs. RIVLIN. Well, let me clarify that. I think the projections that we did of the expenditures that would be likely and the revenues that would be generated by existing State and local tax rates indicate that on the average and in the aggregate, there is probably no overwhelming shortfall to be expected—no great gap between the revenues and expenditures.

That does not mean that there are not very serious crises in some States and in many localities, particularly very big cities, where the revenues are not rising and the expenditures are rising very fast. It is just not clear that general revenue sharing is a very efficient way to get at the serious problems in big cities.

Representative CONABLE. What alternatives do you think are preferable?

Mrs. RIVLIN. There are a variety of major categorical programs—

Representative CONABLE. Even though these require local contribution?

Mrs. RIVLIN. One does not always have to arrange them so they do. Complete federalization of the welfare system would help.

Representative CONABLE. Then aren't you in effect advocating a centralization of services in Federal hands that have traditionally been handled at the local level?

Mrs. RIVLIN. Not all of them. I think welfare is a good candidate. Like social security, it is primarily a job of determining who is eligible and handing out checks. That is the kind of thing that I think can be efficiently handled by the Federal Government.

I would not for a moment suggest the centralization of education, although grants for the special problems of urban education would be a good way to get money into the cities.

Representative CONABLE. Well, it seems to me that the net effect of what you are talking about, if you want greatly increased categorical grants as an alternative to the general revenue sharing, is a centralization of services. You feel that the federal system has outworn its usefulness, do you, at least with respect to many of the services traditionally handled locally?

Mrs. RIVLIN. No. The only service that I have specifically suggested might be federalized is welfare; and I think we are moving rapidly in that direction.

Representative CONABLE. You consider the welfare reform bill reported by the Ways and Means Committee a step in that direction, do you?

Mrs. RIVLIN. Yes, I do.

Representative CONABLE. And do you think that is the way of the future in welfare?

Mrs. RIVLIN. I think we have to think about what it is that the Federal Government does well. One of the things that it seems to be able to handle adequately and fairly is the process of writing checks to redistribute income. That is how I see welfare. The services to people—education, health—I think should probably not be centralized.

Representative CONABLE. Well, isn't this the key to why the cost of local government is rising more rapidly than on the Federal level, the fact that the local government provides services, and services have to be furnished through the payment of wages and salaries, and wages and salaries are going up faster than the cost of financing, which is what the Federal and State Governments do to a substantial degree. Is that the key to it?

Mrs. RIVLIN. I think that is one of the keys to it. We have not suggested in this volume that there is no problem of getting more money to local governments. Indeed there is—particularly in cities. But there are alternative ways of doing it. Revenue sharing is one. I am not against it, but I do not think it is a very efficient way of getting money into the places where the most urgent crisis is.

Mr. SCHULTZE. Could I add one point to that, Mr. Conable? I think in addition you have got to remember that we are in an economy with 6 percent unemployment. One of the calculations we made in the book was that if we were back at full employment, that the revenues of State and local governments would be there and a half billion higher. This is not to suggest there is no longer a crisis. I mean, in some cities, some areas, there is. But also it has been exacerbated by the fact that while the Federal Government can handle in terms of its finances a recession, States and local governments cannot very well. They cannot afford the shortfall.

Representative CONABLE. I would like to suggest that a shortfall in revenue for States and local governments is likely to be considerably more serious in terms of unemployment than a shortfall for the Federal Government.

Mr. SCHULTZE. That is probably true, sir; yes, sir.

Representative CONABLE. Because of the very things that Mrs. Rivlin and I were talking about.

Mrs. Rivlin, you stated in your report that two major health financing proposals are prepared and questions are raised about each. I wonder if you could give use a summary of the difficulties you envision under each of these major proposals. Would you summarize that for us?

Mrs. RIVLIN. Well, the two major programs we examined were the administration's proposal which is primarily in two parts, to cover the working part of the population by mandating on employers a standard package of health insurance, and to cover the poor with a Federal program, and the other principal alternative, the Kennedy-Griffiths bill which goes much further to an entire national health insurance system, totally federally financed.

I think we saw that the major problem in both approaches is finding some way of using health resources more efficiently. Anything that we do to add to the demand for medical care will put more pressure on health care prices. To use resources more efficiently we need to put pressure on the suppliers to keep price down.

At the moment there is very little such pressure. Hospitals are reimbursed on a kind of cost-plus basis, with a third party paying the bill, and there is little incentive to either the doctor or the patient to use this very expensive resource sparingly.

Various ways are proposed in both measures to introduce some cost consciousness. The administration's proposal relies heavily on having the consumer pay part of the bill. I personally doubt whether this can be a very effective way of keeping costs down.

The Kennedy-Griffiths bill I think faces up to this and simply says we are going to have to have administered prices, set by a government agency, in order to keep the costs within bounds, and proposes a complicated mechanism for doing this. It is not clear that this would work, but it might.

Representative CONABLE. I take it that in principle you would favor the Kennedy proposal from what you have said, although you say that you have some doubt about whether it might work or not. Are there not implicit in the Kennedy proposal some problems of cooperation of the medical delivery system and a major restructuring that would have to occur at the time such a proposal was put into effect?

Mrs. RIVLIN. I think we are moving toward national health insurance of some sort, but the major problem I see is that we are not really working hard enough on developing new delivery systems. We are talking about it more than we are taking serious steps to experiment on a large scale with better ways of delivering services.

Mr. SCHULTZE. Could I add a point? I think Mrs. Rivlin was too modest. Her major concern at Brookings is or has been and probably will continue to be worrying about the problem of social experimentation.

Let us take national health insurance. Everybody seems to predict we are going to have it and if we do have it, you are going to be up to a \$40, \$50, \$60 billion program some day.

Now, nobody would conceive, I mean literally conceive, ever designing a new \$5 billion defense weapon without some kind of R. & D. behind it. Nobody would think terribly much about it if you had to spend maybe 4 to 5 years on development. And yet inconceivably we seem to rush into major new national programs, not wanting to wait until we have maybe tried three or four alternatives out in a limited way, and one of Mrs. Rivlin's major concerns is trying to push the idea of doing some fairly well-designed experiments to provide social R. & D., and I just wanted to call to the committee's attention what is a very major lack in the way we as a nation do tend to go about these major social programs on a basis of paper studies rather than having tried some actual experiments, quite literally tried out some alternatives in the real world.

Representative CONABLE. Heedless of the long-term consequences?

Mr. SCHULTZE. Correct.

Chairman PROXMIRE. I think this is an excellent point. What always baffled me, and I, of course, was very happy and still am proud that I

supported medicare, but I am very concerned with some of the consequences of it. It undoubtedly did serve a good purpose in providing much better care for elderly people but it also enormously inflated the cost of health for everybody else and even the older people are not getting the kind of health care which we all know they ought to have.

Isn't it true, isn't the answer for that that the only way you can really provide health care effectively is to recognize we have to have more resources, we have to have more doctors, more paramedical personnel, nurses, by far than we have now, and that as we rush ahead, even if we spend \$10 billion, \$20, \$30, \$40 billion in the next few years, because it takes so much longer to attract and develop the resources, what does it take to train a doctor, develop a doctor? Ten years, 8 years, paramedical, 2 or 3 or 4. Nurses, 5 years and we are doing very little of that now. It is very hard for us to get funds for a new medical school in Wisconsin, which we have needed for a long, long time. Extraordinarily hard. Not being funded.

So I just do not see how all the talk about a health program can mean anything until we as you say have a very careful analysis of exactly where the resources are coming from, when they are coming on the scene so they can produce, and calculate our program on that kind of a basis.

What you are talking about is an R. & D. situation. Mrs. Teeters or Mrs. Rivlin, I guess this is your field.

Mrs. RIVLIN. I think that is only part of the answer, Senator. Obviously we are going to need more health resources; but what kind? If we simply train more doctors with our present organization of medical care, it seems likely that—incentives being what they now are—they would end up mainly being specialists in suburban areas and in expensive parts of big cities, and this would not help at all. Because we do not have any way of giving them incentives to do so, they would not go and practice either in poor rural areas which are short of doctors or in the central cities where there are very few doctors.

Chairman PROXMIRE. But the fact is that even in the suburbs, even in the rich areas, you do not have a surplus of doctors, do you?

Mrs. RIVLIN. No; you do not.

Chairman PROXMIRE. All doctors are pretty busy. You do not have any doctors really who are idle or do not have much work. It would be hard to find one with idle time.

Mrs. RIVLIN. If one is thinking about how to increase medical services it is probably not efficient to train more doctors for the suburbs.

Chairman PROXMIRE. Undoubtedly yes. You certainly have to do both things. I had that in mind when I said we ought to look at the whole picture as Mr. Schultze suggested and develop some kind of research program so we know where we are going before we commit ourselves to an enormous multibillion-dollar program.

Mr. Schultze, we have talked about getting more out of the defense budget, more fiscal dividends out of it by reducing it. Do you have other candidates for increasing the fiscal dividends—impacted aid, medicare costs, public works, sugar subsidies, military bases, farm price supports, space, troops in Europe, military, foreign military assistance. How do you rate these? Where would you make the cuts?

Mr. SCHULTZE. Well, I am a little bit embarrassed about this because if you look at the very last page of our book we have a little

item called postscript, where a year before we had nominated some candidates for cuts and made a box score on what the administration and Congress did and believe it or not, the Senators looked pretty good compared to our box score. I think with a few exceptions—

Chairman PROXMIRE. So it looks as if when you recommend something for oblivion it is likely to be expanded rapidly?

Mr. SCHULTZE. That is right. If we continue this, I would hope our box score gets better, but so far it is pretty low. The maritime program is a good case in point. We were at some pains—not the only ones, others have done this—to point out this has an awfully low payoff in terms of national security for an awful lot of money, but last year there was most enthusiastic cooperation between a Republican administration and a Democrat-controlled Congress in substantially expanding the already existing large maritime program.

Now, I cite that as just one example but there are a number of others. I do not think I have anything new to offer this year that we have not discussed before, Senator.

Chairman PROXMIRE. You talk about the record of the Washington Senators. I presume you were talking about the baseball team, not the U.S. Senators?

Mr. SCHULTZE. Let the record show that.

Chairman PROXMIRE. There is a difference. The baseball team wins once in a while.

Mrs. Teeters, I am somewhat puzzled by your statement on the housing goals. Are you saying that Congress ought to cut back on the goal of two and a half million new housing units—my amendment, 2.6 million, per year, housing units over 10 years—or do you think more funds should be provided to meet this goal?

Mrs. TEETERS. I think there is a conflict of interest in achieving the goal. If you fully achieve the goal or overachieve it you are going to run into a situation where there may be high vacancy rates.

Chairman PROXMIRE. This was based on a number of studies you had—the Douglas Commission, the Kaiser Commission, the HUD study, and when I put that amendment in it was right in the middle of those. The Douglas study, which Howard Shuman had a lot to do with, now my administrative assistant, was a little lower but they were all close to 26 million over the 10-year period.

Mrs. TEETERS. The question we found difficult was—what is the need. If you make the 26-million housing goal, it means that you are going to have to give up something else probably and it is a question of balancing the need for housing against the need for other items in the society. It is not costless to build 26 million houses. One of the ways of going about that, suggested, for example, in last year's Council of Economic Advisers' report, is to run very large full employment surpluses. The size of those surpluses points up directly that if you achieve housing goals, you may have to do with less education or less social security or less welfare.

Chairman PROXMIRE. Well of course, you talk about the high rents for poor families. One reason is that we have such a small vacancy percentage now. We have such a shortage of housing now, isn't that true, and here is one area where if we build a great deal more houses, that more would become available at lower rents to the people with lower incomes?

Mrs. TEETERS. Possibly. You have always to balance this out against the impact you have on the incentive to build new houses. I don't think the vacancy rate happens to be that low. It was 9.2 percent I think a year or so ago which is well above the rates we have had historically in the early 1940's and 1950's.

Chairman PROXMIRE. I would like to check with you later on that.

I note you include mobile homes in your projections for housing starts. We did not have that in mind when we had that proposed \$36 million. It is my understanding that Congress did not include that. Why do you include mobile homes as part of it? Did you make a study?

I do not say that in any criticism but I have a feeling that mobile homes by and large with the exception of a few tend to be pretty tawdry kinds of houses that just depreciate rapidly.

Mrs. TEETERS. I think they depreciate more rapidly but if you look at the housing market you have to include mobile homes. There are a lot of them and the number is growing. I found that the shipments of mobile homes started to accelerate as the cost of construction relative to the overall rate of price increase started to accelerate. You can buy mobile homes at a very low cost relative to other forms of housing. As long as the relative price of construction tends to rise faster than the general price level, I think you are going to see more and more mobile homes. Because you do not like that type of housing does not mean that you shut your eyes to them.

Chairman PROXMIRE. No, no. It is just that I think if we are going to accept mobile homes we ought to have some standard as we do for other housing, conventional housing, and we do not have that. We have been after HUD to develop something like that. We do not have it. After all, you can design mobile homes that are more attractive than most of the conventional homes. On the other hand, we know that is not the case in most instances. They do not have the room, they do not have the sewage, they do not have the other facilities that go with a home and a lot, and as you say, they do depreciate, deteriorate fairly rapidly.

Mrs. TEETERS. I think a word of caution in that regard is appropriate. I think one of the problems in the construction of the conventional house is too many regulations, too many zoning laws, too many special regulations as to what can be done. I agree with you that we could use more standards for mobile homes but I would like to see them done on a broad basis, not on so narrow a basis that it would prevent their use.

Chairman PROXMIRE. Mrs. Rivlin, you note in your statement there are really two parts to the State and local fiscal problems and it is difficult if not impossible to design one program which will solve both problems.

One problem is the cyclical one which Mr. Schultze remarked we suffer from right now. In your book you estimate that in 1970, recession cost State and local governments \$3½ billion in lost tax revenues. This was because the economy operated below its potential, and personal incomes were below what they would have been at full employment.

In 1971 the gap between actual and potential GNP will be larger than it was in 1970. Federal receipts are now running some \$20 billion below what they would be at full employment.

Can you make any estimate as to how State and local receipts will be affected in 1971 or how much they are losing presently at an annual rate?

Mrs. RIVLIN. As a result of recession?

Chairman PROXMIRE. Yes.

Mrs. RIVLIN. We did make an estimate for calendar 1970 that the losses in State and local tax revenue attributable to the recession were about \$3.5 billion. I do not know offhand how one would project this, but the recession certainly cut seriously into State and local tax revenue.

Chairman PROXMIRE. Would you agree it would be larger in 1971 than in 1970?

Mrs. RIVLIN. Yes.

Chairman PROXMIRE. We talk about larger than the Federal basis. Do you think it would be possible to design and desirable to design a counter-cyclical program which would support State and local governments during recessions?

Congressman Conable pointed to the dire situation that State and local governments find themselves in because they cannot, by and large, at least engage in deficit financing as well as the Federal Government.

Mrs. RIVLIN. I think it would be very difficult to design a revenue-sharing plan which would be counter cyclical. But one might think of other ways of doing this.

Mr. SCHULTZE. Let me interject. I want to push a pet idea. It seems to me that one could design something which would not be exactly a revenue-sharing plan but would accomplish, I think, the right objective in this area. It would be something like this.

Each year the Council of Economic Advisers would be charged with estimating the total shortfall in State and local revenues compared to what they would yield at full employment. In turn, that amount would be automatically appropriated and distributed to the States in proportion to each State's share of income taxes to total State and local income taxes and possibly sales taxes, so that a State, for example, which had 2 percent, which collected 2 percent of total State and local sales and income taxes would get 2 percent of the funds. This would have two advantages to it. It would mean that when the Nation does get into a recession, State and local governments are not forced to scramble to cut back their services as they are now. Usually what happens is they have to cut not the services that are the lowest priorities but the ones easiest to cut.

This proposal would not give State and local governments relief from any long-term fiscal crisis but would at least give them stability to plan ahead on the assumption of stable growth—a stabilizing feature from the national economy viewpoint because when unemployment is rising you do not want State and local government to cut back.

It seems to me you would avoid many of the long-term philosophical questions as to revenue sharing compared to categorical grants.

Chairman PROXMIRE. I like that idea. It has a lot of appeal. Has that been tried in any other country?

Mr. SCHULTZE. Not that I know of but I have not researched it. So when I say no, all I mean is I do not know of any.

Chairman PROXMIRE. Again, that would be a good project for Brookings to get into. As you say, it is very very appealing.

The other problem you referred to, Mrs. Rivlin, was the problem of unequal distribution of resources and of needs. Some areas are much poorer than others and public service needs are, of course, greater where there are concentrations of poverty.

What in your opinion is the best way to meet this problem? General revenue sharing does not seem to me to be a sufficient approach because it gives funds to all communities rather than concentrating funds where the needs are greatest.

Mrs. RIVLIN. I think one could meet it in several ways. First, you could devise a general revenue sharing formula which had a need factor built into it more strongly than the administration's does. There could be larger grants for jurisdictions with heavier concentrations of poor people, as Senator Muskie has suggested.

Another way is to use categorical grants with a stronger need factor built in. Some laws now on the books, like title I of the Elementary and Secondary Education Act, are well designed to get Federal funds into areas where specific need is demonstrated by concentrations of poor children.

Representative CONABLE. Would the gentleman yield on that? I disagree with what you are saying about title I. It seems to me the formula is designed to take a poor child in New York and generate considerably more Federal funds for his education than a poor child in Mississippi, for instance, because the formula is geared to the State expenditure per pupil. That is almost a fatal flaw in the proposal.

That is one of the reasons Congress has not been willing to make the quantum jumps in support of education that are indicated in terms of the needs of education.

Mrs. RIVLIN. Well, that particular formula may represent one solution to the difficulty that pervades the question of how to estimate needs; namely, that the cost of educating a child is higher in New York City than it is in Mississippi. Part of the reason for building in the State expenditure was to reflect that fact.

Representative CONABLE. But doesn't that have the effect, then, of raising the ceiling over education rather than raising the floor under areas of education blight? Aren't we, in fact, increasing the disparity between the different educational systems in the various States?

Mrs. RIVLIN. Not by title I, which goes very heavily to the South.

Representative CONABLE. Well, how can it go very heavily to the South? Is that what the distribution pattern shows?

Mrs. RIVLIN. Yes. Title I funds are a much higher proportion of the total State expenditures for education in Mississippi than in New York, for example.

Representative CONABLE. Isn't it true that there is a very wide distribution plan for title I so that better than 93 percent of school districts qualify for title I funds, and isn't it true that you do put more per impoverished children to the wealthy States than you do into the poor States?

Mrs. RIVLIN. More per impoverished child?

Representative CONABLE. Yes.

Mrs. RIVLIN. Yes.

Representative CONABLE. For instance, in Westchester County, a child is worth roughly three times as much in Federal aid as a child is worth in Sunflower, Miss.

Mrs. RIVLIN. There are some anomalies in this, and I, too, would be for concentrating the funds in title I and other programs specifically aimed at the poor, more in areas—Westchester is not one, while New York City is—in which there really is a significant burden of large numbers of poor children.

Representative CONABLE. I am interested in your statement, though, that the money goes very heavily to the South. Is that what the pattern of distribution shows?

Mrs. RIVLIN. Yes.

Representative CONABLE. That Southern States are getting per capita considerably more in education than the Northern States?

Mrs. RIVLIN. For that type of program.

Representative CONABLE. That is the justification for Federal aid to education, trying to raise the floor in areas of educational blight, since we have a mobile population nowadays and we all suffer from under-education.

Mrs. RIVLIN. Federal aid to education programs as a whole have not been noticeably redistributive. Title I is the exception because it does have built into it a formula based on the number of poor children, and there simply are a lot more poor children in the South.

Chairman PROXMIRE. I would like to ask each of you a question which I asked other eminent economists who appeared before us. As you know, the administration proposes to provide a Government guarantee for the Lockheed Corp. in order to prevent it from going bankrupt. The argument made in support of that proposal is that it is necessary to prevent widespread unemployment and disastrous consequences to the economy from the bankruptcy of such a large corporation. Would each of you please respond to this argument and give me your views on the proposal.

Mr. Schultze.

Mr. SCHULTZE. I am not sure it is one of the things I have spent a lot of time thinking about.

Chairman PROXMIRE. Sometimes we give the best answers from—

Mr. FRIED. I have not given much thought to this either, Mr. Chairman. I agree with Mr. Schultze's comments. I suspect that these moves for government aid discourage exploration alternatives that have been more traditional with the operations of the private sector.

Mrs. RIVLIN. I would be against it. We should be worried about localized unemployment, but there are better ways of handling that than establishing a precedent of bailing out bankrupt companies with Federal funds.

Mrs. TEETERS. I would be against it also. I might also point out that the problem is beginning to come up with some frequency: Penn Central, for example. If this is going to be a continuing problem, the Congress should give some consideration to developing guidelines as to what circumstances make major corporations eligible for assistance rather than doing it totally on an ad hoc basis when one gets into trouble.

Guaranteed loans already exist to a certain extent in Small Business Administration for example. Basically I am against loans to large corporations but I think you may have a continuing problem on your hands.

Representative CONABLE. If I may interrupt there, I would like to ask the four members if they are also opposed to farm subsidies, to the SBA, to the Reconstruction Finance Corporation, to the various subsidies paid to business in other areas such as airlines, et cetera. Are you also in favor of the \$4 billion manpower training program which, of course, is designed to prepare people for jobs which may not exist after they have been trained?

Mr. SCHULTZE. I have got to start answering those in order.

With respect to farm subsidies, I say we are spending far too much on them and in particular just as I am against putting the money in the hands of Lockheed creditors, I am also equally consistent in not wanting to put subsidy money in the hands of farmers earning \$10,000 to \$15,000 or more.

The second is SBA. I think it has become, not completely but in part, an outfit making loans at less than bankable rates to bankable firms and I am against a lot of what they do on that ground. I think there are some things they can do well but not a lot of what they are now doing.

With respect to the manpower training program it seems to me you are dealing with another kettle of fish in which you are trying to meet some very specific national objectives with respect to the hard-core unemployed and skilled mixture in our economy, and that is something different than baling out a particular firm.

I can extend the list with a number of existing subsidies.

Representative CONABLE. I am pleased by your answer because you used the word "precedents."

Mr. SCHULTZE. Touché.

Chairman PROXMIRE. Isn't it also true that in every one of the programs mentioned by Mr. Conable, they are of general application with some kind of guidelines, as Mrs. Teeters called for in this kind of program and not for bailing out a particular company, a particular farmer or particular small business, or a particular concern and that that is quite a distinction?

Mr. SCHULTZE. Agreed.

Chairman PROXMIRE. One reason I am concerned about the way the administration perceived the impact of defense reductions on the economy is because of the information we have received that the current defense budget was established partly as a result of political and economic consideration. You may recall last year's speculation that the fiscal year 1972 defense budget request would be sharply curtailed. Toward the end of the budgetary review process, this decision was changed.

Mr. Fried, in the chapter on major defensive options, refers to the "internal bargaining process" which influences the defense budget, and the fact, and I quote your statement:

In the present administration . . . greater reliance than in the recent past is placed on Presidentially determined fiscal guidance to scale the total size of the Defense Establishment.

You also state that the present system of determining the size of the defense budget discourages interest elsewhere in the administration in the proper allocation of defense resources.

I wonder if you would comment on whether the current practice is the most rational way to allocate resources. It seems to me to be

very similar to the way decisions were made in the prior administration and the Office of Management and Budget is failing to live up to its promise. It does not stand up and say no to the Defense Department with the same vigor it stands up and says no to the OEO and other nondefense agencies.

MR. FRIED. On the latter point, I believe Mr. Schultze from his past experience can comment but I think in general that this is right, that the thrust of your comment is right. It is not the best way to run a railroad. This is a very very big chunk of national expenditures. Inevitably in so large an enterprise there are going to be differences in interests and differences in points of view as to what is required and what is not required and that is understandable.

Insofar as possible the object of the exercise is to try to treat this large area of national expenditure much the same as we treat all others and to subject it to the maximum degree to the same kinds of tests. Difficult as it may be, it is the objective that we should shoot for.

I might add, Mr. Chairman, that this is one of the purposes of this Brookings exercise on the budget, to attempt to bring the considerations underlying these kinds of decisions into the public domain.

CHAIRMAN PROXMIRE. Mr. Schultze, would you answer also?

MR. SCHULTZE. I thought he handled it pretty well. I do not think I have anything to add, Senator.

CHAIRMAN PROXMIRE. I think this is one of the most useful aspects of your study. If we can just bring this about I think it would be very helpful because there has been something about defense—it is true we have been able to raise more questions in the last 3 or 4 years than we did in the past but it still is semisacrosanct. There is still the haunting feeling that defense is too sacred to take any kind of a chance, which means we do not question it. We do not make the hard decisions we just have to make, and I think that your study here is most helpful in highlighting the weaknesses involved. In fact, we do not get better defense this way. We just waste more money.

The Council of Economic Advisers in its annual report seems to explain the increase in unemployment over the past 2 years on reductions in defense spending and the decrease in military manpower. Do you agree and do you believe, Mr. Schultze, that the administration took whatever steps could reasonably have been expected in order to soften the economic impact of the changes in the defense budget? More importantly is it your judgment that it would be risky to make further cuts in defense because of the possible effects on the economy?

MR. SCHULTZE. It seems to me the first point is that the particular level of unemployment we are now facing has to do with the impact of the combination of monetary and fiscal policies that have been pursued, not defense. Any administration coming into office in early 1969 would have been faced with the problem of tailing off inflation and any administration would have been faced with some unemployment, but it cannot be blamed on defense, it seems to me. That is clear.

That does not mean that there would not be very particular pockets of problems but the overall level of unemployment is not to be blamed on defense.

CHAIRMAN PROXMIRE. Let me interrupt at that point to say isn't there a peculiar situation where you, the administration announces that it intends to withdraw troops from Vietnam and cut down on the size of

the military force. You can schedule, you can calculate you have so many people coming out and therefore you prepare for that. You have plans to meet it.

I know that it is unfair to compare directly the situation after World War II and the situation now because we did have a different economic situation, when you recognize that we demobilized ten million men. We cut defense spending \$60 billion in a much smaller overall GNP, like cutting \$200 billion now, and we had only 3½ percent unemployment after 3 years of that.

We do have some dammed-up needs now. We do have some unmet needs in housing and other areas.

I am just wondering, of course, whether there could not have been better planning to meet this in view of the fact we knew it was coming?

Mr. SCHULTZE. Well, again all I can do on that. Senator, is repeat that it seems to me it is not so much specific planning or nonplanning for defense industries or returning veterans. An economy operating at very high levels can absorb this, with some transition problems in a few places. The real problem is overall economic policy.

The second point I would like to make is that aside, again, from orderly planning of the pace at which one proceeds, the argument that you cannot afford to cut back defense because of its employment impact is politically bad, economically bad and socially bad and I just do not think it is true.

Having said all that, I want as I say to accompany it an understanding of the fact that it is a very difficult sort of thing to do to manage this inflation-unemployment trade-off. Nevertheless, that is what is at stake, the level of the economy not defense cutback.

Chairman PROXMIRE. You have explained the increase in defense spending on the following factors. pay increases, inflation, expanded weapons procurement, and the stickiness of support or overhead costs. Now, it seems to me, Mr. Fried, that with the exception of inflation, you described areas of considerable unnecessary costs in the defense budget. In my judgment we have too much military manpower, far too many civilian employees in the Department of Defense, we are procuring too many new weapons and spending outrageous sums for them, and we ought to be reducing our logistical tail.

In addition, although inflation obviously has an impact on defense costs, there is no military price index and until one is constructed, we will not know with any precision what that impact is.

Moreover, the increase in defense spending since 1965 has been a prime contributor to inflation. What this suggests is that a cutback in defense will relieve some inflationary pressure. From all of this I find a powerful argument to reduce the defense budget. Do you agree or disagree?

Mr. FRIED. Well, I think the substance of my remarks, Mr. Chairman, was that the way to look at the defense budget, to assess it, to see what we want and what we do not want, should depend in the last analysis on what we want defense for and how to use it most efficiently.

I think it comes down to these kinds of considerations. First, considerations relating to strategies. You can think in terms of what you want to prepare for, how big the risks are, and how much confidence you want to pay for in any given defense posture.

You also have to look at weapons systems, whether they are using resources devoted to defense as effectively as possible. I share some of your concerns about the rise in cost of modern weapons systems and I

think that the full implications of those costs are not consistent with keeping the defense budget at constant levels in real terms. I think they have to be looked at very carefully and they are an important part of the problem.

Third, and again to agree with you, it is necessary to look at defense in terms of the effectiveness with which manpower is used. I indicated before that this will become increasingly important because we have established the principle, which I think is a good principle, that pay levels for military and civilian employees of the Department of Defense should be comparable with the civilian sector. But that means that the cost of manpower is going to go up and it enhances the need to use it efficiently.

Looking at those three factors suggests important areas where defense cuts can be made.

Chairman PROXMIRE. That is a skillfull and able answer. Now, let me ask you to drop the diplomacy and give me a blunt answer, how much shall we cut the defense budget over the next 5 years if at all? I want to ask Mr. Schultze the same question.

Mr. FRIED. Well, I think that the kind of defense option that we suggested as a low defense option is not an unreasonable one. I do not think one can answer these questions in that clear-cut way, but I think cutting \$10 to \$12 billion from the defense budget per year, on an annual basis, over the next 5 years would certainly be a reasonable goal, leaving as the constant the international situation.

Chairman PROXMIRE. Would you say if you do that, because of the erosion of inflation, you come out with about your low budget; that is, a \$78 billion budget after 5 years or so?

Mr. FRIED. It would be significantly less in real terms.

Chairman PROXMIRE. Significantly less in real terms and your answer is that that would be a reasonable way to handle it?

Mr. FRIED. That would be a reasonable way.

Chairman PROXMIRE. You come out for it?

Mr. FRIED. That would be a reasonable objective. I would add that it is possible that a closer look at the use of manpower in terms of support and relationship between support and combat forces might uncover some additional areas of reduction. The combination of those two reductions would represent to my mind a reasonable defense posture for the future, leaving constant the international situation.

Chairman PROXMIRE. Mr. Schultze, how much would you cut the defense budget?

Mr. SCHULTZE. That was such a skillful answer and well done. I would associate myself fully with it. I think the combination of the lower posture as he indicated, plus very careful scrutiny of unit costs, cost per division, cost per air wing, the support costs that go behind all these, would make the kind of reductions that Mr. Fried has talked about very sensible as a goal to pursue and I think it could be done and we would end up with a reasonable budget which fully met the security requirements of the Nation.

Chairman PROXMIRE. So if you do this, then you would increase your fiscal dividend by—over your projection—your projection I take it is about \$86 billion, right?

Mr. FRIED. Eighty-eight.

Chairman PROXMIRE. So you increase your fiscal dividend by about \$12 billion?

Mr. FRIED. Plus whatever savings in manpower support costs you might achieve.

Chairman PROXMIRE. I want to commend you and your colleagues, Mr. Schultze, on your excellent treatment on water pollution. You happen to come up with a Proxmire proposal and I am delighted to see it. It shows great judgment on your part, and it also seems to me it is the only thing that makes any sense.

If you proceed with the present strategy, it is going to cost many billions of dollars and it is going to get the figures you give us, almost \$30 billion—

Mr. SCHULTZE. By 1980.

Chairman PROXMIRE. Over \$50 billion and here you tie in a clear-cut determining economic disincentive to discourage pollution and as we know, it has been tried and where it has been tried, it works.

Let me ask a general question in this connection. Do you think this principle can be applied elsewhere in pollution, air pollution, solid wastes, other areas, too, if we proposed a penny-a-pound tax on anything you cannot consume, which would in turn be used to dispose of solid wastes? Thirty-five-hundred-pound car, for example, \$35 tax. New York Times Sunday edition, about a nickel.

Mr. SCHULTZE. You are getting close to home. Senator. In general, yes, sir. It seems to me that, as a matter of fact, the particular bill you introduced with regard to those charges carries with it a principle which, with study and analysis and research, could be applied elsewhere. I noted this year the administration has proposed a tax on sulphur oxide emissions, from stationary pollutant sources, which is a good idea. I think we ought to give a lot more attention to this technique.

If I might use this opportunity to make one quick statement, the opponents of this approach very often say it is a license to pollute and it seems to me that is just flat dead wrong. This particular approach can be calculated to get any given reduction in pollution more effectively and more efficiently than some comparable set of judicially enforced standards, and the statement that this it is a license to pollute which sometimes one hears in just wrong.

Chairman PROXMIRE. Chairman McCracken of the Council of Economic Advisers was quoted last Friday as telling money managers in Munich that the administration was placing substantial reliance on fiscal policy to help recovery at home while not disturbing international factors. How does this jibe with your description of the 1972 budget as neutral, or restraining, if you take the national income accounts?

Mr. SCHULTZE. I have called it neutral; he calls it stimulating.

Chairman PROXMIRE. How can he possibly call this budget stimulating? Where is it stimulating if it is in balance on the unified basis and in surplus on the national account?

Mr. SCHULTZE. You have the wrong witness.

Chairman PROXMIRE. In other words, you would disagree with Mr. McCracken, is that correct?

Mr. SCHULTZE. Unless he is speaking of something at the moment I cannot fathom, I just do not understand it. He may have something in mind that at the moment I do not see, but the budget as I would look at it from year to year provides little change.

Chairman PROXMIRE. Let me ask you one final question. I think your findings that the highway trust fund accumulates about \$1½ billion additional revenue each year than is needed to complete the international highway system is a good example of an area where we need reform. In my mind this is another example of what is wrong with the highway trust funds. However, there are many of our colleagues who support increased expenditures for highways because they claim there are new demands for such roads.

What analysis can you give to us to convince them that this notion that we need new roads is not true? Or need more new roads than would otherwise be completed by reducing the highway trust fund?

Mr. SCHULTZE. I am not sure I can give you a neat analysis which will convince anybody you do not need to increase the rates of spending on roads. What I do think can be said is the following, that we ought not to decide whether to spend money on roads versus airports versus mass transit versus northeast corridor rail transportation simply because we have a trust fund set up some 15 years ago which generates revenues at the rate it is now generating revenues and automatically devotes them to highways.

Chairman PROXMIRE. No. This committee is on record for the abolition of the highway trust fund.

Mr. SCHULTZE. Yes.

Chairman PROXMIRE. And for putting the results of the gasoline tax into the general fund. I think, as a matter of fact, this would be a good tax return to the States.

Mr. SCHULTZE. Or an incentive.

Chairman PROXMIRE. Let them impose the entire gasoline tax.

Mr. SCHULTZE. That is one possibility, Senator. It certainly ought to be considered.

Another one derives from the fact that the choice of transportation, what mode of transportation to use in a city, particularly a large metropolitan area, is critical for urban development and if there is any one area in which the Federal Government ought to encourage relative flexibility and freedom for city planners to pick and choose, it ought to be in transportation. Yet paradoxically, here is an area where we ram it down their throats. An alternative approach is to broaden the whole concept of the highway trust fund and begin to think about either a larger transportation trust fund encompassing all modes, allowing local flexibility in deciding what they need or, as you say, abolish the trust fund concept totally.

Chairman PROXMIRE. Larger in terms of the area where the funds can be allocated, including mass transit, et cetera.

Mr. SCHULTZE. Yes, sir. If I were an urban planner—thank the Lord I am not—I would feel myself in somewhat of a straitjacket in terms of having to take pretty rigid predetermined amounts for highways where what would be much better would be to give them an overall kitty and, subject to certain constraints, let them have more flexibility.

Chairman PROXMIRE. Well, ladies and gentlemen. I want to thank all of you for superlative performances. This is one of the finest panels we have ever had. I think you have contributed greatly to our understanding. This is a good place to say if we could force members of the Congress to read any book, we ought to require them to read this one. Of course, we cannot, and many of us read few if any books, or any-

thing else for that matter. And I hope we can call it to their attention in other ways.

If you have any ideas how we can dramatize it further let me know and I will do my best to get the message across.

The subcommittee stands in recess until 2 o'clock tomorrow afternoon, when we will hear from James M. Gavin, chairman of the board of Arthur D. Little, Inc., and Robert M. Benson, director of the National Priorities Project, the Urban Coalition.

That is tomorrow, June 2, at 2 p.m., in this room.

Thank you very much.

(Whereupon, at 12:25 p.m, the subcommittee adjourned, to reconvene at 2 p.m., Wednesday, June 2, 1971.)

(The following information was subsequently supplied for the record:)

NATIONAL RURAL HOUSING COALITION,
Washington, D.C., June 2, 1971.

Hon. WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government, Joint Economic Committee, New Senate Office Building, Washington, D.C.

DEAR CHAIRMAN PROXMIRE: We are pleased to note that your Subcommittee has undertaken hearings to consider the economics of national priorities.

Enclosed please find a statement from the Coalition urging the Subcommittee to investigate establishment of a federal capital budget as one means of bringing about reordering of the national priorities.

We respectfully request that our statement be included or read into the record of your hearings, and do sincerely recommend the capital budget to your consideration.

Thank you very kindly.

As always,

CLAY L. COCHRAN,
Chairman of the Board.

STATEMENT SUBMITTED BY CLAY L. COCHRAN, CHAIRMAN OF THE BOARD, NATIONAL RURAL HOUSING COALITION, ON THE FEDERAL CAPITAL BUDGET

Mr. Chairman, we are encouraged that the Subcommittee is devoting attention to the vital subject of national priorities.

We would like to direct your attention to an institutional arrangement which fits what Thorstein Veblen referred to as an "imbecile institution", one which had outlived any earlier usefulness and had become socially destructive.

We refer to the present federal budget system which equates expenditures for the Pentagon's public relations staff with expenditures for the building of a hospital or a decent home for a family.

We urge the Subcommittee to undertake a study designed to establish a federal capital budget, a "Truth-in-Accounting" law.

Vested interests we shall always have with us, Mr. Chairman, but the power of a vested interest very frequently rests as much on the prevailing preconceptions (the Mythology) of the community and the sanctity of the resulting procedures as it does on the ability of the vested interest to finance elections or influence members of the Congress.

There is no ally—for those who are casually or actively opposed to programs designed to increase equality of opportunity in this country—so powerful as our present Federal Accounting system.

Under this primitive system we equate the cost of a children's hospital with a bomber, a loan for a house with the expenditure by the Pentagon of \$28 million a year for public relations.

There is a real economic difference between operating costs and capital formation costs. Every business in this country would be in bankruptcy court if it used the Federal accounting system.

But most important for our discussion . . . the present accounting system makes it possible to kill off essential programs because of the "budgetary impact". The distortions that arise from this are maddening.

We propose that this source of policy distortion and social stupidity be laid to rest at last, and the way to do this is to establish a capital budget.

We do not wish to undertake to submit a statement on the capital budget in any detail at this time because we think a set of formal hearings should be held at which a wide spectrum of views should be heard on the type of system which best suits the needs of this society.

But we urge its importance and look forward to hearings which would lead to the establishment of such a system. The failure to establish a capital budget is one of the basic obstacles to a more rational allocation of social resources.

We would appreciate your including in the record a copy of a resolution passed by the membership of the National Rural Housing Coalition at our annual meeting in March.

RESOLUTION OF THE NATIONAL RURAL HOUSING COALITION ON THE FEDERAL
CAPITAL BUDGET, MARCH 23, 1971, WASHINGTON, D.C.

We join the National Commission on Urban Problems, and others, in recommending adoption of "a Federal capital budget . . . in order that most effective and least costly method of subsidizing housing, namely Federal grants or loans, can be used."

Given the tremendous need for public funds in solving the housing problem of low income people, it is essential that the cost be as low as possible. The Federal government can borrow money and lend it more cheaply, in most instances, than it can subsidize others to make credit available. But the present mythology which makes all public credit look like a permanent loss has been utilized to block direct Federal lending. With a capital budget which separated wealth creating expenditures on capital investments from normal expenditures, this block would be removed, with great savings to taxpayers and a substantial increase in the prospects for achieving the goals we seek.

This truth-in-accounting proposal is a simple matter of altering the way the government keeps its books.

THE ECONOMICS OF NATIONAL PRIORITIES

WEDNESDAY, JUNE 2, 1971

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN
GOVERNMENT OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire and Fulbright; and Representative Brown.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economists; Lucy A. Falcone and Jerry J. Jasinowski, research economists; Ross F. Hamachek, Richard F. Kaufman, and Courtenay M. Slater, economists; George D. Krumbhaar, Jr., minority counsel; Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order.

Yesterday we got the unhappy news that the long-awaited fiscal dividend that was supposed to materialize with the ending of the war in Vietnam will not appear. Charles L. Schultze, former Director of the Bureau of the Budget, testifying in these hearings, stated:

"On the basis of our estimates, there will be no fiscal dividend between now and 1974."

It will be recalled that only a few years ago, as recently as 1969, great hopes were placed on what was referred to in the 1969 Economic Report of the President as the "peace and growth dividend."

In 1967, the President established what came to be known as the Cabinet Coordinating Committee on Economic Planning for the End of Vietnam Hostilities. The members of the committee were the Secretaries of Treasury, Defense, Commerce, and Labor; the Director of the Bureau of the Budget; and the Chairman of the Council of Economic Advisers.

In their report they projected a \$22 billion fiscal dividend for fiscal year 1972, the one that we are just about to enter, and they also forecast that this dividend would increase by some \$7 billion to \$8 billion per year thereafter.

I think this needs to be given some emphasis in light of the non-materialization of the phantom fiscal dividend. Let me quote from the Cabinet Coordinating Committee's report of January 1969:

According to the illustrative calculations, the "peace-and-growth dividend"—available for Federal programs above the base line or for tax reduction—would amount to \$22 billion by fiscal 1972, and would increase \$7 to \$8 billion per year thereafter.

The report went on to observe that this dividend must be used in order to maintain healthy economic growth.

But, in order to achieve the dividend, the Cabinet Coordinating Committee on Economic Planning for the End of Vietnam Hostilities warned that "difficult choices must be made—choices between increased expenditures and tax reductions, between defense spending and non-defense programs, and among competing civilian programs." Unfortunately, the difficult choices have been too difficult for this Government to make. There is no fiscal dividend today; there will be none in fiscal year 1972, and there will probably be none at least until 1974.

What this means, of course, is that the problems of poverty, pollution, unemployment, and urban and rural decay will not receive the attention they demand.

Where have we failed? We have failed to cut defense spending by the amounts necessary to free budgetary resources for the solution of our domestic problems. The hearings today are intended to inquire specifically into the question of whether or not the requirements of national security justify the present high level of defense spending and whether they justify the costs of the War in Vietnam.

Our witnesses this morning are uniquely qualified to address these questions.

The first will be James M. Gavin, presently the chairman of the board and chief executive officer for the Arthur D. Little Corp., and a retired Lieutenant General in the Army. General Gavin has authored several books, including "War and Peace in the Space Age" and "Crisis Now."

General Gavin, I understand you have a brief statement which you have prepared. Why don't you read your statement into the record and make what other introductory comments you would like.

**STATEMENT OF JAMES M. GAVIN, CHAIRMAN OF THE BOARD,
ARTHUR D. LITTLE, INC., FORMERLY AMBASSADOR TO FRANCE,
AND LIEUTENANT GENERAL, U.S. ARMY, RETIRED**

General GAVIN. I must say, first of all, I am most pleased to have this opportunity to appear before the Joint Economic Committee. Perhaps I can best begin by saying that I was a member of the Armed Forces for 35 years, retiring in 1958. Shortly after World War II, I was assigned to the newly established Weapons Systems Evaluation Group. One of our first tasks was to evaluate the plans for the so-called "strategic warfare." We also examined a number of other costly and complex weapons systems.

Following that service, I spent over 2 years in Europe, first as Chief of Staff to the Southern Forces, Allied Forces Southern Europe, a NATO command, and then I commanded the VII Corps in Germany, also a NATO command. I was Chief of Plans and Development and Chief of Research and Development from 1954 to 1958. Nineteen hundred and fifty-four was the beginning of the "new look," with our principal military defense being placed upon "massive retaliation at a time and place of our choosing."

We chose this course, as I understand it, for reasons of economics. As the cornucopia of research and development poured forth an ever-increasing abundance of new knowledge, those in the Pentagon sought

to convert it, where appropriate, to new weapons systems. Hence, we had the Snark, the Navaho, the nuclear propelled airplane, and later Skybolt, and many others on which billions of dollars were spent out of a conviction that they would provide unique weapons systems to implement our policy. It was obvious, even then, that decisions on what weapons to advance through research and engineering, and what to discard at an early stage in their development, had to be made. We could not have everything.

Despite the reasons of economics advanced for our policy of "massive retaliation," I was profoundly disturbed by it. The idea of "Hiroshimas" throughout Europe would never have been acceptable to the American people and the policy itself was far too inflexible to respond to the many lesser conflicts into which we would be inevitably drawn.

So, during the later years of my service in the Pentagon, 1955-58, I devoted a great deal of time to studying and analyzing the problems of national defense. It was obvious that we could not develop and acquire all the weapons systems conceivable based upon available technology without seriously affecting the other essential national programs. It was equally as obvious that we had to have a more flexible military policy, one far more responsive to the realistic needs of our time than massive retaliation would have been.

In 1958, I left the service. At that time I rather tentatively postulated the theory that national defense no longer could rely upon weapons systems alone. And I wrote this theory when I wrote "War and Peace in the Space Age" and "Crisis Now."

That, indeed, the areas of strategy then most certainly—in fact, I referred to it as psychology, the attitude of our people, and the attitude of other people toward our own society—had to encompass the domestic condition, the Nation's economy, and research and development—what we were doing about our future. I believe that events since that time have given considerable validity to this view.

For clarification purposes, may I say a word about strategy. Strategy, perhaps, is one of the most misused and abused words in the English language, in the Defense Department and in the Pentagon. Strategy concerns itself with those large-scale measures which permit a nation to bring its tactical forces into play in a decisive manner and under the most favorable conditions possible. The first objective of strategy should be the accomplishment of a nation's goals without tactical involvement. Second, to have a nation's resources disposed so as to win if a tactical confrontation proves to be unavoidable.

A word about the kind of world in which we find ourselves. It is now truly a global village—a world about which a man can cast his voice almost instantly by global satellite. It is a world in which a man can cast a stone to any other part of the globe and expect retaliation almost instantly. It is a world, in a military sense, in which all of the weapons systems that we have are designed to neutralize those of an opponent and to insure his certain destruction.

Last week a writer on the editorial page of the New York Times, in writing about our strategic alternatives, pointed out that what we now seek is the "assured destruction" of an opponent. The Soviet Union, for example, also seeks the same goal, thus together we seek a posture of "mutual assured destruction," for which the acronym is MAD—and this is what it is.

It is past time, therefore, that we be realistic about our Nation's resources; that, having established our Nation's goals, we seek to develop a strategy to attain those goals, that is, improve the domestic condition in all respects, supporting a viable, dynamic economy, and investing wisely in our future through research and development. Having made this allocation of our resources, we should provide adequate, and no more, tactical weapons systems. For example, it was because of an imbalance in the allocation of our resources that I opposed the Southeast Asian involvement from the outset. From a strictly military point of view, it has been nonsense to spend billions and billions per year, pursuing illusive tactical goals that would never be realized, while our strategic posture steadily deteriorated.

Another maldisposition of our resources occurs in NATO. I have believed in the concept of the North Atlantic Treaty Organization since it was founded. I was one of the first commanders in that command. I served in two different commands in it. It can be stronger than it is now and it will be stronger when we recognize the growing role of the European Economic Community. We should realize that what is now needed is a partnership between two very powerful economic and military, if you will, blocs on each side of the Atlantic. The U.S. commitment could be significantly reduced and, more important, the logistical and training backup in the United States that has been necessary to support those forces in Europe can be proportionately reduced, if we look upon NATO in terms of today in the sense of the European Economic Community, not the NATO of 1952.

I cite these two examples to support my point of view that the strength of the United States in global affairs should begin with our own domestic condition, our economy, and our investment in the future. Further, tactical commitments, whether they be in Southeast Asia or in Europe, that are supported at the expense of any aspect of our strategy, should be questioned for they may be, even in a military sense, greatly in error.

There will be those, I suppose, who will charge, at once, a return to isolationism. I hope we all realize that the world today no longer will permit any form of isolationism. The family of man brought together on this thin, rather inhospitable, crust of space-ship earth is closer together than it has ever been and it will get closer. The earth's resources are limited and even today one-third of the earth's population is using over two-thirds of the earth's resources. Even this situation alone forecasts conflict. Our society is a microcosm of the world society and it is time that we got on with dealing with its problems in a realistic way based on priorities that will serve our national goals.

Consistent with that, we can provide all the tactical weapons systems that we need and that will serve us usefully when required. I will be very pleased to attempt to answer any questions your committee may have.

Chairman PROXMIRE. Thank you very much, General.

General, you say in your statement, and I quote:

I opposed the Southeast Asian involvement from the outset.

Now, when you say that, are you saying it was a mistake for this Nation to enter the war in Vietnam?

General GAVIN. I want to be sure I have the exact reference.

Chairman PROXMIRE. About the top of the page, third line.

General GAVIN. Oh, indeed it was. In fact, there is no doubt in my mind about it; it was a very, very difficult decision before the Senate Foreign Relations Committee in 1965, harder say, than in 1955 when General Ridgeway and I both took the view in the Pentagon that this would have been a mistake. And, I think that subsequent events have, unhappily, more than given validity to that point of view.

I felt in 1966 if the war were to be continued—and I talked to Mr. McNamara about it—I was called over by him to talk about it. I said it would tear our society apart, the very social fabric of our society would be shattered and our Armed Forces would be in difficulty over it. We must bring it to an end.

Chairman PROXMIRE. You opposed it for two basic reasons: one, because of the effect on our society and the other because of the effect on our military capability?

General GAVIN. Yes, sir, Mr. Chairman. I saw the first as a corollary, really. The main objection, and I stuck to it, with my experience with NATO and in military affairs, and as they analyzed the Southeastern Asian situation in 1955 and I went and talked to Diem at the time, it was apparent we were plunging into an Asiatic war with somebody who did not have the resources to wage war with us. It was obviously China, and to some extent, Russia. And, if we were going to war with China, that certainly wasn't the place to do it.

I opposed it at that time and as the war escalated, it became obvious the only confrontation would be when China finally committed its forces, and we came very close to that point at one time.

Chairman PROXMIRE. Is there a right way to fight this war or should we have not been in it at all? At one time or another you have been, I think, rightly or wrongly, quoted as indicating we should have fought in a different way. Our tactics were wrong, that we should—perhaps you were talking about we ought to get out?

General GAVIN. It took this form, Mr. Chairman: First of all, we thought that Diem, although a dedicated man, was rather repressive and considerably lacking in political responsiveness to his people. He took over a country that was in disarray with various factions, sects, each with its own sources of income and weapons. And internal peace was in an uneasy balance. Bao Dai was the head of state and he was spending a great deal of his time in France, usually on the Riviera.

Diem at once began to be rather repressive—and from this came a reaction—the initial national liberation movement.

Now, we then provided aid and we provided trainers. I talked to Mr. Kennedy about this problem in 1960, and on his suggestion, went to see Prince Souvanna Phouma, helped to negotiate a treaty that would guarantee the neutrality and independence from the point of view of Laos. At that time I do not suppose I would have objected at any time to helping them with trainers and some funds. But once our troops were committed we were deeply involved. The commitment of our troops, I objected to in 1955. I strongly objected to that.

By 1966 or 1965, when I appeared before the Senate Foreign Relations Committee, I discussed General Westmoreland's problems. He had many competent forces, poor logistic arrangements, 30 ships tied up at a time in the estuary of the Mekong River going by Saigon, and I was quite worried. He finally achieved some stability and established powerful existing forces at Da Nang and Saigon—for example, I referred to them as enclaves.

So, at that point I voluntarily came forth—and I had not spoken on this subject publicly for 10 years—I voluntarily came forth through a letter in Harper's magazine that later achieved some notoriety I did not expect, and suggested, "Let's bring this to a stop. We have 260,000 men there. They are no longer in jeopardy. We are in a good position now. We have powerful enclaves; based upon the retention of those, let us extricate our forces as promptly as we can."

This was the first statement made, really, since 1955, when I did talk publicly then on the war in Southeast Asia.

Essentially, we are in that particular operation right now. We do have good strength of the enclaves, but that tactic is now being followed.

Chairman PROXMIRE. What does that mean in terms of getting out? The administration has a policy, as we all know, of course, of withdrawing troops on a regular basis. The President has announced it, and he expects to be down to a far smaller number than 250,000 within a year or so. There is some discussion of a residual force in Vietnam. Should we follow this present course, or should we set a date and get out as of that date completely?

General GAVIN. Well, Mr. Chairman, this has been one of the most difficult judgments for me to come to, and that is setting a definite date. For a long time I was opposed to this because it does tie up a commander's hands, and in a way that takes all of the initiative away from him. But, nevertheless, I have watched this war go up to where we are approaching \$30 billion a year in expenditures. We are not in any way seeming to get out; our own society is getting more and more troubled; our troops are becoming more and more demoralized with the drugs and lack of discipline.

I finally, with some reluctance, had to conclude that nobody is going to get out of that place until we say we will get out now.

I appeared on a program sponsored by "Common Cause" a week or two ago. I suggested that we set the date of December 31 this year and adhere to that date. I only did this out of a conviction that the last 5 years of procrastination and delay has achieved nothing but the loss of many, many lives and the loss of tremendous capital resources of the United States. So I am ready now to say: Let us set a date and get out.

Chairman PROXMIRE. As a general with a very distinguished record and certainly with as expert knowledge as any witness we are going to have before this committee, is it practical, would there be any big price to pay for getting out that precipitously in terms of the dangers involved to our troops?

General GAVIN. Well, I might say, I can see in answer to these questions I am heading down the road to criticizing our objectives, as to how the President is trying to do it, and I do not want to do that because I think he is trying to do the best he can. But, from my point of view, everybody has been trying to do the best they can for the last 16 to 17 years, and we have not done very well. It has always gone the other way.

Even our defense budget is going up next year, as I understand it, over the past, the next fiscal year. So, I think that finally, in my mind, it has reached the point where it makes good military sense to say: "Let us set the date and bring this around."

Because, once we do, and once we can allocate the resources of our country to the things that need our attention, first of all, and I mentioned it before, the domestic conditions from health care to housing, education, and so on. Our economy is in serious trouble with the dollar imbalance, causing the dollar to be in jeopardy. It is going to be worse before it gets better, with the price of living going up, with inflation and unemployment going up, taxes going up, something has got to be done to turn this country around.

With the complexion of all of this, let us set the date and get it over with. I feel that is the thing to do.

Chairman PROXMIRE. I think that is an excellent answer. It is not completely responsive because I asked about the military implications of this, whether or not it can be done militarily in any way that would minimize our casualties.

General GAVIN. I understand. I would like to say, having come to that conclusion, we are getting dangerously close to where we may not have enough time. Six months is a very short time to do something like that. I assume much of the logistical support will be converted to the use of the South Vietnamese anyway—ammunition, food, and medical supplies, and so on—and getting the troops out in that period of time is going to be difficult.

But, it is a good idea to set our sights on it and work toward it. That is better than leaving it open ended.

Chairman PROXMIRE. What about the future cost of our military presence in Asia and Europe? I realize that these issues are usually discussed separately, but perhaps we ought to be dealing with them together, the cost of our military presence in Europe and Asia. The administration plans to reduce our forces in Asia, but it opposes any reduction in Europe.

As a former NATO commander, what are your views? Are we balancing our forces properly throughout the world? Do you think we have too many or too few troops in Asia and in Europe?

General GAVIN. I do not think we are balancing them properly at all. I implied that about NATO a while ago. I read the study report on the All-Volunteer Armed Forces, with which I find myself in complete agreement. However, Mr. Kates was not given any flexibility in terms of number of troops, only in terms of what the Pentagon wanted, and the solution therefore was increased pay. It is just as important to cut back forces to reality.

Let us take Europe, for example. I know Europe well. I have been there in two different NATO commands. I have had long discussions with several leaders about the problems of Europe, De Gaulle particularly. I have talked to the Ministers of Defense of several countries at different times, including the Minister of Germany. I must say they wonder why we retain the forces there we do.

What bothers me about it—let us put it this way: when Mr. Kennedy asked me to go to France, he asked Mr. Acheson and me to go to the State Department and get briefed on the current state of NATO. This was 10 years after I had been in NATO—something less than that, perhaps 7 or 8. When I got through with the briefing, I told him I thought it was dismal. All of the things that were then happening in Europe seemed to be ignored.

One of the most significant things is the growth of the Common Market. That is going to be a very powerful economic bloc. It is going to challenge the United States in many areas of world trade, and it is a good thing. These are our friends. And being a powerful economic bloc, it really is a powerful military bloc, and they must assume the burden of their own defense to an increasing extent.

Why do we have troops there? The Minister of Defense of Germany once said to me: "I don't think you should have really, except if there had been Allied troops in the Danzig Corridor, Hitler would not have attacked."

How many troops are there? Well, a million, probably. Now, President Eisenhower at one time suggested, before his death, that we should cut our forces back to a corps. I too, have consistently maintained a corps would be about right.

Chairman PROXMIRE. What does that mean in terms of total troop commitments?

General GAVIN. A reinforced corps would probably come out to around 75,000 troops.

Chairman PROXMIRE. Over what period should we reduce to that size?

General GAVIN. I would reduce that as promptly as we could. That would be easier to do than getting out of Vietnam.

Now, it has been more important, Mr. Chairman, a point seldom mentioned, but what we should realize, when you cut back from the cutting edge of a field army, a corps of troops, or cut back from the 320,000 down to, let us say, the 100,000, you cut back in training base and the logistical pipelines and facilities back here another 200,000 troops, a big wedge, a big theater global slice.

Furthermore, I have long been unhappy about the logistical deployments to support our forces in Europe, believing they are more suited to a World War II type of confrontation than they are to what may ensue. We would, therefore, I would think, cut back a great deal of our warehousing and so on, built upon a World War II concept.

So, realistically, our thoughts are: we would go very, very far in saving dollars as well as manpower in Europe, and make Europe stronger for it, by giving the greater burden of defense to the European community itself.

Chairman PROXMIRE. How quickly would they pick up the slack? Or would they pick it up? Many people argue this one.

General GAVIN. When we went in there, Western Europe was once talking about organizing a European army. They always felt it was to be a European corps of their own until we decided there should be a North Atlantic Treaty Organization.

Let me mention that there is another aspect of Europe which again concerns me very much. The key to the defense of Europe in the missile age is not wholly a thin line across the peninsula of Europe to North Africa. It is the control of the Mediterranean, and North Africa, and not what they do in Germany itself. We see today the Soviet Union demonstration in the Middle East, and economic aid, arms, aircraft, Soviet tanks and so on, on into the northern African countries.

We see the Soviet strength gaining in the Mediterranean. To me it is nonsense to talk about holding the line across Germany, which we were holding 15 years ago.

So, I see reasons for changing this and putting the responsibility on the European Economic Community, to go beyond just purely what, military affairs, and get to economic and large-term survival.

Chairman PROXMIRE. Secretary of the Army Resor recently stated 70 percent of our combat maneuver battalions have been withdrawn from Vietnam. I am informed that only about 50,000 combat troops, if that many, remain. By "combat troops," I do not mean they are all combatants. As you know, our divisions have changed rather dramatically. We have an additional 200,000 support troops in Vietnam.

In your opinion, do we need that many support troops to back up the number of combat troops remaining or does the figure suggest we have much too large a logistic force in Vietnam; we ought to be reducing our support troops at a much faster rate?

General GAVIN. I cannot answer that. I do not know. I suppose a lot of that detail is over there to support the Vietnamese. I really do not know what they are doing with it.

Chairman PROXMIRE. That response does indicate in your opinion it may well be it would seem that we do not need that many support troops to support the combat troops we have. They may have a function supporting the South Vietnamese, but you have already given your answer on your conviction that we should be out of Vietnam by December 31. It is practical to do it; our casualties would not be greater by following up the policies, and you think that for many reasons you have expressed, we should do that?

General GAVIN. Yes.

Chairman PROXMIRE. I have some other questions. I yield to Senator Fulbright.

Senator FULBRIGHT. Thank you, Mr. Chairman. I am sorry I was a little late to hear the General's statement. But I have heard the General several times before the Foreign Relations Committee. I think he is one of the most thoughtful and perceptive men we have ever had before the committee and his testimony on Southeast Asia, about which he testified primarily before the Foreign Relations Committee, his testimony, his views about that situation, have been justified by events since that time.

So, I think there is every reason why this committee and the country should give heed to his view about Europe, as well.

General, it has occurred to me in seeing the maneuvering that goes on in the SALT talks and now about troops in Europe, that our country in the position it holds in the world, more or less sets the pattern.

Or, to put it another way: Whatever we do the Russians feel they ought to do or match and the only way to get away from the stalemate is to take some initiative in these matters. We sit and wait for the Russians to take the initiative. They are not likely to.

However, there is a likelihood, if we should take the initiative such as in the Mansfield Amendment, that the Russians would respond, because the burdens on them are equally as serious as they are on us, on their economy and on their resources. What do you say about that?

General GAVIN. In all of my years, Senator Fulbright, in working with these problems, writing about them, and discussing them, I suppose this has bothered me more than anything else. Our tendency to react to what they do. Surely we should know what our goals are,

commit our resources and achieve those goals. Let the Soviets worry about what we are doing.

But yet we do not seem to do that. When the Soviets make a suggestion, when they talk about things in Europe, we get worried about it and say, what do they mean? What is behind all of this? Long ago we should have reorganized and disposed of our resources in Europe, Europe, vis-a-vis the Soviets, is quite difficult because when they say: Let us talk about recall, we go back to the United States and they just go to the other side of the Iron Curtain, and the countries there are still in jeopardy. We are afraid of the Soviets moving across the Iron Curtain.

But, I think we ought to, on our own initiative. I have been in and out of the Soviet Union since I appeared before your committee, twice. I will be over there in July. They are having difficulties. Their economy is creaking and groaning. They are having trouble even now throughout the satellite countries. Someone has recently said they used the price of any commodities of the free world as the price for trading with the satellite countries now. Some have said recently that if all capitalist countries went Communist, at least one would have to be saved, as a basis for establishing competitive prices in a free market system.

So, through the system, one country they set commodity prices on, on which they would negotiate their trading with their own satellites. They are having trouble. They are having management trouble, trouble of many kinds, spending a tremendous amount of wealth in pursuits such as in the Middle East. But I think they have become ultra-conservative. I think it has lost much of the dynamics to survive. I think our system has done extremely well.

So, I am therefore more troubled about our tendency to react to what they do. We should be able to think through our own goals and dispose of our own resources to obtain those goals. We have not done that. We tend to the status quo and resist change. Europe is a good example

Senator FULBRIGHT. Well, change is difficult, not only in military fields but in every other field. But I know in the past there has been a feeling that we are richer than they are; that if we keep up this arms race they will finally conclude they cannot keep up and that they will then see a settlement. I do not think that is likely to happen. While they have difficulties, they are a tremendous country. They are about three times as large as we are, geographically speaking, and they have tremendous undeveloped resources.

As a matter of fact, we are having our own difficulties. I am not at all sure how one balances that, but in an internal sense, the turmoil that afflicts us, which I think grows out of the misdirected use of our resources, is very great.

I think it is a vain hope to think if we keep on building extensive weapons system that it will be harder on them than it is us. I do not think that is true, myself. I think our system, while it is more productive, it is also more fragile than a simpler or less highly developed and highly industrialized system.

But, coming back to this central question: It seems to me it would be very much in our interests and also in their interest if we would take the initiative. I have been very disappointed about the course

of the SALT talks. They have been going on nearly 2 years, but there has been no progress yet, other than verbal. And the ABM is an example. I bring that up as an illustration. We are told that there was an opportunity for us to make agreement on this, stopping the future deployment of it, and yet we declined because we had insisted upon offensive weapons. There are always some reasons we cannot seem to make an agreement.

Therefore, I think some initiative would be very much in our interest.

About 1 year ago the Senate passed the Brooke resolution which said there should be no more deployment pending the outcome of the SALT talks or progress of the SALT talks. But the administration simply ignored it. I still think, from a psychological as well as economic point of view, it is very much in our interest to take the first step in reduction of forces and weapons systems wherever they be, whether it is ABM or whether it be troops in Europe.

I do not see that we risk a great deal. Do you think it endangers our security if we should make an agreement on either ABM, that type of thing, or on our reduction of troops?

General GAVIN. Well, certainly we should risk as much for peace as we risk for war. I would like to go back—

Senator FULBRIGHT. I am not asking that much.

General GAVIN. I might be willing to take risks. I do not know the details of what goes on in the SALT talks, except what I read in the press, of course. I would like to go back to an observation you made a moment ago about both sides just spending, and spending, and spending.

You know, Mr. Senator, I have been in research now for, goodness, 25 or more years, and I am quite familiar with it. And the volume of new information coming out of research just goes up in an exponential rate. It is continually more and more. And I look back with dismay on my years with the weapons system evaluation group when people were proposing nuclear propelled airplanes and all this and that.

One day in a meeting with scientists talking economics, I said: What this country needs is for the Army to have a fleet of strategic tanks. They will weigh about 1,000 tons apiece, nuclear propelled, a tank with nuclear warheads, meant to ford all rivers, to travel around the continent of Europe, and they would absolutely dominate the place. This thought was the greatest idea they had ever heard. This is a true story. You see how preposterous things can get.

If you really try to convert all new human knowledge into weapons systems, this country will go broke as fast as you can imagine that would happen. We have to make decisions.

There is the thought we continually spend and point out they are spending a lot, too, and they are going without butter, just as we are going without proper housing and medical care. Someone said they are not very well off. This is utter nonsense. This is not the way the human species should live on this planet. We ought to do the things that must be done. Think through our goals and go after them and let them make mistakes if they want to.

But I agree: we have got to make decisions and take some chances to achieve peace. The SALT talks. I talked to you about before, worry me very much, because it is a fact that in order to achieve what

we would like to think of as an adequate posture, we increase our arms spending so we are stronger when we talk. If they break down like other arms talks have in the past, we are going to be in a catastrophic condition. Tremendous amounts are spent on the weapons systems that will again probably deteriorate, and mean only the end of the human condition.

So, I hate to see anything done to jeopardize these talks. I hope they are making some progress.

Senator FULBRIGHT. It is fantastic. You read in the paper just today further stories about the Navy F-14 which apparently is now at about the same status as TFX. It is now estimated that the planes are going to cost \$16 million each. It gets so big it is absolutely fantastic and yet there is grave doubt about its usefulness.

As you know, the first one they built has already crashed. That is following a very similar history of the TFX. I think all of the F-111's, which is the new name for TFX, are all grounded now and they are looking them over to see what they can do about it. But it gets to be ridiculous after a while, the repetitive nature of these systems.

Beyond that, above all of that, it is very dubious as to whether or not they are really useful today under modern conditions. This argument has been going on in the Pentagon for 10 years. But so far, the ones that take a lot of money seem to win out.

Some of us, inspired by the chairman of this committee, have very grave doubts now about whether the money being spent on them is the principal incentive rather than the usefulness of the end product. Nobody can prove that, but it looks very much like that.

I do not know what we can do. We never seem to have enough votes in the Senate to carry anything, except the opposition to the SST, which the chairman of this committee practically spent a year of his life getting done. You can hardly do it on every weapons system that comes along.

But, I think your testimony on the troop business ought to be heeded, just as your advice on Asia should have been heeded. I do not know when we are going to learn. When we look back and see our mistakes, why can't we apply them now? I do not know.

Do you have any advice for us?

General GAVIN. May I say something, Mr. Chairman? Two years ago I talked to the chairman of this committee. It was out of some concern for the Defense Department, and I must say I felt this way about it: I felt that if the East Asian involvement continued, our society was so upset about it then, the casualties if they were continued, we found more and more people against the war and inevitably the Defense Department would be under very severe criticism and yet we need an adequate Defense Department. We need a good and efficient Defense Department. We need a Defense Department to provide technical weapons systems, adequate, modern and functioning, and so on.

Frankly, I was worried about it because I had followed the policies of the past Secretary of Defense quite closely. On my own initiative I went around and visited the heads of a number of our national defense industries and then came to see the chairman about it and later talked to Mr. Packard about this. The policy of requiring the defense industries, the policy of Mr. McNamara, to provide figures on costs and spare parts, 6, 7, 8 years down the road on the weapons system,

really pressing the state of the art has been in trouble. This was the one way to get the cost picture under control, but they didn't. They did not deal realistically with it.

But, as a consequence, about 4 or 5 years after these policies went into effect, we had one defense industry after another with an enormous overrun. I would hope it could be straightened out. Frankly, I am very disappointed in the F-14. I thought it was going to be well managed. This can only do us a great deal of harm. I would like us to have a good national Defense Establishment, but when they make mistakes like this, it discredits the whole structure and troubles me very, very much. I wish something could be done about it, but I do not see in this committee how it can be done.

Senator FULBRIGHT. We might cut down a little on funds. That is all I think Congress can always do, if it has the votes.

My time is up for the moment.

Chairman PROXMIRE. Congressman Brown.

Representative BROWN. General, in your very brief statement, you use the term in a couple of different places, "strategic posture" study deteriorated, and supported at the expense of any aspect of our "strategy."

I think in both instances those were used in connection with tactical, an alternative to tactical suggestions. What is your definition of "strategy," or "strategic posture," in these cases? What are you talking about when you refer to strategy?

General GAVIN. Yes. This is a very, very important point, Mr. Brown. I would like to make precisely clear what I am talking about because we misuse this word very, very much.

I do not think there is a strategic weapon in the Pentagon. I do not think there is a strategic weapons system in the Pentagon. What is a strategic weapon? It was an attractive word for a fledgling young arm that needed a unique mission to grab onto, and they used it in the context of attacking the cities, the industrial sites, and so on, of an enemy country, not their armed forces. And in this sense, it would influence the war strategy indirectly.

A very interesting thing happened over 100 years ago when Mr. Lincoln was conducting the Civil War, or the War Between the States, however you happen to view it. A boat appeared at Hampton Roads and sunk several wooden bottomed ships. He sent for his Chief of Naval Research, Mr. Dalgren. This story is told in "Reveille in Washington," a very good book of that period in Washington history. He said, "Mr. Dalgren, what are we going to do? That boat is going to come up in the Potomac River and throw shells at the White House. If it isn't going to do that, it is going to be razing the ships in the harbors of Philadelphia and New York."

The Confederates had come up with a strategic weapons system that could ignore the Armed Forces, and Navy, and go fight the non-combatants and bring the war to an end strategically. However, Mr. Dalgren said, "Well, we have something in development. It is something Mr. Erikson has been working on for some time. If it is now ready we will commit it."

So, the *Monitor* was sent down to Hampton Roads. It challenged the *Merrimac*. They fought a stand-off on that meeting, and brought an end to the strategy of the Confederate forces. No longer could the *Merrimac* feel free to roam about fighting noncombatants.

Today, the long-range bombardment forces of the Soviet Union, as it is called, exist to destroy our own forces. I think the French call theirs the long-range intervention forces. They are no longer strategic forces. Indeed, the world is so small in size it is hard to believe this, but tactical weapons systems exist to engage any other tactical weapons system as easily as forces engaged each other at Gettysburg a hundred years ago. Strategy is something else.

What is it? I have given a great deal of thought to this and I have written about it and discussed it for some years. Strategy consists of those measures we take short of attack engagement to be sure we win, or if it does not take place, we win anyway.

What are those measures? If these other things are all tactical—in my opinion, clearly they are dealing with the domestic conditions—we should have a society—

Representative BROWN. Solely that, sir?

General GAVIN. No. No, it is a tripart. Domestic conditions, economy, and what we are doing about our future; research and development.

Representative BROWN. Are you talking about research and development in our industrial capacity or are you talking about research and development in our military capacity, or talking about research and development in the social area? What are you talking about?

General GAVIN. I cover the spectrum from biology to zoology; from biochemistry to neurology.

Representative BROWN. Are you suggesting that there are no strategic military weapons at no strategic military positions?

General GAVIN. No. Anything we have that I know of, is tactical, to be precise in the academic sense.

Representative BROWN. In other words, I am trying to get a quick summary because I only have 10 minutes. In quick summary, what you are saying is: There are no strategic weapons systems now because the world is so small, everything is tactical. Is that what you are saying?

General GAVIN. That is right.

Representative BROWN. What do you mean when you say "our strategic position" or "strategic posture," is steadily deteriorating?

General GAVIN. Yes.

Representative BROWN. What does that mean?

General GAVIN. That means our domestic position is badly being eroded. We have inadequate health care.

Representative BROWN. Strategy translates as domestic circumstance, or domestic economy, or domestic social conditions; is that right?

General GAVIN. Domestic conditions, economy and the position of the dollar.

Representative BROWN. It has no reference to strategic military weapons?

General GAVIN. There is no such thing now.

Representative BROWN. I see. All military weapons are tactical?

General GAVIN. That is right.

Representative BROWN. The semantics of it are a little confusing.

General GAVIN. You are quite right.

Representative BROWN. Would you tell me, please, where you say in your statement: "We should provide adequate tactical weapons," what are adequate tactical weapons?

General GAVIN. Yes. Well, today I think that we have allowed many of our tactical weapons systems to run down while we have become involved in Southeast Asia. I worry about when you say "adequate," do you talk about a fighter interceptor, or missiles, or does the Navy need a carrier transport, or more nuclear submarines?

Representative BROWN. You say, "we should provide adequate tactical weapons systems." What do you feel are adequate tactical weapons systems?

General GAVIN. This will take a bit of a rundown, but in brief, I would think in this day and age, I would personally not see a place for a big bomber. I think the missiles are adequate to provide for long-range striking forces. I am quite worried about the defense against missiles, although I am willing to go along with the administration's suggestion we build two sets for military development. I think the Navy—

Representative BROWN. Are you suggesting that there should be research and development in this field, but what then? Should there be no defense against intercontinental ballistic missiles?

General GAVIN. I would think with the two sites for research and development at the moment, we have gone far enough. I would like to see the outcome of the SALT talks before we go any further.

Representative BROWN. As a military man, then, you would suggest we should not have defense capability from potential aggressors?

General GAVIN. I do not see how one can say one should not defend one's self.

Representative BROWN. I don't either. That is why I am asking you. What is your position?

General GAVIN. The best defense might be a fleet of nuclear submarines that could retaliate at once.

Representative BROWN. You would rather have us invest in nuclear submarines than the ABM?

General GAVIN. I think you need a mix to make the enemy's problem complex.

Representative BROWN. You would have both the ABM and nuclear submarines?

General GAVIN. I would say so.

Representative BROWN. I see. What other tactical weapons systems do you think we need for an adequate defense?

General GAVIN. You need highly flexible, highly mobile ground forces and marine forces.

Representative BROWN. You would maintain what size ground forces and marine forces in being, sir?

General GAVIN. Well, you know, certainly I would maintain an adequate number to meet our commitment and that might be—I think we are talking about on a scale now of 13 or 14 Army divisions. They should be modernized and brought up to date. At one time, I think in 1958, I felt we should have 24.

Representative BROWN. How many men in uniform would that be in the Army to maintain 13 mobile divisions?

General GAVIN. It would depend a great deal on where you had them disposed and what logistical backup you needed for them. If you cut back Europe to a division, you could significantly save back here, and I do not know why we would be reluctant to put—

Representative BROWN. If you have 13 and cut back in Europe, where would you put them to keep them 13?

General GAVIN. I do not think you need to be at a loss on that. I think the Pentagon could give you a good answer to that.

Representative BROWN. I am asking for your answer because you suggested 13. I want to try to get a picture of where the 13 would be deposited.

General GAVIN. If we could cut back on five divisions in Europe to one, it would probably take at least three or four out of the inventory entirely.

Representative BROWN. You would not have 13, then?

General GAVIN. Well, I think if we did that now we would have 13. I do not know the exact number we have now. I am not playing the numbers game with you—

Representative BROWN. But if you had 13 where would you put them?

General GAVIN. Well, if we were to cut back to one in Europe, we would probably have troops in Korea; probably have reserves in Hawaii, probably troops in Alaska. We would probably have quite a sizable training base in the United States and we would probably, if we cut back significantly in the regular divisions, upgrade the National Guard and the Reserve divisions.

Representative BROWN. At the time we move to an ultimate military force at the end of the war in Vietnam, what does the Defense Department have in mind we would have in the way of divisions?

General GAVIN. I did not understand your question.

Representative BROWN. What does the Defense Department suggest in the way of divisions in being in mobile readiness at the end of the war in Vietnam when we move to an all-volunteer military system?

General GAVIN. I do not know. You would have to ask the Defense Department.

Representative BROWN. I am under the impression it is about the same you have suggested. So far I have identified a difference of opinion between you and the Military Establishment to the extent of one strategic bomber. Are there other differences?

General GAVIN. There may be, Mr. Brown. I am here, I think, to testify on economic matters and I have a military background and I do not pretend to know more than an awful lot of people do about DOD. I have not had a briefing in DOD for 14 years.

Representative BROWN. Sir, you are here as a military figure.

General GAVIN. I did not think so. No, sir; I am here as a civilian with military background.

Representative BROWN. Because of your military background. Your background is military rather than economic; is it not, sir?

General GAVIN. I have been a businessman for 13 years and a diplomat for two. I am very concerned about the economy and the state of the country, and I will be happy to answer your questions.

Representative BROWN. But apparently you have joined both of these qualifications, because you have the military background and can speak to the capacity of the military and also to economic concerns. I was just trying to question you in the military area, because I guess what we are discussing is the impact of the military on the economy.

But I see my time is up.

Chairman PROXMIRE. General Gavin, with regard to the defense budget, the administration is now requesting \$80 billion in new obligation authority, so it looks like we will be back up to an \$80 billion defense budget. I have two questions.

One: Should we cut the defense budget, and if so, by how much?

General GAVIN. Mr. Chairman, I do not know the basis for the Defense Department's budget. I do not know the assumptions on which it is based. When I knew of the defense budget from a personal point of view, it was \$50 billion. But we could cut back something that approaches something like \$30 billion from Southeast Asia. I would think we could easily bring it down to \$70 billion and probably \$60 billion, but this will take a little time. I do not pretend to know more than the people in DOD do about their own budgets, but I do know what it was before we got in the Southeast Asian conflict, the published figures we were spending then, and I would like to see those diverted again to our domestic conditions, our economy and so on.

Chairman PROXMIRE. I think the argument has been made in real terms, the budget is quite comparable now with the budget we had in 1964, but because of inflation, pay raises, so forth, that the \$80 billion budget would come close to the budget we had just before the big increase in Vietnam. We were already in Vietnam, of course, but not in the big way we are now.

General GAVIN. This is one of the most disturbing arguments of all. I do not understand this. If we have 6 percent of GNP, this is supposed to be a good idea, but yet it builds on itself, consumes itself. As they build more national defense weapons systems, the GNP goes up and the percentage goes up a little more, and that is all right. It is as though if your automobile fatality rate on the weekends went up from 100 to 200, if the population were twice as much driving automobiles, then it is not a bad thing. It is not a good thing. I am very much opposed to considering a defense budget in terms of the gross national product.

I will tell you why, sir. The thing that concerns me about that most is that we ought to think about a net national product. We have finite resources and we cannot continue to consume our national resources thinking of a gross national product as the end-all. We are beyond that point. We have to think of our net national product and I would not for a moment think it was right to gear defense spending to percentage of gross national product, No; this is no good. Sooner or later it is going to do us in.

Chairman PROXMIRE. You do not feel that you can give us your own estimate of how sharply we can cut the defense budget in dollars and cents?

General GAVIN. No; except I would go back to the figures I mentioned before.

Chairman PROXMIRE. \$70 billion; perhaps \$60 billion, but it will take some time.

General GAVIN. Cut us back to around \$60 billion or so.

Chairman PROXMIRE. What advice would you give the Congress about the difficult problem of evaluating the budgetary requests for national defense? How should Congress approach the issue to eliminate or reduce individual programs?

Senator Fulbright said we seemed to have a lot of trouble knocking out weapons systems, even though there seems to be a good deal of sentiment against some as being misconceived and very expensive and redundant and so forth. One approach which I am trying this year, a number of us feel might be able to win. Senator Mathias and I are cosponsoring an amendment to set a ceiling on the amount that can be expended in fiscal 1972 at \$68 billion. How would you approach this if you were in Congress?

General GAVIN. I can understand your frustration and aside from whether or not you are frustrated about it, I can understand why you would get a figure like this. It is one way to get about it. This figure is very close to the figure I have been talking about, cutting about roughly 10 percent or so down to around \$70 billion. Only through this arbitrary approach can you get the result you seek in this committee, in my opinion. The Armed Forces Committee may feel otherwise, but I think this is all right.

This, Mr. Chairman, is a little bit in the realm of what we are going to do about an arbitrary date in getting out of Southeast Asia. After a while you finally get so tired, you say: As of this date we won't give another dime. I rather think it is all right.

Chairman PROXMIRE. Some concern has been expressed about the organization of the Department of Defense, and recent studies have indicated some basic restructuring ought to be done in order to make it more efficient. One suggestion would alter the role of the Joint Chiefs of Staff and make it only an advisory group, with the Secretary of Defense. What is your feeling?

General GAVIN. Well, sir, before a Senate committee in December of 1957, having been through this Sputnik surprise and because of mass retaliation, I recommended a change of this sort. I am happy to note that the Fitzhugh committee so recommended also. Nothing has been done in the meantime. I talked to people in the Department of Defense about this and they seemed to think nothing is going to happen to this recommendation. I do not think the American people realize how this works and after my service and background and present age, I think I can be as frank as I want to about this.

There is more involved in the Defense Department than just spending money or not spending money wisely and continuing weapons systems when they should be stopped. There is the organization for deciding what to do with the resources. As long as a member of the Joint Chiefs is also Chief of Naval Operations, Chief of Staff of the Army, Air and Marine Corps—as long as we have that condition of dual responsibility, a man is responsible for what goes in his service; he is also responsible to the Joint Chiefs and they vote two against one time and again. This is an old, old story and I really think it is just as essential to get that voting system under control as it is to curtail spending anyway you see fit to go about it, as you suggested a moment ago, cutting it back arbitrarily.

The Fitzhugh report recommended that the Joint Chiefs be the advisory body to the Secretary of Defense, and the chief of the service reporting right to the Secretary of Army, Navy, and Air Force. I wholeheartedly concur. This will do a tremendous amount to get spending under control.

Chairman PROXMIRE. You have referred to the Fitzhugh report. In that report there is a reference to the Federal contract research centers. The report expressed the view that it "believes that this is an appropriate time to reassess the special relationship of each Federal contract research center to its departmental sponsor." Do you have any views on this subject?

General GAVIN. Mr. Chairman, I do. I was a member of the Board of Directors of one of the Federal contract research centers, Mitre, for several years and I resigned some years ago. The reason that I resigned was that I felt that I had a conflict because Mitre was then beginning to expand its activities into the commercial markets where the company of which I am chairman, ADL, has been established for over 90 years. We are a publicly owned, taxpaying corporation, and we manage our resources as well as we possibly can with the object of making adequate profit as well as paying our local, State, and Federal taxes. There are several other corporations similar to ADL. We look with great misgiving upon our Government establishing FCRC's that compete with us in the commercial markets. They were established for a specific purpose and to work with the particular department. If technology has now changed so their skills no longer are responsive to the needs of a department, then they should be discontinued. Indeed, in my opinion, in the long run the Government is establishing and supporting undertakings similar to the arsenal system in the Department of the Army and this, I do not think, is in the public interest. Quite the contrary.

Chairman PROXMIRE. One other question: You are no doubt familiar with the administration's proposal to provide a guaranteed loan to Lockheed of \$250 million. The argument has been made it is necessary to avoid the widespread unemployment and the economic disaster that would follow Lockheed's bankruptcy. Can you give us your view on the proposal?

It is a mixed situation because it is the No. 1 defense contractor in the country. They have many important weapons systems. At the same time, this loan would be to provide funding for a strictly commercial production of the L-1011.

General GAVIN. Well, Mr. Chairman, I do not think I am in a position to comment on the merit or lack of that recommendation. I am concerned with the overrun. As a businessman, I do not see making such a guarantee without a change in management, surely. Any business that has got itself in such difficulties, deserves very, very careful scrutiny in any manner, including by the Federal Government.

Chairman PROXMIRE. Why not let bankruptcy take its course, which would do that, really? It would not mean you close down the assembly line. Secretary Connally himself says there might be some delay on some defense contracts, but Lockheed would be able to maintain the bulk of its operations.

General GAVIN. Yes. I would look very, very hard at it. I speak from having talked to a number of businessmen about this, and to other people. The country at large looks with great unease at such a guarantee, knowing how hard it is to get a welfare dollar if you need it, and how hard it is to get support in other programs, then to see a big industry come in and sort of be rewarded for failure. If this is what it is. I don't know. It makes people very, very uncomfortable.

First, management must be looked at. We must do something about being sure it does not happen again if a loan is guaranteed.

Chairman PROXMIRE. You not only protect the management by giving a guarantee, but you also protect the creditors and the stockholders and—while I do not like to see anybody lose any money, this is part of the price you pay for the risk you take.

General GAVIN. Exactly.

Chairman PROXMIRE. I do have one other question before I yield to Congressman Brown. I know you are concerned about the general business picture: continued high unemployment and inflation. I noted in this morning's paper they report business is cutting back its plans to spend on plant and equipment. So, this increase in the dollar outlay is the lowest in many years, and real spending will be down this year as compared to 1970.

Did you have a chance to see the report and what do you see ahead in the way of business recovery without inflation? Where is the expansion coming from?

General GAVIN. I do not know, Mr. Chairman, I did not see this particular report, but I followed very, very closely the trend in the economy. And I think I speak for most businessmen when I say we are very worried and quite disturbed. There is a certain lack of confidence in what is happening in Washington. Essentially, I think it comes from a continuation of spending in Southeast Asia. The greatest thing we could do would be to bring that to a halt as promptly as we can. To keep talking about it as though it is going to be done, and yet we know defense spending is going up in fiscal 1972, leaves a great deal of unease. We are very worried.

The business community sees all around it a 31-percent wage increase settlement in the aluminum industry over 3 years. We see nothing being done really concretely or specifically to get the wage-price situation under control. Unemployment is rising, I know. The cost of living is rising. Inflation seems to be continuing and the thing seems to be eating on itself, so much so you hesitate to talk about it, but yet it is there causing a great deal of unease and worry, and I am very worried about the economy.

Chairman PROXMIRE. You do not see the expansion coming very, very easily or freely?

General GAVIN. No, sir; I do not. I wish I could say I did, but I don't.

Chairman PROXMIRE. Congressman Brown.

Representative BROWN. General Gavin, the troop strength is being reduced as the war is being wound down in Southeast Asia, so that is apparently one method of reducing spending in the military area. Now, other areas would include, I gather, these 13 divisions which you suggested, the tactical weapons system which exists in the military, and the area of research and development. Would you want to put a priority on which of these should be reduced in your opinion to account for the reduction to \$60 billion or \$70 billion which you suggested?

General GAVIN. Mr. Brown, what are you reading from?

Representative BROWN. I said that you have suggested that we reduce military spending to \$60, \$70 billion. I am reading from some notes I made on your comments.

General GAVIN. I beg your pardon.

Representative BROWN. And the areas that I would like for you to suggest a reduction in, to get down to the \$60, \$70 billion would fall in the 13 divisions that you recommended be retained or the tactical weapons system or research and development for the military establishment. What areas there would you put a priority on or are there others you would reduce the spending in?

General GAVIN. I think I used the word "demobilization" as one of the areas.

Representative BROWN. Yes, you suggested that troop strength is being reduced now and is being cut back on. And I assume you would want that done. Where would you put the priorities in reductions of military spending?

General GAVIN. Priority of reduction would go to cutting out our Vietnam deployments as promptly as we can. That would significantly reduce the budget in the direction of \$70 billion. I must say I don't think I would reduce R. & D. The main thing, I think I would look at that. It would be dangerous to cut back on research in the future.

Representative BROWN. Would you increase it from what has been recommended?

General GAVIN. I say it deserves looking at. I do not know what we are spending in DOD on specific projects now. But new knowledge comes out in a very, very fast rate across the board in all areas. In HEW, HUD, new transportation systems, dealing with the environment and so on. All of these must be looked at. I see this as all parts of the problem.

Representative BROWN. So you would not cut R. & D.?

General GAVIN. No; I do not think I would at all. I would certainly cut the Vietnam.

Representative BROWN. Tactical weapons systems?

General GAVIN. I do not know. I do not know what ones you are talking about. There are so many tactical weapons systems.

Representative BROWN. In order to cut back to the \$60 billion or \$70 billion figure, what would you cut except that Vietnam war? We both conceded that is on the way now.

General GAVIN. If I cut the Vietnam war from the present \$80 billion, all that was spent in Vietnam, I would already be at \$60 billion.

Representative BROWN. The rate of spending is \$20 billion a year?

General GAVIN. That is what it is. That brings us to \$60 billion right there.

Representative BROWN. I see. Thank you, sir.

Chairman PROXMIER. I do have just one other question I would like to ask, General Gavin, before you are through. Why do we need the F-14? Is not its major purpose to protect the carrier or carrier fleet which itself is largely obsolete? Isn't that its main purpose? We have the F-4M, I guess it is, which is able to do about everything the F-14 can do, and as Senator Fulbright pointed out, the F-14 is costing \$16 million per copy and they are asking for hundreds and hundreds of them. Why do we need this elaborate turkey?

General GAVIN. Mr. Chairman, I really do not know. I do not know the details of the F-14 performance or its characteristic or what it is.

Chairman PROXMIER. Its mission seems almost obsolete. If the mission is to protect our carriers—

General GAVIN. I recall from talking to some people about that, the Navy wanted a plane with the Air Force and the F-111 was launched as a dual thing and then the likelihood of the F-111 to be a failure, then they got opposition for the F-14 contract. In the opinion of DOD, they needed a separate plane for the Navy, and this looked as though it had high expectations. I am really not in a position to say why.

Chairman PROXMIRE. Thank you very much. Your testimony has been most interesting and helpful and we deeply appreciate it. I apologize that we dwelt as heavily as we did on the military aspects. You are a great military expert, but we are also happy to get your responses in the economic areas.

Our next witness is Mr. Robert S. Benson, who formerly worked in the Office of the Assistant Secretary (Comptroller) in the Department of Defense and is presently the director of the national priorities project for the National Urban Coalition. He is one of the editors of "Counter Budget" and a study paper entitled "The Cost of Security, National Defense and Military Assistance Requirements for the 1970's."

Mr. Benson, we are delighted you are here. You have made contributions over the years. I am very familiar with your constructive suggestions on how we can safely and wisely cut back on defense spending.

You have a substantial statement. You go ahead any way you wish, and without objection, your entire statement, including the tables that you have appended in the back of your excellent statement, will be printed in full in the record.

STATEMENT OF ROBERT S. BENSON, DIRECTOR, NATIONAL PRIORITIES PROJECT, THE URBAN COALITION

Mr. BENSON. Thank you, Mr. Chairman. It is a privilege and a pleasure to be here today.

Everyone has been quick to brandish the phrase "reorder national priorities" when pressed about his or her program for solving America's problems. But no one has yet translated this slogan into a substantive comprehensive program of recommended policy changes. Instead of producing reordered national priorities, a deluge of commissions, panel discussions, and reports has produced only more talk.

This inability to move beyond rhetoric stems from our failure to apply all of this talk about new priorities to our single most important instrument for relating national goals to limited public resources: The Federal budget.

The budget's importance cannot be overstated. Federal outlays will amount to approximately \$230 billion in the coming fiscal year—more than one-fifth of the Nation's entire income. The choices made within the budget play a large part in determining our success in solving national problems and in shaping the quality of our lives.

Defining national priorities without reference to the national budget is like trying to interpret a constitution without reference to the institution it is to govern. Nothing is left but platitudes—empty rhetoric which everyone accepts but which has no real meaning.

In short, the failing sense of efficacy we are experiencing in the country today is the inevitable outcome of efforts to eradicate concrete problems with abstract solutions.

To escape this rhetorical dead end, the National Urban Coalition embarked on a project never before attempted by a nongovernmental organization. We undertook to construct a complete alternative Federal budget offering careful estimates of the dimensions of national needs, the costs of programs designed to alleviate those needs, and the revenues needed to pay for them for each of the next 5 years.

Last February, after nearly a year of intensive effort, this alternative Federal budget—or counterbudget,¹ as it has come to be called—was completed.

Our main purpose was to determine how resources would have to be reallocated, both within the Federal budget and between the private and public sectors, for a frontal attack on the Nation's most urgent problems.

What we discovered was both dramatic and encouraging. Today, I plan to confine my remarks to one dimension of our findings—requirements for national security. How those requirements are defined and determined goes to the heart of the problem posed by the current ordering of our Nation's priorities.

Two things are wrong. First, the definition of national security implicitly employed by the Government is grossly inadequate. A fetish for physical security blocks out consideration of the fundamental aspects of what security really means and distorts the development of policies seeking to enhance American security.

Protection from military attack by other nations certainly is one vital aspect of national security. But it is only one aspect. The Urban Coalition's recent report on the military budget, "The Cost of Security: National Defense and Military Assistance Requirements for the 70's," offers a broader view. The preface to that report states:

National security rests as much on the condition of our domestic society as it does on protection against potential physical attack on the United States by other nations. The most effective way of improving our relations and standing with other nations is by providing a model of democracy at home—a society in which respect for law abounds and in which all citizens are allowed to develop according to their potential.

Available public resources must be allocated in a fashion which recognizes this dual nature of national security.

Second, the process by which Federal budget priorities are set, even beyond the bias introduced by the incomplete definition of national security, gives unfair advantage to military appropriations. For the past two decades, defense needs—as articulated by the Department of Defense and the National Security Council—have been considered first and considered relatively independently of other national purposes. Only after an approximate target for defense spending has been set is attention turned to other public purposes and programs. These programs then compete for whatever funds are left over. The result is as if, in putting in a home garden, the gardener paid no attention to the development of the sizes of the different plants. A large plant grows larger, taking more of the sun and rain, sending its roots deeper into the soil, and taking the nutrients away from other plants. The bigger one plant gets at the expense of other plants, the bigger it can

¹ The National Urban Coalition, "Counterbudget: A Blueprint for Changing National Priorities, 1971-1976," Robert S. Benson and Harold Wolman, editors, Praeger Publishers, 1971.

get—unless pruned down to assure that all plants can achieve a proper and normal development.

When you think about it, this budget process is an outrageous affront to commonsense and common taxpayers. It enshrines military programs in a sacrosanct, special treatment category. This is outrageous because current military programs range from fundamental to marginal in usefulness, just as do the prospective contributions of proposed public programs related to health, education, law enforcement, and other problem areas.

It is possible that despite incomplete definitions of national security and preferential treatment of military programs in the budget process, we still could end up with a defense budget appropriate in relative size to other public programs. But the careful examination we have made of the current defense budget and documented in "The Cost of Security" suggests otherwise. That report makes a compelling case for substantial reductions in defense spending. I would like to use the remainder of my statement to describe the report's approach and central conclusions.

Just as the Secretary of Defense does with each annual posture statement, we began our assessment of U.S. defense needs for 1972-76 with an examination of the capabilities and intentions of potential adversaries and of our own military commitments to allied nations. We next attempted to determine the numbers and kinds of military forces—divisions, air wings, submarines, cargo aircraft, et cetera—the United States would require for deterrence or to fight if necessary. Another way of viewing these requirements is as the U.S. military force contribution needed to promote international peace and stability and to uphold commitments to allied nations. To simplify the analysis, we first considered the requirements for an ongoing baseline force, broken into strategic and general purpose components, and then turned to special additional needs in Vietnam. Finally, we examined alternatives and made recommendations about the major items of equipment those forces should be armed with.

Drawing upon an allocation of the current defense budget among major force units, and melding that information with Department of Defense data released publicly through testimony and other means, we were then able to put a price tag on the defense program we recommended.

This was the approach we followed, the same basic approach utilized by the Department of Defense and the National Security Council. Some of the central conclusions we reached, though, are sharply different from those arrived at by the current administration.

Our analysis of threats and suggested interpretations of treaty agreements is described in some detail in "The Cost of Security." There is not sufficient time now to delve into that detail. Two general conclusions should be noted, though.

First, the threats to U.S. security can be readily identified. Fortunately, we are not beset upon all sides by enemies, but real potential threats do exist. Both Russia and China possess or soon will possess sufficient military might to cause considerable physical damage to the United States. We do not know whether either of these nations would take advantage of a future opportunity to advance its national interest by forcible use of that military might, but we cannot be certain they would not.

Second, these same threats have existed for more than two decades—but they have not remained static. Indeed, in developing recommended levels of military spending, we must be sensitive to the changing nature of external threats to U.S. security. Most recently we have seen encouraging signs for detente between the United States and both China and the Soviet Union. Particularly auspicious is an apparently sincere Soviet interest in negotiating troop reductions in central Europe.

While everything possible should be done to utilize these developments to bring about a lessening of world tensions through reductions of military forces, it would be imprudent to now make U.S. force plans on the basis of possible future agreements.

The Urban Coalition's defense analyses have not fallen into this trap; instead, our analyses are constructed on the principle that changes in U.S. military forces must reflect technological and political changes which have occurred in the world, not those we wish would occur.

Even so, numerous changes have already occurred in the international climate during the past decade which suggest the appropriateness of a shift in U.S. perspectives and military policies. Central among these changes are the following:

The image of a monolithic Communist bloc has been shattered by disputes over aid to Vietnam, rumblings in Czechoslovakia and other parts of Eastern Europe, and most important by the split between China and the U.S.S.R.

We have learned, at a tragic price in Vietnam, what many Army and Marine Corps generals have been saying for years—of the severely limited objectives the United States can realistically aspire to in an Asian land war, even if such involvement was politically and morally justifiable.

There is a current close balance between the nuclear destructive capabilities of the United States and the U.S.S.R., but at a higher and therefore more dangerous level than existed in 1960.

We have some new perspectives on Chinese military capabilities, boiling down to an incipient crude nuclear intercontinental delivery capability juxtaposed against a far less imposing than once thought capability to wage a ground war outside their own borders.

Taken together, these general observations strongly suggest the appropriateness of a smaller U.S. baseline force in the 1970's than we maintained in the 1960's. Current defense forces are unnecessarily large in relation to the purposes they serve. This conclusion is reinforced by several additional factors; the strategic and technological obsolescence of much of the surface Navy in an age where ships are highly vulnerable to sophisticated missiles; capability of many of our allies to shoulder a fuller portion of the burden of their own defense; a narrower, more sharply honed by experience, definition of where in the world the United States has vital security and economic interests; and a tremendous backlog of high priority, competing domestic claims on the national dollar.

Our report next suggests in great detail where reductions in baseline U.S. military forces could prudently be made—by geographical contingency, by force units, by kinds of major items of equipment procured, by Department of Defense summary budget program categories, and by operating and investment costs. It would require far too much time and detail here to present all the associated analyses and

conclusions. The major force unit recommendations are summarized in table 1 attached to my statement; the associated costs are summarized in tables 2 and 3.

Chairman PROXMIRE. May I say, Mr. Benson, that your study is so excellent and I think it is so pertinent and timely as far as this committee is concerned, that I am going to have the entire study printed in full in the record.

Mr. BENSON. I would be delighted to provide the complete study for that purpose, sir.

(The following study was subsequently supplied for the record:)

The Cost of Security

National Defense and Military Assistance Requirements for the 70's



The National Urban Coalition
Staff Working Paper
Counterbudget Background Series:1

Errata Sheet

- p. 24, line 21 "\$92 billion" should be "\$92 million."
- p. 34, line 3 There should not be an asterisk (*) after "Minuteman."
- p. 71, last line Substitute "crippling" for "sinking"
- p. 75, line 7 There should be a comma after "protection."
- p. 78, line 20 There should be no comma after "developed," there should be a comma after "requirement" in the next line.
- p. 89, line 5 "patter" should be "pattern"
- p. 89, line 25 Both "examples" and "sealift" are misspelled.
- p. 89, line 29 The final item in the list is the "S-3A" not the "8-3A."

THE COST OF SECURITY

National Defense and Military Assistance Requirements for the Seventies

Prepared by: Robert S. Benson
May 1971

The National Urban Coalition
2100 M Street, N.W.
Washington, D.C. 20037

Preface

It is certainly fair to ask why The National Urban Coalition, an organization whose fundamental mission is to work for the betterment of life in our nation's cities, is publishing a paper on the United States military budget.

The answer is rooted in the statement of goals and principles adopted at the founding of the Urban Coalition in August 1967. A part of that statement said:

We believe the American people and the Congress must reorder national priorities, with a commitment of resources equal to the magnitude of the problems we face... We are confident that... our society has the ingenuity to allocate its resources and devise the techniques necessary to rebuild cities and still meet our other national obligations without impairing our financial integrity.

The only responsible way to work toward this goal is by stating very specifically how our government can reorder its priorities so that they address the nation's most pressing human needs and also how we can finance the efforts required. In order to provide an informed basis for making these comparative judgments, we found it necessary to examine carefully the dimensions of needs and the contributions of current and prospective programs in every major area of public responsibility. Because military activities now command the largest single share of the federal budget, they were one of the most important areas scrutinized.

Our analysis of military threats to United States security and corresponding U.S. force requirements was performed as objectively as is possible. While our defense program recommendations ultimately reflected tradeoffs made among competing public purposes, the prior assessment of military threats and needs was developed independent of similar assessments of the dimensions of other national needs. Our study benefitted from the guidance and advice of a number of former senior military leaders and civilian government officials in the field of military affairs.

Our findings, particularly our recommendation for a substantial reduction in the budget for national defense and military assistance, will be controversial. That is both understandable and desirable. No area of public policy is in greater need of informed, vigorous discussion by a broad cross-section of American society.

Two critical aspects of the question "How much military spending is enough?" are often ignored in such discussions. First, potential military programs range from essential to marginal, just as do proposed activities in every other area of public policy. Second, national security rests as much on the condition of our domestic society as it does on protection against potential physical attack on the United States by other nations. The most effective way of improving our relations and standing with other nations is by providing a model of democracy at home -- a society in which respect for law abounds and in which all citizens are allowed to develop according to their potential. Available public resources must be allocated in a fashion which recognizes this dual nature of national security.

We believe the proposals for American military forces in the Seventies advanced in this report, framed in the context of a broader set of recommendations contained in Counterbudget, constitute a sensible, realistic program to advance our national security and to encourage peace in the world in coming years. Even more important, we think our examination of these issues -- constituting perhaps the most comprehensive analysis of the total military budget ever undertaken by an independent private organization -- will provide food for thought for an American public which has a vital stake in becoming better informed on this subject.

Sol M. Linowitz
Chairman
The National Urban Coalition

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I) Introduction

Of all our national needs, defense needs have always been considered the most difficult for an observer outside the government to determine, and properly so -- but for totally the wrong reasons. The conventional wisdom has been that only professional military analysts could understand the complexities of modern weapons systems and the true nature and scope of potential enemy threats.

We know better today. Expertise in military analysis is essential to sound policy development, but the locus of that expertise is more diffuse than is generally recognized. Career military analysts in the government do possess a slight edge in currency and scope of information over their outside counterparts, but in a way highly analogous to the relationships between insiders and outsiders in health, education, and many other fields. As more and more outsiders have turned their attention to defense just in the past two years, they have discovered a wealth of information in the posture statements, Congressional testimony, and other press releases of the Department of Defense which they can use to form intelligent judgments.

Defense needs are difficult for the outsider to project in large part for the same reasons they are for the insider -- our defense needs depend fundamentally on the posture and perceived intentions of other nations. This is not true for areas of domestic endeavor. There we can better, though still imperfectly,

measure the needs and forces acting upon them to change their dimensions. Progress toward satisfying those public needs is controlled in relatively more predictable fashion by government policies and resource commitments.

Precisely because they do depend on the policies and actions of other nations, U.S. defense needs are not so controllable. We now know that with an annual public expenditure of about \$4-5 billion per year, we can virtually eliminate hunger in the United States. There can be no such certain statement about national defense. In this nuclear era, no levels of defense spending by any nation can guarantee it security against external threats. Inevitably, any level of defense spending requires acceptance of some level of risk. The challenge to policy-makers is to procure a level and composition of defense forces which seem sensible in the context of apparent adversary defense strength and intentions and of competing claims on national resources.

One final introductory note -- oft understood, but rarely said -- needs to be explicitly stated. We wish to spend no more on defense than we have to. This is because defense expenditures are not directly productive; they provide a protective shield which enables the United States to progress toward the achievement of national goals, but they do not directly advance us toward any of those goals. A banker buying an alarm system and hiring guards for protection against robbery spends as little as is necessary on this function to provide a sensible level of

security, in order that he can pursue with peace of mind his fundamental activity of providing service to his customers, in the process making profits on the borrowing and loan of money. The analogy holds very well for spending on national defense.

Two long-established shibboleths sometimes interfere with comprehension and acceptance of this minimum sensible buy maxim. One is that defense spending above what is sensibly needed for external security is required for economic reasons -- to sustain aggregate demand. This argument is addressed at length in the "Economic Conversion" chapter of Counterbudget*, but the essence of the rebuttal is that such a claim is unfounded in the face of the huge backlog of unmet other national needs.

The other shibboleth is that aggregate levels of defense spending ought to be some constant percentage of GNP. Such a rule of thumb does indeed provide a convenient crutch. It begs the real question, though, of gearing our defense spending to the scope and character of predictable enemy threats, with due consideration to the relative merits of other claims on national resources. What military spending is required for future years may be more or less than past levels. The only sane approach lies in facing up to these difficult judgments rather than leaning on the easy rule of thumb.

*The National Urban Coalition, Counterbudget, Praeger Publisher, 1971.

II) The External Threat

Our assessment of defense needs for 1972-1976* then must begin with an examination of the capabilities and intentions of potential adversaries and of our own military commitments to allied nations. We cannot project the former with any high degree of certainty, because we cannot control them. We can, however, reach some intelligent judgments based on current evidence and recent trends. We must also keep in mind that United States judgments and actions affect in turn the behavior of potential antagonist nations.

To simplify the analysis, we will begin by examining the requirements for an ongoing baseline force and then turn to the special additional needs in Vietnam. It is not generally realized, but even at the peak of our involvement in Vietnam only about 30% of the defense budget has gone to the actual conduct of the war. The remaining 70% has reflected the cost of what has come to be known as the baseline force. It is, in effect, the peacetime force that we maintain both for deterrence and for at least the initial stages of a conflict involving the commitments of the United States.

There is a sense in which we have always possessed a baseline force. However, prior to World War II, the permanent military establishment represented a cost of little more than \$1 billion annually, whereas it required about \$50 billion during the years of the Kennedy Presidency. The structure of the baseline

*Unless otherwise noted, all dates used in this analysis refer to U.S. government fiscal years.

force will be dynamic in character because it depends on the capabilities of potential enemies as well as a number of other variables. The baseline forces in the 1970's are bound to differ in certain important respects from the baseline force we deployed in 1965, the last year in which Vietnam did not significantly affect the defense budget. That 1965 baseline force (which involved abnormally large expenditures for a buildup of our strategic missile forces) required \$51 billion. Approximately the same force (excluding the abnormal strategic outlays) would require about \$65 billion in 1972 prices.

The baseline force in the early 1960's was very much a product of the cold war. The dominant view underlying that force was that both the USSR and the People's Republic of China, whatever their own quarrels, remained hostile to the interests of the United States, that they had strong expansionist tendencies, and that they must be contained within their existing spheres of influence. Accordingly, the U.S. undertook a simultaneous enlargement and modernization of its strategic nuclear forces together with a massive expansion of its general purpose forces. The fundamental thesis was the provision of a second-strike retaliatory nuclear deterrent against any strategic attack on the United States, plus a highly mobile, modernly equipped complement of general purpose

forces capable of providing enough initial forces to prosecute simultaneously wars on three fronts (two major ones in Europe and Southeast Asia and one minor one in Latin America) in which our involvement might be required to sustain our treaty commitments to 45 other nations.

It is futile to argue now about the correctness of decisions made in 1960-1961 which shaped the baseline forces for the ensuing decade. It is far more important at the current moment to make a thorough reassessment of defense requirements based on the nature of current and prospective hostile threats.

The threats to United States security can be readily identified. Fortunately, we are not beset upon all sides by enemies, but real potential threats do exist. Both Russia and China possess sufficient military might to cause considerable physical damage to the United States. We do not know whether either of these nations would take advantage of a future opportunity to advance its national interest by forcible use of that military might, but we cannot be certain they would not. It is because of these Soviet and Chinese threats that we have entered into security agreements with more than 40 nations. Accordingly, we must interpret the obligations entailed by these agreements in terms of the threats.

These same threats have existed for more than two decades -- but they have not remained static. Indeed, in developing recommended levels of military spending, we must be sensitive to the changing nature of external threats to U.S. security. Four changes particularly suggest the appropriateness of a change in perspective.

First and foremost, the image of a monolithic Communist bloc has been shattered by disputes over aid to Vietnam, rumblings in Czechoslovakia and other parts of Eastern Europe, and most important by the split between China and the U.S.S.R. Not only do these developments sharply lessen the prospects for coordinated Communist aggression on several fronts at once, but they also serve to tie down substantial forces on the U.S.S.R-China border which otherwise might be directed at free world forces.

Second, we have learned at a tragic price in Vietnam what many Army and Marine Corps generals had been saying for years -- of the severely limited objectives the United States can realistically aspire to in an Asian land war. Sophisticated U.S. forces, designed primarily for sustained, intensive battles like those fought in Korea or in Europe during World War II, are not nearly so effective in guerilla warfare. They can win skirmishes, but guerilla adversaries can operate less expensively, wait us out, and pick their moments to press the attack. In such circumstances, U.S. military forces prove an ineffective instrument for implementing foreign policy.

Third, we perceive a current close balance between the nuclear destructive capabilities of the U.S. and the U.S.S.R., but at a much higher, and therefore more dangerous, level than existed in 1960. What was claimed to be a missile gap in 1960 turned out to be bogus, at least in the sense understood by the general public. Having made a political issue out of it, though, President Kennedy then felt committed to proceed with substantial upgrading of our nuclear delivery capabilities . The resultant

modernization of U.S. strategic forces in the early 1960's was matched by a Soviet buildup in the latter part of the decade. The emergence of Safeguard, Galosh,* and MIRV's presages another round in this vicious cycle which saps both countries' resources while giving no one a significant advantage. Two factors, however, are contributing to the abilities of nations to make reasonable decisions in the nuclear weapons sphere. One is increased understanding on both sides of the meaning of mutual second strike destructive capabilities and the futility of both anti-missile defensive systems and the seeking of an overwhelming first-strike capability. The other is the emergence of the Strategic Arms Limitation Talks (SALT) now in process. Their potential is unlimited; even a freeze at current levels of nuclear armaments and delivery technology would result in drastically reduced future budgets for strategic weaponry because such an agreement would eliminate the need for cyclical procurement of new weapons -- something which accounts for about one-fourth of current strategic forces costs.

Fourth, we have some new perspectives on Chinese capabilities.

China has developed nuclear capability and may, by the mid-1970's, possess a limited, crude capability to deliver nuclear bombs to the North American continent, but this development has been somewhat slower than we figured a few years ago. Moreover, the millions of Chinese ground troops appear far less imposing than they once did. Careful study has shown how, due to serious logistics constraints, their capabilities for prosecuting a war beyond their own borders are severely limited.

*The Soviet anti-ballistic missile system now being developed around Moscow.

Taken together, these general observations strongly suggest the appropriateness of a smaller U.S. baseline force in the 1970's than we maintained in the 1960's. Current defense forces are unnecessarily large in relation to the purposes they serve. This conclusion is reinforced by several additional factors: 1) the strategic and technological obsolescence of much of the surface Navy in an age where ships are highly vulnerable to sophisticated missiles; 2) capability of many of our allies to shoulder a fuller portion of the burden of their own defense (combined with a narrower, more sharply honed by experience, definition of where in the world the United States has vital security and economic interests); and 3) a tremendous backlog of high priority, competing domestic claims on the national dollar.

With this general background, we need next to determine in greater detail what force needs will exist in the next five years and what they are likely to cost.

We can hope that the next five years will be marked by heightened international cooperation in winding down the nuclear arms race and settling of smaller scale conflicts through negotiations rather than resort to arms. We can hope for broadened recognition of the role, and actual use, of the United Nations as a peacekeeping agent. We can hope that significant arms limitation agreements emerge from SALT and any successor talks. We can hope for further agreements banning nuclear tests and forbidding all uses of weapons on the floors of the oceans. We must work diligently, through diplomatic processes, to advance all of these ends.

But we cannot assume that any of these goals will be attained between now and 1976. Where any are, we will have then the opportunity to cut military spending further. Today, we must develop defense policies without assuming any of these improvements in international understanding.

This conclusion does not mean that U.S. military forces must or should remain static. We already have cited several changes in the international climate which do indicate the appropriateness of a lower U.S. military profile in the 1970's. Changes in U.S. military forces, though, must reflect technological and political changes which have occurred in the world, not those we wish would occur.

III) The Core Requirement

In constructing a defense budget, it is important to keep clear the distinction between what is minimally required to defend the continental United States and what additional increment we feel it prudent to bear in order to foster our economic, security, and ideological interest in the world at large.* Pure defense of the United States actually costs very little in comparison to the total size of our so-called "national defense" budget.

In fact, the term "national defense" is a highly misleading description of the total purposes served by United States military spending. We commonly refer to the whole by one of its parts. A more accurate descriptive term for U.S. military spending might be "national defense and military assistance," after the two central purposes. The term "military assistance" here has a much broader connotation -- representing all U.S. military forces exceeding those required to defend continental U.S. territory -- than in the conventional reference to arms grants and sales to other nations.**

*We think this distinction is a useful one which can add precision to discussion of military force requirements. But beyond that purpose, the distinction is admittedly artificial. Our military forces are postured to fight on the soil of our allies rather than on our own soil. In addition, such a geographical definition of the continental United States does not adequately consider places like Hawaii and the Panama Canal Zone.

**The total spent by the federal government to arm foreign nations is variously estimated between \$4 and \$7 billion a year. The wide variance in estimates is due to different definitions about what should be included from a mixture of cash gifts, sales for credit or cash, military advisory missions, gifts from a stockpile of "excess" weapons, and use of foreign currencies generated by other programs for weapons purchases. The only such aid considered in this chapter is the "Military Assistance Program" and "Support of Other Nations" (mostly special aid for Southeast Asia). Outlays for these programs were \$2.5 billion in 1971.

We shall see in subsequent analyses that, as measured by budget allocations, "military assistance" requires roughly equal amounts as "national defense" in peacetime and more during a situation like the current one where the U.S. is substantially engaged in a war concerning the security of another nation. The best way to comprehend how military spending should be allocated between these categories is to examine what military forces are really required to defend the continental United States.

The answer to this query is that surprisingly little is needed, at least in the context of a so-called 1971 "national defense" budget of more than \$70 billion. The largest component in the package of military forces required for defense of the United States is strategic forces -- both offensive and defensive. Together with required backup supporting components, these strategic forces cost \$16.3 billion in 1971. No serious defense analyst argues against the necessity of maintaining a strategic nuclear deterrent; the threat to U.S. security posed by Russian -- and to a lesser extent in future years, Chinese -- nuclear weapons is very real.

The surprise, though, is that not much more in U.S. military forces are really required for defense of the United States. The reason has to do with our geography and long standing excellent political relations with immediate neighboring countries. No country in the world has the combination of sufficient troop strength, airlift and sealift capability, and amphibious landing capability to execute successfully a major conventional attack on the United States. We, of course, are dealing in the realm

of the hypothetical since any country launching a conventional attack on the U.S. would have to assume the likelihood that U.S. nuclear weapons would be unleashed in return.

Even so, there is the slimmest of possibilities that such a conventional attack on the U.S. -- or, slightly more probably, a suicidal guerrilla attack, unsanctioned by any other nation, on some small piece of U.S. territory -- might happen. Against the possibility of those events, however unlikely, it is prudent that we maintain limited general purpose forces on active duty to protect the United States.

Again, very few such forces are required to do the job. Perhaps four active Army divisions and eight air wings would need to be deployed around our Atlantic, Pacific, and Gulf Coasts backed by six reserve divisions. The attack submarine and land-based airplane parts of current anti-submarine warfare forces would continue to be required for defense against enemy submarines venturing near our coasts. Some mine sweeping forces would also be helpful in the latter role. Virtually no military airlift or sealift capacity would be required for defense of the U.S. against the kind of conventional attack described; in an emergency, civilian airliners could be pressed into service to move men and light supplies around. About half of current general purpose baseline communications expenses, one-third of administration costs, and a proportionate share of other support costs would still be required.

Finally, vigilance would require continued funding of intelligence and research at nearly current levels, effecting reductions only where inefficiency and unnecessary duplication

occurs. The need for intelligence on enemy forces and intentions speaks for itself; significant savings could be achieved from current levels simply because of the contraction from a far-flung force distribution all over the world. We also need to keep seeking to achieve advances in technology on both strategic and general purpose weaponry so as not to be caught at a disadvantage. But we need to learn better how to develop technology without rushing new weapons into mass production before a need develops.

The total portion of 1971 U.S. military spending required for the above forces would be roughly as follows:

Table 1

Core Requirement for Defense of the U.S.
(In billions of dollars; 1971)

Strategic and related forces ^{1/}	16.3
General purpose forces	
4 active Army divisions (& support)	3.1
6 Reserve divisions (& support)	1.8
8 air wings (& support)	2.7
Anti-submarine warfare & mine sweeping	3.0
Intelligence and communications	1.2
Research and development	2.4
Total	<u>30.5</u>

^{1/}A detailed composition and cost of current strategic forces, all of which are included here, is provided in the next section of the analysis. This sub-total includes some funds for research, intelligence, communications and general support.

Three general points must be made about the above set of military forces. First, their size and composition are roughly appropriate for the pure national defense role, but requirements would have to be more carefully defined if at some point in history the U.S. chose to maintain purely such core requirement forces. Second, the above forces represent those assigned the national defense mission in 1971 rather than necessarily an optimum mix. In fact, cutbacks in strategic forces we recommend in the next section of this analysis would more than offset price increases in the general purpose forces described above, so that by 1976 we figure that sufficient pure national defense forces could be procured and operated for approximately \$26.3 billion.

Finally, some forces included above can and do serve more than one role. The protection provided by our strategic nuclear deterrent also is extended to many allied nations. Reserve forces (or even active units) included above could be sent overseas in an emergency as long as sufficient active forces were maintained in the United States. In all these double mission cases, though, the cost of the forces is properly regarded as a national defense mission cost; any additional benefits must be considered a bonus.

The description of such a force aids in the comprehension of the real purposes behind our "national defense" budget; we can add precision to national debate by encouraging use of a substitute term such as "national defense and military assistance."

But such a concept of a national defense force has limited value in suggesting realistic guidelines for a total U.S. military posture. The United States does have a stake in the rest of the world. We would be short-sighted to turn our backs on the international political climate, to forego our leverage in reducing tensions. In a nuclear age, every nation stands to lose from a conflagration unforestalled or unchecked. We must develop then an appropriate total military posture for the United States.

IV) Strategic Forces

The place to begin the analysis is with strategic forces. Today's ultimate weapon -- a single one of which can cripple an entire large city -- is the nuclear warhead. Strategic forces are primarily the weapons systems for delivering these warheads on target from long range and the men who operate the systems. Also included in this category are some systems designed to provide warning and/or defense against strategic attacks by potentially hostile nations. U.S. strategic forces provide security by posing a retaliatory threat which deters strategic attacks by other nations. Sufficient strategic forces to provide deterrence against nuclear attack constitute the single highest priority U.S. defense need.

Current Forces

Strategic forces now in the U.S. arsenal are divisible into six major groups. Three are offensive systems -- sea based Polaris/Poseidon missile carrying submarines, land based Minuteman and Titan ICBM's, and B-52/FB-111 bombers. The other three -- a bomber air defense system, a missile warning system, and the fledgling Safeguard missile defense system -- are defensive in nature. Additional strategic forces spending is required for research on new strategic systems, mostly planned successors to the above systems; intelligence activities to determine the nature and location of enemy strategic forces; communications, command and control systems to warn of enemy strategic attack and provide a means for executing a measured U.S. response; and general support for men manning strategic weapons.

Strategic Offensive Systems: The 41 nuclear submarines now carrying Polaris or Poseidon missiles (16 missile launchers each for a total of 656) provide probably the single best return among all our military investments. By themselves they provide a sufficient deterrent to forestall an enemy strategic attack on the United States. Furthermore, Polaris reliability is high and the submarines carrying it are almost invulnerable to enemy attack. Secretary of Defense Melvin Laird made the following comments on the latter point:

According to our best current estimates, we believe that our POLARIS and POSEIDON submarines at sea can be considered virtually invulnerable today. With a highly concentrated effort, the Soviet Navy today might be able to localize and destroy at sea one or two POLARIS submarines. But the massive and expensive undertaking that would be required to extend such a capability using any currently known ASW techniques would take time and would certainly be evident.*

It is conceivable that the Soviet Union could develop over the next decade improved attack submarines or other systems capable of rendering Polaris submarines ineffective, but such a hypothetical capability is at best several years off and one of which we would have foreknowledge through our intelligence activities.

Currently, 31 of the 41 Polaris submarines are scheduled for conversion to the Poseidon configuration (the other 10 submarines cannot be so adapted). Fourteen conversions have already been funded through 1971, with the first just recently completed. The Poseidon configuration will bring no increase in the number

*Melvin R. Laird, Fiscal Year 1971 Defense Program and Budget, February 20, 1970, p. 40.

of missiles, but will enable each missile to carry ten independently targetable warheads (MIRV's) -- replacing the non-independently targetable Polaris A-3 triplet payload.* The Poseidon payload will be about twice as accurate as the Polaris A-3 payload.*

The land based missile force consists of 1,000 Minuteman and 54 Titan II missiles. All are based in fixed location silos in the United States. Minuteman has gone through two major modifications to extend its capability. Currently underway is the later of these -- a program to convert 500 missiles to the Minuteman III triple warhead (MIRV) configuration. All 1,054 land-based missiles will become increasingly vulnerable during the next few years. The U.S.S.R. probably knows the location of all the silos in which they are housed and, according to Secretary Laird,

The accuracy of the (Soviet missile) SS-9 with a single large warhead is sufficient to destroy a Minuteman in its silo, and it is estimated that the accuracy could be further improved.**

Laird went on to say that 400 SS-9's with MIRV's could be capable of destroying 95 per cent of the 1,000 Minuteman force by 1974 or earlier if the current Soviet build-up continues. All these projections assume, of course, that Minuteman missiles would remain in their silos rather than being fired upon warning of a possible enemy attack. (If instead they were precipitously fired, nuclear holocaust certainly would result.)

*Military Spending Committee of Members of Congress for Peace through Law, "Report on Military Spending," July 15, 1970, MIRV, p.3.

**Laird, op.cit., p. 103.

Bomber forces, as of the end of this fiscal year, are scheduled to consist of 23 squadrons of B-52's (11 of the newer G and H models) and 4 squadrons of FB-111's. Stated another way, we will have 581 bombers in the active aircraft inventory. Three of the B-52 squadrons are scheduled to be deactivated during 1972. Except for two B-52 squadrons temporarily detailed to Southeast Asia, all the bombers are based in the United States. The punch packed by the bombers comes, of course, from the bombs they carry dropped or fired on enemy targets. Chances of reaching these targets are enhanced by penetration aids on the bombers. Advanced new weapons like the Short Range Attack Missile (SCRAM), the Subsonic Cruise Armed Decoy (SCAD), and advanced penetration aids are being developed to enhance B-52 and FB-111 effectiveness in future years. Like Minuteman silos, fixed site bomber bases are highly vulnerable to enemy attack (even more so because airplanes are housed on the ground rather than in silos), but with even a few minutes warning the bombers and their fuel-carrying tankers can be aloft and protected.

Strategic Defensive Systems: Strategic defensive systems are less extensive and in total less costly to maintain. This is so because the fundamental purpose of our strategic arsenal is deterrence, not damage limitation. The most important and least expensive of our strategic defensive forces is an enemy missile warning system consisting of radars, computers, and communications devices. This network is designed to provide us with precious minutes of warning and decision-making time between the spotting of enemy missiles and when they would strike their U.S. targets.

The oldest and most expensive strategic defensive force to maintain is the SAGE -- Air Defense Command. Its sole purpose is defense against Soviet bombers. At one time, this was a critical purpose, but with a current Soviet intercontinental bomber force of less than 150 planes -- and no signs of any Soviet plans to enlarge that force or develop an advanced bomber -- it is now of much less relative importance. Missiles have clearly supplanted bombers as the major strategic threat.

The newest proposed strategic defensive force, and perhaps the single most controversial item currently in the defense budget, is Safeguard. Safeguard is an anti-ballistic missile system consisting of long and short range radars and interceptor missiles whose proposed function is to detect, track, and destroy incoming enemy missiles before they can reach their targets. From its inception, Safeguard has been surrounded by controversy -- over its reliability, cost, vulnerability, and even what missions it is intended to perform. The Administration currently calls for Safeguard to perform three missions:

- Protection of our land-based retaliatory forces against a direct attack by the Soviet Union.
- Defense of the American people against the kind of nuclear attack which Communist China is likely to be able to mount within the decade.
- Protection against the possibility of accidental attacks from any source. *

These are the same three roles cited last year by the Administration. Congress, however, acted to restrict the Safeguard role to Minuteman protection. Administration plans call for protection

*Melvin R. Laird, Fiscal Year 1972-76 Defense Program and the 1972 Defense Budget, March 9, 1971, p. 70.

of selected Minuteman sites of an unspecified number; so far approval has been sought and gained for erection of the system at three sites. The 1972 budget proposal requests funds to prepare for deployment at a fourth site, either Warren Air Force Base or Washington, D. C.

The remaining costs reasonably assignable to strategic programs (broadly defined) are all of a support nature. Allocation of such support costs between the strategic and general purpose categories is necessarily a somewhat arbitrary process without access to highly detailed Defense Department accounting records, but reasonably informed estimates are possible.

Research: We do know from descriptions of research activities in Secretary Laird's posture statement and Congressional hearings that approximately 45 per cent (or \$2.4 billion) of the 1971 defense research and development budget* is oriented toward strategic forces. Strategic R & D is concentrated in five areas: Safeguard, MIRV technology, the B-1 advanced manned strategic bomber, an undersea long-range missile system (ULMS), and a new airborne warning and control system (AWACS). Other strategic research activities include work on an advanced ICBM and alternative basing schemes for land-based missiles. Among the major activities, Safeguard and MIRV work constitute ongoing refinements and improvements on systems we have already described.

The B-1 is an intercontinental bomber proposed by the Air Force to succeed the B-52 and the FB-111. The B-1 is being designed with emphasis on a high (but still subsonic) speed dash

*We use here the program definition of Research and Development rather than the broader appropriation category Research, Development, Test and Evaluation.

capability. The B-1 is smaller and will have a smaller radar profile than the B-52, while their ranges will be comparable. The B-1 is designed to be able to carry a larger payload, but that payload will consist mostly of the same kinds of weapons and penetration aids now being developed for the B-52. The B-1 force is being designed to be able to "scramble" (get aloft) slightly faster than the current B-52 force, but its tankers won't be faster and the net gain is likely to be meaningless in the context of available reaction time. In the final analysis, these performance edges claimed for the B-1 versus the B-52 must be weighed against the fact that both planes require approximately four hours to reach Soviet targets. (Missiles, by contrast, require less than one-half hour.) The B-1 also promises to be considerably more expensive than the alternatives of extending the life of B-52's currently in the force through modifications, arranging for a new B-52 production run, or even building a successor bomber designed instead to have strictly a stand-off missile platform capability. Although current year B-1 funding is limited to \$75 million in research, a contract has been signed for production of prototypes. Funding during 1972 is scheduled to rise to \$370 million.

ULMS, planned as a successor to the Polaris/Poseidon fleet, is an extremely promising concept. The program envisages the development of a more efficient, highly survivable, sea based nuclear deterrent capable of launching missiles with a range equivalent to an ICBM (land based intercontinental ballistic missile) from quieter submarines of improved hull design. The key is the increased

range -- 6,000 - 7,000 miles as compared with only 2,000 - 3,000 for Polaris/Poseidon. ULMS submarines could, therefore, operate out of U.S. bases and remain protected behind U.S. attack submarines arrayed in barriers. Only \$45 million is provided for ULMS research this year.

AWACS is described in Secretary Laird's FY 1971 posture statement as "an airborne surveillance, command, control and communication system consisting of special avionics and a large radar installed in a military version of a commercial jet aircraft such as the DC-8 or 707."* Its main contribution would be the radar's ability to see low-flying aircraft against the surface clutter over land or sea. A balanced order of magnitude improvement in air defense capability would also require development of an over-the-horizon radar and an improved interceptor aircraft with a good "look-down," "shoot-down" capability. The critical question here, is the wisdom of investing considerable sums of money (if procured, eventual ten-year systems costs would likely exceed \$2 billion) for defense against a Soviet bomber threat which has remained constant in terms of numbers and quality of aircraft and assuredly has declined in strategic importance relative to missiles. About \$92 billion is provided this year for air defense research and development.

Other Support Activities: The second major support element associated with strategic forces is intelligence and communications. Because of data classification, it is extremely difficult to determine how intelligence activities should be allocated between strategic and general purpose forces. Information helpful in both areas is

*Laird, Fiscal Year 1971 Defense Program and Budget, op.cit., p. 118.

garnered from all four basic intelligence sources: the open press and technical magazines, satellite reconnaissance, radio and radar reception, and human sources such as defectors. It seems a reasonable hypothesis that strategic force programs benefit relatively more from satellite reconnaissance information, a source of growing relative importance. Communications outlays are also somewhat difficult to allocate because the same communications channels are often used for many purposes. We do know that special communications systems used to warn of enemy missile or bomber attacks clearly relate to strategic programs. We assume altogether that about 55-60 per cent of baseline intelligence and communications expense is assignable to strategic forces.

Residual general support activities include training, medical care, other personnel activities, supply and maintenance, and administration. In these areas, we do have a fairly decent indicator of how support should be allocated between strategic and general purpose forces in the form of military personnel dollars.* This measure must be adjusted to reflect: 1) the higher capital intensity of strategic programs; 2) the tendency of strategic forces to be located in places which are more costly to supply; and 3) the generally higher training costs associated with strategic programs. After adjusting for these partially offsetting factors, we find that about one-sixth of general support costs are allocable to strategic forces.

*We use Total Obligational Authority for 1965, representing the last "normal" defense forces budget year prior to the Vietnam buildup.

Altogether, the 1971 costs of strategic and related programs are approximately as follows:

Table 2

Strategic and Related Forces Outlays
(in millions of dollars; 1971)

	<u>Operating</u>	<u>Investment</u>	<u>Total</u>
Strategic Forces			
Minuteman/Titan	140	785	925
Polaris/Poseidon	820	1,020	1,840
B-52/FB-111	1,300	400	1,700
SRAM ^{2/}	0	155	155
Bomber defense	1,395	105	1,500
Missile surveillance ^{3/}	190	100	290
Safeguard	65	1,425	1,490
Subtotal, strategic forces	3,910	3,990	7,900
Intelligence and communications	1,245	1,725	2,970
Research and development ^{4/}		2,400	2,400
Central supply and maintenance	975	50	1,025
Training, medical and other personnel activities	1,755	75	1,830
Administration and associated activities	205	10	215
Total	8,090	8,250	16,340

Sources: Author's estimates of outlay patterns resulting from TOA allocations described in the FY1971 Budget of the U.S. Government and February 20, 1970 Statement by Melvin R. Laird on the FY1971 Defense Program and Budget, updated to reflect later Administration estimates.

^{1/} Includes all procurement, construction, and research, development, test and evaluation activities.

^{2/} Excludes approximately \$110 million in R&D outlays covered in R&D category.

^{3/} Excludes approximately \$110 million in R&D outlays covered in R&D category.

^{4/} Including ULMS, B-1, Minuteman rebasing concepts, AWACS, SRAM, SCAD, satellites, and other programs.

Policy Recommendations

Several basic assumptions should guide our strategic policies in the 1972-1976 period. These are all independent of any agreements which might emerge from the SALT talks,* although no effort must be stunted to seek meaningful arms limitation agreements in that forum.

Deterrence of nuclear attack should continue to be the fundamental purpose served by U.S. strategic forces. Our nuclear deterrent should also continue to deter attack on our allies. In order to deter a Soviet attack with high confidence, it will be necessary to have the demonstrable capability to absorb a massive Soviet strike, delivered with little or no warning, and still strike back at the Soviet Union with devastating power. Continued ample expenditures for intelligence surveillance, a missile warning system, and research will clearly be warranted.

In planning ahead for the next five years, we must also take cognizance of the emerging Chinese nuclear capabilities. However, the Secretary of Defense has said:

the earliest possible date for deployment [of Chinese intercontinental ballistic missiles] would be 1973, but it is more likely that the Chinese ICBM will not attain IOC [initial operational capability] until a year or two later, and they probably could not have significant numbers of ICBM's deployed until late in the decade,**

*It could plausibly be argued that while the recommended actions we suggest could be taken independently of SALT agreements, the President might wish to postpone such actions until after the talks so that he could use them as bargaining chips. Regardless how the talks turn out, though, we think all our recommendations should sensibly be implemented sometime between 1972 and 1976.

**Laird, Fiscal Year 1972-1976 Defense Program and the 1972 Defense Budget, op.cit., p. 48.

If the Chinese are really determined to kill several million Americans, we cannot stop them. If they have 25 or more ICBM's, they can target them all on one city and have extremely high confidence of hitting their target -- whether or not we possess a Safeguard area defense. So we must rely on deterrence to protect us against a Chinese attack, just as we rely on it to protect us against a Russian attack. Some suggest that the Chinese government is irrational and that deterrence, therefore, will not work against their missile threat. The burden of proof must lie with these critics to persuade us that a third power would allow its country to be completely destroyed for the sake of killing several million Americans. The Chinese have traditionally been cautious in foreign affairs; the evidence hardly suggests that they would pursue such a suicidal policy.

We now possess more than sufficient forces to deter nuclear attack on the United States. The long-standing official Defense Department criterion for an effective deterrent, recently abandoned by the current Administration, required an ability to destroy 20-25 per cent of a potential aggressor nation's population and half its industrial capacity.

Current U.S. strategic offensive forces are more than sufficient to ensure attainment of this objective. According to a former Secretary of Defense, under the worst even reasonably likely assumptions of Soviet capabilities and intentions, "our [programmed] strategic missile forces alone could... destroy more than two-fifths of their total population (more than 100 million people) and over

three quarters of their industrial capacity."* This means that the forces programmed for the early 1970's could cause more than twice as much damage on a second strike as is deemed necessary for deterrence. A more recent assessment found that

The United States can now deliver over 4,200 strategic nuclear warheads against the Soviet Union. Based on extremely conservative estimates, 400 warheads would destroy over 30 per cent of the Soviet population and 70 per cent of its industrial capacity -- thus more than adequately meeting the requirements of assured destruction. The Soviet Union has a similar overkill capability with respect to the United States....

By MIRVing both our Minuteman and Polaris missile forces, we would more than double the number of nuclear warheads, from 4,200 to 9,600, to achieve the same objective of delivering 400 warheads.**

We build these excessively large strategic arsenals because of overly conservative interpretation of intelligence reports, the building of extra "safety" margins, and the maintenance of a mixed offensive force of land-based missiles, sea-based missiles, and bombers -- with each component large enough to perform the mission of assured destruction on its own.

No one knows how to exploit for military or diplomatic profit some numerical advantage in strategic forces, unless that advantage is so large quantitatively and qualitatively that it permits the launching of a first-strike, knockout blow -- an almost unimaginable event with forces of the size and composition currently deployed. Consequently, even without agreements at the SALT, we can safely pare our strategic forces. Continuation of projected plans would perpetuate a huge redundant surplus in the U.S. nuclear arsenal.

*Robert S. McNamara, The Fiscal Year 1969-1973 Defense Program and the 1969 Defense Budget, p. 57.

**Military Spending Committee, op.cit., Strategic Forces: Overview, p.1.

In structuring future U.S. strategic forces, it behooves us also to remain cognizant of the interdependence of U.S. and Soviet actions. The judgments we make about Soviet threats and the corresponding actions we take affect how the Soviet Union is likely to behave. The actual nuclear threat to the U.S. may increase as a result of our increasing our reaction to a perceived threat. All too often, this has been the cycle in the past. As then Secretary of the Air Force Harold Brown said:

The Soviets, 4 or 5 years after we did each of the following things, also did them. They dispersed their silos, they hardened them, they put in the equivalent of a BMEWS to warn their bombers. They built nuclear submarines, with ballistic missile launch capability. *

The end result is that both the U.S. and the U.S.S.R. are probably less secure today than they were a decade ago. The single off-setting optimistic factor is that both nations seem to have acquired during that decade a fuller understanding of the meaning of second strike deterrence, which, coupled with a fuller comprehension of the disastrous consequences of nuclear war, has created a greater reluctance to initiate a nuclear strike.

Under a new deterrence posture for the 1970's, duplication and surplus nuclear capability can be curtailed without jeopardizing U.S. security -- and perhaps, in fact, increasing it through a gradual winding down of the arms race. This claim rests on the assumption that recent trends in the size and composition of

*Status of U.S. Strategic Power, Hearings before the Preparedness Investigating Subcommittee of the Committee on Armed Services, United States Senate, 90th Congress, Second Session, April 1968, pp. 238-239.

Soviet and Chinese strategic forces continue during the coming five years.*

Pruning the Triple Deterrent: The place to start the analysis is with the triple deterrent. Twenty years ago, strategic bombers offered our sole means of long distance delivery of nuclear weapons. Ten years ago, bombers were still important but no more so than land-based missiles; sea-based missiles were only an existing developmental concept.

The future picture is dramatically different. The strategic advantage has shifted to sea-based deterrent systems; land-based missiles and bombers are increasingly vulnerable to enemy missile attack. This is a trend likely to continue. The tremendous nuclear might of our submarine based ballistic missiles, combined with their invulnerability, offer "a credibility and a degree of stability to wind down the arms race."**

This new environment creates doubts about the necessity of continuing to maintain a mix of strategic forces. A credible argument can be made for phasing out all bombers and land-based missiles over the next 2-3 years -- thereby placing full reliance on submarine-based deterrents. We understand the rationale behind such a conclusion, but suggest the appropriateness of a more prudent policy -- one moving in this direction but not so far.

*The Soviet Union has been vigorously improving the capabilities of its strategic submarine fleet, but has slowed construction of sites for additional large land-based SS-9 missiles. The Soviet inter-continental bomber force consists of less than 150 planes and is neither being enlarged or modernized. The Chinese strategic missile force which is expected to materialize, but does not yet exist, was described by Secretary Laird as follows: "for many years to come [it] will be far too small and will lack the accuracy to pose a threat to our strategic offensive capabilities."

**Military Spending Committee, op. cit., p. 7.

Maintenance of a multiple deterrent, even acknowledging the resultant surplus of deliverable warheads, would provide us with a hedge against the extremely remote possibility that the U.S.S.R. could develop some device for crippling our Polaris/Poseidon fleet. Short of totally defusing all our warning systems, it is physically impossible for any enemy to strike simultaneously without our knowing in advance against all three components of our strategic forces -- even if a way of crippling our nuclear submarines could be found.

There is a marginal case then for maintaining a mixed strategic offensive force at least through 1976. But gaining the benefit of a mixed strategic force does not require that bombers or land-based missiles be significantly modernized or even kept at current levels. All that is necessary is that enough of each be maintained to serve the noted purposes.

With regard to missiles, scrapping the 54 Titans offers sensible operating economies with minimal loss in capability. At slightly over \$100 million a year in total operating costs and quite small annual replacement procurement costs, maintenance of the entire Minuteman arsenal is a bargain. Conversion to the MIRVED Minuteman III, however, should immediately cease; such a program is unnecessary to the achievement of nuclear deterrence and would at great expense (the total program cost is estimated to be \$5.4 billion ; current year spending is about \$700 million), serve only to lessen security by unbalancing the arms race.

Programs aimed at developing systems to defend the Minuteman -- whether through mobile basing, hardening of silos, or ABM defense -- should be confined to low-level R & D status. Funding for Safeguard should be ceased altogether. There are serious technological doubts about whether Safeguard will work. It is highly vulnerable to attack; another nation's missiles could cripple Safeguard by striking its radars. And Safeguard harbors potential dangers to the U.S. population through accidents or fallout unleashed in the atmosphere if it ever has to be used. Even if Safeguard does work perfectly, it would save a Minuteman missile only at a cost that would have made it possible to buy 3-12 more Minutemen (i.e. \$25-100 million per Minuteman saved).* To the extent the United States tries to improve its damage-limiting capability, the U.S.S.R. is likely to consider its capability for assured destruction threatened and to add enough offensive forces to nullify our defensive measures. Such a competition is expensive, fruitless, and probably dangerous. The economics of this competition, moreover, favor the offense. A recent deft and accurate comment on the Administration proposal that Safeguard be procured to protect Minuteman bases sums up the situation well: " a system of diminishing utility has to be protected [at a cost of at least \$8 billion] by a system of doubtful effectiveness.** We can

* See testimony of Dr. George W. Rathjens before Senate Committee on Foreign Relations, March 1969, Part I, Hearings on Strategic and Foreign Policy Implications of ABM Systems, p. 364.

**Military Spending Committee, op. cit., Strategic Forces: Overview, p. 13.

obtain a much higher return for our modernization investment dollar in sea-based strategic forces than on Minuteman or systems designed to protect Minuteman.*

Similarly with bomber force levels and modernization. Discussion of the B-1 already has indicated the marginality of the case for this aircraft. "Marginality" is in fact perhaps too kind a word; the B-1 makes no more sense than the ill-fated B-70 designed during the 1960's as a successor to the B-52.* Technological trends raise doubt that we will ever have a need for an advanced design strategic bomber; missiles simply have the edge. If any future bomber role does emerge, it is likely to call for a bomber with stand-off missile firing capability (a role the B-52 can be adapted to serve) rather than the low-altitude dash capability the B-1 is designed, at great incremental expense, to have.

Meanwhile, we can retain the value of a bomber force with significantly fewer planes than are now on ready status. We recommend phasing out by the end of 1973 two-thirds of current bomber squadrons. That would leave active 9 squadrons (approximately 200 planes), presumably 2 or 3 squadrons of them FB-111 with the remainder consisting of G and H model B-52's. These measures would enable base closures and other considerable operating savings, plus a major reduction in procurement quantities of new bomber weapons and penetration aids.

*During the 1960's, two B-70 prototypes and half of a third one were built. The 2-1/2 planes cost the taxpayers \$1-1/2 billion. One crashed, one is in the Air Force Museum at Wright-Patterson Field, and no one is quite sure where the pieces of the half are. Most of the experts who supported the B-70 agree today that we were wise not to procure it.

The foundation of our strategic deterrent in the 1970's should be the Polaris-Poseidon fleet. The only issues are what size force and how much modernization. We have considered several alternatives: a) halting Poseidon conversions, retaining just 41 Polaris submarines; b) converting 14 submarines to the Poseidon configuration (the number already funded), leaving 27 Polaris; c) converting all 31 submarines which can be adapted to the Poseidon configuration and scuttling the remaining 10; d) adapting 31 to Poseidon and retaining the other 10 Polaris in the force -- the Administration recommendation; and e) converting 31 submarines, retaining 10 Polaris, and constructing and arming of 10-20 additional Poseidon configuration submarines.

Each of these five packages would be sufficient by itself to provide a credible deterrent. The relatively least awesome of the five is the current force, which we know is adequate to this task. For this reason, it seems senseless to consider further the option of procuring additional submarines.

The critical question then becomes whether and how far to advance the conversion program to Poseidon - MIRV. Two years ago we probably would have recommended a cessation to MIRV testing and deployment plans in order not to destabilize further the arms race. Now that seems a moot issue. The U.S.S.R. and China know we possess MIRV technology and have begun to deploy it, and so conservatively have to assume that we will continue to deploy it. That being the case, there

are marginal grounds for converting all 31 submarines possible as a hedge against Soviet defense improvements and the increasing vulnerability of land-based U.S. strategic deterrents.

We also recommend continuing to operate the 10 non-convertible Polaris submarines until the end of 1975, by which time all 31 conversions would be complete. Since by that time all strategic submarines will also have 13-year life nuclear reactors (rather than the current 3-year life plants), substantial reductions in overhaul turnaround time will be possible. This fact has significance for force levels. Currently, about 8 of the 41 Polaris submarines are being overhauled at any particular point in time. The longer reactor life does not eliminate the need for other kinds of maintenance, but it will likely mean that no more than four submarines need be in overhaul at any one time. This gain of four Poseidon submarines on station will represent quadruple the number of targetable warheads contained on the ten non-convertible Polaris and thereby provide ample justification for retiring those ten submarines.

Since sea-based missiles seem to offer the most certain future strategic deterrents, it is extremely important that we keep exploring technological frontiers in this field. For the most part, this means a high priority for ULMS research. ULMS is not a system we ought now to rush toward production; that step should be taken if and only if the Russians are discovered to be successfully developing a radically advanced anti-submarine warfare (ASW) concept which threatens Poseidon

survivability. We do feel, though, that insufficient priority is being given ULMS research efforts. Funding for ULMS research and development should increase from the \$45 million provided this year to \$120 million in 1972, then by phases up to \$200 million in 1975. For 1976, we tentatively recommend \$800 million to include the cost of constructing one prototype vessel plus prototype missiles. Such prototype development would serve the purpose of providing us with the ULMS option for the 1980's. It must be clearly understood that prototype development itself would not commit us to procurement of the system; only an order of magnitude advance in Russian ASW capability should trigger that response.

Finally, we have already shown the minimal current importance of the air defense system. Unfortunately this minimal contribution system still costs us about \$1.5 billion a year, despite cutbacks in recent years. Operating and maintaining interceptor squadrons and SAMS weapons is expensive. We recommend phasing out a major portion of the remaining bomber air defense system -- an \$800 million cut to be absorbed equally by SAMS and other parts of the system. What would primarily be retained is a surveillance capability. Consistent with these actions, we would place AWACS in a very low priority R&D status, moving ahead to deployment if, but only if, the Soviets produce an advanced design bomber in quantity. It is difficult, if not impossible, to justify AWACS when the threat it is designed to counteract is an aging Soviet intercontinental bomber force comprised solely of bombers designed over a decade ago.

These measures would leave us with an efficient early warning system, a large but potentially vulnerable Minuteman force (depending on the future of the Soviet SS-9 program), a modest sized but high performance characteristic bomber force, and the virtually invulnerable Polaris-Poseidon fleet. Also provided for would be priority research attention to ULMS, ABRES, bomber weapons and penetration aids -- with lower priority research support in some other areas. This reduced strategic force would still be more than adequate in a retaliatory strike to suffice as an effective deterrent by official Department of Defense standards. The cost of this recommended strategic posture, including required supporting backup, is shown in Table 3.* The cost would decline from a current year level of \$16.3 billion including support costs, to about \$11 billion during 1973-1976.

The elimination of Safeguard, combined with a paring of bomber defense forces, would virtually eliminate the Army's strategic role. The strategic missions burden would be assumed almost entirely by the Navy and the Air Force. Such a division of strategic responsibilities is sensible given the relative expertise and capabilities of the services; the skills of the Army and the Marine Corps lie on the general purpose forces side.

*These cost projections (and similar summary cost projections in subsequent sections) reflect assumptions about increases in prices and retired pay and gains in productivity described fully in Appendices A and B. We assume basically average annual price increases of 3.3 per cent partially offset by 1.3 per cent annual productivity gains.

Table 3

Recommended Strategic and Related Forces Outlays

(In millions of current dollars)

	<u>Administration</u>		<u>Urban Coalition Recommendations</u>				
	<u>Estimated</u>	<u>Proposed</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
	<u>1971</u>	<u>1972</u>					
Strategic forces							
Minuteman/Titan	925	914	235	240	245	135	135
Polaris/Poseidon	1,840	1,757	2,235	2,275	2,315	2,350	865
B-52/FB-111	1,700	1,350	1,180	790	570	515	525
SRAM/SCAD 1/	155	307	100	105	70	0	220
Bomber defense	1,500	1,408	1,225	830	740	805	820
Missile surveillance	290	382	305	350	360	395	405
Safeguard	1,490	1,382	0	0	0	0	0
Subtotal, strategic							
forces 2/	7,900	7,500	5,330	4,660	4,390	4,310	3,100
Intelligence and communications	2,970	3,025	2,755	2,800	2,850	2,900	2,950
Research and development	2,400	2,475	2,040	1,870	1,900	1,935	2,620
Central supply and maintenance	1,025	1,160	855	735	680	695	660
Training, medical and other							
personnel activities	1,830	2,070	1,360	1,170	1,075	1,095	1,050
Administration and associated							
activities	215	240	170	145	130	135	130
Total 3/	16,340	16,470	12,510	11,380	11,025	11,070	10,510

Sources: Authors allocations and costing based on information contained in all documents previously cited in this section.

1/ SCAD assumed to remain in R&D status until a 1976 decision to deploy.

2/ Totals do not add because of inclusion at subtotal level of allocated retirement costs above 1971 levels. The maximum amount of such retirement costs is \$130 million in 1976.

3/ Allocations of totals between operating and investment outlays are about as follows:

	<u>1971</u>	<u>1972</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Operating outlays	8,195	8,510	6,985	5,880	5,475	5,590	5,475
Investment outlays	8,145	7,960	5,525	5,500	5,550	5,480	5,035

V) General Purpose Forces

The so-called general purpose (or conventional) forces and their supporting backup components serve a very different set of missions. Perhaps the most remarkable difference is that "the overall requirement for General Purpose Forces is related not so much to the defense of our own territory as it is to the support of our commitments to other nations".* We now have commitments, widely varying in specificity and legal formality, to 45 countries -- 21 in the Western Hemisphere, 13 in Western Europe, two in Central Asia, six in Southeast Asia and the Pacific, and three in the Far East.

It is possible to imagine a mix of contingencies arising in such a way as to impose a simultaneous demand for U.S. forces in all these areas. But this does not mean that such an eventuality should constitute the basis for planning the general purpose forces. Secretary McNamara pointed out that

These commitments do not require us to execute automatically any specific contingency plan in response to a given situation, without regard to the circumstances existing at the time. And, while we cannot expect to meet all of the contingencies simultaneously, neither can our opponents. **

For planning purposes then, what one does is to take a prudent risk about how many contingencies might occur at once. During the 1960's, general purpose forces (both active duty and Reserve forces) were structured toward the goal of being able to meet simultaneously 2-1/2 contingencies (two major, one minor)

*McNamara, op. cit., p. 78.

**Ibid.

plus prosecute a partially related, partially independent war at sea. Two caveats must be stressed here. Such capability judgments are at best loose estimates. We do not know precisely what number or mix of forces will be required to meet such contingencies. Secondly, the baseline forces are only expected to be able to handle the initial stages of a conflict. As proved the case in Korea and Vietnam, they bear the initial brunt and buy time during which reserve troops can be mobilized and/or new recruits added. The purpose of buying time is to make Russia or China -- whichever might be an aggressor -- pause and consider the nuclear catastrophe which might be unleashed as a consequence of its continuing to press an attack against conventional U.S. forces. These are sensible assumptions and objectives; the prospect of a prolonged conflict between conventional U.S. and Russian or Chinese land and/or sea forces is remote given the full spectrum of military and diplomatic options available to these nations.

Even acknowledging the imprecision involved, these rough contingency guidelines provide a useful benchmark for planning and reflecting the international political and economic climate. President Nixon has made a careful re-examination of these guidelines and announced that future planning will be based on an ability to meet 1-1/2 (one major, one minor) contingencies at once.* That seems an eminently sound judgment in the light of an easing of world tensions and the sharply improved economic

*On a more recent occasion, Secretary Laird was quoted as saying he would prefer to see the concept of preparing for any specific number of wars scrapped as a planning assumption. The particular planning assumption really doesn't matter nearly as much as the fact that the President and the Secretary of Defense both are advocating smaller sized general purpose forces than those which existed in the mid 1960's.

strength of many of our allies. Our recommended posture for general purpose forces is based on the same assumption plus a sharp curtailment of the surface Navy on the grounds that changing technology has greatly reduced the number of roles such forces can usefully perform.

By 1965, U.S. defense forces were postured according to a structure designed to meet the initial requirements of 2-1/2 ground wars plus a war at sea. A listing of general purpose forces available at that time is provided in table 4.

Table 4

Composition of the Armed Forces Active Major Units:

The Baseline Force as of June 30, 1965

<u>Program</u>	<u>Actual Amount</u>
Total military personnel	2,655,389
General purpose forces:	
Army divisions (combat ready)	16
Army armored cavalry regiments	4
Army special forces groups	7
Marine Corps divisions/aircraft wings	3/3
Warships:	
Attack carriers	16
Antisubmarine warfare carriers	9
Nuclear attack submarines	21
Other vessels	331
Amphibious assault ships (in commission)	135
Carrier air groups (attack and antisubmarine warfare)	28
Air Force tactical squadrons	117
Airlift and sealift forces:	
Airlift squadrons:	
C-130, C-133, C-135, C-141	38
C-118, C-119, C-123, C-124	19
Troopships, cargo ships, tankers	106
Active aircraft inventory (all programs)	
Army	6,957
Navy (including Marine Corps)	8,056
Air Force	14,875
Commissioned ships in fleet (all programs)	880

Source: The U.S. Budget, FY 1967, House Document, 335, part 1, p. 76.

There is no agreement on whether those forces were adequate to the task, and whether they were remains a matter for conjecture since the maximum strain never arose. Yet it must have at least been close since we were able to handle simultaneously the buildup in Vietnam and a small contingency in the Dominican Republic without curtailing our NATO committed forces. These total general purpose forces cost about \$37 billion in 1965. Let us examine what forces will be required during the 1970's to support U.S. interests and commitments under the new curtailed planning assumptions.

Location and Nature of Commitments

What must be developed first is a more explicit statement of where in the world, and of what scope, U.S. military forces are required to honor our commitments and advance our national interests. It is not enough to say boldly that our forces will be structured to fight simultaneously one major war -- in either Europe or Asia -- and one minor one. Different kinds of forces and stockpiling plans make sense for major wars to be fought in Europe or Asia.

The Administration has suggested that fewer men will be needed to implement the new posture. They have also announced that no treaty commitments to allies will be abrogated, although some will be reinterpreted. But there remains a considerable lack of clarity concerning areas of the world where U.S. interests are considered vital, and what types and numbers of general purpose forces are deemed necessary to protect those interests.

The President did imply in his first State of the World Message that our major foreign commitments lie in Europe rather than in Asia. Understandably, this Administration (just as any other would) has great difficulty admitting this directly to SEATO allies. But that reluctance in no way alters the reality of adjustments in forces now appropriate to carry out the revised policy.

While the Administration has been less than fully revealing about where in the world it senses that strong American interests exist, an examination of key Administration statements offers some instructive hints. We quote as follows from President Nixon's initial State of the World message.

"Europe must be the cornerstone of the structure of a durable [world] peace"... , but "genuine partnership must increasingly characterize our alliance [with our NATO allies].... We must change the pattern of American predominance, appropriate to the postwar era."

Our "special relationship" and "historical link" to other nations in the Western Hemisphere is acknowledged, but it is implied that the current modest allocation of U.S. general purpose forces to potential contingencies in these nations is fully sufficient. This is so because the risk of attack from some country outside the hemisphere is minuscule.

In Asia and the Pacific, a substantial change is indicated. "Nowhere [since World War II] has the failure to create peace been more costly or led to greater sacrifice. America's Asian policy for the 1970's must be based on the lessons of this sacrifice.... We remain involved in Asia..., [but] our Asian

friends, especially Japan, are in a position to shoulder larger responsibilities for the peaceful progress of the area." More specifically with regard to defense, we will continue to provide a protective nuclear shield and to "furnish military and economic assistance when requested and as appropriate, but we shall look to the nation directly threatened to assume the primary responsibility of providing the manpower for its defense." (Our involvement and obligations in Vietnam will be discussed in a later section of this analysis.)

We continue to have a vital stake in a stable, peaceful Middle East, "but the United States cannot be expected to assume responsibility for developing the terms of peace or for guaranteeing them." The stress is on cooperative efforts with other great power nations and the Middle-East countries themselves. We will continue to provide arms judiciously to friendly states, but envision no direct application of U.S. forces.

Finally, no American military role is envisaged in Africa. "We will help our friends in Africa to help themselves when they are threatened by outside forces attempting to subvert their independent development. It is another lesson of the 1960's, however, that African defense against subversion...must be borne most directly by Africans rather than by outsiders."

The President's second annual State of the World message, issued February 25, 1971, provided a great deal of new rhetoric and terminology, but essentially reaffirmed the perceptions

about U.S. responsibilities in different parts of the world quoted above from the first message. Perhaps the most significant difference in the newer message was heightened concern about the Middle East, reflecting increased tensions and the potential for spawning a conflict between major powers. Even so, the prescribed U.S. role in the Middle East remains essentially the same as the one advanced a year earlier and described above.

A problem with both State of the World messages, and also with Secretary Laird's initial two annual posture statements, is that they reveal far too little thinking about the specific numbers, kinds and costs of military forces dictated by this, at least hinted-at, delineation of U.S. interests and by the shift to the new doctrine of preparation for 1-1/2 wars.

In order to derive an estimate of forces required to implement these broad policies, one must make some reasonable assumptions about the major considerations which dictated Administration development of a new doctrine. The experience of the past decade seems to contain three paramount lessons for the use of United States conventional military forces. The likelihood is that all three had some shaping influence on the new doctrine.

First, conventional U.S. military forces should be stationed and/or committed only in parts of the world where vital U.S. interests are affected. Treaty commitments should be invoked only when a common threat is posed to the United States and an ally -- the original purpose for which all our treaty commitments were designed.

Second, we must honestly recognize the highly limited degree to which foreign policy objectives can be achieved by use of conventional U.S. military forces. Our involvement in Vietnam has proved, at a tragic price, how ineffective our forces can be, no matter how well they perform, in a guerilla war in an unindustrialized nation.

Third, we must carefully evaluate the kinds and amounts of military equipment which will be useful should our forces be committed to some future war. Experience in Vietnam has illustrated the limitations of some kinds of highly sophisticated equipment -- sophistication sometimes results in a loss of reliability or flexibility. In addition, continuing scrutiny is required to weed out systems made obsolete by changing technology.

Consideration of these factors makes possible translation of the Administration's announced broad planning assumptions into a statement of future general purpose force requirement guidelines. In general, they suggest: a) a restrictive interpretation of U.S. military commitments, with U.S. forces to be sent into action only where vital U.S. interests are threatened by China or the Soviet Union; b) increased reliance on allies, particularly in Asia, to provide troops; c) continued U.S. provision to allies of land-based tactical aircraft squadrons; d) increases in the amount of weaponry supplied to all allies for their ground and air forces; e) small reductions in airlift-sealift (although we need a modernized sealift component) and amphibious capabilities; f) restructured and better equipped U.S. Reserve forces; and g) an emphasis on simply designed, reliable aircraft, ships, tactical

missiles, tanks, and other weapons.

Before moving on to a discussion of the detailed meaning of these themes in terms of dollars and specific military force units, we need to examine the composition of current U.S. baseline general purpose forces.

Current Force Allocations

A useful way to examine current forces is by attempting to determine how they are allocated among contingencies. The Department of Defense has not customarily displayed general purpose forces by region, so this can be done only approximately. However, the assumptions that have governed the calculus of requirements are on the record. With them, it becomes possible to arrive at a rough approximation of how, at least for force planning purposes, the forces themselves are related to the main theatres of potential conflict.

William W. Kaufmann, a consultant to the Department of Defense and former Director of the Brookings Institution's Defense Analysis staff, has performed such an analysis, drawing upon a broad spectrum of books, articles, and official government documents.* His conclusions as to the rough size and cost allocations of current general purpose forces by regional contingency are presented in Tables 5 and 6. A different kind of cost breakdown, with support costs segregated, is presented in Table 7.

*Including Secretary of Defense posture statements for 1969 and 1970, the 1969 Statistical Abstract of the U.S., articles in the Wall Street Journal, an Institute for Strategic Studies analysis titled "The Military Balance 1969-1970," an article by Alain C. Enthoven, "Arms and men: The Military Balance in Europe," and Kaufmann's own book The McNamara Strategy.

Table 5 .

Allocation of Baseline General Purpose Forces by Geographic
Contingency as of 1970

<u>Type of force</u>	<u>Europe</u>	<u>Asia</u>	<u>Western Hemi- sphere</u>	<u>Strategic reserve</u>	<u>Total</u>
Active Army divisions	7	6	1	2 1/3	16 1/3
Active Marine Division/wings	1	2			3
Guard and Reserve Forces	7			2	9
Navy air wings <u>1/</u>	4	6	1	4	15
Air Force air wings	16	7			23
ASW and AAW forces (%) <u>2/</u>	50	50			100
Amphibious and other forces (%)	50	50			100
Airlift and sealift forces (%)	50	50			100
Military assistance (%)	30	70			100

Source: William W. Kaufmann, Statement before the Subcommittee on Economy in Government of the Joint Economic Committee, June 5, 1970. Amended by permission of the author.

1/All attack carriers on station (two in the Atlantic, three in the Pacific) and their immediate backup carriers are allocated to Europe and Asia.

2/Excluding escorts for the attack carriers.

Table 6

Allocation of Costs of Baseline General Purpose
Forces by Geographic Contingency, Fiscal Year 1971 1/ 2/

(In billions of 1971 dollars)

<u>Type of Force</u>	<u>Unallo- cated</u>	<u>Europe</u>	<u>Asia</u>	<u>Western Hemisphere</u>	<u>Strategic reserve</u>	<u>Total</u>
Active Army divisions		5.5	4.8	0.8	1.8	12.9
Active Marine division/wings		1.2	2.4			3.6
Guard and Reserve forces		2.5			.7	3.2
Navy air wings		1.7	2.7	.5	1.8	6.2
Air Force air wings		5.4	2.6			8.0
ASW and AAW forces		1.8	1.8			3.6
Amphibious and other forces		.5	.5			1.0
Airlift & sealift forces		1.0	1.0			2.0
Research and development	3.0					3.0
Total	3.0	19.6	15.8	1.3	4.3	44.0

Source: William W. Kaufmann, Statement before the Subcommittee on Economy in Government of the Joint Economic Committee, June 5, 1970. Partially updated and amended by permission of the author.

1/Excluding the incremental costs of the war in Vietnam.

2/Some of both the totals and the allocations differ slightly from our estimates referred to in the text due to rounding and the difference between costs and outlays.

Table 7

Allocation of Outlays for Baseline General Purpose Forces by
Major Military Program

(In millions of 1971 dollars)

General purpose forces	19,770
Intelligence and communications	2,130
Airlift and Sealift	1,200
Guard and Reserve Forces	2,600
Research and Development	2,600
Central supply and maintenance	5,125
Training, medical and other personnel activities	9,120
Administration	1,085
Support of other nations	400
Military Assistance Program	1,130
Total	45,160 ^{1/}

^{1/}The more than \$1 billion dollar difference in the totals appearing in Tables 6 and 7 is accounted for by the difference in time when the estimates were made. Table 7 is based upon the most current information, including information contained in the President's 1972 Budget, and reflects changes in pay rates, increased inflation in defense procurement, and an expanded Military Assistance Program -- among other changes since estimates in Table 6 were made. For purposes of future regional comparisons, we assume that a sensible set of revised subtotal estimates would be (in billions): Unallocated \$2.8; Europe \$20.3; Asia \$16.3; Western Hemisphere \$1.3; and Strategic Reserve \$4.5.

Determining the theatre to which a unit ought to be assigned is a relatively straightforward procedure. Numerous divisions and air wings are physically deployed in Europe or Asia, and Department of Defense testimony before Congress has suggested roughly how many of the units remaining in the United States are earmarked for a particular regional theatre. The direct costs are about the same whether a unit is stationed abroad or in the U.S.,* except for the impact on the international balance of payments. The division of Navy forces between the Atlantic and Pacific Oceans is on the public record; these forces are respectively assigned to the European and Asian theatres. (A case could be made for separating all naval forces costs into a distinct "conventional war at sea" category. We will discuss naval force requirements separately, but here will retain Kaufmann's approach of assigning these forces to the regional theatres.)

Airlift, sealift, and amphibious assault capabilities -- each of which could be used completely in a single theatre if a large requirement arose -- are sensibly allocated evenly between the European and Asian theatres. Intelligence and communications functions are allocated among theatres roughly in proportion

*Although some analysts argue persuasively that overseas units are more expensive because existing manpower assignment policies require the creation of a "rotation base" space in the United States for every overseas space.

to combat force allocations, but research and development of general purpose weapons sensibly is kept in an unallocated category since benefits from R & D do accrue to all forces. Finally, the strategic reserve category includes some Army division units, which just as their description implies are saved as a safety margin against unexpected requirements, and four Navy tactical air wings (attack carrier groups) representing the number unassigned at any particular point in time.

The costing of forces is only approximate, but reasonably sound estimates have been made. Basically the technique is to: 1) subtract Vietnam and strategic and related forces costs from the total 1971 defense budget, thereby obtaining baseline general purpose force costs; 2) separate these by service (Army, Navy, Air Force, and Marine Corps); and 3) drawing upon data presented in the sources cited on the previous pages, allocate the resultant costs among the major force units identified in Table 5. Thus Air Force baseline general purpose force costs, for example, are divided among the airlift mission and the 23 tactical air wings. In all cases, the costs corresponding with force units include a proportionate allocation of such support costs as logistics, supply, medical care, training, administration

communications, and intelligence. Of the \$45.2 billion total cost, \$30.9 billion are calculated to be operating costs, the remaining \$14.2 billion investment (procurement, R&D, or construction) costs.

With this background as a context, we can now move ahead to examine what specific changes are required to adjust these forces to the new Administration doctrine. The shift in planning assumptions and delineation of U.S. interests clearly suggests that the net result of changes should be a contraction of U.S. baseline general purpose forces.

There remains wide latitude for judgement as to the prudent pace and size of force reductions. Choices must be made against the yardstick provided by competing national needs, as well as the guidelines cited above. The analysis which follows suggests that, altogether, baseline general purpose force outlays could safely be cut to \$38.8 billion in 1976, a drop of \$6.4 billion from present levels. This would include a decrease of approximately \$1.4 billion in the cost of Europe-oriented forces and a savings of nearly \$5 billion in Asian-oriented forces. The decrease in forces would be proportionately even greater than the cost reductions because partially offsetting price increases are allowed for in the cost estimates.

European Force Requirements

The words of President Nixon about our relationship to Europe, in conjunction with the growing economic strength of allies there, suggest that it is appropriate for these nations to assume an enlarged share of the dollar and manpower burden of providing for their conventional war defense. A conservative assessment suggests that the force needs there remain fairly constant, once overdue improvements in operating efficiency are effected; what is primarily at issue is who ought to bear what shares of the cost. Currently the United States allocates 7 per cent of its GNP for defense spending, versus an average of 5 per cent for our NATO allies.

Roles and Current Deployments: The U.S. role in European general purpose force defense is to contribute to a NATO deterrent against a conventional attack by the Soviet Union or other Warsaw Pact nations. Symbolically, the most important part of the U.S. contribution has been the four Army divisions stationed in West Germany. Actually the number of American military personnel in Europe has fluctuated considerably during the last decade, reaching over 400,000 during the 1962 Berlin crisis and ebbing down to the current low of 315,000.

The aforementioned divisions stationed in Germany represent only a small part of our NATO contribution, which also includes three additional Army divisions, one Marine division and accompanying air wing, and seven Reserve divisions -- all based in the U.S. --

plus 16 Air Force air wings, four attack aircraft carrier groups, and a significant further complement of naval forces. All of these forces, of course, also require backup support components; the fluctuations in U.S. troop deployments in Europe, in fact, have mostly resulted from a thinning or thickening of the support component.

Controversy is growing over the appropriate size of the U.S. contribution to NATO, with the debate focused almost entirely on U.S. manpower levels in Europe itself. Few people are suggesting larger U.S. troop commitments; the envelope within which reasonable discussion revolves extends from the current 315,000 men down to 50,000. To put the American contribution in context, Table 8 compares total NATO and Warsaw Pact forces.

Table 8

Conventional Forces in Europe: NATO & the Warsaw Pact NATO Countries ^{1/}

Country	Total Military Forces	Army	Forces on Central Front ^{2/3/}	Reserves & Paramilitary
West Germany	465,000	328,000	328,000	780,000
France	503,000	328,000	52,000	470,000
Britain	405,000	198,000	48,500	125,000
Italy	420,000	313,000	none	741,000
Portugal	182,000	148,000	none	515,000
Greece	159,000	110,000	none	223,000
Turkey	483,000	400,000	none	560,000
Netherlands	124,000	82,000	82,000	20,000
Belgium	102,400	78,000	78,000	13,000
Canada	98,300	37,300	5,400	26,000
Denmark	45,500	28,000	28,000	120,000
Luxembourg	560	560	560	350
Totals	2,987,360	2,050,860	622,460	3,593,350
U.S.	3,454,000	1,522,000	200,000	^{4/} 660,000
Totals	6,441,360	3,572,860	822,460	3,593,350
<u>The Warsaw Pact Countries</u>				
Poland	275,000	185,000	185,000	45,000
Czech.	230,000	175,000	175,000	135,000
Rumania	193,000	170,000	none	110,000
Bulgaria	154,000	125,000	none	165,000
East Germany	137,000	90,000	90,000	427,000
Hungary	97,000	90,000	90,000	140,000
Totals	1,086,000	835,000	540,000	1,022,000
U.S.S.R.	3,300,000	2,000,000	400,000	^{5/} 1,750,000
Totals	4,386,000	2,835,000	940,000	2,772,000

Source: Military Spending Committee of Members of Congress for Peace through Law, op. cit., Land Forces in Europe, pp. 4-5, based on data taken from The Military Balance 1969-1970, of the Institute for Strategic Studies, London.

^{1/} These include the total forces of the NATO countries, on the assumption that an attack upon them would invoke a response from all forces and not merely from those assigned formally to NATO. Likewise for the Warsaw Pact.

^{2/} The Central Front is taken to include West Germany, Denmark and the Benelux countries on the NATO side, and East Germany, Poland, Czechoslovakia and Hungary on the Pact side.

^{3/} Airborne and airmobile forces are included with those on the central front, except for those based in the United States. This includes an airmobile division and regiment based in France and part of the French Strategic Reserve.

^{4/} There are an additional 100,000 or so American troops in Europe and surrounding areas.

^{5/} There are an additional 450,000 troops in the European U.S.S.R.

Two major conclusions are evident from an examination of this table. First, there is an approximate parity between NATO and Pact forces -- both in aggregate and along the strategically critical Central Front. Without even dwelling on such significant considerations as relative training levels, firepower, and support capability (in which NATO forces appear to have an advantage, particularly in the critical area of tactical aircraft where NATO forces enjoy a decisive advantage), there exists a legitimate question whether parity in manpower levels is required to deter a Pact conventional attack. Normally, offensive forces require a 3 or 4:1 advantage if they are to have any chance of conquering new territory. Since NATO's mission is defensive, the current 1:1 ratio of troops on active duty may be excessive.

The second conclusion is that the direct U.S. general purpose force contribution to NATO forces marshalled along the Central Front seems modest relative to the total. The key thing again is the symbolism. By having American ground troops in Germany, we make it impossible for Pact forces to mount any sizeable attack without engaging U.S. forces. Knowing that such an engagement almost certainly would trigger broader American involvement -- and perhaps might set off the use of tactical, or even strategic, nuclear weapons -- adds a sobering dimension to any Pact temptation to attempt even a temporary foray or seizure of a small piece of territory.

Ground troops: The contribution to European defense made by American troops stationed there needs to be viewed in a psychological and political context as well as a military one. Fewer U.S. troops than the current four divisions are required purely to serve as a tripwire (ensuring that any major Pact attack must engage U.S. forces). But because we do have four divisions stationed in Europe now, and have for many years, any unilateral decision to reduce that number would likely create serious political reverberations in Western Europe.

We think the debate on U.S. European-oriented troop levels has been misdirected. We agree that our NATO allies should absorb a larger portion of troop costs in the European theatre, both because of their improved economic ability to bear such a burden and because the United States completely finances the strategic nuclear deterrent which protects NATO countries as well as the United States. We also agree the number of U.S. troops oriented toward Europe can safely be reduced without lessening NATO security.

But we differ with the conclusion that the way to achieve these ends is through a reduction in the four U.S. Army combat divisions stationed in Germany. To the contrary, we feel these divisions are among the highest priority items in our military arsenal in contributing to international stability. Their deterrent and symbolic values can hardly be overestimated. If these American forces were substantially reduced, the reaction of our NATO allies would likely be either hasty attempts to reach accommodation with the Soviet Union and other Warsaw Pact nations, or panicked efforts to augment existing military

capabilities, including acquisition of nuclear weapons. Neither of these reactions would enhance European stability or U.S. security.

Instead we recommend that further reductions be made in the number of U.S. support troops in Europe and that some U.S.-stationed but Europe-oriented Army troops be deactivated. The first of these objectives can be achieved without significant sacrifice of combat capability; the range of potential reductions is generally considered to be 50,000-100,000 men. Wishing to stay on the conservative side, we suggest that 50,000 men be cut out of the Europe support pipeline by the end of 1972. We also recommend that one of the four U.S.-based, Europe oriented divisions be eliminated from the force by the same date, thereby leaving seven active and seven Reserve* U.S. divisions oriented toward the European theatre. Savings would exceed \$900 million a year.

Tactical Aircraft: Examination also is required of Europe-oriented U.S. tactical aircraft units, first from the perspective of force requirements in Europe, and then from the different angle of the kinds of aircraft which make the most sense to deploy. These two considerations, of course, are both dependent upon the threat the U.S. faces and the type of missions it therefore must plan to fly. The major kinds of missions flown by tactical aircraft include close air support of ground combat operations, interdiction of

*A general discussion of needed changes in the organization of Reserve forces appears after the examination of regional force requirements.

enemy supply and communications lines*, air to air combat where the goal is air superiority, and air base defense including carrier defense.

1) Force Levels and Modernization Needs: Of a total of 41 air wings** in our baseline force structure, Kaufmann's allocation suggests that 22 effectively are allocated to European defense -- 16 Air Force, four Navy carrier based, and one double Marine wing. NATO aircraft provide a large offensive payload advantage over Pact forces, an advantage which will grow with the introduction of new generation U.S. attack aircraft like the A-6, A-7, and F-111. A large (really too large given the low payoff and expected high attrition) portion of NATO tactical air forces is equipped for the deep interdiction mission, one that does not offer promising prospects because many enemy aircraft are protected by shelters, and because the highly developed infrastructure (e.g. roads, bridges, railroads) in Eastern European countries offers many alternative routes while those temporarily shut down by bombing are repaired. We possess fully sufficient numbers of close air support aircraft, but need a more modern aircraft model.

*The primary assignment on deep interdiction missions is destruction of supply and communications networks (e.g. bridges, railroads, power plants). Pilots on such missions are also sometimes able to take advantage of targets of opportunity should they spot enemy tanks or airplanes caught on the ground.

**Although our analysis adheres to this officially recognized number, there actually are 44 wings. Marine divisions in theory are matched by a single wing of tactical aircraft; in reality these are each the equivalent of two wings.

The area in which we most need to improve our capabilities is air-to-air combat. NATO's advantage over Pact capability in this area is highly uncertain, especially in light of our experiences in Vietnam combatting Soviet built aircraft. The F-4 is the only airplane currently in the U.S. Air Force arsenal suitable for air-to-air combat with the MIG-21, the top Soviet fighter aircraft. But we need now to develop a highly maneuverable successor aircraft, focused solely on performing the air-to-air combat role, to match future modified versions of the MIG-21 and possible production of expected new Russian fighter aircraft such as the Foxbat.

Overall, the U.S. has excess Europe-oriented tactical aircraft capability. The present surplus is among units assigned the deep interdiction role. We recommend that one Navy and four Air Force wings be eliminated (at an average annual savings approaching \$300 million per wing). In choosing which Air Force wings to cut, it would be wise to select U.S. based, Europe-oriented wings in order to maximize the number of remaining wings which could be quickly flown to the Mideast and temporarily rebased there in case such a requirement evolved. We would not anticipate that U.S. forces would become directly involved in defending Israel (although the U.S. should continue to assist Israeli purchases of required military equipment), but it is prudent to retain the capability to do so effectively.

2) Close Air Support Aircraft: As for types of aircraft, the most pressing needs are for a new close air support aircraft and an uncluttered, highly maneuverable new air superiority fighter. Three of the services are now pressing their own candidates to fill the former need. The Marine Corps is already buying the Harrier, a swivel-engine jet that requires only a very short area for take-off and landing. The Army wants to buy, at a cost of about \$4 million each, at least 375 Cheyenne helicopters, a helicopter gunship packed with electronic gadgetry and more heavy armament than any helicopter ever built before. The Air Force proposes buying, at a cost of \$1.6 million per plane, 500 AX's -- a rugged, simply designed, heavily armed airplane that is claimed to be the first Air Force plane designed solely for the close air support role.

Whether or not the Harrier is an ideal plane for close air support and ought to be procured now seems a moot issue. The system seems fairly promising and procurement already has proceeded so far that it seems sensible to complete buying the scheduled 114 planes.

The major controversy lies in the choice between the Cheyenne and the AX, both proposed to support U.S. Army ground troops. More precisely, since even many Army advocates agree the AX should be procured, the issue is whether the Cheyenne also should be bought. Because helicopter and fixed wing aircraft each offer some unique advantages in the role of knocking out enemy troops, tanks, and guns, it is possible that the optimum arrangement would be a combination of the two types of vehicles.

Having such a combination would not necessarily require that both new systems -- the Cheyenne and the AX -- be procured; an improved fixed wing aircraft could reduce the need for an improved helicopter, and vice versa.

What does, unfortunately, seem clear is that the Department of Defense has not been tough-minded enough in analyzing the alternative combinations and choosing the best. Instead, the easy road has been taken -- allowing each service to pursue its own pet project.

The key issues in such a choice seem to be survivability and cost. The Cheyenne, or any other helicopter, promises to be an extremely vulnerable target to the massive anti-aircraft fire which can be mounted by Warsaw Pact nations in the European battleground where potential close air support needs are the greatest. Cheyenne also is projected to cost three times as much as the AX. Given these circumstances, what seems to make sense is to scrap the Cheyenne program and proceed ahead with the AX. To the extent that supplementation with helicopters makes sense in roles they are better suited to perform, this mission can be performed slightly less well -- but at considerably less expense -- by the Cobra helicopter, which has provided devastating firepower in Vietnam.

3) Air to Air Combat Aircraft: While we have in the AX a plane being developed which is well suited to close air support requirements, we are not so fortunate with regard to models being proposed for the air to air combat role. The F-15, which is being touted as a new all-purpose fighter replacement for the F-4, is not responsive to current requirements. Its configuration is

being developed to accommodate complex avionics and a stand-off missile capability at the sacrifice of desirable maneuverability. In Vietnam, the tactical advantage of stand-off missiles has not proved to be worthwhile, and missiles (and their fire control systems) have proved far less reliable than expected. In addition, the F-15 promises to cost 4-5 times as much per aircraft as the \$3 million F-4. Since it will offer nowhere near 4-5 times the F-4's capability in air to air combat, and given overall scarcity of budget funds, proceeding with development and procurement of the F-15 would likely mean an unacceptable reduction in total tactical aircraft forces and capabilities. We propose that F-15 development cease. The F-15 should be replaced by a lighter, avionically simpler fighter aircraft not designed for long-range missile engagements. It is anticipated that such a simpler aircraft, with air to air combat performance characteristics superior to those of both the F-4 and the F-15, could be built for no more than twice the cost of the F-4.

Europe Summary: Along with a proportionate share of net savings from recommended changes in anti-submarine warfare, anti-aircraft warfare, attack carriers, amphibious warfare, and airlift-sealift forces -- all described in detail later on -- the above changes would, by 1976, reduce the cost of U.S. forces oriented to Europe from \$20.3 billion to \$19.0 billion. (Excluding the growth in prices and productivity, the 1976 cost would be \$17.4 billion.) About half of this reduction would represent simply improved efficiency and elimination of outmoded forces.

To the extent that U.S. allies feel uncomfortable with the real U.S. force reductions recommended, they could exercise the option of providing active duty replacement forces themselves thereby effectively assuming a larger share of the NATO defense burden. The United States also should encourage further dollar payments to the U.S. by European allies -- whichever, among a great variety of payment mechanisms, is employed -- as partial offsets for the costs of maintaining U.S. troops in Europe.

Asian Force Requirements

Roles and Current Deployments: United States objectives and commitments in Asia are far less clearly delineated than those in Europe. Our military involvement has changed in emphasis as a reflection of shifting political currents. Major U.S. military intervention since World War II has come in two bursts -- Korea and Vietnam. The deployment pattern of our Asia-oriented forces as we move into 1972 reflects primarily lingering involvement with those two nations, a large complement of naval general purpose forces, and a sizeable group of backup ground troops spread over Pacific Ocean islands and the Western United States.

Major adjustments in these forces are required to conform with the Administration's announced planning assumptions and the guidelines described earlier. U.S. involvement in new Southeast Asia land wars such as Vietnam can only serve to defeat further our real national purposes. We should extricate U.S. ground forces from South Korea and Thailand as expeditiously as possible, as our involvement in Vietnam is reduced. Vital U.S. interests currently exist only in Japan and Taiwan, excluding nations such

as Australia and New Zealand which provide quite adequately for their own defense. And even the threats to Japan and Taiwan are severely limited by restricted Chinese air and amphibious capabilities.

As the President has suggested, the future U.S. general purpose force contribution to Asian allies should consist heavily of tactical air wings. Allies will have to supply their own ground troops. U.S. military assistance funds should contribute to the cost of their weaponry.

No one knows precisely what portion of U.S. Asia-oriented forces should be eliminated as part of the implementation of this new doctrine. A strict interpretation of the shift to a one-and-a-half war planning assumption might suggest elimination of our eight divisions and fifteen air wings now oriented to the Asian war contingency. Such a move would be highly imprudent in consideration of vital U.S. Asian interests which remain.

Ground Troops: A logical place to begin the analysis of specific U.S. Asian-oriented force requirements is with ground troops. Currently we have six Army and two Marine baseline divisions oriented toward Asia. Setting aside temporary realignments due to Vietnam, the normal distribution pattern has been two divisions in Korea with the rest spread as contingency forces over several islands and the continental United States.

The question before us is how many divisions should be eliminated in implementation of the President's new guidelines? As a first step, it makes sense to withdraw both U.S. divisions from Korea along with all tactical nuclear weapons emplaced there under our control. Such a withdrawal is possible without compromising South Korean security, because of the development of the South Korean army into

a superb fighting force, just recently illustrated by their superior performance in Vietnam. The President has already announced U.S. intentions to withdraw one of those U.S. Korean-based divisions, and, during a recent visit to Korea, the Vice-President suggested we should follow suit soon with the other one.

The issue then narrows down to how many of the remaining six divisions are to be eliminated. The Administration has made no indication of the extent of further planned excisions, if any. We think a prudent solution would be the elimination of two of these six divisions. We must stress that this particular recommendation is highly judgmental, rather than one closely tied to specific force requirements. Firm adherence to such requirements would probably suggest further division reductions.

Tactical Aircraft: In Asia, the U.S. plans a tactical aircraft capability to fight against the Communist Chinese and the North Koreans, both of whom possess air forces similar in composition to those of the Soviet Union but slightly less modern. Furthermore, given the cool nature of current Sino-Soviet relations, it is unlikely that the Soviets will be providing China or North Korea with more advanced tactical aircraft in the near future. The U.S. has a large payload advantage over the combined Chinese/North Korean tactical air forces. However, the same uncertainty surrounds the U.S. air-to-air combat advantage in Asia as in Europe. We simply have no way of predicting with much certainty the success of either side in air-to-air combat. It is also clear that, given the highly limited tactical air capabilities

of our SEATO allies, U.S. tactical air will continue to be required for close air support of ground operations against external nation agressor forces.

This brief analysis suggests that the kinds of U.S. tactical air capabilities, including new model requirements, in Asia are very similar to those arising in Europe. Accordingly, the tactical aircraft procurement priorities developed as part of the European theatre analysis could indeed sensibly govern our world-wide requirements.

The number of air wings can be pruned, despite their relatively increased importance under the new doctrine, because of the net reduction in the number of allied ground divisions requiring air support and because of recognition that we operate superfluous numbers of attack aircraft carriers (a section to follow develops this latter premise in some detail). From the current set of 15 wings, we recommend the elimination of three carrier wings (four carriers would remain on Pacific assignment, but since one would always be in overhaul only three wings would be required) and one Air Force wing -- leaving a total of 11.

Asia Summary: These recommended changes in ground troops and tactical air wings -- combined with a proportionate allocation of later recommended changes in airlift-sealift, anti-submarine warfare, anti-aircraft warfare, and amphibious forces -- would, by 1976, reduce the cost of baseline U.S. forces assigned to Asia from \$16.3 billion to \$11.5 billion (Excluding the growth in prices and productivity, the 1976 cost would be \$10.5 billion.)

Naval Force Requirements

In the foregoing parts of this discussion, oblique references have been made to conventional naval forces without addressing directly the scope and shape of our needs for them. Naval forces require singling out because, while assignable to regional contingencies, they also serve a somewhat independent requirement for control of sea lanes.

In all three of the Navy's primary and independent conventional warfare missions -- tactical air, amphibious operations, and shipping protection (anti-submarine and anti-aircraft warfare) -- the forces now provided are either outmoded, overequipped or excessive in relation to the requirements cited in the President's State of the World message. This is true centrally because U.S. naval forces remain structured on the now outdated assumption that an extended conventional war at sea between major powers is a plausible scenario. Such a war at sea took place during World War II; it no longer makes sense in an age in which surface ships are extremely vulnerable to missiles and in which both sides possess powerful alternative weapons.

Tactical Air/Attack Carriers: The Navy has never gotten together with the Air Force to eliminate overlapping sea-based and land-based tactical air coverage. The relative merits and demerits of land versus sea basing form one of the oldest internal arguments within the Department of Defense. The Department has never satisfactorily resolved the argument, and the result is an extended stalemate at a relatively constant mix of land and sea based tactical air forces -- even in the face of changing technological capabilities of potential aggressor nations.

Some mix of land-and sea-based forces continues to make sense for the 1970's. Carriers remain useful for initial surge capacity in conflicts against minor powers and for "showing the flag" (although the latter role often could be performed equally well, and at a great deal less expense, by smaller ships). Land based wings are both cheaper (measured by cost per offensive sortie) and relatively less vulnerable.

Increases in carrier vulnerability during the past decade and projections of more of the same ahead* indeed suggest the appropriateness of a future mix of tactical air forces which places greater emphasis on land-based forces. A considerable portion of carrier sorties (perhaps one-fourth) must be assigned to defense of the carrier, versus less than five per cent defense missions for land-based tactical air. Even so, the carrier remains highly vulnerable to cruise missiles fired from enemy submarines, ships or even land sites. And missile technology is advancing quite rapidly, enough so that -- in addition to the Soviet Union -- many small potentially hostile nations are likely to acquire such missile capabilities during the 1970's. This development will further reduce the number of missions which attack carriers can perform and the number of targets they can perform them against. The number of attack carriers we operate ought therefore to be reduced.

*In his March 9, 1971, statement on the fiscal year 1972-1976 Defense Program, Secretary Laird says "Whereas in 1970, missile-equipped surface combatants accounted for 23 per cent of the [Soviet] major surface combatant fleet, by 1975, we project that some 40-50 per cent of the fleet will be missile-armed." A 90 ton Soviet Komar boat is fully capable of sinking a 60,000 ton U.S. carrier.

Exactly how many tactical aircraft carriers should be retained is a difficult judgmental question. The Department of Defense recently announced plans to reduce the number from 15 to 12 plus one carrier which will experimentally serve a dual purpose attack/ASW role. (We label this experimental carrier an ASW carrier in our force tables.) Some critics have gone so far as to suggest that no carriers make sense in the 1970's; indeed, no other nation has built carriers during the past decade. We think a zero carrier posture stretches a basically valid case too far. We recommend that seven tactical aircraft carriers be retained -- three for the Atlantic and four assigned to the Pacific. The argument for maintaining any more carriers than the seven we recommend rests on the claimed loss of overseas land bases. However, the contingency that we will be called upon to defend a nation while being denied the use of its bases must be considered unlikely.

We assume the newest carriers would be retained, meaning that with the introduction of the USS Eisenhower in 1974, all carriers in the fleet would have been introduced since 1960. Partly because these newer carriers would require less extensive modernization and overhaul during the 1970's than older ships, partly through improvements in crew rotation and other operating practices, the United States should be able to keep at least three and more usually four carriers on station -- almost as many as are available now (five on station) with a 15 carrier fleet.* It

*By temporarily converting an ASW carrier (the Shangri-La) to the carrier role for use in Vietnam, the Navy was able to keep six attack carriers on station during 1970 out of the resultant 16 attack carrier fleet. Announced 1972 plans to maintain only 12 active attack carriers plus one dual purpose attack/ASW carrier, though, suggest that only four carriers will be kept on station at most times.

should be remembered also that individual carrier capabilities are growing -- the two carriers now under construction can support nearly twice the tactical air capability as the carriers they are scheduled to replace.

Such a decision to reduce the attack carrier force has broad ramifications for other Naval ship and tactical aircraft requirements. The need for replacement of aged escort vessels with new destroyers and frigates, both nuclear and conventionally powered, would sharply diminish if the number of attack carriers were reduced to seven. This would be the case even acknowledging the other roles destroyers perform -- protection of commercial shipping, escorting amphibious forces, and hunting and attempting to destroy enemy submarines. Similar reductions would also occur in requirements for underway replenishment ships, tankers, and various other support ships which round out carrier flotillas.

This refocusing of carrier force requirements also suggests the need to rethink the mix of airplanes needed for carrier basing. Much too high a priority is now being assigned the fleet defense role in the design of Navy fighter aircraft, most conspicuously in the case of the F-14 now slated for procurement. Despite Navy claims that the F-14 will be a "multi-mission fighter" designed to provide air superiority, fleet air defense, and air-to-ground capability, the fleet air defense mission seems to dominate the design characteristics.

We must assume the indefensibility of carriers in the face of a concerted Soviet attack (involving intensive bombing and cruise missile attacks) and therefore not squander resources on fleet defense purposes. On the other hand, for operations

against lesser powers where the carrier still can perform a useful role, the complex avionics and defensive missile carrying capabilities planned for the F-14 are excessive in terms of the kinds of air threats these nations could mount. Carrier defense against these threats can more efficiently be provided through other means such as electronic countermeasures and surface to air missiles.

As we learned from our analysis of European and Asian theatre tactical air requirements, the area in which the U.S. most needs to improve its capabilities is air-to-air combat. The F-14A may now actually prove less capable than the latest models of the F-4 (the airplane it is supposed to replace) in this role. Worse, the F-14 is several times as expensive as the F-4 (about \$12 million versus \$3 million per plane), meaning that so many fewer new planes could be afforded that overall carrier-based tactical air capability (for a given number of carriers) would decline. A more sensible solution is one analogous to that recommended for the similar Air Force dilemma -- substitute for the complex craft, in this instance the F-14, a simpler design, substantially less expensive airplane focused on air to air combat skills. Finally, the A-7 should remain an important part of the carrier aircraft complement, serving particularly the close air support role, but fewer A-7's (as well as A-6's and other carrier based aircraft) would be needed for a carrier force which is reduced by about one-half.

The overall financial impact of the above recommendations on carrier force levels and accompanying ships and tactical aircraft would be a reduction in outlays from \$6.7 billion in 1971 to \$3.4 billion in 1976.

Shipping Protection/Anti-Submarine Warfare: Attack carrier task forces also perform a secondary role in the execution of the second primary Navy mission, shipping protection but the main responsibility is borne by other anti-submarine warfare (ASW) and anti-aircraft warfare (AAW) forces.* Comments have already been made on AAW forces in connection with the carrier analysis. Additional AAW requirements exist for convoying shipping in wartime. To the highly limited extent a protracted war at sea retains any plausibility (the Soviet Union is the only potential aggressor with large enough a Navy to pose such a threat, and with all the other possible forms of retaliation available in the U.S. and U.S.S.R. arsenals, a World War II type extended battle between these powers seems most unlikely), we need to keep some additional destroyers and other escort ships in the force.

The primary threat to shipping comes from enemy submarines. We require considerable ASW forces for shipping protection and two other purposes -- defense against Soviet submarines seeking

* Our force and cost allocations in Tables 5 and 6 assign those destroyers and vessels with AAW capability which accompany and provide protection for attack carriers to the tactical air mission. This results in a 1971 cost allocation of \$6.7 billion to tactical air versus \$3.6 billion for ASW and AAW. In recent Congressional testimony, Admiral Moorer has chosen a different allocation pattern, pulling together all the ASW and AAW forces regardless of the mission to which they are assigned. His allocation pattern for 1969 (the latest year data are provided for) is \$5.0 billion for tactical air, \$5.1 billion for ASW and AAW.

to penetrate close to the U.S. coastline, and, in wartime, the hunting and killing of enemy submarines. For these purposes, the U.S. currently relies on a mix of forces including destroyers, attack submarines arrayed in protective barriers off the U.S. coasts, land-based P-3C airplanes, and four ASW carriers equipped with both airplanes and helicopters. All of these systems depend heavily on detection devices needed to locate enemy submarines including such things as radar and sonobuoys.

ASW force issues include size, mix, and modernization requirements. With less than half as many attack carriers in the force, less ASW capability would be required in the future than is now provided. Pushing in the opposite direction on U.S. requirements is the fact that the Soviet submarine force is being substantially modernized. To the extent that Soviet submarines are used for their own barrier reef defenses or operate in areas like the Baltic Sea not directly vital to U.S. interests, then growing Soviet submarine capabilities are of no great concern to us. But recent expanded Soviet submarine operations in the Atlantic, the Pacific and the Mediterranean pose a warning of potentially threatening uses. The net result of these opposing forces -- fewer U.S. ocean operations, an expanded Soviet submarine threat faced by remaining operations -- suggests an ASW force of about current aggregate capabilities, perhaps slightly smaller.

With regard to mix, the growing emphasis on land based P-3C planes and attack submarines, supplemented by destroyers, should be

accelerated. Some Navy analysts suggest that we need to expand the number of attack submarines in our inventory. Such a step might be necessary at some future date, but current recommendations to that effect tend to ignore the diminishing returns from adding barrier defense layers and the contribution of allied nation attack submarines.

Navy actions in recent years reducing the number of ASW carriers in the active inventory from nine to four (actions successively participated in and approved by both Presidents Johnson and Nixon), are a tacit admission that these carriers and their aircraft are no longer essential to counter the growing Soviet submarine threat. Land based aircraft can cover 80 per cent of the oceans' surface, and cargoes and naval forces in need of protection by such aircraft can be routed to areas where such coverage is available. Furthermore, land based planes are considerably more cost effective, an edge which would increase if plans are carried out to procure the very expensive S-3A airplane (formerly called the VSX) as a replacement for those now stationed on ASW carriers. Finally, despite all their protection, the ASW carriers remain highly vulnerable to enemy submarine and air attack, much more vulnerable than attack submarines or land based P-3C planes. We recommend scrapping the remaining four ASW carriers* (thereby saving more than \$400 million in

*Technically three ASW carriers and one combined attack/ASW carrier.

annual operating costs, including backup support costs) and discontinuing procurement of the S-3A.

The increasing Soviet submarine presence requires diligent continuing attention to the modernization of United States ASW forces. The land based P-3C airplanes are new and will serve us in excellent stead during the coming five years. We have already discussed destroyer modernization requirements, with the conclusion that some modernization will be required but considerably less than would be in the absence of a major reduction of attack carrier forces. The additional retirement of four ASW carriers would further reinforce this conclusion. The capability advantages of building nuclear powered escort ships instead of conventionally powered ships generally are negligible and don't begin to balance out the significant added costs. This fact should weigh heavily in the shaping of destroyer modernization plans.

Finally, the U.S. will need to continue making sufficient improvements in the performance of its attack submarines to maintain a relative combat advantage. The SSN-688 and SSN-685, "super-fast, super-quiet" nuclear-powered attack submarines now being developed, are logical responses to this requirement but only in conjunction with the availability for incorporation in them of vastly improved detection and weapons systems. The latter criteria cannot yet be met, and there is reasonable doubt whether the Mark 48 torpedo now being heavily counted on will ever satisfy the weapons requirements. A higher priority Defense Department effort than is currently being given is required on these subsystem problems.

Altogether, ASW and AAW force costs should be reduced about \$500 million. This estimate reflects significantly larger savings from elimination of the ASW carriers and the accompanying aircraft, substantially offset by growing submarine unit costs. This recommended reduction is partially reflected in our ASW-AAW category, partly in forces allocated to Navy tactical air wings.

Amphibious Operations: Force requirements for the final primary Navy mission -- amphibious operations -- would be substantially affected by the shift in planned ground troop deployment capabilities in Europe and particularly Asia. We now have the amphibious capability to land four brigades simultaneously -- two each on the Atlantic and Pacific sides. In emergencies, amphibious forces can be interchanged fairly quickly between theatres by moving men and equipment through the Panama Canal. It could be argued that if the U.S. is not going to supply ground troops in Asia, then it does not require the capability to land them on Pacific beaches. Some need for amphibious landing craft may still exist, though, as assistance to Asian allies if an emergency arose requiring one such ally to go to the assistance of another nation. We recommend that the Pacific amphibious capability be reduced immediately from two to one brigade, thereby saving \$250 million annually.

Airlift-Sealift Forces

While we have evenly divided the costs of airlift-sealift forces between European and Asian contingencies, as a practical matter most of these forces are likely to be employed to move troops and supplies from the U.S. to wherever a crisis arises. Decisions on the size and composition of airlift-sealift forces have to be made, then, in a worldwide requirements context. We foresee some inadequacies in forces planned for the 1970's. The current airlift target of four squadrons of C-5A's and 14 of C-141's appears fully adequate and appropriate. Due primarily to continued rebuffs by Congress, though, existing and already approved sealift forces will be inadequate to meet requirements. Our transportation forces, in other words, will be imbalanced. To a limited extent, tradeoffs between airlift and sealift are possible, but sealift still offers a sizeable cost advantage on other than highly urgent transportation requirements. We suggest that sealift should enjoy the highest single priority among competing Navy general purpose force procurement needs during the next few years. For this purpose we recommend \$500 million be provided annually from 1973 through 1976.

Other General Purpose Force Requirements

Latin America: Currently, one division and one carrier task force are earmarked for a possible "minor contingency" in Latin America (like, for example, the 1965 U.S. intervention in the Dominican Republic). In retrospect, many of the 20th century instances

of U.S. intervention in Latin America have been ill advised. We recommend maintaining the division assigned to this theatre, but eliminating the carrier. Should a situation arise requiring a show of U.S. naval force off the shores of some Latin American nation, then smaller ships could be employed or a carrier task force primarily assigned to Europe or Asia could be temporarily detailed to meet this requirement. Finally, major reductions should be effected in the size of U.S. military missions, military assistance groups, and attache staffs assigned to Latin American nations. Excessive numbers of personnel, relative to actual training needs, are now so assigned. This change would not permit substantial budget reductions, but it would constitute a significant statement enhancing the integrity of our foreign policy posture.

Strategic Reserves: The strategic reserve forces constitute a safety margin. These are active duty, as opposed to Reserve, forces which are likely to be sent into a war like that in Vietnam only after forces regularly assigned to the relevant theatre are used to meet initial surge requirements. While good questions can be raised about some of the purposes served by these units, particularly units currently deployed in Panama and Alaska, no force cuts are herein recommended except that the four attack carriers and their escorts and air wings should be mothballed for annual savings of \$1.8 billion.

Research and Development: Continuing research and development of improved weapons systems is one of our most critical general purpose force requirements. We already have drawn attention to Air Force requirements for development of a new air superiority fighter and the AX close air support aircraft. In addition, research and development support is required for electronic sensor devices and a variety of other Army battlefield equipment. The Navy needs a new air superiority fighter aircraft and, most critically, development of a radically new class of surface ships -- extremely fast (perhaps using hydrofoil propulsion), mobile, heavily gunned and smaller than conventional attack ships. Developing all these systems will be expensive, but even added together (spread over a five year period) the costs need not exceed current aggregate general purpose R & D outlays.

In fact, about \$300 million of the \$2.8 billion currently budgeted for research should be cut purely on improved efficiency grounds. A fair share of the excessive procurement costs which have become public knowledge during the past two years actually have been on systems still funded in the research appropriation category (usually systems in the expensive development stages). We are not referring to the costs of projects which do not pan out; no research program produces 100 per cent successes. Rather we refer to poor cost control and hasty movement forward into advanced development before significant performance problems are overcome. Most of this wasted research money has been on general purpose projects, particularly tactical aircraft and airlift.

Impact on Reserves and Arms Transfers

The above general purpose force recommendations, taken together, would entail a significant reduction in U.S. active duty forces. Such a program can only be sensible if two compensating measures are taken -- an increase in the readiness of the National Guard and Reserves, and expanded arms grants and credit sales to some lesser developed allied nations assuming a larger share of the free world defense burden. Both of these actions are being advocated by the current Administration as an integral part of their recommended general purpose forces realignment.

Reserves: It makes little sense to spend \$3 billion a year on Reserve and Guard forces unless those forces are well led, well equipped, well organized and trained at a level which would make it possible for them to move into combat during an emergency and perform virtually as well as regular active duty units. Most observers, both inside and outside the Defense Department, agree that few Reserve units today measure up to these criteria.

It is important to our defense posture that we maintain a capable Reserve force which could quickly supplement active duty forces if an all-out mobilization should be required in the future. Maintenance of Reserve forces for this purpose also is an economical proposition compared to the alternative of maintaining additional active duty forces. An important start toward raising Reserve readiness up to required levels should be made by outfitting Reserve units much more regularly with the type and amount of equipment issued to active duty units.

But current Reserve inadequacies also stem from deeper organization and personnel causes. Limited available leadership talent is spread too thinly over current size Reserve forces (980,000 paid Reservists and Guardsmen). Reserve forces are organized into units which are too large to utilize available training facilities effectively.

We envisage a restructured Reserve and Guard component of slightly reduced size (about 850,000 paid strength), with the battalion rather than the division as the basic building block. In wartime, Reserve battalions could sometimes be melded with battalions from active duty units to provide balanced, rapid enlargement. A key additional part of upgrading must be improved training for Reserve units.

A key part of the restructuring should be a fundamental redefinition of the roles assigned the National Guard, whose members now comprise 40 per cent of total Reserve and Guard strength. It now seems clear that, short of a World War II type all-out mobilization, political leaders are not about to call the National Guard to active duty to fight in a war. We should recognize this reality and quit pretending that the Guard's primary mission is federal. The Guard should be structured and trained for the state missions (e.g. rescue and relief efforts during floods and other natural disasters, restoring order when riots occur) it can handle and actually is called upon to perform. Sharpening the definition of National Guard roles would make possible savings in equipment and training expense.

The federal government spends about \$1 billion a year on the Guard. Less than half that sum could buy 50 state forces adequate in size and fully prepared to cope with state emergencies, none of which requires tanks, bombers, artillery, rockets, or other major and expensive weapons of war.*

We recommend that the resultant savings be applied toward the costs of improved training and equipment needed for Reserve units.

Arms Transfers: Net outlays for arms grants and credit sales to allied nations are expected to be \$1,130 million in 1971.** This total reflects a short-term special increased requirement mostly due to tensions in Asia and the Mideast. The original 1971 request was only for \$600 million. An enhanced program of military assistance and training above that initially planned level will be required during the next five years, particularly in Asia. As Secretary Laird said, "Unless we help provide [our allies] further assistance, the basic policy of decreasing direct U.S. military involvement... cannot be successful." We must be careful to interpret this policy correctly. It does not imply fueling an arms race in Latin America or Africa, for example. It does not imply full U.S. financing of the costs of NATO ally support troops in Europe. What it does mean is increased U.S. contributions for the training and equipping of allied forces in places like Turkey and South Korea. Secretary Laird has suggested the need

*Alfred B. Fitt, "The National Guard and Civil Disturbance," City, August/September, 1970, p. 43.

**This \$1,130 million solely represents the "Military Assistance Program" (MAP). The only aid-related activities covered by this report are MAP and "Support of Other Nations" (mostly special aid for Southeast Asia). Outlays for these programs combined were \$2.5 billion in 1971.

for an additional \$300 million annually for these purposes above the \$600 million level originally forecast for 1971. We concur in this judgment and recommend that funding reach the \$900 million level by 1974.

Aggregate General Purpose Force Recommendations

A summary of recommended baseline general purpose forces distributed by contingency is presented in Table 9. Table 10 shows what these forces would cost in 1976. The costs reflect the price, productivity, and retired pay increases described in detail in Appendix A. This mix of general purpose forces should be viewed as a goal toward which we should move as expeditiously as possible. It does not correspond, however, with current U.S. forces. Accordingly, we need to provide for an orderly transfer to this new force mix.

Transition: Most of the recommended shifts in force size and composition can be effected relatively quickly because they are in the direction of eliminating men and mothballing equipment already in the force. Only where new procurement requirements are set forth, such as calling for a new tactical aircraft for the Air Force and the Navy, will substantial lead time be required. In general, we have assumed that actions based purely on eliminating inefficiencies can be achieved during 1972. Recommended force level adjustments (e.g. elimination of divisions and air wings, retirement of ships) except where specifically otherwise noted, are assumed to be phased over an 18-month period

Table 9

Recommended Baseline General Purpose
Forces Distributed by Geographic Contingency^{1/}

<u>Type of Force</u>	<u>Unallocated</u>	<u>Europe</u>	<u>Asia</u>	<u>Western Hemi- sphere</u>	<u>Strategic Reserve</u>	<u>Total</u>
Active Army divisions		6	2	1	2 1/3	11 1/3
Active Marine division/wings		1	2			3
Guard and Reserve forces ^{2/}		7			2	9
Navy air wings		3	3			6
Air Force air wings		12	6			18
ASW and AAW forces (%)		50	50			100
Amphibious and other forces (%)		67	33			100
Airlift and sealift forces (%)		50	50			100
Research and development (%)	100					100

^{1/} As of 1976. This force distribution would actually be completely achieved beginning in 1974.

^{2/} Represent Reserve and Guard divisions; Navy and Air Force Reserve units are assumed to be proportionately distributed.

^{3/} Four attack carrier task forces actually will operate in the Pacific theatre, but only three wings will be required since one carrier will always be in overhaul status.

Table 10
Allocation of Costs of Recommended Baseline General
Purpose Forces by Geographic Contingency
(In millions of dollars; 1976)

<u>Type of Force</u>	<u>Unallocated</u>	<u>Europe</u>	<u>Asia</u>	<u>Western Hemisphere</u>	<u>Strategic Reserve</u>	<u>Total</u>
Active Army divisions		4,800	1,710	855	1,990	9,355
Active Marine division/wings		1,310	2,620			3,930
Guard and Reserve forces		3,305			945	4,250
Navy air wings		1,575	1,850			3,425
Air Force air wings		4,810	2,415			7,225
ASW and AAW forces		1,625	1,625			3,250
Amphibious and other forces		545	275			820
Airlift and sealift forces		985	985			1,970
Research and development ^{1/}	2,820					2,820
Incremental retirement costs	1,770					1,770
Total	4,590	18,955	11,480	855	2,935	38,815

Source: Author's estimates, based on techniques described in the text.

^{1/} Incremental over 1971 levels.

encompassing 1972 and the first half of 1973. That exception is the cut in active divisions oriented toward Asia; cutbacks there are slipped six months to allow for matters to settle after our withdrawal from Vietnam. The overall baseline general purpose force outlay pattern reflecting this transition pace is shown in Table 11.

Three general assumptions bear heavily on this pattern of projected costs. First, the variable portion of support costs (e.g. training, supply, medical, and even parts of communications and intelligence) are assumed to decline in proportion to the reduction of combat units. Some "fixed" support costs will always be incurred so long as the U.S. has any military establishment (above some minimum threshold size). But most support costs do vary with the size of combat forces kept under arms.

Modernization: Second, the costs of general purpose forces can vary tremendously depending on the degree of investment in new weapons systems. Our projections for weapons procurement and modernization assume continuation of recent proportions between operating and investment costs. This means that considerable dollars would be available to modernize forces in the ways we have discussed, but that funds would not be used to pursue refinements of large systems to achieve small increments in effectiveness. This critical distinction is responsible for the difference of several billion dollars in the 1972 general purpose force outlays recommended by the Administration and by this report. Compelling needs for modernization do exist. Notable examples include sea-lift, close air support aircraft, and air combat fighters for both the Navy and the Air Force. No sound rationale exists though for procuring wastefully expensive, oversophisticated systems like the F-14 and F-15 fighter aircraft, the MBT-70 tank, nuclear destroyers and support ships, or the 8-3A carrier-based anti-submarine airplane. In far too many such cases, the extra costs above those for more simply designed and more reliable

Table 11
Recommended Baseline General Purpose and Related Forces Outlays

(In millions of current dollars)

	<u>Administration</u>		<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
	Estimated	Proposed					
	<u>1971</u>	<u>1972</u>					
General purpose forces	19,770	22,905	18,780	16,200	15,595	16,210	16,600
Intelligence and communications	2,130	2,475	2,330	2,220	2,260	2,250	2,315
Airlift and Sealift	1,200	930	1,310	1,400	1,315	1,415	1,445
Guard and Reserve forces	2,600	3,000	2,475	2,655	2,800	2,900	2,960
Research and development	2,600	3,025	2,545	2,615	2,700	2,770	2,820
Central supply and maintenance	5,125	7,240	4,690	3,855	3,685	3,875	3,970
Training, medical and other personnel activities	9,120	11,370	7,440	5,930	5,750	5,940	6,115
Administration	1,085	1,260	1,050	1,050	960	1,070	1,095
Support of other nations	400	400	510	530	560	585	595
Military Assistance Program	1,130	1,025	700	800	900	900	900
Total ^{1/}	<u>45,160</u>	<u>53,630</u>	<u>41,830</u>	<u>37,255</u>	<u>36,525</u>	<u>37,915</u>	<u>38,815</u>

Sources: Author's allocations and costing.

^{1/} Allocations of totals between operating and investment outlays are roughly as follows:

	<u>1971</u>	<u>1972</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Operating outlays	30,945	36,200	27,880	24,405	23,935	24,890	25,490
Investment outlays	14,215	17,430	13,950	12,850	12,590	13,025	13,325

Outlays for "Support of other nations" and the "Military Assistance Program" are assumed to be 100 per cent operating costs since these outlays do not serve to develop, procure, or modernize U.S. armed forces facilities or equipment.

alternative systems promise to yield little or no return in useful capability. In some instances, no new system of any type is needed.

A relatively high proportion of our projected investment costs in the early years reflects Navy ship procurement programs already underway. In later years, the emphasis is more on new tactical aircraft for both the Air Force and the Navy. Relatively few funds are provided for military construction; the general contraction in forces means a smaller need for base installations. Only modest amounts are included for Army equipment procurement; a smaller Army will emerge well-equipped from the modernization which has occurred when weapons and equipment were chewed up in Vietnam.

Pay: The third critical assumption concerns military pay levels. These have risen rapidly in recent years in order that pay for military careerists could first catch up and then remain even with pay received by civilian counterparts. We provide in our 1972-1976 cost estimates for future percentage pay increases for all military personnel equal to the percentage increases in the Consumer Price Index. No provision is made, however, for any special additional pay boost for non-careerists at the bottom grades of the enlisted ranks.

We favor movement toward an all-volunteer armed force, and share Secretary Laird's view that it can be achieved within 2-1/2 years -- without requiring any legislative changes. The Department of Defense sees a zero draft requirement, though, in the overall context of a 2.3-2.5 million man armed force; operating under this assumption, they correctly suggest that significant pay increases

would be necessary to induce sufficient numbers of enlistments.

The general consensus of defense manpower experts seems to be that a 2.0 million man force is about the breakeven point; for force sizes below that level, no extra pay would be required to create an all volunteer force. As we shall see later in the summary section, our program recommendations would require only a 2,015,000 man force, just about the breakeven size. Nearly sufficient numbers of enlistments would be forthcoming to preempt the need for pay supplement inducements. Complex questions concerning social equity and the racial, ethnic, and regional composition of the armed forces are involved in the issue of retaining the draft versus placing full reliance on an all-volunteer force. The determining factor, in our judgment, is that the \$3-4 billion required annually to attract sufficient volunteers if the draft were eliminated could more equitably be invested toward further raising the level of guaranteed income support for the general population -- just to cite one among several desirable social goals directed toward needs of the general population.

Another important reason for retaining the draft is to ensure that adequate numbers of persons will be induced to join the Reserves and National Guard. Most manpower analysts are dubious that 850,000 Reservists and Guardsmen, the level called for by our recommendations, can be kept in the force without the pressure provided by the existence of the draft.

VI) Vietnam

Continued U.S. involvement in a war in Vietnam has tragic consequences for many facets of national will, energies, and resources. The rapid withdrawal of remaining American forces should have the highest national priority. As a pragmatic matter, though, Administration statements suggest that we will begin fiscal year 1972 with about 250,000 American troops in Vietnam plus a commitment of continuing technical and financial aid to the government of South Vietnam. Accordingly, near future U.S. defense budgets will have to include funds for some incremental costs in this theater above those for baseline military forces.

Two questions of key importance for defense budgeting are posed by our Vietnam involvement. First, what have been and will be the incremental costs of the war -- that is, the costs incurred over and above the costs of the peacetime U.S. military establishment? Second, to what extent, if any, has the United States paid for the war by withholding needed programs from the baseline force, borrowing equipment and men from units not in Vietnam; reducing outlays for maintenance, and drawing on reserve stocks -- thereby creating a deferred demand which must be met as disengagement from Vietnam proceeds? The two questions are closely related because at issue in varying war cost estimates are how much the war detracted from or aided baseline force modernization.

According to Charles Schultze, former Director of the Bureau of the Budget, the peak incremental cost of the Vietnam War to the United States in any full year was about \$23 billion. This figure was based upon estimates of personnel added to the Armed Forces since 1965 (the last year prior to substantial U.S. involvement in the conflict), ordnance expended, aircraft lost, etc. The estimated distribution of outlays among categories is as follows:

Table 12

Peak Incremental Outlay for the
War In Vietnam

<u>Type of expenditure:</u>	<u>Billions of current \$</u>
800,000 military personnel at \$12,000 per man per year.....	9.6
250,000 civilian personnel at \$10,000 per man per year.....	2.5
Ground, air, and naval ordnance	5.2
500 aircraft at \$3 million per aircraft (average).....	1.5
Replacement of land force equipment and supplies (U.S. and ARVN).....	1.3
Other procurement.....	1.0
Construction.....	1.0
Transportation and petrol, oil, and lubricants.....	1.0
TOTAL.....	23.0

Source: Charles L. Schultze with Edward K. Hamilton and Allen Schick, Setting National Priorities: The 1971 Budget, The Brookings Institution, 1970, Table 2-13, p. 49.

A reasonable history and future projection of incremental war costs, shaped around that maximum amount, can quite readily be developed from budget records and Administration testimony. Since over half the costs are personnel costs, a logical first index to consider is the number of U.S. military personnel deployed to the Vietnam conflict zone, and -- even more relevant -- the increase in U.S. forces worldwide.

Table 13

U.S. Active Duty Military Personnel
(In thousands, as of June 30)

	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>
Vietnam	17	60	268	449	535	539	415	250	84	0
Worldwide	2,685	2,653	3,092	3,387	3,464	3,460	3,066	2,699		
Worldwide increase from 1965		0	437	734	811	807	413	46		

Sources: United States Budgets for 1971 and 1972 and Department of Defense manpower reports for 1964-1970 data; staff projections for future years, based on the assumption that current Vietnam withdrawal rates continue.

The differences between worldwide manpower increases and increases within Vietnam alone, at least through June 30, 1969, are attributable to the war-related buildup of training and support facilities, mostly in the United States. The Defense Department assumes in its cost estimates that prior to June 30, 1965 the relatively small number of U.S. troops in Vietnam were part of the regular baseline force. This assumption seems quite reasonable, particularly upon consideration of the fact that total worldwide U.S. military manpower actually declined between 1964 and 1965.

Military manpower levels are, of course, far from the sole determinant of costs of the war. Civilian manpower employed by the Defense Department increased by about 250,000 at the peak due to war requirements. Even more important factors are combat activity levels in Vietnam as measured by such indicators as ordnance fired, airplanes and helicopter missions flown, and supplies consumed. These activity levels have varied greatly depending on U.S. policies and enemy

actions. In recent months (with the exceptions of U.S. and South Vietnamese incursions into Cambodia and Laos), combat activity -- and therefore expense -- has lessened at a faster rate than the pace of U.S. troop withdrawals.

Based upon all these considerations, the following seems a reasonable assessment of the pattern of U.S. incremental Vietnam War outlays. Projections of future year costs assume the troop withdrawal rates described in Table 13; all U.S. troops would be out of Vietnam by December 1972.

Table 14

U.S. Incremental Outlays for Vietnam War
(In billions of current dollars)

<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>
0	5.1	16.2	21.4	23.0	18.8	13.0	5.9	1.7
<u>1974</u>	<u>1975</u>	<u>1976</u>						
1.0	1.0	1.1						

Source: Author's estimates.

Presented in terms of major military program categories, the outlays for current and future years are estimated as follows:

Table 15

U.S. Incremental Program Outlays for Vietnam War
(In millions of current dollars)

	<u>Administration</u>		<u>Urban Coalition Recommendations</u>				
	Estimated	Proposed	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
	<u>1971</u>	<u>1972</u>					
General purpose forces	4,600	1,670	1,670				
Intelligence & communications	300	100	100				
Airlift & sealift	200	170	170				
Guard & Reserve forces	100						
Research & Development	200						
Central supply & maintenance	2,300	800	800				
Training, medical & other personnel activities	3,000	1,060	1,060				
Administration	300	100	100				
Support of other nations	2,000	2,000	2,000	1,700	1,000	1,040	1,100
TOTAL ^{1/}	<u>13,000</u>	<u>5,900</u>	<u>5,900</u>	<u>1,700</u>	<u>1,000</u>	<u>1,040</u>	<u>1,100</u>

Sources: Author's allocations and costing based on official Defense Department estimates of cost components during U.S. buildup in Vietnam.

^{1/} Allocations of totals between operating and investment outlays are roughly as follows:

	<u>1971</u>	<u>1972</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Operating outlays	7,800	3,600	3,600	1,700	1,000	1,040	1,100
Investment outlays	5,200	2,300	2,300	0	0	0	0

Some Pentagon spokesmen have suggested that one result of Vietnam spending has been a deferral of necessary modernization of baseline forces -- that there exists a backlog of unmet needs which remains to be met once Vietnam operations are cut back if we are to restore baseline forces to combat readiness. This hypothesis can readily be tested in the aggregate by subtracting Vietnam and strategic forces outlays from total defense outlays in recent years and comparing the result against 1965 general purpose force outlays adjusted for price changes. The year 1965 provides a fair basis for comparison, representing a year in which U.S. conventional forces attained their highest levels of readiness and equipage since the Korean War. If funds available for baseline troop support and modernization in subsequent years did not keep pace with funds available for these purposes in 1965, then a modernization backlog could fairly be judged to exist. (We assume that baseline general purpose force requirements remained constant from 1965-1970; what is at issue here is force modernization, not force levels). Schultze makes the comparison as follows:

Table 16

Required Versus Actual Sums Available
To Maintain U.S. Conventional Forces in Modern
Combat Ready Status
[Based on added Vietnam costs; in billions of dollars]

	Fiscal Years--				
	1966	1967	1968	1969	1970
Budget for conventional forces.....	52.2	59.6	60.3	59.6	58.3
Less added costs of Vietnam...	6.0	18.0	23.0	22.0	17.0
Available for maintenance...	46.2	41.4	37.3	37.6	41.3
Required for maintenance....	38.7	39.1	39.4	38.9	42.1
Deficit or surplus.....	+7.5	+2.3	-2.1	-1.3	- .8

Source: Adapted from Charles L. Schultze with Edward K. Hamilton and Allen Schick, "Setting National Priorities: The 1971 Budget" (Brookings Institution, 1970), Table 2-14, p.50.

His phasing of Vietnam war costs is slightly different from ours, but our total of such costs -- \$84.3 billion for the 1966-1970 period -- is only \$1.5 billion less than his. Accordingly, the aggregate modernization surplus Schultze finds, amounting to several billion dollars, applies as well to our calculation. This relationship continues to apply during the current fiscal year, with a substantial portion of the savings from Vietnam reductions being applied to other defense programs.

Schultze concludes that

It is clear that there has not been a deficit of funds -- Vietnam has not in any overall sense 'robbed' the remainder of the forces. A backlog of unmet needs does not appear to have been built up justifying a large diversion of the savings from a cessation of the war into other military channels.*

Furthermore, the results in the above table do not take into consideration the modernization that normally occurs as old equipment is chewed up and old ammunition is expended in combat. The evidence suggests that through replacement of old equipment (primarily guns and airplanes) consumed in Vietnam with modern equipment, we emerge overall with a more modernly equipped baseline force than we would have had we not been involved in a war. Finally, we will inherit from Vietnam not only a great deal of equipment in the field, but also material that is on order and in the pipeline.

* Charles L. Schultze, Testimony before the Committee on Foreign Relations, U.S. Senate, April 29, 1970.

In most areas, to the extent there is deferred demand for specific items, we can meet it from these inventories.

Two central conclusions should be drawn from the analysis in this section. First, a war which has consumed nearly \$100 billion in federal funds during the past six years, will require based on our projections only 10% of that amount during the next five years -- and only about \$1 billion annually after 1972. This change in circumstance could by itself contribute strongly toward a restoration of fiscal stability as well as free considerable resources for productive purposes. Second, there is no special need for force modernization funds beyond those already indicated in our analysis of baseline forces in the preceding two sections. These conclusions, of course, rest on our assumption that all U.S. military personnel will have left Vietnam by December 1972, and that subsequent U.S. expenditures in Southeast Asia will be for other than direct aid by U.S. forces.

VII) Summary of Recommended Program

Major changes in the size and composition of U.S. military forces are demanded between 1971 and 1976. In several instances -- notably research on a new sea-based strategic deterrent system (ULMS), sealift capacity, and modernization of Reserve forces -- significant spending increases are recommended.

These increases are more than matched by recommended major decreases in spending stemming primarily from five factors:

- improved management and operating efficiencies;
- elimination without replacement of systems rendered obsolete by changing technology, combined with careful scrutiny and pruning of new weapons system modernization;
- elimination of wastefully duplicative strategic deterrent forces and a cessation of attempts to build and operate strategic defensive systems such as Safeguard;
- an enlarged defense manpower and dollar burden assumed by U.S. allies in both Europe and Asia; and
- an end to U.S. military involvement in Vietnam (except for a residual \$1 billion annual military assistance contribution).

Altogether, we recommend that U.S. military spending decrease from \$74.5 billion in 1971 to roughly \$60 billion in 1972 and \$50 billion during the following four years. Excluding Vietnam spending, the five-year decline would be only from \$61 to \$49 billion. (In real terms, that amounts to a 28% reduction in non-Vietnam military spending.)

Of the sums above, spending that is directly related to the national security of the United States would shift only from

\$30.5 billion in 1971 to \$26.3 billion in 1976, primarily as a result of recommended reductions in strategic forces. The residual, which constitutes U.S. military assistance (broadly defined) to the defense of allied nations, would decline from \$44 billion to \$24 billion.

These recommendations do not assume any SALT agreements or reductions in U.S. treaty obligations with other nations (now numbering about 45). They do, however, assume implementation of announced U.S. plans to structure future conventional military forces based on a capability to meet simultaneously only 1 1/2 war contingencies rather than the 2 1/2 war guideline which prevailed during the 1960s.

While encouragement is voiced for international peacekeeping and arms limitation agreements as ways of reducing world tension, no changes are assumed to take place in the manner by which serious conflict is deterred. The Soviet Union and the People's Republic of China are assumed to remain potentially hostile to U.S. interests. The day when an international peace-keeping force under United Nations auspices would replace separate national armies is assumed to be beyond the 1971-1976 period.

A summary description of the U.S. defense forces which would exist during 1976 if our recommendations were implemented is provided in Table 17. A few comments about the capabilities of those forces are in order.

We can never be certain about military force plans and intentions of other nations. But we can make some comparisons based on current foreign nation force levels reasonably projected ahead.

Table 17
Summary Military Force Table ^{1/}

Military Personnel ^{3/} (in thousands)	Actual	Actual	Admini	Urban Coalition	
	1964	1970	stration Proposed 1972	1972	1976 ^{2/}
Military Personnel					
Army	972	1,322	942	800	702
Navy	667	792	704	540	502
Marine Corps	190	260	206	190	190
Air Force	856	791	753	670	621
Total	2,685	3,066	2,505	2,200	2,015
Strategic Forces					
Minuteman (missiles)	600	1,000	1,000	1,000	1,000
Titan II (missiles)	54	54	54	0	0
Polaris (submarines/missiles)	21/336	41/656	34/544 ^{4/}	34/544	0
Poseidon (submarines/missiles)	0	0	7/112 ^{4/}	7/112	31/496
Strategic bombers ^{5/}	1,277	516	510	380	190
Manned fighter interceptor squadrons	40	14	11	7	5
Army air defense firing batteries	107	40	21	12	8
General Purpose Forces					
Land forces:					
Army divisions	16	17	13	12	11
Marine Corps divisions	1/3	1/3	1/3	1/3	1/3
	3	3	3	3	3
Tactical air forces:					
Air Force wings	22	23	21	19	18
Navy attack wings	15	13	11	8	6
Marine Corps wings	3	3	3	3	3
Naval forces:					
Attack carriers	15	15	12	9	7
Antisubmarine carriers	9	4	4	0	0
Nuclear attack submarines	19	46	56	56	60
Escort ships	265	231	227	150	130
Amphibious assault ships	139	99	76	80	80
Airlift and Sealift Forces					
Aircraft squadrons:					
C-5A	0	1	4	4	4
C-141 and other	32	17	13	14	14
Troopships, cargoships, and tankers	100	113	98	90	90

Source: The Fiscal Year 1972 Budget of the United States Government, p. 88 for historical data and Administration proposals; author's estimates for military personnel projections.

^{1/}All figures are as of June 30 of the cited year.

^{2/}With only very minor exceptions, these are the recommended force levels for the entire period from the end of 1973 through 1976.

^{3/}Active duty military personnel, as of the end of the fiscal year.

^{4/}Staff estimate of allocation between Polaris and Poseidon.

^{5/}B-52, B-58, and FB-111 bombers in the active aircraft inventory.

Such comparisons show first and foremost that U.S. military forces which would exist during 1976 if our recommendations were implemented would be fully adequate to deter any concerted strategic or conventional attack on the United States itself. The devastating second-strike destructive capability of the virtually invulnerable Poseidon fleet, supplemented by bombers and Minuteman missiles, would deter any strategic attack. Even if some other nation had the transportation and logistics capability to launch a major conventional assault on the U.S. (which none does), our modest conventional forces would quickly fend them off.

Beyond these core pure "national defense" forces, the United States would also possess the strongest and largest set of military forces in the world earmarked for defense of other nations. The Soviet Union and the People's Republic of China both would have more men under arms, but such a large portion of them would be tied down defending their own borders that our claim would hold. Even with the programmed withdrawals of U. S. forces from Europe and Asia, the United States would continue to have roughly as many troops stationed abroad as any other nation now does (the Soviet Union has about 400,000 soldiers and airmen stationed outside Russia; China has none outside its borders except for a few military attaches and trainers).

Total manpower requirements of two million men could be filled without significant use of the draft or major new pay supplements. In other words, total manpower needs would be down sufficiently

from present levels that enlistments would fill virtually all the vacancies. Such an "all volunteer" force would itself represent an important social benefit as well as contributing greatly to service morale.

Tables 18 and 19 describe the cost by program of our total package of recommendations for national defense and military assistance for 1972-1976. The recommended budget would be fully adequate to provide for the forces listed in Table 17. Included in the total would be about \$18 billion annually for investment purposes, \$12 billion of it for procurement covering replacement and modernization needs.

In closing, a few comments are in order about the strength and limitations of our recommendations. They have been tendered with an apparent degree of precision which belies the uncertainties and number of judgmental issues inherent in matters of defense policy. We make no apologies for our recommendations -- in every instance, they reflect our best judgment and estimate of the costs of recommended forces. We simply acknowledge the existence of a range of opinion and possible error around our recommended funding levels.

This acknowledgment provides no rationale for building in additional forces as insurance padding. There are as likely to be errors of excess as errors of insufficiency. And a policy of always opting for larger forces or more sophisticated weapons may increase

Table 18
National Defense and Military Assistance: 1/
Major Purposes

(Outlays, in millions of current dollars)

	<u>Administration</u> ^{2/}		<u>Urban Coalition Recommendations</u>				
	<u>Estimated</u>	<u>Proposed</u>					
	<u>1971</u>	<u>1972</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Strategic & Related Forces	16,340	16,470	12,510	11,380	11,025	11,070	10,510
Baseline General Purpose & Related Forces	45,160	53,630	41,830	37,255	36,525	37,915	38,815
Vietnam	<u>13,000</u>	<u>5,900</u>	<u>5,900</u>	<u>1,700</u>	<u>1,000</u>	<u>1,040</u>	<u>1,100</u>
TOTAL ^{3/}	74,500	76,000	60,240	50,335	48,550	50,025	50,425
Total, excluding Vietnam ^{3/}	61,500	70,100	54,340	48,635	47,550	48,985	49,325

1/ Includes only Department of Defense and Military Assistance Program functions. Excludes Atomic Energy Commission and other minor defense-related activities.

2/ Only the totals have been made available by the Administration. Allocations are based on staff estimates.

3 Totals in real terms (excluding, that is, price and productivity gains) expressed in 1971 dollars are as follows:

	<u>1971</u>	<u>1972</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Total	74,500	74,510	59,060	48,490	45,975	46,580	46,175
Total excluding Vietnam	61,500	68,725	53,275	46,855	45,030	45,610	45,170

Table 19

National Defense and Military Assistance:^{1/}
Budget Program Categories

(Outlays, in millions of current dollars)

	^{2/} Administration		Urban Coalition Recommendations				
	Estimated	Proposed	1972	1973	1974	1975	1976
	<u>1971</u>	<u>1972</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Strategic Forces	7,900	7,500	5,330	4,660	4,390	4,310	3,100
General Purpose Forces	24,370	24,575	20,450	16,200	15,595	16,210	16,600
Intelligence & Communications	5,400	5,600	5,185	5,020	5,110	5,150	5,265
Airlift and Sealift	1,400	1,100	1,480	1,400	1,315	1,415	1,445
Guard and Reserve Forces	2,700	3,000	2,475	2,655	2,800	2,900	2,960
Research & Development	5,200	5,500	4,585	4,485	4,600	4,705	5,440
Central Supply & Maintenance	8,450	9,200	6,345	4,590	4,365	4,570	4,630
Training, Medical & Other Personnel Activities	13,950	14,500	9,860	7,100	6,825	7,035	7,165
Administration & Associated Activities	1,600	1,600	1,320	1,195	1,090	1,205	1,225
Support of Other Nations	2,400	2,400	2,510	2,230	1,560	1,625	1,695
Military Assistance Program	<u>1,130</u>	<u>1,025</u>	<u>700</u>	<u>800</u>	<u>900</u>	<u>900</u>	<u>900</u>
TOTAL ^{3/}	74,500	76,000	60,240	50,335	48,550	50,025	50,425

^{1/} Includes only Department of Defense and Military Assistance Program functions.
 Excludes Atomic Energy Commission and other minor defense-related activities.

^{2/} Only the totals have been made available by the Administration. Allocations are based on minor staff adjustments to translate Administration-supplied Total Obligational Authority to Outlays.

^{3/} Allocations of totals between operating and investment costs are as follows:

	<u>1971</u>	<u>1972</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Operating outlays	46,940	48,310	38,465	31,985	30,410	31,520	32,065
Investment outlays	27,560	27,690	21,775	18,350	18,140	18,505	18,360

risks and lessen security rather than provide a margin of safety. Too many troops or missiles can be destabilizing. Weapons which are overly sophisticated often work unreliably or limit policy flexibility.

Finally, we must reiterate the uncertainties about military plans and intentions of other nations. Our recommendations for U.S. military forces are dependent upon the international political and military assumptions set forth in the text. No five-year plan should ever constitute a rigid operating guideline; the United States must constantly and diligently reexamine the military threats facing it. To the extent that future projections of the behavior of other nations differ from those we have assumed, U.S. forces should be adjusted appropriately from the levels and composition we have recommended. Based on current knowledge, we consider our recommendations an appropriate set of defense policies for the 1972-1976 period.

APPENDIX A: Prices, Productivity, and Retired Pay

Price Inflation: Whenever anyone suggests alternative defense force policies and their prospective costs, the Department of Defense quite properly points out that price increases must be factored into future cost estimates if they are to be meaningful. The prices of military goods and services are subject to inflation just as are other goods and services. During the past few years, due to special circumstances, price inflation on military goods and services has been particularly rapid.

Analysis performed by the Department of Defense on prices of goods and services they have purchased can be compared to general price indices for the U.S. economy to provide a basis for reasonable predictions of future price behavior. The Defense Department essentially develops two measures--one for pay and one for purchases of other goods and services--which are then combined into one overall index. In recent years, the pay index (which now covers approximately 50% of total defense expenditures) has moved slightly faster than the Consumer Price Index (CPI) for the private economy. The index for defense purchases of other goods and services has been closely parallel to the Wholesale Price Index (WPI). During the early 1960's, defense pay rates lagged relatively behind general pay rates in the economy, so that the overall defense price index fell between the CPI and the WPI. Since 1965, there

has been a catchup in defense pay, with the result that the overall defense price index has approximated the same pattern as the CPI.

since it was assumed earlier in this analysis that military pay would increase in step with the CPI from 1972-1976, it seems reasonable to estimate that overall defense prices during that period would rise roughly midway between the pace of the CPI and the WPI. The following table, based on economic projections made in Counterbudget,* shows the patterns we expect to emerge. Defense prices are assumed to increase at the same average rate as prices for all other federal government activities combined.

Table 20
Defense Price Index

	1971	1972	1973	1974	1975	1976
Consumer Price Index	100.0	104.1	108.2	112.3	116.6	121.0
Wholesale Price Index	100.0	102.3	104.3	106.2	108.1	110.1
Department of Defense Price Index	100.0	103.3	106.5	109.7	113.0	116.4

Productivity Gains: Publicly, the Department of Defense almost always rests its case with such a corrective price adjustment. To stop the adjustment there, though, would constitute shoddy analysis. It is reasonable to expect, even in government, that at least some of the price increases should be offset by gains in productivity. During the 1960's, average annual productivity gains in the private sector approached 3.5 per cent.

* The National Urban Coalition, Counterbudget, op. cit., pp. 333-334.

No good figures are available for the public sector, although productivity gains there are generally considered to have been less. Throughout the 1960's, Defense Department budget officials assumed annual productivity gains of 1 1/4 per cent, and subtracted that from estimated price inflation during review of budget submissions.

If average annual productivity gains of 3.3 per cent could be achieved in defense management during 1972-1976, then defense price increases could be fully balanced out. With all the potential savings from improved efficiency in procurement, manpower, and logistics management documented during the past two years, it would seem possible to expect that this goal be achieved. (See Appendix B for citation of numerous areas in which defense dollars could be saved through improved organization and management.) More realistically, perhaps, our calculations assume productivity increases of only 1.3 per cent * annually, roughly the rate officially used during the 1960's. This means an average gap of 2.0 per cent annually by which net defense prices will rise (actually slightly higher in 1972, slightly lower in the later years.)

Retired Pay: Included in all our aggregate program cost figures so far, distributed over the defense programs in proportion to the manpower they contain, have been military retired pay disbursements (since most military manpower is in general purpose and supporting backup categories, most retired pay is allocated to these categories.) This year, these

* The 1.3 per cent productivity gain assumption is an average for the entire Department of Defense budget. Higher productivity gains will be possible in numerous areas, offset by some other functions in which more limited or even zero productivity gains may be achievable.

payments amount to \$3.2 billion. The current administration has no control over this year's retired pay costs and limited control over them during the next several years. By 1976, these steadily growing payments will be up to about \$5.1 billion a year. In 30 years they will annually exceed \$20 billion if we keep the same size baseline force as existed just prior to Vietnam. These costs are uncontrollable in the short-run because they represent legal obligations to persons who have completed at least 20 years of military service. This is the largest hidden cost to society of maintaining a large professional baseline military force during peacetime. These costs can be held down over the long-term, but only by reducing the size of the baseline force or by changing either personnel practices or retirement eligibility criteria to lower the number of men going on the retirement rolls.

These price, productivity, and retired pay assumptions are reflected in the cost projections at the end of each major section (i.e. Strategic Forces, General Purpose Forces, Vietnam) of the analysis.

APPENDIX B: Potential Savings through Improved Defense Management

Virtually all the foregoing analysis has concentrated on force level requirements. What dollar savings have been listed would be achieved as the result of decisions that fewer Army divisions, Navy ships, or other forces will be required in the near future. Wherever such force units are cut, appropriate reductions have also been made in the variable portion of logistics, training, medical, and other support programs.

Hardly any attention has been paid to efficiency issues -- how defense spending could be reduced through improved organization, management, and resource utilization. The claim is made in Appendix A that productivity increases (synonymous here with improved organization, management and efficiency of performance -- including the introduction of labor saving equipment) averaging 1.3 per cent annually -- about \$650 million per year in savings -- should be achievable.

The purpose of this appendix is to illustrate some potentially fruitful areas for achieving such savings.

Areas for Savings

By far the most comprehensive and current official citation of potential ways to save defense dollars is provided in the July 1, 1970 report by the Blue Ribbon Defense Panel.^{*/} At the outset, it must be made clear that the Panel's charter was not specifically to hunt potential ways to cut defense spending. In the words

^{*/}Blue Ribbon Defense Panel, "Report to the President and the Secretary of Defense," July 1, 1970.

of their report:

The objective of the study was not to devise ways and means to save money, per se; it was rather an attempt to discover the cause of shortcomings and to devise and recommend changes in organization and procedures which appear to have potential for increasing the efficiency of the Department of Defense. Should our recommendations be implemented and should they prove as sound as we conceive them to be, substantial savings should result. *

One important by-product of their analysis was the identification of numerous areas where current defense operating costs were excessive. In all cases, their analysis was accompanied by recommendations as to how the noted management deficiencies could be rectified. The following is a partial list of inefficiencies the Panel delineated (organized and numbered for convenience into categories of our design, with page references to the Panel's report following each citation).

Organization

1. There are too many layers of both military and civilian staffs, and staffs are too large in the Office of the Secretary of Defense, the Military Departments extending down through the field commands, the Joint Chiefs of Staff and the Unified and Component Commands. The results are excessive paper work and coordination, delay, duplication and unnecessary expense. (1)
2. In addition to the deficiencies previously mentioned, many of the individual elements of the Office of the Secretary of Defense have become so overstuffed as to reduce their capability. Even with the new functions suggested for OSD, the staff should not total more than 2,000 people. (31)
3. All evidence indicates that the sizes of Headquarters' staffs in the Military Departments are excessive to what is

* Ibid., p. 19.

required for efficient performance of assigned functions. Functional analysis of these staffs reveals an astonishing lack of organizational focus and a highly excessive degree of "coordination" a substantial portion of which entails the writing of memoranda back and forth between lower echelons of parallel organizational elements and which serves no apparent useful or productive purpose. (37-38)

The Secretariats and Service Military Staffs should be integrated to the extent necessary to eliminate duplication; the functions related to military operations and intelligence should be eliminated; line type functions, e.g., personnel operations, should be transferred to command organizations; and the remaining elements should be reduced by at least thirty percent. (A study of the present staffs indicates that the Secretariats and Service staffs combined should total no more than 2,000 people for each Department). (6)

4. The Organization of the Joint Chiefs of Staff provides no significant mechanism for corporate memory, and possesses inadequate technical and professional analytical capability. The absence of corporate memory can be minimized by changes in the rotation and promotion policies of the Military Services to permit the retention of people in the organizational structure for substantially more than two, three or four years. There is, of course, no prerequisite for corporate memory capability that the persons so retained be military officers; they could just as well be civilians. (36)

5. There is another area of duplication which arises from activities throughout the Washington Headquarters' elements of the Department of Defense, and particularly in connection with those activities physically located in the Pentagon. To a major extent, each Headquarters so collocated has its own support organization to handle furnishings, supplies, mail distribution, correspondence control, etc. In some of these activities - such as mail distribution and correspondence control - this duplication causes hopeless inefficiencies. (41)

6. There exist, and existed prior to the creation of the first Defense Agency, innumerable non-combatant functions common to more than one Service. Among such functions for which Defense Agencies have not been created, but where significant economies might result from consolidation, are: (1) Automatic Data Processing Services; (2) Medical, dental and hospital services; (3) Transportation of materials, movement of household goods; (4) Personnel security investigations; (5) Aircraft and aircraft engine depot services; (6) Recruiting; (7) Test and evaluation; and (8) Mapping, Charting and Geodesy.

An alternative to the Defense Agency for consolidation of common non-combatant functions is the designation of one Military Department as "Executive Agent" to perform such functions for all military services. (42)

7. The scope of the two unique functional capabilities of DASA no longer justifies the continuation of the administrative overhead load inherent in a Defense Agency. (44)

Procurement

8. The policies of the Department on development and acquisition of weapons and other hardware have contributed to serious cost overruns, schedule slippages and performance deficiencies. The difficulties do not appear amenable to a few simple cures, but require many interrelated changes in organization and procedures. (2)

9. The Armed Services Procurement Act is at variance with the realities of Defense procurement and adds considerably to the overhead costs of the Department of Defense. (92)

10. The mandatory requirement for a formal Contract Definition has a serious impact on the entire development process. While there are cases where the Contract Definition process is useful, there are others in which there is no logical need for the exercise. Contract Definition is both time consuming and costly. Twelve-to-eighteen months can be devoted to paper preparation and review with little, if any, actual development work going on, and the cost to the Department for a Contract Definition exercise can exceed one hundred million dollars. Such a procedure should be required only on a case-by-case basis, rather than on a mandatory basis presently prescribed in Department of Defense Directive 3200.9. (72)

11. A new development policy for weapons systems and other hardware should be formulated and promulgated [to] ... provide for [among other goals] ...

- More use of competitive prototypes and less reliance on paper studies;
- A general rule against concurrent development and production efforts, with the production decision deferred until successful demonstration of developmental prototypes. (7-8)

12. A reduction in management control systems would both reduce the reporting load imposed on industry by that portion which is duplicative or serves no useful purpose, reduce the cost to the Department, and improve the effectiveness of management control. (82)

Supply and Logistics

13. The term "logistics" has a variety of meanings. Here it is interpreted as encompassing the management of all classes of U. S. military consumable supplies and secondary items worldwide, depot maintenance and overhaul of military equipment, plus transportation and traffic management. These logistics functions inevitably account for a significant fraction of the Defense dollar. The sum of their costs in Fiscal Year 1969 was over \$20 billion. ...

It is clear that significant military logistics improvement can be achieved through efficient, coordinated exploitation of new technologies in the areas of transportation, communications, automatic data processing (ADP), and integrated Procurement Management. To date, however, the full potential of these new technologies has not been realized, nor will they be realized in long-range logistics programs that are presently proposed by most of the Military Services. (97)

14. The current inventory management, distribution, maintenance and transportation systems are needlessly inefficient and wasteful, and even more important, fall far short of the potential for effectiveness of support of combatant commanders. Integration of supply, maintenance and transportation functions for the support of Unified Commands can substantially improve the effectiveness of logistics support, while at the same time achieving greater efficiency and economy. (52)

15. A distinguishing mark of the decentralized and fragmented supply system in the Defense Department is the proliferation of Automatic Data Processing (ADP) systems and programs which are largely incompatible, both intra-Service and inter-Service. This results not only in weaknesses in inventory management and distribution imbalances, but in high and increasing costs of ADP software for a variety of ADP programs to accomplish the same types of functions. The aggregate costs - and confusion - resulting from the development and periodic upgrading, as advanced computers are required and acquired, of ADP programs for each class of supplies by the DSA, the four Military Services and the theater logistics commands, with minimal compatibility, critically impact on the Department's effectiveness, efficiency and economy. The long-range logistics programs under consideration by most of the Military Services will not remedy this problem. (100)

16. The benefits of standardized and integrated logistics have not been extended overseas to any appreciable extent. Defense Supply Agency responsibilities do not extend overseas. (98)

Manpower

17. Officers and enlisted men are rotated among assignments at much too frequent intervals.

It is clear from the evidence that the rotation practices which have been followed result in (a) excessive and wasteful cost, (b) inefficiencies in management, and (c) difficulty in fixing responsibility.

This system of rotation of officers leads inevitably to deficiencies in management. Officers assigned for such limited periods simply cannot acquire a knowledge of the work, become familiar with the qualifications of the people, make plans, set goals and push the work ahead.

This system of rotation not only fails to provide management and leadership needed on the job, but also has deficiencies in accomplishing its stated purpose - the development of the officer himself. Men are not developed by being observers; they must have responsibility to assure growth.

From the point of view of the position to be filled, as well as in the best interests of the officer himself, his job assignments should be of sufficient duration so that he can become thoroughly involved in the work and be fully responsible for results. (137-138)

Intelligence, Telecommunications and Information Processing

18. While the DIA was established primarily to consolidate the intelligence activities at the Washington level, each Military Department currently has a larger intelligence staff than it had before the creation of DIA. Each departmental staff is still engaged in activities clearly assigned to DIA. (45-46)

19. While MC&G [Mapping, Charting, and Geodesy] activities make use of intelligence information, they are not intelligence activities. Savings can be accomplished in personnel and equipment by consolidating the three Service MC&G agencies in a single agency reporting to the Secretary of Defense. (46)

20. The telecommunications systems of the Department of Defense, using every presently conceivable type of signal, carry nearly every type of information. Current annual expenditures are in the two-to-four billion dollar range. More than 100,000 people on the Department's payroll spend full time in telecommunications activities in locations around

the world. These locations are of necessity often remote and costly to support.

The telecommunications requirements of the Department are largely being met, although at a greater cost than necessary. Many fine systems and operations exist. These reflect the efforts of able technicians, engineers, researchers, managers, and executives in the telecommunications field in the Department and of contractors. However, duplication and inadequate inter-operability, Military Department parochialism, and divided and weak central management from the Office of the Secretary of Defense have reduced the efficiency and effectiveness of the procurement and utilization of telecommunications resources. (145)

21. The lack of an in-house capability for hardware systems design deprives the Department of the potential for improved efficiency and lower costs to be obtained from selection among separately priced elements of a computer system available from commercial suppliers, including independent peripheral manufacturers. (153)

22. The Department of Defense directive and guidance system results in an avalanche of paper instructions which are duplicative, overlapping and sometimes contradictory. There is no evidence of a concentrated attempt to reduce the number and scope of the directives and guidance, or to make these documents consistent and harmonious. The need for assessment and review is conspicuous. (94)

Facilities

23. With the announced projections for reductions in the size of the military establishment, fewer facilities will be required, even when allowances are made for future expansions to meet emergencies. Consolidation of military activities at fewer installations would produce substantial savings, and would often contribute to more efficient operations. (177)

24. As of 30 June 1969, contractors held government-owned equipment with an original investment cost of about \$4 billion.

The Department has not been able to maintain control of its inventory of plant equipment. ... Even for these items where records are maintained, the Department unnecessarily procures some new equipment through failure to consult the inventory records or through incomplete or incorrect records. ...

Adequate information is not available to determine the full costs to the Department of maintaining ownership of

industrial plant equipment; to procure, provide to a contractor for a specific contract, reclaim and store at the end of the contract, and maintain inventory records to permit its reuse when needed. However, it is apparent that the Department is not doing an effective or economical job under the present concept. (96)

This list of Defense Blue Ribbon Panel suggested areas for improvement in defense management does not begin to exhaust potential targets. While the Panel generally performed excellent analyses, their recommendations in some areas like procurement management were timid in the face of existing problems; and, by their own frank admission, some other areas were covered barely or not at all.

This core list can be supplemented by recommendations from many other sources -- among them Defense Department study groups, Congressional review bodies, and private sector defense analysts. The following small sampling (listed in no particular categorical order) is taken from several fairly recent studies and analyses.

25. "Service statements of their balanced force structure profiles show a need for substantial numbers of mid-length careers, defined as service for more than 4 years but less than 20 years. These mid-length careers must be made attractive to potential career personnel...Each service should develop a program of force management -- both for enlisted and officer personnel -- under which potential excessive retention up to the 20-year point will be curtailed and desirable retention of individuals beyond the 20-year point will be sought. ... Selective preretirement release of personnel from the career force in substantial numbers will be facilitated by the vested retirement contribution and separation pay recommendations [contained in this] study. ... Significant savings in prospective retirement costs ... [can result] from a conscious application of separation pay provisions to tailor the force to optimum requirements and from a restructuring of retirement provisions, to include both numbers of people retiring and retirement annuities." *

* First Quadrennial Review of Military Compensation, "Modernizing Military Pay," Vol. I, November 1, 1967, pp. 115, 123, 149, 150.

26. "Exchanges and commissaries [should] ... be operated at no net cost to the government except where government support is merited by special conditions ... such as: (1) balance of payments considerations ...; (2) additional expenses incurred in conjunction with combat, field exercise, and other operational activities; and (3) recognized isolated and hardship posts." *

27. "Traditionally, the Army, Navy, Air Force, and Marine Corps have functioned independently in their food service operation, with limited awareness of the operations of their counterparts. ... A typical military base by tradition maintains a myriad of small kitchens and dining halls (mess-halls) for enlisted men; thus duplicating functions including manpower, building space, and equipment. ...

"Overall, if DOD directed standardization of specifications of foods, methods, equipment, facilities and systems for preparation and service of foods for the military, Government agencies, and commercial operations, it could save millions of dollars per year. As an observation, there appears to be no overall plan, with a tendency for research and development to develop specialized glamorous projects rather than the solving of highest priority pragmatic problems with available standard offerings of the industry's private sector."**

28. More careful management is needed in Department of Defense automatic data processing activities, described recently by the House Appropriations Committee as "an area of importance to the defense effort but yet in an area that has expanded at an astronomical rate in recent years resulting in inefficiency and duplication of effort." ***

29. "Consideration should be given to the elimination of duplicate training programs. A case in point is schools operated for the training of young legal officers. Each Service operates its own Judge Advocate General School. The similarity of basic legal training would indicate that one school managed by one of the Services would be sufficient for the training of all legal officers. ... Another area where operating costs may well be reduced is in the training of women officers and enlistees for the Services. A consolidation of basic military training for these women would seem to be feasible. ... Intelligence schools now being operated separately by each Service could also be consolidated into

* ibid., p. 109.

** White House Conference on Food, Nutrition and Health, Final Report, December 24, 1969, pp. 227-229.

*** House of Representatives Report No. 91-698, "Department of Defense Appropriation Bill, 1970," p. 20.

one school for training in basic intelligence operations." *

30. "Whether it is termed cost overrun, or cost growth, or cost increase, fiscal year 1969 can well be characterized as the 'year of the Cost Overrun.' ... the Secretary of Defense testified that cost increases for certain specified weapon systems have totaled \$16,200,000,000 over a period of several years. ... Changes made in weapon system programs are a major contributor to cost increases. Engineering changes, system performance changes, and schedule changes during both the development and production phases have accounted for 39.4 percent of the cost increases cited ... this practice points up to the need for better definition of requirements. ... There have been too many instances uncovered this year of cost overruns resulting from such laxities as improperly defined specifications, delays in delivering Government-furnished equipment, and too much concurrency between research and development and production. ... the Committee is convinced also that contracting procedures must be improved and contract terms enforced. ... No longer should the contractor be rewarded for poor workmanship or failure to meet contract specifications." **

31. "The specifications for new weapons too often call for the scientifically possible rather than the militarily practical. Excessive 'goldplating' has too often been the practice under which the last five percent of the performance specified for a new weapon accounts for fifty percent of the complexity and cost of the weapon. Capabilities have been called for that, while desirable on a low percentage of missions or under unusual weather conditions, impose a heavy and continuous maintenance and logistic burden on all missions performed." ***

32. "The Committee is concerned over the programmed parallel development of navigation and communication satellites. Both the Navy and the Air Force are developing navigation satellites. ... the Army is also interested in using navigation satellites. Not only should one communications satellite be used for both strategic and tactical purposes, thus eliminating duplicating and costly air, ground, and shipboard terminals, but it is technologically feasible to have a single satellite for both communications and navigation purposes." ****

33. "All enlisted men entering the service receive basic training, which in the Army takes eight weeks and costs about \$1,000 per head. ... Some basic training is needed for everyone, and combat infantrymen certainly need the full eight weeks. But not all of the Army's ... new soldiers ... will serve in combat, and four weeks would suffice for the others.

* Ibid., p. 30.

** Ibid., pp. 47-48.

*** Ibid., p. 69.

**** Ibid., pp. 71-72.

The Navy and Air Force have already abbreviated their basic training." *

Achievability Issues

This is a long and impressive list of areas for potential savings. Whether by implementing some of these suggestions improvements can be achieved amounting to roughly \$650 million of new productivity gains annually depends on answers to three questions:

- Can such organizational and management improvements be achieved by mortal managers (or is the Department of Defense simply too complex to be manageable)?
- How many dollars could be saved by correcting the deficiencies noted above?
- How quickly could these improvements be instituted?

Management Skills: Any answer to the first question is highly judgmental and hardly susceptible to proof. Certainly everyone would agree that the management of the Department of Defense -- the world's largest organization both in terms of budget and manpower -- is a tremendously difficult task. Mr. Gilbert Fitzhugh, Chairman of the Blue Ribbon Defense Panel, found it a wonder that the Department ran at all. It is significant though that his wonderment had nothing at all to do with inherent unmanageability, but rather stemmed from observation of archaic management practices

* Robert S. Benson, "How the Pentagon Can Save \$9,000,000,000," The Washington Monthly, Volume I, Number 2, March 1969, p. 35.

and unreasonable divisions of responsibility which placed crushing burdens on a few men at the top of the organization.

The Panel did not throw up its hands over these problems. Rather it made a broad series of organizational and procedural recommendations which it felt would greatly streamline direction of the Department's activities and thereby produce operating savings. The Panel was quite confident of the feasibility of its recommendations, particularly those regarding realignment of responsibilities assigned to the top managers of the Department. This implicit acknowledgment of the fundamental manageability of the Department is generally in accord with the views of other individuals who have closely examined this problem. It also fits with some recent experience of the Department. Even given some questionable definitional rulings on what could be included, the Department's Cost Reduction program during the 1960s did produce substantial operating savings of the general type described above.

Certainly the Panel's views offer as informed and objective an assessment as can currently be obtained. This positive judgment clearly assumes Presidential selection from among the best in American management talent in choosing top defense managers.

Size of Potential Dollar Savings: Assigning an accurate dollar savings estimate to each of the suggested efficiency measures is a virtually impossible task.

Even allowing for some overlapping and duplicative suggestions, though, it is safe to say that successful complete implementation of all the suggestions would result in many billions of dollars saved annually. "Annually" is an important word here because almost every efficiency gain described would be ongoing rather than one-time. Thus, the task would be to achieve \$650 million in new productivity savings each year, rather than requiring an increasing amount of new gains in succeeding years.

Even though it is difficult to determine cost savings from making many of the improvements, some perspective on the achievability of the total task can be provided by a few examples. Many critics of defense procurement policies maintain that improved management in this area alone could literally save billions of dollars annually (conservative estimates range from \$1-3 billion). Improvements in manpower rotation policy can save \$200-400 million annually just in reduced moving expenses, to say nothing of manpower reductions made possible by lowered number of transients and improved job performance. The recommendations offered on exchanges and commissaries, if adopted, would produce savings in excess of \$100 million a year. The Presidential Panel on Large Scale Meal Delivery Systems estimated that elimination of duplicating food service management functions would save approximately \$200-400 million.* Annual savings

* White House Conference on Food, Nutrition and Health, op.cit. p. 225.

in Army basic training costs would be at least \$50 million if the recommended policy changes were implemented.

All of the above savings estimates for specific items are based on current force and activity levels. To the extent that force reductions recommended elsewhere in this report are effected, the gains from efficiency improvements would be proportionately reduced.

Timing: Finally, there is the question of timing. Because the Defense Department is so large and cumbersome, implementation of operating improvements often requires a considerable period of time. The Blue Ribbon Defense Panel qualified their recommendations this way:

We emphasize that such savings as result from increased efficiency will be realized principally in the long term, rather than the short term. Current expenditures yield little to improvements in efficiency, particularly in the Department of Defense where most funds, whether for people or material, require advance obligation. The recommendations of the Panel are not and could not be designed to support immediate budget reductions. The potential savings are in the long term. *

But this reality in no way constrains the ability of the Department to achieve the \$650 million required annual minimum savings. The five-year period we are concerned with is the long-term -- well within the time horizon during which all of these improvements should be achievable. Furthermore, the Department will have had a full year to begin making the changes necessary to implement the Panel's recommendations before the FY 1972-1976 period begins. And some savings will be immediately achievable. The Panel's statement said that savings would be

* Blue Ribbon Defense Panel, op. cit., p. 19.

"principally," not totally, in the long run. Some of the suggestions from other sources also could be realized quickly. Altogether, sufficient savings could be developed to meet the first year target; the task would be even more easily achieved in succeeding years.

In conclusion, all the tests for achieving \$650 million in new annual productivity gains during each of the next five years can be met by the Department of Defense. We reasonably can expect managers of that Department to effect management and organizational improvements of at least this magnitude.

An examination is also made of incremental requirements posed by our current involvement in Vietnam. Continued U.S. involvement in the Vietnam war has tragic consequences for many facets of national will, energies, and resources. The rapid withdrawal of remaining American forces should enjoy the highest national priority. Even so, we will begin fiscal year 1972 with about 250,000 U.S. troops in Vietnam. Our cost projections conservatively assume that those troops will not be completely withdrawn until December 1972. The resulting projected pattern of incremental Vietnam costs is presented in table 4.

The overall impact of our recommendations would be a reduction in the U.S. defense program from \$74.5 billion in the current fiscal year to \$60.2 billion in 1972, and about \$50 billion in each of the following 4 years. The compositions of these costs is displayed in tables 5 and 6. We believe reductions of this magnitude can be achieved without endangering the security of the United States.

While there is insufficient time now to talk about all the specific changes we believe should be included as part of a reduction of current forces, most of those recommended changes fit under one of the six following themes. These are in addition to the savings from U.S. disengagement in Vietnam.

First, the United States should concentrate near-future strategic offensive forces outlays on sea-based deterrents. There is no need to modernize the other two components by MIRV'ing Minuteman or buying the B-1 bomber. In fact, the size of the existing bomber fleet could safely be cut by two-thirds.

Second, we should cease squandering resources on strategic defensive systems. Protection of the United States from nuclear attack rests on deterrence provided by the presence of our offensive forces, not from defensive systems. We must maintain adequate surveillance and command and control systems. But we do not need the expensive and technologically dubious "protection" of a Safeguard, further cutbacks should be made in the SAFE-Air Defense Command system, and money should not be invested in the AWACS system proposed to serve against an aging, shrinking Soviet bomber threat.

Third, the United States really should shift from preparation for 2½ to 1½ wars as our basic general purpose forces planning assumption. In addition to providing this new rhetoric, we should actually eliminate from the active rolls a corresponding set of force units.

Fourth, we should eliminate from the force or at least sharply cut back on these kinds of forces which have become technologically obsolete. The most glaring example is the attack aircraft carrier, which you already mentioned in your questioning of General Gavin; the United States now is scheduled to operate 12 of these ships next year, even though they are extremely vulnerable to cruise missile attack.

Fifth, the management and operating efficiency of our military forces can be improved each year, appendix B of "The Cost of Security" lists 33 specific ways of improving defense productivity. Most of these are quoted from the report of the Blue Ribbon Defense Panel and a recent report of the House Appropriations Committee.

Sixth, we need a new set of equipment purchase guidelines emphasizing procurement of simple, reliable systems, which provide plenty of firepower per dollar invested. By contrast, current policies as reflected in decisions to buy the F-14 and F-15 tactical aircraft, the Cheyenne helicopter, nuclear power for surface ships, and other systems give witness to a continuing fascination with complex avionics and other fancy technological gear at the expense of reliable, combat-serviceable equipment. Current Department of Defense procurement policies are driving taxpayers bankrupt and also are not giving us optimum military firepower for our defense investment dollar.

These then are six general kinds of changes which together explain why and how sizable reductions could be made in military spending during the next several years, beginning in fiscal year 1972 with a \$14 billion cut.

In closing, we must reiterate the uncertainties about military plans and intentions of other nations. Our recommendations for U.S. military forces are dependent upon the international political and military assumptions set forth in "The Cost of Security." No 5-year plan should ever constitute a rigid operating guideline; the United States must constantly and diligently reexamine the military threats facing it. To the extent that future projections of the behavior of other nations differ from those we have assumed, U.S. forces should be adjusted appropriately from the levels and composition we have recommended. Based on current knowledge, we consider our recommendations an appropriate set of defense policies for the 1972-76 period.

Furthermore, we must keep firmly in mind that military forces can only constitute one part of a successful, comprehensive set of policies designed to foster national security. Because the committee expressed a desire to concentrate today on military force requirements, my statement has focused on that issue. But, effective consideration of the contribution of military forces to national security can only be made in the context of an examination of total societal needs and priorities. Such an examination made in Counterbudget led to the conclusion that the total strength and security of American society would be increased by reallocating \$24 billion in military funds to domestic public needs where the American taxpayer will receive more for his money.

Thank you.

(The tables referred to in Mr. Benson's statement follow:)

TABLE 1.—SUMMARY MILITARY FORCE TABLE¹

	Actual, 1964	Actual, 1970	Adminis- tration proposed, 1972	Urban coalition recommendations	
				1972	1976 ²
Military personnel³ (in thousands):					
Army.....	972	1,322	942	800	702
Navy.....	667	792	704	540	502
Marine Corps.....	190	260	206	190	190
Air Force.....	856	791	753	670	621
Total.....	2,685	3,066	2,505	2,200	2,015
Strategic Forces:					
Minuteman (missiles).....	600	1,000	1,000	1,000	1,000
Titan II (missiles).....	54	54	54	0	0
Polaris (submarines/missiles).....	21/336	41/656	4 34/544	34/544	0
Poseidon (submarines/missiles).....	0	0	7/112	7/112	31/496
Strategic bombers ⁴	1,277	516	510	380	190
Manned fighter interceptor squadrons.....	40	14	11	7	5
Army air defense firing batteries.....	107	40	21	12	8
General Purposes Forces:					
Land forces:					
Army divisions.....	16 $\frac{1}{2}$	17 $\frac{1}{2}$	13 $\frac{1}{2}$	12 $\frac{1}{2}$	11 $\frac{1}{2}$
Marine Corps divisions.....	3	3	3	3	3
Tactical air forces:					
Air Force wings.....	22	23	21	19	18
Navy attack wings.....	15	13	11	8	6
Marine Corps wings.....	3	3	3	3	3
Naval forces:					
Attack carriers.....	15	15	12	9	7
Antisubmarine carriers.....	9	4	4	0	0
Nuclear attack submarines.....	19	46	56	56	60
Escort ships.....	265	231	227	150	130
Amphibious assault ships.....	139	99	76	80	80
Airlift and Sealift Forces:					
Aircraft squadrons:					
C-5A.....	0	1	4	4	4
C-141 and other.....	32	17	13	14	14
Troopships, cargoships, and tankers.....	100	113	98	90	90

¹ All figures are as of June 30 of the cited year.

² With only very minor exceptions, these are the recommended force levels for the entire period from the end of 1973 through 1976.

³ Active duty military personnel, as of the end of the fiscal year.

⁴ Staff estimate of allocation between Polaris and Poseidon.

⁵ B-52, B-58, and FB-111 bombers in the active aircraft inventory.

Source: The Fiscal Year 1972 Budget of the United States Government, p. 88 for historical data and administration proposals; author's estimates for military personnel projections.

TABLE 2.—RECOMMENDED STRATEGIC AND RELATED FORCES OUTLAYS

[In millions of current dollars]

	Administration		Urban coalition recommendations				
	Esti- mated, 1971	Pro- posed, 1972	1972	1973	1974	1975	1976
Strategic forces:							
Minuteman/Titan.....	925	914	235	240	245	135	135
Polaris/Poseidon.....	1,840	1,757	2,235	2,275	2,315	2,350	865
B-52/FB-111.....	1,700	1,350	1,180	790	570	515	525
SRAM/SCAD ¹	155	307	100	105	70	0	220
Bomber defense.....	1,500	1,408	1,225	830	740	805	820
Missile surveillance.....	290	382	305	350	360	395	405
Safeguard.....	1,490	1,382	0	0	0	0	0
Subtotal, strategic forces ²	7,900	7,500	5,330	4,660	4,390	4,310	3,100
Intelligence and communications.....	2,970	3,025	2,755	2,800	2,850	2,900	2,950
Research and development.....	2,400	2,475	2,040	1,870	1,900	1,935	2,620
Central supply and maintenance.....	1,025	1,160	855	735	680	675	660
Training, medical and other personnel activities.....	1,830	2,070	1,360	1,170	1,075	1,095	1,050
Administration on associated activities.....	215	240	170	145	130	135	130
Total³.....	16,340	16,470	12,510	11,380	11,025	11,070	10,510

¹ SCAD assumed to remain in R. & D. status until a 1976 decision to deploy.

² Totals do not add because of inclusion at subtotal level of allocated retirement costs above 1971 levels. The maximum amount of such retirement costs is \$130,000,000 in 1976.

³ Allocations of totals between operating and investment outlays are about as follows:

	1971	1972	1972	1973	1974	1975	1976
Operating outlays.....	8,195	8,510	6,985	5,880	5,475	5,590	5,475
Investment outlays.....	8,145	7,960	5,525	5,500	5,550	5,480	5,035

Sources: Authors allocations and costing based on information contained in all documents previously cited in this section.

TABLE 3.—RECOMMENDED BASELINE GENERAL PURPOSE AND RELATED FORCES OUTLAYS
(In millions of current dollars)

	Administration		1972	1973	1974	1975	1976
	Estimated, 1971	Proposed, 1972					
General purpose forces.....	19,770	22,905	18,780	16,200	15,595	16,210	16,600
Intelligence and communications.....	2,130	2,475	2,330	2,220	2,260	2,250	2,315
Airlift and sealift.....	1,200	930	1,310	1,400	1,315	1,415	1,445
Guard and Reserve forces.....	2,600	3,000	2,475	2,655	2,800	2,900	2,960
Research and development.....	2,600	3,025	2,545	2,615	2,700	2,770	2,820
Central supply and maintenance.....	5,125	7,240	4,690	3,855	3,685	3,875	3,970
Training, medical and other personnel activities.....	9,120	11,370	7,440	5,930	5,750	5,940	6,115
Administration.....	1,085	1,260	1,050	1,050	960	1,070	1,095
Support of other nations.....	400	400	510	530	560	585	595
Military Assistance Program.....	1,130	1,025	700	830	900	900	900
Total.....	45,160	53,630	41,830	37,255	36,525	37,915	38,815
Allocations of totals between operating and investment outlays (roughly):							
Operating outlays.....	30,945	36,200	27,880	24,405	23,935	24,890	25,490
Investment outlays.....	14,215	17,430	13,950	12,850	12,590	13,025	13,325

Note.—Outlays for "Support of other nations" and the "Military Assistance Program" are assumed to be 100 percent operating costs since these outlays do not serve to develop, procure, or modernize U.S. armed forces facilities or equipment.

Sources: Author's allocations and costing.

TABLE 4.—U.S. INCREMENTAL PROGRAM OUTLAYS FOR VIETNAM WAR
(In millions of current dollars)

	Administration		Urban Coalition recommendations				
	Estimated, 1971	Proposed, 1972	1972	1973	1974	1975	1976
General purpose forces.....	4,600	1,670	1,670				
Intelligence and communications.....	300	100	100				
Airlift and sealift.....	200	170	170				
Guard and Reserve Forces.....	100						
Research and development.....	200						
Central supply and maintenance.....	2,300	800	800				
Training, medical and other personnel activities.....	3,000	1,060	1,060				
Administration.....	300	100	100				
Support of other nations.....	2,000	2,000	2,000	1,700	1,000	1,040	1,100
Total.....	13,000	5,900	5,900	1,700	1,000	1,040	1,100

¹ Allocations of totals between operating and investment outlays are roughly as follows:

	1971	1972	1972	1973	1974	1975	1976
Operating outlays.....	7,800	3,600	3,600	1,700	1,000	1,040	1,100
Investment outlays.....	5,200	2,300	2,300	0	0	0	0

Sources: Author's allocations and costing based on official Defense Department estimates of cost components during U.S. buildup in Vietnam.

TABLE 5.—NATIONAL DEFENSE AND MILITARY ASSISTANCE: 1 MAJOR PURPOSES

[Outlays, in millions of current dollars]

	Administration 2		Urban Coalition recommendations				
	Estimated, 1971	Proposed, 1972	1972	1973	1974	1975	1976
Strategic and related forces.....	16,340	16,470	12,510	11,380	11,025	11,070	10,510
Baseline general purpose and related forces.....	45,160	53,630	41,830	37,255	36,525	37,915	38,815
Vietnam.....	13,000	5,900	5,900	1,700	1,000	1,040	1,100
Total 3.....	74,500	76,000	60,240	50,335	48,550	50,025	50,425
Total, excluding Vietnam 3.....	61,500	70,100	54,340	48,635	47,550	48,985	49,325

1 Includes only Department of Defense and military assistance program functions. Excludes Atomic Energy Commission and other minor defense-related activities.

2 Only the totals have been made available by the administration. Allocations are based on staff estimates.

3 Totals in real terms (excluding, that is, price and productivity gains) expressed in 1971 dollars are as follows:

	1971	1972	1972	1973	1974	1975	1976
Total.....	74,500	74,510	59,060	48,490	45,975	46,580	46,175
Total, excluding Vietnam.....	61,500	68,725	53,275	46,855	45,030	45,610	45,170

TABLE 6.—NATIONAL DEFENSE AND MILITARY ASSISTANCE: 1 BUDGET PROGRAM CATEGORIES

[Outlays, in millions of current dollars]

	Administration 2		Urban Coalition recommendations				
	Estimated, 1971	Proposed, 1972	1972	1973	1974	1975	1976
Strategic forces.....	7,900	7,500	5,336	4,660	4,390	4,310	3,100
General purpose forces.....	24,370	24,575	20,450	16,260	15,595	16,210	16,600
Intelligence and communications.....	5,400	5,600	5,185	5,020	5,110	5,150	5,265
Airlift and sealift.....	1,400	1,100	1,480	1,400	1,315	1,415	1,445
Guard and Reserve forces.....	2,700	3,000	2,475	2,655	2,800	2,900	2,960
Research and development.....	5,200	5,500	4,585	4,485	4,600	4,705	5,440
Central supply and maintenance.....	8,450	9,200	6,345	4,590	4,365	4,570	4,630
Training, medical and other personnel activities.....	13,950	14,500	9,860	7,100	6,825	7,035	7,165
Administration and associated activities.....	1,600	1,600	1,320	1,195	1,090	1,205	1,225
Support of other nations.....	2,400	2,400	2,510	2,230	1,560	1,625	1,695
Military assistance program.....	1,130	1,025	700	800	900	900	900
Total 3.....	74,500	76,000	60,240	50,335	48,550	50,025	50,425

1 Includes only Department of Defense and military assistance program functions. Excludes Atomic Energy Commission and other minor defense-related activities.

2 Only the totals have been made available by the administration. Allocations are based on minor staff adjustments to translate administration-supplied total obligational authority to outlays.

3 Allocations of totals between operating and investment costs are as follows:

	1971	1972	1972	1973	1974	1975	1976
Operating outlays.....	46,940	48,310	38,465	31,985	30,410	31,520	32,065
Investment outlays.....	27,560	27,690	21,775	18,350	18,140	18,505	18,360

Chairman PROXMIRE. Thank you, Mr. Benson. As I say, this is an unusual statement, and it is a very, very fine one. I think Counterbudget—you say it is unprecedented. It is time, too, somebody did this kind of thing, and I think you say very well you cannot really change our priorities unless you change them in the framework of the budget. That is what it is all about; it is a priority document, and the Counterbudget overall represents, I think, the most significant contribution to more efficient government than I have seen in the years I have been in the Congress.

So, I want to commend you, and the part you played here is most helpful.

Mr. BENSON. I appreciate your kind comments, Senator. One of the most desirable things we felt happen as a result of the publication of Counterbudget was that several organizations might adopt a similar approach in future years, stating how they would slice up the pie and how they would divide resources between the public and private sectors. I think that would be the most useful contribution I could think of to healthy dialog and debate on priorities, such as you have attempted to foster with these hearings you have conducted the past 2 years and continued this year.

Chairman PROXMIRE. I would hope we could get that. I would hope some of the foundations would recognize that would be a tremendously important and vital contribution they could make to our Nation. We have such a difficult time determining our priorities and we were reminded yesterday by Mr. Schultze, who as we know, was a former Budget Director, one of the most brilliant I think we had, and representing the Brookings Institute with others, they pointed out we could expect no fiscal dividend. That means, on the basis of projections over the next 4 or 5 years, there just isn't any money until 1975 and then very little; I think something less than 1 percent of the gross national product available for all of the new programs.

This means no big new health programs, no big new welfare programs. It means no programs in many of these areas that people have called for which, in terms of human needs, the case is so strong. Then there is nothing really substantially for rebuilding the cities.

You come along with a dramatic proposal for providing part of this, a substantial part of it, by cutbacks in the military area. I think there is an interesting contrast, however, between your recommendation and that of Mr. Fried, who was the expert from Brookings yesterday. Mr. Fried said there were roughly three alternatives and he did not say the case could not be made for a lower or higher budget, but he suggested the middle alternative was an \$88 billion of defense spending in the next 5 years, say 5 years from now the budget would be \$88 billion; a lower which would be \$76 billion and a higher which would be \$96 billion. You come and tell us it should be \$50 billion. By 1976, you can cut it back to \$50 billion.

That is good to hear from the standpoint of all of us. We would like to see more of our resources devoted to the private sector without inflation and without an overwhelming burdensome tax imposition. But, it is very, very hard to sell that, it seems to me, to the Congress. It is most helpful, I think, to have your budget to sell them something in between that.

Senator Mathias and I are offering, as I pointed out, a \$68 billion limitation on military spending for fiscal 1972. That is about halfway between the present \$75 billion and your \$60 billion. It is going to be very, very difficult to get to the \$60 billion.

In this connection, let me just ask you one question with respect to that particular point: One of the great fears that you run into and one of the great objections has nothing to do with military strategy or economics. People say, "Well, the SST, stopping the SST caused havoc in Seattle, eliminated 13,000 jobs in the country, 5,000 or 6,000 in Seattle."

But, the kind of program you are suggesting would mean that there would be hundreds and hundreds of thousands of jobs, in fact, including the demobilization of personnel from the Army and cutting off of contracts. How do you meet that? What is the best way, do you think, we could meet that kind of objection?

Mr. BENSON. We were very concerned about this most legitimate question because we were advocating a substantial shift in our priorities, particularly within the public sector. As a result, we took the step of asking two highly esteemed professionals in the economics field—Mr. Otto Eckstein of Harvard University, a former member of the Council of Economic Advisers; and Mr. James Scoville, professor in industrial relations and labor economics at the University of Illinois—to look at this problem.

They took the counterbudget proposals as a whole and put them through some econometric models in an attempt to establish what kind of problems would be created; whether a shift of the magnitude we proposed was feasible, where we should be on the lookout for problems, where we might have to modify our programs to accommodate the goals that we sought to reach. They gave us a basically clean bill of health. We printed their studies as chapters of the counterbudget.

I think one important reason why they gave us a clean bill of health was that we recommended as one part of the program a series of economic conversion measures with an emphasis on programs to aid employees who would be displaced. Altogether, we recommended spending in fiscal year 1972 approximately nine times the level that was actually contained in the President's budget recommendations for economic conversion. We have tremendous conversion problems on our hands already.

Chairman PROXMIRE. How much would that be?

Mr. BENSON. Just slightly under \$2 billion in fiscal year 1972.

Chairman PROXMIRE. So you would cut the defense budget by about \$16 billion and you would use about \$2 billion of that on conversion expenditures?

Mr. BENSON. That is correct.

Chairman PROXMIRE. Conversion was a piece of cake after World War II. As we all know, we cut back \$66 billion, demobilized 10 million people and we had practically no unemployment for several years. In 1948, after years of pellmell demobilization we had 3.5-percent unemployment but now you feel that conversion proposal of \$2 billion would rather smoothly answer the difficulty of the frictional adjustment, the mobility of moving people out of defense industries and into the other areas where you would, of course, increase allocation of resources.

Mr. BENSON. I do not underestimate the stickiness of the problem at all. Our recommended economic conversion expenditures by themselves, of course, would not solve the problem. You have already referred to the other part of the answer, which is: Other programs would be substituted. There are other pressing needs for which we would prefer to see these funds allocated. It is not simply a question of \$2 billion in conversion expenditures taking the place of \$15 or \$16 billion in defense spending that we recommend be cut. Rather, that \$2 billion represents the funds to ease dislocation through retraining and temporary compensation measures while people are looking for jobs.

Chairman PROXMIRE. What does your counterbudget assume for troops in Europe 5 years from now?

Mr. BENSON. The counterbudget assumptions on the number of American troops physically in place in Europe are really quite conservative, I think. We have concluded, as General Gavin suggested, that there is fat in the logistics operations and the rest of the support pipeline in Europe, and accordingly recommended a reduction of 50,000 troops from that support pipeline. We have not, however, recommended a reduction in the number of American divisions in place in Europe.

Chairman PROXMIRE. You still have 4.5 divisions.

Mr. BENSON. The four and a third that are there now. We strongly encourage a U.S. response to the indicated Soviet willingness to discuss mutual troop reductions. If those negotiations did not work out, then we would be willing to consider seriously that a first step in the reduction process be taken anyway by the U.S. Government.

But, basically, we thought that discussion about our manpower commitment to NATO was really misdirected. Instead we ought to look at the total manpower now being allocated to that contingency, a large portion of which is actually physically based in the United States. We did recommend force reductions, both in Air Force wings and Army divisions, among troops based in the United States but clearly earmarked for the NATO contingency.

Chairman PROXMIRE. You apparently made no assumptions at all that the Europeans who are doing so well economically, have more people, and an economic productivity greater than the Soviet Union—that they would be able to pick up more of the burden. We would still have to carry what I think is a disproportionate, at least very heavy share of the overall burden. I hoped we would, following the Mansfield proposal, just cut our commitment there in half and still provide the nuclear umbrella to provide the air support.

General Gavin indicated he would cut it back to one division.

Mr. BENSON. We did, indeed, recommend that European nations assume a larger share of the financial burden on the United States created by the presence of American troops in Europe. There have been offset agreements and other arrangements in the past. We felt the financial contribution of our NATO allies ought to be substantially increased. From a tactical standpoint, we do feel just as General Gavin testified, that sharply fewer than the four U.S. divisions now stationed in Europe are needed to insure that American troops will become involved should the Soviet Union or its allies start a push through Western Europe.

However, we felt there were compelling reasons at this time for not proceeding with unilateral reduction of American troops in Europe aside from the support troops I mentioned. These reasons have to do with the political and psychological impact such an action would have on our European allies. This was a close decision. Many former high-ranking defense officials advised us in the development of our defense recommendations. General Gavin was among them, and as you saw, he disagreed with the viewpoint on European troop levels that was expressed in our defense proposals, feeling that fewer American troops were needed than we recommended. There was some disagreement over this issue, but we were not trying to put together a defense budget that simply cut anywhere anyone suggested reductions ought to be made. We wanted to have a moderate proposal, one that made sense, one that would enhance vital U.S. interests where those interests could be aided by the presence of military forces. But, at the same time we wanted to be sure those forces were equipped with the kinds of weapons that were sensible in terms of tactical fire power and we wanted to be sure we were not maintaining forces to be employed against no longer existent threats.

Chairman PROXMIRE. It is considerably deeper than the Benson recommendation of a couple of years ago; \$9.5 billion cuts, as I recall.

Mr. BENSON. Yes, you refer to an article I wrote. It was almost 2½ years ago, I believe. It was not an attempt to look at the entire defense budget and to suggest an alternative. It was really much more a shopping list suggesting some areas requiring scrutiny, with the feeling that inspection would lead to the conclusion that we could get along without some of the systems and activities singled out for attention.

In fact, I think about half of the specific systems that were referred to in that article either have been eliminated or curtailed to some degree in accordance with the recommendations made in the article.

Chairman PROXMIRE. We were proposing to spend \$80 billion next year in defense. If you adjust your figure, recognizing the inflation aspect of it, what would the \$50 billion buy in constant dollars? That means about \$40 billion or \$35 billion of the budget in terms of 1971 dollars.

Mr. BENSON. I imagine the Department of Defense might suggest that that is what it would translate to. But I find very intriguing their approach to calculating inflation. It is very proper to make an adjustment for changes in prices. We have made a set of assumptions on price movement in the *Counterbudget* and we use the same assumptions in "The Cost of Security."

The Defense Department never turns to another aspect of the problems, however, which is productivity increases one can reasonably expect to achieve. These productivity increases ought to offset some of the price inflation that occurs. We have estimated that defense prices will actually increase approximately 16 percent during the next 5 years, but have felt by the same token that productivity savings amounting to slightly over 1 percent per year ought to be achieved just as they were during the early and middle years of the 1960's.

If you take both of those factors into account, the net increase in prices amounts to slightly over 10 percent; indeed, that would suggest in terms of 1971 dollars, our \$50 billion recommended defense budget for 1976 is somewhere closer to \$45 billion in real terms.

Chairman PROXMIRE. You are talking about your analyses in appendix A?

Mr. BENSON. Yes, sir.

Chairman PROXMIRE. You discuss the impact of inflation on the defense budget because the Secretary of Defense has said within the last 5 years we had a cost growth due to inflation of almost 50 percent. You say, No. 1, that that does not allow enough productivity increases, perhaps, although you refer to the early part of the 1960's for a 1 percent productivity increase.

No. 2, I do not know whether you would question this, but others have argued they just cannot find any index that suggests anything like that kind of an increase of 10-percent inflation factor a year. The wholesale price index is about a third of that or less. And most procurements would fall in that category. There has been a rather sharp increase in pay, at least in some categories, not so much for recruits, but other people in it.

Mr. BENSON. I find myself in an interesting position to comment on that. While I served in the Department of Defense in 1968, I put together an official price index for defense goods and services. I, too, find that those figures you cite are rather incredible. I think you are referring to a press conference Secretary Laird held where he mentioned a 10-percent increase in prices for each of the last 5 years on the average.

Indeed, defense price inflation has been much more rapid during the past 5 years because of the pay factors you pointed out, and also because of the fact that our involvement in Vietnam has greatly accelerated the demand for defense goods and services, thereby also stimulating inflation in the economy as a whole.

But I do not think you could find a representative panel of independent economists in this country who would begin to assert, if they dug into the evidence, that defense inflation approached anything like 50 percent during the past 5 years. Indeed, the prices of goods and services other than pay that the Defense Department procures tend to move fairly closely with the price movement of the wholesale price index. The price increase measured by that index has been substantially less than 50 percent during the past 5 years.

Chairman PROXMIRE. One of the most significant findings in the studies has been the baseline of defense expenditures can be reduced below the pre-Vietnam figures. The pre-Vietnam figures are the "rock-bottom" figures that the Defense Department always refers to after the adjustment in inflation. They say they are close to that now.

In other words, once the costs of Vietnam are behind us, we can have a defense budget smaller in size than the one we had before the war without endangering national security.

You state in your fine study—as I said, I am putting it in the record¹—the baseline force in the early 1960's was very much a product of

¹ See study on p. 69.

the cold war. How can you arrive at the conclusion we can safely reduce our level below the level of the 1960's?

Mr. BENSON. I tried to suggest in my statement, Mr. Chairman, that there are a number of factors which have changed in the international climate since the early 1960's when some decisions were made about the kind of baseline force that was appropriate for that time. I have spoken to the decline in the belief that there is a monolithic Communist conspiracy directed against U.S. interests and have pointed out that, in fact, there is a great deal of squabbling within the Communist bloc about their own interests. I have pointed to changes in technology which have rendered quite ineffective some of our naval forces. I have pointed to another fact that you also have mentioned, the increased capability of our allies, particularly in Europe, but also to some extent in Southeast Asia and South Korea, to shoulder a larger portion of the burden of their own defense.

These are significant changes. There is an increasing movement toward detente and discussion as evidence by the Soviet willingness to talk about troop levels in Europe. Although the slow progress of the SALT talks is frustrating to those of us who strongly hope for an agreement from that arena, it is still an encouraging sign these talks are going on. These are important factors.

They have led President Nixon to suggest the basic planning assumption for structuring our general purpose forces ought to be changed from 2½ wars to 1½ wars.

That decision has significant import for the number of forces we have to provide and the amounts of cost that must be incurred in the defense budget.

We considered those changes and tried to adapt our force recommendations to this revised picture of where U.S. interests exist in the world, where those interests can indeed be fruitfully advanced by the use of military forces. We came to the conclusion that a sharply smaller defense budget is justified and is prudent. That is the reasoning process we have gone through.

Chairman PROXMIRE. In appendix B you list more than 30 areas of potential savings through improved defense management. In effect, you are saying what this committee has learned over the past several years; namely, that there is an awful lot of inefficiency and waste in the management of the Department of Defense. How do you arrive at your conclusions, and can you give us a few examples of how management can be improved?

Mr. BENSON. Let me try to pick a few examples. We arrived at the conclusions, not from some intuitive feel or insight, but rather by going to highly respected sources for information. I refer particularly to the Blue Ribbon Defense Panel report, the Panel chaired by Mr. Fitzhugh, directed to report to the Secretary of Defense and the President. This was the Defense Department's own panel essentially, and yet their report recommended—

Chairman PROXMIRE. I criticized that panel because it did seem to have such a powerful Defense Department affiliation and such a conflict of interest in terms of the holdings of the members. I think they averaged something like \$100 million apiece, their companies that they represented, \$100 million apiece, as I recall, committed pretty much to defense work.

Mr. BENSON. Yes; I remember your criticism.

Chairman PROXMIRE. This was not a panel that would be soft on defense. In fact, they would have an interest the other way.

Mr. BENSON. I pointed out that even though their recommendations in some areas were not very bold in the face of the magnitude of the problems they considered, they made a number of very strong suggestions as to how efficiency in defense management should be improved.

One in particular that comes to mind is what a member of this committee, Senator Percy, of Illinois, fought very hard for on the Senate floor last year, the idea of reducing the amount of manpower rotation that goes on. We have a system today where the typical military officer is forced to move on to a new job every year to a year and a half, on the average. During his 20-year career, he may have a dozen to 15 assignments. This does not enhance job performance efficiency. It also costs a great deal just to move him and his family and household goods. We spend a billion dollars moving people around to new assignments, so-called permanent change of stations.

Senator Percy, very effectively, I thought, advanced the argument that the number of moves should be reduced and secured Senate approval by a vote of 69 to 0 last year to make that change. Yet, somehow, it got eliminated in conference. His amendment was opposed by the Defense Department. The problem was also identified, however, by the Fitzhugh Panel.

Another distinguished source of recommendations was recent reports of the House Appropriations Committee, claimed by a man for whom I have a great deal of admiration, Representative George Mahon. He has done a zealous job of seeking out areas of inefficiency and waste in defense management, and we have quoted many ideas from his committee reports.

I might mention one specific efficiency improvement not included in the list of 33 recommendations contained in our report. I have been concerned that we might not be receiving the full story from the Defense Department when they have talked about their budget being forced up by rapidly increasing personnel costs. It is clear that military pay rates have increased considerably during the past few years, accounting for a large portion of the increase in personnel costs.

Chairman PROXMIRE. As I understand, the total manpower costs range as high as 60 percent of the defense budget.

Mr. BENSON. I believe that is correct, Mr. Chairman. I think the direct pay cost is something like 52 percent, and moving expenses and other personnel-related costs raise the total to about 60 percent. It is a very serious problem. Anyone advocating substantial reductions in defense spending has to address himself to manpower levels and to the ways in which we manage our personnel affairs.

I have been concerned because I suspected another phenomenon might be going on besides simply increases in pay rates. When one inspects the evidence, one finds that other phenomena are going on. We really have a substantial cost overrun problem of a different sort from the ones you had so skillfully shown to exist in recent years in the procurement area.

What has happened is we have fattened up the rank distribution within the Department of Defense. We have proportionately more officers scheduled to be in the force at the end of fiscal year 1972 than at any time during the past 8 years. We have proportionately more high-ranking enlisted men than we had before the war. We have proportionately more middle-level enlisted men. What we have fewer of is lower ranking enlisted men.

Chairman PROXMIRE. How can you reconcile it? Supposing we move to a volunteer Army, which I happen to favor, that costs more in terms of money to pay, to induce people to enlist. It would seem also you would have to provide some kind of promise to maintain the morale of advancement and promotion. I realize we do not want a Mexican army with everybody a general. You cannot have that. You might want that but you cannot have it.

But, how do you reconcile this program, or do you think a volunteer Army would not be consistent with efficient operation?

Mr. BENSON. Without getting into the merits or demerits of a volunteer Army, I think that is not essentially at issue in terms of ratios of officers to enlisted men.

Chairman PROXMIRE. The reason I raised it, one way you maintain some morale on the part of the people who stay in the service for 20 or 30 years is they get promoted and they get command and the people they command will serve 2 or 3 years and are out. If you were a draftee, you are probably a private, PFC, corporal. If you eliminate all of the draftees, you have no draftees, and the people, overwhelming career people who stay in for 20 or 30 years, won't you have a problem with this? Won't you continue to have this kind of exodus, promoting people to noncombat ranks and getting people for them to command?

Mr. BENSON. It certainly is a problem. However, I think even the Department of Defense proposal advocating a volunteer force has never seriously contemplated a force structured in a way which would do away with basic infantry soldiers. They are suggesting that a soldier ought to be paid more during his first 2 years of service as he works his way up the rank ladder. But they still have in mind, even under their volunteer Army plans, that a large number of personnel would come into the force and stay only for a couple of years. I think their proposals really are directed to the fact that by raising the pay of lower ranking personnel we would attract more volunteers—many only for 2 years of service, in addition to those who might stay on for a full career.

I am not suggesting that there should not be a steady flow of promotions to reward the man who performs well and wants to stay in for a career. What I am suggesting is that if we return to the relative distribution of ranks that existed before the war—a proportionate blending of officers and enlisted men and senior and junior enlisted men—we could save, as it turns out, about \$1.3 billion annually. That calculation is based on the force size planned by the Department of Defense for the end of fiscal year 1972, and also on the number of people in the different ranks that they plan to have at that time.

That force is going to cost a certain amount. Then I am saying that if we had the same number of people, but instead of the distribution of ranks they are recommending, we returned to the proportions that existed prior to the war—fiscal year 1964—we would be saving \$1.3 billion a year. That is a kind of cost over-run problem, but it is not one that has gotten any attention at all. It is one that arose because, for very valid reasons, the Defense Department increased the pace of promotions during the Vietnam war. They needed a larger officer base because the total size of the Armed Forces was increasing. They also wanted to be sure that men who served in Vietnam had at least an E-4 rank. That is fine, but it provides no rationale for the Department of Defense not to return to a normal distribution pattern once the war is over.

Chairman PROXMIRE. This is most helpful. I think we will write DOD immediately and ask them for a description of exactly what the situation is now, what it has been over the past 8 or 10 years, and see what we can do about reconciling this, because I think you can make a strong case that there is a great deal of excessive and unnecessary expenditure involved.

Mr. BENSON. Again, this is just illustrative of a number of examples of inefficiency such as those described in the list of 33 in appendix B of "The Cost of Security."

Chairman PROXMIRE. I have been asking our witnesses to give us their views of the proposed bailout of the Lockheed Corp. As you know, the administration wants to provide a guaranteed government loan to Lockheed for the commercial L-1011 program. It argues that without this help, Lockheed might go bankrupt and that this would cause widespread unemployment and catastrophic economic consequences. What is your response to this argument?

Mr. BENSON. Speaking personally, I think the consequence would possibly be a Lockheed bankruptcy, but I do not feel at all that a catastrophic economic consequence would result. Indeed, I think there is a strong likelihood of a change in management—whether or not bankruptcy is declared—which, based on the company's recent performance, would have to be considered a desirable turn of events.

As Secretary Connally has said, some workers might be idled for a short period of time. There might be some delays in the receipt of some vital defense systems for which Lockheed currently has contracts. But I do not see Lockheed grinding to a halt.

I expect that the corporation would be reorganized under new management. The workers would still be employed and would carry out the firm's existing contracts. The result would not be damaging to the security of the country and would not have tragic economic consequences. Under the circumstances I do not see how a bailout in the form of a Government guarantee really can be justified. We talk about a free enterprise system in which risks are to be taken by contractors, but it seems that when large contractors get in trouble we want to

move away from our principles and not allow the results of healthy competition to be felt.

I do not think Lockheed should be bailed out. I do not think there is any rationale for the Government to provide the loan guarantee.

Chairman PROXMIRE. Thank you very much. Thank you for an excellent performance. You are most responsive and I thought your statement was excellent. The answers to our questions were very good and I am very grateful to you.

The subcommittee will stand in recess until Friday morning. We will hear from Ralph Nader and Prof. Robert Haveman in this room at 10 a.m.

(Whereupon, at 4 p.m., the subcommittee recessed, to reconvene at 10 a.m., Friday, June 4, 1971.)

THE ECONOMICS OF NATIONAL PRIORITIES

FRIDAY, JUNE 4, 1971

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN
GOVERNMENT OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire, Javits, and Miller; and Representative Conable.

Also present: John R. Stark, executive director; James W. Knowles, director of research; Loughlin F. McHugh, senior economist; Lucy A. Falcone and Jerry J. Jasinowski, research economists; Ross F. Hamachek, Richard F. Kaufman, and Courtenay M. Slater, economists; George D. Krumbhaar, Jr., minority counsel; and Walter B. Laessig and Leslie J. Barr, economists for the minority.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order. If some future historian were to set out to identify the major catastrophies of the 20th century, he would surely conclude that one of the outstanding ones was the failure of the United States of America, the richest country in the world, to solve its own most pressing problems.

The deterioration of our urban centers and rural communities grows steadily worse. The problems of poverty and racism remain largely unsolved. Pollution of the air and the water increases. Entire species of animal life, such as the swordfish, are becoming extinct as sources of food because of environmental poisoning.

In many respects, American society suffers from giantism. We have concentrated and centralized our political and economic institutions to such an extent that many of them are no longer efficient.

We have often mindlessly fostered growth while ignoring the qualitative aspects of life. Yesterday, the New York Times reported on the impact of suburban sprawl in America. Outlying communities once looked forward eagerly to the coming of new industry, housing subdivisions, and greater populations. Now these things are feared because of the congestion, inadequate services, and environmental devastation that have followed in their wake. In the words of the chairman of the county board of supervisors in Orange County, Calif., "The Chamber of Commerce tells us that growth is wonderful. I see it as a cancer."

In 1970 the gross national product was \$977 billion. Personal income was over \$800 billion. Corporate profits were over \$80 billion. The resources of this country dwarf those of any other nation on earth.

The enormity of the problems at hand is no longer a matter of serious question. Nor is the fact that we have the material wealth and the ingenuity to solve our problems. Yet, we stumble along from one bad year to the next, the distortions and contradictions within our society growing progressively more serious.

On the Federal level we have sapped our real strength and our ability to solve domestic problems by spending far more than we can afford or than is necessary for national defense. This fundamental error in judgment contributes greatly to our misplaced priorities and is a prime reason why they must be reordered.

But too frequently we have attempted to solve national problems by launching massive Federal programs costing billions of dollars, only to see them turn into massive billion-dollar mistakes. A witness said to this committee earlier in the week that one of the things the Government does well is sign checks. But the problem is not whether the Government reallocates the budgetary resources it collects from the taxpayer. The Government does a pretty good job of spending money. The problem is how those resources are allocated. It is on this level that Government performance is poor.

We are fortunate to have as our first witness this morning Mr. Robert Haveman, one of the ablest and most ingenious economists in the country. He was a staff economist on the Joint Economic Committee until a year or so ago, and he was an extremely valuable staff member. He has become well known as an expert in his field. And he is presently a professor of economics, I am proud to say, at the University of Wisconsin. His latest book is "The Economics of the Public Sector."

Professor Haveman, go right ahead.

STATEMENT OF ROBERT H. HAVEMAN, PROFESSOR, DEPARTMENT OF ECONOMICS, UNIVERSITY OF WISCONSIN

Mr. HAVEMAN. Thank you, Senator Proxmire.

It is a strange and different feeling sitting on this side of the witness table than it was when I sat behind you looking at the fellow in this chair.

I am pleased to have the opportunity to testify today on the issue of national economic priorities. I would like to read a short statement and submit a longer statement for the record. I would also like to submit for the record an article entitled "Water Pollution Control, River Basin Authorities, and Economic Incentives."

In the invitation issued to me by the committee it was suggested that I deal with the question of the role of user charges as an instrument in achieving reallocated national priorities. In my view, it is most appropriate that the question of government-imposed user charges be considered in the context of national economic priorities.

Basically, the problem of economic priorities concerns how this society allocates its national resources. If these resources are devoted to uses which are of high value to the people, economic priorities are well ordered; if they are devoted to low-valued uses, economic priorities should be realigned.

In our economy, we rely on prices—which are nothing but user charges—to keep resources from being diverted to low-valued uses. Because each commodity has its price, we have some assurance that people are willing to pay at least as much for the commodity as the value of the resources which go into making it.

User charges established by Government for resources not priced appropriately by the private economy can serve the same purpose. Because they are able to keep national resources from being diverted to low-valued uses, such user charges are essential to achieving well-ordered economic priorities in the public sector. The important role of user charges and economic incentives can be vividly illustrated by focusing on the problem of environmental quality—in particular, the use of government-administered prices to achieve improved water quality.

Numerous reasons have been offered to explain why we have an environmental problem. Some say it is because we have too affluent a society. Because we produce so much, we have so much to dispose of. Others say that we have a problem because we produce the wrong things—too many automobiles, for example, relative to mass transit or too much primary paper relative to recycled paper. Still others tell us that it is the managers of large industries who are at fault because they not only supply us with packages and cans which have to be disposed of but they also pollute our rivers and our skies in the process of making these cans and packages.

While all of these explanations contain some truth, they miss the central and basic cause of the problem of environmental pollution. At its heart, the environmental problem is an economic problem. It exists because the market economy fails to place a price on the use of environmental resources—public watercourses, the air mantle, and public lands. Labor services have their price; capital has its price; land has its price. And because of these prices, the system tends to do an efficient job of allocating these scarce resources to the production of outputs which are of the highest value to people. However, environmental services have no price. As a consequence, they are treated by everyone as free goods.

That people living downstream are abused in that they can no longer fish or swim in the river or that during periods of low streamflow the river becomes anaerobic and smells does not really affect the polluters—they are not required to bear the costs which their actions generate. To them, environmental services are a “free lunch,” but as we all know, to society as a whole there is no such thing as a free lunch.

If the failure of the market system to price environmental resources is indeed the root cause of the problem, then it follows as a corollary that, to be effective, environmental policy measures must seek to correct this failure. In this way, environmental resources can be brought back into the economic system.

Until now, Federal Government policy has failed to recognize the economic nature of the pollution problem. After nearly two decades of policymaking, the waste assimilative capacities of rivers remain free goods. Government has refused to set prices to keep these resources from being diverted to low valued uses. Instead a dual policy of rule enforcement and subsidy has been adopted to achieve improved water quality.

Through Federal grants for municipal waste treatment facilities and tax subsidies for industrial pollution control equipment we are, in effect, allowing waste discharges to generate and dispose of whatever amount of waste they desire—free of charge—and then using taxpayers' money—at a current annual rate of about \$1 billion—to clean up after them. By requiring States to set water quality standards in order to qualify for Federal subsidies, it is hoped that, through negotiation, litigation, and moral suasion, they can be induced to secure reductions in the waste loads of industrial and municipal polluters.

This policy strategy has been a dismal failure.

After a detailed study of several rivers, the General Accounting Office found that even though \$5.4 billion had been spent to construct waste treatment plants, the level of industrial pollution has continued to grow and the quality of the Nation's rivers has continued to deteriorate. In that study the General Accounting Office cited one particular basin in which \$7.7 million had been spent in the construction of waste treatment works from 1957 through 1968; 18 plants were subsidized by the Federal Government in that basin. And because of that subsidy, it was found that waste discharges equivalent to 147,000 people had been treated. However, during this same period, industrial waste in that same basin increased to the extent of 2.4 million people. That is, even though several million dollars of public expenditures had taken place, the treatment that was provided was unable to keep up with the enormously rapid growth in industrial pollution levels in that basin.

With little effective constraint on the generation of industrial waste and with rapid economic growth, the burden on the environment will skyrocket in the coming decades.

One recent study showed that the annual costs of applying secondary treatment to an unconstrained flow of residuals would be \$18 billion in 1973, \$27 billion in 1980, and \$55 billion by the year 2000. The continued spending of taxpayers' money to clean up after polluters—along the lines of the current strategy—is going to be an enormously expensive and relatively fruitless venture.

Federal efforts at regulation have been equally ineffective. In testimony before Congress earlier this month, Comptroller General Elmer Staats stated that existing regulation and enforcement efforts have been slow and cumbersome. A minimum of 58 weeks is required by law between the time EPA decides to call a conference and the date EPA can refer the case to the Attorney General for court action. And, as is well known, tactics for delaying final court action are part of the training of every good lawyer. The primary incentive in the current strategy is the incentive provided industrial polluters to hire lawyers in order to delay administrative and legal efforts to secure reductions in the waste discharge destined for public waters.

If progress toward improved water quality is to be secured a major restructuring of water pollution control policy is required. Incentives must be established to constrain the waste generation proclivities of industrial and municipal polluters and to keep valuable environmental resources from being diverted to low-valued uses. Such incentives can be created by imposing user or effluent charges on waste discharges such that the size of the charge is related to the volume of

harmful substances which they release into the environment. In effect, waste dischargers should be required to "pay by the pound."

Numerous arguments can be offered in support of this user-charge strategy relative to existing policy. The most cogent argument is that it will succeed in reducing waste discharges. The recorded response of waste dischargers to the imposition of municipal sewerage charges provides cogent evidence. For example, after placing such a charge in effect, the city of Cincinnati reported the industrial waste was reduced by nearly 40 percent.

That user charges have induced such dramatic reductions in waste discharge is not surprising. With a price placed on wastes discharged into watercourses, a number of actions which previously looked unattractive to dischargers would become appealing alternatives. These include changes in production procedures within the plant to reduce waste generation as well as the installation of waste treatment facilities at the plantsite. Moreover, such charges induce research and development efforts aimed at developing new technologies for reducing waste generation or recycling wastes.

In addition to providing incentives for reductions in waste generation, a comprehensive national effluent-charge policy would have a second important effect. It would bring public actions into the open and out of the hidden and closed negotiating sessions of enforcement conferences and State-local regulatory efforts. It would greatly reduce the exercise of tactics to delay the effect of policy and to erode its stringency when eventually applied. It would open the process of policy implementation to the scrutiny of the people.

Finally, while the current strategy has placed substantial demands on a tight Federal budget, a user charge strategy would generate revenues. These revenues could be used to finance those environmental measures which municipalities and industrial polluters cannot be expected to undertake.

To illustrate this impact on the Federal budget of the current strategy relative to an effluent charge strategy, I have appended a table to my prepared statement. This table projects the budget outlays for two versions of the current strategy—the proposals of Senator Edmund Muskie and the administration—and the net budget outlays for an effluent charge strategy. The projections cover 5 years, fiscal years 1972–75. The total 5-year costs of the two versions of the current strategy are \$14 billion for Senator Muskie's proposal and \$12 billion for the administration bill. The net budgetary costs of the effluent charge—which includes a grant program as large as that of the Muskie bill—is \$4.3 billion.

It is almost legendary by now that some will label user or effluent charges as "licenses to pollute." This mindless cliché should be laid to rest once and for all. Aside from completely and totally prohibiting the discharge of waste into rivers, all policy proposals envision some optimal level of use of watercourses for waste disposal. The question is: How to obtain that level of use at minimum social cost? Because the effluent charge can be fixed at any level between zero and capacity, a charge structure can be determined which will secure socially optimal levels of water quality. With that charge structure set, individual polluters are free to respond to it in any way they choose. As rational

decisionmakers, they will choose the most efficient and effective methods of reducing discharges in order to reduce the tax. Rather than a license to pollute, user charges are an effective instrument of environmental management based on a clear appreciation of the fundamental cause of the problem.

In conclusion, let me reiterate the important role which government-imposed user charges can and should play in reordering national priorities. As I have tried to show, major improvements in water quality will not be obtained by simply allocating a bigger slice of the Federal budget to the current program. To do so would be to shift high valued resources from the low-valued use, say the military budget, to another low-valued use.

A real reordering of priorities toward improved environmental quality requires first a major overhaul of the current policy strategy, and then, perhaps, a budget reallocation. The increased use of user charges and economic incentives are central to an appropriate policy overhaul and prior to the allocation of an increased level of public expenditures to this and other pressing social problems.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Professor Haveman, for what I think is an extremely persuasive and fine analysis.

(The prepared statement of Mr. Haveman and the article entitled "Water Pollution Control, River Basin Authorities, and Economic Incentives: Some Current Policy Issues," referred to in Mr. Haveman's statement, follow:)

PREPARED STATEMENT OF ROBERT H. HAVEMAN *

It is appropriate that the question of government imposed user charges be considered in the context of national economic priorities. Basically, the problem of economic priorities concerns how this society allocates its national resources. If these resources are devoted to uses which are of high value to the people, economic priorities are well ordered; if they are devoted to low-valued uses, economic priorities should be realigned.

In our economy, we rely on prices—which are nothing but user charges—to keep resources from being diverted to low-valued uses. Because each commodity has its price, we have some assurance that people are willing to pay at least as much for the commodity as value of the resources which go into making it. Thus, because of prices, we feel confident that \$10 worth of resources are not being devoted to the production of a 10¢ candy bar. Similarly, because of prices we know that people who value 10¢ candy bars at only 5¢ will not be using the resources which go into their production. The incentives generated by prices keep our private sector economic priorities well ordered.

User charges established by government for resources not priced appropriately by the private economy can serve the same purpose. Because they are able to keep national resources from being diverted to low-valued uses, such user charges are essential to achieving well-ordered economic priorities in the public sector.

The important role of user charges and economic incentives can be vividly illustrated by focusing on the problem of environmental quality—in particular, the use of government administered prices to achieve improved water quality.

Numerous reasons have been offered to explain why we have an environmental problem. Some say it is because we have too affluent a society. Because we produce so much, we have so much to dispose of. Others say that we have a problem because we produce the wrong things—too many automobiles, for example, relative to mass transit or too much primary paper relative to recycled paper. Still others tell us that it is the managers of large industries who are at

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fault because they not only supply us with packages and cans which have to be disposed of but they also pollute our rivers and our skies in the process of making these cans and packages.

While all of these explanations contain some truth, they miss the central and basic cause of the problem of environmental pollution. At its heart, the environmental problem is an economic problem. It exists because the market economy fails to place a price on the use of environmental resources—public watercourses, the air mantle, and public lands. Labor services have their price; capital has its price; land has its price. And because of these prices, the system tends to do an efficient job of allocating these scarce resources to the production of outputs which are of the highest value to people. However, environmental services have no price. As a consequence, they are treated by everyone as free goods. There is no cost to a person who overuses, misuses, or abuses environmental resources.

Consider, for example, the case of water pollution. Because the market system fails to price the waste assimilative capacity of rivers, waste dischargers are provided these services cost-free. That people living downstream are abused in that they can no longer fish or swim in the river or that during periods of low stream flow the river becomes anerobic and smells does not really affect the polluters. They are not required to bear the costs which their actions generate. To them, environmental services are a "free lunch," but as we all know, to society as a whole there is no such thing as a free lunch.

If the failure of the market system to price environmental resources is indeed the root cause of the problem, then it follows as a corollary that, to be effective, environmental policy measures must seek to correct this failure. Legislation must enable government to establish appropriate prices or charges for use of the environment and impose them on those who wish to use these services. In this way, environmental resources can be brought back into the economic system. The incentives which induce efficiency by rationing the use of labor, land, and capital can also be used to manage the environment. In addition, those of us who are now bearing the costs of the "free lunch programs" for industrial and municipal polluters can be compensated for our losses.

Until now, Federal government policy has failed to recognize the economic nature of the pollution problem. This is nowhere better illustrated than in the development of Federal water pollution control policy. After nearly two decades of policymaking, the waste assimilative capacities of rivers remain free goods. Government has eschewed the use of prices to keep these resources from being diverted to low-valued uses. Instead, a dual policy of rule enforcement and subsidy has been adopted to achieve improved water quality.

Through Federal grants for municipal waste treatment facilities, and tax subsidies for industrial pollution control equipment, we are, in effect, allowing waste discharges to generate and dispose of whatever amount of waste they desire—free of charge—and then using taxpayers money (at a current annual rate of about \$1 billion) to clean-up after them. By requiring states to set water quality standards in order to qualify for Federal subsidies, it is hoped that, they can be induced to secure reductions in the waste loads of industrial and municipal polluters through negotiation, litigation, and moral suasion.

This policy strategy has been a dismal failure. After a detailed study of several rivers, the General Accounting Office found that even though \$5.4 billion had been spent to construct waste treatment plants, the level of industrial pollution has continued to grow and the quality of the nation's rivers has continued to deteriorate.

With little effective constraint on the generation of industrial waste and with rapid economic growth, the burden on the environment will sky rocket in the coming decades. One recent study showed that the *annual* costs of applying secondary treatment to an unconstrained flow of residuals would be \$18 billion in 1973, \$27 billion in 1980, and \$55 billion by the year 2000. The continued spending of taxpayer's money to clean up after polluters—along the lines of the current strategy—is going to be an enormously expensive and relatively fruitless venture.

Federal efforts at regulation have been equally ineffective. In testimony before Congress earlier this month, Comptroller General Elmer Staats stated that existing regulation and enforcement efforts have been "slow and cumbersome." "A minimum of 58 weeks is required by law between the time EPA decides to call a conference and the date EPA can refer the case to the Attorney General for

court action." And, as is well-known, tactics for delaying final court action are part of the training of every good lawyer. The primary incentive in the existing strategy is the incentive provided industrial polluters to hire lawyers in order to delay administrative and legal efforts to secure reductions in the waste discharge destined for public waters.

In addition to the failure of the existing strategy to secure improvements in water quality, it has induced a number of other inefficiencies and undesirable effects. Let me mention a few of them:

Because the existing program subsidizes only "end-of-pipe" waste treatment activities, it artificially biases decisions against alternative abatement activities, many of which are less costly than the construction and operation of waste treatment plants. These activities include changes in internal production processes, the storage (ponding) of wastes until high stream flow periods, the segregation of particularly harmful discharges, the avoidance of accidental spillages and leakages, and the augmentation of the assimilative capacity of the stream through instream aeration and other devices.

States have failed to target Federal grant funds on the municipalities with the most serious waste discharges. As a result of this lack of planning, grants have secured far less improvement in water quality than was possible. The allocation of grants within a state have been based on the state's priority list. In turn, this list depends upon which communities are "ready to go." An allocation of budgetary resources based upon careful economic analyses of the effectiveness of alternative uses would, with little doubt, yield greater increases in water quality than those yielded by the existing program.

In part, because of the lack of effective priorities by which to channel grant funds within states, Federal funds have been concentrated on smaller, largely suburban communities. The large cities with the most significant concentration of pollution have received a disproportionately small share of the allocation. For example, communities with populations of less than 10,000 population, and containing less than 16 percent of U.S. urban population, have received nearly 40 percent of Federal grants. Cities with populations of more than 500,000, containing 25 percent of U.S. urban population, have received about 6 percent of Federal grants.

Current policy emphasizes the attainment of secondary waste treatment for *all* municipalities along a watercourse. The drive for uniform secondary treatment results in excessive treatment at some outfalls and insufficient treatment at others. An optimal basin-wide plan would relate the degree of desired municipal treatment to streamflow conditions and downstream uses (among other variables). In this optimal plan, some municipalities may require tertiary treatment while others may require only primary treatment.

Federal grants for municipal waste treatment plant construction provide an indirect subsidy to industrial and commercial waste sources. By subsidizing the capital costs of municipal treatment facilities, the existing policy tends to reduce the sewer charges imposed on industrial, commercial, and domestic waste sources connected to the sewerage system. The resulting charges, then, fail to provide "full cost" incentives for process change and other forms of abatement which can be undertaken by residual generators. Because approximately 50 percent of the wastes handled by municipal treatment plants is from industrial sources, the size of this subsidy is substantial.

The grant program often subsidizes treatment facility construction in municipalities with combined sanitary and storm sewer systems. With such sewer systems, the existence of a treatment facility provides little assurance of improved effluent. In periods of high run-off and high wasteloads, the entire sewerage load by-passes the treatment facility and is dumped, untreated, into the watercourse.

According to a recent GAO Report, numerous treatment facilities constructed with Federal funds are inadequately maintained, inefficiently operated, and subject to only intermittent inspection. To the extent that this performance shortfall exists, the construction program is incapable of inducing water quality improvements.

The program of grants to individual states and municipalities gives little concrete recognition to the economies attainable by managing the river basin as a unit and does little to either encourage the development of river basin authorities or facilitate their establishment. Without such bodies, the implementation of the optimum set of activities to achieve stream standards is remote, at best. Without the planning capability of such a basin authority, the grant program is "hit-or-miss" and its effectiveness is seriously undermined.

If progress toward improved water quality is to be secured, a major restructuring of water pollution control policy is required. Incentives must be established to constrain the waste generation proclivities of industrial and municipal polluters and to keep valuable environmental resources from being diverted to low-valued uses. Such incentives can be created by imposing user or effluent charges on waste dischargers such that the size of the charge is related to the volume of harmful substances which they release into the environment. In effect, waste dischargers should be required to "pay by the pound."

Numerous arguments can be offered in support of this user charge strategy relative to existing policy. The most cogent argument is that it will succeed in reducing waste discharges—not just retarding their growth. The recorded response of waste discharges to the imposition of municipal sewerage charges provides cogent evidence. For example, after placing such a charge in effect, the city of Cincinnati reported that industrial waste was reduced nearly 40 percent. Similar experiences have been recorded in other cities.

That user charges have induced such dramatic reductions in waste discharge is not surprising. With a price placed on wastes discharged to watercourses, a number of actions which previously looked unattractive to dischargers would become appealing alternatives. These include changes in production procedures within the plant to reduce waste generation, as well as the installation of waste treatment facilities at the plant site. Moreover, such charges would induce research and development efforts aimed at developing new technologies for reducing waste generation or recycling wastes. Without such charges, few costs could be saved by the development and installation of such new technologies. Finally, if environmental services are priced, those commodities whose production imposes large environmental damages will experience increases in their price relative to the prices of other commodities whose production imposes minor environmental costs. And, because higher prices imply smaller demands, production would tend to be shifted toward those commodities with smaller environmental effects. This shift in relative prices is most consistent with the operation of the market system, and can be achieved most effectively by placing a charge on the use of the environment for waste discharge.

In addition to providing incentives for reductions in waste generation, a comprehensive national effluent-charge policy would have a second important effect. It would bring public actions into the open and out of the hidden and closed negotiating sessions of enforcement conferences and state-local regulatory efforts. It would greatly reduce the exercise of tactics to delay the effect of policy and to erode its stringency when eventually applied. It would open the process of policy implementation to the scrutiny of the people.

Finally, while the current strategy has placed substantial demands on a tight Federal budget, a user charge strategy would generate revenues. These revenues could be used to finance those environmental measures which municipalities and industrial polluters cannot be expected to undertake. These include basic research and development, the establishment of regional or river basin authorities to manage the use of regional environmental resources, and the construction of installations to artificially reerate streams or to increase stream flows during low flow periods.

To illustrate this impact on the Federal budget of the current strategy relative to an effluent charge strategy, I have appended a table to this statement. This table projects the budget outlays for two versions of the current strategy—the proposals of Senator Edmund Muskie and the Administration—and the net budget outlays for an effluent charge strategy. These projections cover the five years, FY 1972–FY 1976. The total five year costs of the two versions of the current strategy are \$14 billion for the Senator Muskie's proposal and \$12 billion for the Administration bill. The net budgetary costs of the effluent charge strategy—which includes a grant program as large as that of the Muskie bill—is \$4.3 billion.

In evaluating the merits of an economic approach to environmental policy, let me emphasize that appropriate effluent charge legislation will, by itself, be inadequate to insure the efficient use of environmental resources. Comprehensive environmental management requires the establishment of regional authorities with responsibility for planning for the optimal use of and augmentation of environmental resources, undertaking collective investments, setting water and air quality standards and charge levels designed to meet these standards, monitoring discharge levels into both water and air resources, and regulating patterns of regional land use. To be effective in managing the environment consistently

with regional preferences, these authorities should be governed by directly elected rather than appointed officials.

Moreover, while the proceeds of the effluent charge could be devoted to environmental activities such as stream flow augmentation or waste treatment plant construction, care must be exercised to insure that the incentive effect of the effluent charge is not substantially eroded by the use of the revenue. As was emphasized earlier, the cost sharing arrangements implicit in existing legislation provide industrial waste dischargers with waste treatment services at far less than full costs. To the extent this is so, desired incentives for reductions in waste discharge are reduced.

It is almost legendary by now that some will label user or effluent charges as "licenses to pollute." This mindless cliché should be laid to rest once and for all. Aside from completely and totally prohibiting the discharge of wastes into rivers, all policy proposals envision some optimal level of use of watercourses for waste disposal. The question is: How to obtain that level of use at minimum social cost? Because the effluent charge can be fixed at any level between zero and infinity, a charge structure can be determined which will secure socially optimal levels of water quality. With that charge structure set, individual polluters are free to respond to it in any way they choose. As rational decision-makers, they will choose the most efficient and effective methods of reducing dischargers in order to reduce the tax. Relative to other means of securing equivalent reductions in waste loads, an effluent charge strategy is likely to entail smaller administrative and enforcement costs, be less subject to tactics designed to delay supplementation and erode standards, and by allowing dischargers to frame their own responses to the charge structure, secure desired reductions in waste loads at minimum social cost. Rather than a license to pollute, user charges are an effective instrument of environmental management based on a clear appreciation of the fundamental cause of the problem.

Although I have concentrated on the use of user charges as a water pollution control strategy, I would emphasize that they are also effective instruments in managing other environmental resources. In this regard, I would draw your attention to current legislative proposals regarding a tax on leaded gasoline, a special tax on industrial emissions of sulphur oxides, and a unit charge on disposable bottles.

In conclusion, let me reiterate the important role which government-imposed user charges can and should play in reordering national priorities. As I have tried to show, major improvements in water quality will not be obtained by simply allocating a bigger slice of the Federal budget to the current program. To do so would be to shift high valued resources from one low-valued use, say the military budget, to another low-valued use. A real reordering of national priorities toward improved environmental quality requires first a major overhaul of the current policy strategy, and then, perhaps, a budget reallocation. The increased use of user charges and economic incentives are central to an appropriate policy overhaul and prior to the allocation of an increased level of public expenditures to this and other pressing social problems.

PROJECTIONS OF BUDGET OUTLAYS FOR THREE PROMINENT WATER POLLUTION CONTROL PROPOSALS, FOR FISCAL YEARS 1972 TO 1976

[In millions of dollars]

	1972	1973	1974	1975	1976
1. The National Water Quality Standards Act (The Muskie bill):					
Waste treatment grant program	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500
State and interstate agency grants	20	20	20	20	20
Remainder of FWQA ¹	171	233	318	431	582
Total—FWQA	2,690	2,753	2,838	2,951	3,102
2. The administration proposals:					
S. 3468—Environmental Financing Agency	100				
S. 3470—Research and demonstration	125	² 125	² 125	² 125	² 125
State and interstate agency grants	12.5	15	20	25	30
S. 3472—Waste treatment grants	2,000	2,000	2,000	³ 2,000	³ 2,000
Remainder of FWQA ⁴	52.5	115	195	301	447
Total—FWQA	4,290	2,253	2,338	2,451	2,602
3. The Regional Water Quality Act (The Proxmire bill):⁵					
Pollution abatement grants program	2,500	2,500	2,500	2,500	2,500
Remainder of FWQA ⁶	190	253	338	451	602
Total—FWQA	2,690	2,753	2,838	2,951	3,122
Revenues from effluent fee ⁶	2,000	2,000	2,000	2,000	2,000
Net budget cost	690	753	838	951	1,122

¹ Estimate obtained by assuming that annual FWQA outlays other than for waste treatment facilities grants grow by average rate of growth of these outlays from fiscal year 1969-71.

² While the bill provides authority for fiscal year 1970-72, this authorization is applied to the entire fiscal year 1972-76 period.

³ While the bill provides authority for fiscal year 1972-74, this authorization is applied to the entire fiscal year 1972-76 period.

⁴ Includes estimated outlay for the environmental financing authority.

⁵ It is assumed that the program of grants for pollution abatement will be equal to that of the Muskie bill, but that grants will be made to both municipalities and regional water management associations on a 50-50 basis, as provided in the Proxmire bill.

⁶ It is assumed that a charge of 10 cents per pound of biochemical oxygen demand is imposed on industrial dischargers, and that this charge would induce about a 50-percent reduction in BOD discharges. Because a comprehensive effluent charge strategy would levy fees on the discharge of heat, chemical oxygen demand, and suspended and dissolved solids, and on municipal as well as industrial polluters, this estimate seriously understates the revenue which would be generated under such a comprehensive policy.

WATER POLLUTION CONTROL,
RIVER BASIN AUTHORITIES, AND
ECONOMIC INCENTIVES:
Some Current Policy Issues

BY

A. MYRICK FREEMAN III AND ROBERT H. HAVEMAN

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WATER POLLUTION CONTROL, RIVER BASIN AUTHORITIES, AND ECONOMIC INCENTIVES: Some Current Policy Issues

A. MYRICK FREEMAN III AND ROBERT H. HAVEMAN

I. Introduction

As environmental degradation has emerged as a prominent public policy issue, the Congress has responded by creating legal and administrative frameworks within which the states are to take over the primary responsibility for managing their air and water resources.¹ Because public perception of the problem and the legislative response came earlier for water pollution than for air pollution, our experience with water pollution control policies has been more extensive. Until very recently, all the legislative efforts to control water pollution have emphasized the regulatory functions of setting standards for instream water quality, making rules governing the quantities and qualities of permissible discharges, and enforcing compliance with these rules. Especially at the federal level, this emphasis on public regulation was sweetened by a liberal application of subsidy — the use of public funds for treatment facilities designed to reduce the adverse environmental effects of industrial and municipal waste discharges.

The performance record of existing policy for the control of water pollution at both federal and state-local levels has for the most part been one of failure.² At the state and local level,

* Much of the work on this paper was accomplished while both authors were Visiting Scholars at Resources for the Future, Inc. The authors are indebted to Blair Bower, Allen Kneese, Jack Knetsch, Marc J. Roberts, Clifford Russell, and Thomas Willett for helpful comments on an earlier version of this article.

¹ See J. Clarence Davies, *The Politics of Pollution* (New York: Pegasus, 1970), pp. 37-49.

² The failure of water pollution control policies was recently documented in a report of the Comptroller General which pointed out that despite the expenditure of \$5.4 billion between 1956 and 1969, the quality of the water in most of our rivers has been steadily declining over this period. See *Examination into the Effectiveness of the Construction Grant Program for Abating, Controlling, and Preventing Water Pollution* (Report of the Comptroller General of the United

legislation has been slow in coming and, when passed, has typically been thwarted by serious budgetary and technical limitations. Agencies established to fix water quality standards and to enforce effluent restrictions on industrial and municipal polluters have often lacked the political strength necessary to secure rigorous standards or gain compliance. Federal enforcement policy has met with substantial delays, while those treatment facilities included in the federal grants program have been chosen on a "ready-to-go" basis and not because of their contribution in improved water quality. Moreover, facilities, once in operation, have often been inefficiently operated. The subsidy inherent in federal financing has provided little incentive for undertaking lower-cost abatement alternatives involving internal process changes, instream aeration, and low-flow augmentation.

To many, failure of the enforcement-subsidy approach to pollution control has come as no surprise. Nowhere in this approach is recognition given to the fact that controlling the use of water courses is a basic economic problem of resource allocation — a problem which is in principle no different from the task of allocating the nation's labor force, land area, and capital facilities to their most productive uses. Similarly, it was apparently not recognized that valuable resources which are available to all without charge are destined for overuse, misuse, and economic waste. No attempt was made to correct the zero price implicit in the unrestricted use of the waste disposal services of common property watercourses. Finally, this policy strategy failed to recognize that creating economic incentives to reduce waste generation could be a viable alternative to the treatment and disposal of an ever-increasing and uncontrolled flow of wastes.³

In recent months, recognition of the failures of past efforts to improve water quality has stimulated a search for alternative policy approaches. In the current debate, a number of proposals for reorienting the existing strategy have been developed and

States, General Accounting Office; Washington, D.C.: Government Printing Office, 1969). A similar critique of federal and local efforts to control air pollution is found in John C. Esposito (ed.), *Vanishing Air: The Ralph Nader Study Group Report on Air Pollution* (New York: Grossman, 1970).

³ For an incisive critique of existing federal water pollution control legislation, see Allen V. Kneese, "Strategies for Environmental Management," pp. 37-52 of this journal.

submitted to the Congress and state legislatures. Within the past year, two states have adopted programs which are significant departures from the enforcement-subsidy strategies of the 1960s.

These proposals contain two features which represent a substantial departure from past pollution control policy. The first element recognizes that a river is a system and cannot be efficiently managed in piecemeal fashion by numerous agencies and jurisdictions. It emphasizes comprehensive river basin planning and water quality management. Second, each of these proposals emphasizes economic incentives — prices and charges — as a means of reducing the output of industrial and municipal wastes.⁴

We shall describe the most prominent of these proposals, and discuss several economic and political issues common to them. All of these issues require careful analysis and discussion before the formation of a commitment to a new pollution control strategy. We also present a proposal for reform of federal policy through experimentation with a regional water quality authority.

II. Some Prominent Proposals for Policy Reform

Although most of the current proposals for reorienting water pollution control policy accept the need for both basin-wide planning and economic incentives in the form of charges, they employ a wide range of institutions and techniques to accomplish their objectives. Here we shall briefly describe five of these proposals.

The legislative proposal which most explicitly incorporates incentives and river basin management was offered by Senator William Proxmire.⁵ This bill would establish a national structure of effluent charges to be imposed upon *industrial* polluters. Charges would be based on “the quantity and quality of the waste discharged” and “the resulting damage to the quality of the

⁴ This should not be taken to imply that proposals containing these elements did not exist at the time of earlier legislative efforts. They did. See Davies, *op. cit.*, 45–66; and Allen V. Kneese, *Water Pollution: Economic Aspects and Research Needs* (Washington, D.C.: Resources for the Future, 1962), and *The Economics of Regional Water Quality Management* (Baltimore: Johns Hopkins Press, 1964).

⁵ This proposal is incorporated in Senate Bill 3181, The Regional Water Quality Act of 1970. See U.S. Congress, *Congressional Record*, Senate, November 25, 1969, pp. S 14971–S 14976.

waterway.”⁶ One-half of the revenues from the effluent charge would be granted to municipalities for the construction and operation of waste treatment facilities. The remaining 50 percent of the revenue would be made available to regional water management associations, as an incentive to the establishment of such agencies.

In a recent speech Senator Edmund Muskie outlined what may be his next major proposal for federal legislation. He stated:

There may be a very useful way in which charges related to waste disposal can be applied, both for purposes of meeting the costs of pollution control and abatement, and for the objective of encouraging industries to reduce their output of wastes and to recover and re-use materials. That would involve river basin planning, a prohibition against private discharges of wastes into public waterways, the collection and treatment of all wastes by public agencies, and charges to waste dischargers based on the cost of treating their wastes. During the next five to ten years, such a program would undoubtedly require substantial public grants for the capital costs of combined municipal-industrial waste treatment systems. In the long-run, however, such programs could and should be self-supporting.⁷

In a recent issue of *Harvard Law Review*, Professor Marc J. Roberts described in some detail a proposal similar to that of Senator Muskie.⁸ Roberts' proposal has the following elements:

1. For each river basin an authority would be created by

⁶ The difference between effluent and user charges should be noted. An effluent charge is imposed upon waste discharged directly into rivers and streams. In a very real sense, it is a price paid for the use (or rental) of the assimilative capacity of the watercourse. A user charge is a price set by a public agency (or publicly regulated agency) for the collection and treatment of wastes. The level of the charge is related to the cost of handling and treating the waste. Both forms of charge represent costs to the firm and, as such, encourage economizing on the use of the river as a waste receptor and induce a search for production processes which entail lower levels of waste by-products. The use of effluent charges as a tool for water quality management has been carefully analyzed by Allen V. Kneese and Blair T. Bower, *Managing Water Quality: Economics, Technology, Institutions* (Baltimore: Johns Hopkins Press, 1968), especially Chap. 6.

⁷ Excerpts from "Money for Water," Remarks of Senator Edmund S. Muskie at the National Association of Counties, Washington, D.C., March 24, 1970.

⁸ Marc J. Roberts, "River Basin Authorities: A National Solution to Water Pollution," *Harvard Law Review*, LXXXIII (May 1970), 1527-1556.

the federal government as a special-purpose public agency to plan for and manage water quality for the basin as a whole.

2. The authority would collect and treat in its own plants all municipal and industrial liquid wastes generated in the basin. It would possess the sole right to use the river for waste absorption and dispersal.

3. The authority would be financed by federal grants to cover all or a part of the costs of treating *municipal* wastes and by user or service charges to cover the full costs of treating *industrial* wastes plus the portion of municipal wastes not covered by federal grants.

4. The user charge to be levied by the authority on industrial waste dischargers would be set so as to equal the marginal cost of *treating* their wastes, plus or minus a fixed charge (unrelated to the amount of waste generated) depending on whether the marginal cost charges fall short of or exceed the total cost of the basin authority.⁹

In his proposal, Roberts emphasizes that the marginal cost pricing scheme will induce industrial firms to reduce the quantities of residuals discharged into the collective treatment system. He states:

In general, the most efficient cost structure for private industry service charges would be to charge each firm the marginal cost of abating its pollution. In this way, pollution would become a regular cost of production for the firm and would provide a mechanism for a socially efficient input choice by individual firms regarding internal process changes. If the marginal cost of abatement per unit of pollutant were greater than the cost of an internal process change which would remove the same amount of pollutant, the firm would change processes.¹⁰

The State of Maryland has recently enacted a somewhat similar user charge plan. The Maryland Environmental Service (MES), a public agency, will plan for, build, and operate all waste water and solid waste treatment facilities in the state. It

⁹ See *ibid.*, 1551–1552 for an explanation of the necessity of a fixed fee or two-part charge schedule.

¹⁰ *Ibid.*, 1551.

will finance these by user charges to industrial and municipal customers which would be designed to recover total cost. In the original proposal, the MES was to be the *only* entity, public or private, permitted to discharge wastes in any form into the waters of the state.¹¹

Finally, recent legislation enacted by Vermont employs economic incentives to accelerate compliance with the provisions of state-issued waste discharge licenses.¹² Temporary effluent charges are imposed on those whose discharge of waste into streams *exceeds* that permitted by the permit which they hold. The charge ceases once the terms of the license have been met.

To the extent that these plans incorporate one or both of the features of river basin planning and economic incentives for waste reduction, they represent a marked improvement over prevailing policies and practices. Nevertheless, several of the provisions of these proposals raise critical and difficult issues concerning pollution control. In the following sections, we shall analyze these issues, using the proposals as examples or illustrations. These issues include the scope of the river basin authority (i.e., the range of decisions over which it is to be given responsibility), its powers and functions, the effects of federal cost-sharing, and the river basin authority as a political institution.

III. The Scope of River Basin Authorities

The objective of regional water management is to achieve optimum use of the common property river system in its many functions. These functions range from recreational services, such as swimming and fishing, to hydroelectric production, to municipal and industrial water supply, to navigation services, to the absorption and dispersal of wastes. Where competition among these functions exists — such that utilizing more of one entails less availability of another — the basin authority should, through

¹¹ Study Commission to Investigate the Problem of Water Pollution Control, *A Program for Water Pollution Control* (mimeographed; Annapolis, February, 1967), and Maryland Senate Bill No. 382, which established the Maryland Environmental Service on July 1, 1970.

¹² Vermont Statutes Annotated, Title 10, Chapter 33, Subchapter 1, esp. Section 912a.

planning and evaluation, allocate the limited services of the watercourse optimally among the alternatives.¹³ Although some of the decisions regarding allocation of the river do not impinge directly on water quality, they cannot be isolated from water quality choices because of the interdependence of the entire river system.

In addition to the interdependencies among uses of the water resource, there are important interrelationships between water quality and other economic activities and environmental conditions in the region. For example, the location of a vegetable processing plant along a watercourse affects the decisions of the water quality manager. In turn, the manager should be able to influence the decision about location. Also, the activities of the water quality manager in reducing industrial water pollution cannot be disassociated from the question of the ultimate disposal of the waste materials generated. Induced reduction of liquid waste can aggravate a solid waste problem or, through incineration, lead to increased air pollution. Similarly, policy decisions regarding air pollution and solid waste disposal will affect water quality management. The water quality manager should be able to influence activities which impinge on the services of the water resource and should be required to respond to the side effects generated by his decisions.

These considerations suggest the following principles for the establishment of agencies or authorities for managing environmental quality. First, since air, land, and water-use decisions are interdependent, responsibility for planning in these areas must not be fragmented. Even if all environmental policy decisions are not made by a single regional authority, the institutional arrangement should require that the side effects of decisions made by any one unit be recognized and accounted for by it.

Second, the geographical boundaries of the authority's scope

¹³ The following illustrate the interdependence and trade-offs among watercourse uses, and the dangers in a decision-making process which disassociates them from one another and focuses on only a single use.

1. Increased use of the stream for waste absorption and dispersal comes at the expense of swimming, fishing, and other recreational uses;
2. More use of the stream for hydroelectric generation or navigation comes at the expense of streamflow regulation for increased waste absorption;
3. Increased investment to control the flood potential of the stream may reduce its suitability for "wild river" uses.

must include the river basin, the relevant air-shed, and a meaningfully distinct economic region. Because the boundaries of watersheds and air-sheds seldom correspond, it is often impossible to attain this objective. Moreover, the boundary which, through compromise, is established around a physical system is not likely to correspond to any existing political jurisdiction or economic region.¹⁴

Advocacy of these principles, then, is a counsel of perfection. Nevertheless, if the interdependencies among the uses of a river and among the river and other dimensions of the environment and the economy are ignored, the decision framework itself will induce resource misallocation and inequity.

In this regard, the Maryland Environmental Service is significant. By its very organization, it recognizes the interdependence between water quality and solid waste disposal. However, as an operating agency, MES has no authority in the realm of air quality, nor can it make decisions about the allocation of water among uses. It takes water quality standards as given, and undertakes treatment to meet the standards. To this extent, MES lacks the scope necessary for environmental quality decisions which comprehend all relevant costs and gains.¹⁵

IV. The Powers and Functions of a River Basin Authority

In addition to the question of scope, there is the important question of the arsenal of weapons to be granted to the river basin authority. Indeed, the composition of the arsenal is important even if the responsibility of the river basin authority is limited to achieving a set of exogenously determined water quality standards.

¹⁴ This will, in turn, compound the problem of political structure discussed below.

¹⁵ While MES recognizes the interdependence between water and air quality, the other proposals do not. Moreover, the other proposals, like MES, are either silent on the question of how water quality (and other environmental) goals are determined, or assume that the goals are determined somewhere else and that the river basin authority takes them as given. If, however, the river basin authority is denied responsibility for the establishment of goals or for basinwide resource allocation decisions, one major reason for establishing a regional authority for environmental quality of some kind is essentially negated.

The following list indicates the range of activities which can improve water quality. An agency for comprehensive management of water quality must have available a range of instruments which can induce appropriate levels of each of the activities. While some of these instruments may involve direct agency investment, others will involve agency actions to induce altered behavior in the private sector.

1. Production process changes within plants to recycle residuals or reduce residuals generation;

2. Construction and operation of conventional waste treatment facilities at individual outfalls;

3. The discharge of untreated or partially treated effluent into river stretches with high assimilative capacity;

4. Regional collection and treatment of residuals where economies of scale in treatment or combination of waste products result in lower treatment cost;

5. Augmentation of the assimilative capacity of the stream by regulation of stream-flow or direct treatment of rivers through oxidation lakes or in-stream aeration devices.

If all of these activities can be affected by the basin authority, it is convenient to think of its task as determining the optimal mix of all of the instruments, then inducing private and municipal dischargers to undertake the optimal amounts of 1, 2, and 3, while it undertakes the right mix of 4 and 5.

Relative to a basin authority's possessing a full set of policy instruments, the agencies implicit in some of the proposals we have described appear severely restricted. Consider, for example, the Muskie and Roberts proposals. In both of these proposals, user charges for collective treatment of wastes would provide a financial incentive to dischargers to reduce waste outputs. Hence, both options 1 and 4 are integral components of both proposals. The agency could also employ option 5, as appropriate. However, options 2 and 3 are explicitly ruled out. These plans assume, in effect, that the optimal strategy for the authority would never include discharges of treated or untreated wastes directly to the river by firms. That is, they assume that collection and transport of wastes to the central treatment plant will always be cheaper than discharging wastes with or without treatment at the firm and making up for the additional residuals load on the

stream (if necessary) by increasing the level of treatment of other wastes at the central facility.¹⁶

It is not clear what advantages are alleged to accrue by completely banning private discharges to the watercourse and requiring use of publicly owned collective treatment facilities. If the argument rests on economies of scale in treatment, the ban would be unnecessary. The advantages of economies of scale would be realized whenever the collective facility could offer to accept a firm's wastes at a user charge (cost) lower than the cost to the firm of individual treatment. When faced with alternatives, the rational firm will always choose the lower cost alternative.

On the other hand, it may be felt that waste dischargers would either not respond to effluent charges or would fail to provide the agreed-upon level of treatment privately. While such instances may occur, it should be emphasized that public ownership and operation of the treatment facility does not in itself guarantee ideal performance.¹⁷

Assurance of high standards of performance of either public or private facilities can only be obtained by providing appropriate incentives (either positive or negative or both) along with continual monitoring of performance. It is at this point that an effluent charge can play a role in the authority's management strategy. Since options 2 and 3 are typically part of the least-cost policy mix, the authority should find some way of inducing private dischargers to take the appropriate actions. Some combination of user charges (where economies of scale make col-

¹⁶ Of the requirement that all firms send their wastes to the collective facility for treatment, it might be said that "some plants will be asked to spend large amounts of money [to pay for the public treatment of their wastes] for small or negligible increases in the usefulness of the stream. . . ." See Roberts, *op. cit.*, 1543. This quotation is taken out of context from a passage in which Roberts rightly criticizes a policy of requiring uniform percentage treatment of all wastes at individual outfalls as being inefficient. A ban on private discharges results in similarly inefficient equal treatment at the collective treatment facility.

¹⁷ A recent study by the General Accounting Office has confirmed the widely held belief that municipal treatment facilities are often operated inefficiently and remove smaller percentages of wastes than their design capacity. Over half of the 54 plants studied by GAO were providing inadequate treatment. See *Need for Improved Operation and Maintenance of Municipal Waste Treatment Plants* (Report of the Comptroller General of the United States, General Accounting Office; Washington, D.C.: Government Printing Office, 1970). The reasons for poor performance include overzealous attempts to hold down plant operating costs, the difficulty in hiring trained, competent, and motivated operating and supervisory personnel, and overloading of existing capacity, especially by industrial wastes.

lective treatment attractive) and effluent charges will provide the correct incentives to induce optimal private decisions regarding options 1, 2, and 3.

V. Federal Cost Sharing and Economic Incentives

Federal sharing in the costs of treating domestic and industrial wastes is a significant aspect of present policies on control of water pollution, and would play an important role in the Muskie, Roberts, and Proxmire proposals.¹⁸ Cost-sharing has effects on both efficiency and equity which must be considered in the analysis of policy alternatives.

To achieve economic efficiency in pollution abatement, waste generators — both domestic¹⁹ and industrial — must be required to bear the full social marginal cost of either the dumping of effluent (treated or untreated) into a watercourse or the collective treatment and disposal of wastes. If the federal government bears a share of the capital or operating costs of treatment facilities, user charges which reflect the remaining marginal costs will be inappropriately low. Because of the divergence of user charges from the marginal social costs of waste treatment, dischargers will be induced to send excessive quantities of wastes to the facility. As a consequence, both public investment in treatment facilities and the total costs of waste disposal (public and private) will be larger than necessary. Moreover, the extent of excess cost will be larger the more responsive are dischargers to changes in the user charges imposed on them.

Cost-sharing arrangements have impacts on equity in addition to these effects on efficiency or resource allocation. If the federal government bears a portion of the costs of waste treatment, some of the financial burden of waste treatment would be shifted from those who would ultimately have paid full cost user charges to federal taxpayers. If there were no cost-sharing, the total financial

¹⁸ Also the MES proposal explicitly states that one purpose of the service is to obtain the maximum benefits of federal subsidies for more of Maryland's industrial polluters. See *A Program for Water Pollution Control, op. cit.*, p. 11.

¹⁹ The distinction between industrial wastes is difficult to make and often blurred. Laundries, restaurants, hotels, hospitals, and even food processors are often connected to municipal collection and treatment systems, and their wastes are usually included in the domestic category.

burden would, in all likelihood, be distributed in a regressive manner. A larger *relative* burden would be imposed on lower income groups. This is true of user charges imposed on both domestic and industrial dischargers. In the former case, treatment costs would be likely to be financed through sales or real property taxes or through user fees based on water bills.²⁰ All of these fiscal instruments are seriously regressive. The user charges imposed on industrial dischargers will tend to be passed on to consumers of the goods in the form of higher product prices. Again the general pattern of incidence would tend to be regressive.

Because of the regressive incidence of user charges, some have argued for a more equitable distribution of financial burden. Federal cost-sharing, it is said, would shift the burden of treatment costs from the regressive structure of consumption and state and local taxation to the more progressive federal income tax structure. This argument, however, neglects two important qualifications. First, although cost-sharing can change the distribution of the burden between rich and poor, it also increases the total burden because of the adverse effects on economic efficiency. Whatever equity benefits are gained by cost-sharing come at the expense of higher-than-necessary treatment costs. Cost-sharing is apt to be a very expensive way to obtain distributional equity. Second, in the case of industrial dischargers, the benefits of cost-sharing may not accrue fully to consumers. Rather, a portion of the benefits may accrue to the firms and the owners of specialized factors of production. This is especially likely to be true in the case of large, multiplant, industrial dischargers selling in imperfect markets.²¹

Clearly, the precise nature of the impacts of cost-sharing on equity and efficiency depends on the particular program and its

²⁰ Roberts, *op. cit.*, 1548-1549.

²¹ Another possible defense of federal cost-sharing is that municipalities are often at the limit of their ability to borrow for new capital projects. Federal cost-sharing would reduce the burden on the capital resources of the municipality. Like the equity arguments, this neglects an important qualification. The federal government could alleviate the capital burden in several ways — by requiring full repayment (including interest) of any assistance, by guaranteeing municipal bond issues, or by purchasing municipal bonds either directly or on the open market. All of these would accomplish the desired capital market effect at less cost to the federal government and without the elimination of incentives for waste reduction.

cost-sharing provisions. For example, present federal law authorizes grants to municipalities to cover up to 55 percent of the construction costs of waste treatment facilities. Projects are eligible even if a substantial part of their capacity is used to treat industrial wastes. While federal regulations require municipalities to establish user charges to recover costs from industrial dischargers connected to the public system, the charges need only to recover locally-borne costs. As a result, user charges paid by industrial dischargers have covered as little as 20 percent of the capital costs of the capacity built to treat their wastes.²²

Because of this arrangement, there has been a serious erosion of waste reduction incentives to firms connected to federally supported municipal plants. The resulting excessive waste load is bound to entail significantly higher over-all costs of waste treatment. Moreover, because domestic, like industrial, dischargers can respond to economic incentives by reducing waste discharges, the existing cost-sharing arrangement results in excessive domestic wastes being discharged to the municipal facility.²³ Although the equity effects of the existing arrangement may be favorable, the extra costs (largely public) for waste treatment facilities appear to be an inordinately expensive means of achieving a more equitable distribution of income — especially in comparison to direct income maintenance plans or tax reform.

While its cost-sharing provisions are quite different from existing legislation, the Proxmire bill would also distort the economic incentives which would face municipalities under a system of full marginal cost charges. Not only would this proposal ex-

²² This assumes a 25 percent grant from the state plus the maximum 55 percent federal grant.

²³ The likely response of domestic dischargers to alterations in treatment charges is often underestimated. See, for example, Roberts, *op. cit.*, 1553-1554. The trade-off between solid and liquid wastes inherent in the kitchen garbage disposal implies substantial potential for response. Similarly, those commercial dischargers enjoying a domestic classification are likely to possess substantial opportunities for reducing discharges. For instance, if municipal solid waste agencies impose increasingly higher charges on apartment houses and office buildings, while liquid waste treatment costs are federally supported, the logical response on the part of a building manager would be to install a shredder in the building and discharge the shredded material into the sewage system. (We are indebted to Blair T. Bower for this example.) Finally, it should be noted that, because of the judgmental nature of classification systems, special treatment of domestic dischargers provides an incentive for all dischargers to press for changes in the rules of classification which would improve their chances for receiving a "domestic" classification.

empt domestic sewage from the national effluent charge, but it would also provide grants to cities of up to 50 percent of the revenue of the effluent charge for the construction and operation of waste treatment facilities. With this arrangement, domestic waste sources would have little incentive to reduce the production of wastes. Moreover, municipalities would be encouraged to build, maintain, and operate waste treatment facilities when other options might be more effective or less costly. Also in this case the equity effects from cost-sharing do not appear to be favorable. The source of the revenues is not the progressive federal tax structure; rather, the revenue to be distributed would come from a structure of effluent charges on industrial waste sources. These charges would raise the costs of production in the private sector and would be passed on to consumers in a pattern similar to generally regressive excise or sales taxes.

Finally, the Roberts proposal would alter cost-sharing rules to insure that industrial dischargers bear the full treatment costs of their wastes, but it would exempt domestic dischargers by providing for federal subsidies equal to the share of capital and operating costs attributable to domestic wastes treated by collective facilities. Hence, whereas industrial waste sources would have the proper incentives to reduce waste output, domestic sources would be encouraged to discharge wastes to the treatment system at a higher than optimal rate.

VI. Some Obstacles to Efficient Charge Structures

In our discussion so far and in the theoretical literature regarding pricing, it is assumed that the relevant information is readily available for establishing optimal price structures. Where theoretical pricing principles are applied to a practical task of establishing effluent or user charges, however, serious problems can arise. These problems should not be ignored in the discussion of public policy. Two questions relating to the feasibility of implementing an optimal system of user and effluent charges are the setting of marginal cost prices when cost functions are nonlinear, and the determination of an efficient price or charge structure in a dynamic setting with imperfect information.²⁴

²⁴ Another question concerning information is the feasibility of satisfying the

When treatment cost functions are nonlinear, the marginal cost of treatment is not constant with respect to the rate of discharge. In this case, it is impossible to calculate a marginal cost for each firm which is independent of the actions of all other firms. Every time one firm changes its waste discharge, the incremental cost to the system changes, and every other firm's charge schedule must be changed accordingly. The difficulties and uncertainties this interdependence would impose on decision-makers and individual firms should not be underestimated.²⁵ Individual firms could not operate efficiently if confronted by a service charge schedule which fluctuated over time in response to the level of discharges of other firms.

In principle, the river basin authority could avoid this problem. If the authority knew its own marginal cost schedule and the marginal cost of reducing waste discharges for all firms connected to the system, it could find the least cost pattern of discharges and calculate the set of charges for all firms which would bring this about. To calculate the optimum in a dynamic world, however, the authority would have to know how numerous demand and cost functions and technologies in the river basin were going to shift over time. Satisfying this information requirement is not feasible. As a consequence, river basin authorities will have to resort to rules of thumb and approximations in setting user charges (or effluent charges based on nonlinear damage functions).

The second problem concerns the determination of plant capacity and effluent charge schedules in the absence of perfect information. In order to estimate the optimal *size* of the collective treatment plant, the authority needs to know the treatment cost and process change cost functions of all dischargers. Without this knowledge, the authority is likely to underestimate or overestimate the amount of wastes to be treated at a given posted charge schedule. If it underestimates the wastes to be

monitoring and measurement requirements associated with an optimal system of effluent or user charges. It is not always recognized that the same technical requirements apply to both effluent *and* user charges. See, for example, Roberts, *op. cit.*, 1554-1555. Fortunately the measurement technology is available, and costs appear small relative to the other costs and benefits associated with water pollution control.

²⁵ This problem is analogous to the difficulties of imposing effluent charges when the damage function is nonlinear. See Kneese and Bower, *op. cit.*, pp. 94-96 and 109-112.

treated, it will be faced with costly additions to a plant already built; if it overestimates the waste discharges, it will experience wasteful excess capacity. Similarly, if effluent charges are used as a means of achieving given standards of water quality, the authority must know the treatment cost and process change cost functions of all dischargers in order to determine the appropriate set of charges. If these private costs are not known by the authority, however, it must proceed by rules of thumb and trial and error either in setting effluent charges or in investing in treatment plant capacity. In a world of imperfect information, a policy of effluent charges appears to have an advantage for public authorities. Errors in the rules of thumb applied in this case do not involve public costs sunk in collective treatment facilities which may be either inadequate or excessive.

VII. The Political Structure of River Basin Authorities

One of the most basic issues regarding the establishment of regional basin authorities relates to their institutional and political structure. Yet these questions have received scant attention in either the literature on pollution control or the policy proposals discussed above. Nevertheless, at least two propositions lurk implicitly in much of the discussion regarding the structure of regional authorities for environmental management.

First, it is often presumed that river basin authorities should be federally sponsored and controlled.²⁶ Second, it is suggested that both municipal and industrial waste sources participate in the management of the authority. This is referred to as "local involvement."²⁷

We agree that the problem of water pollution is essentially a federal responsibility. Because of the interstate nature of many river basins and the desirability of avoiding the use of water quality standards and user or effluent charge structures in interstate competition for industry,²⁸ some jurisdiction larger than the in-

²⁶ See, for example, Roberts, *op. cit.*, 1546-1550.

²⁷ This position is taken by Roberts, *ibid.*, 1549-1550. Unfortunately, it is not clear whether he would have representatives of the public participating in the management of the authority.

²⁸ See Roger Sherman and Thomas D. Willett, "Regional Development, Exter-

dividual state is required. The important questions, however, are not ones of the level at which authority resides or the desirability of "local involvement." Rather, the fundamental questions deal with the form of the political structure, the ways in which political interests gain representation, and the mechanisms by which political responsibility is determined.

The terms "political responsibility" and "representation" refer to who makes policy decisions (such as the establishment of water quality standards) and to whom are they responsible. One possibility is to set up the river basin authorities as operating arms of some agency in the executive branch of the federal government.²⁹ The nominal line of responsibility would be up through the federal bureaucracy. Few propose this arrangement, and for good reason. A second possibility is to give municipal and industrial dischargers and other groups representation on a commission or board which establishes policy and directs the activities of a staff. This approach has been taken in some states.

There are, we suggest, several reasons why a commission so constituted would be an ineffective instrument for implementing policies on water quality management. On the basis of both past experience³⁰ and recent research,³¹ it appears that a public authority with regional responsibilities for environmental quality must meet certain minimum requirements, if it is to function effectively and respond to the needs of the people. First, the members of the policymaking body must be directly elected by those who are affected by the decisions which they make. Second, the members of the body must represent a wide variety of disparate interests within geographically defined constituencies. Third, the body must have policy jurisdiction over a wide range of issues. If these conditions are fulfilled, members of the body will be faced

nalities, and Tax-Subsidy Combinations," *National Tax Journal*, XXII (June 1969), 291-293, for a discussion of interstate competition in the context of external costs.

²⁹ For example, MES is an operating agency in the executive branch of the Maryland state government.

³⁰ See, for example, Paul MacAvoy, ed., *The Crisis of the Regulatory Commissions* (New York: W. W. Norton, 1970) for an assessment of the regulatory commissions and the reasons for the observed shortfall in performance.

³¹ See Edwin T. Haeefe, "Environmental Quality as a Problem of Social Choice" (paper presented at Resources for the Future Conference, "Research on Environmental Quality: Theoretical and Methodological Studies in the Social Sciences," June 18, 1970).

with the necessity for taking positions which will assemble a majority of voters, and they will be motivated to form coalitions and enter into vote trades on a wide variety of issues in order to secure passage of those policies which matter most to the voters. Haefele has shown that the theoretical rationale for representative democracy requires just this sort of representation, coalition-forming, and vote-trading.³²

Without question the institutional and political structures of authorities formed in the mold of the regulatory agencies do not meet these standards. There is neither direct election of policy-makers nor are representatives typically chosen from a wide variety of interests. Because the issues to be decided by regional authorities include many basic social choices about the use of natural and environmental resources, a great deal of attention must be given to the devising of an institutional and political structure which effectively responds to the desires of the people. As Haefele has stated regarding the management of environmental quality,

Environmental issues . . . are often primarily regional in nature. There is therefore a need for representational governmental structures at the regional level. . . .³³

It is when each citizen must resolve, within his own mind, how he feels about all aspects of the river basin that choices begin to converge, extreme positions fall, and public choice becomes realistic. But the citizen, speaking as a whole man, can do so only if he can vote.³⁴

³² See Edwin T. Haefele, "A Utility Theory of Representative Government," *American Economic Review* (forthcoming). If these conditions are not met, we are likely to have a situation which he has characterized as follows:

. . . Most of the choices made consciously by governments are either made by technicians who try to "balance" the interests of the affected parties or by a small group of politicians who hide their choices behind a "technical" but meaningless benefit-cost analysis. We thus have the worst of both worlds — technical analysis that is debased by political judgments and political deals in which only a small number and perhaps the wrong people may play. The criticism needs to be made explicit. I am saying two things about the technical analysis and two things about the political process. First, the technical analysis does not cover the full range of technical possibilities, and second, it is tempered by what the technician judges to be political reality. Both are grievous faults. The political process is faulty because, first, it is conducted by the wrong people . . . and, second, it is hidden behind technical surveys which purport to be objective ("Environmental Quality as a Problem of Social Choice," *op. cit.*).

³³ *Ibid.*, p. 73.

³⁴ *Ibid.*, p. 45.

Past experiences with appointive commissions as well as the findings of recent research do provide some insight and guidance, but the ultimate solution is not clear. Political scientists and economists have not reached agreement as to how people should organize themselves to make optimal collective choices. And the question of designing economic, political, and legal institutions for finding agreement on social goals and for carrying out actions to achieve them has been neglected by researchers in the area of public policy analysis. However, lack of definitive answers does not mean that this issue should not be discussed in evaluating alternative policies for control of water pollution. In fact, we judge it to be the most fundamental and difficult issue raised in this essay.

VIII. Toward Reform of Federal Water Pollution Control Policy

The proposals which we have discussed here, through their emphasis on a regional approach to water quality and their advocacy of economic incentives as instruments for securing reduced waste generation, suggest major revisions in federal policy on pollution abatement. Although the scope, functions, and political structure of river basin authorities and the role of federal cost-sharing are inadequately handled in the specific proposals, the policy strategy which they represent would be a significant improvement over the present enforcement-subsidy strategy.

If policy reform does move in the direction suggested by these proposals, enormous obstacles will be encountered. First, the optimal political structure for river basin authorities will collide with established political jurisdictions which are quite unlikely to yield. Hence, even if user charges are adopted, pricing and investment decisions are likely to continue to be partial and piecemeal. Decision-makers will be unable to consider the full range of allocations among uses and interdependencies among activities, and their jurisdiction will not correspond to the appropriate management unit. Moreover, decisions (e.g., on water quality standards) will continue to be made by administrative or regulatory agencies and not by open, freely elected political bodies such as those we have described in section VII. Second, because

of the greater visibility and effectiveness of effluent and user charges (relative to the cumbersome and easy-to-subvert enforcement strategy), they will be vigorously opposed by (especially industrial) waste dischargers.

Presuming the necessity of incremental reform of policies for national water pollution control, we propose establishment of a single experimental river basin authority based on the merger or consolidation of existing agencies responsible for various dimensions of the environment (air, water, land) in a particular region. The scope of the authority should balance the gains from decisions which encompass the major allocations among uses and regions and the disadvantages of large size. Its deliberations should be open and accessible to (and participated in by) the public.³⁵ The experimental authority should minimize reliance on legal enforcement and emphasize the use of economic incentives through user and effluent charges.

As a first step, the authority should post a set of effluent charges varying with the kind of waste being discharged and the time and place of discharge. The charge structure should reflect differences in the damage caused and variations in the assimilative capacity of the watercourse over time and place.³⁶ An estimate of the "correct" set of charges can be approximated by solving a computer simulation model of the river basin.³⁷ Experience with a given set of charges will indicate which charges should be raised or lowered. The optimal set of charges can be approached fairly rapidly with this experience.³⁸ The authority should also empower public utilities, either privately or publicly owned, to offer to accept and treat wastes from domestic and industrial sources. These enterprises would post prices based on marginal costs and

³⁵ The Water Use Advisory Committee of the Delaware Estuary Comprehensive Study may provide a useful model of citizen involvement in decisions concerning water quality goals. See Federal Water Pollution Control Administration, *Delaware Estuary Comprehensive Study, Preliminary Report and Findings* (Philadelphia, 1966), especially Appendices I and II.

³⁶ This assumes that the broad allocational goals have been set and are reflected in water quality standards.

³⁷ See Edwin Johnson, "A Study in the Economics of Water Quality Management," *Water Resources Research*, III (2nd Qtr. 1967), 291-305, for an example of such a simulation. This study is discussed in nontechnical terms in Kneese and Bower, *op. cit.*, pp. 158-64.

³⁸ See Jerome E. Hass, "Optimal Taxing for the Abatement of Water Pollution," *Water Resources Research*, VI (April 1970), 353-365, for a demonstration of this assertion.

build facilities on the basis of the estimated demand for their treatment services. In turn, these enterprises would pay an effluent charge to the authority to reflect the social cost of their discharge of treated effluent into the river and to provide a continuing incentive for high performance in the operation of the treatment plants. This charge would be part of the cost of doing business for the enterprise.³⁹

We judge that careful evaluation of an experiment with these characteristics would provide important evidence on the viability and potential of the comprehensive regional management framework as a basis for national water pollution control policy. There is good reason to expect that the effluent charge, the service charge, and the cost of internally reducing waste discharges by private treatment or process change, in combination with and under the umbrella of a politically responsive and representative regional environmental (or river) authority, would encourage socially optimal and efficient choices leading to pollution abatement.⁴⁰

It should be acknowledged, however, that an experiment such as we have proposed may fail to yield accurate information on the effectiveness of this strategy. For example, the operating success of the authority could be undermined by one or several of the merged agencies. Similarly, as a new and temporary political institution, the experimental authority might fail to generate public participation indicative of that which would be induced by a permanent national effort. Perhaps most serious, the expected reductions in waste generation due to the imposition of effluent and service charges might fail to materialize if the life of the experiment were too short, if there were concerted effort by dischargers to subvert the experiment, or if the probability of this

³⁹ This arrangement would be similar to the Maryland Environmental Service. The MES takes water quality standards as given and is responsible to another state agency for providing treatment sufficient to meet these standards. The MES is basically a public utility agency established to realize economies of scale in collection and waste treatment.

⁴⁰ As an alternative experimental approach, a single element of water pollution (such as BOD) might be subjected to a *national* effluent charge. While such an experiment would yield valuable information on the responsiveness of waste discharges to economic incentives, it would fail to provide evidence on the viability of the comprehensive regional authority as an institution for environmental management.

strategy's becoming the basis for national policy were judged to be low by waste dischargers.⁴¹

Although these reservations must be recognized, we would emphasize that any new strategy for pollution abatement must begin somewhere and in its early states will be subject to risks, uncertainties, and subversions similar to those which would affect the proposed experiment. The advantage of the experiment is that it is likely to yield valuable information regarding both regional authorities for environmental management and the ability of economic incentives to reduce waste generation at relatively low cost. If successful, the experimental regional authority would provide a model for the development of additional agencies in a full-blown national strategy. If judged to be unsuccessful, the nation would not be locked into yet another ineffective policy. If the resolve to reform the existing strategy does exist, an experiment such as the one we have proposed offers substantial advantages. Ultimately, however, it is the existence of the resolve to reform which is the basic issue.

⁴¹ A further difficulty of such an experiment concerns the interregional impacts due to the potential transfer of economic activity from the region in which the experiment is located to regions in which user and effluent charges are not imposed.

Chairman PROXMIRE. I would like to put this in perspective. Let's go back to the President's State of the Union Message last year, January 1970, for which I think he deserves great credit in being the first President to include as a major part of a State of the Union Message the condition of our environment. He called for an extensive program to combat pollution, not only water pollution which you talk about primarily, but air pollution and so forth. And he made some proposals as to how much this would cost. As I say, the proposals have been modified. In fact, just yesterday or today, I guess, the administration sent up—yesterday—they sent up legislation which would increase the cost of the antiwater pollution program.

Now, when we recognize that the purpose of these hearings is to consider our overall priorities, how we can allocate resources more wisely and efficiently, how we can economize on what the Federal Government spends and use it to get the greatest advantage for the public good, it seems to me you are offering something that is most useful in two ways. Number one, you make a proposal here which would greatly reduce the cost of meeting the water pollution problem. And number two, you provide a different kind of strategy which would provide a definite discouragement, a clear-cut, economically determinable discipline on polluters, so that they would have a reason to cut back on their pollution.

I understand that you have evaluated the cost of the Muskie proposal, which perhaps is the principal proposal of the majority in the Senate, at least, at about \$14 billion over the next 5 years.

Mr. HAVEMAN. That is correct.

Chairman PROXMIRE. The administration proposal is about \$12 billion. And your own proposal that you are making here is around \$4.3 billion.

I think that this seems so convincing to me—it costs less, and it should be more decisive in reducing pollution, and it has been tried in Cincinnati, West Germany, and Otsego, Mich., and elsewhere. And wherever it has been tried, it has been successful. Why is it, in your judgment, that these experts—and there are some fine experts on the committees of Congress and the administration—why is it that they adhere so tenaciously to the standard approach in the light of the GAO study and in the light of all the other things that you have indicated, which show that the standard approach is failing, it doesn't work?

Mr. HAVEMAN. It seems to me, Senator Proxmire, that your question gets to the basic issue of how public policy gets formed in a democracy like this one. The current strategy has the support of the major polluters—both municipal and industrial polluters. This is so, in part, because that strategy provides them a sizable subsidy which is paid by taxpayers generally. These polluters have raised a number of arguments concerning effluent charges as a strategy for water pollution control. They argue, for example, that the imposition of such a policy would be punitive, that it would have the effect of punishing the people who use the environment. In my view, that argument is indefensible.

What an effluent charge strategy does is to treat the environment in the same way that this Nation treats other resources, like labor.

It forces businesses to pay for the use of a resource. In that sense an effluent charge can be treated as a rent on the use of a valuable national resource.

Another reason that has been suggested by those who oppose an effluent charge strategy is that if such a strategy were to go into effect, industrial firms would be confronted with a cash flow problem; that is, by paying the effluent charges they would be using moneys which they would otherwise, so they say, be spending for pollution control equipment.

In my view, that argument too, fails to persuade. If there were a record of industry spending large amounts of money on water pollution control equipment, perhaps then the point would be made. That record does not exist.

Indeed, I see no reason why they should bring up a cash flow problem with respect to charges on the use of environmental resources. I have never heard them bring up the cash flow problem when it comes to meeting their weekly payroll, or to covering depreciation allowances, or to paying the rent on the buildings which they occupy.

Chairman PROXMIRE. In view of the fact that the tax would be imposed on all producers of paper, for example, the whole industry would be hit equally, pretty much—there would be some differences, depending upon their means of operation, I suppose, but roughly it would be the same—there would be a tendency, of course, for the corporation to pass this on to the consumer. And I think that is the way it should be. The people who consume a product, a part of the production or process which is polluting the water, should be required to abate that pollution and to provide an incentive for reducing the pollution.

But isn't it true that in the relatively short run the burden on the corporation is a burden on the businessman that would not be excessive, because he would have to pass it on?

Mr. HAVEMAN. I guess I couldn't have expressed part of the rationale for effluent charges any better than that, Senator. One of the things that an effluent charge does best is to alter relative prices in this economy.

It raises the prices of those commodities whose production does great damage to the environment, and relative to these prices, it would tend to lower the prices of commodities whose production does not do damage to the environment.

Now, as to your point concerning the burden of the charge. I think that you are correct regarding the extent of the burden. An effluent charge strategy will induce those industries which are either forced to pay the charge or to undertake treatment or other process changes to incur costs which they otherwise wouldn't incur. To the extent they incur these costs then, and to the extent they are competitive industries, then the prices of that product will rise. However, two studies convince me that in most industries the effect of effluent charges on total cost would be quite small.

Two studies which have dealt with this issue demonstrate that in the vast bulk of industries the effluent charge costs would be less than 1 percent of the value of the output of the firms which would

be paying the user charges, and less than 1 percent of the value added of these firms.

Chairman PROXMIRE. You are arguing that instead of spending \$14 billion, as the Muskie plan would propose, we would be spending \$4.3 billion, so it would be less costly, No. 1.

No. 2, I take it you are arguing that there would be less pollution. The incentive would be clear enough and sharp enough so that there would be less pollution.

And No. 3, whatever additional cost the Federal Government wasn't paying would be passed on to some extent to the consumer, but that there would be a discipline or a requirement for a more efficient utilization of resources, and therefore more recycling, and there would be a tendency, I assume, for the firm to want to increase its profits, reduce its cost, and cut its effluent tax by reducing its pollution and by engaging in more research which would permit it to recycle its wastes.

Mr. HAVEMAN. Yes.

A couple of points on that; while the budgetary figures which I cite pertain only to the Federal budget impact of the two strategies, it should be remembered that in the effluent charge strategy what is taking place is that business firms are being induced through economic incentives to undertake certain expenditures themselves which they wouldn't otherwise undertake.

These would also entail national resource costs.

The point, however, is that with the current strategy, this Nation has adopted the position that there should be uniform secondary waste treatment at outfalls. That is a very, very expensive way of obtaining reduced discharges into rivers. What the effluent charge does is to leave the decision concerning how to reduce waste to the individual discharger.

Several studies have shown that if firms are induced to undertake internal production process changes, they could reduce waste discharges by a very great amount at very low cost. In fact, there is a prominent industrial engineer who, I believe, is now an Assistant Secretary of Commerce who has argued that industrial polluters can gain substantial reductions in waste discharges through changing the kinds of inputs they use, the kinds of production technologies they use, and by undertaking very simple and elementary kinds of efforts to keep discharges from entering directly into rivers, at a very, very low cost.

As a matter of fact, he used the phrase "almost zero."

Chairman PROXMIRE. My time is up.

Congressman CONABLE.

Representative CONABLE. Thank you, Mr. Chairman.

Professor Haveman, you have given us a very persuasive prepared statement here, and I think it is the sort of thing that ought to be called to the public's attention more often.

I think the thing we have to be careful about here is in assuming that there is some magic in this proposal. The fact is that the cost is probably going to be as great to the public whether it is paid in increased prices, by the consumers, or whether it is paid through taxes.

I agree with you that this is a much more sensible way to go about it, because it involves industries themselves in the problem-solving process by giving them an economic incentive to do so.

However, their additional costs are going to be passed on almost entirely to the public ultimately; are they not?

Mr. HAVEMAN. That is correct.

Representative CONABLE. We have to be careful about assuming that Government has some magic wand that it can wave over a problem, like the problem of environmental contamination, and make it go away without any cost to the public. Really, the Government ultimately is incapable of providing any service without some cost to one or another class of the public, whether it be taxpayer or consumer; isn't that right?

Mr. HAVEMAN. That is correct.

Representative CONABLE. The great value of this lies in the increased efficiency that is involved in getting the industrial community through a process of economic incentive into the problem-solving process; isn't that correct?

Mr. HAVEMAN. I wouldn't disagree at all with that interpretation.

Let me give one caveat to it. OK?

Representative CONABLE. Yes.

Mr. HAVEMAN. In my view the basic argument in favor of the effluent charges, Congressman, has to do with the total cost of gaining a reduction in waste discharges. Now, that is a kind of tricky point. Let me try to express it.

Our current strategy adopts the proposition that we should have uniform secondary treatment at waste outfalls. What does this mean? This means that we will be subsidizing the building of treatment plants at outfalls to treat the wastes after they have been generated. That is one way of reducing harmful effect of the waste discharge. You let the wastes be produced, and then you try to clean them up.

What the effluent charge strategy does is something quite different. It says to the polluter, OK, we are going to impose a charge on you if you dump wastes into the river.

Now, you look around for the cheapest way that you can to reduce waste discharges.

In nearly all cases that I have had opportunity to look at, the alternatives available to business for reducing waste discharges are far cheaper than building a secondary treatment plant. In fact, a good estimate of the difference in total cost of reducing discharges is about two to one, that is, it would cost twice as much to reduce waste discharges by X amount if one is going to do it by constructing waste treatment plants at all outfalls than it would if one allows businesses to choose their own most efficient, effective and low-cost means of cutting back on the waste discharges.

So even though there is——

Representative CONABLE. Not allowing them to do it, but requiring them to do it?

Mr. HAVEMAN. Giving them an incentive to do it through the imposition of effluent charges.

Representative CONABLE. There is one thing that bothers me about this, and I wish you would elaborate on it a little more.

What mechanism do you use to establish the user charge? This mechanism is, of course, terribly important, because you are affecting the price of the goods or services that industry provides.

As Senator Proxmire pointed out, these user charges are likely to apply across the board to industries ultimately, anyway. There may be some that are located on streams that have a bigger problem than those that have already made major pollution abatement investments because they are located elsewhere. But you are going to have to make some analysis of the social utility of that particular consumer product or service, since you are affecting the price.

You are going to have to strike a balance in the process of establishing user charges, are you not?

And therefore, user charges become a rather delicate modification of the market-oriented mechanism that we now use. I am not arguing against you, I am just saying: How do you achieve this so that it will be fairly done?

Mr. HAVEMAN. My own preferences on how to proceed on this are as follows:

The first order of business is the establishment of a minimum nationwide effluent charge through passage of Federal legislation. This would be an effluent charge which is likely to be insufficient for many waste discharges and many river basins. But it will provide some incentive for waste dischargers to begin looking for ways of cutting down.

I would suggest a charge of 10 cents per pound of biochemical oxygen demand as a national charge.

The second order of business is to proceed very rapidly in establishing regional water management authorities. These would be agencies which would be governed by elected residents of the region. Such authorities would have the responsibility for monitoring waste discharges in their regions, setting river quality standards in their regions, and working from the base of the national effluent charge so as to modify it appropriately to the conditions in the river basin in which they are located.

Now, let me make one final point. The difficulty in establishing appropriate effluent charges on polluters is, as you say, a tough problem. But it is no tougher than going around and trying to set effluent standards on each outfall in this country.

And as I now see the legislation being currently proposed, Congressman, that is the direction we are going. We are going from a water quality standard approach to an effluent standard approach. This latter approach will require bargaining and negotiation with each of the 40,000 major outfalls in this country, and imposing standards on each of them.

My argument is that that is an administrative nightmare relative to the imposition of an effluent charge strategy.

Representative CONABLE. There is a certain amount of trade-off between water pollution and air pollution, is there not? You are going to have to try to tie it in with air pollution standards, are you not, in order to avoid having industries simply shift the type of pollution they are creating, again, in effect, continuing a socially undesirable practice in simply a different medium?

Mr. HAVEMAN. That is right. And the environmental authorities that I just mentioned should have jurisdiction over all of the environmental media, that is, they should be able to impose charges on and to monitor the use of all the media.

I would go on to say that one of the weaknesses of the current national approach to pollution is unfortunate, because we approach it on a piecemeal basis. We say, OK, now, let us look at water pollution. And we pass a water pollution bill.

And we say, Now let's look at air pollution. And we pass an air pollution bill.

And as you correctly point out, they are interdependent. It is a comprehensive problem.

Representative CONABLE. Thank you.

Thank you, Mr. Chairman.

Chairman PROXMIER. Would you explain briefly, Professor Have- man, what the basis of the effluent tax would be? You talked about the oxygen exhausting measure. How scientifically sure is that? Is it reliable? Can it be determined without question?

Mr. HAVEMAN. The primary characteristic of wastes which get discharged into rivers has to do with their oxygen-consuming characteristics. And the way this is measured is in terms of biochemical oxygen demand. That is a measurable concept. One can take a sample of waste from an outfall, and by applying a monitoring instrument to it, can determine what the biochemical oxygen demand is.

However, there are other characteristics of waste which also harm rivers, for example, suspended particulates, which do not necessarily eat oxygen, but nevertheless pollute water. Suspended particulates can also be measured relatively easily.

The third kind of pollution which is increasingly serious is thermal pollution; namely, the discharge of very highly heated waters into rivers. This, too, is easily measured with a thermometer.

Chairman PROXMIER. At any rate, you think that these would be easily classified so that you would be able to apply a tax on the basis of this, and that in fact this has been done in a number of jurisdictions without serious dispute; is that right?

Mr. HAVEMAN. That is correct.

Let me make one point prior to addressing that question directly.

An optimal effluent charge strategy, Senator, would involve placing different charges on these various characteristics of wastes.

For example, you might want to have a 10-cents-per-pound biochemical oxygen demand charge, let us say a 2½ cents per million B.t.u.'s for thermal pollution, and let's say a 3-cents-per-pound charge imposed on suspended solids. What I am saying then is that one has to figure out what the composition of the wastes are in an outfall and make the charge in accordance with the composition.

The question you are really getting at, I think, is whether or not we can really measure this stuff. And the answer to that question is that we now do have the technology which would allow us to monitor continuously the waste discharges from outfalls at relatively low cost.

For example, the cost of putting a device on the end of an outfall to measure BOD is something on the order of \$5,000 to \$10,000.

Chairman PROXMIER. Looping a system or recycling, of course, is something that has high national priority. There has been a lot of talk about it. What kind of progress have we been making on this?

And would you compare your approach, your suggestion of an effluent tax, with the strategy that the administration and Senator Muskie and others have proposed?

Mr. HAVEMAN. I guess one of the most disturbing things about this Nation's effort to improve environmental quality has been the progress we have made on recycling. We have made very little progress.

Now that, of course, prompts the question: Why has it been low?

Well, the first reason that it has been low, it seems to me, is that there is no incentive now for waste dischargers to undertake the kind of R. & D. expenses which would lead them to technologies which would allow them to recycle wastes back into the production process.

At the current time industries are being subsidized. When they generate wastes under an effluent charge strategy, they would be forced to pay a charge based on the waste they generate. And that charge would induce research and development activities.

One of the important points to be emphasized concerns the implicit incentives in our economic system against recycling of wastes. Let me give you an example which deals with the recycling of scrap steel.

On the face of it one would think that the recycling of scrap metal back into the form of usable metal would be a prime place for recycling. Yet we have been notoriously unsuccessful in doing that. Let me suggest two reasons why this is so.

In the first place, we have a 15-percent mining depletion allowance. That artificially increases the cost of using scrap metal to make new metal relative to the cost of mining new ore and making the metal out of it. That is to say, the 15 percent mining depreciation allowance is a substantial disincentive to recycling wastes which is built into the current system.

A second instance, it seems to me, is even more blatant. At the current time the ICC sets freight tariffs on the transportation of iron ore and scrap metal. And per ton of freight they impose a tariff which is higher on scrap metal than they do on raw ore.

Now, what does this do? This, too, imposes a disincentive for recycling, because it means that those people who want to recycle and use scrap iron have got to pay because of ICC regulations a higher freight rate for transporting scrap metal than they do for transporting raw iron ore.

Chairman PROXMIRE. In your prepared statement you refer to the successful experience which the city of Cincinnati has had with a system of charges levied on industrial waste.

Can you give us other specific examples of the use of such charges? Has Cincinnati's success been equaled elsewhere?

Mr. HAVEMAN. The Cincinnati success, Senator, is probably the most dramatic. However, there have also been reported results from imposing sewer charges on industrial polluters in the city of Otsego, Mich. That has been a great success story, perhaps, as you know.

I believe the city in Missouri that has done the same thing is Springfield. And that, too, has induced a major decrease in base discharge of industrial polluters.

Perhaps the other major source of information on the incentive effect of effluent charges comes from the experience of the Ruhr area in Germany, in which they have now had several years of experience with effluent charges. People who have observed the use of charges there are convinced of the powerfulness of the incentive implicit in them for the reduction of waste discharges by polluters.

Chairman PROXMIRE. Can you explain a little more precisely what the major alternatives to discharge of industrial waste are into waterways? Do we have existing technology available for handling major categories of wastes in other ways? Do some of the alternative ways of treating industrial waste merely substitute air pollution for water pollution?

Mr. HAVEMAN. Essentially, Mr. Chairman, there are three ways of handling the waste discharge problem.

The first way is the one we have been talking about, namely, giving an incentive to dischargers to cast about for other ways of reducing their generation of waste discharge.

The second way is to allow them to generate the waste and then to try to clean up after them. And that cleanup is provided through the construction of waste treatment facilities.

And then there is a third way. And that is the way of inducing changes in internal production processes, in the composition of the inputs used in production processes, and in inducing very elementary kinds of activities to reduce the harmful effects of wastes before they are dropped into rivers.

In my view the technologies for doing this latter, namely, techniques for reducing wastes internal to the plant production process are available. And as I have indicated earlier, on the basis of work done by industrial engineers, those alternatives are there at very low cost, especially relative to the construction of waste treatment plants.

Chairman PROXMIRE. As you know, Professor Haveman, at 11 o'clock the committee intends to place a call to the Labor Department to get an interpretation of the latest statistics.

But before we do that, I do want to call on Senator Miller. He has a question he would like to ask.

Senator MILLER. Thank you, Mr. Chairman.

Professor, I would like to make sure I know what you are advocating here. Now, there are some proposals that a factory, for example, would have to pay a certain amount of money into a local waste disposal treatment plant in proportion to the amount of waste that is treated there. That is one approach.

There is another proposal, and that is to go beyond that, that is to impose some kind of effluent tax, which might well go even beyond the requirements for that local treatment plant operation. Are you in that latter category?

Mr. HAVEMAN. Yes, I am, and with both feet. I have no objection to—and as a matter of fact, I think there are substantial merits in—the notion of going toward collective treatment facilities. For a large metropolitan area, a collective treatment plant may well have substantial economies of scale. And these should be exploited. Municipal or domestic waste discharges could link up with it if they desired. In that case, in my view, the charges which should be imposed on the waste discharger should be the total cost attributable to them in the treatment of such wastes.

Senator MILLER. What is in the first category?

Mr. HAVEMAN. So far I am in category 1.

Now, the primary problem, Senator, is that most industrial waste dischargers are not located so that they have access to major municipal

waste treatment facilities. They are located on river banks, and they dump into riverbeds. For these firms it will be very costly to tie into central collective facilities. They are going to have to pipe these wastes many miles to get them there.

A better alternative, in my view, in these cases of industrial polluters, is to view their use of the watercourse in the same way that you and I view the use of labor or capital. That is, when they use labor or capital, we say to them, OK, you have used that resource, and now you pay the cost of using it.

I would say the same thing with respect to environmental resource services. These services are just like other productive resources in this economy. When an industrial polluter makes use of them, I see absolutely no reason why that industrial polluter should not pay the cost of using those resources in the same way that we, through our economic system, require them to pay for the cost of other resources.

Senator MILLER. Let me get the point clarified. Let's say you have on the riverbank a factory of the kind you are talking about. Let's say I have a factory over here that I can tie into a local municipal treatment plant. Are you going to treat us both alike?

Mr. HAVEMAN. I would have a national effluent charge. That means that if your plant, which is located in the city, can more cheaply have its wastes treated by the municipal plant, that firm will naturally take advantage of that option, and it will pay the sewer or user charges for having its wastes treated in that facility.

Indeed, one of the incentives for inducing your plant to tie up with a municipality is the fact that if it didn't tie up and wanted to use the river, it would have to confront that nationwide effluent charge.

Senator MILLER. I am not necessarily talking about your plant on the river going scot free, I am just thinking that if I happen to locate in an area where I can tie into a municipal plant, I don't think I ought to have to pay any more than my prorated cost of that plant.

Mr. HAVEMAN. I would not disagree with that. And no effluent charge proposal that I am familiar with, including the one I have proposed today, would force that additional charge on an industrial plant.

Senator MILLER. That is what I wanted to bring out. Thank you very much.

Mr. HAVEMAN. Can I make one additional comment on that?

It seems to me that if we do proceed as you suggest, we have got to be very careful that we impose the full cost of treatment on industrial polluters.

Senator MILLER. When you say the full cost, you mean the full prorated cost?

Mr. HAVEMAN. That is right.

Heretofore we have had a situation in which the user charges imposed on industrial polluters which are connected to municipal waste treatment facilities have been somewhere on the order of 20 percent of their full prorated cost. And that is an enormous subsidy provided to industrial polluters in this country.

Chairman PROXMIRE. Professor Haveman, thank you very, very much. Your testimony has been most useful.

And as you already know, I intend to press hard for this effluent tax approach when the appropriate bill comes before the Senate.

Mr. HAVEMAN. Thank you, sir.

Chairman PROXMIRE. Our next witness is a most distinguished American. The Federal Government's need for wise counsel on how to proceed to bring about a greater balance in the allocation of its resources is nothing short of desperate, as I said in my opening statement. So we are fortunate to have as our witness this morning just such a person, a wise counsel.

Ralph Nader has done so much in the public interest over the past several years that it is frankly embarrassing to some of us elected representatives. His accomplishments in the areas of auto safety, consumer protection, tax matters, and environmental controls are literally too numerous to list at this time. The Nation, in my judgment, is deeply indebted to this man, and even the corporate sector and the governmental agencies he has criticized are better off for having been made aware of their shortcomings. Mr. Nader, you may proceed with your prepared statement in any way you wish.

It is an unusually fine prepared statement, Mr. Nader. But I do wish we could get these in, in advance. Our questions would be less unintelligent if we had these 24 hours ahead.

STATEMENT OF RALPH NADER, ATTORNEY AT LAW AND CONSUMER ADVOCATE, WASHINGTON, D.C.

Mr. NADER. Thank you, Senator.

Mr. Chairman, distinguished members of the Subcommittee on Priorities and Economy in Government, thank you for the invitation to comment on corporate sector influences on the allocation of resources.

In any inquiry as to how our society can use more efficiently and justly its wealth, one must marvel at how little thought has been directed toward reassessing the distortions, wastes, and economic depreciations of the citizen's dollar in the marketplace and the unjustified transfer of the citizen's taxes into private corporate coffers. The overly simple and frequently diversionary response to a particular declaration of public need is that more taxes are required. It is time to have the tools of modern economics and the data gathering functions of Government apply themselves to corporate sector impact on the declining quality of the dollar in its various uses.

I think, Mr. Chairman, in your interest in the statistical-collecting activities of the Federal Government, you have commented on the overwhelming emphasis on aggregate statistics and the need to become far more qualitatively oriented and more selectively oriented in terms of just what does another 10-percent increment in gross national product really mean for the well-being of citizens. It is quite obvious that aggregate statistics can hide a lot of waste and a lot of water, or it can hide, by the same token, a higher quality of medical care, or a higher nutritional value of food. And my emphasis this morning is on the qualitative analysis, so that we don't console ourselves with mere growth of aggregate figures, and we begin to focus on just what these figures mean in personal and human terms.

I would like to suggest, in the briefest of form, some guiding frameworks for inquiry with a few of many possible illustrations for each framework. I believe this framework has the analytic utility to its categories which compel a facing of reality and/or the asking of im-

portant questions. Empirically these categories do overlap—a problem in measurement that could be overcome with little difficulty. The pertinent point now is in the recognition of a necessary framework that avoids the myths and spasmodic reactions that substitute faith for propositions to be examined.

There are six discernible subeconomies of consumer-taxpayer exploitation—(1) the involuntary subeconomy; (2) the transfer subeconomy; (3) the controlled market subeconomy; (4) the compulsory consumption subeconomy; (5) the corporate socialism subeconomy, and (6) the expendable subeconomy. Each of these subeconomies avoidably wastes the consumer-taxpayer's dollar or prevents the use of this dollar in ways that should be the right of all citizens.

I would like to go through briefly each one of these subeconomies to evaluate what I mean. The characterizations are my own here. There is a great deal of work to be done in refining each category, but I think the line of inquiry is a useful one for the committee to consider.

(1) The involuntary subeconomy can be defined as the infliction of involuntary expenditures which the consumer would not have incurred or been willing to incur except for unjust and/or preventable impositions. Fragile, withdrawn, ornamental bumpers on automobiles generate about \$2 billion a year of involuntary expenditures arising from easily preventable damages to these vehicles from collisions under 10 miles per hour. The multibillion dollar accident-injury industry, composed of such services as insurance, medical, legal, and repair services, may perform needed functions but such expenditures should not have to be made. Our Nation's declared policy, quite apart from its actual priorities, is to encourage the conditions that would send this industry into an accelerated pace of shrinkage. Shoddy consumer products generally which induce secondary consumer expenditures—ranging from adulterated (fat, water) food products to deceptively described items (many patent medicines and mouthwashes) feed such involuntary consumer expenditures. Note should be taken here for distinguishing between expenditures which no consumer would make with matters of taste. Matters of taste are not included in this category; if a consumer wishes to buy a purple colored toy wagon with cookie-type wheels, that is a matter of taste. What is an involuntary expenditure is the expenditure which the consumer would not out of his or her volition make if priorities—for example, safety, nonfaking of product value—were pursued.

(2) The transfer subeconomy covers the price of a flow of goods or services down the hierarchy of the production to market flow to the ultimate consumer. To the extent that bargaining power, level of awareness, and alternative options (such as litigation, government standards, etc.) are weak, the ease of transferring costs from one level to another (raw materials to fabrication to manufacturer to wholesaler to retailer and intermediate transfers points such as transport and insurance) is increased. The reverse is also true; the stronger the response capability at each level back from the ultimate consumer the greater the difficulty in transferring costs and the more incentive for efficiency. For example, the mass transfer of epidemic pilferage costs in some sectors of the economy illustrates the transfer subeconomy in fluid action. The mass pilferage, for example, at the ports of call in this country amounts to hundreds of millions of dollars annually. And

because of the fact that the cost doesn't rest on the owners of the ships, and because it is integrated in a transfer type system of insurance premiums, there has been little done about it in terms of private sector reaction.

The Civil Aeronautics Board's approval last year of the airlines' rounding off their tickets to the next highest dollar, allegedly for passenger convenience (and a projected \$50 million a year for the airlines until revised months later), was easily incorporated in the transfer subeconomy. There were no objections. The diffused nature of the cost transfer was such that no one firm and no one individual was afflicted with a sufficient cost to make it worth their while to systematically object. There are just loads of costs which blend into overall costs and flow through the transfer in unitemized luxury. Railroad and trucking rate conferences propose their rate increases to the compliant ICC and the large supermarket and other retail chains passively transfer the costs to the consumer with only the rarest of formal opposition to such freight rate increases. I think the first opposition by a supermarket chain was 2 years ago before the ICC. The insurance industry, with its historic neglect of loss prevention priorities—excepting recent focus on useless bumpers—has classically transferred avoidable costs to the passive and unorganized policyholder.

(3) The controlled market subeconomy includes antitrust violations such as price-fixing, product-fixing (colluding to keep the polluting internal combustion engine as is), tying arrangements, shared monopolies, and many other aspects of the closed enterprise system. It also includes other barriers to entry such as misadministered occupational licenses, labor monopolies, oil import quotas, production limitations, and other restrictions on the market that blatantly serve special economic interests to the detriment of consumers and workers. This subeconomy extends to the nonprice or nonquality or nonquantity competition with inordinate market distortions of value competition. Merchandising gimmickry which avoids competition, over-values, and packs games of chance, trading stamps, coupons, and enormous expenditures on inculcating brand name identification have seriously erosive effects on the quality of competition. The corporate manipulation of zoning to artificially restrict or unrestrict the sale or use of land is another often abused characteristic of a corporate-induced control—this time of a public mechanism originally designed for democratic control of certain land uses.

(4) The corporate socialism subeconomy is of enormous magnitude and can be described as the use of government power to either transfer public funds to unjustified corporate control or use or the withholding of proper payments or obligations from government. For example, the massive underpayment of local property taxes by large property owners, such as oil and gas companies, timber companies, and large owners of commercial and industrial real estate, is an enormous drain on municipalities who are desperately in need of revenues for schools and transportation and other needs that often simply evoke the response, "well, we need to add more taxes," instead of asking the questions, how about the taxes that already should be collected that are not collected, or how about the studies in the property tax area that estimate that there is about \$6 billion a year lost by underpayment of property taxes.

Chairman PROXMIRE. Did you say property taxes?

Mr. NADER. Property taxes.

Chairman PROXMIRE. That is an unusual study. We have concentrated so much on Federal income taxes. But you are talking about local property taxes?

Mr. NADER. Yes. For example, we have a study on the oil and gas taxation in the Permian Basin in West Texas, where, according to existing ratios, not any ideal ratios, but existing ratios and standards that the small owner has to adhere to, the industry was paying at the most 40 to 50 percent of what they should be paying.

Chairman PROXMIRE. And the figure you estimate is \$6 billion?

Mr. NADER. \$6 to \$7 billion.

Chairman PROXMIRE. \$6 to \$7? I beg your pardon.

Mr. NADER. \$6 to \$7 billion nationally.

The tax system with its glaring privileges is a many-faceted indirect subsidy for corporate and other special economic interest groups of considerable wealth. The concept of "tax expenditure" needs to become more of a household word to focus public concern and action on this indirect subsidy system with its lack of annual congressional review and deep inequities.

Every time the Congress or the Treasury by administrative action develops a tax privilege, or what is commonly called a loophole, that in effect is a tax expenditure. It is in effect the subsidy of the Federal Government to the particular individual or group that is receiving this benefit.

It is essential in the determination of national priorities that the Congress and the American public be informed of expenditures made through our tax system. These tax expenditures amount to roughly \$40 billion a year and often overlap in function with current or proposed direct expenditures. The annual publication of a tax expenditure budget has met with bipartisan support, as is appropriate for such an important tool of priority analysis. Senators Javits and Percy of this committee have sponsored legislation to institute a tax expenditure analysis as a part of the annual budget report. I believe there has only been one disclosure of the tax expenditure budget, largely inspired by Assistant Secretary Surrey in the latter years of his administration during the late sixties.

Chairman PROXMIRE. I just received one this morning—I read it this morning, I received it the day before yesterday.

Mr. NADER. Fine. That is encouraging.

Senator MILLER. I might point out that I am also a sponsor of that same bill.

Mr. NADER. Senator Chiles has introduced a similar bill, and Chairman Mills long ago urged more careful accounting of back-door spending through the tax system.

I have two inserts here which I will submit for the record, with your permission, Mr. Chairman.

(The inserts follow:)

[From the Congressional Record, May 11, 1971]

By Mr. Javits (for himself and Mr. Percy) :

S. 1830. A bill to amend the Budget and Accounting Act, 1921, to require that the budget contain information with respect to revenue losses incurred and indirect expenditures made through the Federal tax system. Referred to the Committee on Government Operations.

Mr. JAVITS. Mr. President, on behalf of myself and the Senator from Illinois (Mr. Percy), I send to the desk for appropriate reference, a bill to amend the Budget and Accounting Act of 1921, for referral to the Committee on Government Operations.

This bill will require the budget to furnish detailed information about revenue losses, which we estimate this year at \$40 billion, through a variety of special tax provisions. It does not mean there is anything wrong with these losses. We may very well choose to carry them on. But, by providing that the public shall know about them and we shall know about them, at least, they will not be buried in a mass of data but will stand out so that we will be able to grasp what they mean. This bill will require the budget to furnish detailed information about these revenue losses.

The bill requires the budget to contain estimates of the losses in revenues from special Federal tax provisions both: First, on a provision-by-provision basis; and second, by budget function. A provision-by-provision accounting will provide information on the revenue loss caused by each section of the tax code which grants special or preferential treatment. An accounting by budget function will relate revenue losses to the various purposes, such as national defense or health, which the special tax provisions are designed to serve. The latter type of information was provided in the 1968 annual report of the Secretary of the Treasury and also in the statement of Assistant Secretary Weidenbaum before the Subcommittee on Economy in Government of the Joint Economic Committee on June 2, 1970. I ask unanimous consent that the relevant portion of Mr. Weidenbaum's statement be printed in the Record for illustrative purposes at the conclusion of my remarks.

The PRESIDING OFFICER (Mr. Weicker). Without objection it is so ordered. (See exhibit 1.)

Mr. JAVITS. Mr. President, it is my firm conviction that the information requested by this bill will be of inestimable value to the administration, the Congress, and the general public, in establishing Federal tax policies and Government spending priorities.

Publication of these estimates will call attention to the cost to the Treasury of the various Federal tax preferences and will provide clearer insight into the overall allocation of public resources. These estimates must be available so that the public may become more fully informed as to these matters, which bear so importantly upon proposals affecting the tax laws and the spending of the revenues.

Information on the revenue costs of the separate tax preference items on a provision-by-provision basis will obviously be helpful as an analytical and evaluative tool in the continuing struggle for tax reform. Such information will assist us in shaping a tax structure which is both economically rational and fair to all taxpayers.

Relating the revenue losses to budget outlays on a category basis will illustrate the total Government support provided to each budget function or program, by giving recognition to indirect expenditures made through the tax system in the form of special tax relief. We will thus have fuller knowledge and understanding of the true allocation of public resources. Such an understanding is crucial to both the determination of sensible outlay priorities and the evaluation of specific spending proposals.

Mr. President, let me repeat, we are not seeking in any implicit or indirect way to go after any particular tax preference or any particular loss of revenue under the special Federal tax provisions but we feel the time has come to know what they amount to and also how they relate as an indirect expenditure to each particular function set up in the budget.

We hope very much that we shall have early consideration of this matter, what we consider to be a highly desirable reform by the Committee on Government Operations on which the Senator from Illinois (Mr. Percy) and I both serve, as well as by the Senate.

I ask unanimous consent to have the text of the bill printed in the Record. There being no objection, the bill was ordered to be printed in the Record, as follows:

S. 1830

A bill to amend the Budget and Accounting Act, 1921, to require that the budget contain information with respect to revenue losses incurred and indirect expenditures made through the Federal tax system

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 201 of the Budget and Account-

ing Act, 1921, as amended (31 U.S.C. 11), is amended by adding new clauses (13) and (14) to subsection (a) as follows:

"(13) estimates of the losses in revenues for the last completed fiscal year, the fiscal year in progress, and the ensuing fiscal year which result—

"(a) under the provisions of the Federal income tax laws which cause the income tax bases to deviate from widely accepted definitions of income and standards of business accounting by prescribing or allowing (i) exclusion of certain items from gross income, (ii) deductions from income, (iii) credits against tax, (iv) deferral of the imposition of tax, (v) preferential rates for certain classes of income, or (vi) exemption of certain persons from tax, or

"(b) under other Federal tax provisions which grant special or preferential treatment of a similar nature;

"(14) estimates of the indirect expenditures made or to be made by the Government through the application and operation of the Federal tax laws during the most recent fiscal year, the fiscal year in progress, and the ensuing fiscal year, which estimates shall be based on the estimates of revenue losses described in clause (13) and shall be related, insofar as possible, to the expenditures described in clauses (5), (7), and (8)."

EXHIBIT 1

APPENDIX B

EXPLANATION OF TAX AIDS

An important recent development in the effort to make the Federal budget a more useful tool of economic policy has been an increasing awareness of the growing magnitude of fiscal benefits accruing to various categories of taxpayers. Over the years the Federal income tax structure has gradually accumulated a host of special deductions, credits, exclusions, exemptions, and preferential rates designed to achieve various social and economic objectives. It has been recognized that these selective reductions in tax liabilities have the same fiscal impact on the budget surplus or deficit as direct increases in expenditures. In this context they have been termed "tax expenditures." A more appropriate term might be "tax aids."

In the broadest sense a tax can be defined as any identifiable reduction in tax liability by an individual or business compared to a tax base totally devoid of any reduction from income or distinction of treatment of different kinds of income. Such a definition of tax expenditures would include differences in tax liability because the individual was married or single, old or young, healthy or disabled, lived at home or abroad, was charitable or uncharitable, was a homeowner or renter, etc.

But to group together without distinction all deviations from a theoretically neutral tax system would be hopelessly cumbersome and reduce the usefulness of the tax expenditure concept as an added measure of the total fiscal impact of the Federal budget. The more practical approach is to group by functional spending category those tax aids intended to encourage private action to resolve various social and economic problems or to give fiscal relief to those who might receive an inadequate share of current productive resources under a completely neutral tax system. In most cases these tax aids are clearly an alternative to an equivalent increase in Federal expenditures that would otherwise be required.

The first compilation of tax aids under this approach was published in the 1968 Annual Report of the Secretary of the Treasury. This compilation helped create public discussion and improved understanding of the program aspects of tax aids. It also helped to stimulate program analysis of tax aids, an approach which has received the endorsement of President Nixon. In his tax message to the Congress of April 1969, the President stated:

"Tax dollars the Government deliberately waives should be viewed as a form of expenditure, and weighed against the priority of other expenditures. When the preference device provides more social benefit than Government collections

and spending, that "incentive should be expanded; when the preference is inefficient or subject to abuse, it should be ended."

In addition to its value as a catalyst for program analysis, the compilation has value for economic analysis. Such compilations focus on tax aids as important determinants of the size of budget deficits and surpluses. The overall magnitude of foregoing revenues due to tax aids is substantial and, if the budget is not balanced, the deficit and surplus is only a small fraction of that magnitude. Year to year changes in tax aid magnitudes, either because of economic growth or through legislative actions, affect substantially the size of the budget deficit (or surplus) and the expansionary (or restrictive) course of the economy.

Table B presents an updating of data on estimated tax aids for the fiscal years 1968 and 1969 on the basis of the current functional breakdown of Federal expenditures. The present compilation is not intended to provide a full and complete accounting in a theoretical sense of all tax aids in the income tax structure. It is, in fact, a minimal selection of tax aids—minimal in the sense of including only acceptable and practical choices. Certain tax provisions are omitted because their inclusion would require controversial or highly theoretical justifications. Others are omitted because the underlying data is difficult to compile and present in understandable form or because the amounts involved are not quantitatively significant. In short, the choice of the tax aids listed is largely governed by the criteria of public acceptability and practicality.

TABLE B.—ESTIMATED TAX AIDS, FISCAL YEARS 1968 AND 1969

[In millions of dollars]

Tax aids by budget function	1968	1969
National defense: Exclusion of benefits and allowances to Armed Forces personnel.....	500	550
International affairs and finance:		
Exemption for certain income earned abroad by U.S. citizens.....	40	45
Western Hemisphere trade corporations.....	50	55
Exclusion of gross-up on dividends of less-developed country corporations.....	50	55
Exclusion of controlled foreign subsidiaries.....	150	165
Exclusion of income earned in U.S. possessions.....	80	90
Total.....	370	410
Agriculture and rural development:		
Farming: expensing and capital gain treatment.....	800	860
Timber: capital gain treatment for certain income.....	130	140
Total.....	930	1,000
Natural resources:		
Expensing of exploration and development costs.....	300	330
Excess of percentage over cost depletion.....	1,300	1,430
Capital gains treatment of royalties on coal and iron ore.....	5	5
Total.....	1,605	1,765
Commerce and transportation:		
Investment credit.....	2,300	3,000
Excess depreciation on buildings (other than rental housing).....	500	550
Dividend exclusion.....	225	260
Capital gains: corporation (other than agriculture and natural resources).....	500	525
Excess bad debt reserves of financial institutions.....	600	660
Exemption of credit unions.....	40	45
Deductibility of interest on consumer credit.....	1,300	1,600
Expensing of research and development expenditures.....	500	550
\$25,000 surtax exemption.....	1,800	2,000
Deferral of tax on shipping companies.....	10	10
Total.....	7,775	9,200
Community development and housing:		
Deductibility of interest on mortgages on owner-occupied homes.....	1,900	2,200
Deductibility of property taxes on owner-occupied homes.....	1,800	2,350
Excess depreciation on rental housing.....	250	250
Total.....	3,950	4,800

TABLE B.—ESTIMATED TAX AIDS, FISCAL YEARS 1968 AND 1969—Continued

[In millions of dollars]

Tax aids by budget function	1968	1969
Income security:		
Disability insurance benefits.....		100
Provisions relating to aged, blind, and disabled: Combined cost for additional exemption for aged, retirement income credit, and exclusion of social security payments.....	2,300	2,700
Additional exemption for blind.....	10	10
"Sick pay" exclusion.....	85	95
Exclusion of unemployment insurance benefits.....	300	325
Exclusion of workmen's compensation benefits.....	150	180
Exclusion of public assistance benefits.....	50	50
Treatment of pension plans:		
Plans for employees.....	3,000	4,000
Plans for self-employed persons.....	60	135
Exclusion of other employee benefits:		
Premiums on group term life insurance.....	400	400
Deductibility of accident and death benefits.....	25	25
Privately financed supplementary unemployment benefits.....	25	15
Meals and lodging.....	150	165
Exclusion of interest on life insurance savings.....	900	1,000
Deductibility of charitable contributions (other than education).....	2,200	3,000
Deductibility of child and dependent care expenses.....	25	25
Deductibility of casualty losses.....	70	80
Standard deduction.....	3,200	3,600
Total.....	12,950	15,905
Health:		
Deductibility of medical expenses.....	1,500	1,600
Exclusion of medical insurance premiums and medical care.....	1,100	1,400
Total.....	2,600	3,000
Education and manpower:		
Educational expense deduction.....		40
Additional personal exemption for students.....	500	500
Deductibility of contributions to educational institutions.....	170	200
Exclusion of scholarships and fellowships.....	50	60
Total.....	720	800
Veterans' benefits and services: Exclusion of certain benefits.....	550	600
Aid to State and local government:		
Exemption of interest on State and local debt.....	1,800	2,000
Deductibility of nonbusiness State and local taxes (other than on owner-occupied homes).....	2,800	4,150
Total.....	4,600	6,150

[From the Congressional Record, Dec. 13, 1967]

BACK-DOOR SPENDING

Mr. MILLS. Mr. Speaker, this fall in connection with the Ways and Means Committee consideration of the proposed tax surcharge and elsewhere I have on several occasions expressed my views on the need for expenditure controls. I have urged expenditure cuts for fiscal 1968. I have urged limiting controllable expenditures in 1969 to current levels. I have urged longer run expenditure control through appointment of a Government Program Evaluation Commission to examine the effectiveness of both present and proposed programs in terms of their costs and benefits and in this manner to aid us in establishing relative priorities among different Federal activities.

But it is not my purpose at this time to express again my views on the need for these direct expenditure controls. I have spoken at length on this subject in recent weeks. Instead I want to speak briefly on another type of spending which usually is not thought of as spending at all. I am referring to what I call back-door spending. What I would like to emphasize is that the expenditures we turn away from the front door we must not allow to enter through the back door. If we decide that certain programs, however worthy their purpose, cannot be financed at this time by increased spending, because other needs have priority, we should not then turn around and sanction some form of indirect subsidy—in the form of special tax relief—for these programs.

Lately it apparently is tax credits which are in vogue. They are riding a rising crest of popularity as a means of providing a subsidy—or incentive as it is

sometimes called—for programs we apparently do not quite want to face as direct expenditure programs. A tax credit for a given expenditure would, of course, allow the taxpayer to reduce his Federal income tax by the amount of, or a percentage of, the expenditure. The expenditure would then cost the taxpayer nothing, or at best only a percentage of what it would otherwise be. The burden of the expense would be borne by reduced Government tax revenues, which is another way of saying that it would be borne by the rest of the Nation's taxpayers.

Bills now pending before the Ways and Means Committee propose tax credits for a whole host of programs almost all of which most of us would agree would constitute worthwhile expenditure programs if our revenues were unlimited. They include credits for charitable contributions to institutions of higher learning, for all education expenses for secondary education expenses, for the cost of installing underground electrical transmission lines, for the cost of providing employment opportunities in urban poverty areas, for the cost of developing gold-mining property, for the cost of erecting housing in urban poverty areas, for the expense of establishing job-producing business firms in rural areas, for the additional costs attributable to employing older persons, for the cost of air and water pollution control equipment, for the cost of potash mining equipment, for the amount of political contributions, for State and local school taxes, for State and local income taxes, and for the cost of employee training programs. Clearly, if we were to enact the tax credits for all these programs there would be a catastrophic loss of revenue and it would be necessary to raise taxes generally just to maintain receipts at existing levels. Moreover, enactment of these credits would merely whet appetites for a legion of other credits.

It is important to note that these proposed new tax credits differ in fundamental respects from the tax credits that we now have in the law. The existing foreign tax credit, for example, is intended to prevent the double tax burden which would otherwise result if U.S. companies operating abroad had to pay both U.S. taxes and foreign taxes on the same foreign income. The tax credit in this case is allowed U.S. firms to the extent the foreign income taxes paid on their foreign income do not exceed their U.S. taxes on this income. This tax credit is not designed to favor foreign investment by U.S. firms but rather to prevent the discrimination against foreign-earned income which would otherwise result from a double tax burden.

Another example is the present retirement income credit. This credit, although there may be problems with it, also is designed to have an equalizing effect. Its purpose is to equalize the tax liabilities of retired persons who rely on dividends, interest, and taxable pensions, for their retirement income, with the liabilities of those retired persons who receive tax-exempt social security and railroad retirement benefits. In the absence of the credit and given the present treatment of social security income, retired persons with only dividends, interest and taxable pensions would be more heavily taxed than other retired persons who had an equal amount of income derived in part at least from social security benefits.

The 7-percent investment credit is probably the one existing credit which mostly nearly resembles the proposed credits and serious questions can be, and have been, raised with respect to it. Nevertheless, this credit at least is general in its application; and does not single out a specific type of investment for special treatment. All taxpayers who install new tangible personal property with an expected useful life of 4 years or more for use in a domestic business receive the credit regardless of the nature of the property and regardless of the nature of their business or its location. Furthermore, the credit has a broad economic purpose rather than a specific social or regional objective. It is intended to encourage a sufficient volume of business investment so that the economy's rate of growth can be sustained at high levels. The tax credit proposals I refer to have much narrower objectives. They are not designed to encourage more investment generally but rather to encourage more investment in specific types of property, types of services, or areas of the Nation.

I have no quarrel with the good intentions of those who propose tax credits for one type of expenditure or another. I know they feel very strongly that the programs for which they would provide the credits should be undertaken now even though, for one reason or another, they do not choose to seek expenditure programs for these purposes. I want to point out, however, that the grant of these tax credits has precisely the same effect on the budget as an outright expenditure. The only difference is they appear as a negative receipt rather than

as an expenditure. The grant of the additional tax credits increases the size of the budget deficit just as surely as an additional expenditure. That is why I refer to the tax credits as back-door spending. That is why it would do us no good to have expenditure control if the advocates of spending programs need only to run around to the back door to achieve much the same result by tax credits.

Additional tax credits would also have the same impact on the economy as additional expenditures. Since expenditures on the part of private persons would be necessary to earn the credits, demands on available resources would be increased and inflationary pressures increased. Those who advocate these credits should well note the fact that a tax credit which reduces budget receipts is just as likely to force a general tax increase as appropriations for direct expenditure.

Tax credits have other features which I believe actually make them less desirable than expenditure increases. Budgeted expenditures at least receive some review every year and the expenditures made are audited periodically. We do not have enough control over the expenditure programs in my estimation, but at least we have some. The Congress and the public, through the budget, are regularly reminded of the level of such expenditures and can very readily obtain information concerning their nature. On the other hand, once enacted, an income tax credit is not subject to annual review. Furthermore, it is very difficult to discover exactly what private spending is being offset by credits and who therefore is being given the greatest benefit by provision of the credit.

The cost of tax credits is hidden. There is no line in the receipt side of the budget which informs us what tax receipts would be in the absence of the various tax credits. It is true that the Internal Revenue Service eventually can provide some of this information, but the information is so late, so piecemeal and in such a form that it is very difficult to place the information in proper perspective. Furthermore, the information in any event cannot be considered in the context of the budget for the year in question.

I have no doubt that there are many instances where appropriated funds have been used inefficiently. In part this is my reason for proposing a Government Program Evaluation Commission. By and large, however, Federal expenditures at least are spent in ways that further the objective of the program under which they were appropriated. By way of contrast, a large proportion of the Federal tax receipts given up in the form of a tax credit are very often wasted in the sense that they do not result in any increase in expenditures for the desired purpose. For example, if a tax credit were granted for college tuition payments, presumably the objective would be to make sure that all worthy students receive a college education. In this sense, most of the tax credit would be wasted because most of the benefit of the credit would go to families that would finance a college education for their sons and daughters in the absence of the credit. At the same time, the credit would be of no help to those persons whose exemptions and deductions are so high relative to their income that they have no tax. Its impact, in terms of encouraging more worthy students to attend college, would, therefore, be confined to the relatively few cases where the tax relief afforded by the credit provided just enough extra funds to make it possible to finance a college education.

This last point is one of the more basic objections to the proliferation of tax credits. Most of the benefit of these credits go to business firms or individuals who would have undertaken the desired expenditures even if no credit were available. For these taxpayers the credit provides a windfall. Unfortunately, we have no way of determining in advance what proportion of the amount of any given tax credit will be absorbed by such a windfall. We can be reasonably certain in every case, however, that the amount exceeds the waste that would be incurred under a program of direct expenditures. To put it another way, the increase in expenditures for the particular purpose that results from a tax credit, could be achieved at a much lower cost in terms of the impact on the budget deficit if the additional investment were financed through direct expenditures. The expenditures could more readily be channeled only to those who would not otherwise undertake the activity.

As we look ahead to discover ways in which we can keep the budget within reasonable limits, we must not fail to direct a critical eye to the proposals which would give tax credits to those who make certain expenditures. Acceptance of these proposals for back door spending even more than proposals for outright Government expenditures postpones the day when it will be possible to travel again down the road of further Federal tax reduction and greater reliance on the private sector of the economy.

Mr. NADER. It has come to my attention, Mr. Chairman, that your committee is undertaking an analysis of tax expenditures. I look forward to publication of your findings, and hope that an annual tax expenditure budget will become a reality within this session of Congress.

Our constitutional system of separation of powers reserves to the Congress the power to determine priorities through the tax system. The recent Treasury Department depreciation proposals—the ADR system—are a serious encroachment by the Executive on this congressional power. I include for the record the statements of 11 tax law authorities from across the country.

(The statements follow :)

COMMON CAUSE,
Washington, D.C., April 9, 1971.

Re Proposed Reg. § 1.167 (a) (11)

COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C.

(Attention CC : LR :T)

On behalf of Common Cause I am submitting this letter, commenting on proposed Treasury Regulations § 1.167 (a)-11 ("Asset Depreciation Range System"), urging their withdrawal, and hereby requesting that I be given an opportunity to comment orally at the public hearing to be held on May 3, 1971.

Common Cause's interest in the Treasury's proposals stems from four major concerns:

1. The Treasury's proposal to grant between \$3 and \$5 billion in annual income tax abatement to a small, Treasury selected segment of the taxpaying public, without Congressional direction or authorization, constitutes an illegal and unconstitutional arrogation of legislative power.

2. Massive tax reduction now for the exclusive benefit of business men and corporations investing primarily in machinery and equipment is inequitable, burdensome to the taxpaying public, uneconomic, and a gross misallocation of public resources, suggesting new governmental priorities that are counter to those publicly declared by the President and Congress and to the best interests of the nation.

3. The proposed regulations flout the language and purpose of the income tax provisions of the Internal Revenue Code by presuming to authorize deductions for capital investments that have not been consumed in the production of income and, therefore, are not legally or factually an expense chargeable to income.

4. The Treasury's failure to disclose the data and studies which led it to propose sweeping changes in the depreciation system, and its failure to set forth the reasons and considerations leading to and supporting its proposals, make it difficult if not impossible for interested and affected persons fully to weigh the proposals and to comment completely and adequately, thereby violating the Administrative Procedure Act and the Due Process Clause of the Constitution.

A. THE TREASURY PROPOSALS

The Treasury proposals would change the law in four major ways: (a) they would permit some taxpayers to select a period over which to recover their investment in depreciable equipment (other than over the useful life of that equipment) which, in most cases, would allow them to deduct from income an unconsumed portion of a capital expenditure; (b) salvage value may be ignored in determining the basis on which to compute depreciation, thus permitting excessive current deductions in the guise of depreciation; (c) an arbitrary portion of each year's investment in asset improvements, capital by nature, may be treated as though a mere repair, and deducted as current expense from current income, although improvements are not repairs and not current expenses and (d) investments made at any time during the first half of a year may be treated as made on the first day of the year, and those made any time in the second half of the year may be treated as made at mid-year, thus permitting the acceleration of depreciation deductions to points in time even before the taxpayer has made his investment.

B. THE LAW AND ADMINISTRATIVE ARROGATION

Section 263 of the Code explicitly denies the deduction of capital investment, except as the Code otherwise expressly provides. Section 162 allows the deduction of current business expenses to make certain that the taxpayer is taxed only on *net* income. Section 167 permits the deduction for depreciation so that those capital expenditures (non-deductible under §263) may become deductible as they are exhausted over time, thus providing a tax treatment consistent with that provided in Section 162 for other kinds of expenses.

From time to time Congress has explicitly permitted the expensing of certain capital expenditures, always in a clearly circumscribed fashion. It has authorized accelerated depreciation in certain instances. It has also provided, and withdrawn, special tax credits for investment. All exceptions which Congress had made are premised on the existence and acceptance of a fundamental principle, embodied in the statute, its history, and in the decisional law, that assets are to be depreciated over a period estimated reasonably to represent their useful life to the taxpayer who employs them. *Only Congress may deviate from that principle.*

A complete analysis of the law and its history, current procedures, and the Treasury's proposed illegal deviation therefrom, will be submitted at an early date, prior to the public hearing.

C. THE ECONOMICS OF THE PROPOSALS

A recently completed analysis of the economic impact of the Treasury proposals will be submitted to you shortly. It will be apparent that A. D. R. would have minimal stimulative effect in the short run, and even less in the long run; that greater stimulation of the economy could be achieved by providing encouragements to consumption or by a temporary investment tax credit; that in the long run A. D. R. would cause a shift in investment away from housing—thought to be a major national priority—into industrial equipment; that A. D. R. will provide disincentives to inefficient firms to modernize, and it will reward those who, contrary to present law, have failed to retire assets as quickly as their tax depreciation schedules implied that they would; that A. D. R. would give an annual tax abatement to high income taxpayers in aggregate annual total annual allocation for elementary and secondary education, equivalent, for example, to the President's proposed total annual allocation for elementary and secondary education, equivalent, too, to at least \$45 per person in the United States.

D. FAIRNESS AND EQUITY

1. Tax reduction, even when enacted by Congress, should not be directed primarily to high income taxpayers, as A. D. R. is. It is unfair to allow those who invest in equipment to pay tax on a base that is smaller than their real net income, when others are required to use their net income as the base. Deductions for capital investment, not consumed in the production of income, result in a tax base that is less than net income. As unfortunate as that would be if Congress were to do this, it is intolerable when the Treasury—without Congressional warrant—creates the inequity.

2. Procedural fairness—mandated in the Administrative Procedure Act and the Due Process Clause of the Constitution—requires that affected and interested persons be given an opportunity to be heard when new rules are to be adopted by government agencies. This is an especially significant requirement when the new rules propose to give away \$3 to \$5 billion a year to only a small Treasury selected group of people. The opportunity to be heard is an illusory one unless the rule making agency, here the Treasury, presents its data and reasons, and gives the public an opportunity to examine and evaluate them. That has not been done in this case. Common Cause calls on the Treasury now to disclose its data, its studies, and its reasons for the proposals in question.

Respectfully yours,

BERNARD WOLFMAN,
Special Counsel,
Dean, University of Pennsylvania Law School.

LAW SCHOOL OF HARVARD UNIVERSITY,
Cambridge, Mass., April 12, 1971.

Re The Asset Depreciation Range System.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C.
(Attention CC:LR:T).

DEAR SIR: These comments relate to the proposed Asset Depreciation Range System regulations that were published in the Federal Register on March 13, 1971.

TREASURY AUTHORITY TO ISSUE THE PROPOSED REGULATIONS

I have read the statement recently submitted to you by Boris I. Bittker,¹ Sterling Professor of Law at Yale University, in which he concludes that introduction of the ADR System exceeds the Treasury's authority in several respects. I endorse Professor Bittker's reasoning and views. Like him, I have considerable doubt as to the Treasury's authority to issue the proposed incentive-oriented Asset Depreciation Range System regulations for newly acquired assets. Adoption of the ADR System is a decision that should be made by Congress.

LEGAL PROBLEMS WILL LESSEN INCENTIVE EFFECT OF PROPOSALS

To the extent that the business world is advised by its tax lawyers that the legality of the ADR regulations is in doubt—and I believe there will be substantial advice to that effect—the Administration's incentive objectives will not be achieved. Firms are unlikely to invest in new assets which would not otherwise have been acquired if they are uncertain about obtaining the depreciation advantages offered by the proposed regulations. While the regulations would therefore not motivate additional new investment, any investment which occurs in qualified assets will nevertheless cause a revenue loss.

THE PROPOSALS WILL CREATE ADMINISTRATIVE PROBLEMS

To the extent that the Commissioner's power to discriminate against preexisting or foreign assets is doubtful, it may be anticipated that some if not many taxpayers will claim that the ADR System must apply to existing and foreign assets as well as to newly acquired ones. The potential revenue loss and administrative headaches which will result from such claims are not lightly to be ignored.

CONCLUSION

The proposed Asset Depreciation Range System regulations should be withdrawn.

OLIVER OLDMAN,
Professor of Law,
Director, International Tax Program.

INDIANA UNIVERSITY, SCHOOL OF LAW,
Bloomington, Ind., April 16, 1971.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C.

DEAR COMMISSIONER: I have recently had an opportunity to read Professor Bittker's memorandum concerning the Treasury's Proposed Regulations on liberalized depreciation—the ADR system.¹ I agree completely with the memorandum and urge you to withdraw the regulations.

The power of Congress to determine tax rates has been jealously guarded throughout our country's history. The Executive has sought power to adjust tax rates on many occasions and it has not been granted except in the recent Inter-

¹ See Professor Bittker's memorandum on p. 291.

est Equalization Tax provisions and except as incident to the Treaty making power. It is clearly illegal for the Treasury to vary the tax rates for one sector of the economy without an explicit grant of authority. There is certainly no doubt that an arbitrary variation in the rules governing deductions for depreciation is a rate adjustment, as the percentage depletion, deduction and the corporate dividends received deduction demonstrate.

There is also at stake an issue beyond problems of taxation. Agency rule-making is a growing phenomenon which is of vital importance in our society. Irresponsible rule-making, such as the ADR proposals, can only set back the development of a legitimate rule-making function for administrative agencies and bureaucracies.

Thank you for your consideration of this matter.

Your truly,

WILLIAM D. POPKIN,
Assistant Professor of Law.

J. NELSON YOUNG,
COLLEGE OF LAW, UNIVERSITY OF ILLINOIS,
Champaign, Ill., April 22, 1971

OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Internal Revenue Building,
Washington, D.C.
(Attention CC:LR:T).

GENTLEMEN: I am writing to urge that the Treasury Department withdraw its proposed "Asset Depreciation Range System" regulations. As ably stated by Professor Boris I. Bittker in his comprehensive memorandum upon this proposal, there is a serious question as to the statutory authority for this action.¹ In addition, there is a fundamental policy issue involved with respect to these proposed regulations which would provide by unilateral administrative action substantial tax relief for a special class of taxpayers.

In large measure, the effectiveness of our income tax is premised upon bona fide self-assessment. This in turn is premised upon public confidence that the income tax laws are administered fairly and equitably for all taxpayers without favor or discrimination. In my view, the proposed "ADR" regulations seriously undermine that confidence. I respectfully submit that a significant change in tax depreciation policy is a matter for Congressional determination.

Respectfully yours,

J. NELSON YOUNG,
Professor of Law.

NEW YORK UNIVERSITY, SCHOOL OF LAW,
New York, N.Y., April 26, 1971.

Re Asset Depreciation Range System.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C.,
(Attention CC:LR:T).

DEAR SIR: These comments relate to the proposed amendments to the Income Tax Regulations providing for depreciation based on asset depreciation ranges, as published in the Federal Register for March 13, 1971, 36 F.R. 4885.

My initial reaction to these regulations was that they went well beyond what the Treasury could do as an administrative matter. Recently, I have had an opportunity to go over Professor Boris I. Bittker's statement dealing with the Treasury's authority to issue these regulations.¹ I have also examined the memorandum prepared by Covington & Burling in answer to Professor Bittker, and his response to that memorandum. This review makes even clearer to me the fact that these changes really cannot be made administratively.

¹ See Professor Bittker's memorandum on p. 291.

I have also reviewed the statement of Professor Robert Eisner of Northwestern on the economic aspects of the proposals. That statement makes a strong case for the proposition that the depreciation range proposals are wrong as a matter of policy.

I urge you to reexamine your position with respect to the depreciation range proposals and, hopefully, to withdraw them.

Sincerely yours,

JOHN Y. TAGGART,
Professor of Law.

UNIVERSITY OF MINNESOTA, LAW SCHOOL,
Minneapolis, Minn., April 26, 1971.

Re Proposed Regulations § 167 Asset Depreciation Range System.

HON. RANDOLPH THROWER,
Commissioner of Internal Revenue,
Washington, D.C.
(Attention CC:LR:T).

DEAR SIR: I write pursuant to TIR 1075 to urge that the above-noted Regulations be withdrawn as inappropriately and improvidently issued.

Like many tax law teachers, I have grave doubts as to the legality of Regulations which directly alter so basic a tax doctrine as the useful life of a depreciable asset.

This defect aside, there are two further considerations which make these Regulations inappropriate. First, the introduction of the concept of a range of useful lives for assets is inconsistent with, and undercuts the fundamental premise of cost as the controlling principle in permitting deductions in the computation of taxable income. Our experience with percentage depletion ought to serve as a reminder that such departures should not be made.

The second untenable premise of the Asset Range Regulations is their cyclical necessity as a stimulus to the economy. These Regulations are being proposed when current data shows that existing plant and equipment is being operated substantially below capacity. Without a cut-off date or any criteria for withdrawal, these Regulations will endure to induce over-investment in capital goods and a stimulus to inflationary pressures, when the current slump in consumer spending abates.

Adoption of these Regulations will retard the long-term prospects of achieving administrative flexibility in fiscal policy by adopting an erroneous program in an improper fashion.

Respectfully,

LEO J. RASKIND,
Professor of Law.

THE UNIVERSITY OF WISCONSIN, LAW SCHOOL,
Madison, Wis., April 26, 1971.

Re The Asset Depreciation Range System.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C.
(ATTENTION CC:LR:T).

DEAR SIR: I wish to record my strenuous objection to the proposed regulations (published March 13, 1971) that would adopt the so-called Asset Depreciation Range System.

I have long been impressed with the writings of Professor Robert Eisner. As long ago as 1959, in his trenchant article in the *Tax Revision Compendium*, Professor Eisner exposed the fallacies underlying the claims that the Secretary of the Treasury has recently made for the Asset Depreciation Range System. His conclusions then, and in his letter to you dated April 12, 1971, specifically relating to your ADR proposals cannot be faulted. It is clear, therefore, that the

billions of dollars of revenue that will be lost through the ADR can much better be used in any of a number of other ways.

I have also read with care the legal memorandum submitted to you by Professor Boris Bittker.¹ I fully agree with his conclusions concerning the impropriety of attempting to bypass Congress on an issue involving such drastic changes in the law and such great economic consequences.

Sincerely,

WILLIAM A. KLEIN,
Professor of Law.

APRIL 28, 1971.

Re ADR Depreciation Proposals.

COMMISSIONER OF INTERNAL REVENUE,
Washington, D.C.
(Attention CC: LR: T).

DEAR MR. COMMISSIONER: I would like to add my voice in dissent to the promulgation of the "Asset Depreciation Range System" regulations.

I do not object to the principle of delegation of administrative rule making, or necessarily to the need for a reform of depreciation policy to encourage investment in new machinery and other producers' goods. However, apart from any possible constitutional limitations, it is manifest that policy making of this magnitude and which would involve a major shift in tax burden, should be subject to the full range of protection provided by the normal tax law-making processes, and especially to critical consideration by Congress.

Let me in this respect fully endorse the critical analysis provided you by Professor Boris Bittker of Yale Law School and his conclusion that "the ADR System may be a desirable way to step up the pace of business investment, but this is a decision that should be made by Congress."¹

Sincerely yours,

JOHN C. CHOMMIE,
Professor of Law,
Director, Tax Program University of Miami Law School.

BOSTON COLLEGE LAW SCHOOL,
Brighton, Mass., May 5, 1971.

In the Matter of: Proposed Amendment To Income Tax Regulations (26 CFR Part I): Addition of Section 1.167(a)-11 providing for asset depreciation ranges, 36 Federal Register 4885 (March 13, 1971).

These comments are submitted in opposition to the regulations proposed to be issued providing for asset depreciation ranges (ADR) and repealing the reserve ratio test.

These comments will be directed solely to the issue of the legal authority of the Commissioner to issue the proposed regulations. No comments are made and no position is taken with respect to the policy reasons enunciated by the President in announcing the issuance of the proposed regulations. Thus no position is taken, for example, with respect to such questions as to whether additional stimulus is needed for capital investment in the United States, whether the proposed changes in depreciation methods are needed to stimulate the economy generally, or whether the changes will help reduce unemployment.

GENERAL

It is the position of the undersigned that the Treasury does not have statutory authority under existing provisions of the Internal Revenue Code of 1954 to provide for cost recovery allowances as contemplated by the proposed regulations. It is respectfully submitted that this conclusion is required by:

1. The statutory language of section 167 and past legislative history with respect to depreciation provisions;

¹ See Professor Bittker's memorandum on p. 291.

2. Interpretation of section 167 and its predecessors by the Supreme Court of the United States;

3. Generally accepted concepts of depreciation adopted by the accounting profession.

I. LEGISLATIVE HISTORY

Section 167(a) provides:

"There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) . . .",
of property used in the taxpayer's trade business or held by him for the production of income.

Section 167(b) provides for certain methods of depreciation which shall, under regulations prescribed by the Secretary or his delegate, constitute a "reasonable allowance."

Section 167(d) provides that the Secretary or his delegate and the taxpayer may enter into an agreement specifically dealing with the useful life and rate of depreciation of property used by the taxpayer.

The proposed regulations purport to create an asset depreciation range system under which a taxpayer is permitted to adopt as the period over which depreciation may be claimed a period of time which may be 20% shorter or 20% longer than the guideline lives prescribed for such assets. In addition the reserve ratio test is abolished. Thus a taxpayer will be permitted to recover his costs on property qualifying under the proposed regulations without regard to the actual useful life of the property in his hands.

It is this latter fact which deprives the proposed regulations of legal basis under section 167.

From the legislative history of section 167 it is clear that the depreciation deduction is to be related to the actual useful life of assets in the business of the taxpayer. In adopting section 167 of Internal Revenue Code of 1954 the House Ways and Means Committee stated:

"Depreciation allowances are the method by which the capital invested in an asset is recovered tax-free *over the years it is used in a business*. The annual deduction is computed by spreading the cost of the property *over its estimated useful life*." H. Rept. 8300, 1954, U.S. Code Cong. & Adm. News 4047. (emphasis added).

The House Report went on to note, in connection with the double declining balance method authorized, that ". . . based on a realistic estimate of useful life, the proposed system conforms to sound accounting principals." Id at 4048.

It has been argued in support of the proposed regulations that other countries permit faster recoveries of capital investment. The 1954 Ways and Means Committee report specifically took note of these faster cost recovery systems and rejected them.¹ The Committee, balancing the needs of budgetary policy and economic stimulus, concluded that the accelerated depreciation method prescribed in section 167(b) would accomplish the desired objectives "without departing from realistic standards of depreciation accounting." Id at 4049.

Thus it seems clear from the legislative history of section 167 that the depreciation deduction is to be allowed only if the write off conforms to the actual useful life of the property in the hands of the taxpayer.

In 1962 the Treasury issued rules prescribing new guideline lives for classes of depreciable assets. Rev. Proc. 66-21, 1962-2 C.B. 418. These guideline lives replaced those specified in bulletin F, most recently promulgated in 1942. The guideline lives proposed in 1962 were in most cases shorter than those set forth in Bulletin F. In order to insure that taxpayers would not be unable to utilize the shorter guideline lives to achieve a write off over a period shorter than actual experience in the business, the reserve ratio test was instituted. Although somewhat complex in articulation, the purpose of the test was clear: it operated to insure that the depreciation deduction taken by individual taxpayers would conform to the actual useful lives of the assets in the hands of the taxpayer, whether that useful life was longer or shorter than the prescribed guideline lives. It was the adoption of the reserve ratio test that sustained the legality of the 1962 guideline lives.

¹ Specifically Great Britain, Canada and Sweden. Report at 4049.

The 1962 administrative changes are thus not a precedent which sustains the present proposed regulations. Indeed, in the absence of the reserve ratio test, the 1962 regulations would have been equally invalid to the extent that they permitted taxpayers to take a depreciation deduction over a period of time which did not correspond to the actual life of the assets in the taxpayer's hands.

Shortly after adoption of the 1962 procedures, Senator Hartke introduced legislation to repeal the reserve ratio test, Amendment 319 to H.R. 8363, The Revenue Act of 1964. The Hartke amendment was defeated by the Senate Finance Committee on January 22, 1964. See generally, Lent, *Should the Reserve Ratio Test Be Retained*, 17 National Tax Journal 365, 375 (1964). The action by the Senate Finance Committee is a strong indication that Congress understood the function of and necessity for the reserve test.

As the President's Task Force on Business Taxation noted in its Report of September 1970, a shift from depreciation to cost recovery (urged there to be 40% rather than 20%) would require amendment of present law. This judgment was soundly based on prior action by Congress. Where Congress has desired to move from the concept of depreciation to one of cost recovery, it has enacted specific legislation to accomplish the result. Thus, in the Tax Reform Act of 1969, provisions were enacted to provide recovery in five years of the amount invested in certified pollution control facilities (section 169), railroad rolling stock (section 185), and expenditures to rehabilitate low income rental housing (section 167(k)). Earlier, similar provisions had been enacted for amortization certain war time emergency facilities (section 168). In some cases, Congress has provided that otherwise capital charges may, at the election of the taxpayer he recovered entirely in the year incurred. See sections 173 (circulation expenditures), 174 (research and experimental expenditures), 175 (soil and water conservation expenditures), 180 (expenditures by farmers for fertilizer), 182 (expenditures for clearing certain farmland). And, section 179 permits a special first year capital recovery for certain investments by small businesses.²

It can hardly be contended that the Commissioner under the regulatory authority relied upon to sustain the proposed regulations could have effected the special cost recovery allowances enumerated in the preceding paragraph. Yet, if the Commissioner is free to eliminate useful life as a relevant concept to permit taxpayers to deviate from industry averages by 20%, there seems little logical reason why he would not equally be free to provide the kind of artificial capital recovery allowances that Congress has specifically acted upon in the past.

The Commissioner has asserted that authority is derived from section 7805 to issue the proposed regulations. Section 7805 authorizes the Commissioner to prescribe "needful" regulations. This authority does not confer upon the Commissioner power to promulgate *invalid* regulations. Regulations can be prescribed under this authority to implement section 167, so long as those regulations comply with the terms of the section itself. Nor does the regulatory authority specified in 167(b) and 167(d) permit the Commissioner to disregard the definition of the depreciation as that term was understood by Congress in enacting the section.

Prior administrative practice supports the view that the proposed regulations are invalid. As noted above, the 1962 procedures specifically contained rules designed to insure that a particular taxpayer's depreciation deduction would be spread over the useful life of the assets in his hands. In 1934, with Congress's approval, the Treasury issued regulations reducing depreciation allowances by shortening useful lives by some 25%. The specific purpose of this action was to insure that the deduction be spread over actual useful lives. Thus the 1934 action by the Treasury is not a precedent for the present proposed regulations.

In summary, the legislative history of section 167 clearly shows that depreciation must be based on the useful life of assets in the hands of the particular taxpayer; Congress has on occasion provided special cost recovery allowances, but these were specific actions required to overcome the effect of section 167 requirements; prior administrative action with respect to the depreciation allowance has been consistent with Congressional action and affords no basis for the present proposed action.

² The repeal by Congress in 1969 of the 7% investment tax credit would seem a further indication that Congress does not intend at the present time to make special cost recovery allowances available to business.

II. COURT INTERPRETATIONS

The Supreme Court of the United States has repeatedly held that the depreciation allowance is intended to provide for a recovery of asset costs spread over the periods that the taxpayer is benefitted in his business by those assets. The leading case is *Massey Motors v. U.S.*, 364 U.S. 92 (1960). In that case the court was required to determine proper depreciation for automobiles that were disposed of by a taxpayer prior to the exhaustion of their full economic life in the taxpayer's business. The court held that the useful life of the asset for purposes of the depreciation deduction must "be related to the period for which it may reasonably be expected to be employed in the taxpayer's business." 364 U.S. at 107. In reaching this conclusion the court made the following statement concerning the depreciation deductions which are clearly relevant to that legality of the proposed regulations:

"It was the design of the Congress to permit the taxpayer to recover, tax free, the total cost to him of such capital assets, . . . It was the purpose of § 23(1) and the regulations to make a meaningful allocation of this cost to the tax periods benefitted by the use of the asset . . . But, for the most part, such assets are used for their entire economic life, and the depreciation base in such cases has long been recognized as the number of years the asset is expected to function profitably in use . . .

"The wear and tear to the property must arise from its use in the business of the taxpayer—i.e., useful life is measured by the use in a taxpayer's business, not by the full abstract economic life of the asset in any business . . .

"Furthermore, as we have said, Congress intended by the depreciation allowance not to make taxpayers a profit thereby, but merely to protect them from a loss. The concept is, as taxpayers say, but an accounting one and, we add, should not be exchanged in the market place . . .

"Finally, it is the primary purpose of depreciation accounting to further the integrity of periodic income statements by making a meaningful allocation of the cost entailed in the use (excluding maintenance expense) of the asset to the periods to which it contributes." 364 U.S. at 96, 97, 101, and 104.

Similarly in *The Hertz Corporation v. U.S.* 364 U.S. 122 (1960) the court made the following observation specifically with respect to the regulatory authority of the Commissioner under section 167:

"Moreover, the regulation can only carry out the fundamental concept of depreciation—that it is available only in such amount, together with salvage value, as will effectuate the recovery of cost over the period of useful life."

These expressions by the Supreme Court appear to preclude issuance by the Treasury of regulations that do not adhere to the concept of depreciation as a recovery of costs over the useful life of business assets in the hands of the taxpayer.

III. ACCOUNTING PRINCIPLES

The U.S. Supreme Court in *Massey, supra*, noted that depreciation in section 167 is essentially an accounting concept. Thus it is appropriate to test the proposed regulations against accounting principles to see if the regulations are consistent with a definition of depreciation as used by the accounting profession.

In Accounting Terminology Bulletin Number 1 (Committee on Terminology, American Institute of Accountants, 1953) it is stated:

Par. 54. "Depreciation accounting is clearly a special technique (like cost accounting or accrual accounting). It can be sharply distinguished from the replacement system, the retirement system, the retirement reserve system, and the appraisal system, all of which have at times been employed in dealing with the same subject matter in accounting. Depreciation accounting may take one of a number of different forms. The term is broadly descriptive of a type of process, not of an individual process, and only the characteristics which are common to all processes of the type can properly be reflected in a definition thereof. These common characteristics are that a cost or other basic value is allocated to accounting periods by a rational and systematic method and that this method does not attempt to determine the sum allocated to an accounting period solely by relation to occurrences within that period which affect either the length of life or the monetary value of the property. Definitions are unacceptable which imply that depreciation for the year is a measurement, expressed in monetary terms, of the physical deterioration within the year, or of the decline in monetary value

within the year, or indeed, of anything that actually occurs within the year. True, an occurrence within the year may justify or require a revision of prior estimates as to the length of useful life, but the annual charge remains an allocation to the year of a proportionate part of a total cost or loss estimated with reference to a longer period."

Par. 56. "Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation. Depreciation for the year is the portion of the total charge under such a system that is allocated to the year."

This is the classic definition that was accepted by the accounting profession at the time the Internal Revenue Code came into being. See Montgomery, *Auditing Theory and Practice* 317 (1st ed. 1912).

Thus the proposed regulations do not conform to generally accepted accounting principles of depreciation. They represent adoption of an artificial cost recovery allowance which the accounting profession sharply distinguishes from true depreciation.

CONCLUSION

It is respectfully submitted that the proposed regulations establishing asset depreciation ranges are invalid and should be withdrawn.

PAUL R. MCDANIEL,
Assistant Professor of Law.

To : Commissioner of Internal Revenue, Washington, D.C.
(Attention CC:LR:T).

COMMENTS ON TREASURY'S PROPOSED SUBSTITUTION OF COST RECOVERY ALLOWANCES FOR DEPRECIATION

(By Charles Davenport, Acting Professor of Law, University of California, Davis, Calif.)

The President's recent announcement of certain changes in the administration of tax depreciation raises a number of serious questions. The questions are serious because the President proposes to give annual tax relief ranging from \$800,000,000 to \$4.7 billion over the next decade, through an executive decision to change depreciation of business assets. But some of the questions would be as serious if smaller amounts of revenue were involved.

In view of the care Congress exercises in dealing with tax matters, should be President unilaterally burden our revenue raising process with the task of stimulating economic growth? What kind of an impact does the device chosen by the President have on various taxpayers? Is there solid evidence which indicates that the device chosen is likely to achieve the desired result? What impact does all this have on the science of government?

After first describing the new rules and discussing some of the accompanying rhetoric, this paper deals briefly with these questions.

WHAT THE NEW RULES DO

The new rules deal with depreciation of business machinery and equipment. Historically, depreciation has been a technique of allowing a taxpayer to recover from business revenue the cost of assets used in the business, *over the period of use by the taxpayer*.¹ The new rules will modify this technique as described below.

The establishment of a capital cost recovery allowance (herein of asset depreciation ranges)

At present, the Internal Revenue Service employs a so-called guideline life under which taxpayers are permitted to write off assets in accordance with a

¹ This example assumes that the taxpayer is using straight line depreciation. If he is using a declining balance method of depreciation, the rate is applied to the full cost without reduction for salvage value. Thus, the elimination of salvage value will not be of benefit to those who are using a declining balance method of depreciation.

schedule which prescribes useful lives for very broad categories of assets. The taxpayer who chooses to use this method must, however, demonstrate that his asset retirement and replacement practices are consistent with the use of that life. Except for tolerances built in for administrative convenience, depreciation in any one year may not exceed that produced by reference to the period for which taxpayers actually use their assets.

Under the Treasury announcement, there would be no need for a taxpayer to demonstrate consistency between his depreciation practices and the actual useful life of his property. Instead, the Treasury would prescribe a range of lives for broad asset categories, and the taxpayer may use any life in that range. For example, let us suppose a taxpayer who buys an asset which he can reasonably expect to use for a ten-year period. Let us also suppose that the asset has a guideline life of 10 years. Under existing rules, the taxpayer must depreciate the asset over the 10 years of expected use. Under the new system, the taxpayer may pick any life between 8 years (20% less than the present guideline life of 10 years) and 12 years (20% more than the present guideline life of 12 years).² He could write off the cost over the life selected by him, and the Internal Revenue Service would not be permitted to question whether this write-off was at all consistent with the taxpayer's retirement and replacement practices. A taxpayer could do the same even if he thought that he would use the asset for 20 years.

This is a wholly new concept of depreciation because it permits a deduction measured by an arbitrary schedule rather than by the taxpayer's anticipated use of an asset. It is often called a capital cost recovery allowance and is said to be in use in other industrialized tax systems. In this country, however, such a system has not been considered generally appropriate because it has no relation to economic income, and for the most part, our concept of taxable income is built on economic income.

2. Elimination of the reserve ratio test

Part and parcel of this wholly new capital cost recovery allowance is the elimination of the reserve ratio test. The reserve ratio test is a procedure which tests whether the taxpayer's retirement and replacement practices are consistent with the depreciation deductions he claims, i.e., whether his depreciation is consistent with his actual use of assets. But such a device has no place in a cost recovery allowance system because in such a system the deduction is allowable without regard to the period of asset use. Thus, the elimination of the reserve ratio test is a necessary second step in shifting from a depreciation system to the capital cost recovery allowance system.

3. Elimination of salvage value

The taxpayer will also be given the alternative to disregard salvage value in computing his depreciation allowances. No asset may be depreciated below its salvage value, however. The message carried in this apparent double talk boils down to a further acceleration of depreciation. Thus, if a taxpayer today were to buy an asset for \$10 which had a \$2 salvage value, the depreciable amount would be \$8. The amount of annual depreciation would be determined by applying a depreciation rate against the \$8.³ This would continue until such time as the entire \$8 had been written off. Under the revised method, the depreciation rate (as increased by the new system) will be applied to \$10. However, the depreciation must cease entirely when the full \$8 has been depreciated. The effect of course is to advance the time that the depreciation is claimed.

4. First year convention

In addition, there will be an alternative to the present convention concerning depreciation in the year that an asset acquired. At present one half of a full year's depreciation may be deducted in the year in which the equipment is placed in service regardless of whether the asset was acquired in January or December. Under the convention prescribed in the announcement, a full year's depreciation on assets acquired in the first half of the year may be taken. Assets

² The President's January announcement and that by then Secretary Kennedy did not include the so-called "repair allowance." That was not revealed until the proposed regulations. The remarks made herein are not directed toward that allowance. It, however, appears to be more of the same.

³ *Business Taxation*, Report of the President's Task Force on Business Taxation, September, 1970, at p. 29.

acquired in the second half of the year will continue to qualify for one half year's depreciation.

One can compare the new system to the present convention by assuming that asset acquisitions and their costs are relatively uniform throughout the year. As so viewed, the existing rules may be looked upon as allowing one-half of a year's depreciation for all assets bought during the year. Using the same assumption, the new convention would allow three quarters of a year's depreciation on all of the assets purchased in the year. The result then is to allow an additional one-quarter of a year's depreciation on the taxpayer's asset acquisitions for the year.

5. Conclusion

These then are the things which the President has stated he has approved. The net effect of them is to accelerate the taking of depreciation deductions. Under the announcement, in 1971 depreciation deductions will be greater by about \$6.0 billion. By 1976, annual deductions would be about \$9.1 billion over what they would if no change were made. Nearly all of these increased deductions will be claimed by corporations. For the most part, these additional deductions will not result in reduced depreciation deductions in the future. A simple example will demonstrate this effect.

Let us suppose a taxpayer who has 5 assets each costing \$100, each has a useful life of 5 years, and the taxpayer replaces one each year. His current depreciation is \$100 per year.⁴ In the first four years of the new system, he will claim total depreciation deduction of \$450 rather than \$400, or \$50 more than now allowed. In the fifth year, his deductions under the new system will be \$100 for that year and each year thereafter until he ceases his asset purchases or the new system is repealed. He will thus have had an extra \$50 of deductions which will not be recovered by the Government until asset acquisitions cease or until the new system is eliminated. The new rules thus do not simply defer tax. Rather there is a permanent revenue loss.

RHETORIC

The President's statement contains a number of misleading assertions.

1. Lack of authorization of the statute

Implicit in the President's statement is the assumption that the Internal Revenue Service is authorized by the statute to make the announced changes. The claim is that the statute authorizes a reasonable allowance for depreciation; that the Department of Treasury is authorized to prescribe means of ascertaining a reasonable depreciation allowance; and that the system outlined in the announcement is just such a means. The difficulty with this argument lies in the last step. The capital cost recovery allowance produced under the announcement does not result in a reasonable allowance.

In the past, a reasonable allowance for depreciation has been measured by spreading the cost of a depreciable asset over the number of years it was to be used by the taxpayer. Once the pertinent period was ascertained, there were a number of methods by which specific amounts were allocated to different years during this period. In all cases, however, the assumption was that the total cost was to be allocated over the reasonably anticipated period of use of the asset.

Under the technique announced by the President, this assumption that asset cost is to be distributed over the period of use by an individual taxpayer disappears. Rather, the cost of assets may be written off over a period designated by the Treasury. The new scheme amounts to a license to the taxpayer to write off over a stated period the cost of an asset without any relation to his investment and replacement policies. This technique will not yield a reasonable allowance for depreciation except accidentally. For example, for taxpayers who would normally use an asset for 10 years, the ability to write its cost off against income in, say, a 6-year period will not yield a reasonable allowance. In the first six years the allowance is excessive. In the last four years there is no allowance. Since we know ahead of time that these results will occur, the allowance is not reasonable during either period. The system thus is not designed to yield a reasonable allowance and thus is not authorized by the statute.

⁴ Tax Depreciation Policy Options: Measures of Effectiveness and Estimated Revenue Losses, Congressional Record, July 23, 1970, p. E-6964.

Indeed the President himself notes that the announcement was based upon the product of his Task Force on Business Taxation. In its report, dated September, 1970, the Task Force recommended that the present depreciation system be scrapped in favor of a so-called cost recovery allowance. It had recommended using periods shorter than the guidelines by 40%. The President did not adopt the 40%, instead he went to 20%, but in other respects he adopted the recommendation of the Task Force. With respect to whether or not such a change can be implemented by Executive fiat, the President's own Task Force stated as follows:

“. . . [S]ince the shift from depreciation to cost recovery unrelated to the useful life concept does require amendment of the present law, we urge that all the matters covered in the recommendations which are related to such a shift be incorporated in the statute.”⁵

The American Bar Association has made similar recommendations, also noting that legislation was required.

As late as July the Treasury itself thought it was so constrained.⁶

2. Lack of historical precedents

The announcement argues that sound depreciation reform to create jobs and growth has a long history of bi-partisan support. This assertion is followed by a discussion of the depreciation changes made in 1962. Apparently, the purpose is to imply that the changes have a historical precedent in the changes made in 1962. There is no warrant for such implication.

Prior to 1962, gains resulting from the sale of depreciated machinery and equipment were usually reported at capital gain rates. This had led the Treasury to be very cautious in the setting of estimated useful lives because depreciation could be deducted against ordinary income, and if excessive, the gain represented by such excessive depreciation would be reported as capital gain on sale. However, Treasury's caution in allowing depreciation rates created substantial controversy, largely because some taxpayers thought rates allowed by the Treasury were not consistent with their use, and procedurally taxpayers had difficulty in establishing that their depreciation rates were consistent with their investment policies. Recognizing a need to eliminate needless controversy, Treasury surveyed the business community and ascertained that business would not oppose legislation to eliminate the reporting of depreciation gains as capital gain if greater flexibility was granted in setting depreciation rates. While this legislation was pending, in testimony before both the House Ways and Means Committee and the Senate Finance Committee, Treasury promised to revise its procedures for reviewing taxpayer's depreciation rates. This promise was kept by promulgation of the guidelines in Revenue Procedure 62-21.⁷ Several observations are in order.

This Procedure simplified the grouping of assets, and the guideline lives were purposefully set at levels which were below those which had been considered normal when examining depreciation deductions. The purpose was not, however, simply to shorten lives for tax purposes for all taxpayers. Instead, it was intended that taxpayers who had already adopted or who desired to adopt an investment and replacement policy which resulted in below average replacement period should not be penalized by having to justify their use of shorter lives under prior procedures. However, taxpayers were warned that if they departed substantially from the actual lives, or if they used the guideline lives, or other shorter ones, they would have to satisfy the so-called reserve ratio test. The reserve ratio test is an automatic device for testing whether the taxpayer's retirement and replacement policy is consistent with this claimed depreciation rates. In order to prevent any hardship during the period of transition, it was announced that there would be a three-year period during which the reserve ratio test would be assumed to be met. Thereafter, it was applicable.

The mere re-counting of the 1962 changes shows the striking contrast to the recent change. In 1962, there was an effort to improve depreciation as it has been computed historically. There was concern that some rates were too low, and taxpayers were given the authority to shorten lives if *they could thereafter demonstrate* that the shorter life was consistent with their investment practices. This reform was promised both to Congress and the business community while remedial

⁵ *Business Taxation*, Report of the President's Task Force on Business Taxation, September, 1970, at p. 29.

⁶ *Tax Depreciation Policy Options: Measures of Effectiveness and Estimated Revenue Losses*, Congressional Record, July 23, 1970, p. E-6964.

⁷ Revenue Procedure 62-21, 1962-2 C.B. 418.

legislation was being considered. In contrast, the recent action is an abandonment of the historically used system and will institute a wholly new system under which depreciation need not have any relation to actual retirement and replacement practices of the taxpayer.

3. *The deferral of taxes*

The second claim is made that the liberalization of depreciation allowances is essentially a change in the timing of a tax liability. The implication of this claim is that ultimately the taxes will be paid. In a few instances, the claim is true. However, in the majority, so long as the particular taxpayer does not lessen his capital investments, the taxes which are deferred by excessive depreciation charges will never be repaid. While an earlier example illustrates the point, it can be made in another way. Current depreciation on an asset is increased at the cost of lessening depreciation at some future date. When that future date comes, however, increased depreciation on other more recently purchased assets will be greater than the loss on older assets. Thus, one continually uses tomorrow's depreciation against today's income. There will be nothing to borrow only when the taxpayer ceases to make investment at his current rate.

This result is confirmed by the revenue estimates with the news releases. By 1980 there will continue to be an annual revenue loss of some \$2.8 billion.

4. *Revenue loss*

The claim is made that there will be little or no revenue loss because the incentive given will stimulate the economy which will result in greater incomes for some which will lead to greater revenue collection by the Federal government. All of this could be true but it may not be. The new depreciation policy favors certain investments. Such favorable treatment could result in greater aggregate investment, but it need not. The result might be merely to switch investments from assets which are not favored under the announcement to those which are.

But even assuming that there is some net increase in investment, this method of priming the pump, so to speak, must be compared to other things that the government could do to increase economic activity. There are many kinds of alternatives. The government could spend an equivalent amount on education by agricultural subsidies, or it could distribute the dollars to all taxpayers by cutting taxes or allowing credits against the tax. All of this would put dollars in the hands of taxpayers who would then presumably pass these dollars on to other people and thereby stimulate the economy. Many of these optional ways of stimulating spending would appear to be more effective than the depreciation proposal. However, under these alternative spending programs, the dollars spent would be treated as real expenditures and would be treated as a real cost even though they thereby stimulated the economy and produced greater tax revenues. The cost of the depreciation changes is just as real although it is reflected only by decreased tax collections. The question still is what is the gross revenue loss.

TAX POLICY

Perhaps before setting out to review the changes in light of tax policy, the criteria for testing should be established. Largely they are a single one, first espoused no later than the *Wealth of Nations*. Does the tax fall equally on persons similarly situated? If it does not, can the deviation from the desired norm be explained by any principle internal to the administration of the tax law? Put in other words, the burden of justifying uneven tax burdens is on the proponent if other feasible means of establishing his goal are available.

When examined from this bias, the announcement raises a number of questions. The rules will push depreciation deductions to earlier years in the lives of the assets involved. Put another way, the amount of deductions which a taxpayer may take with respect to his depreciable assets will be greater in the early years of their useful lives. An increased deduction has a tax benefit equal to the amount of taxes it saves in the current year discounted for the period elapsing until the taxes are paid. Since, as we have seen, most of the tax savings will be perpetual, there will be no discount. But whether perpetual or short term, the tax benefit for individual taxpayers will depend on the amount of new investment, the degree to which depreciation is accelerated, and the taxpayer's tax rate. We know these vary. Thus, we know the benefits will vary. Some of these variations are discussed below. All of them will result in uneven tax burdens. There is no justification for this unevenness.

1. Greater benefits to the high bracket taxpayers

Any acceleration of a deduction means more dollars to a high bracket taxpayer than it does to a low bracket taxpayer. This follows because the same dollar deduction will yield a greater reduction in taxes to a high bracket taxpayer than it does to a low bracket taxpayer.

Supporters of the changes may attempt to answer this argument by claiming that there is very little bracket graduation because the principal beneficiaries are corporations. In large part, this assertion is true, but not all businesses are corporations. Some are individuals in the 70% bracket. Others are individuals in much lower tax brackets.

Furthermore, even if all businesses were corporations, there still are rate differences which mean deductions will have different benefits to different taxpayers. Most corporations are taxed at only a 22% rate, but the larger ones which report by far the preponderance of corporate income are taxed at a nominal 48% rate. These differences in rates are legislated by Congress, and are inherent in the system of taxation. In addition, some corporations will have tax loss carryovers which will insulate earnings for a substantial period of time. They would be paying no taxes without the increased depreciation allowances, and they will not benefit from the rules.

The overall result of the acceleration of deductions is to favor those who would otherwise be paying a high rate of tax on the income which is shielded by the higher depreciations deductions.

2. Certain assets benefited

Assets which have lives of from between 10 to 20 years will be proportionately benefited more than assets having shorter lives under all of the changes mentioned above other than the so-called full year convention. This results because an acceleration of deductions on a 20 year asset to 16 years deductions otherwise allowable in the last four years. Such remote deductions have little value, and by accelerating them to the first 16 years, their value is greatly enhanced. On the other hand, if a five year asset is involved, deductions which would otherwise be allowed in the fifth year are accelerated. These deductions already have a relatively large value, and acceleration does not increase their value as much proportionately.

The full year convention has the effect of speeding deductions by approximately 3 months. Obviously, such acceleration is greater proportionately for an asset of 5 years than for an asset having a 10 year life.

3. Benefits are distributed unevenly

Taxpayers will either receive no benefits, be penalized, or be benefited by the change. To those taxpayers whose lives for assets is that prescribed under the announcement, no tax benefit is derived. For most taxpayers whose situation would not be in accordance with the shortened life, tax benefits and penalties will result. If the taxpayer's actual life is longer than the period prescribed, he obtains a tax benefit. Those who are using a shorter life than the new period not only obtain no benefit from the change but are disadvantaged with respect to competitors who do benefit from the change. There is no way of avoiding this problem. Even if the periods for the allowable cost recovery were so short that the depreciation deductions of all taxpayers were increased, the degree of benefit to the individual taxpayers would nevertheless vary to create the inequalities which are discussed here.

4. The least deserving taxpayer is helped

The taxpayer who receives the greatest benefit by using the cost recovery allowance is the one who in fact has the longest life for his depreciable property. For example, if the current guideline life for an asset is 15 years, under the announcement the Service will accept 12 years. But a taxpayer owning such an asset today may be using it 20 years and depreciating it over that period. Another taxpayer may be using and depreciating a similar asset over 15 years because it accords with his actual use. Under the new rules both may use 12 years. The taxpayer who has a 20 year use has had his deductions accelerated by 40% while the other taxpayer has had his accelerated by 20%. The one who has the longest actual life for his depreciable property is the one who has followed an unprogressive replacement policy. This taxpayer receives the greatest benefit although it seems unlikely that he is the more deserving individual.

5. *Certain industries benefit*

Some industries are obviously more capital intensive than others. If an industry is required to acquire a lot of capital goods in order to produce its product, it will receive greater benefit from the increased depreciation rates than will those that are not so capital intensive. There is no principle of tax policy which permits the capital intensive industries to be preferred over those which require less capital for operation. Indeed, in some of the transportation industries which are highly capital intensive, it is suspected that the benefits will be so great that the industry itself will not be able to use them. If an industry cannot use the benefits conferred upon it, it will undoubtedly find some way to sell those benefits to those outside the industry who can make use of them in filing their own tax returns.

6. *Helps those with salvage value*

The ability to disregard salvage value is a benefit only to those who have assets which have a salvage value. If the taxpayer has been consuming his assets to the point where they have no value when they are retired from use, he gains no benefits under this new rule. On the other hand, if he turned over his assets relatively quickly so that there always is a salvage value, he will obtain benefits.

7. *Rule is not likely to be changed*

The benefits realized from an acceleration of depreciation are realized over a time pattern which will render repeal difficult. Earlier we established that acceleration of deductions amounts to borrowing tomorrow's depreciation to offset today's income. For some period following commencement of this practice, depreciation is excessive because earlier asset purchases yields normal depreciation while subsequent purchases yield borrowed depreciation. The total of these two is in excess of what accurate depreciation would have yielded. But this excess comes at a price. At some point, there will be assets yielding inadequate depreciation because it was borrowed in earlier years. At that point, the taxpayer may be able to achieve normal depreciation on his total assets because he borrows future depreciation on his younger assets. However, if we tell him he can no longer borrow from newly acquired assets and restrict him to proper depreciation on them, his depreciation on earlier purchases will be inadequate, and he must now begin to repay the earlier borrowed depreciation. The borrowed depreciation is just like borrowed money. In the year of repayment, the taxpayer has less funds that he would have had if no borrowing had occurred.

This point may be illustrated by returning to the taxpayer who has 5 assets having a useful life of 5 years and costing \$100 each. In the first four years under the new system he obtained an additional \$50 of deductions. If the new system were eliminated, in the four following years, his depreciation deductions would be \$50 less than they would have been had the new system never been implemented. In those years he must repay the depreciation he borrowed earlier.

Because such a consequence would likely have a very serious economic impact, there is little likelihood that the new rules will be eliminated.

8. *Politicizing the Internal Revenue Service*

The Internal Revenue Service is charged with the responsibility of administering the Federal income tax. One of its functions has been the promulgation of regulations either as directed by Congress or to provide interpretation of a complex statute. From time to time, these regulations are changed. Often the new interpretation is controversial. In the past the Service has pretty largely refrained from entering the political arena. That is to say the changes in regulations have proceeded from changes in statutes or cases related to the statute.

The depreciation proposals are quite different, however. They represent one political solution to a very serious economic problem. The solution is a unilateral Executive decision having no relation to the purpose of the statute. Rather the purpose is to increase the annual purchasing power of the business community by \$4.1 billions.

This action raises a question whether an administrative agency having vast responsibility for a complex and detailed statute can successfully engage in the dispensation of economic incentives. Having once strayed from its purpose can it be brought back? This question would be present even if there were complete

agreement that the action was appropriate. But where there is substantial doubt about the propriety of the action, the institution itself is seriously weakened. Will it not lose its credibility as an administrator of a technical body of law? Will not all of its decisions ultimately be suspect as "political" rather than "legal"?

9. Conclusion

We must conclude that the proposed changes in depreciation are not good tax policy. Rather than assisting in reaching a goal of equally taxing similarly situated persons, the changes assure us that similarly situated persons will be taxed unequally.

ECONOMIC POLICY

Some have defended the action on the grounds that the new depreciation rules will spur investment in capital goods which will obviously mean more jobs. This, however, is an improper standard by which to test the action. There are many ways to stimulate the economy, and the pertinent question is whether the distribution of this amount of funds, \$2.6 billions in 1971 but rising to \$4.1 billions in 1976, could not be more effectively spent in other ways. While it is of course impossible to estimate the amount of economic activity which will be generated by the changed rule, a number of factors seems to stand out.

First, the potential revenue loss is estimated on the approximate estimates of capital spending in 1971 without regard to economic stimulation resulting from the change. In other words, the revenue estimators assume that there would not be increased capital spending as a result of the stimulation. Second, the benefits are granted not just to those who respond to the incentive but to those who would have invested in any event. To such a person the benefit is not an incentive. It is a gift. The overall result is to fritter large sums in an ineffective way even though some would say such waste is necessary for "fairness."

Third, the experience with the investment credit indicated that the response to it was a greater investment in assets which qualified to receive the credit. This diverted investment from structures (which did not get the credit) into machinery and equipment (which did). If this change has approximately the same effect, and one can expect that it will, as an investment credit, some of the investment in assets which benefit from the change in rules will mainly be shifted, for example, from short-lived assets to long-lived assets because they obtain larger benefits.

Investment which would have otherwise gone into houses will be shifted to machinery and equipment. To the extent that investment is diverted from what would have been a more efficient use, absent the new rules, the policy is not only wrong but it is also self-defeating because it will offset the incentive felt by others.

Fourth, *in terms of long-range policy*, it is not apparent the the so-called incentive effect, if there is any, of these new measures will be considered beneficial. Indeed, under the investment credit, we found that the investment credit necessarily had to be suspended in 1966 and repealed in 1969. In both cases, the belief was that economically the incentive tool had overdone its job. We might reasonably soon conclude that the incentive in this case has overdone its job. However, it is suggested that the incentive in this case cannot be reversed. As noted above when discussing the tax policy aspects, the reversal of policy here would have a severe restricting influence on purchasing power over one cycle of asset lives. Thus, the operation of it would likely be much more haphazard and harder to predict than a mere turning off of the valve. This argues for the proposition that this innovation will be permanent and that there will be no way to reverse it when additional purchasing power is no longer needed by the business community. Furthermore, history tells us that depreciation reforms have nearly always liberalized, rarely tightened, depreciation deductions.

Fifth, there is a large bias here for capital intensive industries. It seems hazardous to base one's estimation that the current economic slump is based largely on declining purchases of capital goods, particularly when manufacturing capacity is now at 75% of capacity.

Finally, and most importantly, the question which must be answered is whether a bigger payoff could have been achieved by spending the same amount of money for other purposes. Suppose that the President had been authorized merely to

take \$2.5 billion in the form of dollar bills and scatter it among the streets where it will be picked up by people and spent. The question is whether or not this money spent in this fashion would not result in a bigger economic payoff. Obviously, such a course might not be politically sound in a number of quarters, but alternatives which do exactly the same thing might be suggested. Suppose, the President had been authorized to lower taxes in the lower income brackets by \$2.6 billion. It is obvious that in the lower income tax brackets, all of this \$2.6 billion would be spent in consumer goods. Yet the corporate beneficiaries may decide merely to pay higher dividends rather than make additional investments. Such dividends might be consumed but likely not as high a proportion as if distributed to lower incomes.

We must conclude then that there is not any apparent body of economic policy which argues that the change in depreciation allowances is the best expenditure of \$2.6 billions.

POLITICAL SCIENCE

Finally, one must question whether or not this action represents what one might describe as good government. This question can be put in focus if one recognizes that the Executive Department has made a unilateral decision to spend \$2.6 billion in the current calendar year. Very shortly, this amount will rise to an expenditure of \$4.1 billion in each calendar year. The question is whether or not the President should take upon himself the initiative to spend this amount of funds and to do so without consulting Congress.

One must couple that question with a second one. Should the executive be able to make a choice as to whom is to receive the benefits of the \$2.6 billion? And is the executive entitled to decide unilaterally that the economy is slumping because corporate taxes are too high? Should this decision then be carried to solution without approval of Congress?

Instead of discussing this matter with Congress, we are told the President consulted with his Task Force on Business Taxation. The Constitutional standing of that group is not specified. It consisted of businessmen, lawyers, accountants, economists, a former United States Senator, and two former secretaries of the Treasury, all exceedingly capable men. Very few, however, could be said to represent the public view. Their recommendations were predictable: the business tax rate is too high. But isn't the individual tax rate too high also?

The President recalls that the Tax Reform Act of 1969 cut taxes for individuals by \$7 billion. One notes only that this was an act of Congress which was considered for a long period of time by the House Committee on Ways and Means, the Senate Finance Committee, and by both Houses as a whole. It was signed into law by the President. At the same time, the Administration recommended that the taxes on corporations, the major beneficiaries of the present tax benefits, be reduced in a two step process from an effective rate of 48% down to 46%. That recommendation was deliberated and rejected.

At hearing on the Tax Reform Act of 1969, the two point reduction in corporate taxes was estimated to cost somewhere between \$1.4 billion and \$1.6 billion. Based on those figures, the present change can be restated as having the same revenue effect as a reduction of nearly 4% in the corporate tax for 1971. In 1976, the total tax reduction would amount to approximately 6%. If these benefits were distributed evenly to all corporations, this change by the President is an administrative action which has the effect of reducing the nominal tax rate on corporations from 48% to 44% in 1971 and finally to 42% by 1976. Is there any doubt that such a program could not be legislated? Is the President attempting to do by the back door what he could not drive through the front door of the Congressional legislative committees?

The re-phrasing of the depreciation change as a reduction in the nominal corporate tax rate is useful for another purpose. One recalls that President Kennedy once suggested that the Executive be given authority to raise and to lower the corporate business tax rate as the economy required. Congress took no action on the proposal, and many fulminated against it on the ground of vesting too much authority in the Executive.

The recent action with respect to depreciation is strikingly similar to a lowering of the tax rate. Certainly, if the President is not to be trusted with the power to create jobs, promote economic growth, and increase competitiveness of U.S. goods abroad through the lowering of the tax rate, he should not be empowered so to do by a change in depreciation rates. But even if the statute so

empowered the President, the exercise of the power is questionable where Congress has refused to reduce corporate taxes.

In a sense, the President is going Congress one better. Because he has seized the opportunity to alter tax rates. But the power here exercised is not likely to be reversed. Thus, the discretion is not unlimited. It may be exercised in only one direction—down. And only in favor of taxpayers making new investments of certain machinery and equipment. His discretion is fettered, but I think few would suggest that this fettered discretion is philosophically preferable to unfettered discretion which Congress refused to legislate to the President.

The decision was irresponsible, but politically astute, on another ground. When tax relief is distributed by administrative fiat, those who are the beneficiaries of it do not complain. Members of the general public who must fill the gap created by the relief may be unable to question the matter in court. When up to \$4.7 billions of annual revenue are involved, is the Executive wise to take the initiative in distributing funds of this magnitude? Particularly, when effective review of the legality and desirability by other branches of government presents some procedural difficulty?

It seems to me that the Executive is wise to act in this fashion only if he is as willing to subject his economic policies to Congressional scrutiny. Indeed if this is the best policy will not Congress applaud and adopt it?

CONCLUSION

There can be no doubt that the economy of this country has been sick for the last couple of years. But can the patient be made well by a distribution of more than \$30 billion of tax relief in the coming decade to the business community after consistent Congressional refusal to grant it tax relief? Certainly, the economic opinion and evidence to support the action is flimsy. The nearly irreversible nature of the action is both bad tax policy and questionable economic policy. The relief has been granted in a fashion which may preclude review of its legality, let alone its wisdom. For these reasons, the ADR regulations should be withdrawn.

To: Commissioner of Internal Revenue, Washington, D.C.

(Attention CC:LR:T).

Re Treasury authority to issue the proposed "Asset Depreciation Range System" regulations.

(By Boris I. Bittker, Sterling Professor of Law, Yale University)

On March 12, 1971, the Treasury Department issued proposed regulations to implement the liberalized system of depreciation for machinery, equipment and certain other property—the Asset Depreciation Range or ADR System—announced by President Nixon and former Treasury Secretary David M. Kennedy on January 11th. Mr. Kennedy asserted that the ADR System was "based on an intensive study by the Treasury Department and its Internal Revenue Service of steps needed to provide greater investment incentives and for job creation." He also stated:

"The reform of depreciation policy will encourage business to increase its investment in new machinery and equipment, and by providing significant tax reductions in 1971 and subsequent years, will help business accumulate the capital required for investment. As a result, our economic growth will be stimulated strongly and many new jobs created for those who are now unemployed or who will enter the work force in the future. Every American—manufacturers, farmers, miners, storeowners, professional and service companies, all others and those who work therein—will benefit.

"By liberalizing and simplifying the depreciation provisions of the tax law, we also have taken a needed step to help U.S. businesses to modernize their productive facilities and keep abreast of rapidly changing technology. New and better equipment in American industry will bring increased productivity, and a strengthening of the competitive position of our country's goods in world markets."

The purpose of this paper is to determine whether the Treasury Department has the authority to adopt these measures by the issuance of regulations under existing law, without further action by Congress in the form of enabling legislation.

A. THE "ASSET DEPRECIATION RANGE SYSTEM"

The ADR System consists of four interrelated departures from the existing depreciation rules:

1. *"Range" of depreciable lives.*—The ADR System grants an election under which taxpayers may depreciate assets over a period selected by them, within a range specified for designated classes of assets. The range allowable under this "Asset Depreciation Range System" runs from 20 percent below the present guideline lives (promulgated in 1962) to 20 percent above these lives. The ADR System applies only to assets that are placed in service after December 31, 1970, and it excludes (a) buildings and their structural components (with some exceptions, discussed below) and (b) property used outside the United States.

2. *Write-off of certain rehabilitation and improvement expenditures.*—A taxpayer who elects to depreciate eligible property under the ADR System is granted a further election, in the form of a special "repair allowance." This is a privilege to deduct expenditures for the "repair, maintenance, rehabilitation, and improvement" of eligible property (up to a specified amount, and subject to an exception for "excluded additions," described below), even though part or all of the expenditures would otherwise have to be treated as capital improvements under § 263, with the result that (absent an election) they could not be deducted currently but would instead have to be depreciated over an appropriate period of years. The privilege is exercisable annually; it covers deductible repairs as well as non-deductible rehabilitation and improvement expenditures, and requires the electing taxpayer to capitalize any such amounts in excess of the applicable repair allowance. The "repair allowance" was not described by the President or Mr. Kennedy in their January announcements of the ADR System, but was unveiled for the first time in the proposed regulations.

3. *"First-year convention."*—In the year of acquisition, eligible property will entitle the taxpayer to either a full year or a half year of depreciation, depending upon whether it is placed in service in the first half or second half of the year. This election will be an alternative to the "half-year" convention of existing law, under which half a year's depreciation may be taken for all assets placed in service during a given year.

4. *Termination of the "reserve ratio test."*—The "reserve ratio test," promulgated in 1962 as a backstop to the reduced guideline lives then announced, is to be terminated for post-1970 years under regulations to be issued "in the near future."

The proposed regulations also contain rules relating to the salvage value and retirement of property depreciated under the ADR System.

* * * * *

In my opinion, for the reasons set out below:

(a) The Treasury does not have the statutory authority to permit taxpayers to depreciate assets over the ranges proposed by the ADR System or to deduct rehabilitation and improvement expenditures as part of a "repair allowance;" and

(b) If interpreted to support these aspects of the ADR System, the statutory provisions on which the Treasury relies would equally support the most extraordinary departures from widely-accepted principles regarding the division between current expenditures and capital items in the computation of taxable income.

B. THE REVENUE IMPACT AND ECONOMIC OBJECTIVES OF THE ADR SYSTEM

Before setting out the basis for these conclusions, I wish to call attention to the revenue impact and economic objectives of the ADR System. These aspects of the ADR System are so drastic in their implications as to raise, in and of themselves, serious questions about the Treasury's authority to issue the proposed regulations without explicit Congressional authority.

1. *Revenue loss.*—The Treasury estimates that the revenue loss from ADR System will start at \$0.8 billion in fiscal 1971, and will range thereafter from \$3.0 billion in fiscal 1972 to \$3.8 billion in fiscal 1980, with a high of \$4.7 billion in fiscal 1976.

I do not recall any action by the Treasury in prior years under any of the statutory sources on which it now purports to act, or indeed under any other

provision of the Internal Revenue Code, with such momentous revenue consequences. While Congress might perhaps vest the Treasury with this extraordinary authority over the level of federal revenue collections—authority that is a first cousin to the power to fix the tax rates themselves—the Treasury's claim that it *now* has the power by regulations to alter revenue collections by \$35 billion or more in a decade calls for close scrutiny.

An instructive parallel may be found in the enactment by Congress, in 1954, of Sections 452 and 462 of the Internal Revenue Code of 1954, designed to bring tax accounting into closer harmony with business accounting by permitting taxpayers to postpone the recognition of prepaid income and to deduct reserves for estimated expenses. When the Treasury concluded that these provisions would cause a larger loss of revenue than estimated, it rushed to Congress with an urgent request, which was granted, for repeal of the provisions. In contrast to the panic induced in the Treasury by the possibility of a *one-time* transitional loss of several billion dollars (an estimate that the Congressional committee thought was too high), we now have a claim by the Treasury that it can, on its own initiative, court a *continuing* loss, estimated to range from \$0.8 to \$4.7 billion each year for at least 10 years.

The Treasury, to be sure, predicts that increased business activity and employment "will provide substantial additional feedback revenues to offset these reductions." This is of course a standard—virtually boilerplate—accompaniment to proposed tax reductions. Giving the fullest possible weight to these countervailing forces, the fact remains that the Treasury proposal entails such enormous revenue consequences that one may properly ask: "Did Congress really authorize this trip?"

2. "*Interpretative regulations*" or *basic fiscal policy-making*?—Under § 7805, authorizing the Secretary of the Treasury to "prescribe all needful rules and regulations for the enforcement of this title," ambiguities and uncertainties in the Internal Revenue Code can be resolved; and such "interpretative" regulations are entitled to great weight. See *Koshland v. Helvering*, 298 U.S. 441 (1936):

"Where the [revenue] act uses ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts. And the same principle governs where the statute merely expresses a general rule and invests the Secretary of the Treasury with authority to promulgate regulations appropriate to its enforcement. But where . . . the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation."

This modest role for regulations—either interpreting an ambiguous statute or filling in gaps deliberately left by Congress to the administrator—is not easily reconciled with the sweeping objectives of the ADR System, as announced by the President and the Treasury, viz., to create jobs, promote economic growth, strengthen our balance of payments, increase productivity, and modernize productive facilities. Of course, a valid regulation is not undermined by the fact that it simultaneously serves broad economic objectives. At the same time, however, these dramatic claims for the ADR System properly invite an inquiry into whether the Treasury, in its conviction that the national economy needs a shot in the arm, has forgotten to ask Congress permission to administer the stimulant.

3. *Administrative substitute for the investment credit*?—The possibility that the Treasury has exceeded its authority is heightened by the strong resemblance that the ADR System bears to the investment credit, which was repealed by Congress, after ample debate, in 1969. Thus, the ADR System applies only to so-called "eligible property," which is defined by reference to the two major criteria employed by § 48 in defining the property that was eligible for the investment credit. These criteria, enacted by Congress to define "investment credit property" and adopted by the ADR regulations to define "eligible property,"—are as follows:

(a) The property must be either tangible personal property, or other tangible property (not including buildings and their structural components) if (1) used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communication, electrical energy, gas, water, or sewerage disposal services, or (2) constituting a research or storage facility for the foregoing activities. Save for the omission of a provision relating to elevators and escalators, these requirements are taken from the general definition of "investment credit property" in § 48(a) (1). In that context, they embodied a judgment

by Congress that the acquisition of these types of property—and not other types—should be encouraged by a deliberate offer of a tax incentive. The lines of demarcation, however, make no sense whatsoever if the ADR regulations are intended to reflect the impact of technological or economic change on the useful service lives of business equipment. They can be understood only as the result of a Treasury decision that investment in particular types of property should be encouraged by a tax incentive, and that other types of property are not deserving of this incentive. This decision may be sound as a matter of fiscal policy, but it can hardly be defended as an “interpretation” of the Internal Revenue Code.

(b) The second criterion of “eligible property” is that it must be “pre-dominantly used within the United States.” Here again the proposed ADR regulations turn to the definition of “investment credit property,” incorporating by reference the elaborate rules of § 48(a) (2) and the regulations issued thereunder. If the ADR rules were intended to reflect the impact of technology on the useful service lives of business equipment, they would not require a taxpayer to distinguish between equipment used in Buffalo and the same equipment used in Toronto, between a vessel documented under the laws of the United States and the same type of vessel documented under the laws of Liberia, or between a truck driven between Toronto and Buffalo and the same truck if driven between Toronto and Montreal. All of these distinctions were thought by Congress to have an appropriate place in the investment credit, which was designed to encourage domestic investment only in order to improve our international competitive position. The same rules might be equally appropriate if Congress decided either to restore the investment credit, or to provide a substitute for it by authorizing the fast amortization of business equipment. Their use by the Treasury reinforces the conclusion that it is seeking by regulation to provide a substitute for the investment credit.¹

This attempt would be suspect in any event, but it is made even more dubious by the language used by the Senate Finance Committee in recommending repeal of the investment credit as part of the Tax Reform Act of 1969:

... even though an investment credit may have been useful in the past in inducing investment in periods when there was a large deficiency of investment, it is not clear that the same type of problem will be faced in the future. For this reason also, the committee concluded that it was better to repeal the credit, rather than suspend it. *If the need should, in the future, arise for a further stimulant to investment, the Congress will then be free to consider various alternative types of treatment.* Moreover, it is not clear once the appropriate rate of investment has been restored, whether in the future special inducements to investment will again become necessary. It may well be that the normal incentives of potentially greater profits in the context of a stable growth, full employment economy will provide the investment needed without resort to special devices to stimulate investments which, on occasion, appear to give rise to investment booms. (S. Rept. No. 91-552, p. 226; emphasis added.)

4. *Administrative adoption of cost recovery method?*—The ADR System bears a striking resemblance to the “cost recovery” method of accounting for capital outlays. Indeed, President Nixon described the proposal as “consistent with the recommendations of the President’s Task Force on Business Taxation,” whose central recommendation was that “for machinery and equipment, the present depreciation system be replaced by a simplified system of cost recovery allowances” over periods 40 percent shorter than the 1962 guidelines. This idea has of course been in the air for some time; another recent instance is the 1969

¹ The dollar advantage of permitting taxpayers to depreciate their business equipment 20 percent faster than the 1962 guideline lives depends upon the life of the asset, the method of allocating depreciation, the salvage value, and the taxpayer’s tax rate and time preference for money. A 1969 Treasury study (Tax Depreciation Policy Options: Measures of Effectiveness and Estimated Revenue Losses, Congressional Record, July 23, 1970, p. E-6964) estimates that a 40 percent reduction in the 1962 guideline lives is equivalent to a reduction in the price of the asset of 6.8 to 8.7 percent, assuming an unadjusted useful life of 10 to 20 years, a tax rate of 48 percent, and an after-tax rate of return of 12 percent. A 20 percent reduction, as proposed by the ADR System, would of course be less advantageous, but it would be augmented by four other factors: (1) the opportunity to deduct rehabilitation and improvement expenditures by electing the “repair allowance,” (2) the elimination of the reserve ratio test, so that a taxpayer can apply the 20 percent reduction to the 1962 guideline lives even if they are shorter than the actual service lives of his assets, as reflected by his replacement experience, (3) the liberalized first-year convention, and (4) the ADR System’s more tolerant treatment of salvage values.

proposal of the ABA Section of Taxation (Committee on Depreciation and Amortization) for cost recovery periods "which will be shorter than useful lives for most taxpayers and which will apply uniformly without regard to individual taxpayers' actual experience." Both the President's Task Force and the ABA Committee, however, candidly acknowledged that their proposals required legislative change; neither suggested that the Treasury had the power by regulations to substitute a cost recovery system for the depreciation rules of current law. In the wake of these proposals for legislative action, an attempt by the Treasury to accomplish substantially the same objectives in substantially the same manner raises, in acute form, the question whether it is treading on thin ice. The ADR System, in short, seems to be an application of the cost recovery mechanism, which has not yet been sanctioned by Congress, to the classes of property that qualified for the investment credit, which was repealed by Congress only a few months ago.

C. "USEFUL SERVICE LIVES" AND THE ARTIFICIAL LIVES OF THE PROPOSED REGULATIONS

In assessing the Treasury's authority to issue the ADR System regulations, I start with the fact that the useful service life of an asset (or class of assets) is central to the statutory and accounting concept of depreciation. Although the determination of this period requires an estimate, and often a difficult one, the Internal Revenue Code does not authorize the taxpayer to select, or Treasury to accept, an artificial period of time, unrelated to the asset's useful life, as the proper period for depreciating its cost or other basis. As I will point out in more detail later, when Congress has wanted to authorize an artificial period for writing off the cost of an asset (e.g., 60 months for World War II "emergency facilities"), it has enacted a statutory exception to the general rule that "useful life" is controlling; so far as I know, it was never even suggested that the Treasury could have authorized such an exception under any of the statutory provisions cited in support of the ADR System.

The importance of the asset's "useful life" has been frequently recognized. The Internal Revenue Code uses the phrase in many places, e.g., § 167(b), (c), (d), and (f). As long ago as 1927, the Supreme Court, in an opinion by Mr. Justice Brandeis, pointed out that consistently since 1913, revenue acts have provided an allowance for depreciation that is related to the property's useful life:

The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost. [United States v. Ludey, 274 U.S. 295]

This statement has for many years been paraphrased, with minor amplifications, in the basic Treasury Regulations on depreciation. See Regs. § 1.167(a)-1(a). The crucial importance of the asset's useful life in the allocation of depreciation has been noted in numerous other instances. Thus, Bulletin F (the standard IRS guide to depreciation for many years) provided:

[T]he period over which [depreciation] extends is the normal useful life of the asset.

The same idea was repeated when Bulletin F was supplanted by Rev. Proc. 62-21, 1962-2 C.B. 418, 429:

The purpose of the [depreciation] allowance is to permit taxpayers to recover through annual deductions the cost (or other basis) of the property over its useful economic life.

In explaining the 1962 guidelines, Rev. Proc. 62-21 employed a series of hypothetical questions and answers, including:

3. Question. At present, depreciation is based on the useful life of property in the taxpayer's own trade or business. How does this depreciation reform affect this approach?

Answer. The depreciation reform retains this approach. Every taxpayer should continue to base his depreciable lives on his own best estimate of the period of their use in his trade or business. The new reform provides guideline lives, based on analyses of statistical data and engineering studies and assessments of current and prospective technological advances, for each industry in the United States. The guidelines which have been developed are felt to provide reasonable standards for taxpayers in the various industries and if used will be presumed to be acceptable unless subsequent events show that they are not appropriate for a particular taxpayer's circumstances.

In *Massey Motors, Inc. v. United States*, 364 U.S. 92 (1960), the Supreme Court held that depreciation: "is to be calculated over the estimated useful life of the asset while actually employed by the taxpayer. . . ."

This holding was buttressed by repeated statements in the opinion to the same effect, which were encapsulated by the Court's description of existing depreciation law as "a system where the real salvage price and actual duration of use are relevant." Finally:

We therefore conclude that the Congress intended that the taxpayer should, under the allowance for depreciation, recover only the cost of the asset less the estimated salvage, resale or second-hand value. This requires that the useful life of the asset be related to the period for which it may reasonably be expected to be employed in the taxpayer's business.

Finally, as recently as last July, in a Treasury memorandum sent to Senator Javits by Secretary Kennedy that discussed the "policy options" open to the Treasury in the depreciation area, the statutory rules governing depreciation were summarized as follows:

These rules, in general, specify that the aggregate of all depreciation deductions which may be taken by a business taxpayer may not exceed the difference between the original cost, or other basis, of the asset and its salvage value, and that this depreciable basis must be apportioned over the estimated useful life of the asset by a consistent method. (Congressional Record, July 23, 1970, page E-6964.)

The Supreme Court's comment in *Fribourg Navigation Co., Inc. v. Commissioner*, 383 U.S. 272 (1966), about the taxpayer's right to deduct depreciation in the year a depreciable asset is sold, is applicable *a fortiori* to the principle that depreciation is to be spread over the period of an asset's useful life in the taxpayer's business:

Over the same extended period of years during which the foregoing administrative and judicial precedent was accumulating, Congress repeatedly reenacted the depreciation provision without significant change. Thus, beyond the generally understood scope of the depreciation provision itself, the Commissioner's prior long-standing practice must be deemed to have received congressional approval.

* * * * *

Against this background, I conclude that the "range of lives" sanctioned by the ADR System exceeds the Treasury's authority in two respects:

1. It provides for an artificial decrease or increase in average useful lives (as estimated by the 1962 guidelines) by 20 percent, unrelated to actual changes in the underlying facts; and

2. It permits taxpayers to employ these artificially-altered averages without regard to the separate circumstances of their own businesses.

Neither of these "reforms" finds any support, in my view, in the statutory provisions cited by former Secretary Kennedy, when he described the ADR System in his news conference on January 11, 1971:

1. Section 167(a), providing for a reasonable allowance for the exhaustion and obsolescence of business assets, must, of course, be interpreted in the light of the well-established rules of depreciation, including the principle that the allowance is to extend over the useful life of the assets. In point of fact, Section 167(b)—not mentioned by Mr. Kennedy in his statement—authorizes the Treasury to prescribe regulations governing depreciation "methods and rates," but pointedly provides that no method may be prescribed that will provide an allowance during the first two-thirds of the useful life of the property greater than would be provided by the statutory declining balance method. This restriction on the Treasury's authority would be utterly nugatory if the Treasury could itself prescribe an artificial "useful life" for assets. Congress deliberately provided that property must have "a useful life of 3 years or more" to qualify for rapid depreciation under Section 167(b) and for the liberal salvage value computation of Section 167(f), and "a useful life of 6 years or more" to qualify for the additional first-year depreciation under Section 179. These—and a number of other Congressional restrictions based on the useful life of property—are utterly inconsistent with the theory that the Treasury can confer an artificial useful life on property.

2. Sections 446, 451 and 461, also cited by Mr. Kennedy as sources of authority for the ADR System, are even less applicable than Section 167. Section 446(b) permits the Treasury to prescribe a method of accounting if a taxpayer's own method does not clearly reflect income; this provision is obviously inapplicable. Section 446(c) permits the Treasury to authorize a combination of certain accounting methods specified by the Code itself, and is equally inapplicable to the ADR System. Section 451, relating to the taxable year in which items of gross income are to be included, has nothing to do with deductions, and makes no mention of regulations. Finally, Section 461 provides that deductions are to be taken "for the taxable year which is the 'proper' taxable year under the method of accounting used in computing taxable income." Like Section 451, it makes no mention of regulations to be issued by the Treasury; still less, does it permit the Treasury to override generally accepted principles of depreciation accounting.

3. Section 7805 authorizes the Treasury to prescribe "all needful rules and regulations for the enforcement of this title." This is obviously a provision of broad import, but it does not supplant the substantive provisions of the code, such as Section 167's rules regarding depreciation. If construed to permit the Treasury to adopt the artificial useful lives for depreciable assets prescribed by the ADR System, it could be employed with equal plausibility to reduce—or increase—useful lives by 50 percent, to provide a uniform 3-year "useful life" for all assets, to authorize capital investments to be written off in the year of acquisition, or to permit assets to be deducted only in the year they are retired from service.

Under the broad authority claimed by the Treasury, it would not have been necessary for Congress to enact any of the numerous provisions for the rapid amortization or immediate write-off of particular expenditures that have been added to the Internal Revenue Code in recent years, since the Treasury—by virtue of its alleged power to decide when capital investments are to be written off—could have provided the same benefits by regulations. I refer here to such provisions as § 174 (research and experimental expenditures), § 175 (soil and water conservation expenditures), § 177 (trade mark and trade name expenditures), § 179 (first-year depreciation allowance for small business), §§ 180–181 (fertilizer and clearing of land), §§ 184–185 (railroad rolling stock and grading expenditures), and § 248 (corporate organizational expenditures).

The foregoing discussion has focussed on the ADR election to use useful lives that are shorter than the 1962 guidelines. My comments are, however, equally applicable to the election to use artificially long lives, since they are also inconsistent with the previously unquestioned principle that depreciation is to be taken over the useful service life of the asset in the taxpayer's business. Indeed, there is an additional objection to an artificially long life, viz., Section 1016(a) (2), requiring the adjusted basis of property to be reduced by depreciation "allowable under this subtitle or prior income tax laws." The clear import of this statutory rule—which the Treasury has been given no authority to suspend or nullify—is that the taxpayer cannot "save" depreciation that is allowable under the law for the current year, in order to use it in a later year.

Finally, I wish to comment on the "repair allowance" authorized by the Treasury in the ADR regulations. It is, at bottom, an election under which the taxpayer may write off, in the year incurred, certain expenditures for the rehabilitation and improvement of property that, under Section 263, constitute capital outlays. This inconsistency with the statute is transparently clear; if Section 263 did not forbid a deduction for these expenditures, the taxpayer could deduct them without making the "repair allowance" election, and could take similar deductions for comparable expenditures to rehabilitate and improve real property or other assets that do not qualify for the ADR System. The proposed regulations acknowledge this departure from Section 263 in a curious way: they provide that rehabilitation and improvements expenditures (so-called "excluded additions") do not qualify for the "repair allowance" if they add an identifiable unit of property, or modify existing property to a substantially different use, or substantially increase its original productivity or capacity. This effort to distinguish among capital outlays has no statutory foundation whatsoever; Section 263 does not provide that some capital expenditures are more non-deductible than others.

One more point: if the Treasury had the power to convert capital expenditures into deductible expenses (under such provisions as Sections 446, 451, 461,

or 7805), it could take far more drastic action than the proposed "repair allowance." Its alleged authority would, with equal plausibility, permit a "repair allowance" that was not restricted to a fraction of the asset's adjusted basis, that covered so-called "excluded additions," and that embraced real property as well as property qualifying for shortened lives under the ADR System. The Treasury's alleged authority would also have enabled it to promulgate the rules of Section 263(e) (rehabilitation of railroad rolling stock deductible despite Section 263) without Congressional action.

In addition to permitting taxpayers to deduct capital outlays, the "repair allowance" can also have the converse effect, viz., allowing the taxpayer to capitalize deductible repair expenses, instead of deducting them, if they exceed the applicable annual limit. This attempt by the Treasury to permit taxpayers to avoid the effect of Section 162 if they have an excess of current deductions is as objectionable as its attempt to permit capital outlays to be deducted currently. Among other things, it violates the intent of Section 172, under which excess deductions create an operating loss that can be carried forward for only a limited number of years. It also implies that the Treasury could, if it so desired, authorize taxpayers to capitalize repair expenses at will.

The distinction between non-deductible capital outlays and currently deductible expenses is so vital to the proper measurement of taxable income that statutory departures from the principle, even if motivated by policy considerations, are widely acknowledged to be tax preferences. Thus, the following items are either defined as "items of tax preference" by Sections 56-58 (imposing a minimum tax on tax preferences) or were proposed by the Treasury or the House Ways and Means Committee for somewhat comparable corrective treatment:

Accelerated depreciation on §1250 property.

Accelerated depreciation on §1245 property subject to a net lease.

Rapid amortization of certified pollution control facilities under §169.

Rapid amortization of railroad rolling stock under §184.

Excess of depletion over basis.

Deduction under §§175, 180, and 182, and Regs. §1.64-4 and §1.162-12 of farm expenditures that would be capitalized under normal accounting principles.

Deduction of intangible drilling and development costs.

With the 1969 battle over tax preferences still so lively in our memory, it is ironic to find that the Treasury is already proposing to add two new candidates—artificial lives for certain depreciable assets and the current deduction of some rehabilitation and improvement expenditures—to next year's list of tax preferences.

It so happens that the Treasury, on a memorable prior occasion, sought to allow taxpayers to write off, as a business expense, expenditures that under conventional accounting principles would be capitalized: I refer to the Treasury's pre-1945 rules permitting intangible drilling and development costs to be deducted. In *F.H.E. Oil Co. v. Commissioner*, 147 F. 2d 1002 (5th Cir. 1945), this option was held to be invalid:

A regulation giving the option which is in dispute has existed, with increasing complexity, since 1918, and has recently been broadened. The legislative mind of the Treasury Department seems determined to maintain the option. The administrative mind, represented by the Commissioner and his lawyers, and supported generally by the courts, is bent on whittling it away. The question of its validity has seldom been raised, the taxpayers not wishing to attack it because it favors them, and the Commissioner not being in position to repudiate the regulation of his own department. The judges have not thought it their business to raise the question; but if the option be in truth contrary to the revenue statutes, it is void, and it is the duty of the judges to declare and uphold the law, and disregard the regulation.

The court held that the option was inconsistent with § 24(a) of the 1939 Code (the statutory predecessor of § 263(a)), forbidding a deduction for amounts paid "for permanent improvements or betterments made to increase the value of any property or estate"—an objection that is equally applicable to the artificial useful lives and the repair allowance contemplated by the ADR System. Moreover, in the *F.H.E.* case, the court held that the drilling expense option was invalid even though the statute explicitly provided for "a reasonable allowance for depletion and for depreciation of [mine] improvements . . . to be made under rules and regulations to be prescribed by the Commissioner, with the

approval of the Secretary.”² In permitting capital investments to be written off (in the guise of the proposed “repair allowance”) or to be amortized over an artificially shortened period, the ADR System does not have even this statutory sanction; and is hence even less defensible than the regulations that were held to be invalid in the *F.H.E.* case.

* * * * *

Two further observations are in order :

1. It is clear that the change in useful lives by the ADR System is not attributable to technical and engineering studies establishing that the 1962 guidelines are inaccurate. For one thing, the 1962 guidelines cannot be simultaneously too long and too short, so as to justify a free choice within the “range” allowed by the ADR System. It is even more fantastic to suggest that the 1962 guidelines are both too short and too long for the special classes of property qualifying under the regulations (primarily tangible personal property used in the United States), but correct for other types of property. The deliberate disregard by the ADR System of actual service lives reaches its zenith in the treatment of public utility assets. Under the proposed regulations, certain public utilities may elect the 20 percent shortened lives only if they “normalize” the tax deferral resulting from the election, an accounting practice that has a bearing on the utility’s rates but that obviously has no impact on the useful lives of its assets. The proposed regulation is, of course, patterned on Section 167(1), which reflects a Congressional decision to relate the federal tax liabilities of public utilities to their rate-making bases—but this provides no foundation for a Treasury decision to link the useful life of an asset to the taxpayer’s accounting practices.

Even if the ADR System were confined to a reduction of the 1962 guidelines, and were generally available, it would be difficult to attribute the proposed change to technological developments since 1962; it strains credulity to assert that *all* 1962 guidelines are out of line by the same 20 percent error. Finally, the ADR System applies only to assets physically placed in service in 1971 and later years. If technological changes have made the 1962 guidelines too long for assets placed in service in 1971 and later years, however, they must be even *more* inaccurate for assets now in service. Yet no correction is authorized for existing assets. In this connection, it should be pointed out that there have been few litigated cases challenging the 1962 guidelines, and I know of no evidence that many taxpayers have endeavored even at the administrative level to establish that they are too long. The complaints directed at the reserve ratio test, indeed, imply that assets are not being replaced as fast as their guideline lives expire; and the ABA cost recovery proposal described earlier states flatly that the lives prescribed by the 1962 guidelines “were purposely shorter than ‘actual lives’ in effect for most taxpayers,” so that since 1962 “the tax system has in fact been operating on the basis of prescribed lives shorter than ‘actual lives.’”³ Finally, the President’s Task Force on Business Taxation, which offered persuasive evidence that foreign cost recovery periods are shorter than ours, offered no evidence that the guidelines are longer than *actual* lives. Indeed, its assertion that United States industrial equipment is dangerously obsolescent in some industries suggests that actual useful lives are even *longer* than the 1962 guidelines.

² Although the court later confined its decision to a holding that the taxpayer did not come within the scope of the regulations, this restriction stemmed from the fact that the regulations had been in force for 20 years, obviously with the full knowledge of the appropriate legislative committees if not of Congress itself; and it was accompanied by the announcement that “we see no fault in our previous reasoning, and think the former opinion a right one to have been rendered 20 years ago.” *F.H.E. Oil Co. v. Commissioner*, 149 F.2d 238 (5th Cir. 1945); see also a later installment of the same litigation, 150 F.2d 857 (5th Cir. 1945), refusing to reconsider despite a Congressional joint resolution, endorsing the regulations.

An earlier case had upheld the validity of the regulations, but because in the court’s opinion the taxpayer’s expenditures for drilling did not *in fact* increase the value of the taxpayer’s property: “The truth is that the hole upon which the money is expended is simply a means of reaching the oil sands, and it is the oil which was debatable, the court concluded that there was room for an interpretative regulation, and that in any event the repeated reenactment of the statute after the regulations were promulgated constituted “almost conclusive proof” of Congressional approval of the regulations. *Ramsley v. Commissioner*, 66 F.2d 316 (10th Cir. 1933). It is a reasonable inference from the *Ramsley* case that if the expenditure had produced a capital investment or if the regulations had been newly promulgated, the court would have been less tolerant.

³ The reserve ratio test was to be the corrective for this practice but, as noted above, it is to be terminated as part of the ADR “reforms.”

2. No doubt the Internal Revenue Service could properly announce that it will, in general, not re-examine useful lives falling within a specified range of the 1962 guideline lives, in order to focus its audit resources on other areas of dispute. A precedent for such a decision may be found in the IRS state sales tax tables, setting out the amounts that may ordinarily be claimed as deductions, without substantiation, by taxpayers at various income levels. The Service reserves, however, its right to require substantiation in appropriate cases. In my opinion, this power could not be effectively renounced by the IRS under existing law; since the Code clearly contemplates that errors on returns can be corrected at any time until the statute of limitations runs, unless a compromise or closing agreement is executed between the taxpayers and the IRS.⁴ The useful lives promulgated by old Bulletin F and later by the 1962 guidelines both acknowledged this inability to convert an audit rule-of-thumb into a binding rule of law, by permitting the announced lives to be re-examined if circumstances so required.

Even if, contrary to the foregoing reasoning, the IRS had the power to establish conclusive administrative rules of thumb in the tax area, this power—like all authority to issue regulations—would have to be exercised in a reasonable fashion. I doubt that anyone would seriously argue that the reduction in administrative friction and cost achieved by the ADR System could justify a \$3 or \$4 billion annual reduction in federal revenue. It is perfectly obvious from the Presidential Treasury announcements that this price is to be paid for the ADR System's anticipated impact on the national economy, not for its administrative virtues. Viewed as a substitute for the investment credit—the context within which the President's Task Force on Business Taxation recommended a reform of depreciation policy—the ADR System may be a desirable way to step up the pace of business investment, but this is a decision that should be made by Congress.

Mr. NADER. These men have publicly expressed their concern that the multibillion-dollar proposals are an unlawful excess of Executive authority. Especially those Members of Congress who favor the stimulation of business investment should be concerned about the unlawfulness of the Treasury action. Recent reports, which I also include for the record, indicate that businessmen are reluctant to invest on the basis of the proposed regulations. This appears in part to be because of an impending court challenge to the validity of the new depreciation system.

(The reports referred to follow:)

[From the New York Times, May 4, 1971]

BAYH TERMS BUSINESS TAX CUT HEARING A 'CHARADE'

(By Eileen Shanahan)

WASHINGTON, May 3—The Internal Revenue Service began three days of hearings today on the Administration's plan to cut business taxes by allowing bigger deductions for depreciation—hearings that the first witness, Senator Birch Bayh, characterized as "an elaborate charade."

Senator Bayh, an Indiana Democrat, based his charge on "the repeated statements by high Treasury officials" that the proposed changes in the depreciation rules "will go into effect regardless of what is said or done at these hearings."

Assistant Secretary of the Treasury Edwin S. Cohen, responding to the same accusation when it was made by another witness, said that he could "assure" the witness that "it will be a meaningful hearing, and we will take into account your views."

⁴Indeed, in the area of depreciation Congress has explicitly provided a procedure for reducing disputes over useful lives, viz., § 167(d) (relating to agreements on useful lives), thus supplying further support for the principle that unilateral concessions by the IRS are not legally permissible. Another example is Section 167(f), authorizing minor amounts of salvage value to be disregarded—a statutory rule that would not be necessary if the Treasury could, as an adjunct to its audit responsibility, announce its intention to disregard items of minor consequence.

WANT PLAN WITHDRAWN

Mr. Cohen added that he was "certain there will be some changes" before the new rules are promulgated.

Senator Bayh and other opposition witnesses asked, however, not just for modifications but for complete withdrawal of the proposed rule changes, which the Treasury has estimated would reduce the taxes paid by businesses by \$3-billion to \$5-billion annually.

There was, however, no indication from any of the Government officials who participated in the hearings—all of them officials of the Treasury Department or the Internal Revenue Service—that there was any possibility that the rule changes would be scrapped.

Those who were questioning the witnesses—Mr. Cohen, his deputies, John S. Nolan and Joel E. Segall; Internal Revenue Commissioner Randolph W. Thrower, and others—all made clear their support for the proposed changes.

SEE BENEFIT FOR NATION

The witnesses who supported the proposed changes disputed opponents' contentions that the Administration did not have the authority to adopt the planned liberalization without asking Congress for authority. They did not, however, speak to the issue of whether the hearings themselves were being conducted improperly.

The advocates, instead, voiced their belief that shortening the period of time over which businesses could depreciate their equipment—which is the principal feature of the proposed rule changes—would benefit not only the economy but also the nation.

A typical spokesman for this viewpoint was Clifford D. Siverd, president of American Cyanamid Company, who testified on behalf of the Manufacturing Chemists Association.

Mr. Siverd said that national concern with pollution of the environment "has accelerated obsolescence in the chemical industry" to a degree that was not foreseen when the present time periods for depreciation equipment were set in 1962. He said that larger depreciation deductions were needed if the chemical industry were to have the money needed to minimize its pollution.

Opponents of the changes criticized both their legality and their probable economic effectiveness.

Dean Bernard Wolfman of the University of Pennsylvania Law School also challenged the legality of the hearing on the ground that the Treasury had never made public the economic basis for its decision to liberalize the depreciation rules. Therefore, he said, opponents were not able to make an adequate response.

[From the Wall Street Journal, May 4, 1971]

TREASURY'S HEARINGS ON EASIER GUIDELINES FOR DEPRECIATION BEGUN

WITNESSES RESTATE PRIOR STANDS ON THE PLANNED LIBERALIZATION; PROPONENTS GET GOOD RESPONSE

WASHINGTON—The Nixon administration opened three days of hearings on its proposed liberalization of depreciation guidelines for business, with the architects of the proposals sitting as judges.

Sixteen witnesses testified at yesterday's session, conducted by Internal Revenue Service Commissioner Randolph W. Thrower and his chief counsel, K. Martin Worthy; Edwin S. Cohen, Assistant Treasury Secretary for Tax Policy, and his deputy, John S. Nolan; along with several other IRS and Treasury officials.

All the witnesses reiterated previous contentions about the proposals. Supporters claimed that the earlier write-offs were essential to stimulate investment and meet foreign competition and that the Treasury has the authority to make these changes administratively. Opponents generally charged that the "tax cut" for business is economically undesirable and only could be implemented by Congress.

The treatment accorded the witnesses differed sharply, however. Critics of the administration proposals frequently were peppered with technical questions, particularly from Mr. Cohen and Mr. Worthy. But advocates of the changes often

were praised for their "definitive" analyses or for being "recognized experts" on the subject and often were only asked to elaborate on the benefits of the liberalized depreciation guidelines.

Although Mr. Cohen promised yesterday that all views expressed at the hearings will be considered, the administration has repeatedly emphasized it plans to implement the changes regardless of what transpires at these sessions.

The administration proposals would create an "asset depreciation range" where businessmen could take depreciation deductions up to 20% shorter (or 20% longer) than currently allowed in the IRS standard guidelines. The proposals also would abolish the "reserve ratio test" requiring businessmen to prove they're actually writing off equipment at about the same pace as they're replacing it, and would allow a larger deduction in the first year.

The Treasury estimates that the revenue loss from the liberalized depreciation would be about \$3 billion in fiscal 1972, starting this July 1, and that through fiscal 1980 the tax loss would total about \$36.8 billion.

Some critics of the proposals were visibly annoyed by yesterday's proceedings. "Worthy looked like he was conducting a cross-examination rather than listening to the important contributions that were brought out," charged Thomas H. Stanton, a lawyer with Ralph Nader's Public Interest Research Group. Another opponent complained that supporters of the liberalized write-offs "were thrown one lob after another" in the questioning.

The question of the Treasury's authority to administratively activate these changes also was sharply debated. Two Illinois Republicans, Sen. Charles H. Percy and Rep. John B. Anderson, strongly defended the Treasury's authority to act administratively on depreciation guidelines and said Congress wasn't being illegally bypassed.

But Democratic lawmakers, including Sen. Birch Bayh of Indiana, Rep. Charles A. Vanik of Ohio and Rep. Henry S. Reuss of Wisconsin, argued that only Congress could make such changes. Sen. Bayh said he "strongly suspects that all of us here today merely are participating in an elaborate charade." Rep. Vanik worried aloud about "rumors" that "we're just here to celebrate a hanging that's already been decided."

Mr. Cohen insisted this wasn't the case and said he's "certain there'll be some changes before the final promulgation of new depreciation guidelines."

Others testifying against the proposals were Nathaniel Goldfinger of the AFL-CIO, Robert Eisner, a Northwestern University economist; Martin David, a University of Wisconsin economist; Richard Pollock, a University of Hawaii economist, and Bernard Wolfman, dean of the University of Pennsylvania law school, who was representing Common Cause.

The other supporters of the changes included Clifford D. Siverd of the Manufacturing Chemists Association; Dale W. Jorgenson of Data Resources Inc., testifying on behalf of American Telephone & Telegraph Co.; Norman B. Ture of PRC Systems Sciences Co.; Ernst Anspach of Loeb, Rhoades & Co.; C. Lowell HARRISS, a Columbia University economist, and John Ellicott, counsel for the National Machine Tool Builders' association and the American Machine Tool Distributors' association.

[From the Washington Post, May 6, 1971]

NADER CHARGES ADR PREJUDGMENT

(By James L. Rowe, Jr.)

Consumer advocate Ralph Nader, who initiated the attack on the administration's proposed liberalization of depreciation policies, yesterday told the leading Treasury tax official that he should resign from a panel hearing testimony on the proposals.

Nader cited a newspaper article quoting Edwin S. Cohen, Assistant Secretary of the Treasury for Tax Policy as saying businessmen could rely upon the depreciation rules going into effect.

The rules—called the Accelerated Depreciation Range system—would permit businessmen to write off the cost of their investments 20 per cent faster than they can now, cutting business taxes by \$3 billion next year and \$37 billion over the decade.

Tuesday, Cohen refused to retract the statement while questioning one of Nader's Public Interest Group tax lawyers, Thomas Stanton.

Nader charged yesterday, "This explicit prejudgment means that the many earnest and able speakers before you have been talking into a void, whenever their comments touched upon the basic unlawfulness of the ADR regulations."

Cohen told Nader he would give the disqualification request "my every consideration." However, he said, his position was the necessary one "unless those who propose the regulations do not pass upon them." The Treasury proposed the specific regulations in March.

Cohen said he conceived of his obligation to "think these proposals through as much as possible in advance," before making them specific. He said his assurance to businessmen meant that in the hearings "nothing so fundamental will be called to our attention that will cause us to change our mind completely."

The Treasury's proposals would also abolish the so-called reserve ratio tests—a test instituted in 1962 which forces businessmen to justify the length of time taken to write off investments as being the actual length of time the asset is used.

Nader cited deputy Assistant Secretary of the Treasury John Nolan's statement Monday that a large number of corporations have failed the reserve ratio test—they wrote off their equipment faster than they used it up.

Nader said, "One must wonder whether this is not a classic example of a special relationship existing between the Treasury and favored constituents. Rather than enforce the regulations to the best extent possible, the Treasury simply proposes in the ADR system to abolish the otherwise applicable law."

The Treasury claims enforcing the reserve ratio test presents unfathomable administrative problems.

The three days of hearings on the proposed regulations ended yesterday with 53 witnesses testifying either in support of, or against, the regulations.

The Treasury panel, including representatives from Treasury's tax policy branch and the Internal Revenue Service, will re-look at the proposals.

Treasury officials predict some final determination—which will probably be a modified form of the current proposals—by early next month.

There is currently legislation in both Houses of Congress to block the regulations and Nader's group has promised to fight the proposals, which it considers unlawful, in the courts.

[From the Economist, May 8, 1971]

A MATTER OF DEPRECIATION

For three days this week, the Treasury sat as judge and jury over a little matter of \$37 billion which the Administration proposes to allow industry in the form of more generous depreciation allowances when paying taxes. The very phrase "depreciation allowances" is an immediate switch-off phrase; it reeks of technicalities beyond the wit of laymen and of most Congressmen—a subject surely fit only for lawyers and accountants. In announcing the change on January 11th President Nixon emphasized its "highly technical" nature and sought to pass it off as a mere administrative reform. To buttress the argument that the reform did not require legislation, Treasury officials stated that it was not a tax cut, merely a matter of timing.

Companies were to be allowed to depreciate their assets for tax purposes over a period shorter (or longer) by as much as 20 per cent than is laid down in the guidelines instituted in 1962 (see box). Since the total allowance would remain the same, it was argued, the Treasury would not be handing out any more money. This line of reasoning incorporated a semantic confusion. It is true that a company making an investment of \$1 million would still write off \$1 million, but in eight years rather than ten. Yet in fact companies make investments year by year—and under accelerated depreciation the Treasury collects less revenue year by year than it would otherwise do. The Treasury estimates the loss at \$2.7 billion in the 1972 fiscal year, starting on July 1st, with a total of \$37 billion for the decade.

There, thanks to the abstruseness of the subject, the matter would have lain: a large tax change presented as a small administrative measure. But this would be to reckon without the groups of Administration watchers that have grown up in the wake of Mr. Ralph Nader's demonstration of the power of the well-informed citizen in a democratic state. Lawyers in Mr. Nader's public interest research group thought that the Administration was probably exceeding the constitutional power which gave to Congress the right "to lay and collect taxes"

and that, at the very least, it was taking a major decision without sufficient public debate.

So they threatened to challenge the legality of the changes on the ground that public hearings had not been held. The Treasury then agreed to hold hearings, even claiming that these had been planned all along. Mr. John Gardner's movement for more rational government, Common Cause, diverted some of its energies to this esoteric battle. And the Taxation with Representation lobby, which tries to bring the general public into the debate about tax changes which is usually conducted solely by powerful pressure groups, weighed in by distributing statements by both sides. Other groups have been agitating against what they see as a diversion to corporate pockets of money that would be better used to alleviate social ills.

The hearings centered on two groups of issues: whether the Treasury was exceeding its administrative prerogative and whether the changes made sound economics. Meanwhile Mr. Edwin Cohen, the Assistant Secretary of the Treasury for tax policy had already said that:

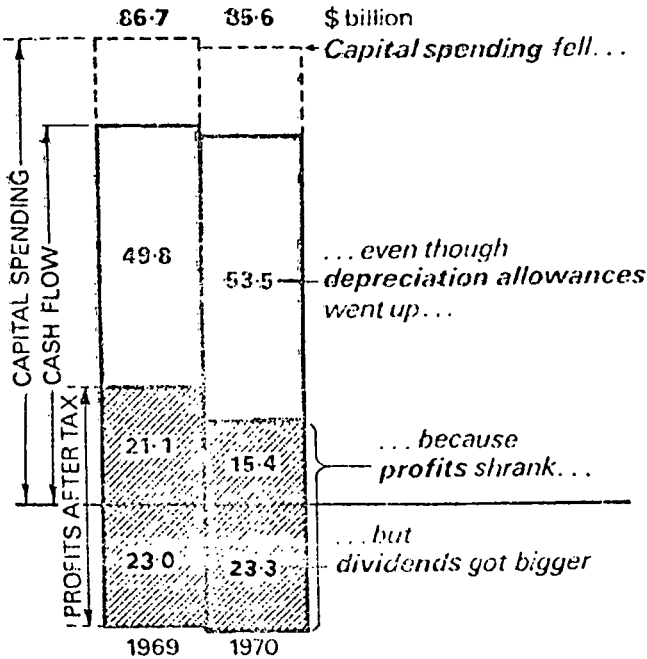
"We don't anticipate changing our mind. As a very practical matter, a businessman can rely on this going into effect in its broad outline."

The question of the scope of administrative authority was hotted up by Senator Muskie the day before the hearings began. He released to the press an internal memorandum that a top Treasury official, Mr. John Nolan, had submitted to the White House before Christmas. It judged that legislation would not be needed to reduce the life of assets by 20 per cent as long as the reserve ratio test (see box) was retained. The current proposals include the abolition of this test. Mr. Nolan has changed his mind since writing that preliminary memo and the Treasury now argues that the wording of the tax code allows it discretion, that it has exercised such discretion several times and that the reserve ratio test has not, in fact, operated since it was introduced. Some support for the Treasury's position can be found in the absence from the hearings of top Senators and Congressmen from the committees most concerned with fiscal policy who are usually jealous in guarding their prerogatives. But once the hearings are over the opposition may take its challenge to court.

The economic argument for the changes was the simple one that higher allowances for depreciation would be an incentive to greater investment and modernisation of facilities and that, by comparison with other countries, American allowances were paltry. The latter may be true, but the relationship between investment allowances and investment is unproven. As the chart shows, the decline in profits last year was offset by a handy increase in the value of depreciation allowances from natural causes so that cash flow and dividends were kept up. If companies are going to pass the money on to their shareholders, the case for higher allowances is weakened.

Between 1963 and 1969 investment tax credits helped to set the framework for high capital spending. These credits were done away with on President Nixon's recommendation in 1969—and the revised depreciation allowances are clearly a politically digestible substitute. The argument against the substitute as compared with the original credits is that as an incentive to invest it is less direct and therefore probably weaker in its effect, though it may actually cost the Treasury more and give more money to the corporations.

Further more, the new arrangements will probably not act to stimulate investment until reflation is already well under way. The worst sort of environment for business investment is uncertainty. And the switch from one type of encouragement to another has helped to create it. The use of an administrative measure to replace one abolished by Congress introduces political and legal conflict and thus heightens the uncertainty.



Depreciation is the amount of money which a company writes off against profits as the assets, which generate those profits, get used up. The rate of depreciation is based on a business judgment of how long the assets remain useful and companies can charge whatever they like as long as auditors are persuaded that it is reasonable. But the tax authorities are much more strict about how much depreciation may be set off against taxable income and have firm guidelines for depreciation allowances. In 1962 the Internal Revenue Service classified American industry into about 50 groups and assigned depreciable lives to most of the assets in each group. For example, assets in gas and electricity transmission were given a life of 30 years, in railways 14, in mining 10, in aerospace eight.

To guard against the possibility that companies might not use the funds gained from tax concessions to replace assets, a reserve ratio test was concocted. This related the accumulated annual dollops of depreciation to the assets that the reserve was being built up to replace.

In fact, the practical difficulties of calculating the ratio test have meant that it has remained in abeyance. But, unless it is repeated, the IRS is now going to have to put it into effect. If the lives set by the guidelines are shortened by 20 percent (or lengthened by 20 percent, which is why the proposals are referred to as the "asset depreciation range system") and there is no test, then all connection between depreciation and the concept of "useful life" is severed. Critics maintain that this severance can only be accomplished by congressional action.

[From the Wall Street Journal, May 26, 1971]

TAX REPORT—A SPECIAL SUMMARY AND FORECAST OF FEDERAL AND STATE TAX DEVELOPMENTS

Insiders predict little change in Nixon's plan to liberalize business write-offs. Many Washington sources consider the recent three-day hearings on the proposal largely perfunctory. They say the hearings will likely have little bearing on the Treasury's final rulings, expected in two or three weeks. Opponents of the more liberal depreciation rules continue their attack. Consumer advocate Ralph Nader and John Gardner's Common Cause plan to team up in a lawsuit contesting the Treasury's authority to institute the faster write-offs without new legislation.

Administration men already feel hamstrung. Some of them lament that any short-term benefit from the changes (which would be retroactive to last Jan. 1) has already been negated by businessmen's fears about the lawsuit. The government men say many tax consultants are advising business clients to stick with their previous accounting methods and count the liberalized write-offs as "a bonus" if ultimately upheld in court.

Congressional action to block the changes is considered extremely remote. But Sen. Sam Ervin's subcommittee on separation of powers is studying the matter with an eye toward possible hearings.

[From the Wall Street Journal, June 2, 1971]

CAPITAL SPENDING PLANS FOR 1971 PARED SHARPLY

PROJECTED GAIN OF ONLY 2.7 PERCENT IS DOWN FROM 4.3 PERCENT BOOST INDICATED IN PRIOR STUDY—NIXON OFFICIALS DISAPPOINTED

WASHINGTON—Businessmen have pared their 1971 capital-spending plans and are scheduling the smallest rise in outlays in a decade, the latest government survey shows.

U.S. businesses are planning only a 2.7% increase from last year's plant and equipment spending, to \$81.85 billion, according to the latest quarterly survey by the Commerce Department and the Securities and Exchange Commission.

This is a sharp cutback from the 4.3% rise projected in a similar survey three months ago, and less than half the 5.5% advance recorded last year. A rise of only 2.7% would mark the weakest showing since 1961, when capital outlays dropped 2.3%. The President's Council of Economic Advisers had forecast that such spending would rise about 3.5% this year.

The cutback in spending plans reflected in the latest survey suggests that many businessmen apparently doubt the economy will stage a sharp recovery this year, Nixon administration officials conceded. "Most businessmen still seem to expect a sluggish economic performance this year," one administration economist lamented.

Further, since capital-goods prices are expected to rise more than 4% in 1971, the latest survey indicates there'll be a substantial drop in real, or physical, volume this year, analysts noted.

"We're certainly not pleased with this report" said one administration economist. But he quickly added that the downward revision in spending plans "isn't the difference between success or failure" of the administration's economic projections. He also noted that these outlays "are a lagging economic indicator, rather than a leading indicator. This really says that businessmen haven't seen enough of a recovery yet to justify upping their expenditure plans."

The slim anticipated rise in capital spending also indicates that the administration's proposed liberalization of depreciation guidelines has had little impact on businessmen, other analysts said. One of the reasons frequently cited by officials for the easier write-offs is to boost capital outlays. The Treasury is expected to issue final regulations later this month on these new guidelines, which will be retroactive to Jan. 1, but opponents of the plan are expected to challenge it in court.

Government officials said most of the downward revisions from the earlier survey were in the manufacturing area. Among durable-goods manufacturers, significant scaledowns in spending plans were registered for aircraft and non-electrical-machinery industries, they said. In the durables sector, the sharpest

drops from three months ago were in chemicals and the food and beverage industries.

Actually first quarter outlays rose to a \$79.32 billion seasonally adjusted annual rate, from a \$78.63 billion pace in the fourth quarter, the report showed. But this increase was narrower by more than \$1 billion than that forecast in the survey three months ago.

The latest survey projects a sharp \$3.06 billion rise in the current quarter to an \$82.38 billion yearly pace. But only a slim rise is seen in the third quarter to a \$82.83 billion rate and capital spending is expected to fall off slightly in the fourth quarter to a \$82.74 billion pace.

The survey sees, manufacturing spending declining 4.2% this year, compared with an 0.3% decline projected three months ago and in contrast to an 0.8% increase in 1970. Durable-goods manufacturers are expected to cut outlays 7.1% from last year, while spending by nondurable-goods makers is seen falling 1.4%.

Nonmanufacturing industries anticipate a 7.3% rise in spending this year, representing little change from the 7.4% increase forecast three months earlier, but down from 1970's 8.8% advance. The sharpest increases are the 18.3% rise forecast for transportation companies, other than railroads and airlines, and the 16.5% advance projected in outlays of public utilities. Air-transportation companies are forecasting a 40% drop in spending plans this year.

Here is the breakdown by major industries of capital spending results for past periods and estimates for current and future periods. For comparability with annual totals, the quarterly figures are at seasonally adjusted annual rates, in billions of dollars:

	Actual 1970 total	Anticipated 1971 total	1971		
			Jan.-March	Apr.-June	July- September
All industries.....	79.71	81.85	79.32	82.38	82.83
Manufacturing.....	31.95	30.60	30.46	30.54	30.68
Durable.....	15.80	14.76	14.21	14.66	14.89
Nondurable.....	16.15	15.93	16.25	15.88	15.79
Mining.....	1.89	1.99	2.04	2.01	2.00
Air transportation.....	3.03	1.82	1.29	2.30	1.56
Other transportation.....	1.23	1.45	1.33	1.59	1.56
Public utilities.....	13.14	15.32	14.64	15.18	15.64
Communications, commercial and other..	26.69	28.94	28.09	28.75	29.51

Mr. NADER. It would be a simple matter for the Treasury Department to withdraw the proposed regulations and submit the proposals to Congress for consideration. Clearly, the Treasury is committed to this unlawful extension of power. It remains for the Congress and the courts to invalidate this unlawful multibillion-dollar tax subsidy.

Direct subsidies in such areas as agribusiness, maritime, business promotion, research and development go on year after year with very little congressional oversight or internal executive branch review and corrective action. It is important to make sure that the conditions that led to the subsidy in the first place years ago still exist, and that the subsidies are being efficiently used for the congressional purpose that is involved, or perhaps for a reconsideration of the congressional purpose. Who, for example, monitors how the Department of Agriculture decides to make what annual payments to whom in its subsidy programs? Big corporate farms receive the lion's share, and who decides what each recipient is to receive? These questions and many others need to be answered if we are to determine ways to improve the public usefulness of existing tax dollars.

Another portion of this subeconomy is inflated government contract or procurement practice. Multibillion-dollar overruns are no strangers to this subcommittee's chairman who has been pointing out regularly to the American people the waste in defense contracting,

the mismanagement among the defense contractors, and the humane, compassionate, and creative uses which these billions could be directed toward if saved. But the defense area is not the only area of vast waste. Other areas of government contracting—from the leasing of buildings to the advisory industry that has grown up around dozens of government departments and agencies—require the engagement of the economy minded. Federal, State, and local procurement practices could be improved to save billions and clean up politics as well, particularly at the State and local level—inducing an economy of tax dollars doubleheader. State and local procurement practices are antiquated, frequently corrupt, and ridden with patronage for party contributors. Simply following a GSA recommendation to the States 2 years ago that they try and cooperate in centralized purchasing from manufacturers, thus bypassing the 20-percent to 30-percent portion retained by wholesalers and other intermediaries, would save \$6 to \$7 billion yearly. Pooling purchases, with regional distribution centers, would also permit economies of scale through volume purchases and avoid regionally rigid market distortions or fixes.

(5) The compulsory consumption subeconomy is not part of any recognized exchange system in its first stages, but it is directly related to economic operations. I am referring to such compulsory consumptions as environmental pollution and occupational health and safety hazards with clear economic costs that reduce the quality of the gross national product and the citizen's dollar. We know that in the aggregate, pollution costs people and the economy billions yearly in health, cleaning, property and resource damage, and agricultural crop damage. The costs to the unborn or to future years are not even estimated. The searing problem of job hazards in factories, foundries, mines, and other workplaces—at least three times more serious than street crime—is also a form of compulsory consumption with more personal impacts visible. Clearly this compulsory consumption of pollution—gases, chemicals, particulates such as coal and cotton dust—represents silent, often invisible, forms of violence that inflict insurance, medical, lost wage, and other consequential costs on people and the economy.

Notice how many of these costs and distortions are really part of the overall gross national product. We should not be proud, for example, of a 10-percent increment in gross national product, a sizable portion of which are expenditures for medical services for injuries as a result of health hazards that should have been avoided in the first place. So that is the kind of low-quality increase of gross national product that deserves to be really scrutinized. The accident injury industry which provides insurance coverage, medical and legal services to people injured in highway crashes, is a part of the gross national product. It employs people, it generates income, and adds to industry. But it is not very consoling to say to somebody who is lying injured or dying on the highway that at least he is contributing to the gross national product. That is not something that we should be proud of when that is incorporated in the gross national product, which is really the whole point of my testimony in trying to articulate various subcategories of these wastes, or these avoidable costs.

Corporate polluters inflict these costs on workers and people when only a fraction of these expenditures are needed if these companies incorporated a strategy of prevention. An ounce of prevention at the

plant investment level is worth the proverbial pound of cure needed when the harms proliferate. This is true of workers themselves in being careful where their care can be an important safety link.

The compulsions emanating from corporations needs to be highlighted more; their power (to pollute for instance) is far more than they care to exercise responsibly. General Motors, by virtue of the engines it designs and the plants it operates, contributes over 30 percent of the Nation's air pollution by tonnage. How can a citizen escape this compulsory consumption of GM's engineering pollution? Is there any city street safe from GM's pervasiveness? Does the economy receive greater value by GM spending \$250 million in the years 1967-69 to change its signs to read "GM Mark of Excellence" when it could have easily developed a nonpolluting engine to its satisfaction during these same years or any years previous?

(6) The expendable subeconomy is composed mostly of poor Americans who are being considered as off-limits by larger segments of the service economy. This phenomenon goes far beyond the practice of the poor paying more. It goes to the refusal to sell at all. Redlining is one of the upper class words; redlining areas of our cities by insurance and banking firms where no business is undertaken at all. Creaming off the top by the insurance industry has been analyzed by insurance specialists before other Senate committees, such as the Senate Anti-trust Committee. But in terms of the economic development of urban sectors, the revolutionary effect of an insurance and credit lockout are obvious.

Economic growth and the growth of Fortune's five hundred increasingly need less and less this expendable subeconomy of America's millions of poor. The restrictive policies by banks and other lenders toward the funds needed for housing, small business loans and municipal bonds have obvious deteriorating consequences for the quality of economic growth and the well-being of many citizens. Government is manipulated or becomes a willing partner in such discriminations and distortions. For example, fast tax writeoffs in leasing arrangements and equity kickers taken for merger loans have quite predictable results, as have the more publicized tax inducements for slumlords. Moreover, is it not the responsibility of the Federal Government, when it artificially restricts the money supply, to insure that all segments of the borrowing public be given equal treatment in subsequent restrictions on loans. Several methods are available to accomplish these objectives. One is to provide different reserve requirements against different types of loans.

Another method is to link some types of deposits to some types of loans. For example, savings and loan association deposits are directed toward housing loans. Banks have similar deposits—time deposits by individuals—which could be similarly adhered as long as there is any shortage of funds for home mortgages or home construction. Other roles need to be alerted—when banks in New York City, for instance, encourage mergers which result in deposits being taken from regional or local banks, these regions find their local banks drained of necessary credit and the local economies suffer as a result. If they suffer too much, the taxpayer, through Washington, is called up.

What is necessary to emphasize about all these subeconomies, described above so generally, is that their ability to support industries, create jobs and generate income cannot in any way justify them in any

scale of national priorities. Clearly, their activities or the needs they meet are not socially desirable or responsible or in many cases are not legal. A safer traffic safety system would certainly weaken or diminish the accident-injury industry and that is as it should be. Our priorities should obviously go in that direction. There is probably no dollar spent better in the Federal Government than that dollar which is spent to prevent pricefixing, to promote competition, with the economies they bring to the average consumer in his or her purchases of goods and services.

And so it goes for each of these subeconomies. The argument by some social scientists that we need a social accounts system, a gross national quality index is on all fours with the suggested line of inquiry in my remarks today. Likewise, the deployment of the computer for direct consumer-citizen uses—a cheap, accessible information utility to permit more intelligent and broader response to the market system and the Government system by people throughout the country can squeeze the waste and the “squeeze” out of the economy and Government to improve the value of the consumer and taxpayer dollar. Senator Philip Hart’s estimate that of the \$780 billion spent by consumers in 1969, about \$200 billion received no value reflects this growing consumer concern with how existing wealth is used for our individual and societal purposes. For example, we have a trillion dollar economy in our country this year. We also have enormous problems of poverty and pollution and deteriorating cities, and inadequate medical service and many other problems that an economy of our size shouldn’t have at all. And the reason that the aggregate pile of wealth isn’t enough, is that we are not paying enough attention to how the consumer dollar and the tax dollar is being used, and what value is being received. And my contention is that literally tens of billions of dollars are being wasted through practices that are either anti-competitive or inefficient or corrupt or wasteful, and I hold the hope that these misdirected resources of consumer and taxpayer exploitation could be redirected to solve many of our pressing problems without the necessity of increasing taxes or of convulsive change in particular levels of sacrifice.

It is clear that Government has long had authority to begin freeing citizens and itself in order to deal with these subeconomies. Much of this authority deals with the most basic and historic functions of our Government—enforcing the antitrust laws, collecting and acting on economic information, promoting health and safety and spearheading scientific and technological development for a higher quality of life, not just spearheading an SST but spearheading a nonpolluting automobile, spearheading adequate ways for taking care of accident victims on the highway, and providing emergency medical services, spearheading nutritional programs—these are all examples of what needs to be given much higher priority. It is encouraging that this subcommittee is exerting its efforts and prestige in this area to awaken the country to the fact that priorities with our existing wealth can open immense potentials that are eminently realizable for solving or diminishing many of our problems and opening up more opportunities for human fulfillment.

Thank you.

Chairman PROXMIRE. Thank you very much, Mr. Nader. You have given us a most useful added perspective.

This committee understandably has looked at the problem primarily from the standpoint of government spending and government taxing. And I have been very puzzled about how we can begin to meet the need that all of us recognize in the health area. We could spend \$20, \$30, or \$40 billion very constructively to improve health facilities a year. We could spend, as I understand it—I have seen one projection of \$40 or \$50 billion a year for family assistance, if we have the kind of a program which would enable people to climb out of poverty.

We have had testimony this morning on the cost of a pollution challenge that we face. There is no way we can do all these things by just cutting military spending, that can help. And we are working hard on that. But no matter how much we cut military spending—and I don't think we can cut it more than 10 percent this year, we will be very lucky to do that, such a reduction can only do a small part of the priority job. It is hard to decide where the money is coming from. You suggest reducing tax expenditures. This is a very fruitful area, although there is a limited potential amount. Now, you put your finger on the private sector of the economy, the 70 percent of the GNP that is outside the Federal, State, and local spending. And I think this is the most useful of all. This is the area where we have the greatest potential savings of all to meet these problems.

However in doing this, because you are almost alone as a prominent American who is making this kind of charge, you have done it consistently, you have been hit, very, very hard lately. I am aware of the Fortune magazine article. Yesterday, we had a meeting of the Senate Banking Committee to decide who our witnesses would be on the Lockheed hearing. And I am happy to say that we finally decided that you would be one, although it was a tough struggle. There was a feeling on the part of some members of that committee and on the part of many Members of Congress that you have a gut-hatred of corporations, that sometimes a corporate profit just makes you see red—and red is the color that they use—that you would end up nationalizing our corporations, that you would preserve socialism, and that you have this kind of a negative attitude toward our economic system, which many feel has been a very productive system.

What is your response to that criticism?

Mr. NADER. The response is overwhelming. I can adduce all kinds of statements and testimony that the entire thrust of the consumer movement, which I have been identified with, is to increase the sovereignty of the consumer in the marketplace, to eliminate monopolies and shared monopolies and anticompetitive practices, and to reduce the power of government where it is very arbitrary and negligent in its exercise. As a matter of fact, this weekend, we are coming out with a 1,150-page study of the antitrust laws and the monopolistic practices in the economy which are subverting the enterprise system by the very practitioners who pay such lip service to it, namely, the largest corporations in the land. I would not even go on the defensive against that kind of criticism offered by the distorted corporate mind directly. I would go on the offensive. I would say that they by their practices are doing more to subvert the market mechanism, strip the consumer of the sovereignty which is the touchstone of the whole market system, and manipulate the powers of government to protect these capitalists from the rigors of competition, ranging from import

quotas to local monopolies to the licensee powers, than anything else.

Chairman PROXMIRE. Do you think that there is hope for this kind of approach? Or do you think we can solve our problems primarily through relying on the free market? Should we foster the free market, or do we have to have a greater government ownership of resources?

Mr. NADER. The free market can carry a much larger burden of rational allocation of resources and efficiency than it is being allowed primarily by corporate oligopolies.

Chairman PROXMIRE. You want more free enterprise, not less?

Mr. NADER. We want more competition in the enterprise system. The title of the study, Senator, is "The Closed Enterprise System." It indicates that in one area after another the concentration of economic powers is closing the enterprise system in many avenues. In short, what I am saying is that we have so many problems in this country—not only now but we have to worry about projected risks in the future—that the market system can undertake a large portion of the burden, but it also requires a governmental presence. And I am sure that industry has recognized, particularly companies like Lockheed, that a governmental presence is required. And I think when we are dealing with, for example, pollution where the main costs are going to be on the young and the unborn, the market mechanism doesn't take into consideration future costs. It is a good regulator of the contemporary exchange of cost-benefit in many areas, but it simply can't deal with some of the enormous futuristic projections of our modern technology. For that we need intelligent planners, both private and public.

Chairman PROXMIRE. Let me ask about that antitrust study to which you have referred. It seems to me that the case is overwhelming that we need far more vigorous and more relevant antitrust policy. The last major case that I can recall, in which the largest corporations were brought under suit was the electrical appliance case back in the 1950's. What we seem to have here is a serious structure problem, and one which goes beyond antitrust matters. The Justice Department has become a political arm of the White House and the administration, not just this administration but any administration. It depends upon the corporate sector for campaign funds and other support, so the executive branch of the Government looks the other way while corporations combine, conspire, merge into conglomerates, and effectively eliminate competition. What can Congress do about that?

Mr. NADER. A number of very specific things. First of all, it can recognize that no government is going to be able to enforce the anti-trust laws dealing with a fair and valid economy so replete with anti-competitive practices with a budget under \$15 million a year. And that is roughly the budget of the Antitrust Division and the section in the Federal Trade Commission which deals with mergers. That is so ridiculous an amount that no matter what the law is in terms of adequate authority, it is not going to be able to scratch the surface.

For example, the Justice Department has filed a suit against IBM. There is a law firm in New York City which has a whole section of the floor cordoned off, and it is stuffed with lawyers and computer experts and economists to fight this case, plus all of IBM's lawyers and all the consultants they can bring to bear, hundreds of full-time people. And how many lawyers in the Justice Department are dealing with

this historic litigation? Three. That is an example of totally inadequate resources. We have recommended a \$100 million budget immediately for the proposed competition protection agency which would avoid the Justice Department problem which you alluded to and combine the Federal Trade Commission and the Justice Department's antitrust activities in one streamlined agency.

The absorptive capacity for \$100 million is immediate, and a pay-off for the consumers fabulous. Every time a major price-fixing conspiracy is broken, millions of dollars are saved—hundreds of millions in the case of the electrical price-fixing conspiracy and the plumbing price-fixing conspiracy, which are recent cases.

I just give you one example. When the Federal Trade Commission broke the bread price-fixing conspiracy in this Washington area, as a result, consumers began to save demonstrably \$3½ million a year, just from that small price-fixing conspiracy in the States, largest metropolitan area. So more money is needed for this extremely economical enforcement process.

Another thing that is needed is amendment of the antitrust laws to cope with the conglomerate trend, and to cope more adequately with the necessity of getting information ahead of time by the Federal Government to pursue a sound antitrust policy. At the present time it is very difficult, given the present powers, for the Government to get any kind of systematic information. A memorable episode during the sixties was the blockage in the Office of the Bureau of the Budget of a request submitted to the agency by the Federal Trade Commission under the Federal Reports Act to obtain, by an industry questionnaire, basic information about the concentration trend in the economy which would have permitted the Federal Trade Commission to intelligently meet the merger wave of the late 1960's. It was not permitted. Congress can see to it that such information is obtained.

These three things that can be done by way of direct congressional action.

Chairman PROXMIRE. Let me ask you about another area that we have been working on.

Congress is having difficulty coping with the latest advance in bureaucratic technology. This administration has done what no other administration has been able to do. It has learned how to MIRV its boondoggles—and as a result, subsidies, corporate bailouts, tax deferrals, and government contracts have proliferated and have been sent over to the Congress in such great numbers that some of them, I suppose, are bound to get through. What can the Congress do to protect the taxpayer from this kind of thing?

Mr. NADER. The response to that is going to take a long time, if you don't mind.

I think, first of all, start with the General Accounting Office, and lift from its shoulders the restrictions imposed by some Members of the House of Representatives years ago on naming names, naming corporate names, and instead of having these very fine studies only in aggregate form, actually begin to allocate responsibility on the part of firms and on the part of individuals, both in Government and in these corporations. If Lockheed has been mismanaged, who has been mismanaging it? Who has a share in the mismanagement? "No one knows my name" is the cardinal watchword of the defense in-

dustry. And that is one very important step forward. But it also highlights a much more important policy that the Congress can pursue and that is the following: Institutions will only be responsible when individuals are responsible within those institutions. And if you will look back over your career of exposing waste in the Defense Department, can you point to one or two instances where the culpable official was fired or was demoted or was fined?

I am sure that you can point to an example where a very courageous whistleblower lost his job—like Ernie Fitzgerald—on the pretext of an economy move by the Pentagon. But for all of the people who are involved in these repeated examples of outrageous waste, documented again and again by your activities, and those of other Members of the Congress, the GAO, and members of the press, dealing with the ones that are responsible has been avoided. I think the most perceptive insight the Congress can make in turning the Federal bureaucracy around is to recognize that over the years sanctions have fled from individual accountability, and the institution takes the brunt, the agency takes the brunt, which can easily roll with the punches and wear out any kind of congressional committee. But unless the individuals, the officials, the middle management levels, or the higher management levels in both these industries and these agencies are subject to a very intricate pattern of accountability and sanctions, we are not going to see such progress. You have suggested legislation freeing individuals of conscience who blow the whistle in these agencies to Congress and other authorities from retaliation or demotion or ostracism, or being fired without due process.

And that is another ancillary innovation that has to be applied throughout the Federal bureaucracy. Now these aren't sloganized-types of programs, they are not very easily dramatized. But I think on reflection we ask ourselves what is most responsibly exercised in our large institutions. It is those areas of public impact where the individual is in charge of a particular segment of the institution and his career is on the line and his promotion is on the line. And too often what we have seen is not only the absence of sanction, but the exact reverse, that is, people who are culpable or who involve themselves in very wasteful government and corporate activities get promoted, they are the ones who get promoted, instead of, if anything, demoted. And that is not the way to encourage motivation for self-correcting behavior inside these organizations.

Another suggestion is the following. I understand that the only computer in Congress puts out the payroll and that is what it does. And everybody knows that the executive branch has got hundreds and hundreds of computerized systems, and everybody knows that the information flow is critical to any congressional policymaking function. And until Congress begins to grapple with developing a technical staff and computer system, not only machines, but also scientists and investigators, there is not going to be the congressional oversight that the Constitution anticipated almost two centuries ago.

Chairman PROXMIRE. I am glad to say that the Joint Economic Committee at long last has access to a computer. And we are just beginning to use it. We have only done so in the last few weeks, but it is beginning. But you have dramatized this very great need. It is a mighty

small beginning, and you recognize what we are up against with the thousands of computers, literally thousands, in the executive branch, and with the utility of the computer in compiling and gathering information, you can recognize what an advantage it is for us to be in a position where we can use it. But we share it; we don't have one of our own.

Mr. NADER. An encouraging step, I must say.

A primitive analogy is the following: Suppose the Congressmen and the Senators could not use the transportation and communication systems in their operations going to and fro and so forth, that only the executive branch had access to transportation and communication. Everyone would say, obviously, Congress couldn't do its job. Well, when you deal with computers you are dealing with something pretty close in importance to traditional communications and transportation systems. It is really a time to call on the executives of these large computer companies and have them educate the Congress and inform the Congress of the enormous services in terms of hardware and software that they can provide to the congressional branch, so that it begins to counteract this fantastic power of the executive department.

Chairman PROXMIRE. My time is up.

Senator MILLER.

Senator MILLER. Thank you, Mr. Chairman.

First, before I ask any questions, I think that I would be derelict if I didn't make a response to a comment by the chairman. And the response would be that after the so-called great society administration, I don't think that we ought to be talking about merely a boondoggle. And I might add further that it is my understanding, based upon pretty good authority, that most of the cost overruns that we are reading about in the newspapers originated in contracts that were negotiated back in those days. Contracts which were negotiated on a matter which Mr. Nader has been attacking and quite properly. This doesn't mean that the current administration is lily-white by any means. But I just didn't think that we ought to be too ready to throw stones. And I don't think it is going to help us in dealing with this subject.

Now, Mr. Nader, I can't agree with everything in your statement, but I want to commend you on the finest analysis of the qualitative approach to our economy I have ever seen.

Chairman PROXMIRE. Will the gentleman yield, just for a moment, since he mentioned my name?

Senator MILLER. I didn't mention your name, Mr. Chairman.

Chairman PROXMIRE. You mentioned my office.

Let me say that I would agree wholeheartedly that the previous administration is certainly responsible for a series of overruns that are absolutely unforgiveable, a great waste. But I think that this administration appears to be on the verge of even topping that. Now, it is true that we don't have the documentation completely for that, it will take a year or two or three or four, before we can do it. But what is coming on the line now, as they say in that song, "Baby, You Ain't Seen Nothing Yet," it doesn't look very encouraging.

Senator MILLER. May I say, I am quite sure that if anything does come under the line, that the Joint Economic Committee—and I include the chairman in this—will do its utmost to see that it gets off

the line. That has been the trademark of the Joint Economic Committee ever since I have had the privilege of serving on it.

An example, Mr. Nader, of why I can't agree with everything in your statement is where you referred to the Treasury's action with respect to depreciation as being unlawful. I don't mind telling you that I disagree with the Treasury's action. But neither you nor I know whether it is unlawful or lawful. As a matter of fact, there is a precedent for the Treasury's action going back to, I think, the days of the Kennedy administration. Only time and the court decisions will reveal whether it is lawful or unlawful. It may be unlawful, I don't know. I just disagree with it. But I don't think we ought to label it unlawful without something more than our own individual opinions to back it up.

Mr. NADER. I have submitted 11 opinions by legal authorities of unquestioned eminence, Senator, just in terms of giving the committee more detail.

Senator MILLER. I am sure you didn't dream that one up. But I can tell you that there are tax lawyers and tax lawyers, and one of the great things about the tax law profession is that we have many violent disagreements over which court decisions are made. So until you get the court decision you are not going to be able to call it unlawful.

Mr. NADER. Obviously, only the court can judge it to be unlawful. So the Treasury's saying it is lawful has no greater tenure under your analysis than any other opinion at the present time.

Senator MILLER. Except as I say, there is precedent. Back in the Kennedy administration days, the Treasury did take similar action. I want to make it clear, I don't agree with it, but I don't think either you or I, even though we disagree with it, out to label it unlawful at this stage.

Mr. NADER. With your permission, the difference between the Kennedy action in the early 1960's and the recent action has been clearly distinguished in the material submitted. Let me just say, the simple point is that under the Internal Revenue Code as it is written in the depreciation sections, there really is no authority for the Treasury issuing accelerated depreciation rates that have nothing whatsoever to do with the wear and tear of the equipment. It has to have a reasonable relationship to the wear and tear of the equipment. But having nothing to do with the wear and tear of equipment is what caused Professor Bittker of Yale Law School and other authorities to say that it was significantly different from the actual depreciation allowances in the early 1960's that the Treasury issued.

Senator MILLER. I appreciate that that is the argument. On the other hand, I think there is another side of the coin. The other side of the coin is that Congress legislated other reasonable wear and tear rates of depreciation. And I think that if you look at the committee's reports and the legislative history, you probably will be able to find some legislative intent which would give the Treasury a broader brush. And I believe that that is the basis upon which the Treasury operated back in the Kennedy administration, and which is what they are following now.

I don't want to labor the point, but I thought I should mention it, because aside from a few things in your statement, I think it is a really very helpful statement.

Now, on item 2 of your statement, I couldn't help but think, when you were reading from it, where does this fit with respect to farm prices? I think you well know that there is a great concern on the part of the farming community over the fact that the farmers' prices are not reflected very well in the marketplace, and that there are increased prices in the marketplace where the farmer is not receiving an increase in his prices, and when there are low prices, there is a long timelag some time between that time and the time when it shows up in consumers' lower prices. Do you have any comments on that?

Mr. NADER. That is an example of how much work has to be done in that kind of subeconomy, Senator. For example, the question is whether the consequences are changing the subsidy pattern according to the recipient? That is, should Standard Oil, for its *x*-acreage in southern California, receive \$140,000 annual subsidy per year? The original intent of the agricultural subsidy was to help the poor farmer cope with market fluctuations way beyond his control, and two, to do something about the market fluctuations, period. The question is—

Senator MILLER. May I suggest that there is a third, and that is to insure to the consumer quality farm commodities and adequate farm commodities?

Mr. NADER. The question is whether now the original basis in one crop or another has so changed and the development of business corporations has so changed significantly that we have got to rethink them, as to whether this is the best use of the tax dollar.

As you know better than I, there are a lot of alternate plans being offered. My point is that if we just take the criteria, is this the best use of the tax dollar and the consumer dollar for the given program—in other words, just measure it from another angle rather than the recipient's standard in order to develop this kind of analysis so that we can say, well, what are the cost benefits across these programs, and not just say, a sort of unilateral type analysis in each pocket of the economy.

Senator MILLER. Let me follow that question with this one. You say to the extent that bargaining power, and so on, are weak, these transferring costs from one level to another are increased. Is it your opinion that farmer bargaining power is weak?

Mr. NADER. In many areas; yes. And clearly that statement holds true for the consumer as well as for the farmer. For example, if their bargaining as to shipping their goods is very weak and they have to pay higher rates than they should, then it is quite clear that the transfer economy is going to go into motion in that direction too. So it holds true from both the consumers' end and the farmers' end.

Senator MILLER. What about the processor and the consumer in the ultimate retail price?

Mr. NADER. This kind of phenomenon could cling to any segment of the transfer economy. It just happens to be the fact that the weakest people are usually at the end, the ultimate consumer, unless you have got an industry with very small participants in it, like in the farm industry, where you still fortunately have some very small farmers. But in many other industries you have got giant extractive companies at the beginning that can't be considered as having poor bargaining power, like copper or oil.

Senator MILLER. My guess is that when there is a weakness at the farmer end, there is a weakness at the consumer end.

Mr. NADER. It is in the middle, you know, where there is a great deal of the problem.

Senator MILLER. You mentioned labor monopolies under item 3 of your statement. And one of the problems we have with an analysis such as yours is that while we may agree on your approach, we may disagree in the evaluations of the value approach. For example, do you think that under item 3 would come wage increases beyond increased productivity?

Mr. NADER. If it is the function of an illegality—

Senator MILLER. I am not talking about illegality. I am talking about economic power; that as a result of the economic power, there are wage increases beyond increased productivity.

And, by the way, I want to make it clear, I think the same approach should be taken with respect to prices, but you mentioned labor monopolies, and I felt that I ought to ask this question in connection with that.

Mr. NADER. Let me give you an example. The construction trade, which has restricted the pool of entry in such a way that they, in effect, have a labor monopoly. And you can see the results, which not only are extremely serious for the housing industry, in general, but it is a shortsighted point of view for the construction trade union, because the market for their services is just going to shrink more and more.

Senator MILLER. Of course one of the problems I have with your analysis—I haven't had a chance to think it through—is that you take an economic approach to quality. And I think that is great, and I am all for it. I think it is one thing that is long overdue, and I like the way you have brought it out. But in taking an economic approach to quality, we may forget about some of the quality that must be taken into account in an economic approach. For example, I can ask you now that we have talked about wage increases, about minimum wage. And minimum wage may fall under item 3 if the work is not commensurate with the minimum wage. But, on the other hand, there is a qualitative part to this, and what is the social consequences that we are looking for. Would you agree?

Mr. NADER. Yes.

Senator MILLER. So while technically, maybe, the minimum wage would fit under item 3, we might excuse it because of the social consequences; I mean, the desirable social consequences from it.

Mr. NADER. Yes. In other words, we are saying that its benefits outweigh its costs.

Senator MILLER. All right. Now, if you recognize that, let me come to the last item, item 4 of your statement in which you were talking about indirect subsidies to the tax system. Now, I suppose that if one wanted to be technical about it, you could put under item 4 the tax exemptions for foundations, for charitable organizations, for educational institutions. Technically, would that not fit under item 4? But we could take it out because of the desirable social and possibly even some economic consequences from that exemption or that subsidy.

Mr. NADER. That is quite true. For example, to take a recent case, the use of tax foundations as a way to siphon off the tax liability of commercial enterprise is a clear-cut example of what I mean. The straight-out tax exemption, say, foundations, should be reviewed to see whether this is really good policy.

Senator MILLER. I think what I am trying to get across to you is this. As a member of the Senate Finance Committee, I can tell you that in the provisions of the Tax Reform Act of 1969, we did try to take into account quality as well as economics. You know we did a substantial job of revising the foundation tax exemption laws. And there are some who did not agree with what we did. But I think we were trying to get the abuses out while at the same time preserving the tax exemption for those who performed very good social activity. In this item 4, I think you could probably include the investment tax credit technically. But I suggest to you, while I disagreed with it at the time it was enacted, I think we have got to recognize that there are many social advantages by giving this tax subsidy to corporations and businesses, and indeed farmers, for the purpose of alleviating an unemployment situation.

Mr. NADER. Yes. The fact that these examples are in these categories doesn't mean that they are per se undesirable. It does mean that when something like that was given in 1950 or 1962, that it should be subjected to some sort of current or periodic review rather than just accepting it as if it were etched in bronze in the statute book.

Senator MILLER. I very much appreciate your very frank responses. And I am pleased to say that I agree with them.

I think that we have, Mr. Chairman, a very fine analysis here on which this committee can build.

And I want to again commend you, Mr. Nader, for this analysis.

Mr. NADER. Senator, may I add, on your point on quality and economics, obviously there are many aspects that cannot be quantified economically to the improvement of the quality of life. But with recent developments of techniques of measurement, we are increasingly able in this country to begin to quantify certain qualitative—if I could put it that way—thoughts.

For example, noise. Noise never found its way into any balance sheet or any government audit. But it is clearly a deteriorating factor to the quality of life. And it is important to begin to try to quantify its cost, and to give rough estimates, where that is possible, in order that we may justify the prevention of noise.

For example, when noise was first seen primarily as an annoyance, it was difficult to say to an industry, you have got to invest x resources to eliminate the noise. But in the last few years medical research has shown that it is far more than just a noise, it has a clear physiological impact detrimentally on the human being, particularly those who have heart trouble. It has also been shown that it clearly impairs hearing quality. At the University of Tennessee, tests given by University researchers show that 25 percent of the freshmen tested have the hearing capability of 60-year-old people.

So we have got all these new dimensions which we can begin to bring into an analysis with some economic quantification. The reason why it is so important to that is because one, for example, can make a religious characterization of noise as an endurable thing. I am sure the Golden Rule applies to that. The reason why it is important to do it economically is not to refuse everything to a man living by bread alone, but because this is a society that is primarily motivated in its power system by economic inducements.

Chairman PROXMIER. The Senator's time is up, but by unanimous consent he may ask another question.

Senator MILLER. I merely forgot another question, which I am sure you can answer quickly.

Where under the subcategories, would you fit the wastage that arises from drug abuse?

Mr. NADER. Here is where we would want to begin bringing together psychology and economics, because you can make a case for it under compulsory pollution, for example, teenagers' defenses are so reduced that those who play on the teenagers, the people who push the stuff and the people who make it and prepare and ship it, that this could be a kind of analogy to environmental pollution.

Senator MILLER. Thank you very much.

Chairman PROXMIRE. Before I call on Senator Javits, I might point out that probably the most persistently destructive noise is the electronically magnified rock-and-roll music. I don't know if you have had an opportunity to witness this at first hand. But what is going to happen to people a generation from now? I didn't have a chance to listen to it until just about a week ago. And I was astonished. It is incredible. It is louder on the decibel level than a pneumatic drill. And this will have a very, very serious effect on the health of the future generations.

Mr. NADER. To be precise, it runs 132-140 decibels. And that compares with the level, the tolerable level of 80-85 decibels. And 132-140 decibels is very serious exposure, particularly to the quality of hearing. And that is one reason why these tests that were conducted by a specialist at the University of Tennessee of incoming freshmen produced these astounding results, that something on the order of 20-25 percent of the incoming freshmen had the hearing equivalent of 60-year-old people.

And most people think of rock-and-roll music in terms of bands. And how many hours do people sit listening to these bands? The problem is, as you know, the enormous magnification of sound by the sound systems, which are in millions of American homes. And the teenager will just sit 10, 20, or 30 hours a week listening to this, and having, as they put it, their minds blown.

And it is a clear occupational hazard to the musicians; there is no doubt about it. Ask any musician who plays acid rock music, and he can point it out.

And there are also these twinkling lights, which have an effect on the eyes of people, in these clubs where these rock bands play.

The tragedy of it is that the people who are victimized by it are assuming the risk if they enjoy it. It is a pleasurable feeling to have their minds blown, as they put it.

There are no standards, by the way, at all.

Chairman PROXMIRE. Senator JAVITS.

Senator JAVITS. Mr. Chairman. I will not detain Mr. Nader long. But I am amazed to find him so old-fashioned, almost reactionary. Our teenage daughter can't study without that 130-decibels, she can't think. She has to have her mind blown and relax.

Mr. NADER. You know, excessive noise is supposed to filter out pain.

Senator JAVITS. It doesn't filter out mine.

But it is illustrative, Mr. Nader—and you know I have great respect for your thinking, which is very originally shown on this document which I have had the pleasure of reading—I must apologize, but I was

upstairs dealing with Latin America and other problems in the Foreign Relations Committee.

But what I have just said is not inapposite.

All the questioning about what you did, about the fact that you have analyzed the leakage—that doesn't necessarily mean that there is no trait of an advantage. For example, I don't happen to agree with you on depreciation allowance. Whether or not the thing was legal as it was done, I am really not prepared to pass on as a lawyer. And if that is bad, the tax credit may be bad, and maybe the competitive system is bad, it is too trustified. But we have to find some way of modernizing the private economy.

The other thing that troubles me greatly is the antitrust laws. You take for granted in your statement that the antitrust laws are good. They may very well be bad from the point of view of the consumer. As you know, they are mainly restricting the little guy while General Motors, you know the biggest operation that there is, and the antitrust laws don't seem to affect it. But some little guy in a trade association who is trying to standardize a few lines to avoid waste in 50 or 100 of them so that he can stay in business as a little businessman finds himself in the hands of the Department of Justice.

But as I say, you have saved me a lot of questioning by your very characteristic and generous statement that you weren't necessarily passing judgment on the desirability.

I have something else to ask you, but I will stop at this point, should you wish to comment.

Mr. NADER. Yes, Senator Javits.

You are quite right that because of the way the antitrust laws have been enforced the large age-long concentration of powers tend to escape enforcement, and oftentimes enforcement comes on those who fix prices in bull semen, or gift stores in the Virgin Islands, and things like that. I am saying that because I think it is important to distinguish between the antitrust laws as they are written and as they are administered. To give you an example, take the General Motors case. There is something like over half a dozen detailed studies by economic and legal specialists in the Antitrust Division as to whether the Department should move against General Motors as a violator of the antitrust laws. And they all ended up by saying that the Department should do so; that there is a long established doctrine and basis under the Sherman Act and the antitrust laws to move against General Motors.

And one of those recommendations was by no less a person than Prof. Donald Turner, who was a former assistant attorney general in charge of the antitrust department. So it is a problem less of the antitrust laws than how they are applied. And I would agree that they have been applied in a highly discriminating fashion, and one that is too correlative with the small-sized violators as compared to the larger violators.

Senator JAVITS. We must remember, you know, as lawyers that it is the courts who made the antitrust law. The construction of the court still make it. And on the economy of scale it is generally thought, much as I welcome mom and pop, that the supermarket is a very extraordinary example of the economy of scale. But you can give me 50 instances which I agree with where scales turn out to be wasteful,

monopolistic, oligarchistic, and contrary to the general public interest.

Mr. NADER. The beautiful flexibility of the antitrust laws, which are like common law, really—and the courts have so interpreted it—is that as they now stand, for example, and as they have stood for many years, the supermarket as such is not considered at all in the light of an antitrust violation. But if a large supermarket chain engages in tying arrangements or monopolistic pricing, or price fixing, it is. Antitrust is a beautifully adaptable tool to recognize both the economy of scale, and to recognize that situations go far beyond that, such as oligopolies or shared monopolies.

Senator JAVITS. But don't you have to reconcile that, Mr. Nader, yourself, in your own fashion, for streamlining and simplicity—for example, your feeling about the great wastefulness in trademarks and brand names; isn't that brought on by the need for competition, even if a lack of it in the non-Communist countries and in the Communist countries would make more goods available to the individuals?

The only thing I would like to introduce—and I don't want to get you off on particulars, which wouldn't be fair to you or me—isn't the other aspect—aside from the fact that you make no judgment, you point out where the leakages are, but you don't judge that they are necessary costs we shouldn't pay—isn't the other argument that also you must allow for social restructuring which is not necessarily tied to the established structure that we have accepted for all these decades, if you want to put society, not just to close up these loopholes but put society on a totally different plateau, which may be more efficient and more just in terms of social justice?

Mr. NADER. Yes, of course. And in making that inquiry it is surprising how much wisdom is still retained in the concept of consumer rights and antitrust enforcement.

Senator JAVITS. There is just one other question I have.

We have been trying to get installed as part of the Office of the Comptroller General, or as an office comparable to it, an office of goals and priorities analysis as a tool for the Congress. Are you aware of that effort made by Senator Mondale and myself?

Mr. NADER. Yes.

Senator JAVITS. You are. Would you have any view about it at all? And does it bear upon this great social issue that you have been describing?

Mr. NADER. It does. And the idea is a very good one. The question is, Will the office have enough powers to get the information necessary to really make the determinations, that its charter requires it to make? And that is not a theoretical question at all; it really is the key. You cannot deal with priorities unless you have almost carte blanche information procurement powers, within constitutional limits, that is, to make these determinations.

Senator JAVITS. We thought that by putting it in the equivalent of the Comptroller General's Office, we would go a long way along that line.

Mr. NADER. I think that certainly it should be under such direction.

Senator JAVITS. Thank you.

Chairman PROXMIRE. I just have a couple of questions.

I cannot let you go without asking you about Lockheed. Although Senator Sparkman has agreed to invite you to testify on the bill to

provide a guaranteed loan for the Lockheed Corp., I wonder if we can get your general reaction to that proposal now without going into details. Do you think it is a good idea, or do you oppose it?

Mr. NADER. I do oppose it, and the alternative; that is, I oppose it fundamentally. But if it should pass the Congress, there are a whole number of conditions that have to be established, not only dealing with the ability of the Government to get information, but also a whole series of reporting functions and analyses of company performance, as well as a turnover in management. I really think that the time has come for Lockheed to shed its top management and to let some new managerial blood take over. If the test of history doesn't call for a change in Lockheed's management, then there is eventually no test that can be met.

Chairman PROXMIRE. As I understand it, you are particularly well qualified because you have done an intensive study, you are in the process of doing one, on the aircraft industry from the consumer standpoint, or the airline industry from the consumer standpoint, and the need for the airbus, the 1011, which, of course, is the reason for the guarantee. This kind of a viewpoint is so rarely available to Congress. We zero in on the narrow problem of the particular company that wants the guarantee, with some kind of vague objections, but we don't look at it in the overall or from the standpoint of the significance of the precedent. And you can, I think, contribute greatly to our understanding on that score.

Mr. NADER. For example, the effect of the airbus on mergers in the airline industry, Western Airlines and American Airlines being an example of the kind of situation. But there will be an opportunity, hopefully, to discuss these in detail later.

Chairman PROXMIRE. The other question I have relates to a proposal I made a couple of weeks ago—and Professor Haveman testified on it very ably this morning—that instead of following the present strategy that we are following on pollution, that we follow a policy primarily based on an effluent tax or effluent charge. You came near it in your statement when you said, "An ounce of prevention at the plant investment level is worth the proverbial pound of cure needed when the harms proliferate." And the purpose, of course, of the effluent charge would be to zero in with a clear-cut, understandable economic disincentive for pollution. A reason why the corporation will find it profitable to increase its income by recycling its waste and by investing in research to determine how it can eliminate or reduce its waste. Have you had a chance to consider this kind of a proposal or come to a conclusion on it?

Mr. NADER. Yes, I have, Senator. And I am really opposed to it. I think that a far superior mechanism would be to have an environmental tax on corporations, which would be used to meet any economic dislocations or wage loss that came about as a result of companies having to adhere to straight-out standards for curbing pollution. I think that it is far preferable to do it by setting standards, by having stiff penalties for their violation, and by having an environmental tax across the board, which would go into a fund to deal with whatever dislocation or labor force—

Chairman PROXMIRE. That would or would not be related to the amount of effluent discharge?

Mr. NADER. No; it would not be related. The only additional incentive that would operate here is that those companies who could show true progress might get a reduction of the across-the-board environmental tax that is applied.

Chairman PROXMIRE. In view of the fact that the environmental tax has been tried in Cincinnati, and it works, and it has been tried in West Germany, and it works, and it works in the sense that it has dramatically reduced the pollution, in view of the fact that it allocates the advantage that an industrial firm has in using the water as a free commodity, it allocates that cost to the ultimate consumer. In view of all that, I just can't understand why you are fundamentally opposed to it.

Mr. NADER. For a number of reasons. One, the Ruhr example is not really that successful as it is made out to be. The reason why I oppose it is that it is almost impossible to administer, if you are going to give procedural safeguards to these companies. For example, if you deal on the basis of how much you pollute the water, you use, and what you take in and what you throw out, you are going to deal with the problem of measurement, which means that you are going to deal with the problem of inspection, which means that you are going to have all the problems involving inspection of these plants and measuring and trying to find an average and trying to plug the loopholes of companies dumping the stuff at odd hours before various inspections.

And the other reason is that it doesn't fulfill the various purposes of this alternative proposal, in that this does not develop the burden of proof of where it is. You see, in a surcharge situation the burden of proof is on the Government. The Government has got to show that the pollution is there. But the situation where we have an environmental tax—you have a gasoline tax and you have other taxes, but where you have an environmental tax across-the-board, then the burden of proof is on the company to prove that they have done better, or that they have progressed in order to get a cut in the taxes that applies to this.

There is also the issue that a more rational bit of planning can be made with the standards—not the kind of standards that exist in terms of ambient air quality, but rather like machinery and industrial process standards, than can be done by the tax.

Chairman PROXMIRE. I don't see any connection between the so-called environmental tax which you say would be fairly uniform and one related to the amount of pollution, the purpose of which is to provide a clear-cut discouragement to using the water or using the air in a way that pollutes it. It seems to me that you have the great advantage in the effluent charge of giving the corporation the discretion to use their best judgement, and a real incentive for doing so, and a reward for doing so, and a penalty for not doing so. None of that, it seems to me, is available in a generalized environmental tax, which you would apply apparently to corporations whether they pollute or not.

Mr. NADER. This is in the sense of getting a rebate on the across-the-board tax.

Let me pose another problem for you. Many of the major polluters in the country are oligopolies, four or five major companies dominate the industry; steel, aluminum, copper, autos, and the like. And they have an incredible ability simply to pass these costs on. And there is

every possibility that they can basically be assessed the same type of cost, and simply pass them on.

Chairman PROXMIRE. I have no objection to their passing them on. If you or I are using a product which requires that the water be polluted in order to make it, I think that you or I as the consumers of that product ought to pay for a substantial part of purifying the water.

Mr. NADER. But my point is—the reason why you advocate a surcharge for one reason is to make it a competitive disadvantage to be a polluter. My point is that—and I will simplify this to reduce the objection at the moment—my point is that there is no guarantee that these oligopolistic industries will—they can all behave in the same way and not fight it out one among the other. There is no precedent, like in the auto industry to—

Chairman PROXMIRE. We may not do a lot of other things, but we pretty well pay taxes.

Mr. NADER. But all of these companies pay on a prorated basis the same amount of taxes, because they don't change it. They just keep doing what they are doing. Then there is no definite advantage. Their costs will go up roughly at the same rate. My point is that we should try both areas. And I think we are both talking theoretically because it hasn't been tried.

Chairman PROXMIRE. That is the part of your answer I like. You want to try both of them.

Mr. NADER. Yes, and see how they actually work because we are just projecting into those areas in terms of human and corporate behavior. It would be interesting to see how those work.

I just want to make one more point. The summary point which I would like to make is the necessity for the Government to concentrate on the qualitative accumulation of information dealing with economic growth or lack of growth.

And, second, that we have to recognize that money is not going to solve the problem. The medical costs of this country are half of the food costs. They are over \$50 billion, some estimates say \$60 billion. And they are projected to go to \$100 billion in about 7 years.

Chairman PROXMIRE. What costs again?

Mr. NADER. Medical and hospital costs. Americans pay a little more than one-half for medical and hospital care than they pay for buying food. And it is going to go up to \$100 billion in just a few years, on every projection that has been put before a congressional committee.

And the point is, I think we have reached the stage in our economic history where we have got to recognize that even if we find the billions, we have got such an absorptive capacity to waste, that it is not going to solve the problem. And that is why we have got to really vigorously go into the area of the quality of service, the quality of the products, the quality of employment and the quality of tax expenditures, and the like.

Chairman PROXMIRE. Thank you for a very fine statement and an excellent conclusion.

The subcommittee will stand adjourned.

Thank you, Mr. Nader.

(Whereupon, at 1:05 p.m., the subcommittee adjourned, subject to the call of the Chair.)