Research Department
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Pentagon Problems

The events of recent weeks have shown that we live in a very uncertain world. An international crisis has erupted in the Middle East, associated with the heaviest desert fighting since El Alamein, and the human and financial costs for all participants have mounted daily.

These developments underline the fact that U.S. defense spending is now rising again from its recent low —and may well continue rising. The increase is shown most dramatically in new budget authority, which signals the strength of future budget spending. Budget authority includes amounts which, under Congressional authorization, enable the Pentagon to enter into obligations requiring future outlays of money.

From a low of $75.2 billion in fiscal 1971, budget authority increased to $81.7 billion in fiscal 1973, and last January's budget shows twice as fast an increase, to $87.3 billion for the current fiscal year. (The total would be expanded by the recent $2.2-billion supplemental request related to the Middle East crisis; on the other hand, it should be noted that the total figure is an approximation, since authorized funds sometimes are not actually spent.) This sharp budget increase is taking place despite a continued cut in military manpower, down 37 percent from the fiscal 1968 peak.

How much is enough?

How much defense capability do we have? In terms of numbers, we have roughly the same in strategic and tactical air strength, and somewhat less in naval and ground forces, than we had in fiscal 1964—the post-Korea, pre-Vietnam high. For example, we now have 13 instead of 15 attack carriers, and 16 instead of 19 1/3 army divisions. However, in terms of firepower and other combat characteristics, we now have considerably more than a decade ago—for example, through the introduction of multiple warheads for the strategic-missile force.

How much do we need? The question is unanswerable, in view of all the military, political and economic intangibles involved in the world power equation. At present, military purchases account for only about 6½ percent of GNP, the smallest share of the past two decades. Some observers claim that not nearly enough resources are allocated to defense, but others argue that the present allocation is far more than necessary.

Military planners, concerned with the capabilities of all possible adversaries, argue for a considerable beefing-up of the armed services. Indeed, military studies early in the 1960s estimated that 52 divisions—in contrast to our present 16—conceivably would be required to cope with all the possible trouble spots in the world. On the other hand, critics contend that savings could be made in a number of areas—by reducing budgeted spending in Southeast Asia, by improving military manpower usage, and by eliminating or postponing the procurement of new

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strategic weapons. With savings from these areas, spending authority could be reduced from $87 billion to $73 billion in fiscal 1974 alone, according to a recent study authored by the Project on Budget Priorities, a group of former Defense Department officials.

Although few can agree on how much is enough, all observers realize that the Pentagon has absorbed vast amounts of resources despite its declining share of GNP. The U.S. has spent over $1 trillion on defense since World War II, and the amount spent just within the past decade ($680 billion) just about equals the $689 billion collected in Federal personal-income taxes over that period. The realization of the large sums involved has led to continued demands for efficiency in manpower usage and weapons procurement.

Manpower costs

Manpower has become an increasingly important segment of the defense budget. Dollar spending for military pay and allowances has doubled over the past decade, and the manpower share of the defense budget has jumped from 41 to 56 percent. The acceleration in military pay has been largely due to the need to attract enough volunteers to permit the elimination of the draft, effective last July 1. This is the main factor behind the rise in total defense spending over the past several years.

The policy of sharp pay raises has transformed a military cost long hidden from view into an explicit dollar addition to the defense budget. Formerly, through the vehicle of the draft, the government was able to pay young men far less than prevailing market rates for their services. A certain segment of society—males aged 19 to 26—was taxed in kind by being paid substandard wages for the two-year draft period. Now, with the shift to all-volunteer armed forces, the government pays prevailing market rates, permitting this special tax to be redistributed among the entire taxpaying population.

The increase in spending for military personnel, in other words, is a necessary consequence of the political decision to end the draft. The higher pay and other costs associated with this shift will total $3.1 billion in fiscal 1974 and substantially more in later years. The most striking impact, however, should be seen in the soaring costs of the military retirement system, which is affected by both rising pay scales and the rising number of retirees. Between 1950 and 1970, retirement costs went from $0.2 billion to $2.8 billion, but in 1990, these costs may total $14.4 billion—and may rise to $24.7 billion in the year 2000—according to actuarial data prepared by the Senate Armed Services Committee.

Certain personnel practices have also added inordinately to manpower costs. One problem is the unbalanced "teeth-to-tail" ratio, with only 15 percent of all personnel in combat forces, and the rest standing in support. Another problem is "grade creep." There are more field grade and flag officers to command 2.2 million men today than there were to command 12.1 million men in 1945; also, there are more sergeants than there are recruits today, compared with a 1945 ratio of seven recruits per sergeant. A development of this type should be expected as the services shift toward an all-volunteer force. Still, if the grade structure existing at the end of World War II were in effect today, payroll costs at today's pay scales would be $2.7 billion less than they actually are.

Procurement costs

Defense Department officials, in one administration after another, have encountered serious problems in controlling the costs of military procurement. Costs are especially difficult to estimate in any case, partly because of inflation, but mostly because entirely new technologies are required in the production of many new weapons. During the crash programs of the 1950s, weapons cost about three times as much as initially expected, while in the less urgent days of the 1960s, final costs averaged about two times estimated costs. Moreover, between 1957 and 1970, 81 major projects with a $12-billion pricetag were cancelled altogether.

Three years ago, the then-Deputy Secretary of Defense, David Packard, declared that defense procurement was in a "real mess," and he thereupon moved vigorously to improve the efficiency of the weapons-acquisition process. Several of his reforms deserve special mention. First is the "fly before you buy" approach, which requires the services to know as much as they can about the product before they buy it in substantial quantities. Second is the upgrading of management expertise in the services, by improving the quality of program managers and increasing their authority. Third is the increased control of "gold-plating", by reducing the tendency to design more sophisticated weapons than are required for the tasks assigned.

Yet no matter what is done in the way of controlling manpower expenses and improving the weapons-acquisition process, defense spending appears to be due for a considerable expansion in the years ahead. According to the annual Brookings Institution budget analysis, simply maintaining current defense policies would require a 15 percent increase in budget requests between now and 1980, to a figure of $97 billion —or $114 billion after allowing for price increases. (If associated programs were included—such as war-debt related interest, veterans pensions, and the operations of the space and atomic-energy programs —another 35 to 40 percent could be added to the final bill.) If defense requests should develop along this line, Congress will continue to be under pressure to reform its budget procedures and sort out its spending priorities, to assure that the Federal budget does not again become an engine of inflation.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 10/17/73	Change from 10/10/73	Change from year ago Dollar	Change from year ago Percent
Loans adjusted and investments*	74,490	—3,200	+9,749	+ 15.06
Loans adjusted—total*	57,490	—2,745	+9,705	+ 20.31
Securities loans	1,019	—2,310	— 198	— 16.27
Commercial and industrial	19,953	— 318	+2,723	+ 15.80
Real estate	17,663	+ 82	+3,112	+ 21.39
Consumer instalment	8,783	+ 6	+1,368	+ 18.45
U.S. Treasury securities	5,250	— 111	— 686	— 11.56
Other securities	11,750	— 344	+ 730	+ 6.62
Deposits (less cash items)—total*	73,048	— 655	+8,952	+ 13.97
Demand deposits adjusted	21,818	— 679	+1,506	+ 7.41
U.S. Government deposits	593	+ 143	— 70	— 10.56
Time deposits—total*	49,384	+ 4	+7,450	+ 17.77
Savings	17,508	+ 20	— 833	— 4.54
Other time I.P.C.	22,830	— 145	+6,209	+ 37.36
State and political subdivisions	5,862	+ 13	+ 922	+ 18.66
(Large negotiable CD's)	11,351	— 152	+5,378	+ 90.04

Weekly Averages of Daily Figures	Week ended 10/17/73	Week ended 10/10/73	Comparable year-ago period
Member Bank Reserve Position			
Excess reserves	— 9	43	— 70
Borrowings	71	113	66
Net free (+) / Net borrowed (—)	— 80	— 70	—136
Federal Funds—Seven Large Banks			
Interbank Federal funds transactions Net purchases (+) / Net sales (—)	—173	+278	—389
Transactions: U.S. securities dealers Net loans (+) / Net borrowings (—)	—230	+520	+133

*Includes items not shown separately.

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