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RM-3359-ASDC
NOVEMBER 1962

PROGRAM BUDGETING:
LONG-RANGE PLANNING IN
THE DEPARTMENT OF DEFENSE

David Novick

PREPARED FOR:
The Office of the Assistant Secretary
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PREFACE

The Cost Analysis Department of The RAND Corporation, under a contract with the Office of the Assistant Secretary of Defense (Controller), has been assisting the Department of Defense in the development of a new planning-programming-budgeting process. This Memorandum describes in a general way the basic principles of the new process.

Material presented herein is to be published in the Proceedings of the Long-Range Planning Seminar held at the Graduate School of Business Administration, University of California at Los Angeles, September 13-14, 1962.
SUMMARY

This Memorandum describes a new planning and programming process that was initiated within the Department of Defense in early 1961. The significant feature of this process is the approach that is taken to decision-making and control in the vital area of defense expenditures. Planning is considered in long-range terms of missions, forces, and weapon systems, i.e., resource outputs, rather than in terms of the standard appropriation categories of procurement, construction, personnel, etc., i.e., resource inputs. In the course of budget review, the need for quick decisions, with their obvious drawbacks, on major programs has been reduced considerably. The annual budget is now only an increment of a longer-range plan.

The new process incorporates an up-to-date, five-year force structure and financial program, expressed in terms of forces, manpower, and dollar requirements. Since this program requires a continuous type of budget review, a program change control system was developed to aid in achieving this requirement. In this system, approval thresholds are established to concentrate attention on the major current or prospective issues, this being an obvious application of "management by exception." These thresholds are in terms of total obligational authority requirements, for the current or budget fiscal year and on a total basis. A progress reporting procedure for about 200 of the most important material items is employed. Milestone schedules are established to reflect the events and activities upon which the financial plan is based. Actual accomplishment is reviewed monthly against the milestones and remedial action is taken or revisions are made to the five-year plan as necessary.

Although the new process is having a very large impact on financial management, as now administered it is leaving the traditional fiscal process relatively unchanged.
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I. INTRODUCTION

Early in 1961 the Department of Defense initiated a new planning and programming process for helping to achieve this nation's security objectives. The significant feature of this process is the approach that is taken to decision-making and control in the vital area of defense expenditures. This innovation is having a very large impact on financial management, but, as now administered, is leaving the traditional fiscal process relatively unchanged.

The Government in general, including Congress, and industry have shown wide interest in the new process. Variants of it may be expected to be adopted by other Government agencies. As a matter of fact, some agencies have already indicated more than a cursory interest in it.

Several major factors in recent years have created a new emphasis on unified financial and nonfinancial longer-range planning for the entire military establishment. Such planning is in terms of missions, forces, and weapon systems, which are the outputs of defense expenditures, rather than in terms of the standard appropriation categories.

The strongest factor has been the diminishing relevance of military service boundaries to the major missions or programs, such as continental defense or limited warfare. Today, a major program is no longer under the exclusive province of an individual military service, but rather, in varying degrees, is under the provinces of all the services. Therefore, a budget by service and in terms of the standard appropriation categories of procurement, construction, personnel, etc., is not truly reflective of such a program. Rough cost estimates by mission area have become less and less satisfactory as a means for meeting the growing need.

Actually, the Air Force was interested in mission-oriented cost analysis even before such costing acquired a strong interservice flavor. For at least ten years now, the Air Force has been concerned with assessing resource allocations for its strategic, tactical, and air defense responsibilities. Consequently, in 1954, definite proposals for a mission-oriented fiscal structure were developed within The
RAND Corporation.* Since then, resource estimates have been provided along mission lines in numerous RAND studies for the Air Force.

Beginning in the early 1950's, weapon systems, because of their extreme technical complexity and advanced sophistication, became enormously costly. This has made it more desirable, consequently, to anticipate cost and performance over the long term and to develop objective methods for selection of weapon systems from the vast array of possibilities afforded by modern technology. Cost-effectiveness analysis of alternative forces and weapon systems has therefore grown in importance. This technique stems basically from operations research in World War II. In recent years keen Air Force interest and a longer time horizon have given it a new vitality and a strong economic orientation.

The long development-production cycle of the typical modern weapon system has increasingly limited the value of annual budgeting as a planning tool. In addition, conventional appropriation categories in the defense budget have further limited the value of such budgeting. These categories have no readily understandable relationship to longer-term military planning in terms of forces, deployments, activity rates, etc. The appropriation categories concern resource inputs rather than outputs.

The interest of Secretary of Defense McNamara in planning and management sciences has led him to seek out those who could help him in this task. His interest has provided the needed impetus to effect a major management change in the immense and complex Department of Defense. Equally important, the extraordinary capacity of the Secretary to master the complexities of vast programs has given vitality and stature to the new planning tools. It is no small test of the new process that it has helped the Secretary and the Administration to make a case successfully for a substantial increase in essential

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defense expenditures over the previous level.

At the time that Assistant Secretary Hitch first took office, he projected the introduction of the new process over a period of several years. This span, however, was compressed by the Secretary, who set an initial objective of achieving planning guidance by major program and weapon system to govern the FY 1963 defense budget formulation.

The new planning-programming-budgeting structure consists of five major elements, which are: (1) a program structure in terms of missions, forces, and weapon systems; (2) the analytical comparisons of alternatives; (3) a continually updated five-year force structure and financial program; (4) related year-round decision-making on new programs and changes; and (5) progress reporting to test the validity and administration of the plan. These will be described later. With the establishment of this system the need has been reduced considerably for what Secretary McNamara has called "hectic and hurried"* decisions on major programs in the course of budget review. The annual budget now is essentially an increment of a longer-range plan.

The longer-range plan, it should be made clear, is a unified Department of Defense plan rather than an aggregation of separate service plans. However, each service is still encouraged to assess competitive means for accomplishing a mission in which it has an interest. In this way service rivalries are maintained on a more productive basis. Service primacy is a lesser subject for debate now than the relative importance of the missions and the potential contribution of each service. This may prove to be a primary advantage in the further implementation of a planning and programming framework in terms of missions, forces, and weapon systems.

With regard to implications of the new process for service organization, Secretary McNamara has disclaimed any significant influence of the new structure toward shifts of organizational responsibility from one service to another. He has in fact pointed out that the new process may serve as a substitute for such change. The actual execution of each mission is, after all, the responsibility of the

interservice and functional commands, which follow more nearly a
mission basis than do the services. Thus, the continued organization
of the services on a nonmission basis is no disclaimer of the impor-
tance of planning by mission.

The new process may, however, result in changes within each serv-
ice. Greater emphasis will very likely be placed on organization by
weapon (and support) system. First, the Air Force, then the Navy,
and now the Army are moving in this direction.

The change of emphasis from annual budgeting in terms of appro-
priations to longer-range planning in terms of missions, forces, and
weapon systems has naturally had an impact on financial improvement
programs. The emphasis on cost fostered by Public Law 863 is seen
now as only part of the answer to the objective of achieving "cost-
based" budgeting. Assistant Secretary Hitch in a speech to an ac-
counting group explained the relationship of the new to the old:*

Cost-based budgeting and accrual accounting deal
primarily with costs over shorter time periods
and with the performance of all of the many tasks
which go to make up an effective fighting machine.
The program system is concerned with costs over a
longer-period of time and with performance in terms
of acquiring and deploying the forces and equipment
in accordance with program goals and plans. Both
objectives are important, but we believe first
attention must be given to the accounting needs of
our programming system.

Much work remains to be done to derive the full benefits of the
new process. The discussion to follow will highlight the more impor-
tant remaining tasks. It will also explore the implications of the
new process for planning — in the Department of Defense, the rest of
the Government in general, and in industry.

*Remarks of Assistant Secretary Charles J. Hitch before the Federal
Government Accountants Association of Washington, Washington, D.C.,
April 12, 1962.
II. NEW PLANNING-PROGRAMMING-BUDGETING PROCESS

PLANNING AND PROGRAMMING

Planning and programming, which are words that will be used often in this discussion, are really aspects of the same process; they differ only in emphasis. Planning is the selection of courses of action through a systematic consideration of alternatives. Programming is the more specific determination of the manpower, materiel, and facilities necessary for accomplishing a program. In addition, except in the very short term where dollars are in effect "given," programming entails interest in the dollar requirements for meeting the manpower, materiel, and facility needs.

The new planning and programming process results in improved planning through the designation of major programs, and of program elements within them, as the units for planning and programming of forces, dollar costs, and manpower. Major programs are directed at the missions, specifically designated as: strategic retaliatory forces, continental air and missile defense forces, general purpose forces, airlift and sealift forces, reserve and guard forces, research and development, general support, civil defense and mutual assistance. Program elements are the forces, weapon (or support) systems, and similar types of integrated activities, by means of which the missions are accomplished. The B-52, Fleet Ballistic Missile, and Nike-Zeus systems are examples of program elements.

The subdivision of the entire defense program into over 800 program elements could not have been accomplished in the limited time available without deferring many possible questions regarding the scope of each program element. Since the scope of many program elements was not necessarily matched to existing appropriation activities or organizations, it was initially somewhat indefinite. Descriptive data reporting has recently been established on such items as program element performance measures, authorized strength and equipment, and concept of operations. This has alleviated the problem somewhat, but further study in this area is still required.
Particularly troublesome has been the question of the proper distribution of the costs of supporting activities. Although such activities are not in themselves output-oriented in the same sense as a B-52 squadron, they must have relevant portions of their costs allocated on some appropriate basis to the designated program elements. An installation or base, for example, may support two or more force units. More explicit rules must be developed to assure stability in cost distribution methods. Without this stability, comparison from one cost submission to the next cannot be meaningful.

Within this structure, planning decisions are made after comparing projected costs and effectiveness of feasible program choices. In such comparisons, a methodical examination of alternatives is made in terms of quantitative estimates of cost (including manpower, equipment, facilities, etc.) and of the expected military benefits to be derived from the systems. A typical comparison might involve the merits of buying more Minuteman squadrons versus more Polaris submarines. The illustrative formats for presenting cost-effectiveness data to the Secretary have been put into the Congressional Record by Assistant Secretary Hitch.*

The programming aspect of the process consists of a five-year force structure and financial program in terms of major forces, dollar costs, and manpower -- all by program element within each of the major programs. This relates financial to nonfinancial planning in a way that is not possible with the standard appropriation structure. The Basic National Security Policy, the Joint Strategic Objective Plan, and the service plans can now be meshed with the Secretary's five-year plan.

Funding considerations no longer need to be the overriding factor to which plans are adjusted. In a speech before the Electronics Industries Association, Deputy Secretary Gilpatric contrasted this type of planning process with the present one:

In the past, the Defense Department has often developed its force structure by starting with

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a budget and sending it off in search of a pro-
gram. Our new system of program packaging has
reversed this procedure, by first determining
our over-all strategy, then fitting the hardware
and the manpower to those objectives.

This does not mean that the over-all defense cost level is of no con-
cern. It certainly is, but arbitrary ceilings are no longer used.

Financial planning for a period longer than a year must always
carry the qualification that actual provision of adequate resources
cannot be guaranteed. If resource levels are changed, however, a
financial plan more directly translatable to program output simplifies
the revision of nonfinancial goals.

Financial planning in terms of major programs and program elements,
and budgeting in terms of appropriations are linked by use of the same
measure of cost -- total obligational authority. They are also linked
by use of planning and programming cost categories which can be related
by appropriations. The principal cost categories are research and de-
development, investment, and operations. These highlight the key decision-
points in the life of a weapon system. Each of the cost categories is
related in a simple way to several of the appropriation categories,
and, in time, it may be possible to achieve an even closer coordination
between the two classifications.

Translation of financial planning in terms of major programs and
program elements to budget activities can be made somewhat easier by
further analysis and revision of the program element structure. Ef-
fective work of this kind has already been accomplished in the research
and development and general support programs. The frequent costings
now required on a program element basis will compel increasing atten-
tion to programming-budgeting consistency and understanding of re-
lationships.

One of Secretary McNamara's objectives is to have at all times an
up-to-date, five-year force structure and financial program. Obviously,
such a goal can only be achieved by the use of some type of continuous-
review process rather than by the traditional, comprehensive annual
requirements review. Consequently, a new program change control system,
which is discussed in the next section, was developed to help attain
this objective.
Bearing on the administrative approach was the concern that approved programs must be carried out within the approved cost figures. Program decision-making would be limited in validity if, in fact, actual costs exceeded the levels upon which approvals had been based. This had been a frequent condition in the past. Advance authorization for cost variances from approval levels was necessary. This would make it clear, in the Secretary's words, that "a reliable cost estimate is an important factor and that those sponsoring the system are expected to personally assume responsibility for the accuracy of that cost estimate."*

**PROGRAM CHANGE CONTROL SYSTEM**

The program change control system represents the first effort by the Department of Defense to establish a general mechanism other than the annual budget for programming, decision-making, and control. **

The system fits closely Peter Drucker's definition of Planning. ***

> It is the continuous process of making present entrepreneurial (risk taking) decisions systematically and with the best possible knowledge of their futurity, organizing systematically the efforts needed to carry out these decisions, and measuring results of these decisions against the expectations through organized, systematic feedback.

Decision-making on individual programs rather than on comprehensive service submissions is the method chosen for maintaining the five-year plan. Approval thresholds are established in the program change control system to concentrate attention on major current or prospective issues -- an obvious application of management by exception. Several bases for submitting change proposals are used: program elements, major items of materiel and construction, and forces and manpower.

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This recognizes the variety of ways in which matters for decision present themselves, and the need to make decisions on a timely basis. In general, programs pertaining to new items are approved in stages -- research and development first and then investment. Thresholds are expressed in terms of total obligational authority requirements, for the current or budget fiscal year and on a total basis.

It would be desirable to encompass within one decision-making system all reviews and approvals made by the Office of the Secretary of Defense. This is presently infeasible, however, because of the complexity that would result from collecting in one instruction so many different bases for reference of matters to that Office.

Standard forms have been established for program change proposals -- one for research and development, and another for forces, investments, and operations. A major feature of these forms is the requirement for projected cost estimates, even for research and development programs. Together with the other data requirements, this is intended to promote decision-making in the context of estimates of long-range implications.

Staff review by the Office of the Secretary of Defense of program change proposals is accelerated by the designation, for each proposal, of a coordinating office, responsible for "spearheading" and integrating the review and proposing the response of the Secretary of Defense. Comments by the Joint Chiefs of Staff are furnished directly to the Secretary, with a copy to the coordinating office. The Secretary is not shielded from controversy, since the coordinating office is required to inform him of differences of opinion.

Only a relatively small number of program change proposals have thus far been reviewed and approved, but an accelerated flow is expected as a prelude to the formulation of the FY 1964 budget. Expe- ditious submission and handling of changes is essential to the effectiveness of the program change control system. The importance of the annual budget process in decision-making has, at least in part, been due to the fact that in the budget process, decisions must be made, whereas in other circumstances they can often be delayed or avoided entirely.
Although the program change control system permits decision-making on an individual program basis, it does not rule out a simultaneous consideration of competing programs. It does not imply that each program is reviewed without any regard to the relative importance of all defense programs and to the total resource requirement-level. This is why continuous analysis of the entire defense program is necessary.

Only summary type data are required in the initial submission of a change proposal. Upon approval of a program change proposal, the service that proposed the change is required to submit the revised program element summary data that make up the five-year force structure and financial program. If major materiel items or construction projects are involved, additional pertinent data must also be submitted. Deferring these more detailed data requirements until after Secretarial approval simplifies the submission of program change proposals and reduces the workload whenever approved amounts are different from proposed amounts.

In order to secure current data on changes of lesser magnitude than the Office of the Secretary of Defense thresholds and to reflect various costing and pricing changes, all data in the five-year plan are updated three times a year. Procedures for automatic data processing of these submissions are now being developed to meet the Secretary's summary and analytical needs.

**PROGRESS REPORTING**

The need for progress reporting on a program basis has been graphically stated by Secretary McNamara:

> The effective management of approved programs also requires a reporting system that keeps top officials constantly informed of the progress being made in achieving established objectives -- in both physical and financial terms on the basis of program entities and not merely in terms of the bits and pieces of programs financed in various appropriation accounts.

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*Annual report of the Secretary of Defense, op. cit., p. 27.*
As a major step toward effective control of new programs and changes to existing programs, the program change control system requires a progress reporting procedure for about 200 of the most important materiel items. Milestone schedules are established to reflect the events and activities upon which the financial plan is based. Each month the actual progress for the reporting month and the anticipated progress for the ensuing three months are compared with the milestones for the period, and the need for corrective action or for revision to the financial plan is evaluated and reported.

Progress reporting is also needed (but as yet is not implemented) for programs of an operating nature. Actual performance should be reported in relation to planned levels, using specific performance and workload indicators pertinent to the program element.

In the review of reports, attention must be concentrated on action regarding the exceptional. Financial plans may require revision.

MORE EXTENSIVE ANALYSIS

There is a vast amount of information associated with five-year planning. Effective use of these data by the Secretary of Defense and his principal advisors is dependent to some extent on imaginative staff analysis to highlight important trends, issues, and actions required.

An important need exists for a systematic exploration of future program costs associated with partial program approvals. For major weapon systems, such as the Nike-Zeus or RS-70, it is customary for Department of Defense management to approve first only the R&D phase of the program. Approval of investment is then contingent on success in the R&D phase. For realistic five-year planning, it is necessary to anticipate possible increments to the official program, predicated upon a variety of assumptions.

The five-year program is expressed in terms of forces, manpower, and dollar requirements. In the selection of the approved programs, cost-effectiveness and other analytical tools are used. Additional exploratory effort will have to be made toward the systematic expression of effectiveness measures for providing a quantitative statement of the output of programmed forces.
DEPARTMENT OF DEFENSE

The Department of Defense is now equipped with a comprehensive system for the continual programming of forces, manpower, and dollars -- a remarkable achievement for a 50 billion dollar a year organization, which since its inception has operated on a markedly different basis. Regardless of how sophisticated a tool the programming system is in translating plans into programs, it cannot of itself assure a high quality of planning. Here, one must recall the previous distinction between planning and programming.

In planning, one seeks a continual review of objectives and the means for their attainment. The preferred alternative remains preferred only as long as additional knowledge of program prospects in relation to competitive systems continues to support that choice. The concern is with weighing and evaluating, and applying all of one's knowledge in the process. In the cost-effectiveness analyses used in planning, detailed cost estimates, which are characteristic of operating budgets, are not required.

In programming, one moves closer to actuality and acquires a greater respect for stability. No longer are objectives challenged, as in planning; instead, attention is concentrated on translating preferred alternatives to reality. More precise costing is now in order, since one must be able to anticipate the budgetary consequence of approved programs.

Planning is of necessity a more informal process than programming, more a matter of attitude than procedure. One must be sure that as much attention and zeal go into the development and use of planning tools as into the development of a programming system.

Here, one must face up to the inherent limitations in planning for the acquisition of enormously complex weapon systems involving advanced technology. Such systems take years to bring from inception to operational status -- in an environment in which strategy needs may change even more rapidly. Accelerated development and production
of a desired weapon of designated capabilities require early decisions based on varying degrees of uncertainty. The effects of these uncertainties on cost estimates must be determined, since these will be important factors in decision-making.

A major uncertainty affecting cost estimates stems from the advanced performance characteristics specified for new weapon systems. Tests of developmental hardware may disclose performance shortcomings from design objectives, often resulting in additional effort and cost. Another important uncertainty stems from the present lack of knowledge in regard to the detailed composition, deployment and employment of future systems. Some assumptions may later prove to have been invalid, thus affecting the validity of the estimates. Cost factors and relationships may not have been realistic, perhaps because of a scarcity of data on similar hardware. It is not difficult to become somewhat distrustful of all weapon system cost estimates at the crucial stages for decision-making -- that is, during development and at the inception of production.

With so many uncertainties facing the military cost estimator, a premium is placed on experience and judgment. The proportion of experienced cost estimators to the growing workload is diminishing, partly because of the rapidly increasing demands engendered by the new planning-programming-budgeting process. The importance of increasing the over-all supply of military cost analysts has been recognized by the Air Force, which is considering the establishment of a career specialty supported by a special training program.

Other steps can be taken to improve cost estimating. Contractor cost reporting to the various elements of the Department of Defense is worth a new look, particularly in view of the introduction of PERT/COST. A need exists for a review of the specialized costing capability in each of the key hardware areas, covering the resource of the Government, industrial contractors, and nonprofit organizations. Also needed is a more systematic assessment of actual cost experience with newer weapon systems against the earlier claims.

In spite of the difficulties involved, cost-effectiveness analysis of alternative systems still remains one of the best methods for
selecting the preferred means of accomplishing national security missions. The new programming system will foster interest in such studies as well as support them through bringing together programs and costs by major program and program element.

DEFENSE INDUSTRY

There will undoubtedly be a profound effect on industry as a result of greater attention in the Department of Defense to systematic planning and programming. There will be an increased demand for contractor studies and longer-range projections from both the Military Departments and the Office of the Secretary of Defense. More emphasis will be placed on the quality of the cost estimates.

The concern of the Secretary that over-all costs of approved programs must not be exceeded without prior review and approval has been a primary motivation in the adoption of the program change control system. It will compel an earlier recognition by the services and their contractors of possible cost overruns, for the entire life of the program. Continuous cost estimating by industry will be required in the course of the program, not only for control but also for testing the validity of the original decision.

GOVERNMENT

The new defense planning-programming-budgeting process has aroused a good deal of interest in Congress and throughout the Executive Branch of the Government. The preparation of the FY 1963 budget as the outcome of a planning and programming process brought the subject closely to the attention of the House Armed Services and Appropriations Committees. Members were impressed with the Secretary's grasp of the defense program, and because of this, became more favorably inclined toward the process contributing to his understanding.
Though accepting the new process as an essential tool of planning, and even claiming some credit for its adoption, the House Appropriations Committee still wanted the budget format to be left unchanged. It is, of course, a virtue of the new process that it does not require a change in budget format. Planning and programming are simply superimposed on the budget and govern its substance, though not its form. The relationship is explicitly stated in the House Appropriations Committee report:

Basically, each annual appropriations bill is simply an additional annual increment to the longer-range Defense program.

In its study of the national policy machinery, the Jackson Subcommittee of the Senate Committee on Government Operations invited the testimony of officials from the Department of Defense and the Bureau of the Budget. The subcommittee expressed firm support for extended time horizons in budgetary projections, and for improved presentation of information to make the budget more useful in illuminating program choices and in measuring program performance. The final report emphasized the need for coordinating planning and budgeting:

Forward budgeting can be no better than the forward planning which underlies it. Many departments and agencies have had little experience with long-range programming -- and relating such planning to budgeting. Departmental planning staffs, traditionally, have only occasionally viewed themselves as co-workers of budgetary officers. The problem of developing the necessary planning skills and of creating a productive partnership between the planner and the budget officer is a vexing one. Its solution deserves, and will require, sustained effort.

The need was especially emphasized for more forward planning in the Department of State. The report also pointed out the importance of

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**Organizing for National Security, Staff reports and recommendations submitted to the Committee on Government Operations, United States Senate, by its subcommittee on National Policy Machinery, Volume 3, p. 97.
relating aid to foreign governments to a nation's self-help development programs and to assistance from international agencies or other outside sources:

Moreover, each part of the United States effort -- economic or military aid, loans or grants, or food for peace sales -- ought to be seen in the light of an over-all program.

A longer time span for foreign aid planning was urged.

The need for an extended budgetary time horizon was recognized in a study of the federal budget by the staff of the Subcommittee on Economic Statistics of the Joint Economic Committee. The generalized use of cost-benefit relationships was advocated as a means of achieving better budgets.*

In the Executive establishment, the Bureau of the Budget is encouraging the departments and agencies to plan, program, and budget on a longer time scale. The Bureau of the Budget, the Treasury, and the Council of Economic Advisers are cooperating in preparing longer-term economic projections.

The Department of Defense example, Congressional interest, and Bureau of the Budget sponsorship of longer-range planning should help accelerate interest within the Government generally in the kind of planning-programming-budgeting process used in the Department of Defense. Expressions of interest from a number of agencies have been received by both the Department of Defense and the nonprofit research contractors who have helped develop and install the new process. One may confidently expect that such interest will continue and grow -- as long as federal programs of broad scope must be conducted in a complex environment in which present decisions have consequences for many years to come.
