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90TH CONGRESS }
1st Session }

SENATE

{ REPORT
No. 394

ECONOMIC EFFECT OF
VIETNAM SPENDING

REPORT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

TOGETHER WITH

SUPPLEMENTARY VIEWS



JULY 7, 1967.—Ordered to be printed
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Mr. PROXMIER, from the Joint Economic Committee,
submitted the following

REPORT

together with

SUPPLEMENTARY VIEWS

ECONOMIC EFFECT OF VIETNAM SPENDING

INTRODUCTION

Total spending on the war in Vietnam during the fiscal year just ended will double the administration's original estimates. And there are already signs that actual spending on the war in the present fiscal year may again appreciably outrun first estimates.

While it is recognized that a degree of unpredictability is inevitable in estimating war costs, it became obvious in the course of the committee's consideration of the 1967 Economic Report of the President that the lack of accurate expenditure data during calendar 1966 handicapped the Congress seriously in reaching appropriate tax, spending, and other economic policy decisions.

The Federal Government's responsibility, as established by the Employment Act of 1946, to maintain relative stability in wages and prices while at the same time pursuing policies for optimum growth and full employment is not well served by enormous unpredicted deviations from initial budget estimates.

Had the Congress known earlier than it did, for example, that Vietnam spending in the fiscal year 1967 would outrun estimates by \$10 to \$12 billion, more serious consideration might have been given to taking the necessary steps to dampen the growing inflationary pressures without falling back on the excessive reliance on monetary policy that subsequently developed.

It will be recalled that the original fiscal 1967 estimate taken into account for purposes of economic policy planning was approximately \$10 billion. Late in 1966, however, the administration indicated that actual expenditures would be \$20 billion. The Joint Economic Committee, in its March 17 report, stated that this doubling of Vietnam expenditures produced disruptive effects in the economy and indicated a need for quarterly reporting to the Congress of anticipated budget expenditures. In the absence of such reporting, management of high employment policy carries an extremely heavy burden of uncertainty.

The committee takes some satisfaction in noting that the Bureau of the Budget, at the committee's instigation, has agreed to a system of *regular* budgetary reporting, with a report to be issued each July and another to follow at the close of the congressional session each year. These reports are a most constructive and necessary step.

In recognition of the great need for better information about defense expenditures, the committee also initiated a proposal for the regular release of defense information. We are gratified that the Department of Defense has agreed to begin regular monthly publication of a new report entitled *Selected Defense Department Indicators*. The first issue became available on June 30. Although much of the data in the new report were previously available, this new publication, for the first time, provides a single source of data about defense activities.

The Vietnam war has other ramifications with great significance for the domestic economy. Not only is there uncertainty about the actual

[NOTE.—Because of other congressional commitments, Representative Bolling was unable to attend the hearings and other committee deliberations, and as a result has no views in respect to this report.]

magnitude of spending on the war, but there is also uncertainty about the economic effects of these expenditures. Our knowledge of the precise extent and nature of the impact of military expenditures on the economy is inadequate. In addition, there is concern about what a cease-fire or deescalation might do to the economy.

It was for these reasons that the committee decided to undertake, as soon as was feasible, a brief inquiry into the domestic economic effects of Vietnam spending. The hearings took place over a 4-day period from April 24 through April 27. In their course, 14 witnesses were heard, both public officials and academic experts.

In addition to testimony from the Department of Defense and Bureau of the Budget, the committee heard from the Assistant Director of the U.S. Arms Control and Disarmament Agency. We were also privileged to hear from our colleague, Senator John Stennis, chairman of the Armed Services Preparedness Subcommittee, who provided us with an enlightening and stimulating statement. Expert witnesses were heard on the current and past impact of Vietnam spending in terms of its effects on firms and industries, as well as on regions and on the general economy. Testimony was also developed on the timing involved in military expenditure impacts; i.e., the relative lag or leadtime that must be taken into account in assessing effects. In addition, data were solicited on the subject of preventing a so-called deescalation gap and on some of the alternative results that might be expected to ensue from certain policy decisions that might be made on cessation of hostilities in Vietnam. Admittedly, prospects for an early cease-fire are not auspicious, but the committee felt that the need for advance planning and preparation warranted some inquiry now. Finally, the committee heard a discussion of alternative military manpower policies.

The list of witnesses follows in order of appearance:

Hon. Robert N. Anthony, Assistant Secretary of Defense (Comptroller)

Hon. Charles L. Schultze, Director, Bureau of the Budget

Hon. John Stennis, U.S. Senator from the State of Mississippi

Archibald S. Alexander, Assistant Director, U.S. Arms Control and Disarmament Agency

Robert W. Eisenmenger, vice president and director of research, Federal Reserve Bank of Boston

Roger E. Bolton, professor, Department of Economics, Williams College

Daniel B. Suits, professor, Department of Economics, University of Michigan

Murray Weidenbaum, professor, Department of Economics, Washington University

Wassily Leontief, professor, Department of Economics, Harvard University

Carl Madden, chief economist, Chamber of Commerce of the United States

Nathaniel Goldfinger, director of research, AFL-CIO

Walter Y. Oi, professor, Department of Economics, University of Washington

Thomas C. Schelling, professor, affiliated with Department of Economics and Kennedy Institute of Politics, Harvard University

Harold Wool, Director, Procurement Policy and General Research (Manpower), Department of Defense

It is obviously impossible in the course of brief hearings to answer definitively all of the economic questions raised by Vietnam. It is hoped that the hearings may serve as a stimulus to the administration as well as to private scholars to develop more knowledge on the subject as an aid to policy formulation. At the same time, the committee has been able to formulate certain general conclusions. While it is not possible, in a general report of this nature, to give appropriate weight to all of the fine analysis that our witnesses provided on this subject, such information is available in the printed hearings. It is the committee's hope that the testimony will prove valuable to Members of Congress as well as interested specialists throughout the country.

FINDINGS

1. Coordination

All in all, the emergence of rising military expenditures as a phenomenon in the economy creates a heavy responsibility for the administration under the Employment Act of 1946. That act declares it to be the "continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy * * * to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power."

As the committee construes this mandate, it incorporates policies for optimum growth and also for relative stability of prices and wages. A shortfall under either of these objectives would detract from the accomplishment of the act's major purposes.

As a corollary of this, the President has a clear responsibility to take prompt and adequate measures to counterbalance the effects of sudden increases (or decreases) in military requirements. Objectives of growth, full employment, and stability can only be served by timely and adequate action to prepare and recommend policies that are carefully designed to avoid dislocation, and particularly wage-price dislocations. There should be improved coordination established within the executive branch to assure these ends, and we commend this problem to the administration's attention.

2. Military expenditures

A. It is probable that actual expenditures for the Vietnam war exceed the official figures by an appreciable margin. The Department of Defense has conceded that it is somewhat unrealistic to establish a definitive distinction between Vietnam outlays and other defense disbursements. (See hearings, p. 17.) As a consequence, the incremental estimates used for Vietnam expenditures should be considered an *understatement*. While the absence of any better guidelines makes it necessary to use these figures, it should be realized that the full effect is probably greater than they indicate.

B. In terms of official figures, Vietnam new obligational authority outran the original estimates by \$14 billion in fiscal 1966, and \$12

billion in fiscal 1967. The size of these increments and their promulgation after the fact, as it were, had a disruptive effect on the conduct of fiscal and monetary policy. For example, had it been known early in the spring of 1966 that \$12 billion over and above the fiscal 1967 budgetary estimates would be appropriated for the Vietnam war, Congress certainly would have given more serious consideration to a tax increase or spending cut and quite probably would have enacted one or the other or both. Such action would have dampened the subsequent inflationary pressures and avoided the havoc caused by the excessive reliance on restrictive monetary policy in 1966 (see 1967 Annual Report of Joint Economic Committee, March 17, 1967, S. Rept. 73, for a more detailed criticism of these tight money measures and the effects upon the economy).

C. The same dreary cycle of events threatens again in calendar 1967. The committee has concluded that, on the basis of the straightforward and reasoned testimony of Senator Stennis, there will be an appreciable increase over the original estimate in spending for Vietnam during the calendar year. The estimate of \$4 to \$6 billion for fiscal 1968 strikes us as by no means an overstatement of the probable increase, and it remains to be seen whether or not even additional amounts will be required.

D. It follows that we again face serious problems with respect to making an adequate assessment of the public policy actions required to maintain high employment, growth, and relative price stability.

E. While the basic uncertainties can best be mitigated by the administration through greater efforts to anticipate and project military expenditures, and more timely conveyance to the Congress of their latest estimates—undertakings that this committee urges upon the administration most earnestly—there are specific measures that will help considerably.

One is the regular budgetary reporting; and second, is the regular reporting of defense contract awards. It is obvious that contract awards provide a guide to estimating future expenditure changes. Moreover, they have anticipatory effects which are important for economic analysis. And they have regional impacts which must be taken into account by those concerned with the formulation of economic policy. The new monthly Defense publication, *Selected Defense Department Indicators*, mentioned above, provides these important data. The committee appreciates the cooperation and assistance received from the staffs of the Department of Defense, the Bureau of the Budget, the Council of Economic Advisers, the Federal Reserve Board, and the Department of Commerce, in developing this report.

3. *Problems of deescalation*

Even though the annual cost of the Vietnam war probably exceeds by an unknown margin the \$25 billion figure that we use as an identifiable estimate, it probably does not exceed 4 percent of gross national product. And even with rumored increases, it would be unlikely to exceed 5 percent. There is no reason why the cessation of Vietnam hostilities should involve the same kind of shock to the economy that the ending of the Korean war produced. But avoidance of depressive effects will require a proper mix of fiscal and monetary policy. A reduction of defense expenditures will open up opportunities to choose among various policy alternatives such as tax reduction, increased

outlays for essential services, additional aid to State and local governments, or debt reduction.

One obvious need arising from the preceding point is for careful advance planning. The committee is gratified to note that the administration, under the leadership of the Chairman of the Council of Economic Advisers, has undertaken a detailed analysis of the problems of deescalation and the requirements for easing the economy over the transitional period. It is our intention to follow with great interest the results of these efforts, as well as to encourage their prompt fruition.

SUPPLEMENTARY VIEWS

While we are in agreement with the report of the committee, we feel strongly that there is one particular aspect of the committee's considerations which requires comment.

The committee devoted one session of its hearings to the economic costs of the U.S. military manpower system, including the implications for manpower policy of the high degree of comparability between skills required by military and civilian sectors. It is obvious on the basis of even a brief analysis that the war in Vietnam has created problems for our economy in the distribution of manpower resources. It has also created a serious problem of distributing equitably the burdens of service among our younger citizens. There is obviously a vast gulf in comfort, convenience, and opportunity for self-fulfillment between the young man in the military and his civilian counterpart. Other congressional committees have dealt with this difficult question of public policy. Our investigation was designed to examine the total economic costs of the present system and alternatives.

One alternative to the present draft studied during the committee's hearing is an "all volunteer" force. Under such a plan, draft authority would be retained and invoked during time of national emergency, but normally the armed services would rely on inducement through higher remuneration during the early years of service, particularly in the lower military grades. In effect, this proposal—which is really only a variation on the present system—would raise pay scales in lower grades sufficiently to make them competitive in the manpower market. Implicit is the need for the military to periodically improve pay and fringe benefits to remain competitive, much as municipal police and fire departments do.

One consideration forces itself upon the impartial observer; namely, the great inequity now involved in the inadequate reimbursement of lower echelon military personnel. We are of the opinion that serious consideration should be given to correcting this specific inequity and to evaluating in a more general way the total economic costs of the present system of military manpower procurement and of alternative proposals which might offer more efficient and equitable means of meeting our military manpower requirements.

We especially want to commend to the reader's attention the committee's hearing on military manpower held Thursday, April 27, 1967, contained on pages 292 through 360 of volume I, "Economic Effect of Vietnam Spending."

Representatives

THOMAS B. CURTIS
WILLIAM B. WIDNALL
DONALD RUMSFELD
W. E. BROCK 3d

Senators

JACOB K. JAVITS
LEN B. JORDAN
CHARLES H. PERCY