level of demand created a favorable profit outlook that afforded an attractive environment for new investment, adding still further to the total use of productive capacity.

The rise in war spending from an annual rate of $48.2 billion in the first quarter of 1965 to the rate of $65.5 billion in the last quarter of 1966 represented a total increase of $17.3 billion. Taking account of induced consumer expenditure, this increase was responsible for a total rise of $32 billion in annual GNP, and for roughly 3.2 million additional jobs. Unemployment declined from 4.8 to less than 3.7 percent of the civilian labor force, in keeping with the rising rate of output.

The 15-percent rise in GNP was, of course, a reflection of both rising physical volume and higher prices. Measured in constant 1958 prices, the overall increase in GNP was only 9.5 percent, the remaining 5.5 percent representing price increases. This can be compared with the preceding 2 years. The total GNP grew 11.6 percent from the first quarter of 1963 to the last quarter of 1964. The increase in physical output during this period amounted to 8.5 percent, prices rising only 3.1 percent.

The higher price pressure, which appeared early in 1966 was especially noticeable in food and raw materials. Although there were expressions of alarm over this development, and a call for tax measures to contain the inflation, it now appears that the price increases were merely the natural concomitant of the shift to a high employment economy. They could have been contained only by tax action heavy enough to hold the prosperity itself in check.

In fact, spending for the Vietnam war rose only slightly faster than the increase in productive potential provided by rising labor productivity and the normal growth in the labor force.

A useful way to examine the general impact of Vietnam spending on the U.S. economy is to go back over the events of the last 2 years, applying the statistical relationships mentioned earlier to remove the effects of Vietnam spending and the induced consumption that accompanied it. Below each historical series in the table is shown the corresponding magnitude after the calculated impact of Vietnam expenditure has been subtracted. The difference between the series is striking. The calculated output of the last quarter of 1966 is almost 4 percent below the level historically observed. The 4 percent is reflected in the figure for unemployment. In place of the erosion of unemployment as it actually occurred, we see a fairly steady rise to a recessionlike rate of 7.7 percent of the labor force. The general economic effect of Vietnam spending, therefore, has been to divert slightly more than 2 years of normal growth in economic capacity away from other programs and alternative uses.

The same table gives a good estimate of what would happen if Vietnam expenditures were cut back at the same rate they were built up. With no provision made to replace them with other much needed Government programs, or with tax reductions to release purchasing power to consumers, the impact of the cutback in defense expenditure would be on the order of a relatively mild recession. Figure 1 shows the development of unemployment implied by the defense cutback compared with the recession of 1958. The solid line in figure 1 marks the rise in unemployment during the recession of 1958. It began with an initial level of about 3.6 percent of the labor force unemployed in