

The key point is that the bulk of military production is carried on in the private sector. As a result, when there is a large expansion in military orders, as occurred in fiscal 1966, the immediate impact is not registered in the Government budget. The initial impact, in terms of demand for resources, is recorded by the Government contractors in the private sector.

Hence, during the early stage of a military buildup, we have to look at the private sector to see the expansionary effects. This is hardly a new phenomenon. The same type of underestimate contributed to the inflation in the Korean buildup. Unfortunately, the same mistake was repeated during the first year of the Vietnam buildup.

The most rapid expansion of military orders occurred in 1966. So did the most rapid rate of inflation since Korea. That was the period when the Nation, and particularly the administration economists, were still congratulating themselves on the success of the 1964 tax cut. Little need was felt, at least officially, for greater fiscal restraint.

To some extent, the inflationary pressures of the Vietnam buildup were accentuated by a liberal monetary policy in 1965, some of the results of which continued to be felt in 1966. Beginning in December 1965, however, the Federal Reserve Board took steps to tighten the availability of credit.

In fairness, some positive impacts of Government economic policy in 1966 should be acknowledged. The Nation achieved a large and rapid shift of resources from civilian uses to military programs, without direct controls over prices or wages. Moreover, economic growth and improvement in the living standards continued despite the defense spending increases and inflation.

In a sense, this post mortem may be too late. The demand-pull inflationary pressures of 1966 seem to have run their course. We do have a legacy of cost-push inflationary pressures which are likely to plague us later this year, particularly as major union agreements come up for renewal.

Looking ahead, however, in the near future the Nation may once again find itself in a situation where economic and fiscal policy fail to take account of the timing of the economic impact of Government spending. If that turns out to be the case, avoidable inflation or recession may occur once again.

Should another major escalation occur in the U.S. commitment in Southeast Asia, it would be important to promptly institute restraining fiscal measures to offset the inflationary impact.

Conversely, should peace come to Vietnam, it would be essential to promptly put into action expansionary fiscal measures to offset the immediate deflationary effects of a defense cutback. Most economists agree that the economy can successfully adjust to a defense cutback, or an expansion. The concern mainly is over our political willingness and capability to act promptly enough. The recent record is hardly reassuring.

As my final point, I suggest that this committee recommend a single simple but basic innovation: A regular monthly report, a set of military indicators, comparable to the economic indicators, presenting the basic unclassified data on military programs. This report should contain: