

and on the economy, was fairly clearly grasped by the public. The Pentagon estimated that it would spend \$72.3 billion in the fiscal year 1968, for all military operations—a figure larger than any earlier period except the peak of World War II. Total military expenditures, excluding military assistance to foreign nations, is estimated to be two-thirds higher than at the Korean War peak and about twice the level reached during the post-Korea low. Nevertheless, the fiscal 1968 estimate represents a leveling of the rapid upsurge in military demand which has occurred since the Vietnam War escalated in the summer of 1965.

In retrospect, it appears that the latter part of 1965 and most of 1966 constituted the period where the domestic consequences of this nation's commitment in Vietnam were not fully or generally understood. The year 1967 does not seem to be a period of equal uncertainty, although the possibility of another fundamental escalation in the level of the U.S. commitment persists. Hence, it seems both necessary and useful to review the earlier period in considerable detail, particularly in the hope of identifying some lessons for future economic policy.

B. The economic policy response in 1966

The January 24, 1966 Budget message of the President estimated that Department of Defense expenditures would rise from \$46.2 billion in fiscal year 1965 to \$52.9 billion in 1966 and \$57.2 billion in 1967. On both a cash and national income accounts basis, the Federal Budget was estimated to be in approximate balance in fiscal 1967; on the administrative budget basis, the deficit of \$1.8 billion estimated for 1967 would be a reduction from the \$6.4 billion deficit envisioned for fiscal 1966.³⁵

On this basis, the President stated in the January 1966 *Economic Report* that, "The fiscal program I recommended for 1966 aims at full employment without inflation."³⁶

The January 1966 Budget Message called for several steps that would increase Federal revenues, notably putting personal and corporate income taxes more nearly on a pay-as-you-go basis and temporarily reinstating the excises on passenger automobiles, and telephone service which had just been reduced.³⁷

On the expenditure side of the budget, despite statements on economy and efficiency, the customary items were found in the details of the document. For example, it was recommended that the Department of Agriculture start construction of 35 watershed projects and 1600 miles of forest roads, that the Bureau of Reclamation start work on three new projects with a total cost initially estimated at \$1 billion, that the Corps of Engineers start building 25 new rivers and harbors projects and begin designing 23 more, that the General Services Administration finance construction of 33 government office buildings and design 10 more, and that the Government Printing Office acquire additional buildings.³⁸

The January 1966 Budget did not contemplate the firm policy of no new starts on public works projects that was maintained during the Korean War. It appeared, at least to many observers, that the Nation could afford simultaneously to wage a two-front war without raising taxes, the domestic war against poverty and the war in Vietnam. That theme was clearly stated in the Budget Message:

"We are a rich nation and can afford to make progress at home while meeting obligations abroad—in fact, we can afford no other course if we are to remain strong. For this reason, I have not halted progress in the new and vital Great Society programs in order to finance the costs of our efforts in Southeast Asia."³⁹

Secretary McNamara's testimony on the military budget in February 1966 clearly showed that the Administration was discounting any inflationary impact of the Vietnam buildup:

"As you can see, by itself, the defense program should not be a major factor contributing to inflationary pressures. I say this even though you are now considering a \$12.3 billion supplemental to the fiscal year 1966 defense budget . . . defense expenditures will, in effect, be no more of an inflationary element in

³⁵ *Budget of the United States Government for the Fiscal Year Ending June 30, 1967* (hereafter referred to as *1967 Budget*), p. 11.

³⁶ *Economic Report of the President, January 1966*, p. 10.

³⁷ *1967 Budget*, p. 9.

³⁸ *Ibid.*, pp. 192-322.

³⁹ *Ibid.*, p. 7.