

In the early February of 1967, the annual hearings before the Joint Economic Committee on the President's Economic Report were the occasion for some attempts at clarification of the earlier budgetary procedure. Senator William Proxmire, the Committee Chairman, opened the discussion of the underestimate of Vietnam expenditures with the following statement:

"... in 1966 our Government made a serious economic policy blunder. Our fiscal policy was established early in 1966... on the assumption that the Vietnam war would cost \$10 billion... it is clear to me that we would have reduced spending and/or increased taxes—possibly both—if we had better and more accurate information."

The initial reply was given by Gardner Ackley, the chairman of the President's Council of Economic Advisers. He stated that one half of the difference between the original estimate of the cost of Vietnam during the fiscal year 1967 (\$10.2 billion) and the revised estimate (\$19.4 billion) reflected the assumption that the war would terminate by June 30, 1967. "The other half reflects the fact that there was a more rapid and efficient buildup of forces in Vietnam than had been initially considered possible, and second, increased requirements resulting from more intensive hostilities than had been initially assumed."⁵²

Mr. Ackley contended that the problem was "not a failure of communication," but due to the "uncertainty of the situation." The tenuous nature of the assumed June 30 termination was brought out during the subsequent dialogue between Senator Proxmire and Budget Director Charles J. Schultze:

"*Chairman Proxmire*... This assumption that the war would end on June 30, 1967, becomes more fantastic as I think about it, because, of course, the war could end on May 1 or June 1, and we still would have been \$10 billion off, or very close to it. So we not only assumed that the war would end on June 30, but we assumed we would know about it well in advance, and we could have slowed down our procurement so we couldn't have procured anything to fight in the period subsequent to July 1, 1967, isn't that correct?"

"Mr. Schultze... I can't answer that yes or no."⁵³

D. The underestimate of the initial economic impact of Vietnam

The second factor explaining the growth of inflationary pressures in the American economy in 1966 relates to the point developed earlier in this study—the leads and lags in measuring the impact of government spending, and specifically in understanding how a military buildup affects the economy.

The key point is that, under our private enterprise system, the great bulk of military production is carried on in the private sector of the economy. As a result, when there is a large expansion in military orders, as occurred in fiscal 1966, the immediate impact is *not* felt in the government budget.

The initial impact—in terms of demand for labor, materials, and resources generally—is felt by the government contractors in the *private* sector. Hence, particularly during the early stage of a military buildup, we have to look at the private sector to see the expansionary effects. As pointed out earlier, this is hardly a new phenomenon. This timing relationship was the factor that contributed so greatly to the inflation that accompanied the first year of the Korean mobilization.

By just looking at the Government's budget during fiscal year 1951, it seemed that the public sector was following a policy of fiscal restraint. Policy officials generally overlooked the almost doubling in the volume of defense orders to private industry during that same period. Unfortunately, the same mistake was repeated during the first year of the Vietnam buildup. *The most rapid period of expansion in military contracts to private industry occurred in 1966; so did the most rapid rate of price inflation in recent years.* But that was the period when the Nation and particularly the Administration's economists were still congratulating themselves on the success of the 1964 tax cut and little need was felt, at least officially, for greater fiscal restraint.

Some detailed analysis of this point seems to be in order. As a benchmark, it may be recalled that in fiscal year ending June 30, 1965 total contracts placed, orders let, and other "obligations" incurred by the Department of Defense were about \$54 billion. The concept of obligations is used here because it is a generic term, including both government payrolls and contracts with private firms. In

⁵² *Ibid.*

⁵³ *Ibid.*