Vietnamese were primarily responsible for the more passive missions, such as pacification and defense of Government centers. Total American troops in South Vietnam exceeded 400,000 by the end of 1966.

In restrospect, it appears that the U.S. role in Vietnam changed from support and advisory to active combat when the South Vietnamese no longer could defend themselves successfully against the combined onslaught of the Vietcong and massive infiltration of North Vietnamese equipment and manpower.

It is futile to speculate as to anyone's ability to have forecast these developments prior to their occurrence. However, it is necessary to note that the uncertain nature of future developments in Vietnam continually clouded the public and private analyses of their enfolding impact on the Treasury and on the American economy.

The evolution of the U.S. role in Vietnam could scarcely be inferred from the day-to-day statements of Administration spokesmen such as Secretary McNamara. On various occasions in 1963–64 he stated that the war was to be fought by Vietnamese and not U.S. troops. In 1965, after U.S. troops were in combat, he stated that the South Vietnamese would bear the brunt of the fighting. The purpose here is not to criticize the inability to make accurate forecasts under extremely difficult conditions, but to emphasize the great uncertainty that existed in evaluating the impact on our domestic economy of the expanding U.S. commitment in Vietnam.

From the point of view of demands on the resources of the American economy, the Vietnam war really had its initial impact in the fiscal year 1966, the 12-month period July 1, 1965 to June 30, 1966. Prior to that time, the Budget Bureau estimated that the additional costs of Vietnam were $100 million or less a year, a rather insignificant factor in a $50 billion military budget or a $700 billion economy.

The January 1966 Budget Message, in constrast, estimated that the Vietnam war would require $14 billion of appropriations in fiscal 1966 and $4.4 billion of expenditures. It appeared at the time, at least to many observers, that the Nation could afford to wage a two-front war without raising taxes, the domestic war on poverty and the war in Vietnam. That theme was clearly enunciated in the Budget Message and in the President's January 1966 Economic Report. In the later document, he stated that, "The fiscal program I recommend for 1966 aims at full employment without inflation" and that "this budget provides . . . for the maintenance of basic price stability."

In retrospect, things did not work out so well. Although the unemployment rate declined below 4 percent, the year 1966 witnessed the most rapid period of price inflation since the Korean War. The basic explanation would appear to be that—despite the assurances in the Economic Report—the increases in government civilian and military demand, coupled with the continued expansion in business expenditures for new plant and equipment, exceeded the capability of the economy to supply goods and services at then current prices. Several factors help to explain the circumstances. One factor was the underestimate in defense spending. The January 1966 budget projected the cost of Vietnam at $10 billion in the fiscal year 1967 and the current estimate is almost double that.

Another factor is a bit more sophisticated. It relates to the lack of understanding of 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. 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