

DEFENSE SPENDING AND THE ECONOMY

At their peak in World War II, defense requirements absorbed almost half of total and 80 per cent of durable goods output.¹ Understandably, apprehension was widespread that post-war reconversion of industry to civilian production would plunge the economy into deep depression, especially since most of the wartime increase in production had come from previously unemployed manpower and machinepower.

But the opposite was the case.² Instead of deflation and depression there was inflation and a boom in business; and unemployment stuck at 4 per cent of the civilian labor force until the brief recession of 1949. The ease of the 1946-48 economic adjustment to reconversion and the buoyancy of the civilian economy during the Korean War presumably accounted for the absence of similar worries about reconversion at the War's end in 1953.

Discussion has recently flared up, however, regarding the economic problems of defense spending, evoked in part by the attainment of "overkill" capacity by both the United States and the USSR and by the 1963 Nuclear Test Ban Treaty between these two powers. The current debate stresses certain features of our present defense program, some of which are encouraging and some are not.

Among the encouraging aspects are the facts that (1) defense expenditures are a much smaller proportion of total economic activity currently as compared with 1945, accounting for less than 10 per cent of Gross National Product (in 1945 the figure was 40 per cent); and (2) between 1945 and 1946 national security expenditures were reduced by 80 per cent (measured in 1960 dollars), whereas current indications are that there will be a gradual tapering of such outlays on the order of 30 per cent over a twelve-year period and from a smaller relative base.

On the other side of the picture, however, current defense procurement is highly concentrated with respect both to type of industry and geographical region. Furthermore, a large share of defense work is being done by specialized contractors who have never produced for the civilian market. Thirdly, unlike the 1946-48 situation, since 1959 the national unemployment rate, until quite recently, regularly exceeded 5½ per cent. Finally, according to the calculations of the President's Council of Economic Advisers the economy has grown at a slow rate since 1955, causing it to fall 5 per cent short of its full-employment potential.³

The first two points invite a favorable comparison with the post World War II readjustment to disarmament. Although the remaining points imply a novel type of readjustment problem, different in character from the 1946-48 and 1953-54 transitions, their magnitude is questionable. For example, regarding economic growth, real GNP is likely to show a gain of 5 per cent in 1964 from the 1963 level serving to narrow the gap between actual and potential GNP.

The purpose of this booklet is to discuss these problems and assess their importance in the light of the current literature on the subject.

THE NATURE AND EXTENT OF DEFENSE EXPENDITURES

Outbreak of the Korean War in 1950 boosted our annual spending for defense and related programs in 1963 dollars by \$24 billion to a rate of \$45 billion in 1951 and to a maximum of \$65 billion in 1953. Most of the increase went for military equipment and other goods and services bought from the business sector. Reduction in 1953-54 by \$11 billion in this type of spending was a leading factor in the 1954 recession. Since that time Cold War tensions have caused these outlays to rise from \$49 billion in 1955 to \$56 billion in 1963, with only slight fluctuations in the intervening years.⁴ The rate in the first half of 1964 was substantially unchanged from 1963.

The trend of defense expenditures (in dollars of 1963 purchasing power) for the period 1947-64 is shown on Chart I, below:

¹ Herman E. Krooss, *American Economic Development*, Prentice-Hall, Inc., New York, 1955, p. 463.

² For an evaluation of this development, see W. S. Woytinsky, "What Was Wrong in Forecasts of Postwar Depression?" in *Journal of Political Economy*, April 1947.

³ *Economic Report of the President*, Washington, D.C., January 1964, Chart 4, p. 38.

⁴ Emile Benoit and Kenneth Boulding, Eds., *Disarmament and the Economy*, Harper & Row, New York, 1963, pp. 272-273; *Manpower Report of the President*, Washington, D.C., March 1964, pp. 155-156; U.S. Arms Control and Disarmament Agency, *The Economic and Social Consequences of Disarmament*, Part II, Washington, D.C., July 1962, pp. 7-8; *Econ. Report of Pres., op. cit.*, p. 209.