6906174609

ECONOMIC EFFECT OF VIETNAM SPENDING

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETIETH CONGRESS

FIRST SESSION

APRIL 24, 25, 26, AND 27, 1967

Volume I:
Statements of Witnesses
and
Supporting Materials

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE
78-516 WASHINGTON : 1967

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402 - Price $1.00

06-B4182

JOINT ECONOMIC COMMITTEE

[Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.]

WILLIAM PROXMIRE, Wisconsin, *Chairman*
WRIGHT PATMAN, Texas, *Vice Chairman*

SENATE	HOUSE OF REPRESENTATIVES
JOHN SPARKMAN, Alabama	RICHARD BOLLING, Missouri
J. W. FULBRIGHT, Arkansas	HALE BOGGS, Louisiana
HERMAN E. TALMADGE, Georgia	HENRY S. REUSS, Wisconsin
STUART SYMINGTON, Missouri	MARTHA W. GRIFFITHS, Michigan
ABRAHAM RIBICOFF, Connecticut	WILLIAM S. MOORHEAD, Pennsylvania
JACOB K. JAVITS, New York	THOMAS B. CURTIS, Missouri
JACK MILLER, Iowa	WILLIAM B. WIDNALL, New Jersey
LEN B. JORDAN, Idaho	DONALD RUMSFELD, Illinois
CHARLES H. PERCY, Illinois	W. E. BROCK 3D, Tennessee

JOHN R. STARK, *Executive Director*
JAMES W. KNOWLES, *Director of Research*

ECONOMISTS

WILLIAM H. MOORE — GEORGE R. IDEN
JOHN B. HENDERSON — DANIEL J. EDWARDS

DONALD A. WEBSTER (Minority)

CONTENTS

ECONOMIC EFFECT OF VIETNAM SPENDING

MONDAY, APRIL 24, 1967

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The joint committee met pursuant to notice, at 10:05 o'clock a.m. in room 1202, New Senate Office Building, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Symington, and Jordan; and Representatives Moorhead, and Curtis.

Also present: John R. Stark, executive director; and Daniel J. Edwards, staff economist.

Chairman PROXMIRE. Today we start the Joint Economic Committee hearings on the past and future impacts of Vietnam spending on the U.S. economy. As I pointed out during our hearings on the President's Economic Report, "Lack of accurate expenditure information handicapped the Congress seriously in reaching appropriate tax, spending, and other economic policy decisions."

Our present purpose is to obtain clarification on three basic questions:

First, is Congress being adequately informed on the rate of change of defense expenditures right now? That is, are they going up, as some interpret, or are they going down, as others interpret?

Second, what impact on our manpower and resources is the Vietnam war now having? I cannot recall any time in our history when the Congress has attempted to assess the full economic impact of a war. In this sense, we may be pioneering, in this inquiry, in a most important aspect of economic policymaking, because we all know the immense and significant and often changing impact that wars have had in the past on our economy that undoubtedly this war is having.

Third, if the President is successful in terminating Vietnam hostilities, are adequate contingency plans available for conversion of the "wartime" uses of our resources into peaceful pursuits.

As background to the first question, let us review briefly the past record.

In August 1965, Secretary McNamara requested a supplemental of $1.7 billion over and above the original budget request to finance military obligations. Then in January 1966, testifying on supplemental appropriations requests for 1966, the Secretary requested $12.3 billion in new obligational authority. It appears that this figure was based on the assumption that the war would be terminated in June 1967, that is, June of this year.

The request for the fiscal year 1967 was based on a similar postulate, that is, that military operations in Vietnam would continue through

June 1967. In effect, the Department of Defense had assumed an artificial cutoff in its underlying assumption. In August the Secretary indicated to the Appropriations Committee that funds were probably insufficient but that they were not in a position to make any estimates at the time on supplemental needs. While it must have been fairly obvious that costs of the Vietnam war were outrunning funds, Congress was not able to obtain an estimate of the additional amount required until late November 1966 when it was indicated that expenditures would be some $10 billion higher than originally estimated.

Now we are assured that the budget requests submitted for the fiscal year 1968 are based on more realistic assumptions. They do not have an artificial cutoff date. Even so, there are now rumors abroad—I should say charges—by very well-informed Members of Congress, that there will be a very sharp increase in our troop commitment in Vietnam with attendant increases in expenditures, so that this committee and other committees of Congress face the same old problem of trying to assess our economic performance and prospects in the face of highly uncertain figures on expected military expenditures.

Quite appropriately our hearings will start with the Department of Defense. Assistant Secretary Anthony is a most competent public official and I know that he has an impressive mastery over the facts and figures. We are pleased to hear from him now.

Mr. Anthony.

STATEMENT OF HON. ROBERT N. ANTHONY, ASSISTANT SECRETARY OF DEFENSE (COMPTROLLER)

Mr. Anthony. Mr. Chairman and members of the Joint Economic Committee, I have a statement that with your permission, I would like to read.

Chairman Proxmire. Yes, it is a good statement, I wish you would.

Mr. Anthony. I am grateful for the opportunity to appear before this committee to discuss a topic of vital importance to the management of our economy. While always a subject of concern to policymakers, the economic impact of defense expenditures assumes a special importance during and immediately after our involvement in hostilities.

At first glance, defense expenditures may not seem to constitute a major factor in our economy. Expenditures of the Department of Defense, including the military assistance program, will amount to only 8.9 percent of gross national product in fiscal year 1967, which incidentally is exactly the same percentage as that in 1962. However, these expenditures have an importance beyond their absolute magnitude, for two reasons. One is the fact that defense expenditures have not only a direct effect, but also an indirect impact through the workings of the multiplier phenomenon. The other reason is that defense expenditures can be volatile, particularly when a sudden change in the level of defense activity is necessitated by changes in the world situation. At such a time, the Defense Establishment is required to make a rapid adjustment in its plans in order to meet the requirements of a new contingency. Such an adjustment has effects on employment, investment, and inventories in the economy at large. Moreover, this impact is uneven; there is a major effect on certain industries and certain regions, and much less on others. Economic strains are also felt in disengaging from a war effort. Thus, it is important that accurate estimates of defense expenditures and obligations be prepared for the use of economic policymakers in framing the fiscal and monetary policies with which they seek to minimize the strains involved in making such adjustments.

Department of Defense Forecasting Techniques

It is important to appreciate the fact that although we *forecast* the expenditures in a given year, we do not *control* the expenditures. Congress does not appropriate in terms of expenditures; it appropriates in terms of obligating authority, that is, authority to obligate the Government—to contract for the acquisition of goods and services. Control is exercised over the placing of contracts, but expenditures arise whenever a contractor sends us a valid invoice under the contract. We do not control the timing of these invoices. When we get a valid invoice, we pay it just as promptly as we can. Our forecasts are, therefore, estimates of when these payments will be made.

We develop these forecasts by projecting the annual increment of expenditures for each of the fiscal year programs within an appropriation account. Each of the 76 Department of Defense appropriation accounts is examined separately, and a spending pattern is established for it based on historical behavior. These patterns differ greatly for the various types of appropriations. At one extreme is "Retired pay," in which we spend well over 99 percent of the program amount in the year for which the appropriation is made. At the other extreme is the "Shipbuilding" appropriation, for which the typical pattern is that only approximately 13 percent of the amount appropriated is spent in the first year, 12 percent in the second year, 25 percent in the third year, and so on for a total of 7 years. The expenditures for the various procurement appropriations spread over periods that vary from 3 years to 7 years.

After receiving the appropriation for a new ship, for example, we must complete the plans for the ship, seek bidders, and award the contract. The contractor then proceeds to order the material and to build the ship. It follows that the expenditures associated with this ship are quite small during the design phase, they rise gradually as the first material arrives and is paid for, they reach a peak as actual construction proceeds, and then they taper off.

These patterns of spending display a reasonable degree of consistency over time, but, of course, they are not absolutely stable. In the early 1960's, for example, as we shifted away from the cost-plus-fixed-fee type of contract and toward incentive types, there was a definite effect on expenditure patterns. Similarly, the exigencies of a buildup, such as we have experienced in recent months, tend to speed up expenditures, and for this reason we have established special patterns for those portions of appropriations that are specifically related to Southeast Asia activities.

These patterns are the basis for our forecasting model. The model itself is technically simple. Historical spending patterns are plotted for each appropriation. Forecasts are then made of the percentage of total expenditure of the funds appropriated for each year which will be spent in the year for which the forecast is being made. In making each forecast, we do not simply read a figure off a graph of historical spending patterns. Rather, we make a judgment for each appropriation based on the recent trend of existing programs, the trend of the patterns from year to year, the changing composition of the program content and the urgency of the requirements. Summed together, the projections for the 76 individual appropriations provide an estimate of expenditures for the Department of Defense. Each year, the expenditure patterns for the individual appropriations are replotted to take account of the past year's experience. These forecasts are checked against similar forecasts prepared by the military departments and Defense agencies.

In recent years, the forecasts have proved to be quite accurate. In fiscal year 1966, for example, the forecast contained in the President's budget, including the increment projected for the supplemental appropriation, was $54.2 billion, actual expenditures were $55.4 billion. However, the model is no better than the inputs, that is the figures for new obligational authority, the unobligated balances from previous years, and the spending patterns. If, in any given year, the Congress should alter the scope or composition of requested funds, or should a contingency develop that requires a significant supplemental appropriation of funds, actual expenditures obviously would be thrown off from the original projections.

The Department normally makes three official expenditure forecasts for each fiscal year. Taking fiscal year 1968 as an example, the first estimate is the one contained in the President's 1968 budget submitted in January 1967; the second estimate will be made in the budget review document, which will be published in the fall of 1967 after the Congress completes its appropriation action; and the third estimate will be given in the President's fiscal year 1969 budget, submitted in January 1968, based on actual experience for the first 5 months of the fiscal year. In addition, the Department cooperates closely with other executive agencies by informally providing them with up-to-date estimates. Especially close contact is maintained with the Bureau of the Budget and with the Council of Economic Advisers.

An event such as the Korean war or the current Vietnam conflict creates problems in defense financial planning as well as bringing stresses to the economy at large. Disruptions occur in the patterns of defense obligations, expenditures, production activity, and inventories. Government and industry people alike know that defense spending will increase, but no one knows how large the increase will be, or how it will affect specific sections of the economy.

Many ways of coping with this problem have been used, with varying degrees of success. Some business firms adjust their inventories and hire new employees in anticipation of increased work. Other firms make no adjustments until they actually receive new contracts. Government financial planners similarly can adjust in either of two basic ways. They can make a guess as to the extent and rapidity of a buildup and immediately request the corresponding obligational authority as a lump sum amount. Alternatively, they can wait, internally adjusting available obligational authority to meet new requirements, and base a supplemental request on later, more complete information.

There are many possible shadings of these two approaches, but between them lie the potential courses of action.

In the Korean war, the Department of Defense attempted to make immediate best guesses as to the size and duration of the conflict, even during its earliest stages. This procedure led to severe estimating problems. At first, it was assumed that the war would be of quite short duration, and fund requirements were adjusted accordingly. Several months later, Red China entered the war, and this required a substantial revision of the estimates of the extent of our financial requirements. In fiscal year 1951, the first year of the war, the Defense Department came to the Congress with three separate supplemental requests. Supplemental requests were also made in each of the following 2 years. Each of the initial budget submissions was based on an assumption that the war would end at the conclusion of the fiscal year being budgeted for.

These estimates of funds needed turned out to be considerably overstated. The magnitude of the overstatement is readily apparent from the following figures: The Department of Defense requested a total of about $164 billion for the military functions for the 3 fiscal years 1951–53; the Congress appropriated a total of $156 billion; the amount actually expended was $102 billion; and the unexpended balances rose from $10.7 billion at the end of fiscal year 1950 to $65 billion by the end of fiscal year 1953. It took 5 years to work the unexpended balance down to about $32 billion. During the 4 fiscal years 1955–58 no additional funds had to be appropriated for Army procurement; the Army lived off excess funds appropriated during the war.

A major problem with such a financial planning policy is that it is much harder for both the Congress and the executive branch to exert effective budgetary control when the outstanding amounts available for obligation far exceed actual needs.

In order to avoid problems of the sort encountered during the Korean war, we consciously tried to learn from that experience, and we chose a very different approach for financing the current conflict in Vietnam. Our commitments for Vietnam began a rapid expansion early in fiscal year 1966. In less than 4 months we deployed 100,000 men to Vietnam. During the fiscal year, we added 439,000 men to our Armed Forces. During the same period, the Vietcong and North Vietnamese military strength was also rising rapidly. At the time, it was virtually impossible to estimate how rapidly our commitments would rise, or when they would level off. Against such a background, estimation of financial requirements and calculation of resulting expenditures could not be made with any degree of confidence for more than the few months in advance for which relatively firm deployment plans did exist.

And yet, it was just at this time that the fiscal year 1967 budget request had to be prepared. The problems in selecting assumptions on which to base this budget were manifold. Meaningful planning as much as 18 months in advance was most difficult, given that we were then still on a sharp buildup curve in our deployments to Vietnam. The eventual requirement for forces was still quite uncertain. The scope of the air activity rested on still unmade military/political decisions.

Furthermore, we had little experience on which to base estimates of attrition, wearout of equipment, and consumption of munitions and supplies of all kinds. The Vietnamese situation was in many respects quite unlike the Korean conflict, and the activity and consumption rates developed during that conflict were therefore very inadequate as indicators of the rates to be expected in Vietnam. The central point I want to make is that the outlook at the time the fiscal year 1967 request was prepared was clouded by a high degree of uncertainty.

In view of this uncertainty, we decided to construct the fiscal year 1967 budget on the arbitrary assumption that combat operations would be financed through June 30, 1967. Translated into Defense financial policy, this meant that funds were not included in our request for the purchase of items that would be needed in fiscal year 1968 and beyond, should the conflict continue. Therefore it was apparent that if the conflict was thought to continue beyond June 30, 1967, or if activity rates increased beyond those forecast, then additional funds would be needed before the year was over. In accordance with this assumption, we developed a budget with requests for new obligational authority of $59.9 billion. Based on this budgetary request, we estimated that fiscal year 1967 Department of Defense expenditures would total $58.3 billion.

Between January 1966, when the fiscal year 1967 budget was presented to Congress, and October 1966, when it was enacted, major developments occurred in the Southeast Asia situation. A possible end of the period of rapid buildup of forces became foreseeable, and the dimensions of the probable extent of our eventual commitment began to emerge. It became clear to everyone in the executive branch and the Congress that we could not with prudence assume that hostilities would cease by the end of fiscal year 1967. Furthermore, the current rate of buildup was exceeding the rate assumed in the preparation of the fiscal year 1967 budget.

Some suggested that the fiscal year 1967 budget should be amended in the summer of 1966, but there still was not a good basis for estimating the total needs for fiscal year 1967. For example, at one stage the Congress added $549 million to the appropriation bill for additional military personnel costs, whereas the actual additional requirements for military personnel are now estimated to be closer to $1.4 billion, almost three times as much.

Therefore, instead of requesting an amendment on the basis of inadequate estimates, it was decided to operate with available funds. This required reprograming actions, and these were submitted to the congressional committees in accordance with normal practice.

Mr. McNamara fully explained the policies that were being followed in testimony before congressional committees in the summer, and Chairman Russell of the Senate Appropriations Committee and Chairman Mahon of the House Appropriations Committee explained the situation on the floor. On August 18, Senator Russell stated "If the buildup in Vietnam continues at the present rate, I do not think there is any question that there will be a very substantial supplemental request the first of the year, which may be $10 billion; it may be more." On August 25, Congressman Mahon said, "It is generally estimated that a supplemental will be required next year * * * in the sum of $5 billion to $15 billion."

Early in 1966 we had only a feel for a broad range in which the supplemental might fall. As the year proceeded and the level at which our buildup would likely flatten became more apparent, we were able to narrow the range of our estimates. In contrast with the unsubstantiated broad estimate that would have been necessary if the request had been submitted earlier, the supplemental request submitted in January 1967 was based on a careful analysis of requirements, and was prepared and submitted in the same detail as our regular budget requests. Hence, the authorizing committees and the Appropriations Committees were able to examine it just as they examine any budget submission.

Our revised estimate of expenditures during fiscal year 1967 made at this time called for an additional $9.7 billion.

At the time we were making our estimates of the size of the needed supplemental appropriations and the resulting expenditure impact, other executive agencies and various Members of the Congress were making their own expenditure estimates based on projection of trends and comparison with the previous year. Subsequent events have shown that several of these estimates were quite accurate. The point is, though, that we in the Department of Defense could not, solely on the basis of our early estimate, develop in good faith a supplemental budget request any earlier than we eventually did and still adhere to the principle of requesting funds only on the basis of specific requirements.

In preparing the fiscal year 1968 budget, we were able to follow a quite different planning assumption from that used in the preceding year. Our basic assumption for fiscal year 1968 was that the war would continue indefinitely at level of activity indicated in our current projections. Accordingly, we included in the fiscal year 1968 budget funds for the procurement of items for periods ranging from 6 months to 18 months beyond the end of fiscal year 1968, the length of time being governed by the procurement leadtime for each of these items. Thus, barring an unexpected significant change in the level of activity in Vietnam, or a new contingency elsewhere in the world, the fiscal year 1968 budget as submitted does represent a statement of our total foreseeable defense needs for that year. The main reason why we chose to base the fiscal year 1968 budget on this different set of assumptions was that we felt that we had a much better basis for judging the extent of our eventual needs than we had had the year before. By the end of calendar year 1966, the major portion of our projected force buildup was already completed. There was a much higher degree of confidence in our projected plans and forecasts when we appeared to be near the end of the curve representing our force building. Also, we were beginning to obtain attrition and consumption data for Vietnam and therefore were no longer required to use the obsolete rates based on the Korean experience.

Posthostilities Planning

While we have chosen to budget for fiscal year 1968 on the basis that hostilities will continue indefinitely, we at the same time are making preparations for the contingency that they might end at any time. In dealing with a situation characterized by as much uncertainty as the Vietnam conflict is, it is of course essential that we develop plans in order to insure that we will be ready to alter our programs as soon as a major change becomes discernible.

One of the keys to a successful transition is the right inventory policy. In peacetime, we must maintain large mobilization reserves of inventory, so that the combat forces can be adequately supported between the time hostilities begin and the time that additional material flows from expanded production facilities. Once this expansion of production has occurred, however, we no longer need this degree of inventory protection. We can instead rely on the then existing production lines. Thus, during hostilities, inventories can safely be maintained at lower levels than is necessary in peacetime. We call this level the "hot-base" level, the level that is necessary when a hot production base exists.

When hostilities end, inventories must be built up to the "cold-base" levels, the levels necessary to sustain us when production lines are cold. This buildup provides an important cushion in the transition period. Instead of an immediate cessation of all Southeast Asia related production when hostilities cease, we can plan on a gradual reduction, using the excess output above the then current consumption needs for the buildup in inventory.

The implementation of this general policy is, of course, difficult because while the conflict continues, we must assure that current production is at least great enough to meet consumption requirements at the end of the production leadtime, and this is at least 6 months, and maybe as long as 18 months ahead. To be on the safe side, we inevitably do some overbuying, and this means that inventories of certain items will be higher than they should be when hostilities cease, but as a general proposition, we expect to be able to make the gradual transition that I have outlined.

Parallel to our internal planning efforts, a number of executive agencies are grappling with the broader question of the impact of a cessation of hostilities on the U.S. economy. The Arms Control and Disarmament Agency has sponsored a number of studies touching on problems of economic adjustment to a curtailment of defense activities, and we have cooperated actively in its efforts. And as you know, the President has asked Gardner Ackley, Chairman of the Council of Economic Advisers, to organize a major, coordinated effort among the executive agencies to review our readiness to make the economic adjustments which a termination of hostilities in Vietnam will require.

The Department of Defense is actively participating in this planning effort and has members on several of the working committees. We anticipate that our principal contributions are likely to consist of estimated changes in expenditures and in the numbers of military and civilian personnel employed by the Department under various assumptions as to the character of the posthostilities situation. In addition, we probably will be providing the working groups with some predictions of the regional impacts of adjustments in our procurement programs.

It would, of course, be inappropriate for me to speculate on the findings of this examination. I will offer the one comment that it would seem well within our capabilities to plan for and execute a smooth transition from support of our participation in the Vietnam conflict to a full peacetime economy. Our expenditures related to Southeast Asia, amounting to $19.4 billion during the current year, constitute only approximately 2.5 percent of the GNP. By comparison, an indication of the Korean war's impact on the economy is the fact that the Department of Defense expenditures increased from 6.7 percent of GNP in fiscal year 1951 to 12.2 percent in fiscal year 1952. An additional important reason why the post-Vietnam adjustment will not be so relatively large is that by keeping a tight rein on aircraft and ammunition procurement, to cite two major examples, we have handled our finances in such a way as to moderate the impact of the military buildup on the economy. All this effort is for naught, though, unless careful attention is given to the task of conversion to peacetime uses for resources. Thus, the most important assurance we have that a smooth transition can be accomplished is that the thorough planning effort needed is already underway.

I can give a preliminary idea of what the magnitude of the planning problem is. We have made a rough estimate that the incremental cost to support our role in Vietnam will be $21.8 billion in fiscal year 1968. By incremental costs, I mean the costs over and above the normal costs of the defense establishment. These so-called "normal" costs are assumed to be the annual costs as they existed at the end of fiscal year 1965, adjusted for price changes and changes in activity not related to Southeast Asia. The increase of $1 billion in our stragetic forces program from $7.1 billion in fiscal year 1965 to $8.1 billion in fiscal year 1968 is a good example of the latter type of adjustment. Of this $21.8 billion, we estimate that operating costs will be $11.4 billion, split $5.1 billion for military personnel and $6.3 billion for other operating costs. Ammunition consumption we estimate at $4.8 billion, aircraft and helicopter attrition at $1.7 billion, equipment and spares consumption at $3.1 billion, and construction at $800 million.

I am sure you understand that it would be completely fallacious to subtract this $21.8 billion from the $73.1 billion expenditures for 1968, and conclude that the posthostilities budget of the Department of Defense will be $51.3 billion. Obviously, future Department of Defense expenditures will be a function of developments in requirements for our non-Vietnam programs. It is impossible to predict now how these requirements will change. Furthermore, the posthostilities budget will be affected by wage and price changes. Wage increases have added a billion dollars a year to personnel costs in recent years. Payments to retired personnel increase approximately $200 million annually, quite independently of current activities of the Department. Prices of purchased goods and services have risen an average of almost 4 percent annually since fiscal year 1965. For these reasons, the task of making posthostilities estimates is much more complicated than a matter of subtracting one figure from another.

There are problems and challenges involved in trying to determine economic policy while we are engaged in or disentangling from a major military conflict. During such periods, the timing and scope of policy adjustments assume critical importance, while projections upon which the policy recommendations must be based are unusually difficult to make. The financial planners at the Department of Defense face similar problems, and our estimates reflect similar uncertainties. Our objective is nevertheless clear. It is to manage the financing of the Vietnam conflict in such a way that, while providing full support to our forces, we minimize the financial risks to the Government and the taxpayer.

Senator PROXMIRE. Well, thank you very much, Mr. Anthony, for a noble effort. We certainly appreciate it.

Mr. Anthony, the reason that this committee is concerned about this, and certainly the reason I am concerned about it, is because the policies of your Department have such a decisive and substantial effect on our economy.

Last year, as you know, we had a very sharp increase in prices during the first 8 or 9 months, an unacceptable increase. Also, we had the highest increase rates we have had in 40 years, which were cruel and punishing.

Many of us feel that if we had had accurate, timely information we could have done one of two things: We could have either increased taxes to take the pressure off the economy or we could have cut spending or maybe both. We did not have that, and in your presentation, which, I think, is technically very competent, and, I am sure, completely sincere, it is hard for me to tell whether there was any real consideration given to the effect of, not of policy, but of the disclosure to the Congress and to the public of what the estimates of the Defense Department are just as soon as those estimates can be at all firm or reliable or even an improvement on the basis of the estimates that you have had before.

You see, what I am asking for is not the kind of thing which I think you had properly delineated, the changes in inventory policy, which are very interesting and, perhaps, very helpful to the economy, but whether or not there has been adequate consideration given to a change in disclosure policy, information policy, to the Congress.

Mr. ANTHONY. May I make two comments on this? First, and I think most important for your purposes of obtaining the best information you can possibly get for the future, is the fact that the problem was especially difficult during this period of an extremely rapid buildup, and we should have a much easier job of making forecasts in defense expenditures from here on than we have had previously. Therefore, this problem should not exist in the future as long as hostilities continue at approximately the planned present rate.

Chairman PROXMIRE. Let me interrupt you right at that point. Exactly because the situation was uncertain and was hard to determine, isn't this precisely the reason why the Congress should have been given more frequent estimates instead of waiting until we had gone home?

Mr. ANTHONY. I want to address that in just one moment. I do not want to leave what I have just said unfinished without saying: let us face it; there is going to be another problem in the phase down. On the buildup there was a problem. On the phase down there is going to be another one; the problems of estimating under those circumstances are also going to be difficult.

Now let me come back to the other part of your question. I tried to explain why the estimates of obligations from which expenditures——

Chairman PROXMIRE. You did a good job of explaining.

Mr. ANTHONY (continuing). Are derived are extremely difficult to forecast during a buildup phase.

I think the example of the $549 million of military personnel costs which somebody thought was the right amount at one time, and which turned out to be only about a third of the right amount, is an indication not of anybody's error, but just of the difficulty involved in making forecasts at this phase.

I do not think that these difficulties in forecasting or in the publication of official revised figures actually prevented the people interested in the economy from making pretty good forecasts of what was going to happen. For example, I know——

Chairman PROXMIRE. That is right.

Let me interrupt you at that point to say this is the whole point. You see, these people were able to make pretty good estimates, but we never had confirmation from the official source. We had different Members of Congress and the economists making estimates. But the Defense Department, which is the source of the best information, refusing to make their own estimate, leaves us in the dark, and it means it is very hard for us to shape wise policy. It is hard enough to persuade Congress to either increase taxes or cut spending, and if we do not have the kind of hard information from the most reliable source it is almost impossible.

Mr. ANTHONY. Well, sir, I do not think it was a case of refusing to make up-to-date estimates. In our own internal estimates of what was going to happen in view of the speedup, and the implications of obligations already appropriated by the Congress, we went at it, I think, not essentially different from the way a lot of other people went at it. A favorite formula which turned out to be quite close as it happened, was to observe that in 1966 expenditures by quarters were roughly $12, 13, 14, and 15 billion, and then to go on to say that in 1967 they will be $16, 17, 18, and 19 billion. That adds up to $70 billion, which is pretty close to the actual expenditures for 1967.

Well, that was one way of estimating, assuming a straight line continuation of the buildup, and it turned out to be not too bad.

Chairman PROXMIRE. Let me read you a quotation from a man I think is eminently qualified in this area, Senator John Stennis, chairman of the Preparedness Subcommittee of the Senate Armed Services Committee, who is going to be our leadoff witness tomorrow morning. He said on October 13, and I quote:

> I do not make the assertion that we planned this war on a piecemeal basis lately. The facts establish in many cases this is all too true. It is certainly true in the area of funding. The requests of the Congress for the money needed to finance the war may be deferred until the last possible moment. For example, even with the requirements of escalation staring us in the face, Congress was told as late as July of last year that the fiscal year 1966 budget request covered all the months which were then foreseen to be needed by the military forces.

Let me repeat that:

For example, even with the requirements of escalation staring us in the face the Congress was told as late as July of last year that the fiscal year 1966 budget request covered all the funds which were then foreseen to be needed by the military forces.

It was not until Secretary McNamara returned from his trip to Vietnam that we were informed that a supplemental appropriation would be inevitable. Even so, despite an open invitation by Congress, Defense authorities then refused to present a realistic estimate of the actual requirements which had been generated as a result of hostilities. The matter was delayed until January of this year. We were then presented with a supplemental request for $12.7 billion.

Now, I do appreciate the assurances that you are giving us again that you are firm and you have indicated in your statement that you are firm on your estimates for 1968. You do not think that they are going to increase very much. I want to ask you if you still feel that way in view of the statistics disclosed in the Economic Indicators, which are as follows: In February of 1966 the Department of Defense military $4.2 billion; March, $5.2 billion, that was last year.

Now, this year they have accelerated from $4.2 billion in February to $5.5 billion this year and in March to $6.6 billion this year. This is between a 25- and 30-percent increase.

Now, perhaps this is just about what you would expect, but I want to make sure it is, and I want to know if the April expenditures are running at about the same level because, if there is anything at all in the picture which would cause you to modify or caution us on the possibility of an increase—a very well informed Senator said this yesterday, that he had good information that some 100,000 additional troops may go to Vietnam, and we do not want anything that is classified, of course, in this room, but we do want to have the best estimates you can possibly give us, because we do have a responsibility for advising the Congress on economic policy, and we cannot do it unless we get your information as firm as possible.

Mr. ANTHONY. Let me first go back to the early part of your comment and then discuss our current situation as I see it.

Chairman PROXMIRE. Right.

Mr. ANTHONY. I think Secretary McNamara made great efforts to explain to the Congress, beginning when he presented the budget in January or February 1966, the assumption on which it was based—the fact that should the situation change, then additional requirements would have to be submitted. Indeed, the statement he made several times—I think Senator Symington heard him make it—was something like "I don't know whether this budget is too high or too low, but I know it is not exactly right." He was trying to express at that time the uncertainties that existed.

Chairman PROXMIRE. When did he say he did not know it was too high or too low, roughly?

Mr. ANTHONY. Did he not say that before your committee some time either in January or February, Senator Symington?

Chairman PROXMIRE. He said he thought it was too low——

Mr. ANTHONY. Yes, quite possibly.

Chairman PROXMIRE. Too high, rather.

Mr. ANTHONY. Certainly. It could have been too high. By hindsight we are now looking at a situation in which the conflict did, in fact, continue. This is 13 or 14 months after we were talking. It was conceivable that the conflict would have ceased.

Chairman PROXMIRE. Well, even if the conflict ceased May 1, even if it ceases before the June 30 deadline, you still have a terrific underestimate. It is almost a joke that you missed by 100 percent, and this is not a department that has not been meticulous about its estimates and about its figures. You have a fine and hard-earned reputation for it. That is the thing that is very, very hard for me to understand—how a department headed by Secretary McNamara, who is so very careful to do his best to get information as precise as possible, missed by such a fantastic amount and then said that, according to you, he did not know if he was not overestimating.

Mr. ANTHONY. I think we are talking about different Mays. You are thinking about May 1967. If, in May 1966, hostilities had ceased, this budget would have been too high.

Chairman PROXMIRE. Yes. I thought you were making the assumption though that the war would end on June 30, 1967, end of the fiscal year.

Mr. ANTHONY. For the purpose of formulating the budget.

Chairman PROXMIRE. That is right. Even if it does end before that time you are still way low in your estimate.

Mr. ANTHONY. Looking at the situation in April 1967 we know that the estimate made in January 1966 was too low. But looking at the situation in January, February, and in the spring of 1966, it certainly could have turned out to be too high. If hostilities had terminated at that time, it would have been too high.

I now find the reference on the Secretary's statement I alluded to earlier. On February 23, 1966 before the Joint Senate Armed Services and Appropriations Committees, he said:

"I don't want to mislead you into thinking that I believe we have estimated them"—that is, the budget request—"accurately. We have either overestimated or underestimated, but we have made the best estimate we can."

Chairman PROXMIRE. My time is up.

Senator Jordan?

Mr. ANTHONY. Mr. Chairman, I did not address the latter part of your question.

Chairman PROXMIRE. Is that all right, Senator Jordan?

Senator JORDAN. Yes, please do.

Mr. ANTHONY. The situation currently is as follows: March expenditures are in. At $6.7 billion they are a little higher than I thought they were going to be.

Chairman PROXMIRE. Give us a little better understanding of what you mean by "little." What did you estimate for that?

Mr. ANTHONY. Well, I thought we would be closer to $6.4 billion.

Chairman PROXMIRE. And they are $7.7 billion you say?

Mr. ANTHONY. $6.7 billion.

Again the $6.4 billion estimate was my personal opinion; all of these estimates are personal opinions. We have been trying to figure out whether expenditures in the past few months indicate a trend. We are not sure that they do. In March, as it happens, there were three paydays instead of two as there are in the average month. There were 23 working days, about the most working days you can have in a month, as compared with 21 in the average month. All of these things tend to make me think March is a little higher primarily for abnormal reasons than suggesting any substantial upward trend. However, March being high, the third quarter, therefore, is a little higher than I thought.

We still may come out to $68 billion for 1967. I think it may still be possible—it is a little tight, though. I do not think the difference is going to be very much, and it may not be any. In order to come to $68 billion for the year, we have to have $17.4 for the fourth quarter. This is still higher than the second quarter. It is a little lower than the present third quarter. All of this means the second quarter was lower than we thought it was going to be, and the third quarter was higher. There probably was some shifting between quarters which tended to distort the figures.

So my general answer to your question is that we are not changing our forecast of $68.0 billion now, but we are watching this very, very carefully, and we may be led to change it somewhat—by $500 million to $1 billion, something of that order, I would say.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you.

Mr. Anthony, the 1967 budget request was prepared on the assumption, as you have stated, that the war—the hostilities—would cease by June 30, 1967. The chairman has gone into some of the vast discrepancies that appeared in that planning. Even if the war were to cease by June 30 of this year—tell me why—what was the reason for the change in policy. You say that "Our basic assumption for fiscal year 1968 was that the war would continue indefinitely at levels of activity indicated in our current projections"?

So you have changed from the assumption in the 1967 budget that the war would terminate at a time certain to one of indefinite duration.

Mr. ANTHONY. Yes.

This, incidentally, was an assumption never made during the Korean war. Each budget during the Korean war was based on the stated assumption that the war would terminate before the beginning of the next fiscal year.

I am sure you would agree one has to make some assumption. One does not know when the war is going to terminate, and in this very complicated, vast exercise of building a budget everybody has to work on the same set of ground rules.

In the budget for 1967, had we gone to the other assumption then, we would not only have had to estimate the speed of the buildup and the rate of the buildup, but also the point at which it would level off and continue thereafter, then we would have had to translate all of these physical things into monetary terms by the application of attrition rates and consumption rates based on the Korean experience. The end result would have been an extremely unsatisfactory set of figures because everything was so uncertain at that time.

So it seemed much preferable to make the assumption we did, one that did not require so much guessing far out into the future, make that assumption perfectly clear to everybody—and we certainly tried to make it clear at the time—and then recognize that, should hostilities continue or should activity rates increase, we would have to request more funds.

In 1968, as I have tried to indicate, we are in a much better position to make reasonably accurate estimates. We can see the end of the buildup. We have better attrition rate and consumption rate data. Consider, for example, attrition rates. In order to make an estimate of aircraft procurement requirements in the 1968 budget under the new assumption we have to estimate the losses of aircraft through the end of calendar year 1969. That is a long way off, and the farther out you extend your estimates the more "guessy" those estimates become

These still are not going to be right, you know; even our current estimate of attrition rates are certainly not going to be exactly right, but it is a lot easier to make meaningful estimates now than it was a year ago.

I think that is essentially the difference.

Senator JORDAN. But are you not shifting from one extreme to another? In the first instance you planned on cessation of hostilities by June 30, 1967, and now you are planning that the war will go on indefinitely.

Mr. ANTHONY. I do not think it is quite right to say that in either case we are planning such and such a thing. We are—

Senator JORDAN. You are budgeting on that premise.

Mr. ANTHONY. We are building a budget on a certain assumption.

Senator JORDAN. Yes.

Mr. ANTHONY. I think really those are the only two ways you can build a budget. Those are essentially the two choices. You either build it on the assumption that hostilities will terminate at the end of the budget year or you build it on the assumption that they will go on indefinitely.

Senator JORDAN. When the Vietnam war does terminate, do you anticipate that the U.S. forces and defense spending will be reduced to pre-Vietnam levels?

Mr. ANTHONY. I think it is very premature to make any estimates of what will happen. Studies are going on. One cannot know in the actual world what period of time we are talking about. What expenditures will be reduced to is the level needed to support the Defense Establishment at that time.

That level will depend on our commitments at that time, force requirements to meet those commitments, and on the prices of those, taken altogether, which is an unforeseeable set of facts.

Senator JORDAN. Over how long a period of time do you anticipate the conversion to peace will occur? You talk about going from "hot base" to "cold base" levels, and how long a time do you anticipate that transition might take?

Mr. ANTHONY. I think it useful to split this period down into two parts. The first period is when hostilities have ceased but you are uncertain as to whether they have ceased for good. The length of this period is completely unpredictable.

Then the other period—and I think that it is this second period you are talking about——

Senator JORDAN. Yes.

Mr. ANTHONY (continuing). Is when we are convinced that they have ceased for good.

I think the Korean war indicates that the time required to get down to the peacetime level is 2 years or so. It is certainly not as short as 1 year, and it may be longer than 2 years. It is, say, approximately 2 years. If we work things right, we will be able to carry out, not an abrupt termination but a gradual phasing down.

Senator JORDAN. A gradual phasing down?

Mr. ANTHONY. Yes.

Senator JORDAN. Last January President Johnson called for a major coordinated effort to review our readiness for peace, and, as I understand it—and you remarked about it in your statement today—the Chairman of the Council of Economic Advisers, Mr. Askley, is coordinating that program.

However, could you tell us on the basis of your own role what has been accomplished specifically to date?

Mr. ANTHONY. I think there are others more competent than I to talk about the total Government effort. But talking about the effort in the Defense Department, we are working out various sets of what we call scenarios, possible things that might happen when hostilities terminate.

I do not personally regard individual scenarios as very important, because there are so many different ways in which hositilities might terminate. But some specic activities which are part of this whole effort and which were going on much before this coordinated effort started are, I think, quite significant.

In the first place, we have a posthostilities plan; our 5-year defense program always has a year of peace assumed in it, and so we know at any moment of time what we are aiming for when hostilities cease.

In the second place we are working out policies, i.e., what our policies will be under various posthostilities circumstances. We are also getting people to understand these policies and to discuss them.

In the third place we are working out procedures—that is, ways of making certain that we can take quick action when the need for action arises.

Another very important part of this planning process is having accurate information. We have major efforts underway to get up-to-date information on our most important inventory items so we will not be in the dark as to what to do about those items when hostilities cease.

I think all of these things are important parts of the effort to make a smooth transition to the post-Vietnam situation.

Senator JORTAN. You remark that the pattern of spending is not absolutely stable, and this we know, and you said, "In the early 1960's we shifted away from the cost-plus-fixed-fee type of contract toward an incentive type, and there was a definite effect on expenditure patterns," when this was done.

This committee has been very much interested over the years in moving from cost plus to other types of procurement. Could you tell us for the record how fast that progress has been? What percent of our present purchasing is on an incentive or bid basis and what percent is still cost plus?

Mr. ANTHONY. I am sorry. I do not have those figures; I will be glad to put them in the record, but the increase has been dramatic over this period of time.

(The following information was later supplied for the record:)

In fiscal year 1961, 37 percent of our contracts were of the cost-plus-fixed-fee type, and 63 percent were fixed-price, cost-plus-incentive-fee, or some other incentive type. The cost-plus-fixed-fee type dropped to 32 percent in fiscal year 1962, to 21 percent in fiscal year 1963, to 12 percent in fiscal year 1964, and to 9 percent in fiscal year 1965. In fiscal year 1966, despite the pressures of the buildup, the percentage was still only 10 percent.

Senator JORDAN. For that we commend you. This has been a major concern of this committee. Thank you.

Chairman PROXMIRE. Thank you, Senator Jordan.

Senator Symington?

Senator SYMINGTON. Thank you, Mr. Chairman.

Mr. Anthony, let me commend the way you present your position. But I would like to know how much you think this war is costing. Prior to the last appearance of Secretary McNamara I asked the staff of the Senate Appropriations Committee about the cost of the war. They estimate around $2.5 billion a month—total, $30 billion.

I asked the Secretary of Defense how long he felt the cost of the war could continue on the basis of $2.5 billion a month without affecting, perhaps in serious fashion, the American economy. His answer, as I remember it, was, first, he thought it was nearer $2 billion a month than $2.5 billion. Secondly, he felt the costs could continue forever.

I am interested in the cost of this war. It seems nobody has come up with the normal cost accounting you would have in a large industrial, or in other branches of Government.

You surprise me when you say, "At first glance defense expenditures may not seem to constitute a major factor in our economy." That is some statement.

At second glance, however, apparently you think it is. Have you been to Vietnam?

Mr. ANTHONY. No, sir.

Senator SYMINGTON. One goes around Cam Ranh and the other installations and watches the billions of dollars that are being shelled out for that type and character of construction. When you read the amount of money involved, to say it may not constitute a major factor in our economy, is hard to understand.

It is the largest single expenditure in our economy, is it not?

Mr. ANTHONY. Most certainly. I would not debate anything. My sentence is a lead-in to the paragraph which goes on to say that defense expenditures are, of course, very important; that is the main point I am trying to make.

Senator SYMINGTON. I have had longstanding differences with the Pentagon on this GNP ratio analysis.

You say, "Our expenditures related to Southeast Asia amounting to $19.4 billion during the current year constitute only approximately 2½ percent of the gross national product."

Are you telling this committee that the cost of the war, under sound accounting principles, now amounts to only 2½ percent of the gross national product of the United States?

Mr. ANTHONY. As I have discussed with you before, Senator Symington, we do not have a cost accounting system for the Vietnam conflict. I think you and everyone agrees that one does not set up a cost accounting system for a war.

Senator SYMINGTON. I do not quite understand what you mean by that statement. Do you mean we do not have a system designed to find out what is the true cost of the war?

Mr. ANTHONY. We do not have an accounting system, a system of debits and credits that has a set of books called Southeast Asia in which we put as debits for all the amounts of money tagged with Southeast Asia.

Senator SYMINGTON. I know you only have single entry bookkeeping, without assets on one side and liabilities on the other. As the chairman pointed out earlier, at times you have been pretty far off; but is there no place where you check how far off you are, or are not, when you estimate the actual cost of the war?

Mr. ANTHONY. No, sir, and I would be glad to expand on that a little bit if you find this an undesirable thing.

Let me explain what the figures that we have tried to put in the statement do mean. They really result from requests that you and others made last summer that we try to come up with an estimate of the cost of the war. Now, there were two essential approaches we could take to that. One is what is called an allocated cost approach in which we would try, for example, to include a part of Secretary McNamara's salary, and all of the other allocations associated with the costs. We decided that was not really the better approach and was not the one you were interested in.

Senator SYMINGTON. Could you let me interrupt there? I want to listen, but want to be sure I understand.

Cost consists of material, labor, and overhead. Overhead can be divided into variable and fixed. You can establish your variable overhead, and can take a percentage of fixed overhead. That being true, inasmuch as the heat is so much on the Congress about the heavy cost of the war, is it not possible to estimate material costs and variable overhead—labor cost is obvious. If you want to split part of your fixed overhead, fine.

But it seems to me the basic elements of cost especially when you are working on a resultant basis—not extrapolation—it disturbs me that here are three different estimates of the costs of this war: One from the Senate Appropriations Committee, $30 billion a year. Another from the Secretary of Defense several months ago, closer to $2 billion a month. Then you have a figure here of some $19 billion.

I know the trials and tribulations of costing any product, but I do think that somewhere, sometime, somehow, the American people should know the cost of this war. We are not getting it in the Appropriations Committee, nor in the Armed Services Committee. You would say $19 billion?

Mr. ANTHONY. Certainly I would, and I think my figures are not inconsistent with Secretary McNamara's because when he was talking, I am sure he was rounding to the $2 billion a month. We are here using the same figures. His estimates of the cost of the war are the estimates my people work out.

Continuing my description of how we developed cost figures, I think I was saying that this allocated cost approach is not the figure you want. We do not, for example, see any great point in trying to depreciate the ships and other major equipment items that are involved, even if we could.

Instead, we went to an incremental cost approach. I think this is what you had in mind when you said labor, material, and variable overhead.

We have tried to estimate incremental costs associated with Southeast Asia. This cost is certainly greater than the cost, say, of the people that are in Southeast Asia, because our whole support establishment has expanded because of Southeast Asia.

Senator SYMINGTON. That is what I wanted to ask. As example, take the tremendous expansion on Guam, also the large expansion on Okinawa, both incident to B-52 operations. Are they all in the $19.1 billion figure?

Mr. ANTHONY. Yes, sir.

Senator SYMINGTON. Are the costs incident to the transferring of troops from Germany, retraining of pilots? Are such costs also in the $19.1 billion figure?

Mr. ANTHONY. They are in there. They are intended to be in there. We do not build it up in that amount of detail, but they are in there as part of the operating costs, which is what you are now talking about.

What we did was to take the 1965 operating costs, adjust that for price changes that have occurred since 1965, net out other known changes in non-Southeast Asia programs, and say the remaining costs in succeeding years were Southeast Asia related. I think therefore, we are automatically picking up the kind of things that you mentioned even though our system does not go into Guam and split the costs on Guam between non-Southeast Asia costs and Southeast Asia costs. The system just plainly does not work in this way.

Senator SYMINGTON. These expenditures are what you are talking about?

Mr. ANTHONY. No, the figure of $21.8 billion that I give you for 1968 is a cost figure.

Actually in the buildup phase many different types of figures float around because obligations, expenditures, and costs are three different concepts, quite different concepts, and in the buildup phase they are radically different numbers. In a level-off phase, they all are about the same. So when I say $21.8 billion—if you will permit me to round it to $22 billion—$22 billion is really pretty close to obligations, expenditures, and costs for Southeast Asia.

Senator SYMINGTON. For the period of?

Mr. ANTHONY. One year.

Senator SYMINGTON. Ending next June 30?

Mr. ANTHONY. June 30, 1968. Our cost figure for fiscal year 1968 is $21.8 billion. Our cost figure for fiscal year 1967 is $19.5 billion. Our expenditure figure for fiscal year 1967 is $19.4 billion.

Senator SYMINGTON. Then for the fiscal year 1968, starting next July 1 you estimate that the total cost of the war in Vietnam will be about $22 billion.

Mr. ANTHONY. Incremental costs, yes.

Senator SYMINGTON. What does that word mean?

Mr. ANTHONY. The same as what you meant, I think, when you tried to define the term.

Maybe I am professorial in this, but I never would give a figure for the word "cost" without some kind of a modifier to it. The word "cost" is absolutely meaningless taken by itself. Here, I think we are both talking about incremental costs in the sense of the costs that are incurred for Southeast Asia that would not be incurred were there not Southeast Asia. Is that not the concept you have?

Senator SYMINGTON. I have one more question. The Secretary of Defense defends the cost of the Vietnamese war as not being punitive on the economy on the grounds it is not an increasing percentage of the gross national product.

Now, We have labor problems going on. It would appear there may be some major increases in costs, increases incident to labor demand and therefore very possibly increases in prices. That will increase the gross national product automatically, will it not?

Mr. ANTHONY. Yes, sir.

Senator SYMINGTON. But you still feel, regardless of the international position, that if the gross national product increases and the percentage of increased cost of the Defense Department does not increase in percentage of the GNP that figure in itself demonstrates it is not punitive to the economy; correct?

Mr. ANTHONY. I would prefer that economists, who are much more versed in this subject than I, talk about this.

My impression is that the effect on the economy depends heavily on the rapidity of an increase and not the absolute amount at any level. That is, the economy can adjust to any level; the difficult time, the time of strain, is when you are building up rapidly to a new level.

I should also say, Senator—I should have said earlier when I gave you the figure for 1968, that this figure was in terms of current prices. I did not try to build in the inflationary factors that you just mentioned.

Senator SYMINGTON. Do you think this philosophy would justify—and I ask this with great respect—claims on the part of some people in this country as well as in other countries, that we are promoting a war economy to maintain economic stability?

Mr. ANTHONY. Not at all, no, sir.

Senator SYMINGTON. Thank you.

Thank you, Mr. Chairman.

Chairman PROXMIRE. I would like to do my best, Mr. Anthony, to try to button up your estimates on the expenditures and the costs and the appropriations for the fiscal year 1968, and I go back to what you have said in your statement, quote: "Thus, barring an unexpected signficant change in the level of activity in Vietnam, or a new contingency elsewhere in the world, the fiscal 1968 budget represents a statement of our total foreseeable defense needs for that year," and you do not modify it at all.

Now, this morning's reported escalation—this morning newscasts reported some escalation in Vietnam. There have been some who have said we are going to send 50,000 additional troops there. One distinguished Senator said yesterday 100,000 additional troops will go there. What are your assumptions here? Do you assume that there will be additional escalation, or do you assume there will be no additional escalation?

Mr. ANTHONY. We assume a moderate amount beyond the end of 1967, and I would like to be more specific.

Chairman PROXMIRE. Beyond the end of June 30, 1967.

Mr. ANTHONY. Yes. And I would like to be more specific about the word "moderate"——

Chairman PROXMIRE. Good.

Mr. ANTHONY. If I could.

We are assuming that the increase in manpower worldwide, which is, I think, the best way to measure the full impact of Vietnam will increase above the fiscal year 1965 base by 734,000 in June 1967, and by 811,000 in June 1968.

Chairman PROXMIRE. You are not giving the Vietnam personnel. You are giving the overall military.

Mr. ANTHONY. Which is a better way of measuring the budgetary impact, you see; it is better to look at the full picture. The difference between 734,000 and 811,000 is a measure of the increase expected in 1968.

Chairman PROXMIRE. Let me ask you, out of the sum of this—and I am not asking you to disclose anything—but supposing 50,000 of these additional men were in Vietnam. What effect would that have on the budget?

Mr. ANTHONY. I do not want to comment, I think, on any possible specific plans for Vietnam.

Chairman PROXMIRE. I am not asking that. I am asking you to tell me what effect it has if instead of having an additional man in the armed services here in this country he is in Vietnam. Does it make a substantial difference or not?

Mr. ANTHONY. Yes, it makes a difference. The cost of a man is between double and triple if he is in Vietnam rather than in this country.

Chairman PROXMIRE. Then on that basis, can you tell us how much your estimate would be changed if (a) there were 50,000 more troops in Vietnam and (b) there were 100,000 more troops, not asking you to disclose what the plans are and obviously you should not and you will not.

Mr. ANTHONY. I could not.

I cannot make an estimate on just that one factor. I would be glad to supply something for the record.

Chairman PROXMIRE. Do you want to supply it for the record?

Mr. ANTHONY. Yes.

Chairman PROXMIRE. Good, I would appreciate that. You cannot tell us or give us a general idea whether this is $1 billion, $2 billion, or $3 billion, something of that kind, or whether it is much less than that.

Mr. ANTHONY. I would rather do a little calculating on that if I may, Mr. Chairman.

(The material referred to was subsequently submitted and follows:)

In fiscal year 1967 the incremental cost of Southeast Asia operations was about $20 billion, and the average number of personnel deployed in that year was about 400,000. A division of one of the numbers into the other gives a quotient of $50,000. The multiplication of $50,000 by 50,000 gives $2.5 billion, and by 100,000 gives $5 billion. However, these results are not satisfactory estimates of the cost of any specific deployment plan. In order to make such an estimate, one must know a great deal about the specific proposal—the mix of troops, aircraft, and ships, and the planned activity levels.

Chairman PROXMIRE. Last Friday, two distinguished economists discussed the Veitnam impact here in Washington at a meeting at the Shoreham Hotel. Professor Smithies, whom you know, said that our strategy in Vietnam is not the same as it was during World War II and the Korean conflict. At the same meeting Professor Musgrave said the Defense Department should not announce planned defense expenditures for national security reasons.

My question is, do either of these observations influence the quality of information that the Congress is getting from the Defense Department?

Mr. ANTHONY. I have heard of Professor Musgrave's statement, and it really puts us over a barrel, does it not, because we are criticized either way.

No, I think the answer is that when we give an expenditure estimate, it is the best expenditure estimate that we can give, and I would rather give none at all than——

Chairman PROXMIRE. You do not feel, or do you feel, when crowded this morning to give us estimates, whenever this is going to happen that this is something you cannot give us accurately because it may somehow give information to the enemy as to what our plans are?

Mr. ANTHONY. You stated the question in such a way that it had nothing to do with any particular plan. You just said pick a number and make an estimate for us, and this I will try to do. The figures that I gave you in my statement were not figures dreamed up, you know, with a few hours work. There is a lot of work behind those figures, and I think the people involved in that activity should do that kind of work to carry out the request that you made.

Chairman PROXMIRE. From what you said earlier, you seemed to think you might be off $500 million or $1 billion in your estimates, but that is about it, and that there is nothing that you know of now in the picture that would constrain you to give a different estimate as of this morning——

Mr. ANTHONY. That is correct.

Chairman PROXMIRE. Than was given last January.

Mr. ANTHONY. That is correct. I will not change the $68 billion that was given in January. I am just saying that in all of these estimates you ought to allow some margin of error, and I would like at least a billion dollar margin.

Chairman PROXMIRE. You gave a number of reasons why it was difficult or impossible for the Secretary of Defense, in your judgment, to give us a much earlier or better estimate in 1966 for the 1967 year than he gave us.

I have—we have in our files in the committee a letter from the Director of the Budget Bureau, Mr. Schultze, who will be here this afternoon, telling us that in July they are going to give us the estimates at that time of expenditures. Is there any reason why in July your estimates would not be substantially more accurate than they would be in January or April? That is, are you not getting closer and closer, at that point, to the 1968 fiscal year so that you can make any adjustments for any errors and so forth that might have developed or any changes in strategy at that point have become public?

Mr. ANTHONY. Mr. Schultze has talked with us about this possibility, and we are surely going to try to give a figure in July—is it July, or is it August?

Chairman PROXMIRE. Mid-July, we hope.

Mr. ANTHONY. We will certainly do our best. The earlier we give a figure, the less certain it is going to be.

Chairman PROXMIRE. We want it so that the Congress can have a basis for judgment on appropriation bills before we act on most of them. So we need the answer in July.

Your last section where you deal with the deescalation prospects gives us very little specific information in the impact of deescalation. It does indicate these things, as I understand it. In the first place, it will not be as great as Korea because the effort in relationship to our economy is far less, far less, one-third or one-half as much, perhaps, is that correct? In other words, the deescalation in Korea for two reasons would have a greater, far greater, impact than deescalation in Vietnam, first because of the inventory policy which has been changed, and, second, because tragic and big as our effort is in Vietnam, it is of far smaller effort than Korea in relationship to our economy.

Mr. ANTHONY. The problem is a little more complicated than taking these percentages of the gross national product in the buildup phase in Korea, because in the phasedown in Korea we had two things going on at once. We had a phasedown from Korea, but then we also had a decision to expand the Military Establishment which, you see, dampened the phasedown from Korea. So the absolute drop in defense expenditures after the Korean situation was not as big as those increases during the buildup phase that I have indicated.

But, even allowing for that, you stated the impact would be less as a percentage of gross national product, and I think this is certainly so.

Chairman PROXMIRE. Why would this not be a fairly good basis for estimating the impact on the economy?

Mr. ANTHONY. It would. It is a rough basis.

Chairman PROXMIRE. Then in the second place you indicate that your inventory policy will modify that substantially.

Mr. ANTHONY. Yes. The timing. You see, what the inventory policy does is modify the timing of the phasedown, not as to the absolute amount.

Chairman PROXMIRE. You say some industries and regions are affected more than others, but you do not give us anything specific on it. Do you think you could later on? You say you are beginning this contribution to the President's estimate of the effect of the war on the economy, which is preliminary, of course, to the plans as to what to do about it. Certainly this committee would be very interested in that, and I think it is our duty to press hard to get that information so we can debate it and discuss it and arrive at our judgment on what the economic policy ought to be so that perhaps in 6 months from now you could come back and give us a more specific description of the impact of this (a) on industries, (b) on regions, and so forth, so we can see the effect of it.

Mr. ANTHONY. We will be glad to try it. Even though it is very hard to predict a phasedown for a region, one of the things we are examining—which I personally think has a lot of promise—is the hypothesis that the phasedown will be a mirror image of the buildup, accordingly, we will examine very carefully the buildup characteristics in a region and then say, "This is a good first approximation as to how it will go down the other side of the curve." Work like this is underway.

Chairman PROXMIRE. You have stated that you cannot take a simplistic view, and you have replied to Senator Symington in the same tenor that whereas the costs that you give in your statement of

Vietnam is $21.8 billion, and the overall budget was $73.1 billion, you say you cannot subtract $21.8 billion from $73.1 billion and come up with a $51.3 billion figure.

Can you not try to arrive at some figure which would be—that we could latch onto that we could have some reliance on, or at least some range so we could be in a better position to evaluate this? It seems to me it is simple to say you cannot subtract the amount, that on this basis the incremental cost of Vietnam—or however you want to put it, and say you arrive at anything very useful. What can we do?

Mr. ANTHONY. You can look at the phasedown problem itself regardless of what the leveloff figure is.

You see the level-off figure will depend very much on what the actual date of hostility termination is, and that is completely unforeseeable.

For example, other things being equal, the level-off will keep going up year after year by the amount of wage and price increases. But other things never are equal because of other changes in our Defense Establishment. I think the economic impact problem stems mainly from the pattern of the phasedown, and that is the thing which we are working on.

Chairman PROXMIRE. Has the Secretary not been quite successful over the past few years in keeping down the cost of the Defense Establishment in spite of inflation and in spite of increased wages—that is, if you make the assumption, or if you assume, we did not get involved in Vietnam, or Vietnam had not gone on.

Mr. ANTHONY. Yes, sir.

Chairman PROXMIRE. Is it not true that from 1962 or 1963 on we have had a fairly stable Defense Department cost?

Mr. ANTHONY. This is true.

Chairman PROXMIRE. Absent Vietnam.

Mr. ANTHONY. This is correct—it has been stable. It has actually been decreasing a little bit in absolute terms and decreasing markedly as a percentage of the gross national product; yes.

Chairman PROXMIRE. You see, this is what I am basing my questioning on now.

If he has been able to do that, why can we not make the assumption that when the Vietnam situation is over that we can expect there will be—we may be fairly close to what we were then. Of course, we have to—we do not know what is going to happen on such things as the anti-missile-missile deployment, that kind of thing, but if we do not have that kind of a big strategic cost, is there anything wrong with assuming that we might be able to level off at $50 billion to $55 billion?

Mr. ANTHONY. Neglecting changing prices, in constant prices or in actual——

Chairman PROXMIRE. I say the Secretary has taken pride, and I think justifiable pride, in being able to keep the cost down in spite of a steady inflation.

Mr. ANTHONY. I do not think—I think that could be true.

Chairman PROXMIRE. All right, in stable prices. Assuming the 1967 prices.

Mr. ANTHONY. You mention, of course, one phenomenon the antiballistic missile—just one, which would make a tremendous difference in the whole budget.

Chairman PROXMIRE. Yes.

Mr. ANTHONY. In terms of stable prices, it would seem to me that roughly what you say would be so, but it is a very complicated thing. Retired pay, you know, just goes up $200 million a year no matter what you do today. These are obligations already on the books, so this phenomenon steps the budget figure up and up and up.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Anthony, you go to some length to compare this war in South Vietnam budgetwise with the Korean war. You say the Department of Defense requested a total of $164 billion for military functions for the 3 fiscal years 1951 through 1953; Congress appropriated $150 billion, but the amount actually expended was $102 billion.

You go on to state it took about 5 years to work the unexpended balance down to $32 billion and that during the 4 fiscal years 1955 through 1958 no additional funds had to be appropriated for Army procurement.

The Army lived off excess funds appropriated during the war.

Do you anticipate there will be anything like that problem of phasing down when we get to cessation of hostilities in South Vietnam?

Mr. ANTHONY. Well, of course, there is going to be a problem.

Senator JORDAN. Yes.

Mr. ANTHONY. There are, of course, going to be some surpluses simply because we are not perfect. We have these tremendously long pipelines that we have to turn into inventories, but we hope and confidently expect that the problems will be much less than they were in Korea, simply because of the techniques we have tried to use in this situation.

Senator JORDAN. You have better programing, better machinery for keeping track of the expenditures in the budget and so forth.

Mr. ANTHONY. Most important, we have much better knowledge of what our inventories are and what we need to order to keep our inventories up to the level they should be. We have much better knowledge than we had during the Korean conflict and much more careful control.

Part of the budgetary process that we are using involves trying to justify each item in the budget in exactly the same detail as we would in peacetime. With that as a base, you have a much better way of maintaining control, always recognizing the uncertainties that are bound to be present in hostilities.

Senator JORDAN. What special provision is there in your budgeting procedure that would take care of another hot spot developing? Suppose Korea broke out? What provision have you made in your budget to take care of another "hot" war?

Mr. ANTHONY. The budget itself does not provide for that contingency. We, therefore, would require more funds should that develop.

Senator JORDAN. You would be right up here with a supplemental to take care of any situation that might arise.

Mr. ANTHONY. Either a supplemental or use section 3732 of the Revised Statutes, which gives us authority to spend money without appropriation in such an emergency.

Senator JORDAN. But there is no such item in your budget. You would have to make up—such extra expenses you are put to would have to be made up in an extra appropriation that would be sent up.

Mr. ANTHONY. That is correct.

Senator JORDAN. Thank you.

Chairman PROXMIRE. Thank you, Senator Jordan.

Senator Symington?

Senator SYMINGTON. Thank you.

Mr. Anthony, you say it costs 2 to 3 times as much to have a soldier in Vietnam than in this country.

Mr. ANTHONY. Yes, roughly.

Senator SYMINGTON. How much does it cost to have a soldier in this country?

Mr. ANTHONY. Well, I am giving you very rough orders of magnitude figures.

Senator SYMINGTON. Yes.

Mr. ANTHONY. Let us say $10,000.

Senator SYMINGTON. $10,000?

Mr. ANTHONY. $25,000 to $30,000 for a man in Vietnam per year.

Senator SYMINGTON. If you averaged $25,000 in Vietnam and multiply that by 50,000, would you not have a figure the chairman asked for.

Mr. ANTHONY. It might be a good first approximation.

Chairman PROXMIRE. Thank you, Senator Symington. You are very helpful.

Senator SYMINGTON. I am trying to get to the costs.

Mr. ANTHONY. Thank you.

Senator SYMINGTON. I know I will slip a digit, so somebody figure that out.

Mr. ANTHONY. That is what I was afraid of, too.

Chairman PROXMIRE. $20,000 times——

Senator SYMINGTON. $25,000 times 50,000.

Mr. ANTHONY. My figure expert will do it.

Senator SYMINGTON. That would be about $1.25 billion, would it not?

Mr. ANTHONY. That is what my expert says.

Chairman PROXMIRE. Very good.

Senator SYMINGTON. If General Westmoreland in New York today asks for 100,000 more men, what he would really be asking for moneywise would be about $2.5 billion.

Mr. ANTHONY. If we went by that.

Senator SYMINGTON. If we went by that stand. You are the one who sees the costs.

Mr. ANTHONY. I try to do the analysis in a little more sophisticated manner than that.

Senator SYMINGTON. I just want to get in my mind what the additional cost of 100,000 men would be.

Chairman PROXMIRE. Would the Senator yield on that? I want to be sure of the assumptions on which you made that calculation. You calculated a difference between a man here and Vietnam and multiplied that by 100,000 or you calculated the total cost in Vietnam over that?

Mr. ANTHONY. Total cost.

Senator SYMINGTON. Do you add to that, say, the cost of the airplane that he may go down in?

Mr. ANTHONY. That is what I have not done.

Senator SYMINGTON. So it would be a figure considerably more than $2.5 billion, if you put it all in.

Mr. ANTHONY. More. These are the operating costs.

Senator SYMINGTON. Have you past figures you could utilize to figure the total cost that you could supply for the record?

Mr. ANTHONY. I would be glad to try to supply them.

Senator SYMINGTON. Would you do that?

Mr. ANTHONY. Yes.

(The figure requested above is included in material previously supplied by the Department which appears on p. 21.)

Senator SYMINGTON. Incidentally, I do not want to disagree ever with my able chairman, but anyone who thinks attacking a couple of military airfields is escalation, if that is what was referred to, I cannot agree. I cannot see why, we do not attack more meaningful targets.

There would be a great deal less escalation with a great deal more success if one attacked more meaningful targets instead of another 100,000 ground troops in Vietnam; which, if we do, most certainly will be escalation.

Chairman PROXMIRE. If the Senator will yield, what I was referring to was simply the phrase used, as I understand it, by the newspaper reports this morning. I certainly was not making any assumption that this is or is not escalation.

Senator SYMINGTON. Mr. Secretary, everybody goes on what you might call the "kick" of—well, it is a lot more, but it really is not a lot more because it is a lesser percentage, or no greater percentage, of gross national product.

Now, I have an article here by Dr. Robert Stevens from the Harvard Business Review. He was formerly senior economist at Standard Oil of New Jersey, so he has practical experience, including a lot of international experience due to their foreign holdings; and (b) he is now a professor of international business at Indiana University. So he seems to have had a career on both the practical and theoretical sides.

One paragraph in an article he wrote in the Business Review last December says:

> Today when our economy still remains unrivaled in the world, if the popular premise that economic strength always confers financial strength were sound, then people might still think it natural for the United States to be running an international payments surplus provided various frictions and temporary obstacles to its achievements could be removed. But the simple argument from basic economic strength to continuous financial strength is not valid.

It seems to me that is what you are consistently doing. You say because we have the economic strength expressed by our unprecedented gross national product, our fiscal and monetary positions are automatically sound.

Without getting too deep into a subject that has interested me for some years, we are now to the point where we have less than 10 percent of the free nonmonetized gold necessary to pay off those abroad who could call us, who own the paper dollars we have promised to redeem in gold through their central banks.

Of course, as our gross national product grows partially because of increases in labor costs and prices, that automatically makes us less competitive in foreign markets.

I wonder if this constant reliance, in all statements out of Defense that we do not have to worry too much about these growing costs, waste—I think we will all agree that war is waste, because it is no longer a percentage of our gross national product. I just wonder at times whether that is sound economic thinking.

Mr. ANTHONY. I think all I have said is that the $22 billion of cost is a cost that our economy easily can handle. Now, handling it properly does imply proper monetary policies, proper fiscal policies. It does not automatically handle itself. But it is a manageable problem, and the fact is we have managed it without price controls and wage controls.

Senator SYMINGTON. So you feel it is a sound approach, as you say on the first page of your statement, that "8.9 percent of our gross national product in fiscal 1967," which you say, "is exactly the same percentage as that in 1962."

Mr. ANTHONY. A sound approach in what sense, sir?

Senator SYMINGTON. To gage the problem of our defense expenditures on the basis of our gross national product.

Mr. ANTHONY. No, sir. I think, as I said earlier, it is one way to look at it. I think a more important thing is the rapidity of buildup, that is the thing that creates more stresses on the economy. You brought in another factor which I think is also very important, the balance-of-payments problem, which, of course, is made more difficult by this situation.

Senator SYMINGTON. Well, it is a fact that we have financed world trade for 18 years by printing paper gold. I am not saying that is wrong and hope we arrive fairly soon at some agreement as to what the additional currency development should be.

At the same time we are financing this trade abroad not only of our own country, but all other developed countries, spend considerably more of our gross national product in percentage for defense than does any other developed country.

Do you know about that?

Mr. ANTHONY. Spend it for what?

Senator SYMINGTON. For military.

Mr. ANTHONY. We spend——

Senator SYMINGTON. More of a percentage of our gross national product for military than any other developed country in the world.

Mr. ANTHONY. No, we do not spend as much as the Soviet, by quite a lot.

Senator SYMINGTON. Well, I am glad to be corrected.

Mr. ANTHONY. I cannot give you exact figures. The job of trying to translate Soviet figures into what the actual facts are is extremely difficult. But it is my impression that any way you look at those figures the percentage of gross national product spent on defense is considerably higher in the Soviet Union than in the United States.

Senator SYMINGTON. My statement would still be correct, however, if I said the free world, is the correct?

Mr. ANTHONY. I cannot say for sure, but I think that is substantially correct.

Senator SYMINGTON. Those are the figures I saw.

Mr. ANTHONY. I think so. If there is an exception, I will correct it for the record.

Senator SYMINGTON. Thank you.

Thank you, Mr. Chairman.

Chairman PROXMIRE. I would just like to say—I am just about through—I would like to say that I appreciated very much what Senator Symington has emphasized. I think there probably is an additional observation that ought to be made and that is that this Vietnam war situation is contributing most adversely to our balance-of-payments problems The President indicated that, as I recall, in his economic message. Not only most adversely but so badly that it is conceivable that our payments would be in balance even on the liquidity basis if it were not for Vietnam, $800 million, as I understood it, the loss directly.

There is an indirect balance-of-payments loss, I think, of a billion dollars because of increased imports and so forth because of the Vietnam situation, and I think this is certainly another most important consideration along with the budgetary and inflation costs.

Mr. ANTHONY. Yes, sir.

Senator SYMINGTON. Will the Chairman yield?

I associate myself with his remarks. Inasmuch as the agreement we have with the Germans incident to the purchase of material has either fallen apart or at least is not progressing as originally planned, the statement of the Chair in that connection is even more pertinent. This will naturally affect the balance of payments to the degree it is not carried out.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. I just have one question, Mr. Chairman.

Have any studies been made, Mr. Anthony, relative to where these dollars are spent; to give you an example, for each dollar spent in the hot war in South Vietnam, how much is required stateside to back up that expenditure in the civilian economy? In way of making munitions, airplanes, helicopters, and whatnot.

Mr. ANTHONY. If I understand you correctly, almost all of it is spent stateside. We take very drastic steps to spend as little as we can in foreign countries for the reasons Senator Symington was giving.

Senator JORDAN. Yes. The losses and the costs are actually overseas, but the spending is stateside.

Mr. ANTHONY. That is correct.

Senator JORDAN. But for the military aspect of the spending, how much is the civilian counterpart to back it up?

Mr. ANTHONY. Of the $22 billion of costs that we are talking about, I should think somewhat more than $20 billion actually ends up being spent in the United States. Military people send their pay back to the United States, where their families spend the bigger part of it and so on.

Senator JORDAN. This is a total cost then that you are giving us.

Mr. ANTHONY. The incremental costs, yes.

Senator JORDAN. The incremental costs?

Mr. ANTHONY. Yes, sir.

I may not be understanding your question properly, but I think you are asking——

Senator JORDAN. I am trying to find out if there are costs over and above the $21.9 billion that you have given us here that are in the civilian industrial complex of the United States——

Mr. ANTHONY. No, sir.

Senator JORDAN (continuing). That are not calculated in this figure.

Mr. ANTHONY. No, sir. This is not the spending in Vietnam.

Senator JORDAN. No.

Mr. ANTHONY. This is the spending on account of Vietnam.

Senator JORDAN. As a result of Vietnam.

Mr. ANTHONY. As a result of Vietnam, and almost all of it, as I say, winds up in the United States.

Senator JORDAN. And it is a complete cost without any indirect cost being absorbed in some other fashion.

Mr. ANTHONY. No depreciation, no indirect overhead, as Senator Symington said. It is the direct incremental costs. It is my rough guess of the costs, because, as I explained to him, we do not keep books on the war.

Senator JORDAN. Thank you.

Chairman PROXMIRE. Well, thank you very much—I cannot say Doctor, and though I—Mr. Anthony—yes, of course I can say Dr. Anthony—Dr. Anthony was a radio character some years ago—but you did a superlative job this morning, not only in your statement but in your responsive answers to our questions, and I must say I was very much impressed and very much enlightened.

Our witness this afternoon will be the Budget Director, Mr. Schultze, at 2 o'clock this afternoon.

(Whereupon, at 12 o'clock noon, the committee recessed, to reconvene at 2 p.m the same day.)

AFTERNOON SESSION

Chairman PROXMIRE. The committee will come to order.

Our witness this afternoon is Charles L. Schultze, the Director of the Bureau of the Budget, a man who is an old friend of the committee, and a man of great ability.

We are very happy to have you here for obvious reasons, but especially on this particular subject, which is the impact of the Vietnam war costs on the economy, and equally important, as you emphasize in your statement, the effect of deescalation or negotiations, which it seems to me is peculiarly and specially a problem for the Budget Bureau and for the Director of the Budget Bureau. And I know you can give us some extremely helpful testimony. Your statement is very good.

You may proceed in any way you wish, Mr. Schultze.

STATEMENT OF HON. CHARLES L. SCHULTZE, DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. SCHULTZE. Thank you, Mr. Chairman.

If you don't mind, I will read my statement. And if it is too long, let me know, and I will cut it short.

Chairman PROXMIRE. It does not seem to be a lengthy statement. You may proceed.

Mr. SCHULTZE. Your committee is considering both the economic impact of our military expenditures in Vietnam and the economic policies which will be appropriate when peace in Vietnam is achieved. I would like to address myself particularly to the second part of your inquiry—the economics of adjustment to a reduced level of defense expenditures.

As you are well aware, the President has established a task force under the chairmanship of Gardner Ackley, Chairman of the Council of Economic Advisers, to develop economic plans for the post-Vietnam period. That task force has begun its work but has not yet completed any significant part of it. I am, therefore, in no position to discuss this matter in terms of specific conclusions or recommendations. I would be pleased, however, to consider with you today the general aspects of the problem and the types of policies that have to be considered.

No one can predict when peace in Vietnam will come. Despite a long and honorable series of efforts to find peace, the war continues. But peace will come. And its coming will bring both opportunity and challenge. An opportunity to use the resources now devoted to military operations for peacetime purposes—in raising living standards and meeting important national needs. A challenge to adopt policies which will swiftly and smoothly transfer to those other uses the resources freed by the reduction in military demands.

A reduction in defense spending releases resources of manpower, materials, and capital. Other spending must take its place if those resources are not to remain idle, thereby triggering even further reductions in spending, employment, and income. There is, of course, wide room for argument among reasonable men as to precisely what form the additional spending should take—whether for private consumption or investment or for Federal, State, or local programs. But there should be no doubt in anyone's mind that appropriate fiscal and monetary policies can insure an adequate level of overall demand and accomplish the transfer of resources to whatever end uses we as a nation desire.

Let us turn for a moment to the magnitude of the problem.

Although the number of men and the amount of material devoted to the Vietnam operation is large, the military effort there has quite obviously caused far less economic disruption to the American economy than World War II, and substantially less than the Korean war. Defense purchases of goods and services have risen by some $20 billion (at seasonally adjusted annual rates) since mid-1965, when the buildup in Vietnam started. While this figure seems large, it represents less than 3 percent of our gross national product. Defense outlays constituted 9 percent of GNP in fiscal 1962 and 1963. They fell to 9.3 percent of GNP in mid-1965. The additional spending for Vietnam has simply restored this percentage to its 1962–63 level.

In contrast to the present situation, defense purchases during the Korean period rose from 4½ percent of GNP in mid-1950 to 12½ percent in the first quarter of 1952. In that period the incease in defense puchases absorbed nearly one-half of the increase in GNP. In the present case, the rise in defense purchases has taken only one-fifth of the increase in national output. During the first year and a half of the Korean buildup we added 2 million men to the Armed Forces, almost exactly equal to the total increase in the labor force over the same period. In the comparable Vietnam period, the size of the Armed Forces increase was only one-third as large as during Korea, while the rise in the labor force was 50 percent larger. The point is that the economic impact of the present conflict has not caused anywhere near the economic reorientation and disruption that the Korean conflict did—and Korea followed quickly on the World War II period of shortages in nondefense investment and consumer goods, while Vietnam follows a period of great prosperity and productivity.

I do not use these percentages to imply that our Vietnam operations are not costly—simply that they take only a small percentage of our total output. The figures do give us an overall measure of the economic impact of the war and suggest the magnitude of the opportunities available and the adjustment to be faced when the war ends. Our experience between 1961 and 1965 and in other, earlier, periods clearly demonstrates that the American economy does not need the stimulus of a war to reach and maintain economic growth and prosperity. Shared widely among our people the bounty of abundance should be a pleasure and not a problem.

The economic adjustment to reduced defense expenditures poses three sets of questions:

First, to what end uses do we wish to put the resources freed by lower military demands—this we might call the end-use problem.

Second, how can we assure that aggregate demand in the nonmilitary sectors of the economy rises in step with the reduction in military demands, so that from the viewpoint of the total economy there is no transition pause or recession—this we might call the overall transition problem.

Third, what policies do we adopt to ease the transition problem for those individual areas and regions which are heavily dependent for their employment and income on defense installations or defense contracts—this we might call the regional and area transition problem.

As I stated earlier, these are the questions which Chairman Ackley's task force is studying in detail. At this point I can only outline the general nature of the problems in each of these three areas.

Turning first to the end use to which we put the resources, freed from military use, coming to maturity in the next 5 years are 10 million children born between 1947 and 1952. This compares with 15 million reaching maturity in the past 5 years, 12 million in the 1957–62 period, and 10 million between 1952 and 1957.

These young people bring with them a potential expansion in demand for housing, automobiles, electrical appliances, furniture, and other household durables—for all the items which are involved in family formation. In turn, this prospective increase in consumer demand will in turn require an expansion of our industrial capacity. In addition, fundamental State and local services—water, sewage, police and fire protection, schools, and so on—must expand even to maintain existing levels of public services.

There are other major current needs in the public sector. We face an almost desperate need to increase the quality of our air and water. We feel obligated—even compelled—to improve the quality of education for our children and to make sure that high-quality education is available to all. We see the need to improve and to rejuvenate urban areas and central cities, and to make major inroads on the problem of urban slums. We recognize the need to improve and modernize our transportation system. Our problem, indeed, will not be to search for possible uses of the resources which will become available when hostilities end, but to determine priorities among a host of pressing demands, private and public.

A conscious decision about the use of resources freed by a cessation of hostilities cannot be ducked. It does no good, for example, to say that this question is one which should be settled in the marketplace—that Government should leave the answer to private decisionmakers. When the demand for military goods and services is reduced, there is no automatic mechanism which provides for an increase in private spending to absorb the freed resources. Rather, the Federal Government must decide how to provide for an offsetting increase in demand—through tax reduction, through additional nonmilitary Federal spending, through easier monetary policies—or more likely, through some combination of all three. And our choice among these various instruments of economic policy will dictate the end uses to which the newly available resources are put. In short, the very steps we take to insure that the freed resources are utilized will determine how they are utilized.

The relative emphasis we place on tax reductions versus increases in the Federal budget, for example, quite obviously, will determine how the newly available resources will be split between the private and the public sector.

We cannot avoid making this choice, and to make it intelligently we need to assess the relative benefits which will accrue to the Nation from such alternative. And, in the case of tax reduction, we do not cut taxes in the abstract—we must choose some particular form of tax reduction. The kind of reductions which we adopt will determine, roughly at least, how the resources freed by lower military spending are divided between private consumption and private investment, and whether the additional private consumption is enjoyed by those with lower or higher incomes.

In similar vein, the more we rely on an easier monetary policy and lower interest rates to stimulate demand, the less we can employ tax reductions or expenditure increases. And since monetary policy tends to operate primarily on investment decisions, particularly housing investment, the relative emphasis we place on fiscal versus monetary policy will also help determine the specific uses of freed resources. Our options to choose between fiscal and monetary policy in a transition to lower defense expenditures are not, of course, unlimited. I do not believe a $20 billion reduction in defense outlays, for example, could or should be met solely by changes in monetary policy, accompanied by neither tax reductions nor other budget expenditure increases. But, on a more restricted scale, there is some range of choice between fiscal and monetary policy in providing a transition to lower defense expenditures.

We turn now to the overall transition problem. The specific combination of policy actions which would be appropriate in a period of declining defense outlays must be chosen not only in terms of the end uses we desire for the freed resources, but also in terms of the transition problems involved in transferring the resources. Our object is not merely to assure that these resources are ultimately absorbed in high-priority uses, but also to see that the transfer is made smoothly and without an intervening pause or recession.

This second objective poses a timing problem. The increase in overall demand in the civilian sector of the economy must roughly keep pace with the decrease in military demands. Yet, each of the policy instruments available to us—tax reductions of various kinds, expenditure increases, and monetary policy—differs from the other in two respects which are very important for this timing problem:

First, there are timelags between taking a policy action and the impact of that action on the economy—and these lags are not the same for each policy instrument. Cutting personal taxes, for example, will generally have a more immediate impact on aggregate economic activity than will a tax cut on corporate income.

Various types of Federal expenditures differ from one another in the magnitude and timing of the fiscal stimulus which they produce. Increased expenditures for direct Federal programs have a faster and more certain effect than an increase in grant-in-aid funds for State, local, or private projects. Most of the grant-in-aid programs require matching funds and these must be approved by State legislatures and city councils before the programs can be undertaken. Loan funds made available for college housing or hospital construction must be reviewed at several levels before construction begins. In many areas of most pressing need, in the fields of health, education, and manpower training, limitations of trained personnel or organizational barriers slow down the rate at which programs can be expanded. Yet many of these grant-in-aid programs may well have a significantly higher social priority than direct, fast-acting Federal programs.

And direct Federal programs, too, have a large variation in the timing of their impact. Federal expenditures for services or transfer payments to individuals often have a more immediate economic effect than increased procurement or construction outlays.

The second kind of transition question we have to take into account relates to our ability to forecast the magnitude or timing of the economic impact of various policy measures varies widely from one measure to another. We are more certain, for example, about the response of consumer purchases to a reduction in personal taxes than we are about the reaction of private investment to a reduction to corporate taxes. In the monetary area we are more certain of the response of housing construction to changes in credit availability than we are of changes in plant and equipment investment.

One important fact we do know. An expansion of investment in response to changes in taxes and monetary policy is quicker and more certain when the economy is prosperous and growing in a balanced fashion than when we are attempting to reverse a downturn. This fact underlies the importance of acting in a timely fashion to keep economic activity rising steadily. Not only is timely action desirable for its own sake, but it makes easier the task of deciding on the appropriate magnitude and composition of economic policy.

In summary, we are confronted with two sets of objectives: to direct the resources freed by a reduction in defense outlays toward the end uses we as a Nation desire, and to make the transition smoothly and quickly. The fact that some policy instruments are more uncertain in their effects and take longer to have an impact by no means implies that we need forgo their use. We should not, as a general rule, choose low priority Government programs over high priority ones, simply because the latter may be slower acting. We need not abandon tax cuts directed at increasing investment, because their magnitude or the timing of their impact is somewhat uncertain. Rather, we should aim for the use of freed resources in ways which yield the highest benefits from the Nation's standpoint. But we must, in developing and adopting a combination of policy instruments, take into account the timelags and uncertainties of various policies and make our plans accordingly.

There is one final point which is worth bearing in mind. We are dealing with a shift of resources amounting to perhaps $15 or $20 billion, with the shift most probably spread out over more than a year. But each year—year in and year out—the productive capacity of the American economy, measured in constant dollars, grows by some $30 to $35 billion. Each year, therefore, quite apart from any reduction in defense outlays, fiscal and monetary policy must aim at providing a $30 to $38 billion increase in demand to absorb this capacity, lest unemployment and excess capacity begin to mount. Over the past 6 years this task has been accomplished—not perfectly, of course, but all things considered, accomplished well.

Based on past experience, therefore, the economic transition to lower defense expenditures poses a problem well within our capacity to handle successfully.

Let us turn now to regional and area transition problems. There are some areas and labor markets which are currently much more heavily dependent than average for their employment and income upon defense procurement or defense installations. Even with overall fiscal and monetary policies which keep overall demand and production moving ahead steadily, there will be individual communities and areas facing particularly difficult transition problems.

An examination of recent data on the dispersion of Defense-generated employment may help to give some idea of the nature of the transition adjustment facing particular areas.

The Economic Impact Division of the Department of Defense has conducted surveys of employment generated by major defense contracts. In June 1966 this survey covered 2.4 million employees, representing about 3 percent of the total labor force. It included civilian employees at Defense installations. (Data for December 1966 are now being collected and tabulated but are not yet available.) Using this data, the Economic Impact Division analyzed the characteristics of the 292 labor market areas which had more than 500 defense-related workers, or in which the ratio of defense employment to the area labor force exceeded 5 percent.

Two of the more important aspects of the survey are shown in tables 1 and 2 below.

TABLE 1.—*Ratio of defense employment to labor force by size of labor market, June 1966*

Ratio of defense employment to labor force (percent)	Defense employment		Labor force size groups (000)							Number of areas
	Number (000)	Cumulative percent	Under 25	25 to 50	50 to 100	100 to 250	250 to 500	500 to 1,000	Over 1,000	
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)
15 and over	207	8.7	15	4	4	2				25
12 to 14.9	124	13.9	7	5	3	1	1			17
9 to 11.9	427	31.8	14	4		5	7		1	31
6 to 8.9	236	41.6	10	12	6	3	3	1		35
3 to 5.9	690	70.5	20	12	13	10	4	5	4	68
Under 3	703	100.0	3	21	30	37	13	9	3	116
Total	2,387		69	58	56	58	28	15	8	292

TABLE 2.—*Ratio of defense employment to labor force by type of employment, June 1966*

Ratio of defense employment to labor force (percent)	Type of employment						Number of areas
	Military installations	Aircraft	Missile and space	Ammunition	Ships	Undistributed	
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
15 and over	16		2	1	4	2	25
12 to 14.9	13			2		2	17
9 to 11.9	14	4	2	3	1	7	31
6 to 8.9	23		1	3		8	35
3 to 5.9	33	5	4	2	1	23	68
Under 3	30	9	3	9	1	64	116
Total	129	18	12	20	7	106	292

Mr. SCHULTZE. The first table clearly shows that high ratios of defense employment to total labor force are primarily a characteristic of smaller labor market areas. On the 292 areas, 73 have ratios above 9 percent. Of these 73, all but 17 are found in areas with a total labor force of under 100,000 workers.

This, of course, is not surprising. Even a large defense production complex in a major metropolitan area is not likely to account for a significant proportion of the labor market.

One other point is clear from the first table. The 292 areas were selected because of their relatively large defense concentrations. Yet 60 percent of the defense-generated employment in these areas is found in labor markets where defense employment accounts for less than 6 percent of the labor force of that area.

Table 2 classifies defense-dependent areas by the type of employment involved. In constructing this table, all defense employment was assigned to the category which accounted for 50 percent or more of the total. And this does tend to reduce somewhat the effect of the table. But the main point, I think, is brought out. The central characteristic brought out by this table is the fact that high ratios of defense to total employment occur primarily because of the existence of a defense installation in small labor market areas. I am distinguishing defense installation for contracted defense procurement. High defense dependency in the smaller areas generally does not arise because of employment by defense contractors—but because of civilian employment in defense installations.

There are, I believe, three implications from this analysis for transition problems:

1. The number of areas and the number of employees in labor markets with a high ratio of defense to total employment is relatively modest. (The December 1966 data, however, will probably show a larger number of areas with high-defense dependency, since defense employment rose significantly between June and December.)

2. The problem of transition will be concentrated in a limited number of smaller labor market areas.

3. The impact on the localized transition problem of reductions in defense procurement will be much less than the impact of reductions in the size of the Armed Forces and the installations to which they are attached.

Let me turn now, if I may, to Federal programs to aid in the transition:

The economic dislocation which comes to a local area because of a reduction in defense-related employment is similar to the dislocation which occurs when shifts occur in private demand. Local unemployment and economic distress are equally severe whether they occur because of the closing of an automobile plant or the closing of a military base.

We are in a much better position today to cope with such problems than we were 5 or 6 years ago. Existing Federal programs have been strengthened and a number of new programs have been developed which are designed to aid in the economic development of communities. Although many of these programs were initially conceived as aid to chronically depressed areas, they have been used successfully and in a coordinated way to aid communities which had to reorient employment and production because a major industry ceased operation. South Bend, Ind.; and Lisbon Falls, Maine; are the primary examples of successful transitions following the shutdown of private firms. Presque Isle, Maine; Greenville, S.C.; Decatur, Ill.; York, Pa.; and Ogden, Utah; are examples of successful transitions following the closing of Government installations. In Presque Isle, Maine, for example, there were 1,200 military and 275 civilian jobs at the Air Force base before it was closed in 1961. Now there are more than 2,000 civilian jobs in their place.

In York, Pa., when the naval ordnance plant was sold, 95 percent of the civilian personnel elected to remain with the corporation which purchased it and since the sale, civilian employment has increased by 60 percent.

In Ogden, Utah, the former naval supply depot was declared excess; 636 acres and 149 buildings were sold to private industry for $6.3 million. As a result, the Navy saves almost $5 million per year, new jobs have been created, and the facility is back in productive use in the civilian sector of our economy.

Federal aid to these communities covers a wide range of programs—from income maintenance, employment information, and retraining, to low-cost loans and community planning.

The Department of Labor has been conducting demonstration projects to determine how best its resources can be used in meeting problems of industrial dislocation. This work should provide valuable guidance in the post-Vietnam period. The Manpower Training and Development Act has established numerous programs of training or retraining to aid either economic development or transition and its programs are available to skilled and professional employees. Additional assistance is provided by the use of surplus Federal property and equipment in these training programs.

In addition to employment and training programs, the Federal Government provides aid to economically distressed communities through the Economic Development Administration. Technical assistance and planning grants are available to communities for planning economic development. In addition, if the area has been designated a redevelopment area or economic development center, long-term, low-cost industrial and commercial loans are available to finance the development. Federal aid is also available for the construction of necessary development facilities—such as the access roads, water supply and sewers necessary for the operation of an industrial park. For example, a development association in Portsmouth, N.H., is now using EDA technical assistance to plan for the phasing out and redevelopment of the facilities of the Portsmouth Navy Shipyard, scheduled for closing in 1975. EDA technical assistance is being used to assist in the conversion of the Brooklyn Navy Yard into an industrial park.

Recent legislation now makes it possible to designate areas as redevelopment areas if the closing of a plant or military installation could be expected to make the area eligible for such designation within 3 years if assistance were not provided.

The Federal programs mentioned so far are available to any community experiencing local economic distress, whatever its cause. In addition, there are several Federal programs specifically associated with the Office of Economic Adjustment of the Defense Department which is concerned primarily with the closing of installations. The Department has established a central employee referral system which matches the information on displaced Defense employees with available job openings. A cooperative effort has also been developed to retrain displaced employees if their current skills cannot be utilized. The employee referral system attempts to keep employees in the same general geographic region but there are problems of relocation and housing. Limited travel and moving expenses are available and recently the Defense Department has been authorized to purchase employee housing if the loss can be expected to exceed 10 percent.

Federal programs are available to assist localities to adjust to future reductions in defense-related employment and these can be improved. Much also depends, however, on the initiative of State and local governments, private business, labor unions, and other interested groups to utilize the programs and to develop community plans for the transition period. The Federal Government can provide assistance but the people most directly affected can better analyze the potential of local resources, both material and human. More than at any prior time, we are aware of the problems brought about by sharp changes in defense activity and are better prepared to manage the transition. However, it does take planning and cooperation from all sectors of our economy.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mr. Schultze, for another very competent, interesting, and imaginative paper.

Mr. Schultze, next year, as you know, and as we all know, is an election year. The administration may be reluctant to come in for another tax increase next year. And Congress may be reluctant to demand the absolute data in time. Will we repeat last year's error? How can we work together to avoid this possible repetition?

Mr. SCHULTZE. How do I avoid stopping beating my wife?

I am trying to collect my thoughts to get at your point.

In the first place, we have, as you know, proposed a specific fiscal program, certain specific actions this year. And one of the obvious points is to take a look at what happens here——

Chairman PROXMIRE. What I am getting at, you know what happened last year, with prices rising and with the big deficit we had, causing interest rates to rise, and so forth. Many of us have been concerned about the reverse happening at the beginning of this year. Now, the indicators are pointing in the other direction. They suggest that we might have a tighter economy than was indicated in February and March.

Now, if the war is escalated, and if we do not pass a tax increase this year—and there is a big indication we may not—my question is, what can we do to be better prepared for next year so that we get the kind of information which will alert Congress, and at least make us familiar with the economic dangers we face from changes in Vietnam spending?

Mr. SCHULTZE. My difficulty with the question, Senator, is that we believe the economic situation will require a tax increase before next year. And this essentially is what we would believe is the first prerequisite of handling the situation.

Now, you ask me what happens if we do not get what we think is necessary to handle the economic situation, how can we better handle the situation next year. I am a little bit at a loss as to how to answer that. It seems to me that if our economic forecasts are correct, and if a tax increase is not passed, there will be even more reason to come in earlier next year with the same request.

Chairman PROXMIRE. Mr. Anthony appeared here this morning speaking for the Defense Department. And although there have been a lot of rumors and much talk about escalation in the Defense Department, he was standing firmly by the January estimate. This is mid-April, and there has not been any change in his view. He thinks it is unlikely that we would be spending more the rest of the year. To me it would seem that if we are going to put Congress in the mood for a tougher policy, either for a tax increase or for a spending reduction in a nondefense area, that the administration should recognize that warning of an escalation and make a frank statement of any increase in the defense spending beyond what was originally estimated.

Mr. SHULTZE. As you are, of course, aware, you and I exchanged letters with respect to making interim budget information cost available to the Congress.

Chairman PROXMIRE. Yes, that was very helpful, and I certainly commend you on your willingness to do that.

Mr. SCHULTZE. And on the basis of that letter we would be transmitting revised estimates for the fiscal 1968 budgetary outlook some time in late July, or at the worst very early August, at which time this would clearly be a factor to be taken into account.

Chairman PROXMIRE. So you are suggesting that one way we can work together is this more frequent estimate?

Mr. SCHULTZE. Yes, and we have so agreed in our exchange of correspondence.

Chairman PROXMIRE. Now, I am going to ask the question from the other standpoint. Vice President Humphrey indicated earlier this year that the ball game would be over in Vietnam this summer, meaning presumably we might be negotiating, de-escalating rapidly, and so on. Right now, not 6 months from now when the report might be made by the Ackley Committee, but right now, what plans do we have for conversion of our resources in the event that the war should end in the next month or two or three?

Mr. SCHULTZE. It seems to me that the plans we have for doing that will be those developed by the Ackley Committee. The committee itself would have to telescope its plans into a very short time period in order to do that in only 2 or 3 months.

Chairman PROXMIRE. But the Ackley Committee is just organizing, just getting going.

Mr. SCHULTZE. It is a little more than just organized. We are well into the way of taking a look a tthe problem. But none of the work has been completed. Clearly under the conditions you indicate that work would have to be telescoped substantially. But as you are aware, Senator, the Congress, on a number of occasions in the past, has shown that it can react responsibly and very quickly to administration requests for action if needed on a fiscal matter.

Chairman PROXMIRE. What kind of action can the President take? What are the dimensions of his actions? He has control over the budget in the event, first, that there is escalation, and he wishes to contract the nondefense spending, or second in the event that there is deescalation and negotiations, he may want to expand the nondefense spending? What kind of discretion does he have? Obviously he exercised some last November when he announced a $3 billion cut. Since then he has adjusted that. But how far could the President go either in cutting or in increasing spending?

Mr. SCHULTZE. I am not sure, Senator, that I could give you a specific number which would be a measure of his control. But as you have indicated, we did withhold and defer some $5 billion in Federal contracts.

Chairman PROXMIRE. Five billion?

Mr. SCHULTZE. In contracts which have a $3 billion expenditure impact. And of course the economic impact of Federal Government actions isn't just the result of expenditures. In relation to timing, there might be an effect when contracts are made, even though the expenditures may not take place for some time.

In summary, I would say that the President does have some significant but not very great ability to defer or postpone the awarding of contracts that would thereby have impact on expenditures.

Chairman PROXMIRE. Give us some figures. You said that he was able to defer $5 billion in contracts that would have $3 billion impact on spending. Obviously he didn't go as far as he could go, or maybe he did, I don't know. But it seems to me he could have gone farther, perhaps instead of $3 billion he could have cut $5 or $7 billions of spending. One thing he could clearly have done—something that was done, as I understand it, in World War II—would have been just to have stopped all the nondefense public works, for instance. And this is around $9 billion a year.

Mr. SCHULTZE. I don't know, Senator. As a matter of fact, during the time period in which we were interested in the deferrals, we literally stopped all new starts on water resource projects. There may have been one or two exceptions.

Chairman PROXMIRE. He is not confined to new starts, however?

Mr. SCHULTZE. He is not confined to new starts, although once you get beyond new starts it is more difficult. For example, look at what happened during Korea. We did come in with no new starts for a year, but we did not cut off all new construction, because you have on-going work for a contractor on the job. And once you go beyond new starts, you have to make a judgment with respect to how much you cut into that.

Chairman PROXMIRE. You see, what I am getting at is, there is a very real possibility, it seems to me, that you might need no congressional action at all to adjust in the first year or so, for this reason. Supposing negotiations in cease-fire come tomorrow? Mr. Anthony has testified to what Secretary McNamara announced some time ago, that there would be quite a gradual scaling down in procurement, because they would build up depleted inventories. Also I presume demobilization would not come like that, it would come over a period of several months, it would be some time before we would draw all of our people back from Vietnam. So that the effect on defense spending would be a gradual reduction of that $15 to $20 billion you are talking about. Now, can you put these two things together, then, to indicate the degree to which in your judgment the President could act to absorb, say, for several months at least, on the assumption that the economy is moving along about as it is now, to absorb this cutback by his own Comptroller of the Budget?

Mr. SCHULTZE. Staying for the moment within just the expenditures, it seems to me that there are three levels of action. First, without additional appropriations or authorizations, there is some limited amount by which the President could increase on-going programs without congressional action. Primarily these happen to be programs where there are certain unobligated balances, or where the funding is through the back door funding. This is true in the case of many of the housing programs and development programs where you have large authorizations that you can spend without the appropriation process. Without appropriations I cannot give you any magnitude, but there is some modest amount about which the President could expand the spending.

Chairman PROXMIRE. Give us some idea of the magnitude. What was done last year?

Mr. SCHULTZE. That was done the other way. You are talking about increase.

Chairman PROXMIRE. Could you increase to the same extent?

Mr. SCHULTZE. No, I do not think you could. Remember always, Senator, that you want to keep this—you want to do this in the context of (a), emphasizing high priority programs in the spending increase, and not simply increase for the sake of increase, and (b), taking account of bottleneck problems with respect to handling this from the administrative end and from the recipient end. There is a limit to how much you could expand in a short period of time in certain areas, even apart from local or funding problems. So taking everything into account, I would say the amounts of expandability, without any appropriation actions, is probably a good bit less than the amount we were ready to cut back, subject to the restraint I indicated subject to having some priority concepts in mind.

Chairman PROXMIRE. How about on the revenue side, does the President have any discretion whatsoever?

Mr. SCHULTZE. May I stay with the expenditures for a while?

Chairman PROXMIRE. Very good.

Mr. SCHULTZE. There is a modest amount that could be done in letting additional contracts speed up. In other words, you let additional contractors speed up your schedule of obligations. And I think this is probably altogether somewhat less than the amount of deferrals we were able to make.

Secondly, in this particular year the amount of appropriations the President is requesting for a number of programs in the major social areas is somewhat less than the authorization level. So it would be possible with a supplemental to increase expenditures significantly in a number of areas without having to come back for additional authorizations.

And then finally, there would be some programs where you would need to have both authorization and appropriation. In summary, there are the three levels I mentioned. First, some action could be taken without any congressional action.

Chairman PROXMIRE. And that is limited in your judgment to less than $3 billion a year?

Mr. SCHULTZE. I would say less than $5 billion.

Chairman PROXMIRE. $3 billion for an expenditure basis.

Mr. SCHULTZE. I would say less than that, probably.

Secondly, there is another significant amount where a simple supplemental would do it, as opposed to having to come in for new authorization. There may be $4 to $5 billion there, representing the difference between specific authorizations and appropriations.

And then, finally, you have got to come in for additional authorizations.

Chairman PROXMIRE. My time is up. Let me try to complete. On the revenue side, it is my understanding that there is very little if any discretion that the President has.

Mr. SCHULTZE. That is right. Very little there.

Chairman PROXMIRE. He cannot recommend any speedup, or—or does he have any discretion left now in slowing down corporation tax payments, for example, or any other aspect?

Mr. SCHULTZE. I believe there has been some in the area of relationship between collection and accruals. I would not be able to spell them out for you right now.

Chairman PROXMIRE. Would you see if you can find them and put them in the record, the amount involved here, several hundred million or maybe a billion dollars?

(The following material was later supplied:)

ANSWER TO SENATOR PROXMIRE'S QUESTION CONCERNING AUTHORITY OVER THE TIMING OF TAX PAYMENTS

There is no administrative discretion as to the date by which estimated and final payments for individuals and corporations are made (or as to the timing of the withholding from individuals' wages and salaries).

The time for payment of excises and the time by which employers pay over social security and withheld individual income taxes is left to be established by Treasury regulations. The regulations issued in 1966 and 1967 providing for more rapid payment of these taxes were part of the continuing effort in recent years to improve the efficiency of tax collections and to put them on a more current basis. Such improvement was an objective of the Tax Adjustment Act of 1966 which instituted graduated income tax withholding and a step-up in the payment of corporate income taxes.

It is also the purpose of the recommendations in the President's Budget Message for two further accelerations in corporate payments to be effective for calendar year 1968. One of these proposals will increase the ratio of a corporations estimated tax to its final tax liability from 70 to 80%. The other eliminates (over a 5 year period) the present exemption on the first $100,000 of corporate tax liability from the requirement of payment on a current estimated basis. Each of these proposals will accelerate corporate tax payments by $400 million in fiscal year 1968.

Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

Mr. Schultze, I am a little bit disturbed that your entire paper is directed toward deescalation assumptions, while our hearings are on the economic effect of Vietnam spending. If last year was, regrettably, any indication, this year we may be facing something more along the lines of escalating. What would be the economic impact of an escalation?

I would have liked to have examined more thoroughly some of those deescalation assumptions. Accordingly to Mr. Anthony, our basic assumption for fiscal 1968 was that the war would continue indefinitely at levels of activity indicated in our current projects. So certainly as we look at this picture I am very much interested, and so is this committee, in deescalation.

Let me ask this: The administration has a task force under the chairmanship of Gardner Ackley to develop economic plans for the postwar period. But what about the effects of an indefinite period of continuing at the same level? Is there any task force directing its attention to that, or to possible escalation?

Mr. SCHULTZE. The Ackley committee itself is considering all sorts of different possibilities with respect to deescalation on military spending changes. So there would be a number of different options to be looked at.

Representative CURTIS. I mean, will they look at the other side of the coin?

Mr. SCHULTZE. It is not the charge of that committee.

Representative CURTIS. It is not?

Mr. SCHULTZE. It is not.

Representative CURTIS. That is what I wanted to be sure of.

Mr. SCHULTZE. The committee stems from the President's Economic Report, where he charged the Chairman of the Council of Economic Advisers with taking the lead in planning for post-Vietnam.

Representative CURTIS. I am of course pleased to see that emphasis. But in the light of what happened in fiscal 1967, and in calendar year 1966, and the failure to anticipate the levels of Vietnam spending, I would be impressed if we were to have a task force on that.

Is the Secretary of Labor or the Manpower Authorization Board geared into this task force?

Mr. SCHULTZE. Yes, sir.

Representative CURTIS. I was very disappointed earlier this year when I asked the Secretary of Labor about the Interagency Advisory Committee on Essential Activities and Critical Occupations. I found that they have not changed any assumptions since 1962 in the use of manpower. Now, I think one of the great problems we have here is matching military need for skills with the civilian skills.

Some of the work of the statistical section of the Department of Labor shows a correlation between military needs for skills and those existing in a civilian society of around 80 percent and over. You say in your statement, 2 million men were added in the Armed Forces in the first year and a half of the Korean war buildup, and you say that in the comparable Vietnam period the size of the Armed Forces increased only one-third as much.

Mr. SCHULTZE. About 750,000.

Representative CURTIS. But what is equally important from an economic standpoint, how great is the buildup of the munitions industry in the two periods?

Mr. SCHULTZE. The munitions industry—I am not sure I could tell you, but I could give you an indication of some defense procurement.

Representative CURTIS. By munitions industry I mean in effect that which has been increased as the result of the Vietnam war. And I have used the term "munitions industry" broadly to describe any such industry. For instance, the textile industry was affected quite a bit by last year's buildup in military procurement. I think this is an important figure, because the administration in my judgment has lost sight of the fact that to some degree our unemployment statistics—and they are very favorable, of course—reflect this kind of manpower authorization, the 750,000 additional in uniform, plus around a million and a half, probably, in the civilian munitions type area. But that is a rough guess.

Mr. SCHULTZE. Of course, Mr. Curtis, everybody is quite agreed that undoubtedly there is a significant increase due to Vietnam—as I indicated, 3 percentage points of our gross national product is going into Vietnam, and on the labor side this means large numbers of workers, both directly and indirectly. I figure, of course, that if we hadn't had Vietnam, then fiscal policies would have been proposed and adopted by the Congress, which we believe could have maintained the same level of prosperity without Vietnam.

Representative CURTIS. That may be. But that does not excuse not looking at the facts and getting the hard facts in for what they are.

Mr. SCHULTZE. We have not.

Representative CURTIS. Well, give me the figure, then, for how many are employed as a result of the Vietnam buildup in the munitions industry, if you have not neglected it.

Mr. SCHULTZE. Let me, for example, give you two numbers. No. 1, take a look—get one idea of the magnitude, at procurement expenditures. Now, I admit these cover both soft goods and hard goods. But hard goods account for more than three-quarters of it.

Representative CURTIS. Let me interrupt for this reason, Mr. Director. I am happy to get at this figure however we could. But the pertinent point right now is that apparently the administration has not developed the figure from this kind of data.

Mr. SCHULTZE. I have not had a chance yet, Mr. Curtis, I was about to.

Representative Curtis. I mean in your prepared statement. I can get a lot of things on cross-examination. But as we have pointed out before in our interrogation, it is one thing for the administration to come forward with their prepared paper so that it discusses the things that are pertinent, and another thing to answer off the cuff when I interrogate on substantial things. There certainly are no estimates in your prepared statement of how much the employment has been increased as a result of Vietnam.

Now, proceed.

Mr. SCHULTZE. I was going to give—my paper was not essentially written around that point—I should not say my paper, my testimony.

As I indicated, you can get at this two ways. One is on the expenditure side for procurement. It was running about $12 to $14 billion a year prior to Vietnam. Now, the budget amount for 1968 is $21.6 billion procurement. So the increase in procurement expenditures is in the $7 billion plus area. That is No. 1.

Representative CURTIS. Is that procurement for goods and services?

Mr. SCHULTZE. No, just goods.

Now, again, part of the operation and maintenance account is also goods. Essentially we break it by procurement and by operation maintenance. But the big item is the procurement item.

Secondly, the Department of Defense—and I cited some of the figures from it—has made surveys of the defense employment covering the very largest part at least of defense procurement, and was unable to get all the way down to the subcontractors.

There is an article [1] which I would be glad to submit for the record that looks at those in any number of different ways, Mr. Curtis, in terms of where they were employed and how much. And I will submit that for the record.

(The article referred to has been included in the appendix to these hearings.)

Representative CURTIS. The pertinence of this, of course, is that when you deal in aggregates you don't get a complete picture. You

[1] "Economic Impact of Defense Programs," by Col. Vernon M. Buehler, U.S.A., Director of the Economic Impact Division of the Office of the Deputy Assistant Secretary of Defense (Economics), Office of the Assistant Secretary of Defense (Systems Analysis).

also get structural shifts, because we used different kinds of plants and different skills for the peacetime expenditures than we do for military, of course.

Mr. SCHULTZE. I quite agree. And one part of my paper was attempting to try, and very crudely, I admit, some measure of concentration by area of these.

Representative CURTIS. I am trying to do the breakdown, which I think is even more significant, by skills and for what purpose are they used, and which is for a certain period.

This was the problem after the Korean War to a large degree, the fact that we had to find jobs for a little less than a million people coming back. Certainly if you include the munitions industry, this number was well in the area of a couple of million.

Mr. SCHULTZE. As you indicated, Mr. Curtis—and I fully agree—the correlation between military and civilian skills is probably higher than most people think. And secondly, maintaining an overall level of economic demand is the most important requisite. A large number of problems are taken care of because both the plant and the manpower particularly is flexible.

Representative CURTIS. I read a statement by Secretary Fowler in which he assumed that the revenue, or the revenue estimates of the Treasury Department, would remain at the same level even if there were a deescalation of the war in Vietnam. If this is an accurate statement, he was making no allowance for the problems involved in this structural shift. I am talking about revenues now. And certainly one should allow for some loss of revenue as a result of this shifting. Don't you agree?

Mr. SCHULTZE. I would say very little loss, Mr. Curtis. I think that policies can be pursued which will get the transition done both quickly and without an economic pause.

Representative CURTIS. Let me suggest that if the administration has not done its homework yet in the area of what skills are under pressure, and what plant capacity is under pressure because of Vietnam, they are not going to be in a position of alleviating the problems in the structural shift area. Maybe you will do it geographically. But I am talking about the relation of skills and plant utilization.

Mr. SCHULTZE. As a matter of fact, the Department of Labor does have on the way a look at occupational requirements, occupational skills. That is one thing that Mr. Ackley will look into it.

Representative CURTIS. I see my time is up. I might add at this time that in spite of the testimony produced at our Subcommittee on Statistics last year, in which all witnesses said that we needed the job vacancy statistics and that they were feasible, the representatives of AFL–CIO and the Department of Labor are the ones who wouldn't move forward into developing this. I would regard this as a very essential statistic if we are going to do the job of shifting, whether it is an economy based on war or major shift in the economy itself.

Mr. SCHULTZE. I recall that in the last two budgets before this committee the Labor Department asked funds for this job vacancy survey. After two failures it was not included the third time, but we did ask for it twice.

Representative CURTIS. Yes, but if this administration would be really energetic in trying to get these statistics, and pointed it out to the congressional leaders and the public, there is no question but that they could get the funds, particularly as they had it pretty solid and they probably could vote on it. I suggest that the AFL-CIO is opposed to it for their own reasons. And this has had a compelling effect on the administration and the Congress.

Mr. SCHULTZE. This is your particular version of it. All I am saying is that we tried hard to get it at least twice.

Chairman PROXMIRE. Congressman Moorhead?

Representative MOORHEAD. Thank you, Mr. Chairman.

Mr. Schultze, in your testimony you point out that our gross national product is increasing at an annual rate of $30 billion to $35 billion and you express concern that there be enough demand to absorb this capacity. What I would like to ask you, sir, is not what would happen in the case of sudden deescalation, as the chairman asked, or in the case of escalation as Mr. Curtis asked, but suppose—and I hope I am wrong about this—suppose the war continues at roughly this present level, which is, what has been projected—what will be our economic situation concerning supply and demand?

Mr. SCHULTZE. Let me make a try at that at least.

Suppose for the moment, just as an assumption that will be responsive to your question that defense expenditures just leveled out at the 1968 level for another year or two. Just assume that a growing economy, to use the productivity and labor force increase, would need $30 to $35 billion worth of real growth. Also, if prices would rise, let's say, the one to one and a half percent a year that you had before Vietnam came along. Then the money value of GNP would have to rise about $40 to $45 billion a year. At the same time, with constant tax rates, that kind of economic growth will take in about $7 to $8 billion a year additional revenues each year. And it seems to me clearly that you would be faced under these circumstances with the question of what you do with that $7 to $8 billion of additional revenue, and whether, without additional increases in Federal expenditures or some tax changes, the economy will continue to move ahead, to eat up that $40 or $45 billion a year. What I am saying is that, by the very fact that our revenues are based on income, the fact that income must grow to keep the economy healthy, you cannot stand still, you have got to take action. You are automatically forced into making fiscal policy changes, tax reductions, or expenditure increases, under the kind of circumstances you postulate. And I would agree that you do not simply look at whether expenditures go up or down to find the solution to the problem.

Representative MOORHEAD. Do I understand you to say that with this steady continuation of the war we would have a very mild form of the same problem which would exist to a greater degree in the case of deescalation?

Mr. SCHULTZE. Barring a real upsurge in private demand which fortuitously would be able to take care of it—barring that—yes, sir.

Representative MOORHEAD. In your statement you talk about the 18 million children reaching maturity. And you report this as a good thing for home formation with all that this entails. It seems to me that not so long ago we used to read the same statistics and wring our hands and say, "How are we ever going to find jobs for the 18 million men that are coming into the job corps?" What is the difference? What has changed the climate?

Mr. SCHULTZE. Nothing has changed the climate. I don't believe I was involved in the hand wringing. So from my point of view the climate has not changed. That is about the only answer I can give you.

Representative MOORHEAD. You consistently believe that this is an economic plus rather than——

Mr. SCHULTZE. Yes, sir. It does not mean that there are not some problems posed by it. But it seems to me that on the side of aggregate demand a large number of people coming into the family formation age bracket tends to be a plus. Now, usually several years before that these same people will have come into the labor force. You can absorb these young people coming in. I think we have shown it by the employment record of the last 6 years. Even if you want to go back before Vietnam, these people generally have been absorbed. The real problem is not large numbers, large numbers of people coming into the labor force are not the problem. The problem is the skills and education of these people, and whether or not there is some proportion of them who are not suited to take the kind of jobs that the economy offers. That is the problem. It is a problem of structure, not the aggregate number. I think we can handle the aggregate number even if they were three times this much. It is a question of education and skills and motivation, and everything else that is behind it, and what proportion of your youngsters coming in that do not have those skills or education or motivation. This, it seems to me, is the problem.

Representative MOORHEAD. Mr. Schultze, will the Ackley committee address itself to what you call the end-use problem?

Mr. SCHULTZE. Yes, sir, it will take a look at the end-use problem. It is impossible at this time to predict what conclusions the committee will reach concerning this problem. But, clearly, one of the major questions facing you is tax cuts versus expenditure increases. And what kind of tax cuts and what kind of expenditure increases. You just don't lay out a single plan and go blindly ahead, because events never quite match up to what you thought they were going to be. What you really need is to break the problem down to logical parts and look at what alternatives and options are open to you and be ready to move on those options as events occur. But you don't necessarily, it seems to me, in this kind of situation come up with a single rigid plan which will fit only one set of circumstances and plunge blindly ahead with that. You examine what your various circumstances might be and what kind of options you have under several kinds of circumstances. Examination of options—this is a major value of this study—instead of coming up with a single blueprint that you then put away and forget about.

Representative MOORHEAD. I am glad to hear you say that there will be options, because it seems to me that the basic decision of whether you place emphasis on the private sector or the public sector, or the mix in between, is one on which no committee of this form could possibly decide.

Mr. SCHULTZE. As a matter of fact, our constitutional and Government structure is obviously set up to insure that this should be a matter for the President to propose and the Congress to adopt or reject or modify. I fully agree with you on that.

Representative MOORHEAD. Thank you, Mr. Chairman.

Chairman PROXMIRE. Senator Jordan?

Senator JORDAN. Thank you, Mr. Chairman.

Mr. Director, I appreciate the thoroughness of your statement. You have pretty well reiterated the testimony we had this morning from Mr. Anthony with respect to the comparison between this war in Vietnam and its effect on the gross national product, and that of the Korean war. Both of you have said that the cost of this war is generally conceded to be about 3 percent of the gross national product, whereas the Korean conflict got as high as 12½ percent in the first quarter of 1952. My first question is, are we talking about constant dollars here?

Mr. SCHULTZE. Let me first say that the Korean war did not cost 12½ percent. Rather, total defense expenditures were 12½ percent, of which Korea itself was a part, perhaps 6 or 7 percent. There are two numbers to compare: 12½ percent of GNP for total defense expenditure during the Korean war, and 9 percent for defense now. Only 3 percent of present GNP is attributable to Vietnam. Of the 12½ percent total defense expenditures at the time of the Korean conflict, 6 or 7 percent was attributable to Korea. That is No. 1.

No. 2, in terms of constant dollars the ratio would come out about the same, the reason being that since Korea prices both of the gross national product and of defense spending have risen by very roughly the same amount.

So while you are quite right in your implication that prices have gone up, they have gone up on the numerator and the denominator both, so it would not change the ratio very substantially. It might change it a little, but not very substantially.

Senator JORDAN. To get to a point that Congressman Curtis explored with you somewhat, you say that during the first year and a half of the Korean buildup we added 2 million men to the Armed Forces, and it was almost exactly equal to the total increase in the labor force over the same period. And we would say then that 2 million men went into the Armed Forces and 2 million men went into the labor force. In the comparable Vietnam period, the size of the Armed Forces increase was only one-third as large, and you have translated that into about 750,000.

Mr. SCHULTZE. Yes.

Senator JORDAN. And the rise in the labor force was 50 percent. And then there were about the same number of people that are involved in both of these.

Mr SCHULTZE. Maybe it would be better if I actually used the numbers rather than the percentages I did.

Senator JORDAN. All right, 50 percent of more than 3 million.

Mr. SCHULTZE. Three million, that is correct.

Senator JORDAN. What significance do you attach to that, the fact that one man is in the Armed Forces in Korea, one man in the labor force, in the case of Vietnam, one man in the Armed Services, and four men in the labor force at that ratio?

Mr. SCHULTZE. Of major significance is the fact that in the time of Korea, as I am sure you recall, we were building up from very small

Armed Forces. Our capabiilty to take on something like Korea was substantially less than our capability to take on Vietnam. Hence the addition to the size of the total Armed Forces was less now simply because we were starting with a much larger number.

Senator JORDAN. Because we started from a lower point.

Mr. SCHULTZE. In Korea we started from a much lower point. And in addition, the age of the population is such that there was a larger number of people coming into the labor force during this past 18 months than during the Korean period.

Senator JORDAN. Then you go on to say here, Mr. Schultze, that our experience between 1961 and 1965 in another earlier period clearly demonstrates that the American economy does not need stimulus of a war to reach and maintain economic growth and prosperity. Do you think it clearly demonstrates our experience from 1961 to 1965?

Mr. SCHULTZE. I would say 1961 to 1965 clearly demonstrates it. I would also say that if we look at the reconversion after World War II, and other periods in our past history, it, too, demonstrates this. I particularly say that fiscal policy in terms of taxes and expenditures can clearly be used to maintain steady full employment—or close to it. You never have perfection.

Senator JORDAN. Not automatically.

Mr. SCHULTZE. It has got to be a policy action, yes.

Senator JORDAN. It has got to be a policy action.

You said some time during your statement that something like $20 to $25 billion was the amount of displacement, perhaps.

Mr. SCHULTZE. $15 to $20 billion.

Senator JORDAN. All right. And that gross national product is increasing $30 to $35 billion a year. This makes a subtsantial demand on reprograming both in the public and private sectors in order to keep this transition moving smoothly and to take up that amount of slack, isn't that true?

Mr. SCHULTZE. That is correct, sir. I think what I was trying to get at was something like this. Every year, quite apart from the transition or deescalation, our capacity grows $30 to $35 billion. And you have got to find uses for those resources, so that the problem of $15 to $20 million more on top of the $30 to $35 billion is not something completely new. It is not the kind of a problem that we have never had to face before.

Senator JORDAN. No more than 50 percent of what we have to do this year.

Mr. SCHULTZE. Exactly.

Senator JORDAN. You have enumerated a number of areas where this money can be channeled in the way of improvement in transportation and in air and water pollution, and housing and so on.

Mr. SCHULTZE. Yes, sir.

Senator JORDAN. My question to you is, Has anyone in the administration made a study of the amount of economic and physical rehabilitation that will be required in Vietnam itself after the war?

Mr. SCHULTZE. In terms of a complete study, not to the best of my knowledge. I am not sure I can really respond fully to the question. Clearly this is one of the things that will have to be looked at—which the Ackley committee will have to look it. And at the moment I am not sure exactly what is available.

Senator JORDAN. Wouldn't you think it is important, as we look at the program, the domestic program of the United States, that we certainly take an inventory of the needs caused, if by nothing else, our own destruction in Vietnam?

Mr. SCHULTZE. I fully agree, Senator.

Senator JORDAN. To your knowledge, no one is directing their attention to that?

Mr. SCHULTZE. No, sir, I did not mean that. What I did say is that I don't know of a completed study of this. This does not mean that nobody is looking at it. And one of the major things that is going on now in Vietnam is reconstruction and pacification. I simply have no personal knowledge of the extent to which that has been extrapolated into the situation when you have peace. That does not mean it has not been done. But obviously one of the major things that our people are now concerned about in doing the planning in Vietnam is precisely the problem of pacification. And what you are talking about is an extension of that, and much more rapidly, because you won't have the military problem in front of you. All I mean is that I have not seen a particular piece of paper.

Senator JORDAN. I think it would be important if we could have an evaluation of what we calculate our effort would be in that particular area if and when hostilities cease.

Mr. SCHULTZE. All I am saying at the moment is, I have no personal knowledge of the status of those things.

Senator JORDAN. Will you make inquiries with such information as is available and supply it for the record?

Mr. SCHULTZE. I will make inquiries.

Senator JORDAN. Thank you.

(The following information was later submitted:)

REHABILITATION AND DEVELOPMENT IN VIETNAM AFTER THE WAR

AID has contracted with Development and Resources Corporation, headed by David Lilienthal, to examine the requirements for economic development and reconstruction in Vietnam after the war. Their preliminary report is scheduled for completion this June, at which time, agreement will be reached on priority areas of study and the number of U.S. technicians needed to carry out the planning effort. The Vietnamese government and private Vietnam citizens will participate in the joint planning group.

The Council of Economic Advisors is coordinating various executive branch studies on post Vietnam planning related to U.S. economic policy. One such study addresses the U.S. balance of payments. Part of that study will be directed to the foreign aid and related costs to the U.S. of the rehabilitation and development of Vietnam.

Chairman PROXMIRE. Thank you, Senator Jordan. I think that is very interesting and we should pursue that. We are spending about $½ billion in Vietnam in economic aid according to Mr. Anthony this morning. And the President indicated in his Baltimore speech in 1965 that after the war was over we would expend about $1 billion in the Mekong Valley area.

Mr. SCHULTZE. Economic aid to Vietnam is about 50–50, that is right.

Chairman PROXMIRE. So if we are now spending a half billion dollars in this Vietnam economic area, and we may later spend $1 billion in the Mekong Valley over a period of years, that is overwhelmingly dwarfed by the present military costs. So if we could stop the war in Vietnam the savings will greatly exceed the likely cost of reconstruction, at least on the basis of these figures.

Mr. SCHULTZE. Yes.

Chairman PROXMIRE. I would like to ask you whether the effect of the Vietnam war on the economy, whether it is jobs or prices or interest, would not be significant enough on the basis of your testimony to disturb the economy, provided we have the full information on it in advance and act prudently on the information. You testified that the President cannot do this himself, he is very limited, he is quite limited on the amount of spending that he can either cut down or expand. Therefore, it seems to me it is imperative that we get congressional cooperation on this.

Mr. SCHULTZE. I agree.

Chairman PROXMIRE. And you cannot get congressional cooperation very well if you don't give us the facts. The facts are just overwhelmingly significant. Now, is this a fair statement?

Mr. SCHULTZE. I will agree.

Chairman PROXMIRE. Now, looking at what happened after World War II—we have in that case a relatively economic catastrophic development—the Federal expenditures, Government purchases of goods and services in 1945 were $82 billion. The following year, 1946, they were $27 billion, less than one-third. Now, you were able to do that during a period when unemployment stayed below 4 percent—1.9 percent in 1945, 3.9 percent in 1947, 3.9 percent in 1948—and in 1948 we had a surplus of over $8.5 billion. In 1954—1953–54—we were adjusting to the Korean war. We had a sharp cutback in military spending and in overall Government spending. And unemployment stayed down during every year except 1953 when it went to 5.6 percent, but in the other years it was well below 5 percent. What I am getting at is, how about the possibility of considering some debt retirement, in the event that we can secure negotiations and cease fire, and so forth, what are the possibilities in your judgment of being able to maintain a reasonable level of employment and cut back spending so that we can reduce the national debt?

Mr. SCHULTZE. Senator, I would go about that in a different way. I would ask myself what is the appropriate fiscal policy in combination with the monetary policy. The appropriate mission of fiscal and monetary policy is to make a smooth transition. To do that you have to take into account the strength of demand in the private sector. If you put all that together, and it comes out that the appropriate Government policy is to run, to pick a number out of the air, a $5 billion deficit, then you want to think about a $5 billion deficit. I would not start by saying, I want full employment and a smooth transition and debt retirement as an objective.

Chairman PROXMIRE. I did not start that way. I know no era of new economics should start that way, if you do you get zero in the classroom.

Mr. SCHULTZE. All I am saying is that I cannot answer that question except as a residual of the other question.

Chairman PROXMIRE. Let's get it as residual.

Mr. SCHULTZE. At this stage I am not prepared to answer it. That is precisely the kind of thing we are looking at in the Ackley committee. What is the magnitude of the fiscal policy requirements? And what monetary policy actions will be required.

Chairman PROXMIRE. I do not mean necessarily, as they say on "Meet the Press," the questions of the interrogators do not indicate their viewpoint necessarily. But we have had since 1961, as I say, great economic progress, lower and lower unemployment, enormous increases in corporate profits, which is very productive as far as Federal revenues are concerned. And yet we have had continuous deficits, and the prospect this year of a very large deficit indeed. And I am just wondering if we can assume that by following the kind of policies you suggest that we at the same time can expect possibly to reduce the debt. We did after every other war in our history until World War II. And we did after World War II for 2 years.

Mr. SCHULTZE. In the first place, you have got to ask yourself what budget you are talking about. For the purpose you talk about, what is appropriate is the deficit or surplus in the national income account budget. You might, for example, be running a surplus in the national income accounts budget and not run one in the administrative budget. Again, it just turns out that the way we handle our budget, if you happen to have a big deficit in your trust fund, then you could well afford to run a surplus, let's say, in your administrative budget to offset——

Chairman PROXMIRE. I understand that.

Mr. SCHULTZE. All I am getting at is, first, you are asking really for a numerical conclusion. And I am not prepared at the moment to be able to furnish one. And second, I think you have to talk about running a deficit or surplus in a particular budget before you talk about debt retirement. I just do not think one can make a specific conclusion about whatever would be possible or not possible until——

Chairman PROXMIRE. On the basis of the demographic figures that you gave us, it would seem to me that we may be moving into a period where we are likely to have to run into ever larger deficits. Here's why: You pointed out that a very large number of children are going to achieve maturity during the next few years. They are going to be workers, no longer consumers, they are going to be added to the work force. Under these circumstances, where they are producing and are workers, and you have more people able to produce, isn't it likely that you are going to have to have a big Federal fiscal stimulus to the economy if you follow the full employment surplus logic, that you are going to probably have a series or risk at least a series of quite substantial deficits? We ought to be prepared for it. We are going to have to have tax cuts. And we will require a great increase in Government spending programs if we are going to achieve this low level of unemployment and high level of employment.

Mr. SCHULTZE. Clearly if, as after World War II, the level of demand in consumer and investment goods were running very high and very strong, then it may well be that for purposes of rational economic policy you would have to run a substantial surplus. As a matter of fact, after World War II we did not have a large enough surplus. We ran one for a couple of years. I am sure it should have been larger. Because the pent-up demand from World War II was overwhelming. Clearly, in that magnitude we do not have it.

Chairman PROXMIRE. We do not have it at all to speak of.

Mr. SCHULTZE. Pent-up demand does not seem to be present.

Chairman PROXMIRE. We had controls, and we don't have them now.

Mr. SCHULTZE. As a general proposition we had 2 or 3 years of extraordinarily high consumer savings in World War II which we have not had recently.

So we are dealing with a question of surplus or deficit—to take the surplus out—which is of a much smaller magnitude than after World War II. But this then gets down to a much more refined calculation as to what your expectation is with respect to private housing demands and consumers savings and so forth, and then translate that to what would be the appropriate Federal budgetary surplus or deficit. And as I say, you are getting down to areas of refined numerical calculations when you are talking about swings in the order of a half a percent in the GNP. After all, a $4 billion surplus is a half percent of the GNP.

Chairman PROXMIRE. You had a very interesting table. Could you give us the reasons for the large proportion of defense business in the tables you have presented to us?

Mr. SCHULTZE. In the tables which I mentioned, I think, in the colloquy with Mr. Curtis, we do have the States and regions laid out. We do not have the individual labor market areas.

Chairman PROXMIRE. Did you lay those out as far as the Vietnam war is concerned?

Mr. SCHULTZE. No.

Chairman PROXMIRE. Because it is difficult to analyze the effect of Vietnam deescalation because two-thirds of this defense spending is not Vietnam.

Mr. SCHULTZE. This is total defense, not segregated by Vietnam.

Chairman PROXMIRE. Can you break it down on Vietnam spending; that would be very helpful.

Mr. SCHULTZE. To the best of my knowledge on this kind of calculation, no, sir.

Chairman PROXMIRE. Wouldn't it be well worth getting that kind of information?

Mr. SCHULTZE. I think what one would have to do would be to translate in terms of the aggregate—again, one of the things we want to look at in the Ackley committee is our own capability.

Chairman PROXMIRE. I should think that would be relative—I know it is nothing in this area where you have such enormous sums—but it would be relatively simple for the Defense Department and the Budget Bureau to be able to determine what is being used in Vietnam, where it is being procured. Helicopters, for example, are one item which I think would be sharply reduced, with Vietnam deescalation, and you must know where those are being procured. And many other items that are being used in Vietnam. And there are others, research expenditures of various kinds, ballistic missile procurement, that kind of thing, which would not be affected at all by Vietnam.

Mr. SCHULTZE. What would be required is a kind of study of what kind of contracts would be cut, and then go back and translate that information into the specific areas that might be affected. Now, as I say, this is precisely one of the things that the Ackley committee is taking a look at; and it is examining the mechanisms that we have available to do that translation. Of course, a lot of the translation involves not just prime contracts, but subcontracts.

Chairman PROXMIRE. I saw a very interesting statistic in the Wall Street Journal reporting on the Vietnam veterans, showing that after World War II 29 percent of those of us who were in World War II took advantage of the GI bill to take further education; after the Korean war 50 percent did; and they said in this war 84 percent are doing so. This is most encouraging as far as the future of the economy of the country is concerned, but it also indicates a tough challenge. You indicate that it may be in this area that we do not have the personnel or the facilities to handle some of these things. Now, you were not specific as far as the GI bill is concerned. But is this one of the areas where we should be concerned about providing a sufficient instructional personnel and facilities, and so forth?

Mr. SCHULTZE. In general, I would agree. I was specifically addressing my comments—as it is quite relevant—to the limitations. The rate at which you could increase the Federal Government's programs is very limited in some cases by the availability of trained personnel; this is particularly true in such areas as health, employment counseling, and city planning. Another area is education, where personnel skills are very important and their shortage can be a limitation on how rapidly one can increase education programs. If you look at the education picture in the United States you see that the colleges and universities are being hit very heavily by the influx of those children who 10 years ago were in elementary schools and secondary schools. You see the big enrollment problems that we had in the postwar years now being transferred from elementary and high schools to the colleges and universities. However, my comment was a more general one. Increasing Federal expenditures is not something that you should do by taking into account only purely technical factors and seeing where one might feasibly increase Federal programs from the point of view of funding availability. One should also consider the desirability from the end-use standpoint, from the social and economic values of the alternatives considered, and also from the practicability of the action with respect to the availability of the skilled personnel to do it.

Chairman PROXMIRE. Let me ask you if this is true. This is a problem as far as your educational institutions are concerned, because they are being used to their capacity now. But at the same time it is a helpful adjusted to what otherwise might be an unemployment problem. After all, if you are going to have a demobilization of 500,000 men over a period of a year and a half or 2 years, and most of them are going to be in education, then you do not have to worry quite as much about having jobs available immediately. Of course, maybe they will want jobs to supplement their GI benefits if they are married, and so on. Even so, it is much less of a problem, and it is a different kind of a problem. You have to look at the kind of jobs you need for them when they finish.

Mr. SCHULTZE. Conversely, having taken that education, the mix of the labor force will probably be better suited for the mix of the jobs available simply because of the fact of their education. That has been our experience in the past.

Chairman PROXMIRE. Thank you.

Congressman Curtis?

Representative CURTIS. After listening to this, I just wish a little more that this were a paper, and before the eyes of the task force under Chairman Ackley. I certainly hope that this task force will make its working papers available to the public, and certainly to Congress. This secrecy would seem to be a habit of executive task forces. Surely there is nothing involved in this kind of study that needs secrecy, is there?

Mr. SCHULTZE. This I have not even discussed with the task force.

Representative CURTIS. I should direct that to the task force. But I am still concerned about the executive department now having created two commissions to study manpower authorization for the military. And Congress still does not have the working papers, if there were any. In fact I am convinced by now that there were no working papers, but that they just had their conclusions and presented them.

Mr. SCHULTZE. If you will recall, for example, the one on the draft, there were voluminous appendices and statistics.

Representative CURTIS. I have read those working papers—those are conclusions.

Mr. SCHULTZE. There are also——

Representative CURTIS. I beg to disagree with the gentleman. There are practically no work papers. One has to guess where to get this information. And frankly, it is almost useless.

But there is one specific question. The Armed Services Committees and other students of the area of expenditures have said that the first phase of the Vietnam war was operated to a considerable degree on inventory in pipeline. And if this were so, the levels of expenditure would just continue on at the projected operation that we have in Vietnam, and would, I think, increase. And at the end, if that were the planning of the Defense Department, we would have to fill up inventory and pipeline. Would you care to comment on that?

Mr. SCHULTZE. I am not sure that I can comment at all in any detail, simply in terms of lack of detail. It is quite clear, of course, that when you move into any situation like this, you initially do draw down inventories until you get your pipelines running again. That is quite correct.

Representative CURTIS. What I am trying to do is direct that point to the then level of expenditure.

Mr. SCHULTZE. Quite right. What you will find is that the actual level of expenditure will at first be less than and then more than the actual rate at which you are using materials, simply because of the inventory fluctuation. You are quite right on it. And in turn, whenever you cut back you have to take into account your policies with respect to inventories—for example, the fact of having fought a conflict that lasted over some months gives us a better idea of what kind of inventory we should have. So one of the other things you must look at is the inventory policy as you start cutting back expenditures.

Representative CURTIS. You say—and I am quoting from your statement:

> But there should be no doubt in anyone's mind that appropriate fiscal and monetary policies can insure an adequate level of overall demand and accomplish the transfer of resources to what ever end we as a Nation desire.

And I emphasize the word "transfer," because this is, as I see it, a key—there is a real cost involved in the transfer. We mentioned the GI bill as one of the costs in transfer, and one that I frankly think is a good one, but it does increase our governmental expenditures. The disabled veterans' benefits is another factor in this transfer that is important.

But also in this transfer there is an increase in the training and retraining that is going to have to go on in the private for profit sector. According to their estimates, they have come up to an expenditure level now of around $14 billion a year in training and retraining. Now, if training and retraining is increased to some degree, and requires a shifting of plant, modifying it in whatever way is necessary to get a peacetime product, to get the plowshare instead of the spear, it also has a cost. This all relates to the corporate profits and other business profits, which in turn relate to the revenues that the Federal Government can count on.

I am explaining why I was critical of quoting Secretary Fowler's assumption that the revenue of the Federal Government would continue at the same level as we are experiencing during the Vietnam war operation. Have you made any estimates of the costs involved in transfer, including increases in expenditure of the Federal Government—and I mentioned a couple of areas—as well as the effects on Government revenues.

Mr. SCHULTZE. I have not made an estimate specifically along those lines, Mr. Curtis. My own view would be that the actual cost of transferring resources, while it exists, is not by any means massive. For example, the GI bill——

Representative CURTIS. May I argue with you a little by giving another illustration. After World War II, the demand for our agricultural products, of course, fell way off. We had asked our farmers to plow up additional acreage in order to be able to meet the wartime demands for agricultural products until the Western European countries and other countries came back into industry. This created a problem in transfer after the war, and I think rightly so. And we said to those under our subsidy programs, we are not going to leave you high and dry. We never did effect a transfer because we just continued the support after that.

I am trying to illustrate some of the costs involved in transferring resources. This is what I hope the Ackley committee is going to direct attention to, both the cost of transferring resources; namely, plant to peacetime production, but probably even more costs, and certainly more important, the cost of changing manpower skills.

Mr. SCHULTZE. I agree with you, Mr. Curtis. Undoubtedly that is an area that requires a good bit of investigation and study, but all I wanted to point out was: Don't overemphasize the cost of the transfer.

Representative CURTIS. I can't, because I don't know what the costs are. And I would argue the other way. I think the administration not only underemphasizes the costs, but is not even coming up with some estimates. I don't know what they might be. But I do know that these problems have been very real in previous wars.

Mr. SCHULTZE. When we went into Vietnam the transfer cost was not a really serious one, because of the relatively modest proportion it represented of total economic activity. The transfer of resources that occurs every year as individual industries grow or decline is probably much larger. I am just putting it in perspective.

Representative CURTIS. Certainly in a technological, rapidly changing society the instance of transfer is increased. But it was sufficient, I would argue, to create what we call a recession after the Korean war.

Mr. SCHULTZE. That wasn't because of transfer costs.

Representative CURTIS. I argue at any rate that the evidence shows that it was almost entirely in the transfer area. From a partisan angle the critics of the Eisenhower administration granted it on another basis, almost ignoring the problems involved in shifting from a war economy to a peace economy.

Mr. SCHULTZE. And yet after World War II we didn't have a recession as a transfer cause.

Representative CURTIS. We didn't immediately. But I think we had these various problems which were caused by other conditions.

Mr. SCHULTZE. The only point I wanted to make for the record, Mr. Curtis, is that I don't think you can say that transfer costs are such, either in magnitude or in nature, that it is going to pose major recession problems. It doesn't mean that there won't be any problems at all.

Representative CURTIS. I wasn't saying that necessarily, I am just trying to direct attention to it particularly—I might say that in the structural area only our need for skills in health, education, and welfare impedes our growth there. We are talking in terms of hundreds of thousands of jobs going begging. And if this kind of shift is going to put a further load in that area, it means that we have got problems. I wouldn't necessarily say that we are going to come into a recession, because I don't think we will.

This leads me to the point where you say this:

> There is no automatic mechanism which provides for an increase in private spending to absorb the freed resources.

And I was wondering what you thought the marketplace was, if that isn't an automatic mechanism in our society which will go to work immediately on absorbing the private spending.

Mr. SCHULTZE. Not unless certain decisions are made with respect to either taxes or other Federal spending.

Representative CURTIS. Isn't this what happened after World War II?

Mr. SCHULTZE. No, sir.

Representative CURTIS. What happened?

Mr. SCHULTZE. We had a massive reduction in taxes.

Representative CURTIS. I see what you mean.

Mr. SCHULTZE. I am not saying that within the consumption sector that we should be telling consumers what to do. What I do mean——

Representative CURTIS. I was afraid you were.

Mr. SCHULTZE. No, I was pretty clear, I thought. All I am saying that if you reduce defense expenses by—you name a figure, $15 billion—something else has to be done to make sure that $15 billion is used up, it could be a tax reduction, or monetary policy, or other Federal expenditure increase, but it won't happen by itself.

Representative CURTIS. Then we are on the same wavelength. I frankly had read this to mean that the Government had to get into the expenditure policy area to tell us how to allocate our resources.

Mr. SCHULTZE. May I read the sentence?

Representative CURTIS. We can go on.

Mr. SCHULTZE. The next sentence to the one you quoted, I thought, made the point. But maybe I am wrong.

Representative CURTIS. I didn't get it, I will be honest with you. And then when you had your colloquy with the chairman using some of this to retire debt, I became even more concerned.

But, to continue, you say:

> The relative emphasis we place on tax reductions versus increases in the Federal budget—
>
> There we get into an area where we might have a quarrel, maybe we don't—for example, will determine how the newly available resources will be split between the private and public sector.

Let me ask: On tax reductions have you contemplated a tax credit as a very fine way possibly of having tax reductions?

Mr. SCHULTZE. We have neither included or excluded—we have excluded nothing.

Representative CURTIS. You wouldn't exclude it? In other words, in according tax reduction you could include, for example, the tax credits which many Congressmen put in, such as I, myself, for part of the cost of educating your children.

Mr. SCHULTZE. We wouldn't exclude looking at anything.

Representative CURTIS. Up to date the administration pretty well excludes tax credits as an alternate method of spending money on education, and on the area of air pollution and water pollution, because there are many of us who suggested that it would be a much preferable way for expenditure policy through a tax credit, rather than increasing the Federal budget expenditures. Do you see what I am trying to get at?

Mr. SCHULTZE. All I am saying is that in looking at the particular cases you mentioned, for a number of reasons—and I realize you disagree—in these particular cases we felt that it was not good policy.

Representative CURTIS. I appreciate the difference. But certainly from the standpoint of aggregates it doesn't make any difference, does it?

Mr. SCHULTZE. In the aggregate sense?

Representative CURTIS. Yes.

Mr. SCHULTZE. No, usually it is the program sense.

Representative CURTIS. And that is what I would like to discuss.

My time is up, Mr. Chairman. I would like to come back later.

Chairman PROXMIRE. I just have a couple of very brief questions.

This morning you were discussing the balance-of-payments impact of Vietnam. And it seems that there was a direct effect of $800 million to a billion dollars, and an indirect effect last year of maybe a billion dollars, adverse effect in Vietnam. For the record, would you—unless you would prefer to reply directly, because this may be a little bit out of your field, the Treasury may be helpful to you—I wonder if there is any additional pressure on our balance-of-payments deficit that can be eased as far as our policies in Asia are concerned or elsewhere as the effect of Vietnam expenditures.

Mr. SCHULTZE. Aside from obviously realizing and being familiar with the numbers you have indicated in terms of the fact that Vietnam has had an impact on the balance of payments, I am not prepared at the moment to talk about specific measures. These that we have gone through, as you are aware, are an illustration of the situation. But I am not prepared at the moment to talk about the details of it.

Chairman PROXMIRE. I think it would be helpful for our record to indicate when you correct your remarks any other alternative that may be available and might be considered.

(The following information was subsequently supplied:)

MEASURES TO RELIEVE PRESSURE ON THE U.S. BALANCE OF PAYMENTS ARISING FROM EXPENDITURES ON VIETNAM

Measures have been taken to encourage military personnel abroad to return a larger portion of amounts earned to the U.S. Such measures include improved procedures to facilitate allotments, and the Uniform Service Savings Deposit Program which authorizes the Government to pay interest rates of up to 10 percent for savings received from servicemen overseas.

Special efforts are also being made to assure that overseas expenditures by contractors are held to the minimum amount needed to carry out program requirements. Overseas expenditures by the principal Defense Department construction contractor in Vietnam have been held to about 20 percent of contract payments in the past eighteen months.

Procurement under the economic essistance program in Vietnam is restricted to the U.S. or to certain less developed countries where they can meet urgent requirements more promptly than the U.S., provided the countries agree to accept payments in dollars tied to financing imports from the U.S. through a special letter of credit. A waiver authority permits an exception when urgent requirements can be satisfied feasibly only from other countries.

Recently, a P.L. 480 local currency sales agreement was concluded with the Government of Vietnam under which all the proceeds of the sale are to be reserved for U.S. uses to meet our expenditures in Vietnam as a substitute for dollars.

Chairman PROXMIRE. One other question: The Arms Control and Disarmament Agency has this to say. I will read this and ask you for your remarks:

The alternatives for defense industry are by no means limited to producing goods and services for commercial purposes. Recently, interest has centered on the possibility that defense companies' capability for "systems" analysis and engineering, as well as their Government-market orientation, might be well-suited to the competition for the expanding requirements of Federal, State, and local governments in such fields as air and water pollution control, urban development, public transportation, education, and information retrieval. The State of California has let a number of contracts for feasibility studies by defense contractors for the solution of broad problems of the State. ACDA has contracted with the Denver Research Institute to pull together and evaluate the many threads of this public sector potential for defense industry which are now being considered and discussed.

And I wonder to what extent you think it is true that the defense industry can reorient or guide civilian needs in the public sector, especially the sector that is non-Federal.

Mr. SCHULTZE. I think I would probably take the middle-of-the-road view on that. On the one hand, it is perfectly clear that a number of problems that we have in the public sector—water pollution and urban rehabilitation are two examples—do lend themselves to systems analysis.

Take urban rehabilitation. You are faced with the problem of standard rehabilitation on inherently unstandard dwellings. It lends itself to the systems approach.

Obviously water pollution, the problem of whole river basins, lends itself to the systems approach.

And there are any number of alternatives usually available, no one of which is the sole answer. And the appropriate combination has to stem from a very careful systems analysis and a very close look at these complicated areas.

So, on the one hand, I fully agree that the applications of systems analysis to these problems is both possible and probably hasn't been done enough. And the capability of some of these defense contractors clearly is in that line.

I would then modify that by saying that one of the major problems in these areas is not the technological problem, but the institutional problem, dealing with multiple governments, cities, metropolitan areas, composed of 200 or 300 different levels of government, river basins composed of States, counties, and cities, and other units. So that unlike the defense area, where you stipulate an objective, and simply go to it in a sense, in the civilian area, one has to work out institutional mechanisms for making sure that the systems analysis is more than just a piece of paper. Hence, I take it, there are great potentialities, but you can't make a simple transfer from a defense situation to either a private or public situation.

You have to taken into account these institutional difficulties.

Chairman PROXMIRE. Then your reply suggests further action by some agency, presumably the Federal Government, to try and work out reasonable agreements to the extent that you can't in a State? California is ideal, it is so big, it is like three or four States of average size. And so it is to be expected that she might take the lead in this area. This suggests, however, that in many States where you have a common river basin or other common situations that might bring them together, that this is what you need. You suggest that you are not going to be able to get this automatically, it is going to take some Federal leadership, perhaps, to persuade these areas to work together to take advantage of defense contracting resources.

Mr. SCHULTZE. There are two areas. I can't recall the exact language or the exact provisions. But the last year's water pollution legislation did provide for river basin planning in the water pollution control. Now, the legislation finally came through with some of the requirements on this, perhaps a little weakened, but in any event it is there. Similarly in the model cities legislation there is an opportunity for the application of rehabilitation techniques over a wide area. But in any event, I would agree on this, you need some kind of leadership to work both institutionally and technologically on the systems analysis approach to these problems.

Representative CURTIS. In St. Louis, by the way, we are under Federal legislation. We do have it by State agency in Missouri and Illinois where we get at many of these subjects. And it is very desirable, and a great deal more emphasis needs to be placed on it.

Let me get back to my final line of questioning, taking up where the chairman asked about the possibilities of some debt retirement. I would suggest this is another way of relying on the private sector to pick up expenditures in lieu of the Federal Government.

Now, I am interested in this, not just from the standpoint of getting a balanced budget. We will just assume an even break. I have got three basic reasons. The first, and by far the most important is to get better expenditure policy through the discipline that a balanced budget produces. I think we have got a very weak expenditure policy in many programs.

The second is the international balance of payments.

And the third is to free our monetary policy, so that it is more flexible in avoiding inflation.

But now I want to come to the question.

The ratio of the Federal debt to GNP is right now about 45 percent. And I think that to relate the size of the debt to GNP is an accurate measure. GNP to a degree reflects our revenues, the economic activity and the profits made from it. But I have raised the question as to whether or not 45 percent is the optimum ratio. I have suggested a ratio of around 15 percent, which is what it was during most of the period of this country's fastest growth rate. Has the administration got in mind any optimum ratio? Do they want it around 45 percent, or if they had their way, would they like to shoot for 25 percent? What do they think an optimum ratio is?

Mr. SCHULTZE. Quite frankly, Mr. Curtis, I don't think there is an optimum ratio.

Representative CURTIS. What you mean is that—I hope what you mean is that no one has yet studied it.

Mr. SCHULTZE. No, sir.

Representative CURTIS. You surely think the Federal debt has sufficient economic impact so that there probably is some ratio that would be better than another. Would you think 100 percent is a good ratio?

Mr. SCHULTZE. No, sir; all I meant was that the key thing was what you do in order to change the ratio.

Representative CURTIS. We will talk about that after we get the optimum. Maybe we can't achieve it.

Mr. SCHULTZE. I disagree. I don't think you can set an optimum and then change the budget willy-nilly to get that optimum.

Representative CURTIS. I didn't say that. I said, let's find out what the optimum is, and then we can argue. We can't achieve it for various reasons, or we have to protect it over a period of time. But to have an optimum, I would think is desirable. But when you have made the record——

Mr. SCHULTZE. The key point, Mr. Curtis, is that if you were in the year, let us say, 1924—I don't know what the ratio was—but say it was 10 percent——

Representative CURTIS. Around there.

Mr. SCHULTZE. To go from 10 percent to 40 percent would have been catastrophic in 1 or 2 or 3 years. The economy adjusts itself to given levels of financial institutions and the kinds of financial paper. Therefore, I am not sure that I can, outside of the context of what budgetary steps are needed to make changes in the debt, pick a number and say, that is the optimum number and any number higher or lower is bad.

Representative CURTIS. This is very interesting, because there are a number of people that picked the optimum ratios of unemployment. And some of them said 4 percent. And this administration had some optimum ratios in regard to pricing and wage increases relating to a specific economic factor of productivity.

Mr. SCHULTZE. I think this is quite a different thing.

Representative CURTIS. All right. I am sure that the Council of Economic Advisers doesn't feel that there is an optimum need here, because it was never discussed in the interrogations that I have tried to make.

Well, there are ways of lowering that ratio, and those are the ways that we followed since World War II, mainly, by inflation.

Mr. SCHULTZE. I disagree, Mr. Curtis.

Representative CURTIS. Because what was followed—I am not saying it was planned——

Mr. SCHULTZE. The main way that that ratio was lowered was the increase in GNP. And the largest part of that increase was not inflation.

Representative CURTIS. I think the figures will show differently. It was around two-thirds of the reduction, considering the fact that it is in the constant dollar, and GNP is in your current dollar—I once computed it, 2 or 3 years ago, but then about two-thirds of it was the result in inflation rather than a real increase in GNP.

Mr. SCHULTZE. Certainly in the last 10 years by far the largest part of your increase in GNP has not been——

Representative CURTIS. I am talking about since World War II, since 1946.

Mr. SCHULTZE. In the immediate postwar years it was primarily inflation, but since 1948 I am certain——

Representative CURTIS. There hadn't been much decline in the ratio—the big decline was up until the heavy inflation stopped in 1951.

Mr. SCHULTZE. In 1948—it has been more than cut in half since 1948.

Representative CURTIS. I didn't accept your 1948 figure. I took the 1951 figure, which is the date of the Federal Reserve—Treasury accord——

Mr. SCHULTZE. It has been almost cut in half of that.

Representative CURTIS. Let me finish—the date of the Federal Reserve Treasury accord in effect pretty well stopped the World War II inflation. So you have to include that in that figure. But since the heavy part of the inflation, then we moved to creeping inflation, the ratio hadn't declined——

Mr. SCHULTZE. It has been cut in half.

Representative CURTIS. The big decline in the ratio since World War II came immediately after the war, and was largely the result of inflation. We can put the figures in the record, though, so that anyone reading the colloquy can look at them.

(The following table was supplied by the Bureau of the Budget for insertion at this point in the record:)

TABLE 3.—*Ratio of public debt to gross national product*

Fiscal year	Public debt at end of year [1]	Gross national product	Ratio
	Billions	*Billions*	*Billions*
1920	$24.3	$87.8	0.277
1925	20.5	88.9	.231
1930	16.2	96.7	.167
1935	32.8	68.7	.478
1940	48.5	95.0	.510
1941	55.3	109.4	.506
1942	77.0	139.2	.553
1943	140.8	177.5	.793
1944	202.6	201.9	1.004
1945	259.1	216.8	1.195
1946	269.9	201.6	1.339
1947	258.4	219.8	1.175
1948	252.4	243.5	1.036
1949	252.8	260.0	.972
1950	257.4	263.3	.977
1051	255.3	310.5	.822
1952	259.2	337.2	.768
1953	266.1	358.9	.741
1954	271.3	362.1	.749
1955	274.4	378.6	.725
1956	272.8	409.4	.666
1957	270.6	431.3	.627
1958	276.4	440.3	.628
1959	284.8	469.1	.607
1960	286.5	495.2	.578
1961	289.2	506.5	.571
1962	298.6	542.1	.551
1963	306.5	573.4	.534
1964	312.5	612.0	.511
1965	317.9	651.8	.488
1966	320.4	712.0	.450
1967 (estimate)	327.3	762.5	.429

[1] Includes Government enterprise debt guaranteed by U.S. Treasury.

Representative CURTIS. There was an article in the Wall Street Journal this morning, in regard to the Federal Reserve. And the point, as I understand it, was that it now based its monetary policies largely on the open-market operation of purchasing or selling Federal securities. This is the basic method that was used to increase the money supply. But this was not emphasized in this same article, although it was mentioned that the Federal Reserve also has a function to preserve an orderly market for Government securities. When you have it down to a certain size, particularly a rollover of a debt—we have got over 50 percent now in securities of 1 year less—the burden of the open-market operations become quite difficult. This is particularly true if you are trying to roll interest rates down, because there is an impact on the interest rate as a result of the interest set in Government securities. Would you agree with those observations and make the comment?

Mr. SCHULTZE. Obviously, the size and composition of the Federal debt has a relationship to the maintenance of orderly markets. But it seems to me that the relationship is rather tenuous as a general proposition, and in maintaining that orderly market, that particular objective is not, I would say, strongly influenced, not strongly influenced by the size of the Federal debt.

Representative CURTIS. Wouldn't you agree that it was the conflict of these two functions that brought about the Federal Reserve Treasury accord of 1951?

Mr. SCHULTZE. Yes, sir; I think that is generally correct. That does not necessarily means that the existence of a debt the size we have now, itself, makes the maintenance of an orderly market difficult. That was my point.

Representative CURTIS. That is the thing we are leading up to. I am just trying to explore the details to see whether that, indeed, is true.

I would observe that in 1966 we had the highest interest rates since right after World War I.

Mr. SCHULTZE. Correct.

Representative CURTIS. And to some degree it seems to me that it was the result of a problem the Federal Reserve Open Market Committee had in trying to do two things—to increase the money supply in accordance with the demands of private enterprise system and the demand of the Government for money in that same system, and at the same time not to let interest rates get completely out of hand. And a third factor, the impact that the interest rate had on our balance of payments.

In other words, raise the interest rates domestically, and we have an influx of foreign investment which does occur. I am simply directing your attention to some of these factors, economic factors that are involved in the management of the Federal debt.

Mr. SCHULTZE. My only point was that in maintaining an orderly market, that particular point is not necessarily or particularly made more difficult by the existence of a large debt. That was the point that I think you started with.

Representative CURTIS. That is right. And this is what I hope that we can begin getting a public dialog on. I am willing to beg my side of the question. I want to examine into it.

I have raised this over a period of years with Government witnesses, or Council of Economic Advisers, as well as yourself and the Secretary of the Treasury, I think that you have just presumed that you are right on it——

Mr. SCHULTZE. No, sir.

Representative CURTIS. But there is no evidence on that, while the evidence is quit clear as to what has happened, both as to the international balance of payments and the high interest rate. And I say it does relate to the size of the debt in relation to gross national product. And my observation is, I don't see how you can avoid it.

Mr. SCHULTZE. I am very interested, Mr. Curtis, in the evidence you have in regard to the Federal debt—you said that we never come forward with any evidence. I would be interested in the evidence that the existence of a large Federal debt has made the maintenance of orderly markets more difficult.

Representative CURTIS. I related it to the interest rate, the high interest rate in 1966, I related it for context back to the Federal Reserve Treasury accord in 1951.

Mr. SCHULTZE. How is the maintenance of an orderly market made more difficult by $180 billion than $280 billion?

Representative CURTIS. An orderly market for the Treasury means trying to market their securities at the interest rate they would like to get?

Mr. SCHULTZE. I disagree. There is no definition of maintenance of orderly market condition which says the Federal has got to support the Treasury interest rate or whatever rate the Treasury expects.

Representative CURTIS. That was the basis of the Federal Reserve-Treasury accord.

Mr. SCHULTZE. I fully agree—the problem before 1951 related to pegging long term Treasurys at a fixed rate.

Representative CURTIS. And then the Federal Reserve said that they were no longer going to provide a market for Treasury at the interest rates the Treasury was seeking to put on the debt securities.

Mr. SCHULTZE. I full agree. But that isn't the maintenance of orderly markets.

Representative CURTIS. I think we are going to bog down in semantics here.

Mr. SCHULTZE. I didn't introduce the question. My point is that the maintenance of orderly markets, Mr. Curtis, essentially refers to the maintenance of liquidity of Treasury securities and the assurance that the market will function smoothly and not be churning all over the place, and that holders of Federal securities have a good secondary market to which they can go. It seems that this is essentially the area——

Representative CURTIS. Then you have a much more limited concept of an orderly market than I do. And I would simply conclude by saying that the Federal Government certainly thinks it has got some responsibility under the terms of providing an orderly market to have a concern for the interest rates that the Treasury seeks to put on its debt certificates.

Mr. SCHULTZE. This relates essentially to the maintenance of steady market conditions during the narrow period when the underwriters are distributing securities. But the maintenance of an orderly market should not be confused with the preaccord policy of supporting Treasury bonds at a fixed rate. That is what I am trying to get at. I fully agree with you that the accord of 1951 was based on that problem, the opposition betwen maintaining a steady, unchanging rate for Federal securities on the one hand, and the flexible use of monetary policy on the other. They were in conflict, you are quite right, and the accord was aimed at resolving that conflict. What I am saying is that the maintenance of orderly markets can still be done without having to go back to pegging the Treasury rate at any fixed level. And it has been done.

Representative CURTIS. My time has long expired. But I am glad to develop this a bit.

I would make another observation. The term "market," particularly when you are talking about securities, includes, of course, the interest rates. That is part of it. And the Treasury estimates what interest rate they can sell at in relation to maturities, and then the Federal comes back with its estimate. So, I think that I am well within reason when I say that the Federal Reserve's responsibility to try to preserve an orderly market must await the interest rate that the Federal Government seeks to get. Then it comes back, why do we have a low interest rate, why do we have these high interest rates, mainly in Government securities? And it was because, I would argue, of the size of the Federal debt in relation to the GNP, at least that is the syllogism I presented.

Mr. SCHULTZE. That is a conclusion; yes, sir.

Representative CURTIS. That is my conclusion.

Thank you.

Chairman PROXMIRE. Thank you, Congressman Curtis.

Thank you again, Mr. Schultze. Once again you have shown your remarkable and unusual ability in this field, and you have certainly enlightened us very, very much.

Tomorrow we will continue in the hearing room of the Senate Banking Committee, room 5302, of the new Senate Office Building. Our first witness will be Senator John Stennis, chairman of the Preparedness Subcommittee of the Armed Services Committe of the Senate. And our second witness will be Archibald Alexander, U.S. Arms Control and Disarmament Agency. We will have just the morning session tomorrow.

The committee will stand in recess until tomorrow.

(Whereupon, at 4:10 p.m. the committee adjourned, to reconvene at 10 a.m. Tuesday, April 25, 1967.)

ECONOMIC EFFECT OF VIETNAM SPENDING

TUESDAY, APRIL 25, 1967

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The joint committee met, pursuant to recess, at 10:05 a.m., in room 5302, New Senate Office Building, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senators Proxmire, Sparkman, Symington, and Percy; and Representatives Curtis, Rumsfeld, and Brock.

Also present: John R. Stark, executive director; and Daniel J. Edwards, staff economist.

Chairman PROXMIRE. The committee will come to order.

Today we continue our hearings on the economic effect of spending for the war in Vietnam.

As indicated previously, Budget Director Schultze has agreed to supply this committee with revenue and expenditure data in July so that we may take full cognizance of any changes in the fiscal situation in our own appraisal of economic developments. When we have the benefit of those figures, and Mr. Gardner Ackley also does, this committee intends to have him before us as a witness to give us the benefit of his latest appraisal of the economy. I think it is most important that this committee conduct a midsummer review and form its own judgments on the subject.

Regrettably, the administration's review of the problems of deescalation of the Vietnam war—by the so-called Ackley committee—will not be available by midsummer. We understand that it will be available some time in late August or early September. At such time as it is available, we also want to hear from Mr. Ackley on the administration's findings and conclusions about the economic transition at the end of Vietnam hostilities.

I want to stress that this committee is not only concerned with the effect on the economy of deescalation. We are also just as deeply concerned, of course, with the effect on the full range of possibilities, including greater commitment, continuation of the war at present level, and so forth.

The committee is privileged to have as today's opening witness one of the most knowledgeable people in the world on the subject of U.S. military preparedness: Senator John Stennis, chairman of the Armed Services Subcommittee on Preparedness. In the course of yesterday's hearings, I had occasion to quote from Senator Stennis' incisive statement of October 13, 1966, examining the disparities between the administration's original estimates for the Vietnam war for 1966 and the final figures. He can help us greatly in our present inquiry and we are delighted to have him here.

STATEMENT OF HON. JOHN STENNIS, U.S. SENATOR FROM THE STATE OF MISSISSIPPI

Senator STENNIS. Mr. Chairman, first I want to thank you and the members of the Joint Economic Committee. I consider it really a privilege and an honor to appear and talk to you gentlemen on this subject, and I want to commend the chairman and the other members of the committee for the very fine job that you are doing. You are quite helpful indeed, and I think you have a great place in the sun here, and that you will contribute more and more as the months and years come and go. I am very anxious for more to be done along the lines on which you gentlemen are proceeding.

I really was surprised, gentlemen, when your chairman invited me to appear before you. After all, in the fields of finance my experience is rather limited but it might be that for those of you who are not on the Armed Services Committee and who don't have a chance to follow military matters closely, I might say something of value, based on the experiences I have had.

Mr. Chairman, and members of the Joint Economic Committee, I was pleased to accept your very kind and flattering invitation to meet with you today. Although I have no great expertise in economic matters, I am delighted to make whatever contribution I can to the furtherance of your important work and the solution of the serious and weighty problems with which you are confronted.

My statement today will be directed primarily to the history of defense budgetary planning and appropriations requests for the past 2 or 3 years. This will show, of course, that the original basic military budgets presented to the Congress proved to be grossly inadequate for the needs. The necessity to return early in the succeeding Congresses for very large supplemental defense appropriations not only established the inadequacy of the original budgets but made sound overall budgetary and economic planning difficult, if not impossible. In my opinion, this situation still exists with respect to the fiscal year 1968 defense budget, although to a lesser extent.

Let me go back briefly to the summer of 1965 when the large-scale buildup of our combat forces in South Vietnam commenced. Let me emphasize that I review this history solely to emphasize the problem and to suggest how it might be better handled. At that time the fiscal year 1966 defense appropriation bill was pending before the Congress. It sought new obligational authority of $48.5 billion, a reduction of $7.9 billion from the service requests.

This budget had been finalized in the fall and winter of 1964. It was essentially a peacetime budget. In no way did it take into account or fund for the large demands on our military resources and assets which resulted from our greatly increased involvement in the war in Vietnam. It was clearly apparent that, since the budget had been put together, the cost of the war had gone up and up in every respect.

Since I was at that time serving as acting chairman of the Committee on Armed Services and the Defense Appropriations Subcommittee because of the temporary illness of Chairman Russell, I publicly urged the Secretary of Defense on several occasions during June and July 1965, to come to the Congress with all the facts and with such upward revisions in the defense budget as were necessary to take up the slack caused by the heavy, ever-increasing, unprogramed and unfunded Vietnam expenditures. I did that in keeping with my concept of my duties as a constitutional officer, I was acting chairman of this subcommittee, and we were at war. I know it and also knew there wasn't any money in the bill for the war at the escalated scale. It was going to be financed under the transfer authority.

While Secretary McNamara did not see fit to do this, in August 1965, he did submit a request for an add-on of $1.7 billion to the fiscal year 1966 request. While this was approved, it was still far from being adequate. I pointed out in presenting the appropriation bill to the Senate on August 24, 1965, that the amount provided definitely would not finance the war during the then current fiscal year.

At about that time, that is, in August 1965, I publicly estimated that in January 1966, we would be faced with a supplementary defense appropriation request of from $12 to $14 billion. That was purely an estimate, but I thought my colleagues in the Congress and the public as well were entitled to my best judgment.

The supplementary defense appropriation request for fiscal year 1966 presented to us in January 1966, was for $12.7 billion. It was, of course, approved. Thus, the basic defense budget of $48.5 billion which the Congress considered in the spring and summer of 1965 ballooned to $63.3 billion in early 1966—including about $900 million to fund the pay raise—because of the tremendous increase in military operations and costs. Even with the supplemental, the amounts provided the Army were not entirely adequate. By May of 1966 the Army had estimated an additional requirement of over $900 million to carry on its operations for fiscal year 1966. As a result of all of this, the overall fiscal and economic planning for fiscal year 1966, including estimates of the size of the deficit, was thrown completely out of balance.

In fairness it should be pointed out clearly that the large buildup of military operations during calendar year 1965 necessarily threw the original estimates out of balance to a considerable degree. The point which I made while handling the fiscal year 1966 defense appropriation bill was that there was no effort whatsoever to give the Congress a realistic or practical estimate of the additional funds which would be required to finance the war. The $1.7 billion finally requested in August 1965 was obviously entirely insufficient and was known to be at the time.

The same cycle evidenced itself for fiscal year 1967. The basic military budget presented was about $59.9 billion in new obligation authority—some $3.5 billion less than the total for fiscal year 1966, despite the fact that our military operations had escalated and it was entirely clear that the cost of the war had gone up very substantially. It was also $12.9 billion less than the services had requested. It was again clear that this was entirely inadequate. Fiscal planning at that time, as the Secretary of Defense frankly stated, was based on the arbitrary assumption that the war would end by July 1, 1967. This proved to be unrealistic.

The tragedy here was that we were required to legislate and appropriate in this vacuum of facts. Even if the facts couldn't be told to the public, I think it was a downgrading of the legislative branch of the Government to keep us in the dark in that manner.

Although repeated questioning in executive session failed to bring from Defense officials even a ball park estimate of the rate of spending for the war or what the fiscal year 1967 supplemental request would be, I estimated in a statement on the floor of the Senate that it would be from $12 to $15 billion.

In January of this year the after-the-fact funding bill came in. The supplemental request was $12.9 billion, raising the total of the new obligational authority for fiscal year 1967 to $72.8 billion. The defense expenditures estimate for fiscal year 1967 was raised to $67.9 billion, about $9.6 billion over the original budget estimate. Once again, therefore, the funding of the war on a piecemeal basis threw the original budget, and, therefore, overall economic planning, entirely out of kilter.

I don't have any particular connections with the business world, but I did learn from them, after the fact, something about how much it meant to them to have some guidance and some information upon which they could base their production planning and adjustment in supplies. These things can't be done accurately. There is a slippage there that is inevitable. There are changes in circumstances and facts, but I think we owe it to the legislative branch of the Government and to the economy as a whole to do the very best we can. I am sure that you gentlemen agree.

Congress has the primary responsibility under the Constitution for the appropriation of funds. In doing this we are entitled to all of the facts and the very best financial estimates that can be made by those in the executive branch of the Government, who are closest to the problem. Otherwise, we are not able to fulfill our obligations, and it seems to me that the way this matter was handled in calendar year 1965 and calendar year 1966 forced the legislative branch of Government to what was, in effect, a neglect of duty.

In addition, as I have said, I think that the business, financial, and labor segments of our economy are entitled to know, as far as security permits, the "facts of life" with reference to our fiscal affairs so that they may better plan for their own future and thus keep our economy strong.

These were the basic principles of government which were my motivation in insisting on realistic figures during these 2 years. Another basic fact is that, because of the lack of information, and being "in the dark," so to speak, as to even the approximate cost of the war, the Congress passed defense appropriations bills during these 2 years in amounts which fell far short of the actual costs. As a result, the entire national budget was understated, thus making it more probable that other appropriations for new or expanded programs would be approved during the rush at the end of the session. That is a major fact of life. Despite the exclusive congressional responsibility as to appropriation bills, we did not have the facts before us; even those handling the defense bills didn't have the real facts that would afford sufficient guidance.

As the Secretary of Defense has stated, the basic approach in preparing the fiscal year 1968 defense budget was changed, and I commend this very highly. It theoretically funds the war in Southeast Asia for the entire year but at the levels of troop deployments and military operations which had been approved and authorized at the time the budget was put together and finalized. This is in happy contrast to the year before when the budget was based on the assumption that the war was going to be over by June 30, 1967. That was a laudable change. I quote now from the Secretary of Defense who said this year:

"Accordingly, barring a significant change in the character or scope of the Southeast Asia conflict, or unforeseen emergencies elsewhere in the world, the fiscal year 1967 supplemental and fiscal year 1968 budget should be sufficient to cover our requirements until fiscal year 1969 funds become available, even if the conflict continues beyond June 30, 1968."

The fiscal year 1968 budget requested $75.3 billion in new obligational authority, with the expenditures being estimated at $73.1 billion. It is a tight budget. The new obligational authority is only about $2.5 billion above the total for fiscal year 1967 even though our military operations have escalated substantially. Of course, you take the news of yesterday. This indicates further escalation which could throw the estimates completely out of balance. The Secretary of Defense reduced the requests of the services by about $17.6 billion for fiscal year 1968. Admittedly, some desirable programs have been eliminated or deferred.

I am highly pleased with the more realistic approach to the fiscal year 1968 budget which eliminates any arbitrary assumption as to the date the war will terminate. I also approve of justified reductions in the service requests that do not deny essential military requirements.

However, it is still very doubtful that the fiscal year 1968 budget is adequate even for the scale and scope of military operations envisioned when it was approved.

It should be added that neither the fiscal year 1967 supplemental nor the fiscal year 1968 budget completely provides for replacement of assests which have been drawn upon to wage the war in Southeast Asia. Gentlemen, I think this is a major point, especially for those of you who are not on the Armed Services Committee, although you may be fully advised. The 1968 budget does not provide for replacement of the assets which have been drawn upon to wage the war in Southeast Asia. Nor does it provide procurement funds which would be required simply to replace items already in the inventory with later models except for helicopters and tactical aircraft and where the newer model is required to replace consumption. These matters are being deferred and will have to be funded in the future.

If I may give some illustrations of what I mean to indicate that the money bill is piling up and will have to be paid sometime later. There is no modernization overall program, except for certain items, the direct requirements of Vietnam, and items required to replace consumption. That may be all right under the circumstances, but it is a fact of life that we will have to face later.

There has been a drawdown of many items. There was at one time an acute situation with respect to a simple thing like clothing, particularly that needed for the climate in which the war is being fought. Procurement of tentage and materials of that kind had to go on a crash basis. That had the effect of putting much of our production here at home into the war effort. As a result, the foreign suppliers came in and got a greater share of the domestic market. I am talking about textiles now. That ran their quotas up—their imports up for that year—which is the basis for figuring their quotas for succeeding years. This shows how these things impact.

There is another illustration with respect to the replacement and drawdown of equipment. I understand that an entire division's worth of equipment in the strategic reserve had to be drawn upon to equip Active Force units. This, of course, was the proper thing to do under the circumstances, but my point is that the cost is going to have to be picked up later.

Aircraft is another example. We had to take aircraft away from the Reserve components. An example is the old C–123, a very valuable plane, and some lighter aircraft from the National Guard. This action was necessary and proper. Again, however, my point is that those things are not figured in the replacement cost in this budget and perhaps shouldn't be. But they are running up the bill for the future.

The Atlantic Fleet has been drawn upon significantly to support Southeast Asia and the deficiencies will have to be remedied. Otherwise we will have a greatly diminished defense effort in that area.

The fiscal year 1968 budget does provide money, which the preceding two didn't, for the longtime lead items, like airplanes, the production base for expendable ammunition, and logistic equipment. This is very important and, in this respect, the budget is sound. It provides also for trucks, material handling equipment, and the communications equipment which is needed. But those are items which we are having to procure and we will have to procure even more in the future.

In addition, this budget is based upon a planned level troops to be deployed. As you know, that number is still classified, but it has been announced that we have around 438,000 men in-country now, and that was at a very recent date. This budget is based upon a higher number of men than that. However, based on what I can learn and what General Westmoreland and others have said, and on records that we have seen, it is my personal opinion, and I have said this publicly, that by the end of this calendar year we will perhaps have 500,000 men in South Vietnam. That is more than are planned for in the present budget.

When you deploy just a few thousand men above the present planning, you run into added costs mighty fast—mighty fast. Compared to the number of men that are there now, 50,000 seems a small number. But you go to chewing up millions of dollars mighty fast if you add in 50,000 above this budget.

You know what the budget is based on. It is a classified figure. I won't mention it here. But if you should put in 50,000 above what is planned for, just to train them and transport them and support them, why you would have an increase there of from $4 to $6 billion mighty fast. That is on top of the present budget. Of course, from the news we know already there has been an escalation of the air attacks and other matters.

I emphasize that I am not trying to hold anyone to a precise figure. With a big budget like this, some $75 billion, we are going to have slippages, variations and changes in the course of a year. However, this budget is not enough in my opinion, and it could very well happen, as I have suggested that billions more will be needed.

Let me emphasize again that the adequacy of this budget is, at best, limited to the scale of military operations and size of deployed military forces which had been approved when the budget was formulated late last year. The amount in the budget, if adequate to begin with—and this is doubtful—will remain adequate only so long as our troop commitments and the level of military operations do not exceed those which had approval at the time it was presented. In other words, the budget remains valid only as long as the planning level on which it is based and other planning factors on which it was based remain valid.

In my opinion, it is already clear just a few months later—and a full 2 months before we get into fiscal year 1968—that we are going to be forced to exceed the level of troop commitments which was approved when the fiscal year 1968 budget was finalized. Our responsible military commanders have already asked for substantially more troops than have been approved.

That is particularly pronounced in the I Corps in the northern part of South Vietnam which is the responsibility of the Marine Corps, and in the IV Corps in the Mekong Delta area. As you have read, we have already been forced to transfer several thousand Army troops from other areas of Vietnam to the I Corps to assist the Marines in meeting the threat posed by the large-scale infiltration of North Vietnamese forces in and near the demilitarized zone. Thus, we have been compelled to weaken our forces elsewhere.

Of course, as we know, General Westmoreland is in the country. He spoke in New York yesterday. He will speak, as I understand it, to a joint session later this week. I don't know how far he will go in these matters. I don't know how far the President will see fit to announce anything new. But these are the figures that I get, based upon past experience.

Therefore, in the face of hard realities and clear military requirements, I am convinced that unless the unexpected occurs, it will be absolutely essential to commit many thousands of military men to South Vietnam above the presently approved number. It is almost inevitable that the cost of the war will go up in men, machines, materiel and money.

It may be that it will be difficult for us to find major ground combat units to deploy to Vietnam without calling up Reserves or drawing down on forces deployed elsewhere, such as Europe or Korea. With this reservation, however, I feel that the end of calendar year 1967 will find at least 500,000 American troops in South Vietnam. This is some 60,000 more than are in the country at this time and is substantially more than are called for under the presently approved program. Even this number would be less than our military commanders have requested.

For all of these reasons, I do not believe that we can keep within the fiscal year 1968 military budget request if the war continues and I feel that next January we will again be faced with a request for a significant supplemental defense appropriation.

I think the amount is so highly uncertain at this time that I should not try to make an estimate now. It would be a guess, at that.

Mr. Chairman, that covers the points that I have in mind, sir, and I thank you very much.

Chairman PROXMIRE. Senator Stennis, I want to thank you for a most enlightening presentation. It was hard hitting but it was extremely well documented and it gives us information that we haven't been able to get before.

It also conflicts explicitly with the position taken by Assistant Secretary Anthony yesterday before us, and I would like to ask you about some of the conflicts involved.

First, I want to make sure I understand. You estimated in 1965, as I understood you to say, that the 1966 budget was inadequate, and needed a substantial supplemental. Is that correct?

Senator STENNIS. Yes; that is correct.

Chairman PROXMIRE. You said between $12 and $14 billion, and you were right on the nose. It was $12.7 billion. It couldn't have been closer.

Then, again in 1966, you estimated that the 1967 budget would be badly off, and again you were right; so that twice, for 2 successive years the Congress has not had an accurate estimate by the Defense Department.

Senator STENNIS. That is correct.

Chairman PROXMIRE. It has been way off both times.

Senator STENNIS. I don't claim or deserve any credit for those estimates. I was just doing the best I could, from where I was, and I say again that the budget is much nearer home base this year, without a question.

Chairman PROXMIRE. You say they are much nearer home base this time without a question, because they are making different assumptions, but at the same time, you indicate that on the basis of your expectation and prediction that by the end of this calendar year, which would be right in the middle of fiscal 1968, you anticipate 500,000 troops, and you say that this——

Senator STENNIS. Excuse me, by the end of this calendar year.

Chairman PROXMIRE. That would be in the middle or fiscal 1968.

Senator STENNIS. That is right.

Chairman PROXMIRE. 500,000 troops. And you say that this is well above the estimates in the budget of the troop strength which they posted for Vietnam, for fiscal 1968.

Senator STENNIS. That is correct.

Chairman PROXMIRE. On which they had based these estimates.

Senator STENNIS. That is correct; yes.

Chairman PROXMIRE. And you say, without giving any specific figures as to the situation here, you say that if they have 50,000 more troops in Vietnam than they estimated originally in January, the cost would be between $4 to $6 billion?

Senator STENNIS. I just said this. If they put in 50,000 troops above the number that the budget is based on, and increase the Active Army commensurately, then the extra cost, in my opinion, would run $4 to $6 billion.

Now that is purely an estimate. I think if they don't put in any more than they based the budget on, it is still a very tight budget.

Chairman PROXMIRE. Then you said—and I would like to know exactly when you mean by this—that the news of yesterday by itself throws the 1968 budget out of balance. Were you talking about General Westmoreland's speech in New York yesterday, or was it something else?

Senator STENNIS. I was referring to the step-up of the war, a step-up of the bombing at least, which I believe it is the only way to get results. If that is continued, it will perhaps increase the ground fighting, even though eventually I believe it will stop it. But the indications are that, instead of a slowdown in the war and a deescalation, with a consequent diminution of what the budget is based on, it certainly looks like it is going in the opposite direction and stepping up. That is the way it looks to me.

Chairman PROXMIRE. Yesterday Mr. Anthony said that he saw no reason why the Defense Department shouldn't stand by its estimates of January. He said that they may be off half a billion or a billion dollars but he doubted that, and he would stand by the original estimates.

You think that they are going to be off and it is going to be substantially more than $1 billion without giving any specifics?

Senator STENNIS. I said if there is no step-up in the manpower—the money goes into the manpower. It is when you put in an extra 10,000 or 20,000 or 50,000 men; that is what really would require substantial additional money for this budget.

I said if they don't step it up beyond the budget planning in manpower, it is still a very tight budget. I would think it would run over the budget some—that they couldn't avoid it.

Now if you step up the manpower, as I have already said, say, as much as 50,000 men over the planned budget figure, then my estimate would be that it could well cost $4 to $6 billion extra. Of course, that depends on the intensity of the war.

I am making these statements just as an amateur, but as one whose position as a legislator puts me fairly close to it. I think we all have a responsibility. Mr. Anthony is very close to this problem and I am sure he is being honest with the committee.

Chairman PROXMIRE. You have had intensive experience here and I think your testimony has great value.

When you referred to the failure to allow for replenishing inventory, clothing, aircraft——

Senator STENNIS. Yes.

Chairman PROXMIRE. Do you feel that any of this would be included in the 1968 budget? I want to make sure I understand that. I gather you felt that this would definitely increase costs in the future.

Senator STENNIS. Well, in the future. I was referring more to the future. I think the committee should understand that the budget would be higher if we were not drawing on our reserves and deferring procurement. It is all right to do this, because we are at war.

But we are using up this material that will someday have to be replaced. I referred to the clothing. There was at one time a very acute situation with reference to clothing, but that has cleared up. I gave an illustration of the manner in which it impacted on the textile industry.

We have been taking equipment away from our Reserves and the National Guard rather than giving them their normal buildup. I also referred to the necessity to use a division's worth of equipment from the Strategic Reserve. This equipment could have been available for the use of the Reserve components but the Active Army needed it. It was proper to use it for that purpose, but you just deferred the cost of equipping a Reserve division.

Then I illustrated with the aircraft, too. We have taken some away from these Reserve units. We had to have it and that is all right, but still, it is going to have to be replaced some day. The same thing has happened to the Atlantic Fleet.

So those matters are not in the budget. That is my point.

Chairman PROXMIRE. Are there costs other than the costs involved in training, transporting, and maintaining 50,000 additional troops, say, in Vietnam that are not included in the 1968 budget?

Senator STENNIS. Well, as I said, I think the 1968 budget makes a rather——

Chairman PROXMIRE. Leaving those aside, assuming that we stay at the level which was estimated by the Defense Department at the beginning of this year, in manpower in Vietnam, throughout fiscal

1968. That is an unreal assumption, but I want to make sure that we have all the ingredients of cost involved.

Senator STENNIS. Right. Well, I think the 1968 budget at the planned level does put in the necessary money for these long leadtime items, like airplanes.

Chairman PROXMIRE. It puts that in.

Senator STENNIS. It takes 18 months to 2 years for the planes to come off the production line. Well, they put in the proper amount of money for those things this time, but not last year or the year before.

Expendable ammunition, that is ammunition consumed during that budget year, there is enough money in the budget approximately, as I understand it, to cover the ammunition that will be needed.

The logistic equipment, the trucks and the heavy handling equipment, are also in the budget. They are provided for, not like it has been for the last 2 years. So in that way it is a much sounder and better and realistic budget than before.

Chairman PROXMIRE. The big error would come if we have to send additional men to Vietnam.

Senator STENNIS. That is exactly right. I say it is a tight budget though, based upon the planned number of men.

Chairman PROXMIRE. Let me ask you this, Senator Stennis. Don't you agree that we ought to have an estimate from the administration? Wouldn't it be helpful to the Congress and to the country to have an estimate, without making any commitments, of what in their judgment it will involve if we have to send an additional 50,000 men, what a 500,000 level, for example, would represent.

I ask this because you are a very modest person, and I am willing to accept your estimate of $4 to $6 billion. But it would seem that it might be helpful to have the Defense Department's estimate too.

Senator STENNIS. Let me quickly say I would much rather have theirs, than mine.

Chairman PROXMIRE. Do you see any strategic reason why they can't give that to us?

Senator STENNIS. I think they could give it to you rather readily, gentlemen. I know last year I thought that we were entitled to some kind of an estimate. The committee that was handling the bill was certainly entitled to an estimate as to what they thought then the supplemental request would be in January 1967. As I have said, as late as October 1966, and they declined to mention a figure.

If they had just given an estimate to the chairman of the committee, it would have made me feel better. As it was, however, when the bill was on the floor, I felt that the Senators who were not on the Appropriations Committee or the Armed Services Committee did not have the guidelines they were entitled to. They would have voted for the military appropriation, of course, but maybe not for some of the other appropriations had they known about the true deficit. I think we are entitled to more information.

Chairman PROXMIRE. My time is up, but I want to come back.

Congressman Curtis, the ranking minority member of this committee, has graciously deferred to Senator Sparkman who has to leave.

Senator SPARKMAN. My questions will be very brief. Thank you, Mr. Chairman.

You mentioned the Atlantic Fleet.

Senator STENNIS. Yes.

Senator SPARKMAN. Would you expand on that just a little?

Senator STENNIS. Well, I was referring to the 6th Fleet in the Mediterranean and the 2d Fleet in the Atlantic. A good deal of that is classified, Senator Sparkman, but we have drawn down on them significantly. In other words, if these forces should be called into action they would certainly be powerful and formidable, but they would not be as combat ready as had been planned.

Senator SPARKMAN. It wouldn't be completely ready to go.

Senator STENNIS. No, not completely. That is a part of the picture.

Senator SPARKMAN. Yes.

Senator STENNIS. I am not downgrading the Atlantic Fleet at all.

Senator SPARKMAN. I have seen references recently to the effect that if this additional buildup in our troop force in Vietnam, which General Westmoreland is reported to be asking for, if that comes through, it probably would mean calling up the Reserve. Are the Reserves ready to go?

Senator STENNIS. Yes. We have Reserves that are ready to go.

Senator SPARKMAN. I mean are they equipped? You refer to Reserves.

Senator STENNIS. Yes. I was thinking more about training. There has been some headway made on having the Reserves far better equipped than they were, particularly some of them. We would have some ready to go rather quickly. They would have to have some more equipment, but my guess is if you called up a Reserve division from the Selected Reserve Force, one of those that was especially ready, it would be far less expensive than it would be to create a new division. But it would still require transportation, manpower cost, support and equipment, which would run into money fast.

Senator SPARKMAN. Is that covered in the present budget?

Senator STENNIS. No, sir, except that manpower at a certain level is covered in the budget.

Senator SPARKMAN. But building up the equipment, materiel.

Senator STENNIS. Well, there is perhaps some of in the budget for building up Reserves. I couldn't give a figure on that. But there has been a special effort to build up some units of the Reserves. This is known as the Selected Reserve Force. But by no means all of them. As a matter of fact, some equipment has been taken from the Army Reserves and the National Guard, for one reason or another, for the buildup in Vietnam.

But we do have some divisions now that with additional equipment and added training could be made ready to go. This, of course, would require more money since it would exceed the manpower level of the budget.

Senator SPARKMAN. You did not suggest the amount, but you did use a figure at one time, $4 to $5 billion. You said if we had this buildup of manpower, it would not take very long to push the required amount up by $4 to $5 billion.

Senator STENNIS. Yes.

Senator SPARKMAN. Could that be taken as a rough estimate?

Senator STENNIS. Well, I said just this: if we should go 50,000 men above the budget planned level, then for transportation, support, training and other essentials, we could very quickly increase the cost by $4 to $6 billion in a 12-month period.

Senator SPARKMAN. Is it your understanding that General Westmoreland's mission home is perhaps to ask for additional manpower?

Senator STENNIS. Senator, I wouldn't know any more about that than you do. However, I think it is.

Senator SPARKMAN. He spoke at New York yesterday. Did he give any indication to that effect?

Senator STENNIS. I haven't read his speech. I am familiar with what he has already said and the troops he has asked for. You see, the Mekong Delta area, for instance, has been an area that for a long time we hoped the South Vietnamese would be able to take care of and finally control. Well, we have changed our minds about that, and we have started sending our men in there.

That was months ago. We recognized that if it is cleaned up, it is probable that we have got to do it. That is one reason why I say that I think it is going to take more men. I don't believe there is any way around it, if we have to go all out.

I don't know what General Westmoreland is going to say. I have said publicly before that I believe he has been requesting more men than he has yet been given. But I am sure the President has any request that comes from General Westmoreland constantly under advisement.

I just know that within my mind. But I don't know what he is going to say over here. He was not encouraging about the war ending at an early date in his speech yesterday, as I read the headlines.

Senator SPARKMAN. In the figures you have dealt with, is there any part of that for the pacification program?

Senator STENNIS. Well, I have dealt primarily with the military part of the program, as I understand it. Now I don't know exactly what is classified about the pacification program. I just say this. We have many military men over there who are engaged in it.

Senator SPARKMAN. Yes.

Senator STENNIS. And to that extent the cost is in the budget.

Senator SPARKMAN. As I understand it, it is a joint program.

Senator STENNIS Yes.

Senator SPARKMAN. Both military and AID.

Senator STENNIS. That is right.

Senator SPARKMAN. I was just wondering the extent to which that program may call for stepped up financing.

Senator STENNIS. I am not well versed on the economic aid part of it. Our men, our military men, have engaged in that program, and not with rapid success. I don't say total failure, but it has required more manpower there than we thought.

Senator SPARKMAN. I want to thank you for your presentation. I am going to have to leave. The Foreign Relations Committee is having an executive session that I promised I would attend.

Senator STENNIS. I am flattered that you stayed this long.

Senator SPARKMAN. Thank you.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman, and thank you, Senator Stennis, for your forthright statement.

I am encouraged to think that maybe the Congress is going to assume some very much needed leadership in this area.

Before directing your attention to a statistic, I want to comment that I was very disturbed that yesterday the prepared paper of the Director of the Bureau of the Budget on our subject, which is "Economic Effect of Vietnam Spending," was directed solely to the problems of deescalation. There was no discussion of the administration assumption that the Vietnam war is going to continue at the present level indefinitely, let alone the assumption, which is the more realistic one I would think, that there is going to be a further escalation.

Now this is in further context with the administration's Economic Report this year, which directed the Congress' and the public's attention to the national accounts budget and away from the administrative budget. This has to do with the cash flows that face us right now, and those that are going to face us in the ensuing months, and create the economic problems in the area of tight money, inflation, and so forth.

I am often critical of the news media, so it is a pleasure for me to give an accolade to the enterprising reporter of the United Press International. I have one of their clippings. This appeared in the Evening Star of April 21, 1967, calling attention to the fact:

U.S. military spending soared to $6.7 billion in March, its highest level since the start of the war in Vietnam, the Treasury reports. The March total compares with outlays of $5.6 billion in February and $6 billion in January.

(The item referred to follows:

[From the Evening Star, Washington, Friday, April 21, 1967]

DEFENSE OUTLAY RISES IN MARCH

(By United Press International)

U.S. military spending soared to $6.7 billion in March—its highest level since the start of the war in Vietnam—the Treasury reports.

The March total compares with outlays of $5.6 billion in February and $6 billion in January.

If military spending continues at a rate of $6.7 billion for the three remaining months of fiscal 1967, the defense budget will exceed President Johnson's January estimate by more than $2.5 billion.

During the first nine months of fiscal 1967, which ends June 30, military spending totaled $50.5 billion, including $500 million of military aid.

Three more months at a rate of $6.7 billion would put the total for the year at $70.6 billion instead of the $68 billion Johnson estimated in his January budget.

In the January budget, the war in Vietnam accounted for $20.9 billion of the spending total.

The administration has not publicly revised its January budget totals, but one high governmental official said last week that he expected Vietnam spending to exceed previous estimates.

In fiscal 1966, which ended last June 30, military spending totaled $55.4 billion. During fiscal 1968, which begins July 1, $73.1 billion is budgeted for defense.

It then goes on. Now these are the indicators, of course, that they are referring to. They are in the April 1967 Economic Indicators prepared for the Joint Economic Committee by the Council of Economic Advisers. On page 35 is the chart of Federal financing, and in column four we see Department of Defense military spending, and then military assistance. The figure for March 1967 is $6.6 billion plus $0.1 billion for military assistance. If this level were to continue, Senator—and incidentally, this is still fiscal 1967.

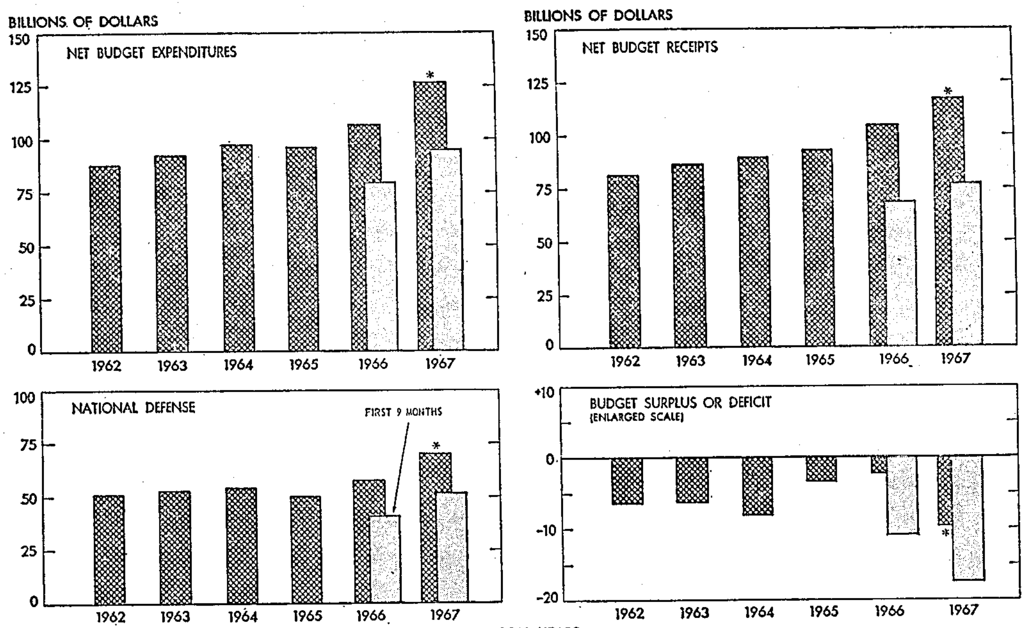
Senator STENNIS. Yes.

(The page referred to is reprinted herein, see pp. 82, 83.)

FEDERAL FINANCE

FEDERAL ADMINISTRATIVE BUDGET RECEIPTS AND EXPENDITURES

The administrative budget expenditures for the first 9 months of fiscal 1967 were $95 billion. In the corresponding period of fiscal 1966 expenditures were $80 billion. Receipts for the same period were $78 billion in fiscal 1967 and $69 billion in fiscal 1966.



*ESTIMATE.

SOURCES: TREASURY DEPARTMENT AND BUREAU OF THE BUDGET

COUNCIL OF ECONOMIC ADVISERS

[Billions of dollars]

Period	Net budget receipts	Net budget expenditures				Budget surplus or deficit (—)	Public debt (end of period) [2]
		Total	National defense [1]				
			Total	Department of Defense, military	Military assistance		
Fiscal year 1962	81.4	87.8	51.1	46.8	1.4	—6.4	298.6
Fiscal year 1963	86.4	92.6	52.8	48.3	1.7	—6.3	306.5
Fiscal year 1964	89.5	97.7	54.2	49.8	1.5	—8.2	312.5
Fiscal year 1965	93.1	96.5	50.2	46.2	1.2	—3.4	317.9
Fiscal year 1966	104.7	107.0	57.7	54.4	1.0	—2.3	320.4
Fiscal year 1967 [3]	117.0	126.7	70.2	67.0	1.0	—9.7	327.3
Fiscal year 1968 [3]	126.9	135.0	75.5	72.3	.8	—8.1	335.4
1966: Feb	8.3	8.2	4.5	4.2	.1	.2	323.7
Mar	11.3	10.2	5.6	5.2	.2	1.1	321.5
Apr	9.9	8.4	5.0	4.8	(4)	1.6	320.1
May	8.5	9.1	4.9	4.6	.1	—.6	322.8
June	17.2	9.4	6.3	5.9	.2	7.7	320.4
July	5.7	10.3	4.9	4.7	(4)	—4.6	319.8
Aug	7.2	11.0	5.6	5.4	.1	—3.8	324.9
Sept	12.5	11.9	6.0	5.7	(4)	.6	325.3
Oct	5.8	11.0	5.5	5.3	.1	—5.2	327.4
Nov	7.4	10.4	5.5	5.3	.1	—3.0	329.9
Dec	10.6	9.5	5.9	5.7	.1	1.1	329.8
1967: Jan	9.4	10.0	6.2	5.9	.1	—.6	329.4
Feb	7.8	9.5	5.8	5.5	.1	—1.7	330.1
Mar	11.4	11.7	6.9	6.6	.1	—.3	331.5
Cumulative totals, first 9 months:							
Fiscal year 1966	69.2	80.1	41.5	39.1	.6	—10.9	321.5
Fiscal year 1967	77.7	95.2	52.2	50.0	.5	—17.5	331.5

[1] In addition to items shown, also includes atomic energy and defense related services.
[2] Includes guaranteed securities held outside the Treasury. Not all of total shown is subject to statutory debt limitation.
[3] Estimates.
[4] Less than $50 million.

NOTE.—Total budget receipts and expenditures exclude certain intragovernmental transactions.

Sources: Treasury Department and Bureau of the Budget

Representative CURTIS. The figures you gave us for fiscal 1968, were for $75.3 billion in requests for new obligational authority with expenditures of 73.1 billion. If we would assume—and I think we can assume—that this March figure in the latter part of fiscal 1967 is going to probably be at least the mean figure for fiscal 1968, multiply $6.7 billion by 12 months and we have $80.4 billion, not $73.1 billion.

I recall in September 1965, when the same monthly figure came out in the Economic Indicators, in a speech on the floor of the House I called attention to the fact. This is a little bit partisan perhaps, but I said the real President Johnson had now stood up. I was always asking which was the real President Johnson, the one who was asking the Congress for more power to spend or the one who wasn't spending the money that Congress had given him the power to spend. Both were true.

Up to that point, President Johnson had not been spending heavily. He was spending at the level of fiscal 1965, of $96.5 billion, which was commendable. But we saw in that month of September, as I said, the real President Johnson. He started spending then at a level that ended up at $107 billion in fiscal 1966.

We now see this break that has just appeared in the past few days, where the actual expenditures were $6.7 billion for the month of March, an escalation in one month of just over $1 billion.

Senator STENNIS. Yes.

Representative CURTIS. Would you care to comment? It was mainly pointing up what I think are the points that you are making in your very fine address.

Senator STENNIS. Thank you. Congressman Curtis, and thank you for the statement you made as a background for your question.

On the overall expenditure picture, I don't have anything of particular value for you gentlemen. I gave the total NOA and expenditures just to present the entire picture. I have concentrated on the war itself, and the added cost that it is bringing about. I have already covered that in full.

But I don't see, with the war going on, unless there is something that I don't know about, that the President or anyone else can hold expenditures down. The figure you have mentioned of $6.7 billion could be about right. But that is really out of my field.

Representative CURTIS. This, of course, is what the Joint Economic Committee must concern itself with.

Senator STENNIS. Yes.

Representative CURTIS. And then serving as I do on the Ways and Means Committee——

Senator STENNIS. Yes.

Representative CURTIS. The President has clearly overstated revenues in this budget. We now know this is true by the first quarterly returns on corporate profits and gross national product. We have a serious problem with the Federal debt, and how we are going to manage that. The leadership has got to come from somewhere.

My good Democratic friends are in control of the Congress, and I just plead with you to assume the leadership that has been dropped in the White House. Otherwise we are in for serious problems, but at least we might start to cope with them.

One specific thing, Senator, that is in your field of expertise. Yesterday I asked the Director of the Budget whether or not it wasn't true that the first part of the Vietnam war was financed to a degree out of use of pipeline and inventories. He agreed. Then I raised the question, what does that mean in terms of forward projections? Aren't we going to have to restock inventories afterward? I notice you emphasized this point.

Senator STENNIS. Yes.

Representative CURTIS. I just wanted to state I was glad you did emphasize it. It certainly is not emphasized in the presentation of the Administration. Not that Mr. Schultze disagreed, but he simply didn't emphasize it. Apparently he didn't think it was of consequence because he didn't have it in his preliminary paper.

Do you have an idea how much we might be talking of in terms of billions?

Senator STENNIS. No, I do not. I mentioned it because I know it is a fact, and that is more in the field that I have been working in. I think you correctly stated that this committee's overall problem is to get that entire overall picture, but I cannot answer your broad question.

While I would not know how to estimate it, it is not a small amount. I can't estimate how much it would cost to replenish those inventories, because some of it you wouldn't replenish. It would be outdated. In many cases, you would want more modern materiel, equipment, and weapons. But it would be a tremendous undertaking to replenish it. Perhaps we should be doing some of it now. But there has been a crash, as you know, for items required in the war so far.

Representative CURTIS. I see my time is up. I again want to thank and compliment you.

Senator STENNIS. Thank you, Congressman, for what you are doing, too.

Chairman PROXMIRE. Thank you, Congressman Curtis.

Once again a Republican and member of the committee has been very gracious. Senator Percy has deferred to Senator Symington, who has to be at the same Foreign Relations Committee executive session as Senator Sparkman. Senator Symington.

Senator SYMINGTON. Thank you, Mr. Chairman. I appreciate the courtesy of the Senator from Illinois.

I did want to come to hear our distinguished colleague from Mississippi, who, as you say, is one of the foremost authorities in this country, or any other country, on what is now going on in Vietnam.

I would congratulate the chairman on these hearings. They are most constructive both to the Congress and the people; and I commend my colleague for his frank and objective presentation this morning.

I plan to make a talk on the floor of the Senate this morning, and will read it. It is not long, two sentences.

On the first page of a 14-page statement made yesterday to the Joint Economic Committee by Assistant Secretary of Defense (Comptroller) Robert N. Anthony, Mr. Anthony makes the following observation:

At first glance Defense expenditures may not seem to constitute a major factor in our economy.

As our late colleague, Senator Robert S. Kerr of Oklahoma, used to say:

I thought I had seen and heard everything and I have been to the Dallas fair twice.

I didn't fully realize how incredible that statement was, until I heard the distinguished chairman of the Preparedness Subcommittee detail again what he had detailed so ably before in the Armed Services Committee and the Appropriations Committee, in past years.

I have a letter this morning which the able counsel of the Preparedness Subcommittee, Mr. Kendall, sent me. It is written to Senator Stennis by the Chairman of the Joint Chiefs of Staff, and says:

DEAR SENATOR STENNIS: I understand that during the course of his testimony before your committee this morning, General Bruce Holloway, Vice Chief of Staff of the Air Force, was asked why Kep and Hau Loc were authorized for strikes in North Vietnam. These two airfields were recommended for strikes by the Joint Chiefs of Staff and were approved in accordance with normal procedures. These strikes were in consonance with the concept of gradual increase in military pressure against the enemy.

I plan to write him:

With the requested recent air attacks on the airfields of Kep and Hau Loc, in your letter of April 24 to Senator Stennis, you state and I quote "these strikes were in consonance with the concept of gradual increase in military pressure against the enemy." We know the enemy is building up steadily his defenses around the meaningful military targets, defenses such as SAM sites and antiaircraft and the hundreds of thousands of small arms. Therefore, the longer we wait to hit these military targets, the greater loss in American lives. The day before yesterday we lost heavily in planes and pilots.

Therefore, tomorrow we will lose more if we carry on with this concept of gradual increase of military pressure. Could I ask you, as Chairman of the Joint Chiefs, why you apparently plan major and rapid increases in ground forces in South Vietnam, but only these gradual increases in naval air and navy forces engaging the enemy in South Vietnam?

That is the end of the letter.

I notice, Mr. Chairman, that there are an increasing number of public officials who say we should get out of the air and concentrate on the ground. To those who have studied this war, that means we should delay any possible successful outcome in the future of the war, and increase the number of American casualties.

That is my conviction. I would be interested if the able Senator or the chairman of the Preparedness Subcommittee would have comment.

Senator STENNIS. I would comment briefly in this way. I agree with you wholeheartedly. I wish that I could see some other way out, but all of us on our Subcommittee have had this problem very much on our minds for years now, and I don't believe there is any other way. I believe that we are prolonging it by waiting.

We will eventually have to do what you have outlined, and to stop the loss of life, the cost and the other suffering, we just have to go on and do it as soon as possible.

I want to thank you too for your fine remarks, Senator Symington. I have learned most of what I know about these problems from you. We have been sitting beside each other now for more than 10 years, I think. Your contribution to our subcommittee has been tremendous and I know it will continue to be.

I wish there was some other conclusion besides what we have.

Senator SYMINGTON. Mr. Chairman, I appreciate those kind but undeserved remarks. There is one other question I would ask the witness, not having had a chance to discuss it with him.

We have stopped the air attacks on North Vietnam five times. Anybody who would care to see the pictures of what they did in the last cessation, and those pictures are available, and I would be glad to arrange for members of this committee to see them, will then realize what these cessations cost us.

We have achieved absolutely nothing from these five cessations that we have agreed to with respect to air attacks. During a 4-week period we extrapolated an estimate of casualties in North Vietnam which came to less than 100 based on the best estimates of our own people and civilians in North Vietnam.

During that same period however the total casualties in South Vietnam were over 8,500.

Senator STENNIS. Yes.

Senator SYMINGTON. I wonder therefore, why nobody suggests perhaps we might have a cessation in South Vietnam, from a humanitarian standpoint, as against constantly talking about stopping in North Vietnam. Would the able Senator care to comment on that?

Senator STENNIS. Well, I have had the same observation, of course. It is a natural impulse of our people and all civilized people not to want to bomb where civilians were involved at all, but this is war, and the supplies are coming from those places that we have started to hit. Unfortunately it is impossible to avoid civilian casualties no matter how hard we try.

But on the other side of the ledger, the bombing saves the lives of Americans, South Vietnamese, and the lives of others who are fighting with us. It is necessary and vital.

I want to add to what you have said about the 4-day let truce. Mr. Chairman, those were the most revealing pictures I have ever seen, and I see a lot of them. But during the 4 days that the Senator referred to, while we were immobilized and couldn't attack, the activities on the sea, land, everywhere, even including a human chain moving supplies in some areas, were tremendous.

I urge you to take time to see those pictures. Some of them were in the newspapers, though only a few I think. But you will really see what happened. Actually the President held it up 5 days and there wasn't any activity on the fifth day, because they had completed their planning. It was an amazing thing to see.

Senator SYMINGTON. I thank the chairman and I thank the able Senator from Illinois for his courtesy.

Chairman PROXMIRE. Senator Percy?

Senator PERCY. Senator Stennis, I want you to know that what you said in 1966 about the budget was given careful attention by many of us who had the responsibility of conducting responsible campaigns. As a matter of fact, it led me in St. Louis to indicate that I felt a tax increase was necessary last year.

Senator STENNIS. Yes.

Senator PERCY. That is not a very easy thing for a candidate to public office to say, but as a result of following your figures very closely I estimated the budget deficit would be about $10 billion, as against the 1.8 forecast. Do you think a tax increase should have been enacted in 1966, based on your best judgment?

Senator STENNIS. Well, I didn't advocate it then, so my lips are buttoned up now on what should have been done in 1966. I certainly expect to support one in 1967, unless we should make economies in other programs that would make it unnecessary.

Senator PERCY. I think we will support you in the economies, but the other one is subject to some questions. If I interpret your comments correctly, our troop forces in the approved budget was, as of the end of calendar 1967, 448,000. If the increase of 60,000 would bring us to 500,000 what does that include, when you say troop forces? Does that include the Air Force and the Navy? What would be our total estimated military force commitment then in the Vietnamese situation by your estimate by yearend, calendar yearend this year?

Senator STENNIS. The question is a little long and I will not go back to the first part. When I said I thought that by the end of this calendar year we would have perhaps 500,000 men, I was talking then in terms of men on land in South Vietnam. That would not include the men on the sea, you see, in the ships, and those in other countries, such as Thailand.

We have considerable naval forces offshore, as you know. The number, I think, is about 45,000. I don't know whether the figures have been published about other countries in Southeast Asia. I believe they have for Thailand. Not being certain, however, I would rather not mention the figure.

Senator PERCY. Senator, is it your feeling that if we have to step up 60,000 men on the ground this year, part of it being for combat, part for the pacification program, that this job could be done just as well by Philippine, Malaysian, possibly even Japanese forces, rather than just American forces?

Senator STENNIS. If you will permit me to say so, Senator, I really didn't use the 60,000 figure. I did not mention the figure that the present budget is based on. That is classified. I said that we had 438,000 over there now, that had been announced, and I discussed the possibility of there being 50,000 above the budget-planned figure. I just mention that to keep the record straight.

Now you mention the question of troops from other Asian countries. I heard you on one of the national programs Sunday, and I heartily agree with you, with reference to the need for troops from the Asiatic countries. I have said that after all, the successful stopping of the spread of communism in Asia can never be done unless it is done partly by Asian troops with the determination, willpower, and resourcefulness to do it. I think we ought to emphasize that to our people.

We have spent a world of money and training on the South Vietnamese, many of whom have done mighty well, and we deserve and need the support, as I have said, of other Asiatic nations. However, to set out now to train their armies for this fighting and equip them with everything and get them in there in appreciable numbers would take a long time.

Senator PERCY. I am wondering though, Senator Stennis, if for instance the threat against Maylaysia is far less now, with the change in the situation in Indonesia.

Senator STENNIS. Yes.

Senator PERCY. It would seem to me that with those forces, who for 15 years fought guerrilla warfare, would be more experienced than our forces. These young boys going out now are fellows taken off our cities and our farms, are those who never had experience or training, never lived in the jungle. Why couldn't we get Malaysian forces in there faster than we could get in raw recruits that are being drafted?

Senator STENNIS. That is a good point. Any that are already trained would be excellent, and I think we ought to try in every way we can get, first, the diplomatic support, second, the moral support, including support in every aspect in chancelleries of the world, and finally some material and military support.

I suppose the President has tried to do those things. I think we are going to have to make a new start. Frankly, it looks to me like we are going to have to go on and win this one, and then reevaluate everything, Senator.

If we don't get Japan's help in saving the Pacific area, why I don't know that it can be saved. Japan is the most powerful non-Communist nation in all the Pacific. If we don't use them, I am doubtful of what will become of the area out there. I am not blaming them. We wrote the provisions of their constitution, but it is a fact of life. We must have them I think.

Senator PERCY. I am impressed with the estimated cost that you have of putting an American over there.

Senator STENNIS. Yes.

Senator PERCY. It runs to about $100,000 a man. Now that is a great deal of expense. We have to average it out. A man might have a $6 million jet or he may have a $40,000 tank.

Senator STENNIS. Yes.

Senator PERCY. It seems to me that from the standpoint of cost, we could commit ourselves to equip these Asian forces at far less cost and certainly less cost in manpower. It seems to be that the threat to them, their security, their well-being, their right of self-determination is far greater than the threat to us back here. They are the first line out there.

Senator STENNIS. You are correct.

Senator PERCY. In returning from England with Congressman Rumsfeld, I think we were impressed with the fact that rather than our allies giving us greater support in this area, it seems there is going to be a lot less support.

There is talk in England of the British pulling out east of Suez. They now have got 40,000 forces in Singapore. What if they did pull out of Singapore? At your estimated cost of maintaining a man, that is another $3 to $5 billion. Is any provision made in the budget for picking up that kind of an obligation and responsibiliy?

Senator STENNIS. Oh, no. There is no provision to assume the burden if they pull out. I just pray that that won't happen.

But I agree with you. Our allies should give us greater support.

It is necessary to have their agreement before they will fight or before they will take part, and they are not coming as yet. The Philippines are in jeopardy if anyone is, as I see it, and they are helping some but not a great deal militarily. Somebody must be mistaken about this being a crisis or a real challenge.

Senator PERCY. Senator Stennis, could we relieve the pressure on us economcially in this implied commitment we have to police the whole world, now that Europe has been rebuilt, now that they have got something really to fight for, now that the East-West tension is not nearly as great as it was under Stalin, is there some basis for believing we can gradually, with the concept and cooperation of our allies and possible mutual deescalation from East and West reduce the load and the cost that we have in Europe?

Senator STENNIS. Well, that certainly is a possibility. Frankly, I personally think this is not the right time to jump up and do this on a drastic scale. I am on the joint committee that has been appointed from Foreign Relations and Armed Services to hear the Mansfield resolution.

That generally is my position. We could cut down a good deal of the money cost, I think, without reducing the military value and power. But there has got to be a reevaluation, and that includes NATO, although I lean toward NATO as a very valuable alliance. It has been good and still can be.

I made the point in 1954, by the way, when we went into Vietnam, Senator, that we were going in alone. That impressed me. No one went with us when we went in. Therefore, no one was directly obligated to stay with us. That is the way it is almost.

Senator PERCY. Thank you, Senator Stennis, very much.

Chairman PROXMIRE. Congressman Rumsfeld?

Representative RUMSFELD. Senator, you have heard comments from Senator Symington and Congressman Curtis and Chairman Proxmire about remarks that were made before this committee by the Director of the Budget, Mr. Schultze, and by Mr. Anthony. You on at least two occasions have considerably more accurately forecast the budget costs of the conflict in Vietnam than has the administration.

As I recall, Congressman Laird also made a statement on the floor of the House of Representatives highlighting your statement, adding some thoughts of his own on the fact that the administration was grossly underestimating the cost of the war in Vietnam.

I wonder how you can explain this. Why is it that you, Congressman Curtis who indicated he noticed the indicators changing, and Congressman Laird could considerably more accurately predict what the total costs are going to be than could the administration? Do you think they know what the costs are going to be, or is it that they don't know, and you in fact do, and Congressman Laird does? You were accurate.

Senator STENNIS. Well, I don't deserve any credit for the estimate I made. It was just an effort based on information I had to make the calculation.

Representative RUMSFELD. Was the same information available to the administration?

Senator STENNIS. Why of course, of course, and I called on them to make an estimate, because at that time I happened to be handling the appropriation bill, and was conducting hearings, and my fellow Senators were asking me how much was in the bill for the war.

Representative RUMSFELD. So they had the same information, and yet they refused to——

Senator STENNIS. Why of course. They had more information than I had. They were more capable of doing it than I was. It wasn't a question so much of them giving the wrong estimate. They just didn't give any estimate for the 2 years that you referred to, and the second year, that was covered by saying, well, they just figured it to June 30, 1967, and that was it.

Representative RUMSFELD. Did they excuse this on the basis of security, that they don't want to telegraph to the world what their anticipated efforts are going to be?

Senator STENNIS. Well, I don't know. You know as much about that as I do. I am not here to pass on the other fellow. I was just trying to give you the benefit of what little I know, and have seen, and you are going to have to make a judgment on that, gentlemen.

Representative RUMSFELD. The problem is, of course, as you indicated, for the Joint Economic Committee, and for the Members of both Houses, to try to look at the broad picture.

Senator STENNIS. You are right.

Representative RUMSFELD. With respect to the budget.

Senator STENNIS. That is correct.

Representative RUMSFELD. And try to make some judgments as we proceed.

Senator STENNIS. Yes.

Representative RUMSFELD. Using the best information we can find. It seems there is a pattern here over a period of 2 years.

Senator STENNIS. Yes.

Representative RUMSFELD. And I am pleased to see you indicate that this is at least a tighter budget.

Senator STENNIS. Yes.

Representative RUMSFELD. I assume by that you mean more accurate.

Senator STENNIS. Yes, a more accurate budget.

Representative RUMSFELD. You would guess then that the margin for error is going to be less than it was in the past 2 years.

Senator STENNIS. Oh, yes. I don't think there is any doubt about that.

Representative RUMSFELD. Given the anticipated project buildup.

Senator STENNIS. That is right, the anticipated level of operations. There is no doubt about it being much more accurate.

Representative RUMSFELD. How long can we go without figuring into the budget the replacement costs for the drawdowns on such things as the Atlantic Fleet and other military units around the world outside of Southeast Asia, from a military standpoint? I think this will give us information on future budgets.

Senator STENNIS. That is correct. I am hardly in a position to say how long we can go. I would have to have a list of the items before me, the major items at least, and get some kind of an evaluation by military men that would give better guidelines.

I know that those things have been happening in a large way from time to time, and they can't continue forever, and it is running into money. There are some replacements I am sure, but nothing like full replacement.

Representative RUMSFELD. You indicated that you didn't care to estimate the costs of these drawdowns that have not yet been replaced.

Senator STENNIS. Yes.

Representative RUMSFELD. Because you recognize, as all of us of course do, that some of the things will not be replaced.

Senator STENNIS. Yes.

Representative RUMSFELD. Excluding that category of items that wouldn't be replaced, can you give us an estimate of the drawdowns, assuming they were all to be replaced?

Senator STENNIS. Gentlemen, it is such a relative matter as to what should be replaced and how much should be replaced, in view of modern conditions, that I would hurt the cause, I think, if I tried to give an estimate in dollars. I am not informed enough to do it this time. It would take a special study to do it. You could possibly assign a staff member to that who is knowledgeable in that field, and he could come up with some kind of a figure for you.

Representative RUMSFELD. Turning to your comments on the Reserves, Senator, do you have any figures you can give us about relative costs? I think you indicated that we could do it a lot cheaper by calling up some Reserves.

Senator STENNIS. Yes.

Representative RUMSFELD. Than we could by starting at the beginning of the funnel through the draft.

Senator STENNIS. Well, the main saving, as I understand it, in view of the condition of some of the Reserve units, would be in the area of training. In other words, we already have a good many of them trained up to a point that is not too far from being "ready." Of course, once you called them up, the costs from there on, except for training, would be just as much as for an Active Army unit, but we have already spent the money in training them.

As you know, generally speaking, you can keep a man almost up to par in a good Reserve unit at about from one-fourth to one-fifth what it costs to keep a Regular. You get from 4 to 5 to 1 for your dollar that way.

That is why I think this: That this program as a whole—the military program—has become so expensive that we are going to be driven more and more to the Reserves, keeping that talent organized and near a full readiness condition. That is the only way we can carry the staggering cost of this increased military program over the years ahead.

I wouldn't know how much we would save by calling the Reserves rather than starting with raw recruits, but it would not considerably alter the bill.

Representative RUMSFELD. You commented on the pacification program?

Senator STENNIS. Yes.

Representative RUMSFELD. I recognize the problems of discussing this, but I would be interested in your comment on this thought. The military effort over there is going to be worthwhile to the extent that we and the South Vietnamese are able to preserve whatever measure of freedom is won through the military effort. To the extent we are not able to preserve that measure of freedom, the successes from the military effort will have been for absolutely nothing. Therefore, the pacification program becomes extremely important on which I am sure we both agree.

Senator STENNIS. Yes, I do.

Representative RUMSFELD. We recognize, and you alluded to it, the difficulties we are having in South Vietnam with the pacification program. We moved through a series of different efforts, the "strategic hamlet," "the rural development," "the rural redevelopment," now they are in this "revolutionary development cadre program"—still with very modest success only.

It it your thought from your experience in this area, and you have long experience in this area, that ultimately there is going to have to be a shift in emphasis, an escalation of the manpower in the pacification program? Is this your view, if we are going to succeed on the nonmilitary side of the war, so that the military side of the war will have been worthwhile?

Senator STENNIS. Well, in the first place, I wholly agree with you that this whole thing could be lost if we win, so to speak, militarily, and then just pull out of there and leave. In 3 to 6 months, I think, they would be cut to pieces again. So I think we are going to have to stay, not for desire of territory or anything but for protection to them.

No. 2, about the pacification program, that certainly is a problem, and it has got to be welded together in some manner. I don't know just how much a westerner can teach an Asiatic in an Asiatic country about self-government, or how fast this can be done. They have their ideas about those things and we have ours. I am beginning to feel like there is a missed connection there in some way.

Representative RUMSFELD. It certainly looks like it from the situation thus far.

Senator STENNIS. Yes. Perhaps the military uniform is not the way to do it. We have got to use it now under the circumstances. But I envision there that we will have to stay, and evolve an altogether different plan from what we are using now. That is the way I see it. You have been over there, I believe, and had a special look at this thing. I would be glad for you to comment for my edification.

Representative RUMSFELD. The conclusion I think you are reaching and I am reaching is that regardless of when the Department of Defense may assume or speculate that the war might be over, that from that date on, even if the formal military part ended today, we would still have, if we weren't to lose what has been gained, a requirement for a substantial commitment, if we were to move through this so-called pacification program. This is your conclusion.

Senator STENNIS. You are absolutely right, I think, and we ought to always make clear though that we are doing and are continuing to do that for their protection, and not for conquest, not for territory, and not for any gain. I am sure you agree with that.

Representative RUMSFELD. Yes, sir. My time is up. I certainly thank you for taking your time today.

Senator STENNIS. I thank you very much.

Chairman PROXMIRE. Congressman Brock?

Representative BROCK. Senator, I have been very grateful for your testimony this morning. It has opened a lot of doors.

Senator STENNIS. Thank you, Congressman.

Representative BROCK. I will try not to take too much of your time.

Senator STENNIS. That is all right. I am glad to see you again.

Representative BROCK. I have been fascinated in skimming through and just picking up the figures from your statement. I would like to recap them and see if we can come to some conclusion.

In 1966 the military requested $7.9 billion more than the Secretary of Defense submitted to Congress. His original figure was $48.5 billion. Then we had to come in with a supplemental, with two supplementals totaling $14-plus billion, actually considerably more than even the services originally requested, taking it up to $63 billion.

Senator STENNIS. Yes. Of course, that was the year the war escalated, you know, in calendar year 1965.

Representative BROCK. That is correct. In 1967 they requested $12.9 billion more.

Senator STENNIS. Yes.

Representative BROCK. More than the Secretary of Defense submitted to the Congress, and as a matter of fact, our supplemental for that year was exactly that amount of money, $12.9 billion. We ended up spending $72.8 billion.

For fiscal 1968 they requested $17.6 billion more than was authorized in the budget. The budget figure was $73.1 billion. Congressman Curtis has pointed out that if we just maintain it at the current level, it will be $7.3 billion more than the request, or $80.4 billion.

Senator STENNIS. Yes.

Representative BROCK. And with the projections that General Westmoreland has made and that you have made today, I think it is fairly reasonable to assume that $6.6 or $6.7 billion per month may be low. We have seen it run a continual increase in monthly cost, and if that is just the starting point, we could be another $4 to $10 billion above $80 billion.

The reason we are engaged in these hearings is that every Member of Congress has a responsibility in voting on any bill to take it within the context of its impact on the total economy. Only as we know what deficit is going to be created by defense spending, only then can we judge the merit and the relative priority of nondefense spending.

Senator STENNIS. Yes.

Representative BROCK. We have a specific responsibility, and I am concerned that this information, or lack of it, which we have had in the past had created some of the economic difficulties we have today.

Now not every Member unfortunately will take the opportunity to read your testimony, but is there any way in which we can effectively force a more accurate picture being brought to the attention of the Members of Congress?

For example, it has been suggested that maybe a quarterly review of Defense expenditures and costs should be made available to this committee or to your committee. Is this something that would address itself to the problem we face?

Senator STENNIS. Well, I think it would be helpful; yes. The Congress has the power over these appropriation bills; there is no question about that. If we just stop them and don't move them, why something must happen.

Representative BROCK. Congress seems to have the power over the appropriations, but we don't seem to have the power over the information.

Senator STENNIS. Yes; that is right.

Representative BROCK. That makes the appropriation valid and I am concerned over this lack.

Senator STENNIS. To stop the progress of the bill would be one way to get a more complete presentation of the facts as they exist. I am not suggesting that we be arbitrary, but we are entitled to more information, and I think we are getting far more information for fiscal 1968, and that it is more accurate and realistic, as I have emphasized.

Representative BROCK. If it is more realistic, then its realism is based upon a realistic hope that there will be no escalation.

Senator STENNIS. Yes; that is a part of the planning of the budget as I understand it. It is valid only if there is no appreciable escalation of the war in numbers, and so forth.

Representative BROCK. As I understand your comment on the Mekong Delta problem, we decided to go in because we felt they were unable to cope with its themselves, the Asians. I have heard that this operation would take an absolute minimum of 50,000 additional troops and that is an absolute minimum, and some estimates have been considerably higher.

I have also heard that it might take an additional 50,000 just to beef up the Marines below the DMZ.

Senator STENNIS. Yes.

Representative BROCK. If this were to become an explosive area. Now that to me adds up to 100,000 additional men, if those two should become serious problem areas.

Senator STENNIS. Yes.

Representative BROCK. Am I wrong in my estimates, or is this something we should not be concerned about?

Senator STENNIS. Well, we should be concerned about it. I have already given my estimate that in my judgment by the end of this calendar year, we will probably have 500,000 men in Vietnam. I just stand on that statement. That is about as accurate as I can be, and I mentioned the Marines and also the Mekong Delta area as part of my thinking.

Representative BROCK. One final question in a different area. You discuss the fact that we have not completely replaced the inventory that we are using, except in the area of long-range procurement of helicopters and things such as that, long-term procurement items.

Senator STENNIS. Yes.

Representative BROCK. I have been very concerned in the last few years over the fact that we have depleted the equipment available to our Reserve and National Guard units.

Senator STENNIS. Yes.

Representative BROCK. Are we beginning to correct that situation or is it still——

Senator STENNIS. Well, they have suffered very severely, and there has been no appreciable correction as a whole yet except in the areas where the units are being specially prepared in training for a possible callup. But, by and large, there has been no repair, appreciable repair of the damage, and that is a big item for the future, too.

Representative BROCK. Senator, you are aware that any organization, government or business, can minimize its out-of-pocket cost by utilizing inventory.

Senator STENNIS. Yes.

Representative BROCK. But there has to come a day of reckoning if they are going to stay in business.

Senator STENNIS. That is right.

Representative BROCK. Are we taking any gamble with the security of this country by reducing these inventories, or are they noncritical inventories?

Senator STENNIS. Well, we have a lot of strength in addition to the strength we are using in the war in Vietnam, but the more of our forces that we display there and the more we stretch out and use up our reserves and materiel, the weaker we will be if we should have an attack somewhere else. That has been something we have been thinking about a lot.

These drawdowns and all have affected the situation. I don't want to leave the impression that I think now that we are in a critical shape, because when I talk to you, I would be talking to our possible adversaries as well. In addition, we have a lot in reserve, but I don't think we can just go along happily assuming that we could carry out all our commitments alone.

That is one reason why I agree so completely with Congressman Rumsfeld about the Asiatics, and with Senator Percy, too.

Representative BROCK. I think we all share that desire.

Senator STENNIS. Yes.

Representative BROCK. Thank you very much, Senator.

Senator STENNIS. Thank you.

Chairman PROXMIRE. Thank you, Mr. Brock.

Senator Stennis, I do have one brief question. I apologize.

Senator STENNIS. That is all right, Senator.

Chairman PROXMIRE. All the discussion has been around the possibility of a 50,000-troop increase above the estimate in the budget. Many well-informed people in and out of Congress have estimated 100,000. I know that is not your figure. If it is 100,000, can we simply double your figure and say it would be not $5 billion, give or take a billion dollars, but $10 billion, give or take $2 billion? In other words, can we just double that or is there some other factor that would be involved here?

Senator STENNIS. Well, my figures now are based upon an estimate of 50,000 men above the budget as planned, you see.

Chairman PROXMIRE. I understand.

Senator STENNIS. The added cost would be mainly for training, transport, and support.

Chairman PROXMIRE. Right.

Senator STENNIS. Yes, generally if you double that to 100,000, it would take almost twice as much money as I estimated, although maybe not fully twice as much; yes.

Chairman PROXMIRE. Senator Stennis, I want to thank you for a very fine, I would say a brilliant presentation. You are most, most helpful to us this morning. You have certainly immensely enlightened us, and have helped these hearings greatly.

Thank you very much.

Senator STENNIS. I thank you, Mr. Chairman, very much. I really thank you for inviting me. It was your invitation, not my solicitation, as you remember. I am delighted though to meet with you and the membership of this group that I think is making a real contribution. Something has got to be done, and it is the congressional assertion of responsibility which is needed, as I see it. We have got to do more of it.

Congressman Curtis, may I just say this. The level there of expenditures that you gave, did that figure for $7.3 billion over the budget—I believe Congressman Brock used that figure——

Representative CURTIS. I think what he was doing was taking your expenditure figure.

Senator STENNIS. Oh, yes.

Representative CURTIS. Of $7.3 billion plus and then projecting out the expenditure figure at a level of $6.7 billion times 12 gives us $80.4 billion.

Senator STENNIS. Yes.

Representative CURTIS. And that is where the $7 billion comes from.

Representative BROCK. That is correct.

Chairman PROXMIRE. Is there a word of caution in order here? It is very hard to take a 1-month figure.

Senator STENNIS. Yes.

Chairman PROXMIRE. Or a 2-month figure, and then multiply it by 6.

Senator STENNIS. Yes.

Chairman PROXMIRE. Because there are seasonal aspects to it.

Senator STENNIS. Yes.

Representative CURTIS. Let me comment on that. I considered that when I took this monthly figure in September 1965. Of course this might be so, but the interesting thing is that Government expenditures really have no seasonal aspect, month by month, except the month of June.

Senator STENNIS. Yes.

Representative CURTIS. Right before that magic date you see something happen. This was quite interesting and, of course, this was the answer of the administration, but it turned out that that expenditure level was quite accurate.

I did the same thing in October last year, when the President sent up the suspension of the investment credit.

Senator STENNIS. Yes.

Representative CURTIS. I described again the way I look at these expenditure figures, and project them forward, and again they argued that the monthly figure had to be treated with caution.

Indeed it does. But I would observe that going back several years, there seems to be no pattern of seasonality in monthly expenditures. The real pattern is what we are going to see, and I think very clearly.

This has been escalation. The President hasn't told us this. This has actually occurred. We are now reading a figure that indicates what happened say about a month and a half ago.

Senator STENNIS. Yes. Well, I think your remarks are very timely, but, if there is no stepup in the manpower, I wouldn't want to say that I believe now that there is going to be a $7.3 billion figure over the budget militarywise, although I believe the budget is very tight and it will run over some.

When you escalate the war, as you said, you are going to escalate the cost and it could very well run 7.3, even without putting any more men in there. It could. But it would require a considerable escalation I think to make it go that high.

Thank you very much, gentlemen.

Chairman PROXMIRE. Thank you, Senator Stennis.

Our next witness is a man who should certainly get credit for his patience as well as his great ability, Mr. Archibald Alexander of the U.S. Arms Control and Disarmament Agency.

Mr. Alexander, we are very happy to have you come before us from a Government agency which is of extreme interest to all of us. I understand you have been doing some real studies in this area of what happens to the economy when the defense is reduced. We are very happy to have you.

STATEMENT OF HON. ARCHIBALD S. ALEXANDER, ASSISTANT DIRECTOR, U.S. ARMS CONTROL AND DISARMAMENT AGENCY

Mr. ALEXANDER. Thank you Mr. Chairman. If it is agreeable to you, I will read quickly through my statement, which will take about 10 minutes.

Chairman PROXMIRE. Fine.

Mr. ALEXANDER. Mr. Chairman, we thank the committee for the opportunity to appear before it in connection with its current hearings on the effect of the Vietnam war on the U.S. economy. As suggested in your letter inviting me to appear today, I shall address myself primarily to the arms control and disarmament aspects of the broad subject you are considering, since these are the aspects in which we were given responsibilities by the act of Congress which set up our Agency in 1961.

Our Agency's special interest in the Vietnam war is that upon its termination, the domestic economic consequences may be expected to be instructive as to the consequences that would follow an arms control and disarmament agreement resulting in reduced defense spending.

Section 31(h) of the Arms Control and Disarmament Act gives the Director of our Agency authority to conduct research and other studies on the "economic and political consequences of arms control in disarmament, including the problems of readjustment arising in industry and the reallocation of national resources."

The research in this field is necessarily directed at a moving target. No positive postulations can be made as to the time and kind of a future arms control agreement. Thus, the objective must be to examine a variety of possible future contingencies, and to arrive at suggestions for methods of dealing with their economic consequences. Since 1961, most of the arms control agreements have resulted in little impact on defense spending. However, when the Vietnam cease-fire occurs, it should provide an excellent sample, in real life, of what happens in the economy, and of the efficacy of what is done by remedial action. Thus our Agency is bound to follow this aspect of Vietnam with the utmost attention.

It so happens that a certain amount of research has been done, for or by our Agency, which may be useful to our Government in deciding what to do in order to minimize dislocation and make maximum use of opportunities when defense spending goes down after the Vietnam war is over.

Before giving you a general description of this research, which is listed and described in greater detail in exhibit A which I file with my prepared statement, I should like to make two general observations about the research and its premises.

The first observation, based on the experience of the United States in the years since the end of World War II, is that we are likely, over a period of time, to run into some periods of increasing, and other periods of decreasing, defense expenditures, according to whether our security and that of the free world are more or less menaced. Thus, in order to maintain national and international security, we shall have to plan our economic moves so as to be prepared both for increases and for decreases in defense spending. Flexibility in this regard, and in regard to measures dealing with the economic consequences of defense spending, must be a premise of our thinking. We cannot plan to travel indefinitely in one direction on a one-way street, whichever way it is headed.

The second observation, as to reductions in defense spending, is that, since we do not have the gift of prophecy, and must develop knowledge and policy alternatives for a variety of degrees of reductions, we had to ask the researchers, in appropriate cases, to make several assumptions regarding the severity of the reductions. For instance, in preparing the request for proposals on some of the industrial and regional impact research, we have provided assumptions concerning the severity of the decline in defense spending. These assumptions were made after discussion with some of the other departments and agencies of the Federal Government, and taking into account the kinds of arms control agreements which might be reached.

Our research on the economic consequences of arms control and disarmament has been divided, for convenience, into four main categories. These may be called:

1. Measurement of impact;
2. Impact on industry;
3. Impact on employees; and
4. Impact on regions and communities.

The research, almost all contract research, which I have listed in exhibit A, has been classified in this way, although some of the research necessarily covers more than one class of impact. For instance, regional impact necessarily takes into account manpower and industrial problems peculiar to the region.

Measurement of Impact

The first group of studies attacks the problem of measurement of impact, in terms of geography, industry, and people, which would result from termination of particular kinds of items of defense expenditures. It was early agreed by those who considered this problem that unless it were solved, valuable leadtime would be lost in putting into effect any measures that might be needed to supplement existing economic and social processes in facilitating transition for regions or communities, employees, and industries or firms. Much of the research in this field has been done through or with the Department of Defense, as well as in collaboration with the Departments of Commerce and Labor. I think it is fair to say that there has been perceptible progress in improving the data needed for this kind of economic early warning system, through which much more remains to done. An example of progress is the so-called MA–175, page 1 of the exhibit, a census of shipments to Government agencies by defense-oriented industries, made by the Census Bureau as a supplement to the Bureau's regular Census of Manufactures. This census has been done for 1963, a year preceding the Vietnam buildup, and within a relatively short time 1965 will have been covered, covering a period when the buildup had begun. These forms now show for the first time defense shipments by States and industries, and including subcontractors. This helps determine probable impact, when combined with the knowledge of which industries are involved in which procurement program.

Further work is underway to improve the capability of the Federal Government to trace down the impact of termination of defense contracts.

Impact on Industry

Three industries heavily involved in defense have been the subject of contract research designed to give us understanding of the effect on the industries of reduced defense demand. These are the electronics, page 6 of the exhibit; shipbuilding, page 8 of the exhibit; machine tool industries, that is on page 13.

The first two have been completed and have been widely distributed, not only within the Government but to the public and to members of the industry. Both are available at the Government Printing Office.

Another interesting study in this group was a case study of the experience of 12 defense-oriented firms which attempted to diversify into nondefense work, page 9 of the exhibit. Six examples were of firms that had succeeded in this effort and six of firms that had not. The size, geography, and kind of manufacturing were varied. The report contains recommendations on Federal policies and guidelines for diversification planning by defense firms. It also has a set of instructional guides for use, in conjunction with the report, in management seminars on diversification. This has been summarized in the Harvard Business Review and quoted elsewhere, and is available at the Government Printing Office.

A current research effort is underway on uses of defense technology for civilian purposes.

Impact on Employees

In studying the impact on employees, we decided to examine three cases of defense layoffs in different parts of the country. First was the layoffs after the Dynasoar contract cancellation, affecting employees in Seattle, page 14, and the layoffs at the Martin Co. at Denver, page 16, and at the Republic Aviation facilities on Long Island, page 17.

These studies will be compared analytically in a fourth study which will be called "Analysis of Defense Worker Reemployment." This is described on page 19. These four studies should show us, based on actual experience, which types of defense workers had difficulty securing reemployment and what factors seemed to help them and what to hinder them.

We have also underway two studies dealing with the transferability of skills from defense to civilian-oriented production, pages 20 and 21. The purpose of this effort is to identify opportunities in the non-defense sector of the economy for defense engineers and highly specialized technicians and blue collar workers. The resultant information can be used to help ex-defense workers find new employment and at the same time to promote the efficient utilization of the Nation's skilled manpower.

Impact on Regions and Communities

As you know, there is uneven geographical distribution of defense spending in the United States. Some States, some smaller regions, and some communities are almost unaffected by defense spending, whereas others are greatly dependent on it. We have therefore designed research, and we have received some useful results, in the field of community or area readjustment to reduce defense spending. One contractor examined Baltimore, Seattle and southeastern Connecticut. page 23 of the exhibit. This study examined the potential impact of assumed reductions in defense spending and estimated the economic effects in the metropolitan areas. It also provided a voluminous checklist of policies and programs which should be considered, in order to facilitate adjustments. The checklist covered things which might be done by the Federal Government, State and local governments, private industry, labor, et cetera.

One result of the portion of the study that dealt with southeastern Connecticut was the formation of a regional economic development commission by the 16 or so communities involved and a proposal by this commission to the Federal Government for financial assistance in preparation of an economic diversification plan and in evaluating the effectiveness of the plan and its implementation after the latter had been carried out by the local authorities. I am glad to say that the Department of Commerce, with some financial participation by our Agency, has made a contract for this purpose, after appropriate coordination with the New England Governors, and so forth. If a successful plan is developed for this heavily defense dependent region, it should be of value as a prototype or guide for other parts of the country.

Another study is one which deals with the consequences of the closing of some of the bases covered by Secretary McNamara's announcement in late 1965, page 27 of the exhibit. This study will examine the results for the people employed on the bases at the time of closing, for the physical installation, and for the community or area, including local commercial or industrial establishments involved in supplying the bases. We selected military bases in Pennsylvania, the South, Kansas and the Far West, some near large communities and some relatively isolated.

In conclusion, I should like to mention that our Agency in every instance coordinated proposed research in advance with other appropriate departments and agencies of the Government—for instance, the Departments of Defense, Commerce and Labor and the Council of Economic Advisers.

Since the establishment of the Committee on Economic Impact of Defense and Disarmament, created by President Johnson under the chairmanship of Dr. Gardner Ackley in late 1963, this coordination has been effected in accordance with the Committee's policy as stated in its report dated July 1965.

Now that our Agency has, by itself and with the help of other parts of the Government, obtained results from research into a number of aspects of the total problem, it seems to us that we should prepare integrated contingency plans for dealing with the various contingencies which might arise as the result of reduced defense spending due to arms control and disarmament. And we believe that much of the research which I described will be useful in connection with contingency planning for the economic impact of the Vietnam cease-fire.

(Exhibit A to the statement of Mr. Alexander is as follows:)

UNITED STATES ARMS CONTROL AND DISARMAMENT AGENCY

RESEARCH ON DOMESTIC ECONOMIC IMPACT OF DISARMAMENT
(As of April 21, 1967)

EXHIBIT A

(Referred to in prepared statement of Archibald S. Alexander, Assistant Director, U. S. Arms Control and Disarmament Agency, before the Joint Economic Committee April 25, 1967.)

I Measurement of Impact

II Impact on Industry

III Impact on Employees

IV Régional or Community Impact

TABLE OF CONTENTS

TABLE OF CONTENTS (Cont'd)

I

MEASUREMENT OF IMPACT

ACDA/E/RA-7

CONTRACTOR: Various contractors through Department of Defense

TITLE: Studies to Measure the Economic Impact of Defense Spending

DESCRIPTION: These cover a number of efforts to develop data and data systems which can be used to improve knowledge of the impact of defense purchases of goods and services on the economy. Their broad purpose is to see how such purchases, in aggregate or broken down by military program, contribute to the economic activity levels of industries and regions (or communities) and to what extent sufficiently stable relationships exist for use in predicting the industrial or regional impact of changes in defense purchases of goods and services. The data are of interest to ACDA for purposes of estimating the impacts of disarmament and to other agencies in estimating the impacts of other changes in defense spending (Office of Business Economics of the Department of Commerce, the Bureau of Labor Statistics, the Department of Defense).

Efforts thus far include the following:

(1) A census (MA-175) of shipments to government agencies in 1963 by defense-oriented industries conducted by the Census Bureau; the survey covers shipments to or receipts for work done for Federal agencies and their contractors or suppliers; the survey was supplemental to the 1963 Census of Manufactures; the results of the survey are contained in Special Report MC 63 (S) - 2 of the Census Bureau issued March 1966, available from the Superintendent of Documents, Government Printing Office, Washington, D.C., for $.30 per copy. The report shows value of shipments and receipts by industry groups and geographic areas. A similar survey covering 1965 shipments is contemplated.

(2) Contract work by CEIR on imputing value added and employment from the Census survey data and on defense procurement of goods and services not covered by the survey.

(3) Contract work by Research Analysis Corporation on tracing the broad impact of the DOD Five-Year Force Program and on methods for tracing industry inputs to major weapon systems.

(4) Contract work by Stanford Research Institute on tracing the grographic impact of R&D expenditures.

(5) Tracing of geographic impact through regular plant reporting methods developed by DOD.

Modifications and new initiatives are planned under the FY 1967 program.

DATE OF COMPLETION: Continuing

ACDA/E-59

CONTRACTOR: University of Michigan (Professor Daniel Suits).

TITLE: Survey of Economic Models for Analysis of Disarmament Impacts.

DESCRIPTION: This study involves a broad survey of the uses of economic models for predicting the economic impacts of arms control and disarmament and of possible offsetting programs of tax reduction or public expenditures. The survey covers econometric models, input-output analysis, regional models, and microeconomic simulation. The study considers the relative desirability of relying upon existing models (e.g., those of the University of Michigan Research Seminar in Quantitative Economics, the University of Indiana Business School, the Wharton School and the Brookings Institution) rather than developing a new ACDA model.

DATE OF COMPLETION: July 1965

ACDA/E/RA-31

CONTRACTOR: Census Bureau, Department of Commerce

TITLE: Shipments by Defense-Oriented Industries, 1965

DESCRIPTION: This is for work on the MA-175 survey conducted by the Census Bureau for shipments to Government by defense-related industries in 1965 and is an extension of the work covered in MC 63 (S) - 2 (see ACDA/E/RA-7). The survey of 1965 shipments covered a considerably larger number of industries than the 1963 survey. ACDA's contribution to the 1963 survey was part of its total contribution to the Department of Defense for economic impact studies; the Agency's contribution to the survey of 1965 shipments was made directly to the Census Bureau.

DATE OF INITIATION: August 1966

ACDA/E-125

CONTRACTOR: Research Analysis Corporation

TITLE: Economic Impact Analysis: Minuteman II and Other Weapons Systems

DESCRIPTION: Through contract analysis, plant visits, etc., the project will endeavor to identify prime contractor and first-tier subcontracting by 4-digit SIC for the Minuteman II weapon system. The project also will identify insofar as possible the location of output of prime and first-tier subcontractor plants for this system and for other systems being studied under contract to the Department of Defense and the Bureau of Labor Statistics.

DATE OF INITIATION: December 1966

II

IMPACT ON INDUSTRY

ACDA/E-48

CONTRACTOR: Battelle Memorial Institute

TITLE: The Implications of Reduced Defense Demand for the Electronics Industry

DESCRIPTION: This study analyzed the problems and opportunities for the electronics industry under conditions of reduced defense demand. In addition, conclusions were drawn pointing toward appropriate action to minimize adjustment difficulties and to develop alternative marketing opportunities.

This study (1) characterized the electronics industry as it is presently composed, (2) examined the effects on the industry of major reductions in military demand for its output, (3) considered problems of the adjustment of industry resources to different patterns of output and marketing, (4) examined efforts made thus far by the industry to reduce its dependence upon military demand and (5) provided a planning guide which suggests possible actions to be taken by government, industry and labor to ease the impact of defense demand reductions. This study (ACDA Publication number 28) is available from the US Government Printing Office.

DATE OF COMPLETION: September 1965

ACDA/E/RA-16

CONTRACTOR: Supplemental Contract, Bureau of the Census, Department of Commerce

TITLE: Geographic Tabulation of Selected Electronic and Associated Products

DESCRIPTION: The Bureau of the Census prepared special geographic tabulations of data on electronics and associated projects, based on the Bureau's Current Industrial Reports Series M36N. The data were made available to the Battelle Memorial Institute for use in connection with contract ACDA/E-48.

DATE OF COMPLETION: August 1965.

ACDA/E-66

CONTRACTOR: Midwest Research Institute

TITLE: Industrial Conversion Potential in the Shipbuilding Industry

DESCRIPTION: Based upon the evaluation of key economic factors, this study identifies 55 industries (4-digit SIC's) whose products offer conversion opportunities for the shipbuilding industry. The 55 industries were selected from an initial list of 160 industries which appear to have resource requirements and operating characteristics similar to those of the shipbuilding industry.

The 55 industries are largely in the areas of structural metals, transportation equipment, and industrial machinery. The study reviews their "conversion attractiveness" for shipbuilders in terms of (1) comparability (labor skills, technology, marketing), (2) financial requirements and profitability, and (3) size and growth characteristics. All 55 industries, however, are represented as providing going opportunities for shipbuilders - that is, opportunities which would entail no dismantling or scattering of labor, equipment or other resources.

DATE OF COMPLETION: May 1966

ACDA/E-68

CONTRACTOR: Denver Research Institute

TITLE: Defense Industry Diversification

DESCRIPTION: This study describes and analyzes the experience of twelve defense-oriented manufacturing firms in attempting to diversify into non-defense, non-aerospace markets. The analysis is intended to contribute understanding of the management problems facing defense firms in attempting to "branch out into unfamiliar, commercial markets"; diversification experience is assumed to have value for clarifying problems of industrial conversion for defense firms in the event of substantial reductions in the defense market. The study was undertaken on the assumption that diversification is a useful step preparatory to conversion.

The twelve case studies, eleven of which identify the names of the firms involved, include experiences of diversification attempts through internal product development and through acquisition. The report describes successful and unsuccessful attempts to overcome problems involving differences between defense and commercial business such as marketing methods, cost structures, product design and management attitudes and practices. The study submits recommendations for Federal Government policies on defense diversification and guidelines for diversification planning by defense firms. In addition to the report, it provides a set of instructional guides for use with the report in management seminars on diversification. The study is contained in ACDA Publication No. 30, for sale by the Superintendent of Documents, US Government Printing Office, for $2.25 per copy.

DATE OF COMPLETION: January 1966.

ACDA/E-103

CONTRACTOR: Denver Research Institute

TITLE: A Preliminary Examination of the Public Sector Market for the Systems Capability of Defense Firms

DESCRIPTION: The study will examine preliminarily the potential application of the so-called "systems capability" of defense industry to non-defense non-aerospace projects in the public sector of the economy--that is, projects involving problems handled by state or local governments and/or the Federal Government. Through a systematic literature search and interview program, the contractor will endeavor to identify (1) the nature of the systems capability, (2) the extent to which it is unique to defense-aerospace firms, (3) the non-defense public sectors which appear to offer the best opportunities for application of the systems capabilities of defense firms, (4) differences between systems and non-systems approaches to public sector problems and (5) the implications of the adaptation of defense systems technology to non-defense, non-aerospace public sector problems for reducing economic dislocations from disarmament.

DATE OF INITIATION: April 1966

ACDA/E/RA-15

CONTRACTOR: Northeastern University, through the Small Business Administration

TITLE: Defense Conversion Problems of Small R&D Firms

DESCRIPTION: Under this arrangement, the Agency has contributed funds in support of a contract let to Northeastern University by the Small Business Administration. The Department of Defense has contributed an equal amount to the project. The contract calls for research to determine the management and marketing problems, possible solutions, and growth potentials of small engineering and R&D firms in New England who will be affected by defense conversion. Original case material will be developed, built around defense conversion problems and directed towards the needs of the owners and managers of businesses. Instructional material for use in a management workshop will also be developed.

DATE OF COMPLETION: August 1966

ACDA/E-118

CONTRACTOR: Analytic Services, Inc.

TITLE: Obstacles to Technological Innovation

DESCRIPTION: The purpose of this study is to develop insights into the problems of accelerating the rate of technological innovation in the public sector, bearing in mind the impact of disarmement on the availability of financial and technological resources.

The study will analyze the process of technological innovation in the following cases: (1) the application in the United States of nuclear energy to electric power generation, (2) high-speed intercity ground transportation--the so-called "Northeast Corridor" project, and (3) intra-urban rapid transit--the San Francisco Bay Area Rapid Transit System. Obstacles having a rather broad applicability to the public sector will be identified and evaluated. These will be considered in terms of their implications for innovation in the public sector, particularly in the context of a significant shift of resources from defense to non-defense activity. The study further will consider the kinds of public policies most likely to overcome such obstacles.

DATE OF INITIATION: June 1966

ACDA/E-130

CONTRACTOR: Resource Management Consultants, Inc.

TITLE: Defense Dependency of the Machine Tool Industry and Disarmament Implications

DESCRIPTION: This study is designed to ascertain the defense dependency of this major capital goods producing industry as indicated by (1) the share of total machine tool shipments and advanced technology tools destined to be primarily used to produce defense items, (2) the size, composition and handling of the extensive government inventory of Machine tools. The influence of defense demand on the marketing and pricing practices of the industry, and its technological advancement can then be analyzed. The investigation of defense dependency and past industry actions will provide the basis for analyzing the implications of arms control and disarmament on the industry. Specifically, the areas of interest include (1) technological advancement, (2) the labor force and impacted communities, and (3) possible alternate markets. Recommendations for public policies to minimize adjustment difficulties will be based on the foregoing analysis.

DATE OF INITIATION: March 1967

III

IMPACT ON EMPLOYEES

ACDA/E/RA-13

CONTRACTOR: State of Washington Employment Service, through Department of Defense

TITLE: Case Study of the Effects of the Dyna-Soar Contract Cancellation

DESCRIPTION: This is the first of three studies on the reemployment experience of workers laid off at defense plants. The other two studies deal with layoffs at the Martin Company, Denver plant, and the Republic Aviation Corp., Long Island plant (see ACDA/E-67 and ACDA/E-69).

The study was designed to cover the reemployment experience of 5,229 workers of the Boeing Company, Seattle, who were laid off between December 1963 and March 1964 due to the cancellation by the Department of Defense of the contract for manned space vehicle Dyna-Soar. Information on these experiences was obtained by a questionnaire mailed by the Washington State Employment Security Department under contract with the Department of Defense. The questionnaire was first mailed in May 1964 and produced a 72% response. The questionnaire was mailed again in August 1964 to the respondents to cover experience in the May-August 1964 period and produced a 77% response. The questionnaires sought information on the personal and work characteristics of the workers, on their labor force status at the time of mailing the questionnaires, on their post-layoff experience in regard to employment and unemployment (including types of occupations, job locations, and new earnings), on obstacles encountered in seeking new employment, and on sources of assistance utilized in obtaining new employment or in maintaining income. The data have been tabulated to reflect the more important relationships bearing upon occupational mobility.

The report is contained in ACDA Publication No. 29, available from the Superintendent of Documents, Government Printing Office, Washington, D.C., 20402, at $1.50 per copy. A summary is contained in ACDA Research Report 65-3; the summary, entitled "The Dyna-Soar Contract Cancellation, A Statistical Summary" was prepared by Robert Brandwein of the ACDA Economics Bureau staff. A similar summary by Mr. Brandwein is contained in the October 1965 issue of the University of Washington Business Review and the October 1965 issue of the United States Department of Labor's Monthly Labor Review.

DATE OF COMPLETION: June 1965.

ACDA/E-67

CONTRACTOR: Martin Marietta Corporation

TITLE: Study of the Reemployment Experience of Disemployed Martin Company Workers

DESCRIPTION: This is one of three studies on the reemployment experience of workers laid off at major defense plants. The other two involve layoffs at the Boeing, Seattle and Republic Aviation, Long Island plants (see ACDA/E/RA-13 and ACDA/E-69).

The study is designed to cover the reemployment experience of some 4,000 workers laid off at the Martin Company plant in Denver during the first nine months of 1964. Information on these experiences has been obtained by a questionnaire mailed to the former Martin workers. There has been about a 75% response rate in connection with the questionnaire. Like the questionnaires used in the Boeing and Republic studies, information has been sought on the personal and work characteristics of the displaced workers, on their labor force status at the time of mailing the questionnaire, on their post-layoff experience in regard to employment or unemployment (including types of occupations, job locations, and new earnings), on obstacles encountered in seeking new employment, and on sources of assistance utilized in obtaining new employment or in maintaining income. The data have been tabulated to reflect the more important relationships bearing upon occupational and geographic mobility.

The data have been interpreted broadly in terms of the characteristics of the local labor market.

DATE OF COMPLETION: December 1966.

ACDA/E-69

CONTRACTOR: State of New York, Department of Labor, Division of Employment

TITLE: Studies of Reemployment Experience of Disemployed Republic Aviation Corporation Workers and of Defense-Non-Defense Job Relationships. 2 vols.

DESCRIPTION: This is one of three studies on the reemployment experience of workers laid off at major defense plants. The other two involve layoffs at the Boeing, Seattle and Martin, Denver plants (see ACDA/E/RA-13 and ACDA/E-67).

Part I of this study, "Reemployment Experience of Disemployed Republic Aviation Corporation Workers," is designed to cover the reemployment experience of some 10,000 workers laid off at the Republic Aviation Corporation plant at Farmingdale, Long Island, New York, between November 1963 and October 1964. Information on these experiences has been obtained by a questionnaire mailed to the former Republic workers. There has been about a 50% response rate in connection with the questionnaire. Like the questionnaire used in the Boeing and Martin studies, information has been sought on the personal and work characteristics of the displaced workers, on their labor force status at the time of mailing the questionnaire, on their post-layoff experience in regard to employment or unemployment (including types of occupations, job locations and new earnings), on obstacles encountered in seeking new employment, and on sources of assistance utilized in obtaining new employment or in maintaining income. The data have been tabulated to reflect the more important relationships bearing upon occupational and geographic mobility.

The data have been interpreted broadly in terms of the characteristics of the local labor market.

ACDA/E-69 (cont'd)

Part II of this study was completed in December 1965. This report,"The Transferability of Defense Jobs to Non-Defense Occupations," describes the experimental efforts of the New York State Department of Labor to identify occupations in the non-defense sector of the economy which are similar to the occupations in the Republic Aviation Corporation work force. The work involved classification of the Republic job titles into Dictionary of Occupational Titles Codes, identification of those occupational codes found predominantly in the aircraft or other defense industries and the search for non-defense occupations involving similar skills, materials and working conditions. The methodology developed in the study was found to be effective in developing relationships between semi-skilled and skilled occupations but ineffective for developing relationships among scientific, engineering and similar professional occupations. The report contains recommendations for utilizing the Dictionary of Occupational Titles in planning for future work force reductions in the defense industry. An appendix to the report, entitled "Job Relationships Between Defense and Non-Defense Occupations" contains the lists of specific non-defense occupations found to be related to the defense-oriented semi-skilled and skilled occupations at Republic Aviation.

DATE OF COMPLETION: August 1966

ACDA/E-113

CONTRACTOR: University of Colorado

TITLE: Analysis of Defense Worker Reemployment

DESCRIPTION: The purpose of this project is to analyze the problems of reemployment for defense workers under mass layoffs based upon the results of three surveys of the reemployment of defense workers.

Using data and materials from the studies of mass layoff experiences at Boeing, Martin and Republic (ACDA/E/RA-13, ACDA/E-67, and ACDA/E-69), the study will analyze and compare reemployment results for those covered by the surveys. Inferences will be developed as to factors bearing upon geographic and occupational mobility.

DATE OF INITIATION: June 1966

ACDA/E-102

CONTRACTOR: Department of Employment, State of California

TITLE: The Potential Transfer of Industrial Skills from Defense to Non-defense Production

DESCRIPTION: The purpose of this project is to gain insight into problems of retraining semi-skilled, skilled and technical workers (other than professional workers) that may arise as a result of substantial reductions in defense spending. The study will analyze the occupational composition of the work force of two plants in California which manufacture defense missile systems and subsystems to determine the extent to which the skills utilized are potentially transferable to occupations in non-defense, non-aerospace production. Included in the study will be an analysis of retraining problems displaced workers may face and an analysis of the long-range demand for the non-defense, non-aerospace occupations which are identified as being similar to the occupations in the subject missile plants. In addition to its use as an aid to estimating the importance of retraining in facilitating economic adjustment to disarmament, the results of the study will be used to identify reemployment opportunities for laid-off defense workers.

DATE OF INITIATION: April 1966

ACDA/E-110

CONTRACTOR: Stanford Research Institute

TITLE: Transferability and Retraining of Defense Engineers

DESCRIPTION: This study will attempt to assess the skill and work environment barriers to the transfer of engineers from defense to commercial engineering work. Data will be gathered from engineers and managers in companies having both defense and commercial activities to identify any significant obstacles and evaluate the role re-training or re-education might play in overcoming them.

DATE OF INITIATION: June 1966

Expect to Fund in FY 67

TITLE: Pensions, Severance Pay, and Related Benefits for Laid-off Defense Workers

DESCRIPTION: The purpose of this study is to determine whether it is feasible to identify standards of adequacy of pension rights, severance pay and related benefits for workers of defense contractors. The study will focus on older workers with long-term job tenure who would be laid-off because of defense reductions resulting from arms control and disarmament. The topics to which the researcher will address himself include:

(1) Comparisons between benefits for workers of defense contractors and benefits for workers in non-defense oriented firms or industries.

(2) Concepts or standards of adequacy of fringe benefits used in collective bargaining in both defense and non-defense industries.

(3) Influence of contracting procedures of the Department of Defense upon fringe benefits.

(4) Evidence that employees of defense contractors are paid a "wage premium" to compensate for the greater instability of defense-dependent employment.

Should the determination of some measure of adequacy of benefits for defense workers prove feasible, the contractor will provide a design for making such determinations.

IV

REGIONAL OR COMMUNITY IMPACT

ACDA/E-57

CONTRACTOR: National Planning Association

TITLE: Community Readjustment to Reduced Defense Spending

DESCRIPTION: This study provides an evaluation of the potential impact of certain assumed reductions in defense spending on the Seattle-Tacoma, Baltimore and New London-Groton-Norwich (Conn.) metropolitan areas. The evaluation is treated in the context of case study material to provide insights into the problems of community adjustments to changes in defense spending. An important derivative of the approach is a checklist of policies and programs to be considered for dealing with regional adjustment problems, together with a characterization of each indicated measure according to economic objective, short or long term value, principal beneficiary, degree of effectiveness, and other pertinent factors.

The arms reduction assumptions used in the study are: (1) a strategic nuclear delivery freeze, (2) an across-the-board cut in major categories of armament (that is, a reduction of 10% per year for three years along the lines of the first stage of the program for general and complete disarmament submitted by the United States to the Eighteen Nation Disarmament Committee in March 1962, and (3) a gradual reduction in defense expenditures or a reduction in such expenditures of $12 billion over a five-year period. July 1, 1965 was taken for the starting date for carrying out the assumed reductions. The impacts from the assumed reductions were analyzed in the framework of projections for the economy, based upon trends applying before changes due to the conflict in Vietnam. Regional impacts were derived principally from information available on prime contract awards. These impacts are translated into gross disemployment and net disemployment after application of national offset programs.

DATE OF COMPLETION: January 1966

ACDA/E-58

CONTRACTOR: Kirschner Associates

TITLE: Adjustments to Reduced National Defense Expenditures in New Mexico

DESCRIPTION: This study is a "companion" to the one performed by the National Planning Association (see ACDA/E-57) and a contract for the study resulted from the same request for proposals by the Agency.

The study involves reliance upon the same reduction assumptions used in the National Planning Association study plus an additional assumption of a 25% cut in AEC weapons R&D, coupled with an across-the-board cut. Regional income and employment effects are traced on the basis of certain simplifying or arbitrary assumptions as to how the national military program cutbacks would affect specific programs of the Department of Defense and the Atomic Energy Commission in New Mexico. The results are applied statically as of 1963.

The report evaluates the economic development and redevelopment climate in New Mexico and provides recommendations for facilitating more thorough advance planning in the state for economic losses related to changes in defense spending.

DATE OF COMPLETION: January 1966

ACDA/E-85

CONTRACTOR: The University of Washington

TITLE: Impact of Defense Purchases on Industries in the State of Washington

DESCRIPTION: The University already has conducted a Washington State Interindustry Study with partial financial support from the Washington State Department of Commerce and Economic Development. The university will expand the Interindustry Study by developing a set of "defense input-output" tables which will facilitate more meaningful identification, segregation and measurement of the sales and purchases among industries in the state which result from national defense activities. Specifically, these sales and purchases will be related to the levels of demand associated with individual military bases in the state and with purchases by the Department of Defense of military hardware and of "soft" goods for military consumption outside the state. The project will provide information on methodology which can be of assistance to other states or regions in evaluating the local economic effects of changes in defense spending.

DATE OF INITIATION: June 1965

ACDA/E-88

CONTRACTOR: National Planning Association

TITLE: Measurement of Community Dislocation Sensitivity and Adjustment Potential

DESCRIPTION: The study endeavors to develop and test a method of statistical indicators which can be used to evaluate the sensitivity of communities to economic dislocations from changes in defense spending and the potential of the communities for economic adjustment to such changes. The method will be developed from data applicable to nine selected communities. The procedure involves determining in the first instance the economic and demographic characteristics which bear on dislocation sensitivity and adjustment potential--income, employment, and fiscal dependency on defense activity, non-defense economic activity, public and social services, resource and transportation assets and liabilities, regional environment, economic institutions, and similar measures. Data sources to represent these characteristics then will be examined and available data collected. The final step will be to draw on the data to describe and analyze important economic relationships and to convert these relationships (or combinations of relationships) into appropriate indicators.

The data from the project will be drawn from existing available sources--Federal, state, and local. Should the data available prove inadequate to develop a useful indicator system, the study will indicate the nature of the data gaps which must be filled to develop such a system.

DATE OF INITIATION: June 1965

ACDA/E-90

CONTRACTOR: University of Kansas

TITLE: Civilian Manpower and Community Impact Analysis: Changes in Status of Military Installations

DESCRIPTION: This study will evaluate the economic impacts of the program announced by the Secretary of Defense on November 19, 1964 to reduce activity at 80 domestic military installations.

The study will concentrate largely upon the economic impact in the affected communities and give special attention to the impacts in Bangor, Maine; Savannah, Georgia; Middletown, Pennsylvania; Mobile, Alabama; Salina, Kansas; Amarillo, Texas; and Moses Lake, Washington. These will be analyzed from available data reflecting changes over time in such aspects of local economic activity as employment, wages and earnings, retail sales, construction and sale and rental of real property, sales of public utilities, and public finances. To increase knowledge of community response to economic impact situations, community action programs in Salina to deal with the current cutback will be analyzed in depth. The study will evaluate the role of actions or plans regarding the disposition and civilian re-use of land and facilities released by the Department of Defense in each area.

In addition to studying the community impacts, the project will provide summary data and analysis relating to the reemployment experience of the civilian employees of the Department of Defense whose jobs have been affected by the November 1964 order. Insights into the problems of skill transfer and geographic mobility will be sought from the analysis.

DATE OF INITIATION: June 1965.

ACDA/E/RA-33

CONTRACTOR: Robert Nathan Associates, through the Economic Development Administration, Department of Commerce

TITLE: Southeastern Connecticut Economic Readjustment Study

DESCRIPTION: The project is to develop a plan, in cooperation with the local community, for broadening the economic base of the New London-Groton-Norwich area and thereby lessening its dependence upon defense spending. In addition to the economic redevelopment plan, the contractor also will develop a contingency plan for readjustment programs in the event of an actual cutback. A second part of the project involves evaluation of the plans and their implementation by a second contractor to EDA.

DATE OF INITIATION: April 1967.

Chairman PROXMIRE. Mr. Alexander. Thank you for an excellent statement. This is most helpful to us.

Several thoughts occurred to me in connection with your statement. No. 1, what is the relationship of your agency to the Ackley committee that was appointed this year, that is to study the effects of the deescalation of the Vietnam war? Is Mr. Foster a member of that committee, or is anybody from your agency represented on that committee directly?

Mr. ALEXANDER. Mr. Foster is not a member of that committee, which is a Cabinet level committee. We are, however, represented on some of the working groups into which the top committee is subdivided.

Chairman PROXMIRE. All the members of that committee are Cabinet members?

Mr. ALEXANDER. All of the members of what was referred to earlier in these hearings as the Ackley committee, I believe, are Cabinet members.

Chairman PROXMIRE. Except Mr. Ackley.

Mr. ALEXANDER. Except Mr. Ackley.

Chairman PROXMIRE. I see. Because it just occurred to me that your committee should be, it seems to me, the one that has the best claim to representation on it. You are created for the purpose of studying arms control and disarmament in all of its aspects, and certainly one of the major studies you conducted with great competence, I would say on the basis of this, is what would reduction of armaments, what effect does that have on our economy.

Therefore, you have these years of research and a very helpful viewpoint that I think can contribute a great deal. But I understand it was a Cabinet committee, and apparently that is the difficulty. I wish they could make an exception, not only of the chairman but of Mr. Foster.

Mr. ALEXANDER. Well, sir, I will tell what you say to Mr. Foster, but I might say, sir, speaking seriously, that we are in daily touch with the people who are doing the work on this, and we have furnished them, of course, copies of the research and given them our ideas.

Chairman PROXMIRE. I am sure you are doing all you can possibly do to work with them. It seems to me you ought to have a voice in the committee's determination of where this goes, and so forth.

What is your impression as to the present status of this Ackley committee? We have had a lot of pessimistic talk this morning. General Westmoreland gave a pessimistic estimate of the duration of the war yesterday, saying there is no end in sight, and maybe he is right. And we certainly must be prepared for that.

On the other hand, we never do know. Sometimes the clouds are darkest before the sun breaks through. It is conceivable that we could have negotiations rather soon. What would happen? Do we have any contingency plans available now to your knowledge to move in, if the war should end promptly?

Mr. ALEXANDER. Mr. Chairman, I suppose there could be argument whether if there is a cease-fire in Vietnam, that is technically due to arms control and disarmament. I don't think we need to get into that technicality. All the planning and the research which we have done on different aspects of the problem are available to the Ackley committee. My understanding, however, is that the Ackley committee is only beginning its work and that it probably——

Chairman PROXMIRE. That is the difficulty, yes.

Mr. ALEXANDER. It will probably take some months before they actually have contingency plans.

Chairman PROXMIRE. Let's understand, that is why we did not press him. He preferred, I am sure, until he had more information before he came before the committee, and for that reason we are waiting until late August or September to ask him to come before us.

But you see, we are very concerned about what may happen. We should be prepared for every possible eventuality. What you are telling us, however, is that the Ackley committee itself is beginning and it will be some time before they would have very useful recommendations?

Mr. ALEXANDER. That is my understanding, sir.

May I make one other comment on that point?

Chairman PROXMIRE. Yes.

Mr. ALEXANDER. If there is a cease-fire for reasons referred to by Senator Stennis and by the Secretary of Defense, there would be some appreciable period, I think before the reductions which will occur, take place. So that I think, I trust, there will be time to prepare these contingency plans.

Chairman PROXMIRE. Yes and no. There is a tremendous difference between having a shooting war going on with all of the attrition of equipment, with the use of ammunition, with the fact that we have 500,000 troops there. We may have to have a force there perhaps for some time to help protect Vietnam, though it is debatable. But how big a force? It certainly wouldn't be 500,000 troops. It could be 300,000. It could be 100,000. It could be far less than it is now.

After each war in the past, whether rightly or wrongly, certainly after Korea, especially after World War II, there was an extraordinarily rapid reduction in Government purchases of goods and services. We brought that out yesterday on a satistical basis, and in 1 year after World War II, it was cut to one-third of what it had been.

The economic impact was dramatic and sudden. The Korean war was quite sudden too. While I think that Senator Stennis might be right, he may not be right about whether or not we have substantial troops over there. But still it would seem to me that we might have a sudden, swift economic impact, although I think you are right to caution us that it might not be as swift as it has been in the past.

I would like to ask you in your "Measurement of Impact," you say that the census has been done in 1963, and within a relatively short time, 1965 will have been covered covering a period from when the buildup was begun. It seems to me this would be very helpful, if this was brought up to date, to 1967. How long is that likely to take?

Mr. ALEXANDER. Sir, that is perhaps based on the calendar year 1966 or calendar year 1967?

Chairman PROXMIRE. Yes.

Mr. ALEXANDER. Based on calendar year 1967?

Chairman PROXMIRE. Well, yes, I presume so. I see your problem. Calendar year 1966.

Mr. ALEXANDER. Sir, usually there has been a timelag of the order of 2 years in the preparation of these, because of the fact that the census goes out and the forms come in and have to be processed. There are other things, however.

Chairman PROXMIRE. So it has limited value when you have a rapid buildup of the kind we have had, because the situation obviously 2 years ago was completely different than the situation right now.

Mr. ALEXANDER. That is quite right. I would think 1966 or 1967 would be necessary to have in order to estimate the situation at the time of the cease-fire.

Chairman PROXMIRE. I just had one other thought, and that is, this would be most helpful to us, of course, if we could somehow get data that was related to the Vietnam war, because obviously, it doesn't help very much to know, in my view it doesn't help very much to know, simply, that there might be a $15 or $20 billion reduction in the level of arms spending.

This is of some use, but unless we can pinpoint the kind of procurement and the kind of impact the Vietnam commitment involves, we are not in a very good position to judge what to do with regard to regions, with regard to industries, or, perhaps we can do quite a bit with regard to manpower, is that correct?

Mr. ALEXANDER. Yes, sir. I think we are not as well off as we hope to be by midsummer actually, because there is work going forward which I think either Mr. Anthony or Mr. Schultze spoke of yesterday, to bring together the contract on the one hand with the people and the places, and the firms specifically involved on the other hand.

Chairman PROXMIRE. So we know what effect a cease-fire would have in Vietnam. Obviously this has a direct effect on procurement and the question of the personnel involved would be more gradual as you and Senator Stennis have cautioned us, but I would assume that we would have to slow down our procurement, although there would be this period of replenishing inventories.

Nevertheless, it would involve a specific impact, not one that we can generalize on. Research obviously would be affected relatively little, where as the procurement of helicopters would be affected directly and very greatly.

Mr. ALEXANDER. You put your finger on the most difficult part of the problem. To say 10 percent doesn't tell you who is going to get hit by it, and that is what you need to know. We will never know precisely, of course, because of the competitive system of procurement, but we can tell much more approximately, and certain items are procured only from certain sources.

Chairman PROXMIRE. Thank you very much.

Congressman Curtis.

Representative CURTIS. Thank you, Mr. Chairman.

And thank you for that fine presentation. Incidentally, just on that replenishment problem, I directed some questions to Senator Stennis. He very rightly said in replenishing pipelines and inventory, there is going to be a mixup of some sort.

Some things you won't want to replenish. This becomes quite important. First you have to try to estimate how much, and if it is billions, and I suspect it is, that would be involved, you also have to determine in what areas. Would it be textiles, drugs, or where would the replenishment come? This is the way you would relate it, as I would view it at any rate, to the impact on the economy.

Now, first, let me ask, Mr. Chairman, to be sure that exhibit A is part of the record.

Chairman PROXMIRE. Absolutely. Yes, indeed. I am glad you recommended that. That should be in.

Representative CURTIS. Yes. It shows the studies that you have been making in capsule form.

Now, let me ask you a question. I have in front of me the Sixth Annual Report of the U.S. Arms Control and Disarmament Agency, transmitted February 20, 1967. That is correct. That is the date. This is the period January 1 to December 31.

Now I have been scanning it, and I want to be sure I am right. About the only part of this report that deals with the economic impact of reduced defense spending begins on page 22, and goes over to page 24.

The purpose of my asking the question is to try to settle in my own mind the extent of your involvement in this matter in light of your other duties and the other work that your agency is performing.

This is a 27-page report. Would it be accurate to say that two and a half pages of a 27-page report is about the proportion of time that you would spend on this aspect of your work? The rest of it would be in the area of various international agreements and so forth?

Mr. Chairman, may we include the pages I refer to in the record?

Chairman PROXMIRE. Without objection it is so ordered.

Representative CURTIS. Would you comment, Mr. Alexander?

(The portion of the report referred to by Representative Curtis, pp. 22–24, is reprinted below:)

ECONOMIC IMPACT OF REDUCED DEFENSE SPENDING

Under its legislative mandate, the Agency conducts research on the economic consequences of arms control and disarmament and the reallocation of national resources. The sharp increase in defense spending imposed by the Vietnam conflict has underlined the importanct of preparing for economic adjustment to eventual reductions in defense expenditures. ACDA, working in close cooperation with other Federal agencies represented on the President's Committee on the Economic Impact of Defense and Disarmament, continues to give the matter careful attention in its program of studies.

Planning requires a systematic knowledge of the flow of defense dollars and of the jobs thus created in certain industries and areas of the country. The task is complicated by the degree to which the dollars going to prime contractors ultimately are received by many large and small subcontractors and material suppliers scattered throughout the country. The survey of "Shipments of Defense-Oriented Industries" conducted by the Census Bureau with funds contributed by ACDA, the Department of Defense, NASA, and AEC has made an important contribution to overcoming this difficulty.

ACDA and other agencies are working to develop other means for estimating the impact on individual industries of changes in major defense programs. One coordinated research effort, for example, relates to the economic effects of a strategic nuclear delivery vehicle freeze agreement—or a possible agreement not to deploy ABM systems. A freeze on missile production would have an obvious impact on metal industries providing metals both for missiles and machinery.

For many communities in the United States, defense-related activity has been an important source of economic growth, and reductions in that activity—unless planned for in advance—may create serious local unemployment, declines in retail sales and construction, and depressed property values. Local problems may derive from the closing of military installations or from cutbacks in defense orders of goods and services. ACDA research is addressed to both situations. The Agency's contract with the University of Kansas, for example, calls for an evaluation of the economic experience of Bangor, Maine; Middletown, Pa.; Savannah, Ga.; Salina, Kans.; Mobile, Ala.; Amarillo, Tex.; and Moses Lake, Wash., as the result of the closing of military installations important to the respective areas. Other universities in the general area of the affected communities are assisting in the Kansas study.

The National Planning Association (NPA) completed a study for the Agency in 1965 of the policy tools available for dealing with regional economic adjustment problems. One of the areas included in the study was the New London-Groton-Norwich (Connecticut) area. The study stimulated interest on the part of community leaders in southeastern Connecticut in planning for ways to cope with the uncertainties in patterns of defense spending for that area. The NPA report showed that the Electric Boat Division (at Groton) of the General Dynamics Corp. accounts directly or indirectly for about seven out of every 10 jobs in the area. Termination of the contract to build Polaris submarines has caused a serious reduction in employment.

After extensive discussions with local community leaders, ACDA and three offices of the Department of Commerce are sponsoring a study project. It will involve planning, implementation, and evaluation phases, with the Government agencies sponsoring the first and last phases. The Agencies hope to derive insights on advance planning problems of value to adjustment problems of other communities.

One way for areas like New London-Groton-Norwich to adjust to reductions in defense spending may be to convert their plant facilities to the production of goods and services for civilian markets. The possibilities for industrial conversion by the defense segment of the shipbuilding industry were investigated for the Agency by Midwest Research Institute. MRI screened 900 industries for information on production, labor skills, technology, and marketing and concluded that 55 had sufficiently similar characteristics to the shipbuilding industry to suggest that the latter can diversify to the products of those industries. The shipbuilding study supplements other studies sponsored by the Agency on the broad problems of diversification and conversion. The report by the Denver Research Institute on "Defense Industry Diversification," which covered 12 case studies, has been particularly well-received by defense industry management and the business press.

The alternatives for defense industry are by no means limited to producing goods and services for commercial purposes. Recently, interest has centered on the possibility that defense companies' capability for "systems" analysis and engineering, as well as their Government-market orientation, might be well-suited to the competition for the expanding requirements of Federal, State, and local governments in such fields as air and water pollution control, urban development, public transportation, education, and information retrieval. The State of California has let a number of contracts for feasibility studies by defense contractors for the solution of broad problems of the State. ACDA has contracted with the Denver Research Institute to pull together and evaluate the many threads of this public sector potential for defense industry which are now being considered and discussed.

While conversion to private or public sector markets might reduce the dislocations of arms reductions, this process cannot be relied upon to absorb all or even nearly all the losses of defense jobs. Consequently, the Agency continutes to devote considerable attention to the problem of displaced defense workers. More precise knowledge of how to ease the adjustment of workers to defense cutbacks is being derived from the three studies sponsored by the Agency concerning the experiences of workers who lost their jobs at the Boeing plant in Seattle, the Martin plant in Denver, and the Republic plant on Long Island. The Boeing study was completed in 1965 and the other two in 1966. The University of Colorado is preparing an integrated analysis of the three layoff surveys which will provide guidance for policies to assist displaced defense workers to obtain new jobs.

Jobs in defense plants often involve skills which are not entirely comparable to those in nondefense industries. More precise knowledge of the differences and similarities between defense and nondefense occupations is required in order to judge retraining needs in the event of arms reductions. To expand the work done earlier by the State of New York on classifying jobs at the Republic Aviation plant and relating them to nondefense jobs, ACDA has asked the Department of Employment of the State of California to perform a similar task for occupations of blue-collar workers and technicians at two missile plants in California. In addition to giving insights as to retraining needs, it is hoped that these occupational classification studies may be used as tools to assist in finding new job opportunities for released defense workers.

Scientists and engineers constitute a special-skill group among defense workers and the use of their services in nondefense sectors of the economy depends upon rather special factors. Much needs to be learned in this area and, as an initial effort, the Agency has sponsored a study by Stanford Research Institute on the transfer of engineer skills from defense to commercial work. The study will emphasize the experience of engineers who have shifted from defense to commercial work within the same firm.

Mr. ALEXANDER. Yes, Mr. Curtis, I think that that is a fairly accurate indication of the proportion of the personnel of the Agency that are devoted to domestic impact. I can't pretent to be completely happy about that, naturally. No bureaucrat ever concedes that he is adequately staffed.

So far as the contract research is concerned, however, I think that a larger proportion of that total goes to the domestic economy impact than one-tenth.

Representative CURTIS. That is very responsive and helpful in getting this concept.

Senator Proxmire has asked the relationship of your Agency to the economic impact of Defense and Disarmament Committee created by the President under the chairmanship of Dr. Ackley. I, too, raise a serious question.

I don't care whether it is cabinet level or what it is. I raise a question of not having an agency—and I have voted for funds for your Agency and will continue to as long as you are along the line—but not to have that agency represented right at the top level. It is insufficient to talking about coordinating, that you do work at this level. I know you can't respond to these observations, but I'm making them for a definite purpose. I would hope that the administration would understand these basic points.

Now I do notice, though, that you do go on and say after all this research and with the help of the other parts of the Government, and I am now quoting, "We," and I think you are referring to the Agency, "should prepare integrated contingency plans for dealing with the various contingencies which might arise as a consequence of the reduced defense spending due to arms control and disarmament. We believe that much of the research which I described would be useful in connection with contingency planning for the economic impact of the Vietnam cease-fire."

Frankly, I would hope that you would be doing just that, I hope that your contingency plans would be the plans the administration might be relying on, rather than duplicating them or, it almost seems to me, ignoring this Agency that Congress created. I voted for it for essentially these reasons. In fact, I would like to knock out of your title the word "disarmament." I would like to see the world disarm, but it is so unrealistic these days. I regret to see that people have been confused about what I think is a function of your Agency.

Now, I started to say that you have talked about your relationship with the Committee headed by Dr. Ackley. I am very concerned about your relation with the Manpower Utilization Board, I guess that is its title. It is headed by the Secretary of Labor. This is the Board that is supposed to be considering deferments, occupational deferments for defense-oriented industries.

Is your Agency represented on that Board?

Mr. ALEXANDER. No, sir, it is not.

Representative CURTIS. Well, of course, I have been very disappointed. When I interrogated Secretary Wirtz this year about what that Board was doing, if I understood him correctly, he said that they had made no major changes or evaluations since 1963. In other words, as far as utilization of skills is concerned, the Vietnam war might as well have not occurred. That commission apparently has not changed it views. Yet it is right at the heart of what I think your prepared statement is discussing.

Chairman PROXMIRE. Would you like to respond to that?

Mr. ALEXANDER. If I may respond.

Representative CURTIS. Sure. Please do at any point here.

Mr. ALEXANDER. Without arguing whether we ought to be represented on such a commission, I believe that they are familiar with the research on manpower problems that we have had done.

Representative CURTIS. Yes. Just referring to some specifics, referring to the section in your statement "Impact on industries"—your studies on the reduced defense demand for electronics, shipbuilding, and machine tools. I am putting in a plug. I think textiles would be a very good industry to study. It was heated up by the Vietnam demand, and is, as I understand it, in some economic difficulties right now. This would possibly be a good area to study. I would like to see something on that myself.

Now, in talking about the impact on employees, Secretary McNamara, in testifying before this committee last year and again in the testimony of the Defense Department this year, discussed some of the programs that the Defense Department has when military operations and bases are closed down. Have you all been involved in that?

Of course, I think you have responded by saying you know about them and know what they have done. But have you been involved in any way in the planning of the adjustment features, when those bases have been closed down?

Mr. ALEXANDER. No, sir. We have not. We are involved in making a study more precise than any that has yet been made of what does happen to the people in the surrounding community, but with respect to existing policies, we have not been involved.

Representative CURTIS. They are actually doing this, or did do it. Decatur, Ill., is one where there was a big closedown. That is even better than a study, to be actually involved.

One other point. You emphasized two studies dealing with the transferability of skills from defense to civilian-oriented production. I am deeply concerned about this. Some studies indicate that the correlation between skills needed by the military and skills in the civilian sector is over 80 percent today.

I, myself, think it is higher than that. I think it is most important, both from the standpoint of deescalating as far as skills are concerned, and in escalating the war and the further use of skills. I am glad to see those two studies.

You say, "We shall have to plan"—talking about the country in this instance—"our economic moves so as to be prepared for both increases and for decreases in defense spending."

This is the point I directed Mr. Schultze, the Director of the Budget, yesterday, and others. I would agree that your agency probably has been directed only to consider decreases and yet, if I may argue a moment here, I think if you were involved in increasing military requirements, you would gain great insight into how we can decrease. Do you see what I am getting at?

Mr. ALEXANDER. Yes, sir.

Representative CURTIS. Would you comment?

Mr. ALEXANDER. Yes. I agree that we need to be involved in the increases, in the sense of knowing what is happening. I think we have no jurisdiction or right to be deciding or helping decide how much the increases are.

Representative CURTIS. No, no. Nor do you have anything to do with how much the decreases are; but as I understand it, we have asked you to see what the impact will be. The decisions on defense spending must be as a result of other policies and very basic policies. But it still would be important to relate the problems involved in increasing the use of skills, the use of plant facilities, and all the rest. They are related to the problems when we deescalate, which leads me to an observation you make. You say:

MEASUREMENT OF IMPACT

The first group of studies attacks the problem of measurement of impact, in terms of geography, industry and people, which would result from termination of particular kinds of defense expenditures.

Let me urge you to put in there, probably at a higher level—skills—the impact in terms of skills. I think a great deal of the focus should be on the skills and the correlation between the skills. I would hope that a great deal of our studies would be in the area of following this point through on the basis of skills.

I think those are the points I want to make.

I am most pleased to have this Agency testify before us. I hope that this committee will keep in touch with your organization. We should be on your mailing list for your studies, as they come out, and the Joint Economic Committee should be on your mailing list. Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mr. Curtis. I would like to suggest one final question.

I noticed, Mr. Alexander, in studying your exhibit, that this was the impact on industry and employees, by and large, in the 1963–64 period, and in 1965. At any rate, it is a period in which there were two factors involved.

No. 1, there was obviously no overall reduction in defense spending.

No. 2, it was a period in which the economy seemed to be moving ahead, unemployment dropping, opportunities for both industries and employees improving. It is quite different, therefore, than the possible effect of a substantial decrease spending in the area of $15 to $20 billion.

Under those circumstances, I would assume that it might be quite a bit more difficult for both industry and employees to adapt to a situation in which the whole economy has been affected.

Mr. ALEXANDER. I think that is entirely right.

Chairman PROXMIRE. Fine. Thank you once again.

Representative CURTIS. Could I ask one other question?

Chairman PROXMIRE. Yes indeed.

Representative CURTIS. Does your Agency tend to report to any particular committee of the Congress, Foreign Affairs? Of course, Appropriations, to get your money.

Mr. ALEXANDER. Appropriations, I assure you, we have to be very detailed with. We have been reporting to a number of other committees on different aspects of our work.

Representative CURTIS. Would you list those?

Mr. ALEXANDER. Primarily, the Disarmament Subcommittee of the Foreign Relations Committee of the Senate, which has had hearings in executive session quite lately; the full Committee on Foreign Relations, also; and within the past year there were extensive open hearings held by the Joint Committee on Atomic Energy, in connection with the so-called Pastore nonproliferation resolution.

And then in February 1967, the Acting Director of the Agency briefed the House Foreign Affairs Committee in executive session.

Representative CURTIS. Thank you very much.

Chairman PROXMIRE. Thank you, Mr. Alexander, once again. This is most helpful, and especially I appreciate the specific content of your presentation. This is just the kind of thing that I think will be most enlightening to the members of the committee and to the Congress. Thank you very much.

Mr. ALEXANDER. Thank you, sir.

Chairman PROXMIRE. Tomorrow, we meet in room 318, Old Senate Office Building, for the current and past impacts of the Vietnam war on the civilian economy; four witnesses, three in the morning and one in the afternoon. We will be in recess until tomorrow morning at 10 o'clock.

(Whereupon at 12:25 p.m., a recess was taken, to reconvene on April 26, 1967, at 10 a.m., in room 318, Old Senate Office Building.)

ECONOMIC EFFECT OF VIETNAM SPENDING

WEDNESDAY, APRIL 26, 1967

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The joint committee met, pursuant to recess, at 10:15 a.m. in room 318, Old Senate Office Building, Hon. William Proxmire (chairman of the joint committee) presiding.

Present: Senator Proxmire and Representative Griffiths.

Also present: John R. Stark, executive director; and Daniel J. Edwards, staff economist.

Chairman PROXMIRE. The Joint Economic Committee will come to order.

Gentlemen, we are delighted to have you with us this morning. We are most impressed by your qualifications.

Our discussion this morning will be on the current and past impact of the Vietnam war. Our first witness, who will speak on the impact on firm and industry, is Mr. Robert W. Eisenmenger, vice president and director of research, Federal Reserve Bank of Boston. Mr. Eisenmenger.

STATEMENT OF ROBERT W. EISENMENGER, VICE PRESIDENT AND DIRECTOR OF RESEARCH, FEDERAL RESERVE BANK OF BOSTON

IMPACT ON FIRM AND INDUSTRY

Mr. EISENMENGER. Thank you. I have been asked to testify this morning about fluctuations in military spending for Vietnam and their impact on firms, industries, small isolated communities, and large metropolitan areas. I imagine I was invited because the Research Department of the Federal Reserve Bank of Boston has supported numerous studies which analyzed the impact of various defense closings on local communities in New England. In addition, I have recently written a book which discusses the problems of economic adjustment in New England since World War II.

As most of you probably know, with the exception of the coal mining areas and some of the depressed agricultural areas, primarily in the South, probably no major section of the country has experienced such a radical transformation of its economic base in the last 20 years as has New England. When World War II ended and outmoded machinery was no longer needed to satisfy swollen wartime demand, the region's antiquated textile industry collapsed and laid off 180,000 employees over a period of 15 years. In many metropolitan areas unemployment was serious. For example, during 1948 the unemployment rate averaged between 13 and 25 percent in Lawrence, New Bedford, Fall River, and Providence-Pawtucket. Even as late as 1958 the unemployment rate averaged more than 10 percent in these same cities and was 15 percent or more in many of the smaller textile cities.

Today, the unemployment rate in New England as a whole is only 3.3 percent, well below the national average of 3.6 percent. Only two of our large textile cities now have serious unemployment problems. Thus, given enough time, it would appear that even the most depressed communities can make a strong comeback. We may ask ourselves, however: Is it necessary for communities to go through such a long, hard readjustment process before they regain economic balance?

What would happen if the Vietnam war should end suddenly and national defense spending were cut by 20 percent or more? Would many of the country's large economic areas have the same agonizing readjustment problems that New England's textile communities faced after World War II? No one can answer this question with 100 percent assurance, but I am reasonably confident that a very substantial defense cutback would not bring similar problems to many metropolitan areas in the United States. The problems of the older textile cities in New England were considerably different from those of most metropolitan areas which depend heavily on defense spending today.

I have four reasons for saying the situation is different now:

1. New England's depressed textile towns had a very slow economic and population growth rate long before most of their economic base collapsed with the textile industry. To a surprising extent, in contrast, most defense-dependent areas have been growing very rapidly for many years. For example, the Los Angeles population increased by more than 45 percent between 1950 and 1960. More than three-quarters of this total gain was accounted for by net in-migration from other parts of the country. More recent figures show a 10.5-percent increase in population in Los Angeles between 1960 and 1964, almost half of which was accounted for by migration. The figures for Hartford County, Conn., another defense-dependent area, are somewhat similar. Between 1950 and 1960 there was a population increase in Hartford County of 28 percent. About two-fifths of this percentage increase was accounted for by net in-migration.

My main point is this. Even if large military cutbacks occurred, these exploding areas might merely see a decline in their rate of growth and consequently, in their rate of in-migration. As a result, the areas' industries might well be able to absorb the existing labor supply without major difficulties. This is not to say that there would be no problems in the transition period. The housing industry and some of the service industries which expanded in anticipation of a continuation of a rapid rate of growth would likely have an overcapacity problem for a number of years, but it is difficult to envision the kind of problems that faced the stagnant textile communities in New England.

2. New England's depressed postwar mill towns also differed very substantially from most of today's larger metropolitan areas in that their economic health depended largely on one stagnant industry—

textile manufacturing. Furthermore, most of their nontextile firms were also in slow growing industries.

Two years ago, looking at metropolitan areas where defense spending is of major importance, the National Planning Association made a study of the possible impact of defense cutbacks on Baltimore and Seattle-Tacoma. The NPA was reasonably optimistic about Baltimore where 15 percent of the total civilian employment was defense-related, because Baltimore has a diversified economy with many firms in growing industries. The NPA study suggests, therefore, that even a substantial military spending cutback, if offset at the national level by tax cuts or increased spending, would bring little economic and social disruption to Baltimore.

The N.P.A. study was slightly more pessimistic about Seattle-Tacoma where 24 percent of the total civilian employment was defense-related and military personnel accounted for 6 percent of total employment. Here again, however, there was no suggestion that defense conversion would create the kind of problems that plagued New England's textile communities for so many years. The study foresaw unemployment of only 2 to 7 percent of the work force. While the N.P.A. did point out that many scientists and engineers at the dominant Boeing plant would be displaced, these professional employees are among the most mobile members of our society. In addition, the N.P.A. expected that the rising national demand for commercial airliners and the area's growing service industries would prevent major economic disturbances.

3. Even during World War II, New England's textile towns could not have been considered the Nation's most prosperous communities. The case is different, however, for today's defense-dependent metropolitan areas. Professor Weidenbaum of Washington University in St. Louis has found that as of 1963 the regions with the highest per capita incomes were receiving the bulk of the defense contracts and that low-income regions were obtaining only a small share. He concluded, therefore, that a reduction in war spending and an equivalent increase in other types of Government spending would inevitably work to the advantage of the lower income sections of the country.

My examination of military procurement data indicates that the distribution of defense contracts has changed very little since Professor Weidenbaum made his study in 1963. There is one important exception to this generalization. The proportion of defense contracts allocated to California has declined significantly in the last few years. But, on the whole, the defense contracts are still directed predominantly to the high-income manufacturing centers in the United States. Thus, with a big increase in defense spending, these areas have developed labor shortages. I am sure, for example, that the rapid rise in defense spending in 1966 and 1967 explains the extreme labor shortage which we now have in Hartford, New Britain, and New Haven, Conn., and in Manchester, N.H. A reduction in defense spending would help alleviate some of these problems by reducing labor shortages in high-income areas and bringing additional income to low-income communities.

4. One of the obvious characteristics of military procurement is that it must be concentrated in geographical areas where the average

skill level of the labor force is very high. The Battelle Memorial Institute has shown, for example, that engineers and technical workers constitute only 11 percent of the work force of electronics manufacturers producing consumer products. The corresponding figure for military and space products is 33 percent. In contrast, semiskilled and unskilled labor make up 63 percent of the work force in the consumer products sector of the electronics industry, while the figure for the military and space sector is only 27 percent. For these reasons, the defense products manufacturers tend to locate in areas where the labor force has diverse and above-average skills. But it is in just these areas that the labor force is most mobile and most able to change jobs if shifts in Government spending bring about an abrupt change in employment requirements. These high-skill areas differ substantially from the textile communities in New England. As of 1960, for example, the median number of years of schooling of the adult male population in New Bedford and Fall River was 8.6, compared to a statewide average of 11.3 in Massachusetts.

All in all, I conclude that most of our large metropolitan areas would undergo relatively minor disruptions if there were a cutback of only 20 percent in defense spending. The smaller metropolitan areas or isolated rural communities which are linked to military spending in various ways present a different case, however, and I will now turn to them.

For some of these smaller metropolitan areas and towns, there might be serious problems. For example, the National Planning Association examined New London, Conn., in their 1965 study of the potential impact of disarmament. The N.P.A. found that 71.5 percent of the civilian employment was defense-related. Furthermore, military personnel accounted for 16 percent of total employment. In addition, defense purchases were concentrated in one giant firm which entirely dominated the area's employment situation. For these reasons the N.P.A. concluded that New London is almost totally dependent on military spending for highly specialized shipbuilding and would be seriously affected by defense cutbacks. And I am sure that at least a few other communities in this country are equally vulnerable.

I should point out, however, that defense spending in small metropolitan areas and rural communities is more likely to be related to defense bases than to military procurement. As you know, there are important differences between these two types of military spending. Contracts for military procurement are usually given to private manufacturers who hire civilian employees. These employers in turn subcontract work to other manufacturers. The prime contractors, the subcontractors, and their employees also buy a great variety of services, supplies, and materials in their metropolitan area. The final result of an increase of, say, 100 persons in the employ of a prime contractor is an increase of another 100 or 200 in the employ of subcontractors, service establishments, and government agencies. In the parlance of economists, the employment multiplier is in the range of two to three.

In recent years the Federal Reserve Bank of Boston has supported a number of studies on the impact of various New England military installations on employment and economic activity in nearby towns and small metropolitan areas. The results were consistent in each case.

They show an employment multiplier which is much less than that for a manufacturing firm in a large metropolitan area. We estimate the employment multiplier for Fort Devens, a military installation near a small rural town in central Massachusetts, to be only 1.2. Our estimates for the Pease Air Force Base near Portsmouth, N.H., range between 1.2 and 1.4. In other words, for every additional 100 people stationed at these military bases, it is likely that only 20 to 40 additional people are needed to service them in the immediately surrounding towns.

It is easy to understand the differential multiplier between a private manufacturing firm and a military base. Most military bases are relatively self-sufficient. They obtain their supplies and parts from central supply depots and manufacturing firms in our large metropolitan areas. Military personnel often have their own on-base housing as well as their own PX, movie theater, barbershop, and recreation center. Surprisingly, it also appears that young military personnel save a somewhat larger portion of their pay than civilian employees. In addition, if military personnel do spend money on recreation, they are likely to travel long distances to major cities. Thus, when there is a big expansion at a military installation, the surrounding area does not expand as much as it would if there were a similar buildup at a private manufacturing facility. Obviously, when there is a contraction, the surrounding area is not nearly as hard hit.

One of our studies has also suggested that Government manufacturing facilities such as shipyards have a smaller employment multiplier than private manufacturing plants. Our estimates for Portsmouth, N.H., suggests that a Government shipyard has a multiplier of 1.6 as compared to 1.8 for a private manufacturing firm in the same area. Incidentally, I don't want to suggest that the specific multiplier figures I have quoted are applicable to all parts of the country. Under many circumstances, the local multiplier impact of Defense installations could be greater than 1.4 or 1.6. Nevertheless, it is quite clear that Defense installations have a lesser local impact than civilian plants.

Last year the Federal Reserve Bank of Boston studied the action being taken by communities affected by planned Defense installation closings in New England. We looked at the Watertown Arsenal in Boston, the Springfield Arsenal, Mass., the Dow Air Force Base near Bangor, Maine, and the Portsmouth Naval Shipyard. In each case we were pleased. The adjustment problems appeared to be small at the Watertown Arsenal which was only a minor employer in the Boston metropolitan area, and the communities were taking some action to plan for the adjustment. The Sprinfield Arsenal is now rapidly undergoing conversion—in part, to a private facility operated by the General Electric Co. The future closing of the Portsmouth Naval Shipyard will undoubtedly cause problems. However, the entire Portsmouth area now has a severe labor shortage. It appears likely that private employers will be able to absorb most of the shipyard workers who do not wish to stay with the Defense Department. I should also mention that the Defense Department's policy of guaranteeing a job to each permanent employee who is displaced is generally of great help. In the case of employees in the Boston area, more than three-quarters of those who wished to be transferred within the Department of Defense have been relocated within commuting distance of their homes. Of course, other agencies of the Federal Government have a whole array of programs for retraining, placing and providing financial assistance for displaced workers. Distressed communities can also receive help. In general, Mr. Garner Ackley's 1965 Committee on the Economic Impact of Defense and Disarmament gives all these Federal agencies good marks for their work.

At the beginning I suggested that I would also consider the problems of individual firms and industries. If there were substantial defense cutbacks, what could be done to alleviate the financial problems of particular firms and industries which supply the bulk of our defense products? There has been much testimony on this subject and the best of it has been very pessimistic. For example, in 1963 testimony before the Subcommittee on Employment and Manpower, Murray Weidenbaum showed that 80 percent or more of the sales of some of our largest defense contractors go to the Defense Department. He was also skeptical about the ability of these specialized corporations to compete effectively in private commercial markets. In most cases they are research and development oriented and do not have the ability to produce large numbers of items at a low unit price or to market them effectively. I suspect, however, that public discussion about the vulnerability of individual firms to defense cutbacks has caused many managements to diversify by developing new civilian products or, and this may be more important, by acquiring or merging with firms that already have commercial marketing and production capability. For example, the Raytheon Manufacturing Co. was almost 100 percent dependent on military business in 1960. Now about one-third of its sales are to the private commercial market. Much of their marketing capability has been obtained by buying out smaller firms. The Laboratory for Electronics has had a similar record. Another possible example is the aerospace industry. There the Government's share of the net new orders of prime contractors declined from 88 percent of the total in 1963 to less than 60 percent in the early part of 1966. However, I do not wish to pose as an expert in this specified field, and it is possible that if a thorough study were made on this topic, it would show that there has been little trend toward diversification in the defense-related industries.

In closing I want to make one or two additional cautionary statements. First, all of my optimistic comments about the ability of the economy to adjust to a 20-percent cutback in defense spending assumed that monetary and fiscal policies would stabilize the national economy. Our studies in the New England area indicate that the adjustments are relatively easy if we are working in an economy which has overall full employment. The adjustment problems would likely be extremely difficult if the country should move into a recession.

My second note of caution is this: I do not wish to leave the impression that I believe that a shift of $10 billion or $20 billion in Government spending would create no hardships. It obviously would, and some communities, particularly small, undiversified ones, would be seriously hurt. In these cases, the Federal and State governments should move in with all of their available resources to cushion the impact on the affected individuals. However, my principal point this morning has been that the total impact would probably be considerably less severe than might be expected from just a brief glance at the gross statistics.

Thank you.

Chairman PROXMIRE. Thank you very much, Mr. Eisenmenger.

Our next witness on regional impact, current and past impact of the Vietnam war, is Prof. Roger E. Bolton of the department of economics at Williams College. Mr. Bolton.

STATEMENT OF DR. ROGER E. BOLTON, DEPARTMENT OF ECONOMICS, WILLIAMS COLLEGE

Mr. BOLTON. Thank you, Mr. Chairman.

REGIONAL IMPACT

In this area, the first question we must ask is just why the regional effects of economic trends and policies are important. The ultimate goal of economic policy is the benefit of persons. The effect on people is what should concern us. Except for the fact that Congressmen and Senators represent specific regions, why are regional groupings of people important? Why does the regional tag on people matter?

It would not matter if there were perfect mobility of people between regions. In that case economic policy would need only to aim for a balance between supply and demand at the national level, as far as full employment and stability policies were concerned. Changes in aggregate demand, such as an increase or decrease in defense spending, could be offset by general monetary and fiscal measures, and it would not matter whether the regional distribution of demand changed as a result. In regions where demand declined there would be unemployment at first, and in regions where it increased there would be labor shortages and inflation. Regional adjustments of two kinds would occur, and they would eliminate both the unemployment and the inflation. First, labor would move away from the declining area to the expanding area, attracted by rising wages and employment opportunities in the latter. Second, if the declining area is suitable for production of some items in demand in the new situation, industry would move into the declining area, to escape higher wages and labor shortages. Eventually equilibrium would be reached with full employment in all areas, as long as the national total of aggregate demand were adequate.

But, of course, mobility is not perfect, especially for older, less skilled, and less educated workers. Mobility between areas seems even less perfect than between industries in the same area, since the barrier of geographical distance is added to other barriers. When there are changes in composition of demand by product, such as might be caused by the net effect of a change in defense spending and aggregate policies to offset it, the resulting unemployment in some regions and excess demand in others will not be quickly eliminated by the regional adjustments described. Labor may be reluctant to move until inflation and unemployment have become severe and persisted a long time. If an area had produced some very specialized product, the demand for which had fallen, and if the area is not suitable for products the demand for which has gone up, industry will not expand into it and the second adjustment will not occur either. The experience with depressed areas is sufficient evidence that this kind of immobility can be a problem. In recent years a very buoyant economy has eliminated the severe unemployment in many such areas, but this has not occurred without substantial inflation elsewhere in the economy, suggesting that this is necessary to break down the barriers of immobility.

If unemployment and inflation are things to worry about, then, the regional dimension of demand does matter. But asking the question, "Why?" does serve a useful purpose. It reminds us that the problem is not one of regions per se, but of the people in them. If their problems can be solved by encouraging movement elsewhere, this is more appropriate than giving artificial favors which allow inefficient production to continue forever in the region. In the long run, it may be quite proper that some regions and areas decline and die in the economic sense, as long as people do not remain in continued distress.

How this discussion applies to the subject of these hearings should be evident. The rapid Vietnam buildup and the required cutback in other things—such as highways, automobiles, and housing—constitute changes in the composition of aggregate demand, with regional effects. If the war ended and the appropriate fiscal and monetary policies were taken to stimulate new demands to replace defense demand, this would constitute another change in composition of demand by product and might result in a different regional distribution.

In the 1950's, when defense expenditures rose rapidly again after the post-Korean cutback, the composition of demand changed markedly. The new missiles and electronics items differed markedly from the conventional ordnance and equipment which had been needed in the Second World War and the Korean war, and they also differed from the civilian goods and services which would have been produced instead, if taxation had not cut the demand for them to make room for defense production. The shift was away from ordnance, ammunition, vehicles, and the routine supplies to support large forces in combat. The shift in regional distribution which resulted is well known and has been extensively documented. Defense demand shifted away from Middle West and Middle Atlantic manufacturing areas, which were suited for production of conventional equipment, and toward the southern and western areas of the country, which proved more suitable for manufacturing and testing the sophisticated new weapons. The Pacific coast and several Mountain States had their growth greatly affected as a result. The older manufacturing areas reconverted to civilian goods, following their natural comparative advantage. For some time after the temporary recession in 1953–54, nondefense demand was strong. In the late 1950's its growth slowed, excess capacity and unemployment began to persist, and the areas which had lost defense demand envied the success of the newer areas which were growing rapidly.

The more recent increases for Vietnam have also changed the geographical distribution of defense demand, partially reversing the trends of the later fifties and early sixties. The war is the more conventional type, and the needs for ordnance, vehicles, and combat supplies have grown much more rapidly than for missiles, ships, and electronics. Inspection of Defense Department data on commodity classification of prime contracts in fiscal years 1965 and 1966 shows very large increases in 1966 in the relative importance of vehicles, weapons, ammunition, food, textile and clothing products, and several different categories of equipment and supplies of ordinary types. These increases in the percent of contracts imply very large increases in dollar amounts, because the national total increased by more than one-third in 1966 over 1965. The increase for ammunition is especially striking. The absolute dollar value of contracts for ammunition increased by more that $2 billion. There were, on the other hand, declines in the share of contracts going for missiles, ships, and construction (in this country) so large that the absolute dollar value in these programs declined. The amount for missiles had already fallen sharply in fiscal years 1964 and 1965, and figures from direct surveys by the Defense Department of large missile manufacturing plants show declines in employment of about a third between 1963 and 1966.

Along with this change in commodity pattern has come a change in the regional distribution of procurement. All the major census regions received more prime contracts in fiscal year 1966 than in 1965, but the increase varied greatly in size. The increases for the Mountain and Pacific regions, for example, were quite small and their fractional share of the total fell greatly. Despite the large increase in the national total, increases were relatively even faster in the East North Central, South Central, and New England regions.

Chairman PROXMIRE. What is the east north central region? What States does that include?

Mr. BOLTON. Ohio, Indiana, Michigan, Illinois, Wisconsin.

Chairman PROXMIRE. Thank you.

Mr. BOLTON. Other areas of the country had increases roughly in pace with the national total. Although prime contracts do not indicate the true regional distribution of all defense production, because of the subcontracting across regional lines, they are nevertheless very important indicators. A very large part of the contract value is produced in the State the prime contractor is located in.

Inspection of data on prime contract value classified by both commodity and State, clearly shows the regional effect of the new emphasis on conventional equipment. Relative to the total change for the State, increased ammunition contracts were large for many Midwestern States, for Tennessee, New Jersey, Texas, California, and some States in the South. New England benefited greatly from weapons contracts; and the Midwest from vehicle procurement. Helicopter contracts loomed large in Pennsylvania and Connecticut; and aircraft engines in Connecticut, Massachusetts, New Jersey, Ohio, and Indiana. Textile and clothing products were important for many Southern States and several New England ones. Various miscellaneous kinds of equipment and supplies, such as military building supplies, production equipment, photographic equipment, and construction equipment were contracted for in large quantities in all the East North Central States, and some Southern ones. The wide variety of items for which large contracts were placed in the traditional Manufacturing Belt of Ohio, Inidana, Illinois, Michigan, and Wisconsin in particularly striking.

These have been indications of the procurement picture. There are also data on changes in civilian and military payrolls. Between June 1965 and June 1966, about three-quarters of the increase in civilian employment at Defense Department installations took place in nine States: California, Virginia, Maryland, Texas, Utah, Georgia, Oklahoma, Pennsylvania, and Missouri. In the same period, the States in which there were the largest increases in military personnel assigned, and thus the States where they spend at last some of their pay, were Texas, California, Georgia, Illinois, Hawaii, New Jersey, Missouri, Virginia, and South Carolina. In civilian and military payrolls, then, the Midwest has not participated nearly as much as it has in procurement. Their regional distribution has followed the traditional lines of concentration in the south and west.

What would happen if Vietnam requirements suddenly fell must remain partly conjecture, but some general observations can be made. First, it is clear that the adjustment problems of any area suffering a reduction in defense demand are eased if there is adequate demand in the economy generally. Monetary and fiscal policies must be strong enough and prompt enough to insure an overall balance. Other witnesses will speak to this, and, I trust, discuss the difficult problems of timing and the necessity to look at defense obligations and not only cash expenditures by the Treasury. Expenditures may be rising even as real demand is falling. Second, the heavy increase in demand in the Midwest may pose relatively few problems for adjustment in case the buildup is reversed. This region has a highly diversified base for the manufacture of consumer durables, capital goods, and the materials they require. Strong demand for the products of the Midwest would probably result from almost any combination of Federal policies to offset the decline in defense demand—decreased taxes, increased transfer payments, more grants to State governments, or lower interest rates to stimulate investment.

Certain other characteristics of the buildup, however, suggest some difficulties. Weapons, ammunition, and textile and clothing contracts are perhaps now stimulating production in areas which could not maintain the employment if the composition of demand changed. Weapons and ammunition are needed in only small quantities in the civilian economy, and the domestic textile industry has long had a rugged time of it with foreign competition. Some Southern and Plains States, and perhaps Vermont, have been affected by increases in these contracts and might face somewhat more difficult adjustment problems.

But in general, if the right aggregate demand policies were followed, the regional adjustment problems in a post-Vietnam situation would probably be less than they would have been following a general disarmament several years ago. Then, when disarmament was something we could hope for, concern was expressed about areas like California and the Mountain States whose economies were so dependent on defense production of a very specialized kind, with few civilian counterparts. Many of the workers indirectly dependent on defense demand there are not the highly educated, mobile scientists and engineers we hear about. If disarmament were to come now, this would still be of concern. But as far as the specific increment in spending for Vietnam, the problems would probably be less severe if the increment were suddenly eliminated and civilian demand substituted. By "civilian demand" I mean nondefense demand, public and private. This is because of the heavy expenditures on items similar to civilian goods, or which are produced in regions which also produce civilian goods. Even the specific localities which have suddenly expanded in very specialized military production might be helped by being close to areas which could make the changeover more easily. This is not to say there will not be some areas where unemployment will be a problem. Policies should be readied to cope with them. One important factor will be how long the buildup continues. The longer it does, the more long-term commitments people will make in the areas, commitments in business capital and housing, for example.

These are only tentative conclusions. It would be wise to study closely the areas which have recently received large increases in demand, to estimate the ease of their reconversion to other kinds of production. It is not just important to measure the regional impact, it is also necessary to assess the capability for various kinds of adjustment. Although the buildup's end is not yet imminent, a study to determine regional adjustment problems in advance would be very helpful. It would guide policies to assist adjustment when it is required. If areas can be efficiently reconverted to other production with certain Federal policies, such a study would suggest what is appropriate, given the comparative advantage of the area and the existing stock of business and public capital it has. And advance information would also help identify cases where labor mobility ought to be concentrated on and the area better allowed to decline in the long run.

Thank you.

Chairman PROXMIRE. Thank you very much.

Our last witness this morning, before we have our question period, is Dr. Daniel Suits of the department of economics, University of Michigan, who will discuss the impact of the general economy, of the current and past situation.

STATEMENT OF DANIEL B. SUITS, DEPARTMENT OF ECONOMICS, UNIVERSITY OF MICHIGAN

IMPACT ON GENERAL ECONOMY

Mr. SUITS. Like any other expenditures, outlays for defense have a multiplied impact on the economy. Not only does war production add directly to the gross national product, but the additional income received by workers and others connected with war production induces additional demand for consumer goods. A statistical analysis of these induced demands, conducted by the staff of the Research Seminar in Quantitative Economics at the University of Michigan, suggests that each dollar of war outlay stimulates about 85 cents of additional output of consumer goods. By the time all effects have worked themselves out, the addition of $20 billion to annual defense outlay adds a total of about $37 billion to the GNP.

At present prices, approximately one additional man-year of employment is needed for each additional $10,000 of GNP. By the time all effects have worked their way through the system, therefore, the initial $20 billion of defense expenditure together with its induced consumption impact is responsible for about 3.7 million additional jobs.

With this as background, we can now examine the course of events over the last 2 years. As shown in table I, defense expenditures, which had been nearly steady, began to rise in the second quarter of 1965, and continued to rise at an accelerated rate. The increased demand for war materials expanded total output and employment. The higher wages and profits paid by defense firms expanded household buying power and raised the demand for consumer goods. The generally high level of demand created a favorable profit outlook that afforded an attractive environment for new investment, adding still further to the total use of productive capacity.

The rise in war spending from an annual rate of $48.2 billion in the first quarter of 1965 to the rate of $65.5 billion in the last quarter of 1966 represented a total increase of $17.3 billion. Taking account of induced consumer expenditure, this increase was responsible for a total rise of $32 billion in annual GNP, and for roughly 3.2 million additional jobs. Unemployment declined from 4.8 to less than 3.7 percent of the civilian labor force, in keeping with the rising rate of output.

The 15-percent rise in GNP was, of course, a reflection of both rising physical volume and higher prices. Measured in constant 1958 prices, the overall increase in GNP was only 9.5 percent, the remaining 5.5 percent representing price increases. This can be compared with the preceding 2 years. The total GNP grew 11.6 percent from the first quarter of 1963 to the last quarter of 1964. The increase in physical output during this period amounted to 8.5 percent, prices rising only 3.1 percent.

The higher price pressure, which appeared early in 1966 was especially noticeable in food and raw materials. Although there were expressions of alarm over this development, and a call for tax measures to contain the inflation, it now appears that the price increases were merely the natural concomitant of the shift to a high employment economy. They could have been contained only by tax action heavy enough to hold the prosperity itself in check.

In fact, spending for the Vietnam war rose only slightly faster than the increase in productive potential provided by rising labor productivity and the normal growth in the labor force.

A useful way to examine the general impact of Vietnam spending on the U.S. economy is to go back over the events of the last 2 years, applying the statistical relationships mentioned earlier to remove the effects of Vietnam spending and the induced consumption that accompanied it. Below each historical series in the table is shown the corresponding magnitude after the calculated impact of Vietnam expenditure has been subtracted. The difference between the series is striking. The calculated output of the last quarter of 1966 is almost 4 percent below the level historically observed. The 4 percent is reflected in the figure for unemployment. In place of the erosion of unemployment as it actually occurred, we see a fairly steady rise to a recessionlike rate of 7.7 percent of the labor force. The general economic effect of Vietnam spending, therefore, has been to divert slightly more than 2 years of normal growth in economic capacity away from other programs and alternative uses.

The same table gives a good estimate of what would happen if Vietnam expenditures were cut back at the same rate they were built up. With no provision made to replace them with other much needed Government programs, or with tax reductions to release purchasing power to consumers, the impact of the cutback in defense expenditure would be on the order of a relatively mild recession. Figure 1 shows the development of unemployment implied by the defense cutback compared with the recession of 1958. The solid line in figure 1 marks the rise in unemployment during the recession of 1958. It began with an initial level of about 3.6 percent of the labor force unemployed in the fourth quarter of 1956, and rose to around 7.7 or 7.8 percent unemployment in the third quarter of 1958.

The calculated impact of deescalation, shown by the dotted line, begins with a somewhat higher level, initial level of unemployment in the economy, and rises to approximately that same recession level of 7.7 percent.

It goes without saying that even this impact could be greatly minimized, if not entirely avoided, by phasing in alternative Government programs and tax adjustments in pace with declining war costs.

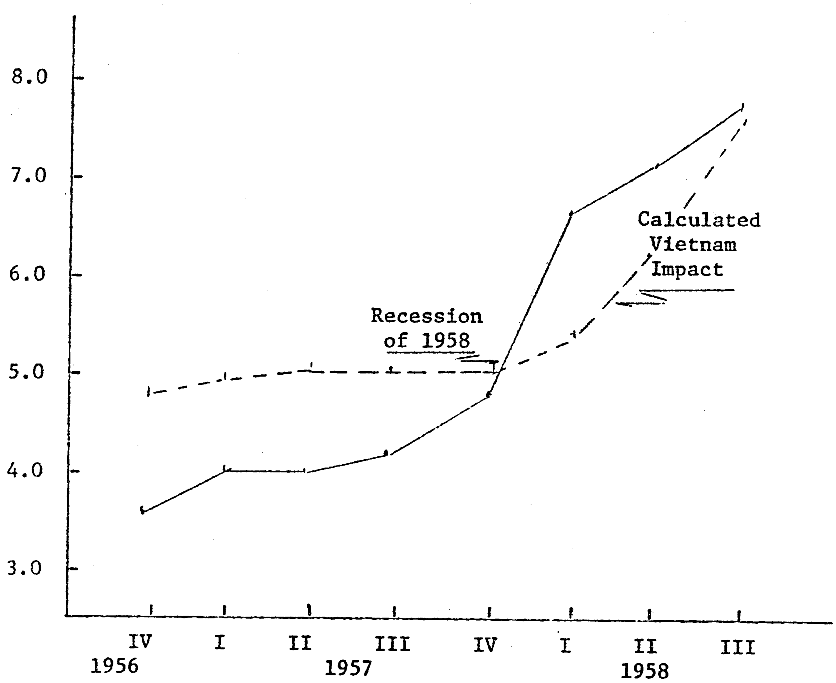
(The tables referred to follow:)

TABLE 1.—*Impacts of Vietnam expenditure on gross national product and unemployment* [1]

	1965				1966			
	I	II	III	IV	I	II	III	IV
Defense expenditure	48.2	49.1	50.7	52.5	54.6	57.1	62.0	65.5
Gross national product (billions of dollars):								
Historical data	660.8	672.9	686.5	704.4	721.2	732.3	745.3	759.3
Vietnam removed	660.8	670.2	680.5	695.1	707.9	713.8	718.7	727.5
Unemployment (percent civilian labor force):								
Historical data	4.8	4.7	4.5	4.2	3.8	3.8	3.8	3.7
Vietnam removed	4.8	5.0	5.1	5.1	5.1	5.6	6.2	7.7

[1] Source: Calculated by Research Seminar in Quantitative Economics, the University of Michigan. This research is supported by a grant from the National Science Foundation.

Figure 1. Comparison of Calculated Vietnam Impact with the Recession of 1958



Chairman PROXMIRE. Thank you very much, gentlemen, for three very, very interesting and helpful papers. I must say that I am most impressed.

I would like to start with Mr. Eisenmenger. Mr. Eisenmenger, as I understood you to present your paper, it was your emphasis that the reason that New England was able to make this remarkable adjustment which you describe is because of the fact that we did have a buoyant economy, we did have diminishing unemployment throughout the country during part of this period, much of this period, and for this reason there was a demand that available workers and industry were able to fill, and that if we had not had this, the transition would have been more difficult, if not impossible, is that correct?

Mr. EISENMENGER. Yes; and my other point was that the adjustment process in New England really took a lot longer than you would expect in the case of a similar loss of economic base in other areas. In New England adjustments were required of depressed, highly specialized textile communities which had the problems posed by older workers, an immigrant labor force and the absence of growing industries.

You just didn't have any of the mobility then that you have in our rapidly growing metropolitan areas today. The adjustment problems were centered in small metropolitan areas, not in diversified metropolitan areas such as Hartford, Boston, or New Haven, which I might add, really didn't have any serious problems after World War II. Thus, it is not valid to compare the rather specialized problems of New England's textile communities, which had almost everything going against them to those of the rapidly growing, sophisticated and diversified metropolitan areas which receive most of our procurement contracts today. These areas would have almost everything going for them if there should be an adjustment.

Chairman PROXMIRE. What would you say we have learned from that particular adjustment that we can use in the Vietnam war situation, other than the point that has been made very well by Mr. Suits, Mr. Bolton, and you, that we obviously should follow a policy, tax policies, spending policies, and monetary policies that will stimulate the economy and keep the level of demand at an appropriate rate? What mistakes were made that we can avoid in the future, and so forth, in this particular New England situation?

Mr. EISENMENGER. I don't know if anyone could really have anticipated the problems in New England.

Chairman PROXMIRE. I am not saying that you could have anticipated them, but having gone through them.

Mr. EISENMENGER. What we could have done?

Chairman PROXMIRE. Yes; perhaps increased mobility is one possibility.

Mr. EISENMENGER. Yes. I hate to have a fatalistic view about these things, but you had so many people who were just about ready for retirement, older people who had held only unskilled jobs all their lives, in New Bedford and Fall River. You couldn't really expect such people to move to other areas. It is pretty hard to visualize any mobility program that could have helped them.

Chairman PROXMIRE. One of the points that your observation suggests is that we have been working in the Senate in the last few days on a provision that people can retire on social security at the age of 60. They get a reduced benefit so the cost to the Government over a period of time is nil. This would obviously reduce labor supply and cushion the employment impact.

This obviously would diminish the pressure on jobs. It would tend to increase demand to some extent, at least in relationship to available supply. How about this as a ——

Mr. EISENMENGER. It would certainly help. However, you may have very substantial Federal spending for early retirement in all areas of the country just to help what may not be a very serious problem, except in a few isolated communities. In other words, it may be an inefficient way to spend Federal money to accomplish desirable social goals. For instance, you may have to make early retirement payments in Chicago, which is a booming area, and in Worcester, Hartford, and Springfield, just to save what may be a few problem areas—New London, Conn., perhaps, a few southern towns, and maybe one or two towns in southern California. My off-hand guess is that it is an inefficient way to solve what is probably a minor problem.

Chairman PROXMIRE. Did I understand you to say that an inflationary economy is necessary in order to reduce chronically high area unemployment?

Mr. BOLTON. I think that was a point I suggested, Senator.

Chairman PROXMIRE. I see.

Mr. BOLTON. I think the past evidence does suggest that quite strongly.

Chairman PROXMIRE. So that you would say in these areas that are particularly hard hit by an ending of the war in Vietnam, that to solve the problem as far as they are concerned, given the people in that area, if they don't move, that you are going to have to have an inflationary economy in your judgment.

Mr. BOLTON. I think much would depend on the characteristics of these areas. These areas would probably not be in as bad shape as the depressed areas of the past, and I don't think—perhaps there wouldn't be too much excess demand pressure which would be required to bring an adjustment in the case after Vietnam, but one's assessment of this depends on one's standards as to what is a reasonable amount of inflation and what is a reasonable amount of unemployment. All the evidence we have I think suggests there is a trade off here, and given present policies and practices of people on mobility, it is just very difficult to have your cake and eat it too.

Chairman PROXMIRE. Let me turn this around for all of you gentlemen, just a minute. As you know, the day before yesterday General Westmoreland in New York said he foresaw no end of the war, and implied that they would need more troops in an escalation, and yesterday Senator John Stennis, in testifying, also indicated that he felt that there would be an escalation this year, an escalation of an additional 50,000 troops with an impact on the economy of $4 to $6 billion more spending than the administration had planned for, although they had planned for a large increase.

I would like to ask the three of you how will this affect the industry, the regional economic and the general economy? We will start with Mr. Eisenmenger. Are we equipped, in other words, to meet this in your judgment, with the presently available labor supply and plant facilities?

Mr. EISENMENGER. This buildup would create structural problems and maybe "structural inflation" because it would increase demand in the Middle West, our industrial heartland, the more sophisticated manufacturing centers in New Jersey, New York, and New England, and probably the Far West. These are the areas that are already growing very rapidly and that have relatively high wage rates in order to pull in people from other areas.

So I think it is quite clear that, more than just an increase in aggregate demand in general, this escalation would create pockets of excess demand where some inflationary problems and wage rate pressures would appear.

It is for this reason that I may not be quite as concerned as Mr. Bolton about a possible decline in Vietnam spending, because I think the result would be a more reasonable distribution of Government spending across the country. You wouldn't have defense spending causing such differences in regional growth as you now have at the present time.

Chairman PROXMIRE. Would you care to pinpoint this, Mr. Bolton? You indicated the Middle West has had a particular increase because of the Vietnam war situation, in the demand for more conventional supplies and equipment, and less emphasis on the missiles, and so forth, which are produced on the coast.

Mr. BOLTON. I think it is certainly true if the buildup took the form of another 50,000 in combat troops that the same kind of regional distribution would occur as we have had in the previous buildup. You have two main types, the purchase of a lot of ordinary weapons, ammunition, and combat supplies in the Midwest, and you would also have extensive expenditures in the South and West for operation of training bases, and so forth, which this would require.

I think especially in the Midwest that this would be an addition to demand in an area which is already pretty much at full capacity. We know of the labor shortages, I think in areas like Milwaukee, for example, and in certain special occupations.

I think that if this additional increment were put on—perhaps Mr. Suits should really deal with this—but I would hazard a guess that we would be adding to the inflationary pressure, unless we reduced other demands in the economy below what we now anticipate they would be.

Now this may simply require keeping them at the present level. It is not necessary to cut down other demands in order to free capacity for defense demand, because the capacity of the economy is growing very rapidly at all times, about 4 percent a year.

Chairman PROXMIRE. You see, if we are going to increase capacity, and perhaps we are going to have to if we are going to have a continued escalation, and it may be more rapid than was suggested with 50,000 troops, it could be more, we have the alternative of either reducing spending or increasing taxes and hoping that the increase in taxes will be translated into less pressure by the private sector of the economy. The kind of spending that we might reduce is in the space program, public works programs, other areas that would involve some substitution of the resources that would go into the Vietnam situation.

Mr. BOLTON. That is correct. That is the choice which must be made. My own value judgments are to continue public programs at their present level and to raise taxes to reduce private spending, but reasonable men can easily disagree on this.

Chairman PROXMIRE. You would agree that the economic impact would be roughly the same?

Mr. BOLTON. In the regional sense I would say yes.

Chairman PROXMIRE. Wouldn't it be easier to pinpoint it from a regional standpoint if you reduce spending?

Mr. BOLTON. I don't understand the question.

Chairman PROXMIRE. Well, if you have a big public works program on the self or about to move, in an area where you already have a scarcity of manpower, and you expect the defense demand is going to require the use of that manpower and of those facilities, in that area you would restrain your public works operation, cut your roadbuilding.

Mr. BOLTON. That is true. You probably would be able to pinpoint the decreases more precisely. That is a point I suppose for reducing public spending.

On the other hand, as I indicated, I think an increase in taxes would reduce consumer demand, and this also would have a heavy impact on the Midwest. We know consumer demand would probably be heavily in durables.

Chairman PROXMIRE. Because of the automobile industry?

Mr. BOLTON. In durables such as automobiles or in housing construction, or something of this sort.

Chairman PROXMIRE. It is pretty hard, you know, to have anything but a very diffuse overall national impact if you increase taxes. If you follow the administration's proposal of a 6-percent increase in a surtax on individuals and corporations, I don't know how you could construe that as reducing the demand for automobiles, for instance, and then making it possible to produce more jeeps or helicopters.

Mr. BOLTON. Well, you must remember that no matter where the initial change in demand is, that there are subsequent responses, multiplier responses.

Chairman PROXMIRE. Yes. I am talking about the regional situation right now.

Mr. BOLTON. I am saying these induced effects would eventually work back into the traditional manufacturing areas as well, so that even if you reduced public works expenditures in California say, eventually some of the reduction in the impact, not all of it but some of it, would come back to the Midwest, because steel, for example, and various kinds of construction equipment, and so forth, is produced in the Midwest.

Chairman PROXMIRE. You see, the reaction I get is that when we talk about meeting the problems of escalation, and a greater demand on our resources and inflationary pressures, the answer is to increase taxes.

Then when we come to the deescalation problem, negotiations, the answer is to increase public spending on programs that we need, spending on antipollution, spending on various antipoverty programs, and so forth.

So that it would seem that the taxpayer gets it either way. He doesn't get any relief on deescalation, at least that doesn't seem to be the top priority, and he has to pay more on the escalation.

Mr. BOLTON. That is true.

Chairman PROXMIRE. I am just asking that to have you justify it.

Mr. BOLTON. The people who advocate this are not really being inconsistent or anything. They express a preference that the share of the gross national product going into public goods is too small, or certainly should not be any smaller, and every taxpayer is also a citizen who shares in the benefits of air pollution control, expenditures on education, and so forth. As I say, this reflects my own value judgment.

Chairman PROXMIRE. Well, also of course, you can be more precise in your choices. You can be against air pollution and against water pollution and at the same time feel that there are areas of public spending that ought to be reduced.

Mr. BOLTON. Yes.

Chairman PROXMIRE. Like maybe the space program.

Mr. BOLTON. Yes.

Chairman PROXMIRE. And some other areas of public expenditure, perhaps roadbuilding, and maybe some of the others.

Mr. BOLTON. Yes, I would certainly agree with that.

Chairman PROXMIRE. Mr. Suits?

Mr. SUITS. I would like to endorse that last point. There are many areas of public expenditure which are, after all, critical. It is not a matter of choice whether we have a police force or do not have a police force. By the same token, I should say right now such areas as pollution control and a strong poverty program are critical. We really cannot afford to cut these back.

I am less impressed than many people appear to be with the urgency of our space program, and I would be perfectly satisfied to reduce expenditures on that score. Moreover, this is precisely the area where one would get the laregst tradeoff as far as war production is concerned. The space program is certainly something that one should be prepared to sacrifice I think.

One cannot expect to fight a war without making some kind of sacrifices. The question is whether we should sacrifice new automobiles or new clothes or space programs, or whether we should make sacrifices in areas of pollution control and poverty reduction programs.

I would like to say that the economic impact of the overall effect of prospective escalation is certainly the last aspect of it we are concerned with in reality. Nevertheless, to turn our attention to the economic implications of it, I would think, on the basis of my calculations, that our economy is not now in a tight inflationary position. We are actually in a better position than we were 6 months ago to absorb an additional $4 billion of defense expenditures at annual rates. I presume this is the kind of number that you meant, an additional $4 billion this year above the $12 billion that people are already——

Chairman PROXMIRE. You see there is already a big increase for defense.

Mr. SUITS. Yes.

Chairman PROXMIRE. I was just asking what was the increase for this year. I don't have it right in mind, but as you know, it is very substantial.

Mr. SUITS. Yes.

Chairman PROXMIRE. If on top of that you have the midpoint that will be $5 billion, according to Senator Stennis yesterday, a $5 billion increase on top of the massive increase we already have, you have, No. 1, the problem of the impact on the economy generally, which I am sure you are addressing yourself to.

You have, No. 2, the problem Mr. Bolton was concerned about, and I think properly so, the impact on particular regions, which are already straining their resources and have a real manpower shortage, and so forth, the impact on them.

Mr. SUITS. Yes. Now to take the overall picture, last November in making our projections for calendar 1967, we allowed for an additional $12 billion over calendar 1966 in defense spending.

Now if this would be an additional $4 billion on top of that, it would add roughly 1 percent to the 1967 GNP.

Chairman PROXMIRE. You are talking about that combined with the multiplier effect?

Mr. SUITS. Yes.

Chairman PROXMIRE. Incidentally, the staff questions your multiplier. They think that 1.85 is small, and that it could easily be substantially more than that. The impact of this spending would be in my view considerably more than 1.85.

Mr. SUITS. Let's take up this question of the size of the induced effects; 1.85 does strike many people as being a low multiplier. I think the reason is that we have an exaggerated notion of how much of our demand is actually induced by income as compared to outside forces, consumer whims and so on.

The position of the automobile industry, which—at least up until the last couple of weeks—has had declining sales in face of a very rapidly rising consumer income, is a case in point.

Now the multiplier 1.85 works out roughly as follows. If we begin with an initial $1 of gross national product, not all of this of course reaches the household. Some of it goes for depreciation allowances, some of it is taken in taxes, some of it goes into corporate saving, and so on. Out of an initial $1 of GNP, only about two-thirds, about 67 cents actually reaches the household.

Chairman PROXMIRE. This is, you would agree I am sure, very theoretical, isn't it, because if you are doing this in a period like 1964, 1965, 1966, when we have this massive acceleration of business investment in plant and equipment, when it virtually exceeds, well, it is about at a level with the cash flow, and they invest almost everything they have, their depreciation reserves, their undivided profits, everything that is not distributed as dividends, under these circumstances these assumptions you are making wouldn't be true.

Mr. SUITS. Yes, this is quite correct. If you are going to include the pressure on capacity utilization, such as we saw last year, and the impact that this has on business plant and equipment expenditure, then the multiplier in this sense could very easily be as high as 3. That is correct.

Chairman PROXMIRE. I am very impressed and interested in your estimate. It could be misconstrued easily, that the Vietnam situation, if we didn't have the Vietnam war, and we didn't follow any other compensating governmental policies, we could have a depression, in the fourth quarter of the last year, a depression to the extent of 7.7 percent of our work force out of work.

Chairman PROXMIRE. In other words, unemployment would be close to 8 percent.

Mr. SUITS. Yes.

Chairman PROXMIRE. It would be at a level that most of us would feel was a genuine recession.

Mr. SUITS. Yes. This is, of course, supposing merely that we subtract out the Vietnam impact, and then look at what is left. This doesn't imply that we wouldn't have had other uses for these same resources.

Chairman PROXMIRE. Other uses, but at the same time, if you look at the non-Vietnam sector of our economy, while the increase has been modest, there has been an increase in general in spending, in most of our programs.

Education has increased at a very substantial rate as far as Federal Government assistance is concerned, and I am sure you are not satisfied and many other people aren't satisfied with the rate. It could be more, but it is a rapid rate, if we are going to absorb all of this $22 billion we are spending in Vietnam, in these other areas.

Don't you think it is unrealistic to assume that Congress would spend that much money?

Mr. SUITS. Oh, expenditures I don't know. Let's put it this way. In the last 10 years, say since the recession of 1958, I believe that all of us, and perhaps most particularly the Congress, have come to a much greater appreciation of the rôle of the Federal Government in balancing the economy.

I think the tax reduction of 1963, I think the rescinding of the investment tax credit, I think the President's request to have the investment tax credit reapplied, the current application for the 6 percent tax add-on, all of these things bespeak a much greater sophistication than we have ever had before in this area, and I have every confidence that the Congress and the administration would take such steps as they would deem necessary to forestall the occurrence of a recession of this magnitude.

Chairman PROXMIRE. What are you saying, if we could remove the Vietnam war situation, we could have two things. We could have an increase in Government programs, we could have a substantial tax reduction.

Mr. SUITS. That is right, in such combination as we thought was best suited to the needs of the country.

Chairman PROXMIRE. And I take it you would also say that as we move into a period of negotiations to the extent we ever do, that under those circumstances, cease-fire, that under those circumstances we could have both.

Mr. SUITS. That is right.

Chairman PROXMIRE. Yesterday we were cautioned, I think very wisely, by Senator Stennis that the Defense Department is following a policy of living off their inventories, depleting them and they are doing this deliberately and they have said so, but he said it will be a long time in his judgment before those inventories can be replenished, and before we can bring the Defense Establishment back up to the level that he thinks the President and the Congress feels would be adequate, so that we do have that compensating factor and that gradual blending into a more normal situation.

Mr. SUITS. That is correct.

Chairman PROXMIRE. Do you want to comment, Mr. Bolton?

Mr. BOLTON. Yes. I just wanted to make sure my previous remarks weren't misunderstood. The taste one shows for a combination of public and private goods depends a lot on whether you are talking about four or five billion dollars or whether you are talking about $20 billion. I didn't want to imply that I was in favor of spending all of it in either case on public goods. I simply was expressing the idea that the proportions might be increased somewhat in favor of public goods, but I certainly would support lower interest rates to stimulate private investment, private construction, and some tax decreases, if we are talking about a cutback, in order to stimulate private demand. I just want to make that clear.

Chairman PROXMIRE. Mr. Eisenmenger?

Mr. EISENMENGER. I want to make one comment. I would agree with Professor Suits that a reduction in spending for our space effort would make a great deal of sense when you have a national war effort going on, because these two activities do use the same resources. But, and I would also like to emphasize that I am an economist and not a political scientist, it is hard to visualize how you could cut the interstate highway program differentially in your fast-growing areas, say in the Middle West, the Far West, or the Northeast. I imagine it would be difficult to get political acceptance of that idea.

Chairman PROXMIRE. Yes. The roadbuilding program would be hard to cut unless you do it overall, as the President tried to do in December when he announced that he was shrinking the program, and did. There are other programs that aren't individually as big as that program, but are big, that you might conceivably be able to slow down, especially with regard to dam building, Federal buildings, and that kind of thing.

Mr. EISENMENGER. Yes.

Chairman PROXMIRE. I will yield to Mrs. Griffiths in just a minute. I would like to ask, and this is almost on behalf of the ranking Republican member, Mr. Curtis, who has been very diligent in questioning about this, and I think building up a good strong case.

Many of us feel we ought to have job vacancy statistics. The administration has recommended this, but the Congress has failed to provide it. We feel this would be a helpful element in providing for the kind of labor mobility we need. We don't have these job vacancy statistics on a national basis. There are some that we get in the area of, what is it, 15 or 16 labor markets, but we don't have it on a comprehensive basis.

What is the feeling of you gentlemen? Do you feel that this would be helpful in view of the fact that you have spoken at some length on the importance of mobility?

Mr. EISENMENGER. I would rather not talk too much about it, because I could soon run beyond my area of competence. I believe Sweden and the Netherlands do have a system of national registration and companies supply job vacancy data. I have a feeling it would take quite some time just to arrange the governmental machinery for data collection. The difficult question is: Do the benefits exceed the costs? [I just don't have any special competence. I would rather not comment.]

Chairman PROXMIRE. The cost is fairly modest as I recall, $10 million, and we would get information, accurate information on unemployment, the availability of jobs. We would know where they were and we would be in a much better position to encourage people, therefore, to move from one area to another and to maximize our resources and prevent idleness in one area and prevent scarcity where you have production and where you needed people.

Mr. EISENMENGER. It has always sounded very plausible to me, and I would tend to agree with you. I just don't know what the mechanical administrative problems are—requiring every employer to record with some governmental agency when he has a job vacancy. But it sounds reasonable.

Chairman PROXMIRE. Certainly in the period where we are moving possibly to escalation in Vietnam, and where you are going to need more production, and you want to ease inflationary pressures, this might be helpful. Mr. Bolton?

Mr. BOLTON. Yes, I would say it would certainly be a good thing. I think the compliance problems would be eased by the fact that many employers are crying for labor, so they presumably would be quite willing to give information.

But I would emphasize that information is just one part of mobility. We need all the other things which go along with it. As you say, the encouragement, and perhaps some financial support and extensive retraining programs, and so forth. Just knowledge of job vacancies will never be sufficient in itself.

Chairman PROXMIRE. Mr. Suits?

Mr. SUITS. Yes, I think there are two aspects. The question of compliance, for example, has to do with the question of obtaining a complete job inventory, so to speak, or a complete listing of positions open. That would be one thing that one might aim at.

On the other hand, if we are thinking merely of statistics that match the present unemployment data on a household basis, or employment data on an establishment basis, we might very well depend on a much smaller sample of firms to provide this information, to get a general picture of the pattern of openings, of where we need people and of what kind of people are available to fill these jobs.

Chairman PROXMIRE. So you only have a sample in unemployment.

Mr. SUITS. That is right, and this might be adequate for most purposes, certainly for purposes of overall planning, if we had a corresponding sample from a small sample of establishments. I am not a sampling statistician and I don't know how many establishments would be needed, but reliance on a sample would reduce greatly the total burden on the business community, so that it is quite feasible to collect data of this kind. At the present time we are more or less flying blind. We only have one side of the scissors, and we don't know where the other side is.

We know how many people are looking for jobs, but we don't know how many jobs are looking for people, nor what kind of jobs are looking for people. This would be immensely helpful.

Chairman PROXMIRE. Very good.

Mrs. Griffiths?

Representative GRIFFITHS. It seems to me that you have too many things that mask the real unemployment of the country. I have just come from Ways and Means, and we are doing social security. Part of the unemployment of the country is masked by the welfare laws. You can't tell who is unemployed or who is available for work because of it.

A large part certainly of the money that is spent for defense is spent in the State of California. California absolutely will not permit a woman to work, I understand, over 48 hours a week. They have some very qualified women who are not permitted overtime. Now, I understand that this case is coming up through the courts, and maybe the Supreme Court will have sense enough to say that a woman is a person and that the equal protection of the laws apply, and therefore, you will be able to hire them for more than 48 hours.

But part of the scarcity of labor would be done away with if they could be hired, and this is particularly true in defense industry. It seems to me that one of the problems of the defense industry is that it is occupied by highly unionized, highly articulate workmen, plus the fact that you are paying for the lobby of the manufacturers out of Federal money, to come down here and lobby to get additional contracts, and to set up a system where a large part of their expenses are paid that is really not true with other manufacturers.

Therefore, I think that any statistics have to be more carefully looked at than we are now drawing statistics for unemployment. Would you like to say something?

Mr. BOLTON. May I ask, Does that California law apply to all women or just those with children?

Representative GRIFFITHS. All women.

Mr. BOLTON. That does strike me as being unreasonable then; yes.

Representative GRIFFITHS. What objection do you have for those with children? Why would you like it to apply to women, those with children? Fifty percent of all women are working now. Why do you want some to stay home?

Mr. BOLTON. I was just going to suggest that there is some basis for having some standards and not allowing a mother to neglect her children, even if it means getting a——

Representative GRIFFITHS. You mean like a woman with a 400-word vocabulary, it is a good idea for her to stay home with all 13 illegitimate children.

Mr. BOLTON. I agree that is a problem.

Representative GRIFFITHS. It is a very bad idea. The idea is that those children should be put some place where they have a chance and the woman herself should be given a chance.

Some years ago I asked in this committee about machine tools, and finally the GAO has come in with a report, and I found out that, of course, the original tooling clause was put in the Defense Department contracts, so that a manufacturer would not be compelled to purchase equipment that was not ordinary equipment for his company, the exotic equipment, the equipment that was used purely for the manufacturer of defense products.

Now I really was thinking about tools, jigs, dies, and fixtures that are put on equipment, and that are not kept track of by the Federal Government. I asked the GAO to see if they could find out really where that equipment was and how we do keep track of it.

In one plant, I believe in California, the manufacturer told them that he put on 20 men for a year to sort out the Government's equipment, as opposed to his own.

They found out all kinds of interesting things. One manufacturer had two 4-ton presses, and he asked for an 8-ton press, in the interests of economy. He used it for 1 year in the aircraft industry, and then the whole thing went over to commercial production and he was back on the two 4-tons. So that in fact in this industry, we are subsidizing some manufacturers as opposed to others, where they are really competing commercially.

This hasn't been done. This is done with defense contractors. It is not done with general and commercial contractors. Personally, I would like to find out where we are wasting the money, and I am sure that we will be able to pick up quite a lot of money and we will be able to make this change more easily.

Thank you.

Chairman PROXMIRE. I would like to ask each of you gentlemen, as professional economists, how you react to the administration's preparation, for deescalation. If hostilities should cease tonight, the administration has no contingency plans to put into effect tomorrow morning.

All of you have stressed the need for prompt action. What is your feeling about this? There is the Ackley committee that has been created that will report in September or so, but until that time, we aren't prepared. How about it?

Mr. BOLTON. I certainly would say that there ought to be advance planning. I do not know how much such planning there is in the administration. My impression is that there is not a great deal.

Chairman PROXMIRE. Our staff has checked with the various administrative agencies, and they find again and again in one agency after another—we don't have any plans.

Mr. BOLTON. Well, then I would certainly say that is unfortunate. I think that to some small extent, that perhaps our willingness to try to find a way to cut back on the defense budget at certain times would be increased if we were more confident that we could adjust in the economic sense.

I think that was perhaps especially true earlier. I don't know whether it really applies to the particular situation. But I for one would think that such advance planning might actually contribute in a small way to a situation in which the planning would have to be used.

Chairman PROXMIRE. Mr. Eisenmenger.

Mr. EISENMENGER. Are you thinking of planning in advance for the specific direction of accelerated Government spending in the case of deescalation?

Chairman PROXMIRE. Yes.

Mr. EISENMENGER. Then, if there is no planning at the administrative level, you should be very concerned. If you don't have that type of advance planning, then you are more or less forced to use generalized fiscal and monetary policy in reaction to a deescalation.

A lot depends on how important it is to you that Government spending be increased in specific areas.

It doesn't take much advance planning just to have a tax cut. But to reallocate Federal spending wisely does require planning. That is my point.

Representative GRIFFITHS. Mr. Chairman, I might point out that I once believed that a tax cut was a very simple thing to enact.

Mr. EISENMENGER. I don't mean that.

Representative GRIFFITHS. But it took the Ways and Means Committee a week to reinstitute the investment credit, and I may point out the Senate has been working on it ever since.

Chairman PROXMIRE. That is a relatively simple restoration that is almost unanimous. Everybody is for it. The administration has asked for it, in view of the economy, but you can imagine some other kind of reduction.

Mrs. Griffiths had a wonderful statement. She said she thought a tax cut would go through the Congress quicker than a declaration of war.

Representative GRIFFITHS. I certainly did. I couldn't imagine anybody in the whole world that wouldn't be glad to have a tax cut.

Chairman PROXMIRE. I must say I shared that view, but I have been disillusioned too.

I would like to ask you, Mr. Suits, because this is so crucial to your analysis, which is fascinating and I know you are a great expert in this area, if you could spend just a few more minutes justifying your multiplier figure. The staff is very troubled about it and I am concerned about it and it is most important, of course, if we are going to get a fair analysis of what we are up against if we do reduce spending or if we increase spending.

Mr. SUITS. I will be happy to.

First, may I say that the multiplier figure that I used is derived from what we call an econometric model of the U.S. economy, a system of approximately 90 statistical equations that represent the various interrelationships in the economy. However, the general order of magnitude of the multiplier is very easily justified.

Out of an additional dollar's worth of production, after we take off depreciation allowances, taxes, corporate savings, contributions to social insurance, personal taxes, and so on, we get down to about 67 cents of household income available for spending—what we call "disposable income."

The figures indicate that taking one year with another, and one family with another, about two-thirds of this additional disposable income gets spent, which means that out of an additional increase in production of $1, you get something like four-ninths of a dollar of additional spending. This responding ratio of four-ninths gives us a multiplier of nine-fifths. So that the overall general magnitude 1.85 is quite reasonable.

Now this multiplier includes in its impact the accumulation of additional inventory that accompanies higher sales levels, but it does not include in its impact the additional investment in plant and equipment that generally accompanies a very tight demand on our productive facilities.

In other words, 1.85 is what you might call a direct impact multiplier. It does not envisage a second or third order effect, in which business firms go out and add to their plant and equipment budgets as they did during last year.

Chairman PROXMIRE. So it is a conservative modest estimate.

78-516—67—vol. 1——12

Mr. SUITS. That is right.

Chairman PROXMIRE. It doesn't follow all the way through.

Mr. SUITS. That is right.

Chairman PROXMIRE. And it could be substantially higher.

Mr. SUITS. That is right. If one takes this plant and equipment into account, it could very easily be as high as three.

Chairman PROXMIRE. Why do you figure that the employment multiplier of a Government shipyard is lower than a private shipyard.

Mr. SUITS. I haven't any idea. I refer that to my colleagues.

Mr. EISENMENGER. I was the one who made that statement.

Chairman PROXMIRE. You were the one who said that, I beg your pardon.

Mr. EISENMENGER. At a Government facility such as a shipyard, most supplies are not obtained in the immediate metropolitan area.

Chairman PROXMIRE. You weren't talking about the national multiplier.

Mr. EISENMENGER. No, no; the local multiplier.

Chairman PROXMIRE. The specific local. That would answer it.

Mr. EISENMENGER. At the Portsmouth shipyard many supplies are obtained from outside.

You also have the special situations that many of the shipyard workers live outside of the Portsmouth area. They travel 30 to 50 miles to Portsmouth, because the shipyard pays high wages. Thus, there are some special conditions involved in that estimate of the Portsmouth Shipyard multiplier.

Chairman PROXMIRE. I have another question for Mr. Bolton. I have worked, as I think Congresswoman Griffiths has too, on the depressed areas legislation. Senator Paul Douglas, who was chairman of this committee, was a great sponsor of that legislation and I cosponsored it. We sponsored it on the basis of feeling that there is real value in trying to preserve a community, and of course you can go too far in this direction, but you do have the facilities there, you have the schools there, you have in some cases, in many cases you have a good strong civic sentiment of people who want to stay together and work together, and so forth.

Doesn't your analysis suggest a somewhat callous view toward the community that has lost contracts, that has become very heavily and deeply involved in defense work? Then when the Vietnam was is over, we have a deescalation, you walk away from it. Isn't there something there that maybe is a little more than just straight economic analysis that we ought to fight to try and give the people there an opportunity at least to preserve?

Mr. BOLTON. I don't think it is callous, Senator.

Chairman PROXMIRE. Maybe "calloused" isn't the right word. I would just say ignoring other values possibly.

Mr. BOLTON. Let me say a few things. There probably aren't going to be that many areas, and I put in those remarks just to make sure that we didn't try to preserve every single community in the country.

Now I don't think it is callous, because I was very careful to say that the people in the areas should be helped, but I am trying to say that it may be better simply to help them by giving them transfer payments or perhaps an early retirement plan, or something of this sort, rather than try to carry on certain kinds of production there inefficiently due to subsidies.

Chairman PROXMIRE. No, no; I am thinking of something else. You are from Michigan, is that right?

Mr. BOLTON. No; I am from Massachusetts.

Chairman PROXMIRE. You are from Massachusetts. Mr. Suits is the man from Michigan. Well, Massachusetts I am sure has the same situation that upper Wisconsin has in some of its areas, perhaps even more intensively.

I am thinking of a town that used to be a mining town in northern Wisconsin. The level of education is high, the level of skills are high. The people like the town. It is on Lake Superior. It is a beautiful place. It has real recreational possibilities, with imagination and capital. It would seem to me that we ought to take a very long look at this situation before we conclude that it is just uneconomical, because obviously they can't mine anymore, and just walk away from it.

Mr. BOLTON. I would agree with that. I wasn't saying that. In all of these areas there is a lot of capital, especially public capital, and there is perhaps a skilled and educated labor force which might be converted into other kinds of production. But you know, I think we have to make sure that there is some capability there, and if we simply have a blanket policy to save every area, we are being somewhat callous to the taxpayer and all the other citizens who have to suffer the wastes of such inefficiency.

There would be a difficult problem there of balancing the few against the many. I, for one, would not want to be an administrator who had to carry out the kind of hard look that I am suggesting. It would be very difficult politically. But as I say, if you do have a blanket policy, which would penalize all the rest of the country, then I think that would be wrong also.

Representative GRIFFITHS. I asked Mr. Wirtz in general meetings on the Economic Report if any of the money had been used to transfer people from one area to another, and there hasn't been.

Mr. BOLTON. My impression is that this has not been a common strategy.

Representative GRIFFITHS. They just won't leave.

Mr. BOLTON. You know, I consider myself a very humane person, Senator.

Chairman PROXMIRE. I am sure you are. You wouldn't be teaching at Williams, is that right?

Mr. BOLTON. Yes.

Chairman PROXMIRE. If you weren't humane.

Mr. BOLTON. And I would say that if we try very hard, and if in the end the people do not move, then I don't want to leave them in the lurch. I would want to help them, but I think we ought to try very hard. That is all I am saying.

Chairman PROXMIRE. We are not arguing about helping people because I am sure you want to help them as much as I do, or more. What I am talking about is whether or not we shouldn't consider the economic viability of an area.

Mr. BOLTON. I think you should.

Chairman PROXMIRE. Because a defense industry has moved out, there are other alternatives that you can consider that are just as productive economically with some capital investment and some retraining and that kind of thing.

Mr. BOLTON. I agree with you. As I say, I think the areas which might have to be abandoned are probably very few. In an economy, after all, where the population is growing rapidly and the spaces are filling up, and many of the big metropolitan areas are already becoming too crowded and too smoky, it may mean that we need these areas very soon.

Chairman PROXMIRE. I am just about through. There was one question that the staff suggested we ought to ask Mr. Suits, because you haven't had a chance to comment on it, and that is your reaction on the absence of contingency plans in the event of deescalation in Vietnam.

Mr. SUITS. The ideal contingency plan, I suppose, is one that is already on paper in a hard form, and funded, at least on a standby basis. It would be ideal if we could have a package of these worked out.

I don't know what the political and constitutional problems are, but surely on the administrative side, the least we could ask is for a committee or group to sit down and say what kind of economy do we want to have at the end of this war in Asia? If they would compile a list of the kind of programs we want to bring in, it would put us much in the position that we were in just recently when we turned off the spigot on the road program and then turned it back on again.

Chairman PROXMIRE. On a much bigger basis, yes.

Mr. SUITS. On a much bigger basis. Now, as I say, I don't know what may be the political problems and the constitutional problems of working this out, but surely on the administrative side there is no difficulty in at least having the blueprints, and knowing what kind of funding would be required.

Chairman PROXMIRE. Because certainly you were saying earlier that you thought the economic considerations were much less important than the other considerations.

Mr. SUITS. Oh, yes.

Chairman PROXMIRE. And, of course, you are dead right, except that economic considerations, I think, enter into our attitudes toward Vietnam, if we are honest with ourselves. We have to recognize that people are employed, they are getting profits, they are getting salaries, and so forth, out of this situation, and I am convinced that the economy would be far better off if Vietnam could be over in all kinds of ways, not only in terms of a tax cut and other programs, but in many, many other ways, lower interest rates, almost every aspect of the economy would be improved, and improved with any kind of prudent action on the part of the Federal Government.

Mr. SUITS. There is absolutely no question about that.

Chairman PROXMIRE. Gentlemen, thank you very, very much. This has been a most enlightening and informative morning, and we very much appreciate it. Thanks a lot, for a fine job.

The committee will resume its hearings in this room at 2 o'clock this afternoon.

(Whereupon, at 11:50 a.m., the committee recessed until 2 p.m. of the same day.)

AFTERNOON SESSION

Chairman PROXMIRE. The committee will come to order.

Our witness this afternoon is a distinguished professor, Murray Weidenbaum, chairman of the Department of Economics, Washington University, St. Louis, Mo.; a man who has done more works I think, in this area than anybody in the country, and who has compiled a most helpful, detailed study which I hold here, "The Impact of Vietnam War on American Economy."

Professor Weidenbaum, I can tell you that we have based these hearings very largely on your excellent work, which has been referred to by witnesses, including witnesses this morning, and we are very privileged to have you. I apologize for the absence of some of the other members, but there will be other members here later today, and I am sure you appreciate these are mighty busy times; other committees are in session.

You go right ahead.

STATEMENT OF MURRAY L. WEIDENBAUM, CHAIRMAN, DEPARTMENT OF ECONOMICS, WASHINGTON UNIVERSITY

TIMING OF IMPACTS

Mr. WEIDENBAUM. Thank you, Mr. Chairman, for those very kind remarks. I should like to point out that the views I express, both in that formal report and orally today, of course, are strictly my own opinions.

I would like to just offer orally the highlights of that 100-plus page report.

Chairman PROXMIRE. That will be fine. Without objection your full report will be included in the record at the end of your remarks.

Mr. WEIDENBAUM. The key points are:

1. The persistent uncertainty as to the nature and extent of the U.S. commitment in Vietnam.

2. A lack of general understanding ——

Chairman PROXMIRE. **Will you repeat that first point again.**

Mr. WEIDEBAUM. Persistent uncertainty as to the nature and extent of the U.S. commitment in Vietnam.

Chairman PROXMIRE. Right.

Mr. WEIDEBAUM. 2. A lack of general understanding of the speed with which the military buildup affects the economy.

3. Confusion in interpretation and delay in the release of budget information in 1966.

4. Resultant basic problems in national economic policy which we are now facing.

An evaluation of the impact of U.S. expenditures for Vietnam on the American economy must begin with a review of the events in Vietnam itself and of the increasing U.S. involvement there.

From 1954 through 1963, the United States was providing minor amounts of assistance. Fewer than 1,000 American troops were involved. Beginning in November 1963, with the overthrow of the Diem government, the U.S. commitment increased, but slowly at first.

By the end of 1964, the total of American troops in South Vietnam was a little over 23,000. A significant change in the nature of the conflict occurred in 1965—the intensification of infiltration of arms and personnel from North Vietnam. The buildup of U.S. troops then accelerated rapidly, reaching over 184,000 at yearend.

Since early 1966, American forces have been conducting the bulk of the offensive military actions against the Vietcong. The South Vietnamese are primarily responsible for the more passive missions, such as pacification. Total American troops in South Vietnam have exceeded 400,000 since the end of 1966.

In retrospect, the U.S. role changed from support to active combat when the South Vietnamese no longer could defend themselves 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. The evolution of the U.S. role in Vietnam could scarcely be inferred from the day-to-day statements of administration spokesmen. On various occasions in 1963 and 1964, Secretary McNamara stated that the war was to be fought by Vietnamese, not by 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. My purpose 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 viewpoint of demands on the resources of the American economy, the Vietnam war really had its initial impact in fiscal 1966. Prior to that 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 and a $700 billion economy.

The January 1966 budget message, in contrast, estimated that the Vietnam war would require $14 billion of appropriations in fiscal 1966 and $4 billion of expenditures. It appeared at the time, at least to many observers, that the Nation could wage a two-front war without raising taxes—the war on poverty and the war in Vietnam. That theme was enunciated in the budget message and in the President's January 1966 Economic Report, where he stated:

"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 that way; 1966 witnessed the most rapid inflation since Korea. The basic explanation is that, despite the assurances of the Economic Report, the increases in government civilian and military demand, coupled with the continued expansion in business investment, exceeded the capability of the American economy to supply goods and services at then current prices.

Two key factors helped to explain what happened. The first factor was the underestimate in defense spending. The January 1966 budget projected the cost of Vietnam at $10 billion in fiscal 1967, and the current estimate is almost double that.

The second factor is the underestimate of the speed with which a military buildup affects the economy.

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:

1. Data on military obligations and expenditures by program category.
2. Data on military manpower, including draft calls.
3. Data on defense contracts by product group, industry, and geographic area.
4. Data on defense materials set-asides.
5. Data on orders, sales, inventories, and backlogs of defense industries.
6. The latest official forecasts of military programs, as well as comparable historical numbers, and
7. Seasonally adjusted as well as raw or actual figures.

Most of these numbers are available on a hit-and-miss basis, buried in a slue of Government reports, but are never put together in any one single release. This military indicator report should be published at a regular time each month, be readily available to the general public, and the data should be as current as Federal statistics generally.

The military indicators report should be as short as possible, omitting mere operational statistics and other data not essential for intelligent public policy analysis.

Such a report would only be telling us as much about the major component of the public sector as the Government already tells us about some of the smallest parts of the private sector. A monthly military indicator would be a major advance in our economic knowledge and would fill a key gap in our statistical information system.

Thank you.

Chairman PROXMIRE. Thank you for an excellent, concise statement, which also ends on a most constructive note for the future. Would you suggest that we could include in the monthly economic indicators these specific military statistics that you are talking about?

Mr. WEIDENBAUM. I think that would be too tall an order. Perhaps the highlights.

Chairman PROXMIRE. Why couldn't we simply have a table, which would include everything that you have suggested, and simply have it as an additional table?

Mr. WEIDENBAUM. Senator, it would be the longest table, maybe the size of this table I'm sitting at.

Chairman PROXMIRE. Is that right? You said you didn't want everything, and you listed how many specific——

Mr. WEIDENBAUM. Seven points.

Chairman PROXMIRE. Was it seven?

Mr. WEIDENBAUM. Yes. It could be shorter.

Chairman PROXMIRE. You also stole my first question. Let me read my first question to you and see if we are thinking along the same line. How valuable would it be for the Joint Economic Committee to receive a single monthly report from the Defense Department containing new orders in the latest month, the total outstanding orders, the expected future delivery dates of both new orders and total outstanding orders and the expected time phasing of prepayments on new orders and outstanding orders.

I take it that is part of what you are asking.

Mr. WEIDENBAUM. Yes, sir.

Chairman PROXMIRE. But only one part.

Mr. WEIDENBAUM. That is right.

Chairman PROXMIRE. For instance, this doesn't include the manpower information which you suggested.

Mr. WEIDENBAUM. Or the data on the industry side, the defense industry side, the contracts, the backlogs, inventories. I think the two recommendations are certainly consistent.

Chairman PROXMIRE. Let me ask you this. You say this would be a very long table. How many tables would this amount to if it were comparable to the economic indicators? Seven or eight tables?

Mr. WEIDENBAUM. I really haven't sat down to design it, but say, six to 10 pages.

Chairman PROXMIRE. Six to 10 pages?

Mr. WEIDENBAUM. That should do it.

Chairman PROXMIRE. Now, is this information available now to the Defense Department?

Mr. WEIDENBAUM. Yes, sir. All of this information is released, but not on a regular basis, and often it is buried in a variety of either operational reports or other statistical releases of the Department of Commerce or the Department of Defense, but it is not put together in any one single place, and it is not released in a regular fashion.

Chairman PROXMIRE. How big a job would it be, how big a staff would it take, to do this job, and how many hours would they have to work? Could two competent men do this, in your judgment, or would it be a matter of 10 or 20?

Mr. WEIDENBAUM. I think much more of two than of 10 or 20. I also think, though, what it really would take is official policy that the data would be made available.

Chairman PROXMIRE. Can you think of any reason at all why the availability of this data wouldn't serve the national interest and the interests of the President and the Congress?

Mr. WEIDENBAUM. I could think only of positive reasons why this data would foster intelligent public policy action.

Chairman PROXMIRE. There is nothing that is classified.

Mr. WEIDENBAUM. Not at all.

Chairman PROXMIRE. It is all disclosed.

Mr. WEIDENBAUM. Yes, sir.

Chairman PROXMIRE. But it is not pulled together and it is not regularly recorded.

Mr. WEIDENBAUM. That is right.

Chairman PROXMIRE. Do you know of any request for this kind of information that has been denied or turned down?

Mr. WEIDENBAUM. There have been many recommendations, including recommendations by economists testifying before this committee for this kind of information. There have been reports of this committee which recommended not an identical set of data, but many of these data. The point on the inventories of Government producers, suppliers, this recommendation appeared in a report submitted to the Joint Economic Committee, as I recall, in the early fifties. There is a long history behind this.

Chairman PROXMIRE. Well, I will tell you this. In view of your particular knowledge, would you work with the staff of this committee for the purposes of composing a memorandum on which you would specify the case for securing this information?

Not only what we want, but the reasons why this information is so vital and necessary for sensible judgments in our economy, so that businessmen could have it, so that economists throughout the economy could have it, so that the Members of Congress could have it, and so forth.

Mr. WEIDENBAUM. I would be pleased to, Senator.

Chairman PROXMIRE. That would be wonderful. That would be very helpful. Now, I would like to ask you to give me your interpretation and your estimates and analysis of the testimony which we had yesterday from an extraordinarily able man, Senator John Stennis of Mississippi, who as you know is chairman of the Preparedness Subcommittee and very well informed, and twice he has hit right on the nose the spending which the Federal Government has had, and has disagreed sharply with the administration; but he has been right and they have been wrong.

Yesterday, he indicated that the assumptions on which the administration had posited its budget failed to take into account an escalation which he felt was very likely, up to 500,000 men by the end of this calendar year, which would be the middle of the coming fiscal year.

He thinks they are short, apparently, about 50,000 men. He did not say that, but he said if they are short 50,000 men, the cost of these additional 50,000 men would be, in his judgment, $4 to $6 billion for all the factors that are involved.

Now, Robert Anthony, the Assistant Secretary of Defense, testifying the day before, said that in his judgment the cost of one soldier in Vietnam is $30,000. Of course, Senator Stennis was basing his estimate on a different assumption. He was including the cost of training, the cost of transporting, as well as the cost of maintaining, supporting, and supplying men in Vietnam.

Would you feel that the assumption that 50,000 additional troops in Vietnam would probably require $4 to $6 billion—do you think that may be a fairly reasonable estimate?

Mr. WEIDENBAUM. If you can just wait a moment——

Chairman PROXMIRE. You go ahead, take your time.

Mr. WEIDENBAUM. With my hand calculator, 50,000 men at $4 billion?

Chairman PROXMIRE. Four to six. Yes, I think the mid-figure would be five, give or take a billion.

Mr. WEIDENBAUM. I claim no expertise of precision of per man costs of the Vietnam war, but under the assumption—and this has been stated by a number of observers, that on the average there is one man in logistical support for each man in Vietnam, which would mean for a 50,000 buildup directly in Vietnam, we are talking about a total increase in the Armed Forces of 100,000 men—it strikes me that the Senator may be toward the high end of the range.

Mr. Anothony may be at the very low end of the range, but I think the average would be closer to the Senator's estimate. I have a great respect for someone whose forecasts have been as accurate as Mr. Stennis.

Chairman PROXMIRE. You indicate that one of the big troubles, and we of course agree with you wholeheartedly, has been the uncertainty as to the nature and extent of our commitment. Now, do you feel that this was a factor in the failure of the administration so dismally, starkly, to estimate the Vietnam cost last year?

You will remember in January, as you say, they estimated $10 billion. It turned out to be, as you say, about twice that. In a sense, they were off 100 percent.

Do you feel this was a major factor here?

I don't recall that there was any escalation much beyond the assumptions that most of us made, and of course, as I say, Senator Stennis and one or two others were quite accurate.

Mr. WEIDENBAUM. I think blaming the entire $10 billion underestimate on uncertainty is too charitable an explanation. I think, though, we need to realize that making the assumption that the war would be over, not a prediction, but an asumption that the war would be over by the end of the budget year, was the standard budgeting procedure for the Korean war, so there was plenty of precedence for making that assumption.

Chairman PROXMIRE. But then in the Korean war, as I recall, we appreciated a great deal more than was used, didn't we?

Mr. WEIDENBAUM. That is right, and this is one of the concerns that Secretary McNamara has expressed many times over, the desire to avoid making such unnecessarily premature funding of defense activities that when the war is over, we as a nation have an excess amount of materials in inventory and of funds available to the Pentagon.

However, granted that you don't want to be overly generous in the funds you make available to the Department of Defense for purposes of awarding contracts and committing the funds, and making that assumption, and that is an operational assumption that I personally respect the Secretary making—the point, however, is that assume, for fiscal policy purposes, as it was apparent, that the $10 billion figure was an underestimate, that the war would not likely be over in June 1967, that perhaps it was still too early for preparing a supplemental appropriation—and this is the point that the hearings I read have been dwelling on—but the time wasn't too early to take the necessary fiscal policy action.

The statement has been made many times that during——

Chairman PROXMIRE. And if we had had this monthly series of reports, this monthly series that you have suggested, we would have been prepared to make a judgment as to whether or not taxes should have been increased, other spending reduced, and so forth.

Mr. WEIDENBAUM. I think so; and specifically the statement was made repeatedly that we did not know, the administration did not know, whether the supplemental, additional funds to be spent in fiscal 1967 for the military would be $5 or $10 billion, or somewhere within that range in excess of the initial estimate.

Grant that, that there wasn't exact certainty, however, knowledge was there that $10 billion was too low, that the figure was going to be maybe $15, maybe $17, maybe $20 billion.

Well, for fiscal policy purposes I don't think it was essential to wait until we could come up with the fine 19-point-something. As soon as the administration publicly admitted that there was an underestimate in defense spending, that expenditures were going to be higher than originally budgeted, that was the time to make fiscal policy adjustments.

Chairman PROXMIRE. I believe, as I recall, that Secretary McNamara indicated, when, in July or August, that there would be a supplemental, that they had underestimated; but he did not indicate how much.

You see the difficulty for Congress is that we have to work with the figures that we have available, and there is a tendency for those of us on Appropriations and Finance Committees to think in terms of the most recent hard estimates, where they give specific figures and facts.

Under these circumstances, it was felt it would be hard, because we were relying on a budget estimate so inaccurate that it was very difficult for us to either persuade the Members of Congress to go for a tax increase or to make a real effort to hold down spending.

Mr. WEIDENBAUM. I think, though, that it was important to make the distinction between congressional action on military appropriations and congressional action on fiscal policy; that is, tax increases or slowdown in nondefense spending and even though Congress hadn't enacted, because they hadn't even received, the request for the supplemental, as soon as it was general knowledge that the impact of Vietnam had been underestimated, that the cost of Vietnam had been underestimated, hence that the basic assumptions underlying the January 1966, budget were no longer relevant, that was the time for a change in fiscal policy.

Chairman PROXMIRE. You specified that, and this was an interesting emphasis, because we had little of it on this committee in our consideration last January and February, when the various administrative agencies and others were before us in justifying the President's economic plans for the Government in the next fiscal year, that is the lack of general understanding of the speed with which the military buildup affects the economy.

Would you detail this a little bit? Would you explain what you mean and why this is misunderstood, and how we can achieve a better understanding?

Mr. WEIDENBAUM. During much of 1966, the focus of the Council of Economic Advisers was on the so-called National Income Accounts Budget, in particular, during the first half of 1966. This National Income Accounts Budget showed a surplus of about $3 billion. This was taken by the administration as an indication of fiscal restraint. It was cited repeatedly.

Chairman PROXMIRE. In general, that is quite sound, isn't it?

Mr. WEIDENBAUM. I don't think so. Let me say this, that it certainly is sounder to take the NIA than the administrative budget in this respect.

Chairman PROXMIRE. Wait a minute. I am saying in general, I am not saying in 1966 it was sound. I am saying it usually is a guide. This is a better guide than some of the other guides we have had in the past.

But this does show, is this true or not—the total Government spending and Government revenues, including trust fund revenues and expenditures on an accrued basis, not a cash basis?

Mr. WEIDENBAUM. I have to say not quite.

Chairman PROXMIRE. All right.

Mr. WEIDENBAUM. For two reasons: first of all, it excludes all of the lending transactions of the Federal Government, which are very large and very important. These are included in the cash budget. They are not included in the National Income Accounts Budget.

I feel the second drawback to the National Income Accounts Budget is its accrual on the revenue side, and that is, it records the payment of corporate taxes when the liability accrues to the companies, not when the cash is received at a later point by the Treasury. However, it shifts gears on the expenditure side. It doesn't reflect the receipt of the Government payment by a Government contractor on an accrual basis, which would precede the actual cash flow, but it reflects this payment on a delivery basis, which is after the cash flow, because of the temendous amount of progress payments.

So you have a measure which during the period of a military buildup shows receipts on a leading basis, so to speak. It records the receipts before they are in the Treasury, and it doesn't record the expenditures until some time after they have left the Treasury. Inevitably during this kind of period, this budget, which overestimates, so to speak, receipts and underestimates expenditures, will show a far more favorable situation than the underlying relationship between the budget and the economy. In my formal paper——

Chairman PROXMIRE. Let me just ask you on this point—what is your answer? What should we be looking at? Is the cash budget a better basis?

Mr. WEIDENBAUM. For this purpose, I do think the cash budget is better.

Chairman PROXMIRE. For measuring the impact in a period of rapid war buildup, you would rely more on a cash budget?

Mr. WEIDENBAUM. Yes, sir.

Chairman PROXMIRE. What did the cash budget show in 1966?

Mr. WEIDENBAUM. I must say I don't have the figures with me.

Chairman PROXMIRE. Did they show a deficit?

Mr. WEIDENBAUM. While I am looking for the figures, may I point out that in my formal paper, I have made an adjustment of the National Income Accounts Budget to cover this contingency. In other words, I have adjusted the National Income Accounts Budget for the fact that deliveries lag behind expenditures. In other words, I adjust the expenditures on a National Income Account Budget so that they are consistent with the revenues.

In doing that, I don't show a surplus in 1966. I show a Federal deficit in 1966.

Chairman PROXMIRE. That is simply adjustment in the NIA budget you show a deficit.

Mr. WEIDENBAUM. Yes, that is in the NIA budget. I have now the comparisons between cash budget and National Income Accounts Budget. In the second half of 1965, the cash budget showed a much bigger deficit than the National Income Accounts Budget. In the first half of 1966, it showed a much smaller surplus than the National Income Budget. In the second half of 1966, it showed a much bigger deficit.

The results are consistently less favorable than the National Income Accounts Budget. I think this is one of the problems. But I am a little dismayed to see, as I note in the January 1967 Budget Message, this comparison between the administrative budget and the NIA budget. It is sort of, frankly, beating a dead horse.

I recall a Presidential budget message just a few years ago saying, in effect, "We are no longer going to emphasize the old-fashioned administrative budget. We are now going to emphasize the comprehensive cash budget, which is the best measure of Federal finance."

Somehow or other we have conveniently forgotten that, and now we measure, compare the NIA budget to the administrative budget. I think the more relevant comparison is to the cash budget.

Personally, I would opt for the cash budget because it is, first of all, more comprehensive. It includes things like the big lending programs we have that don't show up in the NIA budget and, secondly, it is more accurate. It presents a more accurate portrayal of the impact of a defense buildup or of a defense cutback on the economy.

Chairman PROXMIRE. Now, proceed to spell out the speed of the military buildup affecting the economy.

Mr. WEIDENBAUM. If I may, fiscal 1966, as I point out in my formal statement, was a period where Vietnam really took hold in terms of being important as a factor in the budget and in the American economy. That is the second half of calendar 1965, July, 1965, through December, 1965. This was the point where the Federal budget on the NIA basis was running a small deficit, $1.4 billion.

However, this was the period of tremendous buildup in military orders, military obligations, in the second half of 1965, were running on the average of $60 billion, which was a $7 billion increase over just a year prior. Making the adjustment——

Chairman PROXMIRE. That was, or was not, reflected in the NIA budget?

Mr. WEIDENBAUM. It is not reflected in any of the budgets.

Chairman PROXMIRE. But this is the kind of thing that you say in your summary. It isn't reflected in the Government figure, but it is reflected in the action of the private contractors.

On this basis, they go out and hire people, they make commitments on machinery, they buy raw materials, they go through this kind of action which expands the economy.

Mr. WEIDENBAUM. Precisely. It is the private production on Government account that increases the GNP. If you can conceive of several steps, breaking up the GNP into simply private sector and public sector, during the period where the defense contractors are working on Government orders, this shows up in the private sector.

This is value added in terms of the production of aircraft, tanks, ships, and so forth.

Chairman PROXMIRE. Roughly, how did this work in 1966 in terms of the timing? You say late 1965?

Mr. WEIDENBAUM. Yes.

Chairman PROXMIRE. That was the time of the buildup. The Government would increase its orders in September, October, November of 1965, no reflection whatsoever in any current budget, but those orders were obviously immediately escalating the economy.

Mr. WEIDENBAUM. Precisely. And this is the key part. That the increase in the orders result directly in increase in private production, which shows up immediately in the GNP.

Chairman PROXMIRE. Those figures you say were available, but hard to dig out.

Mr. WEIDENBAUM. That is right.

Chairman PROXMIRE. And these are the figures that you are asking the Defense Department to make available on a regular monthly basis, and a comprehensive basis so they are all put together in one place.

Mr. WEIDENBAUM. That is right.

Chairman PROXMIRE. And on the basis of these figures, you will be able to see, anticipate, understand the effect that this is having on the economy, although it is not reflected in the budget figures?

Mr. WEIDENBAUM. Precisely, because a simple-minded view is to see little activity in the public sector, great activity in the private sector, and say, "Well, the public sector is acting in a very restrained fashion. All the inflationary pressures are in the private sector." But if you look just a little more deeply than that, what is the inflationary pressure in the private sector? It is precisely the production by Government contractors.

You then look at the next period, where the production is completed. The items are delivered to the Government. What shows is a big plus in the Government budget during this period, which is recorded in the accounts. But in the private sector, there is a big minus, as inventories are liquidated, and as the completed weapons are shipped to the military.

You add the minus in the private sector to the plus in the public sector, and you get zero increase in the GNP.

The increase in the GNP occurred in the previous period, during the private production. Hence, by looking only at the formal Government budget, we are missing the period where military demand increases the GNP, which is the production in the private sector, not the delivery to the public sector.

Chairman PROXMIRE. Will these figures put us in a position where we can appraise the degree of the impact on the economy?

Mr. WEIDENBAUM. Yes, sir.

Chairman PROXMIRE. This morning, we had three very excellent papers, and one of the papers by Professor Suits estimated two things:

No. 1 was a very modest multiplier, and he agreed it was conservative. He did not trace it all the way through, but a multiplier of about 1.85 percent for the expenditures, which would give us some idea about the effect of these Government defense contracts, that they might be expected to have on the economy.

And in addition to that, he estimates that, all other things being equal, and he agreed of course they wouldn't be, but all other things being equal so that we could understand the comparison, that with Vietnam out of the picture, instead of having approximately 4 percent unemployment last year, or less, or would have had about 7.7 percent unemployment, I think, in the last quarter of last year.

Would those figures about square with your own understanding, or what do you think of this kind of estimate (a) on the multiplier, and (b) on the effect on the economy?

Mr. WEIDENBAUM. I have a high regard for Professor Suits' econometrics work. I have no reason to question the accuracy of his figures. However, I question the relevance of the results.

Chairman PROXMIRE. He did not offer this as an indication that Vietnam was preventing unemployment. In fact, he takes a very sharply contrary view.

But just as a way of measuring, you know, to reduce to a comprehensible basis an understanding of what Vietnam means in terms of jobs, in terms of the effect on the economy, and so forth.

Mr. WEIDENBAUM. Oh, from that point of view I think that is a very good indicator of how much of the economy is directly or indirectly affected by the Vietnam spending. But I have rephrased it that way.

Chairman PROXMIRE. Yes.

Mr. WEIDENBAUM. It doesn't indicate the decline in the economy, if we weren't——

Chairman PROXMIRE. Yes, he said that. He was very, very specific about that, and he agreed, as did all the witnesses, that, of course, the economy is infinitely better off in all kinds of ways, if we can have negotiations and a cease-fire in Vietnam. There would be no problem in finding policies of tax reduction and progressive spending programs that would take up the slack.

We would be better off in every sense, but this was simply a way of measuring it. Now, how about the multiplier? Have you had any opportunity to study that?

Mr. WEIDENBAUM. No, I haven't. In fact, I have used Professor Suits' estimates in some of my own work. I have no reason to try to improve on them.

Chairman PROXMIRE. This brings us to the question, when we get this information, and we have some understanding of what it is doing, what do we do. What policies would be most appropriate for the Joint Economic Committee to recommend to the Congress in terms of taxes and spending?

I realize you have to put in all kinds of value judgments to come down precisely on any side, and I am just wondering from a technical standpoint if you can help us to suggest, in view of the rapidity with which this acts on the economy, this increased defense spending, what counteraction in terms of either spending or taxes or both, do you think would be most appropriate?

Mr. WEIDENBAUM. I think in terms of three general kinds of actions, but specifically the kind that can be implemented rapidly. In other words, in general, tax reduction, Government spending increases, and changes in monetary policy are the three basic ways of doing this.

However, my guess would be that the great majority of specific actions in these three categories would not be appropriate. They wouldn't take hold fast enough.

My guess would be that on the tax side, a simple, straight percentage across-the-board change in tax rates, plus or minus, would be, if any, the only really effective way of probably offsetting whatever change was noticeable in, say, the military budget.

On the expenditure side there would be essentially transfer payments, such as unemployment compensation, veterans' pensions, OASI programs.

Chairman PROXMIRE. These are pretty hard to reduce politically. They are easy to increase but they are hard to cut.

Mr. WEIDENBAUM. I think this is one of the reasons that economists have been emphasizing the tax side rather than the expenditure side, particularly if the alternative—I would assume it is relatively easy to increase expenditures as opposed to reducing taxes, but the relationship isn't quite reversible. Somehow or other, it seems to be easier to change taxes than expenditures on the companion side.

Chairman PROXMIRE. Expansion is much easier than contraction. That is why we rely on monetary policy to restrain inflation and reduce taxes and increase spending to stimulate the economy.

Mr. WEIDENBAUM. Well, monetary policy doesn't come out with flying colors during the past year. It was rather late in——

Chairman PROXMIRE. I am not so sure. It came out almost with—it slammed on the brakes with a resounding crash and roar; in that sense, it wasn't flying colors, but it sure as the dickens slowed down the economy, in spite of the fact that the Vietnam war has been escalating, and we have been sending more and more troops overseas, those highest interest rates in 40 years that we had during much of 1966 did result in an economy in which all the indicators were either level—or practically all of them—either level or pointing down by the fourth quarter of last year. It is hard to find any that were going up.

Mr. WEIDENBAUM. I think it is one of the problems. You can take a look at, say, the money supply. It really started turning down, I guess it was in April after so much of the direct Vietnam inflation.

Chairman PROXMIRE. That is right, but the consequences weren't immediate, in comparison with the length of time it takes to get through the Ways and Means Committee of the House, the Finance Committee of the Senate, and then put it into effect, and then get the result with tax changes, the monetary policy did work, although it took some time to do it, and it perhaps overreacted. I think it did.

Mr. WEIDENBAUM. I think there is a distinction there. Incidentally, the statement this morning that you can get a tax cut through the Congress faster than a declaration of war struck me——

Chairman PROXMIRE. That was retracted by the author of it, Mrs. Griffiths.

Mr. WEIDENBAUM. The reason it struck me as amusing, and I don't mean the current controversy on the tax credit, is that we haven't had a declaration of war since 1941. But the point I really would like to make is that even though monetary policy might take effect, monetary policy actions——

Chairman PROXMIRE. Let me just go back to that. We haven't had a President who asked us for a declaration of war. I think if he did, it would go through awfully fast. We have had Presidents who have asked for a tax reduction. It took President Kennedy about 2 years to get the 1964 reduction.

Mr. WEIDENBAUM. Yes, sir.

Chairman PROXMIRE. And I think it is going to take us a long time to get even an across-the-board reduction. The investment credit is relatively very, very simple, as you know, and easy to act on compared to these other things.

Mr. WEIDENBAUM. In a way, though, I think the comparison is misleading. Certainly, the Federal Reserve Board can make decisions

78-516—67—vol. 1——13

fairly promptly, but in terms of the timelag between their making their decisions and the impact on private spending, income and employment, we might find that those timelags are greater than the timelag between the time that Congress reduces taxes and the increase in aftertax income on the part of the taxpayers, and the increase in their consumption.

So, even though Congress may take longer to enact a tax change, than the Federal Reserve may to enact a monetary policy change, that shorter lag, that looks favorable to monetary policy may be more than offset by the longer time it takes for monetary policy directly to affect employment and income than the tax change.

Chairman PROXMIRE. Again, I am not so sure. I think it is very possible that the monetary policy actions taken by the Fed beginning in April, began to slow down the economy earlier than the fall. The indicators suggest that the economy leveled off in the fall, and that was quite a slowdown, because it had been moving up at a rapid rate. But there was a period before that when, absent the policy of the Fed, if they had continued to expand the money supply 6 or 7, or 8 percent, we might very well have taken off with an even greater increase in business spending.

Mr. WEIDENBAUM. Yes; but the initial Federal Reserve actions for a tight monetary policy occurred in December 1965.

Chairman PROXMIRE. Well, the money supply did not turn around until April. They did increase the discount rate on December 2. At any rate, it is my fault. We got away a little bit from your principal recommendations, which I think are extraordinarily helpful.

I would like to suggest, Professor Weidenbaum, that we try to see what we can work out informally with the Defense Department, and then we proceed just as hard and as fast as we can to get precisely what you have recommended today, or at least as much of it as we possibly can get, get it on a timely basis, on a monthly basis.

You feel that it ought to be separate. It ought to be called something like defense indicators, or something like that, separate from the economic tables, because these economic tables are comprehensive now. They are 37 pages. This is a publication, as you know, of this committee.

Mr. WEIDENBAUM. Yes, sir.

In fact, I think in terms of another spinoff, if you will. I noticed that after the economic indicators were introduced, the Department of Health, Education, and Welfare has come up with something called HEW indicators.

Chairman PROXMIRE. Yes. We even have State indicators.

Wisconsin has her own indicators of the level of the economy in our State, and a number of other States have developed this.

Mr. WEIDENBAUM. And in this case, we would be doing another specialized report, where the economic indicators would still be the most general set of pertinent statistical materials, but whether it is Health, Education, and Welfare, or Defense, or other key elements to the economy, we would have another specialized set of tables.

Chairman PROXMIRE. There is this one consideration, and that is the Health, Education, and so forth, are somewhat different. The sole purpose of our requesting, at least of this committee requesting, it is for the purpose of getting greater enlightenment on the economic impact of what this rapidly changing and dynamic sector of our Government, what the effect is that this has on the economy.

Mr. WEIDENBAUM. Yes.

Chairman PROXMIRE. And it is directed at economic information and for this reason I think we ought to give at least some consideration to its incorporation into economic indicators. This is a regular monthly publication, and it might exert a pretty good discipline, if this could be worked into the regular tables we have here, unless there is some timing reason why it should come out at a different time of the month.

Mr. WEIDENBAUM. That is certainly a thought. Anything that would help speed up—for example, I have here, unless my mail is particularly poor, what is the latest available issue of Military Prime Contract Awards, which is the most detailed data on Defense orders. My issue is July–September 1966. This is late April 1967.

Chairman PROXMIRE. When did you get this?

Mr. WEIDENBAUM. Unfortunately, it is not dated. I don't have a date on it, but it was issued covering the periods through September 1966.

Chairman PROXMIRE. Also, I think the advantage of having it published here is that it would call attention to the economic implications of this information, and the various people around the country, including the editors and commentators and economists and executives, and Members of Congress who get this, would have it immediately called to their attention, this information which would be of, I think, more significance, because it is related to the other basic information that is right here.

Mr. WEIDENBAUM. It dawns on me, Senator, I should have immediately jumped on the bandwagon and endorsed a recommendation for including the material in the economic indicators, because in 1957, in testimony before this committee, I recommended that data on budget obligations be included as one of the lead indicators in the standard compendia of Federal statistics such as economic indicators, and I forgot my own recommendation.

Chairman PROXMIRE. Very good.

Well, I want to thank you. The staff does want me to ask you one more question. As a professional economist, we asked the gentlemen this morning, how do you react to the administration's lack of preparedness for deescalation? If hostilities ceased tonight, the administration has no contingency plans to put into effect tomorrow morning.

Of course, you have stressed the importance of prompt action in the other way. How about it?

Mr. WEIDENBAUM. First of all, I make a distinction between the economic factors and the political-military factors. I have, of course, no competence in the latter two areas. And there may be political and military reasons that I am not aware of.

Chairman PROXMIRE. No, I don't think so. I think that the President acted to appoint the Ackley committee in his economic message. He said he was going to appoint Chairman Ackley, but Chairman Ackley won't be prepared to report until September. Meanwhile, although our staff has checked with a number of Government agencies, they say they don't have any particular plans to put into effect if there should be negotiations, but when the Ackley committee reports, it will recommend what we should do.

At that point we will have this information. Now we don't have it. It seemed to us that without waiting for the Ackley committee, that it would be possible for them to arrange almost overnight certain proposals that might be sensible for us to prepare to put into effect if we should get a cease-fire.

Mr. WEIDENBAUM. I must say, one, I am concerned about the lack of public availability of any contingency planning.

Secondly, I personally fail to see the reason for the tremendous amount of delay. As you know, I was the first executive secretary of the Ackley committee, the President's Committee on the Economic Impact of Defense and Disarmament, and of course I am aware of the difficulties involved in getting agreement among a wide variety of Federal agencies. But given the six points in the Presidential Economic Report on Post-Vietnam Planning, where the President very clearly, to my pleasant surprise outlines the six key kinds of actions which can be taken to offset the deflationary impact of peace in Vietnam, I think that the implementation of those six points is something that could be done quite quickly.

In my formal paper I presented the key alternative ways of achieving each of those six points, and it strikes me essentially that these are not problems that require a great deal of background research. Certainly, the tremendous amount of work that has been done on the economic impact of disarmament, the 1963, 1964——

Chairman PROXMIRE. The Arms Control Agency testified on that, Mr. Alexander, who is head of that particular part of it. He was before us yesterday.

Mr. WEIDENBAUM. Good, because I think the agency has contributed a great deal to our knowledge of the economic impacts of defense cutbacks, and we can draw on that material already, without awaiting the tedious review of policy details.

In my formal paper I have a table on page 67 where I array what I think are the major alternative specific kinds of actions that the administration can consider in each of the President's six categories.

I just do not understand why this is a matter for 6 months or more of study, because the key aspect of a post-Vietnam adjustment program is the timely, quick, prompt, implementation of actions.

Chairman PROXMIRE. Two of the points that he recommends might take some time and effort. He suggests, No. 4, to determine priorities for the longer range expansion of programs to meet the needs of the American people, both for new and existing programs.

Now conceivably that would take some consultation, not only with the Budget Bureau, but some of the other people who are involved to find out what their priorities were, and what would be feasible to put into effect promptly, and so forth.

Then the other one is to study and evaluate the future direction of Federal financial support to our States and local governments. This is something that might require some consultation with Governors and with other people around the country, as well as the resolution of the problem involved putting the Heller-Peckman proposal into effect, for instance.

Mr. WEIDENBAUM. I think it would be helpful to make a distinction between a one-two punch, so to speak. There is the initial set of actions and there is a followon set of actions.

I think the initial set of actions, the kind of thing that maintains the aggregate demand of the conomy immediately, something that takes hold as soon as the defense contracts are cancelled, as soon as defense workers are laid off, as soon as servicemen are returned as veterans—that initial action is essential to head off any postwar recession.

Chairman PROXMIRE. At the same time, I think that some of this takes some calculation. For instance, the announced program by the Defense Department to phase out slowly our procurement, replenish inventories and build them up over a period of time.

The statistics revealed by the Veterans' Administration, that whereas less than 30 percent of the veterans of World War II went to college under the GI bill, 50 percent of the Korean war veterans did, and 84 percent of the Vietnamese veterans are going on with their education, taking advantage of the GI bill.

This suggests that the manpower adjustment may be a lot easier than we have had before, and that the adjustment can be relatively gradual and relatively gentle.

Mr. WEIDENBAUM. I am glad to hear that. I wasn't aware of that. That would take care of obviously the majority of one part of the problem—that is the returning veterans.

It wouldn't deal with the deflationary impact on the private sector, the defense companies, their employees, the geographic areas where they cluster.

Chairman PROXMIRE. Of course, it also indicates we have to make some plans for getting the available instructional personnel, and so forth, for these veterans coming back. This is going to have an impact on our higher educational institutions, with a flood of veterans, unless you are going to jam them into a great big lecture hall. You are just going to have to have more teachers available.

Mr. WEIDENBAUM. There are many private universities that would welcome these veterans eagerly.

Chairman PROXMIRE. The ones I know, my kids can't get into.

Mr. WEIDENBAUM. I will be glad to send them applications to Washington University.

Chairman PROXMIRE. They will probably end up there. They will be delighted to be there.

Mr. WEIDENBAUM. Fine.

On the question of initial adjustment policies, here we have I think a package of monetary policy which of course is under the jurisdiction essentially of the Federal Reserve Board, but I think a simple, straightforward, across-the-board tax reduction, sort of the reverse of the beautifully simple recommendation in the latest budget message for a tax increase, just change the algebraic sign, that would be an essential part of the first line.

The second of course, would be unemployment compensation. Usually, we wait until a recession and then we liberalize unemployment compensation. It strikes me that this is the kind of thing that can be done before you see the whites of their eyes, so to speak.

Then, of course, we have the second-level category of adjustment actions. Those avowedly require more time. The long-term expansion in Government programs, decisions on whether we should have a tax credit or shared revenues or a Heller-Pechman plan.

However, to the extent that the initial actions, the monetary policy, the tax reductions, the unemployment compensation maintain the overall viability of the economy, maintain the growth of the economy, high levels of employment, income and purchasing power, to that extent we make easier the secondary job of essentially the structural shifts required to adjust to peace in Vietnam, the State aid, the long-term expansions in Government programs.

But while we are deliberately, slowly wrestling with these other areas that take more time, I think the thing that needs to be done immediately is the preparation of the first line of offense, so to speak, and I can't see why that is such a drawn out process.

Chairman PROXMIRE. Thank you very, very much, Dr. Weidenbaum. You have been an excellent witness and I will make sure that the absent members discover what they have missed. They will be interested in the record you have given us, and these constructive suggestions are most helpful. I am sure that we will use them in our report here, and also do our level best to try to get exactly the kind of information you propose, because all of us in Congress are troubled, as I am sure the administration is, at errors that we made economically in 1966.

The New York Times properly called it "the year of the economic goof," because of the fact that we were unprepared for this escalation in military cost, and as a result we had these high interest rates, unacceptable inflation, serious problems that we could have avoided with wiser policies, if we had had the information and acted on it.

Your contribution has been just excellent, and I very much appreciate it. Your report will be included in the record of today's proceedings.

The committee will be in session tomorrow morning in room 4200, at 10 o'clock, to hear Professor Leontief of the Department of Economics at Harvard University; Carl Madden, chief economist of the chamber of commerce; and Nathaniel Goldfinger, director of research of the AFL-CIO.

Thank you very much.

(Whereupon, at 3:05 p.m., the committee adjourned until Thursday, April 27, 1967, at 10 a.m.)

(The report referred to follows:)

IMPACT OF VIETNAM WAR ON AMERICAN ECONOMY

[Background paper prepared by Murray L. Weidenbaum, for panel report. Published by the Center for Strategic Studies, Georgetown University, Washington, D.C., April 1967.]

CONTENTS

PREFACE

This study of the domestic economic impacts of the Vietnam war was prepared in the Spring of 1967. Of necessity, it is an initial exploratory effort limited both by time constraints and the paucity of available data. It can hardly substitute for, but perhaps it will hold the line until the completion of a more leisurely and thorough analysis which the importance of these events surely deserves.

Personally, I have found this a very difficult report to write because several of the key participants in the events analyzed are former colleagues and friends. However, my purpose has been neither to defend their acts nor to attack them, but to illuminate the economic aspects of an important area of government policy. Certainly, given the difficulties of the environment in which they operated, I have encountered neither heroes nor villains of the piece.

M. L. WEIDENBAUM,
Washington University, St. Louis, Mo.

I. INTRODUCTION [1]

This study traces the expansion of the U.S. defense effort resulting from the changing American commitment in South Vietnam, analyzes the impact on the

[1] The author wishes to express his appreciation to his research assistant, Mr. Stephen F. Seninger.

U.S. economy, and examines the resultant questions of domestic economic policy.

Several *key points* emerge from this study: (1) *persisting uncertainty as to the nature and extent of the United States commitment,* (2) *a lack of general understanding of the speed with which a military buildup affects the economy,* (3) *confusion in interpretation and delay in the release of budget information in 1966,* and (4) *resultant basic problems in national economic policy.* The final section of this study deals with the process of economic adjustment to peace in Vietnam.

A. Some historical perspective

Until comparatively recently, expenditures for national security were a minor factor in American economic activity. In the half century prior to 1930, such outlays normally equaled less than one percent of the Gross National Product (GNP), except for the World War I period. From 1931 to 1939, military outlays averaged 1.3 percent of GNP. Since World War II, however, the Cold War and the Korean and Vietnam conflicts have raised security programs to a relatively high level even in the absence of hostilities. Immediately prior to the Vietnam buildup, purchases by the Department of Defense were about 8 percent of the total output of the Nation. The proportion was of course higher during World War II (peak of 48 percent) and the Korean War (peak of 12 percent).

The most recent levels of military demand reflect an extended period of Cold War, interspersed by incidents leading to limited conflicts, such as Korea and Vietnam, and temporary thaws and defense cutbacks, such as in 1957–58 and in 1963–64. An abrupt change in the nature of the external environment—a sudden intensification of war or a cold war thaw—and in this country's reaction to it, might well cause another major shift from the present proportion of resources devoted to security programs. Unlike many other categories of demand for goods and services, the level and composition of national security expenditures are relatively independent of influences in the private economy. Yet, these military demands heavily influenced the private economy.

The impact of defense on the economy depends not only on the level and rate of change of spending. The availability of resources and the state of peoples' expectations affect the timing and extent of the impact on prices, production, and economic growth. Heavy reliance on deficit financing during World War II, in contrast to the emphasis on tax financing during the Korean War, produced different results on consumer income and spending both during and after the war.

Even before the Vietnam buildup, military spending had been dominating the Federal Budget. Such spending accounts for over 85 percent of all Federal Government purchases of goods and services. In real terms (when the dollar figures are adjusted to eliminate changes resulting from inflation) virtually all of the increase in direct Federal purchases of goods and services during the past two decades has been accounted for by defense programs. The aggregate of all other purchases by the Federal Government is at about the same real level as in 1940. The large increases in Federal spending for civilian purposes have been transfer payments and grants, which do not show up in the GNP as Federal purchases of goods and services. Hence, the rise in the Federal share of GNP from 6.2 percent in 1940 to 10.3 percent in 1964 was accounted for almost entirely by military and related security expenditures. On this basis, it can be seen that these security-related expenditures have been the primary factor in the expansion of the Federal Government as a purchaser and consumer of goods and services.[2]

B. The U.S. commitment in Vietnam

An evaluation of the impact of the Vietnam war on the U.S. economy requires first a review of recent developments in South Vietnam itself and of the changing nature of the U.S. involvement. The nature and extent of the American commitment in South Vietnam was continually unfolding during the period 1963–66. This, of course, created fundamental difficulties both in forecasting U.S. military expenditures and in analyzing their impact on the American economy.

It is the essence of present-day limited war for one side to be uncertain of the future actions of the other. However, in the hitherto conventional conflicts such as the role of the United States after Pearl Harbor, there was little uncertainty as to the extent of our own participation in World War II—the maximum effort

---

[2] For a more detailed analysis, see M. L. Weidenbaum, "Defense Expenditures and the Domestic Economy," in Stephen Enke, editor, *Defense Management,* Englewood Cliffs, Prentice-Hall, Inc., 1967, pp. 317–336.