THE OUTLOOK FOR DEFENSE SPENDING—HOW GREAT AN UNCERTAINTY?*

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During the current business forecasting season a hedge that is fast overtaking the privet and the boxwood in popularity is the uncertainty occasioned by the war in Vietnam. This, we are told, makes the economic outlook for 1967 unusually hazardous to forecast. In some of the more tremulous analyses, the forecaster confesses disarmingly that he really has no idea what will happen—but if it does, all bets are off,

In the popular sense of the word "uncertain," this approach has some validity. Conceivable developments in Vietnam range all the way from an abrupt withdrawal of U.S. forces to a thermonuclear war with Communist China and the Soviet Union. Defense spending might, conceivably, drop $10 billion (annual rate) by the end of 1967, or increase $50 billion—with a comparably wide range of implications for the economy.

In a statistical sense, however, the "uncertainty" attached to the outlook for the war and for defense spending is subject to more precise and more useful definition. A forecast of defense spending through the end of 1967 made now does involve somewhat more uncertainty than a forecast of corporate depreciation, consumer expenditures for services, electric power generation, the tides, or California weather in August. But it involves *less* uncertainty—in the sense of probable relative error—than a forecast of auto sales, housing starts, inventory accumulation, the balance of payments, the stock market, or California weather in December.

Specifically, I shall put my view of the outlook for defense spending in these terms: *Defense spending on the Commerce or gross national product basis appears likely to continue increasing at an annual rate of about $1 billion a quarter through next spring, then $1 billion a quarter to the end of 1967. This would mean total defense purchases of goods and services of $65 billion in the calendar year 1967, up from about $58 billion in 1966 and $50 billion in 1965. On the administrative budget basis, I expect defense spending (including atomic energy) to total $66 billion in the 1967 fiscal year, as compared with the $57.7 billion now officially estimated for fiscal 1966 and $60.5 billion estimated for 1967 in last January's budget.*

To attach numerical though highly subjective value to the "uncertainty" surrounding these figures, my current impression is that there is a 70-percent probability—or about a one sigma range—that defense spending in 1967 will fall within $2 billion plus or minus of the estimates on the two bases. Outside this central range, the distribution becomes quite skewed: I would assign only a 5-percent probability to defense expenditures being lower than these estimates by more than $2 billion and the remaining 25 percent to the wide open upper range.

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