NATIONAL DEFENSE AND PROSPERITY*

On July 28, 1965, the President asked the Congress for supplemental funds for defense spending in order to meet the increased requirements of our commitments in southeast Asia. That request opened up a new chapter in the annals of our economy and economic policy; and our history is still being written in that chapter.

The economy moved ahead very rapidly in late 1965 and early 1966, attaining the lowest rates of unemployment and the highest rates of industrial utilization achieved on any sustained basis since the Korean war. The Nation recorded outstanding heights of achievement in output, employment, and real incomes. But we also registered some less welcome new heights in interest rates; and we interrupted a gratifying record of remarkable price stability that had persisted through the first half of the 1960's.

The latest chapter of our economic history is marked by new episodes in the use of economic policy. Our stabilization tools were employed to achieve restraint rather than stimulus of demand. For years, promoting balance in the economy had called for strengthening demand to make it match supply. Suddenly, demand threatened to be too large. Talk and action focused on tax increases rather than tax cuts. Monetary policy occupied the center of the stage more often than ever before.

These developments occurred simultaneously with an important buildup in our defense expenditures and military manpower. None of them was independent of the developments in defense. But the interrelationships are not simple. The connections between the developments in defense and the record of our economy in this Vietnam chapter deserve careful inspection to throw light on our recent progress and problems. Such an understanding is also vital in appraising the challenges that lie ahead—in the short run, sustaining steady growth and stability during the period of active hostilities; and, over the longer term, maintaining high employment in a peacetime environment.

Prior to the Defense Buildup

In considering the economic impact of the recent defense buildup, we might remind ourselves how well we were doing when it first began. As of mid-1965, we had enjoyed an uninterrupted economic advance for 52 months, the longest peacetime expansion in our history. Our real GNP had expanded by about one-fourth in that period, considerably faster than the growth of the economy's supply capabilities. We were able to catch up as well as keep up with our growing capacity.

The unwanted reserves of idle men and machines gradually were brought into productive use. Unemployment, which had amounted to more than 7 percent of the civilian labor force in May 1961, was down to 4½ percent. The average operating rate of our industrial

*Remarks by Arthur P. Okun, Member, Council of Economic Advisers, before the American Ordnance Association, Fort Lesley J. McNair, Washington, D.C., Oct. 12, 1966.