

market economy rather than by Government policy. Priority systems for defense materials were, of course, important. But basically, it was the American enterprise system that met the needs of defense so magnificently. In our economic system, manpower, machines, and materials move where they are needed in response to market incentives. The economy takes major shifts in stride. It absorbed a one-third decline in housing starts in a 5-month period without creating pockets of unemployment. It generated a one-third increase—amounting to \$20 billion—in the capital goods sector in the last 2 years before the strains really began to tell. It should not be surprising that the economy adapted to the defense buildup so well.

The recent experience reflects a number of factors: the strong military position we had when the Vietnam emergency began, our use of economic policy tools, and the great size and productive capacity of our national economy. Unlike World War II or Korea, the Vietnam emergency did not require a major reshaping of America's global military strategy. Ever since the Korean war, we have maintained high levels of defense expenditures, continuously rolling over our stock of defense weapons to take advantage of the latest technology and to maintain an up-to-date arsenal. Instead of spending 5 percent of our GNP on defense as we did in 1949 and 1950, we maintained expenditures of 9 or 10 percent of our GNP on defense from 1954 through 1962. These were investments made in readiness for the contingencies that have since turned so regrettably into reality. As a result, the Vietnam conflict found us well prepared and required a relatively small buildup in total military procurement. At 8 percent of GNP, defense purchases in 1966 constitute a smaller fraction of our national output than in any year between 1954 and 1963.

In World War II, because defense expenditures ran 30 to 40 percent of GNP and absorbed such an overwhelming fraction of certain key industrial outputs, it was judged unfeasible to regulate demand entirely through fiscal and monetary policies. Huge budget deficits were tolerated, and they were financed in ways that added mightily to national liquidity. In light of this policy strategy, it was necessary to contain inflation by direct wage and price controls. In the case of Korea, the onset of the conflict was met by the American public with a wave of war hysteria and an outburst of speculation and hoarding. That initial destabilizing buying spree was the key justification for adopting direct wage and price controls.

The huge defects in both the World War II and Korean systems of direct controls were not basically the result of poor planning or inept administration. They were intrinsic to any set of mandatory regulations that enmesh the market in a web of redtape. Inevitably, such a system will often keep price tags stable only through bare shelves and low quality products. On any reasonable assessment, or even a reasonably pessimistic assessment, of the outlook for the Vietnam conflict, there is no earthly reason why we should want to or need to travel that route again.

NORMAL PROBLEMS OF PROSPERITY

Let me emphasize that I am not claiming that the task of managing economic policy in this Vietnam chapter of our history is, in any sense, easy. What I am saying is that the hard challenges that we face are