At times of high employment and near-capacity levels of output, a resource transfer from civilian use to military use is normally effected by either tax increases or a system of Government controls. Neither route was followed with respect to the Vietnam build-up in late 1965 and 1966. Instead, the price mechanism was utilized to effect the resource transfer, i.e., the Federal Government bid away goods and services from civilian use for the war effort.

Selected expenditures as a percent of GNP

Quarter	National defense	Consumer durable goods	Residential structures
1964:			
1	8.1	9.3	4.6
2	8.2	9.5	4.4
3	7.8	9.6	4.3
4	7.5	9.1	4.1
1965:			
1	7.3	9.9	4.2
2	7.3	9.6	4.2
3	7.4	9.7	4.0
4	7.5	9.7	3.9
1966:			
1	7.6	9.7	4.0
2	7.8	9.2	3.8
3	8.3	9.4	3.3
4	8.6	9.2	2.9

Source: U.S. Department of Commerce.

Overall price increases thus operated as a silent tax in the absence of more restrictive fiscal or monetary actions. The growth of real after-tax personal income slowed as prices rose faster relative to money incomes than previously. Associated with the slowdown in the growth of real spendable income was a decline in real demand for civilian goods, in particular for automobiles and housing.

In response to excessive dollar demand for goods and services, and thereby for loan funds, and to some extent to restriction on monetary expansion beginning in the spring of 1966, interest rates rose. This increase in the price of credit helped to effect the transfer of resources by discouraging demand for those goods where capital and interest are important elements of total cost, e.g., housing and commercial and industrial buildings.

The resultant rise in interest rates affected housing more than if the resource transfer had been effected by taxes. Housing probably would have been affected if incomes had been reduced by tax increases, but the extent would probably have been less. Interest rates would not have risen so rapidly, and the cost of new housing services would not have increased as much if a more restrictive course of fiscal action had been followed.

Any transfer of resources in a high-employment economy involves a cost, and some groups gain at the expense of others. However, transfer by tax increases permits the effects to be planned and regulated while maintaining the advantages of free markets. The price inflation mechanism causes inequities that are often unpredictable