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Economic Impacts of the Vietnam War: A Primer

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This report does not deal with the war itself, its immorality, its dangers of expanded world conflict, or even its constitutionality. We are concerned with the structural changes and impacts on our own economy and on the realities with which planners deal daily. In particular, we briefly examine the direct impacts of the war on individuals, its cost in social programs foregone, its role in the paradoxical squeeze of inflation and unemployment, its diversion of national resources and energies, and its relative economic irreversibility, resulting from the structural changes produced by warping the productive system. We do not treat its impact on dividing the nation politically, on alienating American youth, and on distorting the political process.

The War and the Planning Profession

The political positions taken by the American planning profession are limited, for the most part, to lobbying for planning laws, programs, and appropriations which are self-serving. The American Institute of Planners, as the representative of a large proportion of these planners, has eschewed partisan political stands, even though the Democratic Party has privately been considered by many planners to be more favorable than its rival to "pro-planning" programs. Ideologically, many planners are probably faintly "New Deal-ish," and the planning movement was given a hefty boost in that era. On the question of the war economy, if not on that of war and peace, planners may be more ambivalent or divided than on that of the domestic programs. For one thing, the Democratic Party, including its New Deal wing, has not been notorious for escaping military commitments. For another, the defense establishment has engendered a certain amount of planning—from the intellectual exercises of Project Lincoln to Rand Corporation, and from air raid shelter to urban decentralization programs. For these reasons, along with the general urgency of the present Indochina situation, we feel that it is important to examine, as fully as this space allows, the impact of our present war economy on the domestic scene.

Direct Costs of the War

Over the last three years, the war in Indochina has cost the U.S. about $30 billion a year, above and beyond the normal cost of maintaining our national defense. At the rate of $26 billion per year this comes to half a billion dollars a week, $71 million per day, or $3 million an hour, twenty-four hours a day, seven days a week. Yet this underestimates the *direct* cost of the war to the United States alone. If it were possible to add up all the *indirect* costs (where we *could* be in terms of private production, personal welfare, social betterment), non-priceable costs (loss of lives, social unrest, governmental conflicts, and loss of world esteem) and costs to the rest of the world (the destruction of Indochina, disruption of trade, expansion of military costs in other countries), these costs would make our direct expenses appear insignificant.

Direct costs can be estimated and compared with other types of dollar measurements, such as Gross National Product. (Defense gets about 10 percent of GNP, and from one-third to one-half of that goes for Indochina.) Cost may also be allocated by who pays (the average taxpayer contributes about $600 per year toward defense). Translated into dollar equivalent alternatives, three weeks of the war would cover the entire Model Cities program budgeted for 1967–68 and, at the same time, cover the construction costs for the Bay Area Rapid Transit system in the San Francisco region.

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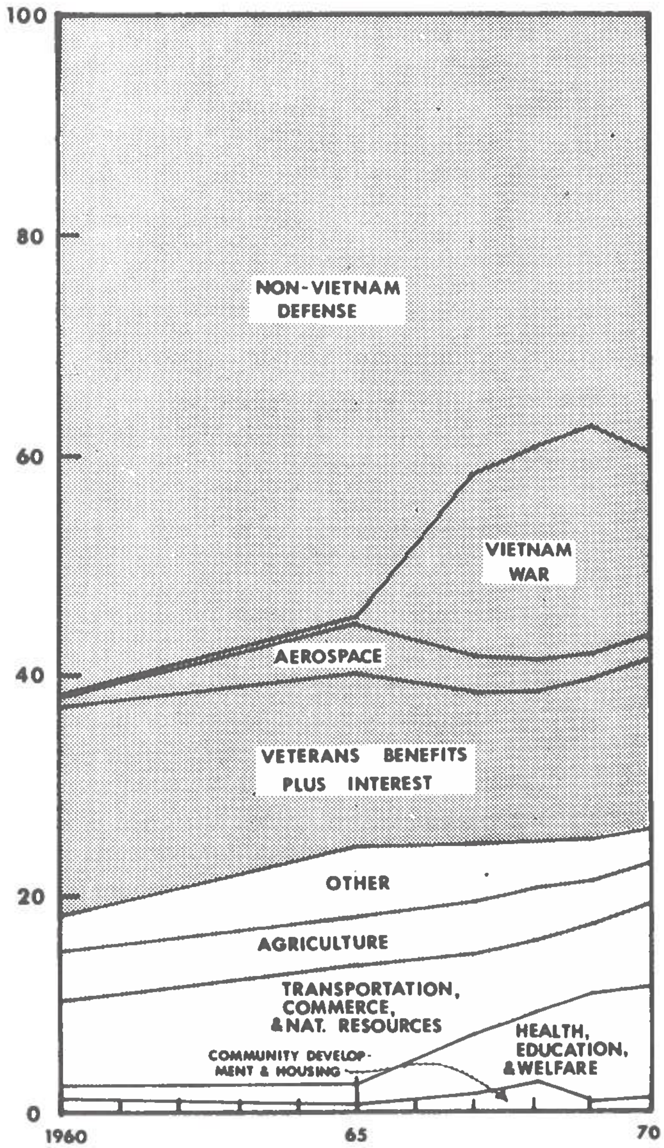
Indirect effects can be documented as well. Unemployment has turned sharply upwards in the last year, after eight years of steady decline, largely as a by-product of efforts to curb the inflation caused by the war. The war taxes the consumer by restricting potential consumption output and raising prices. If 4 percent of the current 7 percent annual inflation rate is attributed to the war, that is equivalent to increasing personal income taxes by 30 percent. Opportunity costs can be inferred from consideration of alternative uses of these resources, but this is mere speculation, for the performance of our society without war is a matter for conjecture. Having mentioned the non-price costs we must put them aside. This does not imply that these costs are less important than the measurable costs, or the cause of less concern. In fact, direct and indirect costs that are verifiable are themselves sufficient reasons to question the wisdom of the war. Economics in this case are on the side of ethics and humanitarianism.

Inflation and Unemployment

The single most dramatic economic impact of the war has been its striking inflationary push, accompanied by its counterpart, demand-pull. The sources of this runaway inflation, which in the past months has been "flattening-out" at a rate of about 6 to 7 percent per year, are discussed here.

Cost-Push A conception of inflationary origins that has been accorded a high place by recent administrations is one that has prices rising as a result of price increases in basic factors of production, particularly labor. In this reasoning, automobiles become more costly because of higher costs for steel, which in turn are due to higher wages for steelworkers. Autoworkers then get on the bandwagon and demand higher wages, accelerating the effect, and passing the increase to the consumer. Hence, the cries for "restraint" and "wage guidelines."

Since real wages (dollar wages corrected for price levels) decline in inflationary periods, workers will make claims for higher wages to maintain purchasing power. (In certain industries, wage levels are tied to cost-of-living contracts, making the push "automatic.") This makes the separation of cause and effect difficult, because neither inflation nor wages will sit still very long while the other increases. Responsibility for setting off the chain is difficult to determine and would require extended observations to show that one effect fol-



Manifest national priorities are revealed by comparing expenditures for different purposes in the federal budget. (Trust funds such as social security are included in the federal budget even though they are independent of it; these funds have been removed from the data presented here.) Defense alone accounts for a full 55 to 60 percent of the budget, and to a large extent the war has been taken out of the defense budget rather than added on. If aerospace, veterans benefits, and interest on the national debt are added to the defense budget, the military-aerospace portion of the federal budget absorbs almost 80 percent—veterans benefits and interest on the national debt are primarily a result of past and present wars.

The remaining 20 percent is then available for all other national programs, including physical resources, human resources, and the general operation of the government. Agricultural subsidies eat up almost twice as much as the entire HUD budget. Transportation, commerce, and resources include national parks and recreation, highway and transit programs, the postal service, business loans, regional development, and the business regulatory functions. Health, education, and welfare includes manpower training, various aids to education, science, and other research. Community development includes model cities, urban renewal, community planning, housing, and rehabilitation and mortgage programs.

Source: Statistical Abstract of the United States, 1969 *(Dept. of Commerce: 1969).*

lowed the other cause, with appropriate lag. In fact, the causality may be less important than the result. In the aggregate, wages have not kept pace with inflation. These and other data suggest that, since the Second World War, inflation in the U.S. has had a very small cost-push component, though the size of the push is difficult to estimate.

Demand-Pull The alternative to cost-push as an explanation of inflation is demand-pull, but this concept subsumes several variations. Too many dollars chasing too few goods is the immediate cause of inflation, with the possibility of an over-supply of money, insufficient investment in productive capacity, or immobility of factors being underlying causes.

Current inflation can be attributed to all three of these influences, but in reverse order. Monetary theorists such as Milton Friedman emphasize the importance of the money supply, but they would not deny the importance of the other variables. There is some evidence that the money supply has not played a major role in this inflation, largely due to Federal Reserve policies in 1969–70. That supply, as measured by demand deposits and currency and including the flow of "Eurodollars," has been increasing at a substantially declining rate since 1968 (from 6 percent per annum to about 3.5 percent per annum in early 1970), without appreciably affecting the rate of inflation. But a consequence of the efforts to curb inflation by controlling the money supply has been high interest rates, which in turn have severely affected sectors such as housing.

Insufficient investment, in a general way, is a major cause of the inflation. Growth in real Gross National Product (in constant dollars) was approximately 4 to 5 percent per year during the sixties. Measured in current dollars this same growth was about 10 percent annually, which means that over half the measured growth was due solely to price increases. When growth in disposable income is not matched by increases in productive output, unless difference is saved, inflation results. The federal government contributed to this inflation in two major ways: (1) personal and corporate taxes were not high enough to siphon off the excess of income over output while at the same time (2) the government was stimulating, directly and indirectly, investment in military and aerospace goods and services that could not be purchased by private consumers. In effect, tax dollars have been competing with private consumption dollars for the same scarce resources, thus bidding up the prices of those resources.

Underinvestment also hit the supply of labor. The shift of labor into military production maintains the disposable income of those workers shifted, but cuts the production of consumer goods which can be bought with that income. The fact that war expenditures were piled on relatively full employment insured that this result would occur, and government's bidding for skilled labor worsened the effect. The $9,000 engineer in the private sector hired by a defense industry for $11,000 has an increase in usable dollars at the same time that his contribution to the "consumables" economy is reduced to zero.

Even if aggregate demand were equal to aggregate supply, heavy emphasis on a limited number of industries utilizing specialized resources could cause short-run inflation. For instance, to the extent that it is difficult to shift commercial shipbuilding men and equipment into production of warships, Navy ships must be built with high-cost and relatively scarce production factors.

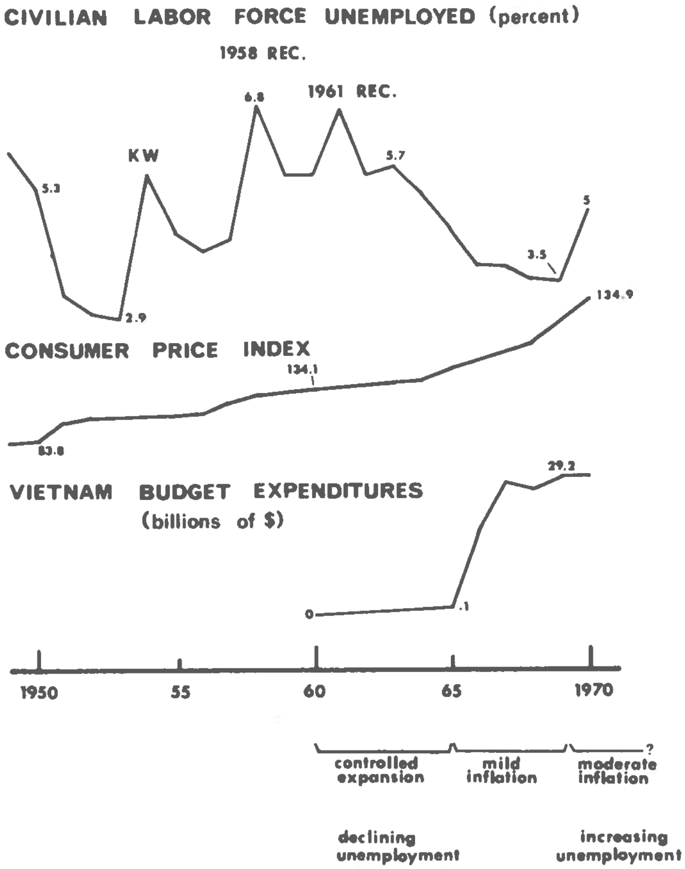
Whatever these effects, the economy is so interconnected that inflation is transmitted from sector to sector despite immobilities in resources. These structural effects have sometimes been neglected by the conservative neo-Keynesians, a fact that may explain Lyndon Johnson's insistence that we could have unlimited guns without sacrifice of butter.

Use of Correctives

To blunt the inflationary pressure, the government has tried or considered a number of steps. None of these has been fully effective, and some have had undesirable side-effects. Three of the main instruments of economic management are: fiscal policy; monetary policy; and wage and price controls.

Fiscal Policy Since the early 1960's, the federal government has accepted the fact that it has the responsibility for maintaining national economic stability. Growth, controlled inflation, and the gradual reduction of unemployment have replaced the balanced budget as the neo-Keynesian federal fiscal policy (though President Nixon seems to have revived the budget issue). The mechanisms employed are taxation and expenditure by the federal government; taxation dampens inflation while expenditures stimulate a sluggish economy. Other things being equal, a deficit budget is inflationary or expansionary while a surplus will have a contracting effect. From this standpoint, the appropriate policy in a demand-pull inflation is to increase personal and corporate income taxes, while encouraging investment to expand industrial capacity.

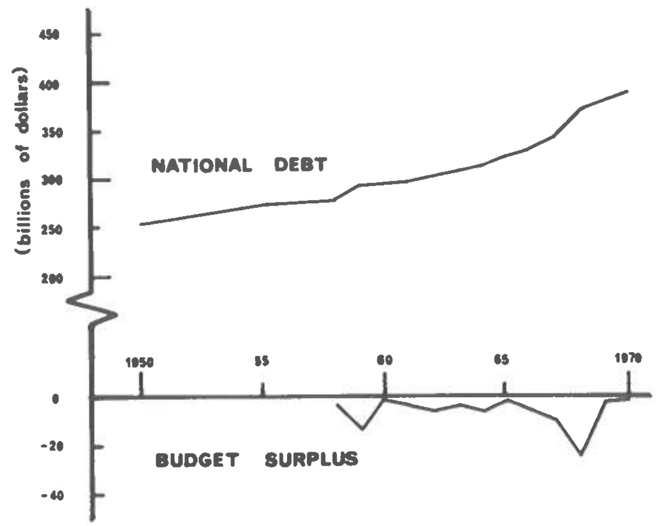
Current fiscal policy has done the opposite. Federal budgets have been running in the red, investment in consumption has been stifled, and invest-



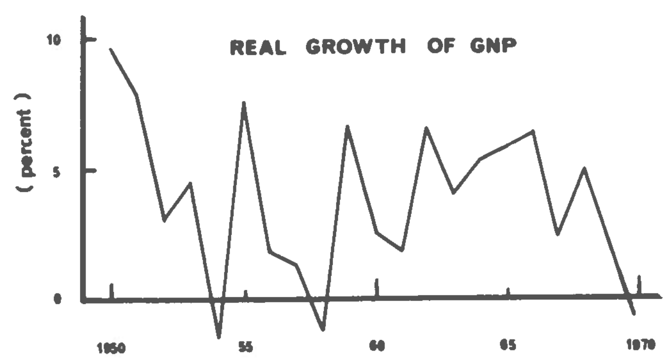
The unemployment rate series begins in a recession following the post-war inflation, dropping rapidly during the Korean War (KW). With the termination of the Korean War, the government immediately stopped a major portion of defense outlays without either offsetting expenditures or tax cuts, resulting in a deflationary (surplus) budget and a sharp recession. Two other recessions have occurred since, one in 1958 and one in 1961. Since the last of these, we have enjoyed a period of declining unemployment, controlled expansion, and general stability. This was reversed in 1968 so that unemployment has risen back to the 5 percent level, from the 1968 post-war low of 3.5 percent.

Inflation is indicated by the consumer price index, which gives the relative price of a representative bundle of goods and services based on an arbitrary starting year. The index moved gradually upward through the fifties, occasionally responding to one of the recessions (consumer spending is not strongly influenced by mild recessions due to built-in stabilizing mechanisms such as transfer payments, including welfare), at a rate of about 2 percent a year. This rate continued until 1965, when it accelerated. At present, inflation has reached an annual rate of about 7 percent a year.

Expenditures for the Vietnam War began around 1960, but the major escalations in the war have occurred since 1965. Since 1967, outlays for the war alone have approached $30 billion annually. (The exact amount is not available; government figures may understate the true amount by as much as $10 billion, since they exclude such items as the CIA, which employs over 15,000 persons, and military aid.) War expenditures alone would not cause the current inflation if it were not for the fact that the government has chosen to finance the war with borrowed monies, rather than through increased taxation. This can be seen in the federal budget deficit, which remained close to zero through 1965, but which had grown to $25 billion by 1968. In that year, the deficit was approximately equal to the direct expenditures in Vietnam.



Major increases in the national debt normally occur during wartime, with the debt remaining stable in peacetime. The expansion of the 1960's contributed gradually to the national debt, but achieved stability, full employment, and economic growth without inflation. Since 1967, the rate of increase in the debt has accelerated while at the same time the desirable features of the previous expansion have been lost. The real rate of growth (correcting for inflation) of GNP—quite volatile up until 1960—was maintained at over 5 percent for most of the decade but has recently declined to less than zero.



ment funds have been diverted to non-market war industries. The failure of the government to increase taxes sufficiently to control inflation is a result of (a) the unwillingness of both Congress and the Administration to pass on the real costs of the war to the taxpayer for fear of his reaction, and (b) the difficulty of planning a budget when the future costs of the war are unknown, either because of unforeseen events or Department of Defense dissembling. Instead, the cost of the war is passed on through inflation, and the taxpayer is deluded into thinking that the inflation is caused by greedy workers or expensive social programs.

Monetary Policy The Nixon Administration has chosen to rely more heavily, thus far, on restraining the money supply and raising interest rates. This limits the amount of money created through credit and reduces the demand for investment goods. The policy is deflationary in the short run but dampens output in the productive domestic sectors resulting in a growing deficit in needed production of housing and non-defense plants and equipment. Investment in defense industries is maintained—despite tight credit and inflation—by government demand. The attractiveness of this monetary policy to the administration is enhanced by the fact that it shores the government debt and balance-of-payments position by attracting short-term credit from outside the country while avoiding tax increases. But, since this money must be repaid shortly at inflated interest rates, it is a costly way of buying time.

Wage and Price Controls Arthur Burns, Chairman of the Federal Reserve Board, has recently hinted at direct control of wages and prices, reinforcing the impression that the inflation is of the cost-push type. Only a complete set of wartime controls would be adequate to contain present inflation, and if controls are to be effective, they must be accompanied by rationing. The result is a high level of forced savings of the World War II type. After that war, savings were quickly dissipated by inflation; the savers paid double. Partial wage and price controls would exacerbate the inequities produced by the war. While Burns' suggestion was probably a feeler, or propaganda, in view of the Administration response, the possibility remains that controls could be used to suppress the symptoms of disequilibrium induced by the war economy.

Consequences of Inflation

Inflation is not necessary, even in wartime. Indirect monetary and fiscal policy instruments are capable of keeping inflation within reasonable bounds—around 3 percent a year. Our current crisis is due to the political and mechanical difficulties in applying the correct policies and to the extreme strain placed on the economy by the war effort. The traditional trade-off between inflation and employment—so that price stability is reached at high levels of unemployment—has not occurred. Rising unemployment in the past year has not dampened inflation, and the coincidence of accelerating unemployment and inflation is remarkable evidence of the structural imbalances in the economy.

If all prices and wages rise or fall proportionately, distribution effects are minimal, and the result is merely a change in scale of the economy. In practice, inflation is never so neutral. Persons on fixed incomes, such as pensioners and welfare recipients, suffer declining real incomes while owners of wealth or fluid assets keep pace with prices. High interest rates and inflation together favor the well-endowed. The resulting redistribution favors the rich at the expense of the poor, worsening income distribution. The rich increase their holdings, the middle classes run faster on the treadmill, and the poor experience hardship. And where money incomes rise with inflation, keeping real income constant, a further tax on consumers results from the fact that taxes are related to *money* incomes.

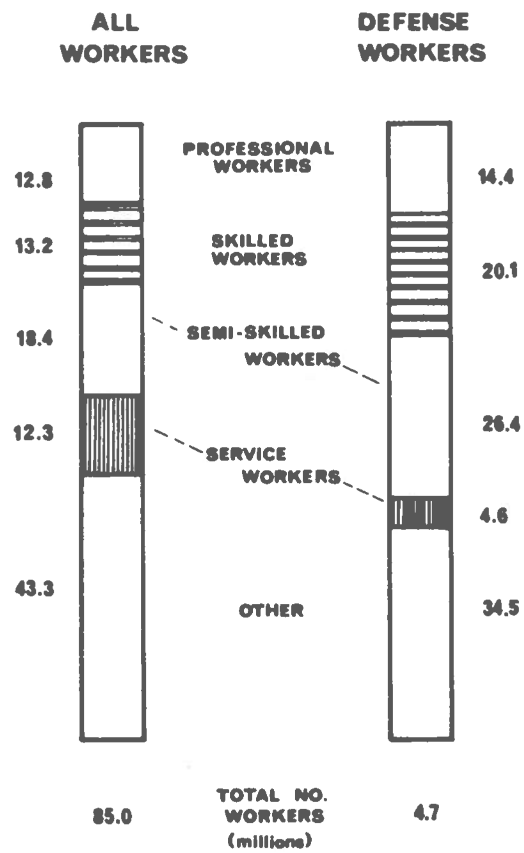
Even if domestic inflation were perfectly distributed so that its effects were completely neutral, its international effects would be serious. Unless all other countries are experiencing the same, or higher, rates of inflation, exchange rates between the U.S. and other countries must be adjusted by devaluing the dollar. For most countries this is not a serious problem, but for large nations whose stability is essential for world trade, the hint of devaluation causes international trade crises. Strong pressures now exist on the dollar, both from our balance of payments deficit and from declining confidence in the American economy.

Unemployment

It is widely believed, especially by certain trade union leaders, that defense spending creates jobs. This notion should be subjected to close scrutiny. Growth of defense industries has had an important impact on the distribution of skill levels among the employed and on the regional redistribution of jobs. When these factors are taken together, it can be shown that military spending has had perverse effects on certain aspects of employment.

During the Second World War, defense production served to stimulate the economy and create jobs. (The arms boom did more in this respect than the New Deal programs.) At that time there were many idle resources and much unused capacity after a decade of depression. War spending drew these resources into production and the unemployed and underemployed into productive jobs. But the present war spending splurge took off from relatively full employment in an economy operating close to capacity. The result was inflation rather than growth. Defense industries had to hire persons who were already employed in productive jobs, and they mobilized capital that would otherwise have gone into production for the private market. Moreover, these employees were often working at high skill levels; defense industries use proportionately fewer unskilled than the private sector as a whole and are less likely to hire from the ranks of the unemployed.

Regional redistribution resulting from defense contract patterns creates residual problems. Cali-



The distribution of skills in defense employment versus non-defense employment has some subtle but revealing implications about the structure of the economy. Professionals appear in only slightly higher proportions in defense firms but are probably higher paid than their non-defense counterparts. Skilled workers and semi-skilled workers are much more heavily represented in defense work (46.5 percent versus 31.6 percent for the two combined) at the expense of service workers—the relatively low-skilled. (This effect would probably be even more pronounced if laborers could be separated from farm workers, who would not be expected to participate strongly in defense production.) Thus the jobs that defense "creates" are in skilled occupations where labor is scarce. The new jobs are not for the poor, and, in fact, their jobs are sacrificed. This effect may also help to explain why a large proportion of the working middle class believes that the war has helped them and the economy.

Lack of demand for unskilled workers has been partially offset by the war itself, which has used some 700,000 new men to do the fighting, mostly men in the eighteen to twenty-three age bracket. Since the armed forces selected the best of the group (almost 50 percent were rejected on physical or mental grounds), much of the competition was removed from the low-skill job market. The war has had the effect, on the one hand, of structuring the private market to offer fewer jobs to the young and the poor, and on the other, postponed the time when the deeper problems must be faced.

fornia and Texas are the heaviest recipients of defense contracts, and consequently of employment migration. (The Los Angeles-Long Beach SMSA, for example, has 17.6 percent of all mathematicians and 14.7 percent of the physicists in the National Register of Scientific and Technical Personnel, and three California SMSAs have 28.8 percent of the astronomers, 25.4 percent of the mathematicians, and 24.8 percent of the physicists in that register.) California has recently been feeling the pangs of cutbacks in aerospace which employs many of these high-level technicians. The largest defense contractor, Lockheed Corporation, is in danger of heavy cutbacks due to cash-flow problems. The costs of this overconcentration are felt not only by the regions left out of the contracting and losing by migration, but also by the recipients, who are dangerously vulnerable to changing conditions. As the economy grows and changes, it is likely that some regions will prosper and others will decline, but there is need to ease the transitions, rather than exacerbate them.

Balance of Payments Effects

For the last two decades the U.S. has had a minor but nagging deficit in its aggregated balance of payments: more money left the country than came in. Like many macroeconomic indicators (including GNP), there are some conceptual problems in measuring the balance of payments, and there is more than one operational definition. There are also questions as to how the measure is to be interpreted, since it summarizes a lot of diverse information. However, there is no doubt about the central fact: we have consistently run at a deficit for a long period of time.

No one questions the undesirability of indefinitely operating at a deficit, since the situation is analogous to an individual who spends more than he earns. Eventually his savings are used up or his credit is terminated. The international implications of these consequences—using up our gold reserves and devaluing the dollar—are perhaps relatively more catastrophic for the nation than they are for the individual. Apologists for the balance of payments deficit claim that the reasons for the imbalance are essentially short-run and will correct themselves or can be corrected by measures short of devaluation. Some of these reasons are: (a) our trade balance is favorable and the deficit is caused by foreign aid; (b) the deficit is caused by U.S. investment in foreign countries, which is helping them and will eventually return us a surplus; and

TABLE 1 *Balance of Payments, 1963 ($ billions)*

	Payments	Receipts	Balance
Current account	29.787	27.007	−2.780
Capital account	5.278	5.398	.120
Total	35.065	32.405	−2.660

Source: *U.S. Balance of Payments* (Washington, D.C.: Dept. of Commerce, 1964).

(c) the strength of the dollar is dependent on confidence in our economy, not on how much gold we have. These arguments are, at best, misleading. Our economic relationships with the rest of the world are in critical condition, and our defense expenditures enter into the imbalance in many ways, both directly and indirectly.

Further discussion will be under two headings, which break the components of the balance of payments into current account transactions and capital account. Current transactions involve imports and exports, foreign aid, military expenditures, and other items that are more or less in the nature of consumption, and hence are not cumulative (they do not augment a stock or increase wealth); capital account transactions include private investment, credit, money, and gold. This breakdown is less common in the balance of payments field, but the items within each category are so interrelated that not much can be gained by considering each one independently.

CURRENT ACCOUNT

Until recently it was true that the U.S. exported more goods and services than it imported, but this was largely an accounting fiction. If merchandise only is considered, excluding military goods, the balance is approximately zero. But this includes a substantial volume of exports that is the result of foreign aid, since 80 percent of foreign aid is tied to American exports. How much of this would have occurred without the ties or without the aid is open to debate, but it would certainly be much less. Thus, if foreign aid is included in the balance, it is negative and has been so for some time. Add in transportation, military expenditures, and travel—all of which earn deficits—and the balance on current account for 1963 is $2.780 billion, payments over receipts. Our position since then has continued to weaken.

Bombs are produced in the U.S., are purchased by the government, and are neither exports nor imports. They are a form of domestic consumption that we choose to consume by exploding them (reasonably enough) in some other country, and they are not entered into the balance of payments. Military expenditures abroad are of three types: (1) money spent by military and civilian personnel working overseas; (2) purchases by the military of foreign supplies and equipment; and (3) purchases by the military of foreign utilities, transportation, and other services. The sum of these expenditures ($2.88 billion in 1963) is enough to completely offset the current account deficit, but would mean no bases or military personnel abroad and would probably reduce our exports (both supplies and military goods) in addition.

It is interesting to note that these expenditures have already been heavily adjusted to minimize their payments effects. Military personnel and their families are encouraged to buy (imported) American products and are often provided with subsidized goods (the military buys and sells them at a loss). In military procurement, if the cost of U.S. goods and services is less than 50 percent more than equivalent local products, U.S. goods are purchased. Deals are made with some of our allies to sell them U.S. military goods and services equal to or in some proportion of our expenditures in their country. The result is that the cost of maintaining a foreign military extension is much higher than it needs to be, simply to reduce the negative balance of payments effect.

Other components of the current account are also interesting. Transportation services, while only 4 percent of GNP, contribute almost 11 percent of our payments deficit, making it a relatively big loser. It is also symptomatic of much of the payments problem. We took a $422 million loss on air and ship passenger fares, which means Americans travelled heavily on foreign lines. In the case of ships, we rarely either make or run them, and in the case of planes we support our aircraft industry by selling sophisticated planes to foreign countries who desire glamorous airlines. Freight charges and charter fees, plus other payments, added $389 million to the deficit, largely because of our limited shipping capability. The American shipbuilding industry does not exist in the world market for two reasons: (1) the majority of its resources, including research and development, are employed by the navy, which builds very high cost ships; and (2) the federal government will pay up to 33 percent of the price of a ship in order to keep the industry commercially competitive. The effect of this subsidy, however, is to keep the industry from having to make the necessary technological advances to be competitive. While Japanese ships dominate the world market, American shipbuilders ask for higher subsidies.

The transportation deficit is partly offset by expenditures on port services, which produced a surplus of $505 million. A final important component in the current account is travel—essentially tourism—which loses us $1.13 billion a year. Encouraging both Americans and foreigners to travel in the U.S. and restricting travel and expenditures abroad only partially offset the basic difficulty—U.S. prices are high for foreigners and foreign prices are cheap for Americans. Inflation, of course, makes the situation worse.

CAPITAL ACCOUNT

Many opportunities for investment exist in foreign countries, and U.S. capital has been generally eager to take advantage of them. These investments are, in general, justifiable transfers of the location of capital to improve its efficiency and can cause a slight payments deficit only in the short run. The present situation is not so simple. Over the last two decades, American capital has chosen to leave the country and seek higher and easier returns rather than develop new techniques for improving American labor productivity, and this process has been aided by the government's use of political devices to enhance private economic objectives abroad. This has led to a market distortion that has often earned the label of exploitation or economic imperialism. A good case can be made for saying that in Latin America we have taken out more than we have put in.

More recent domestic policies have aggravated this problem. Instead of applying higher taxes to pay for the war (the appropriate policy), the government has tried to cool the economy through tighter money and higher interest rates. This has the effect of throttling domestic private investment, particularly in consumer goods and construction, while attracting foreign short-term capital, for instance, loans. These loans are taken mostly by the government, representing a borrowing to pay for the war, and the loans must be paid off fairly quickly at high interest rates—hence a request to raise the debt ceiling. The influx of short-term capital temporarily offsets, to some extent, the balance of payments deficit, but will make it worse in the long run.

As inflation progresses, our balance of payments position worsens and confidence in the dollar and this country's ability to correct its mistakes is reduced. This means even higher interest rates since any kind of investment becomes more risky under these conditions. American long-term capital will increasingly go abroad, and the trade balance will deteriorate even further. A run on our gold reserves would produce an international monetary crisis, making devaluation both inevitable and extremely costly in terms of speculation and stability in the entire free world. Strenuous efforts will soon be required to keep the situation under control.

The balance of payments problem is less important in itself than as a symptom of the structural changes in our economy brought about by the war. Our failure to keep pace, technologically, in such industries as typewriters, sewing machines, machine tools, and rail transportation means that domestic labor productivity is low and capital investment lagging. When and if the U.S. returns to a peacetime economy, the structural problems, including their important counterpart unemployment, will emerge as a painful assignment. The major symbol of these structural shifts, which have been taking place over two decades, is the emergence of the "military-industrial complex" which President Eisenhower saw as imminent.

The Military-Industrial Complex

The elitist view that a handful of very powerful men make all the important decisions in the private and public economies (and that these men are not elected) is probably not true in the narrow sense, but a good deal of evidence supports the contention that power and wealth are heavily concentrated in this country. It is not necessary to subscribe to this argument, however, to acknowledge the existence of a group of firms and government agencies that behave in an observably consistent fashion. Whether the cause is interlocking directorates, personal relationships, common values, the institutional framework in which they all operate, or some other structural characteristics of our economic system is not of immediate consequence in establishing the existence of a military-industrial complex.

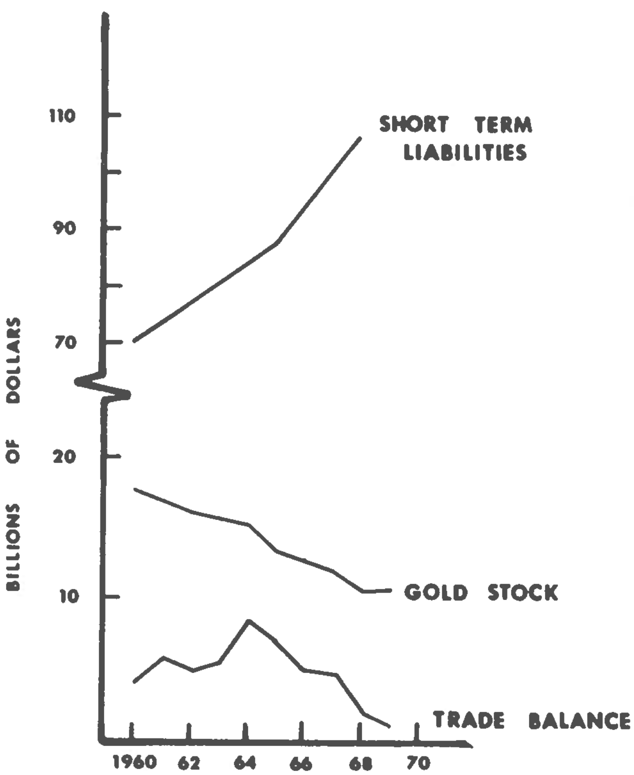
Unfortunately, a number of simplistic notions (such as world exploitation and corporate war profiteering) have served to obscure what is a complex and little understood set of relationships. We present here the issues of excess profits on the part of defense contractors, impacts of defense spending on private research and development, and an emerging form of socialism (referred to as "state capitalism") which characterizes part of the defense industry, without developing or evaluating the arguments in a very thorough manner.

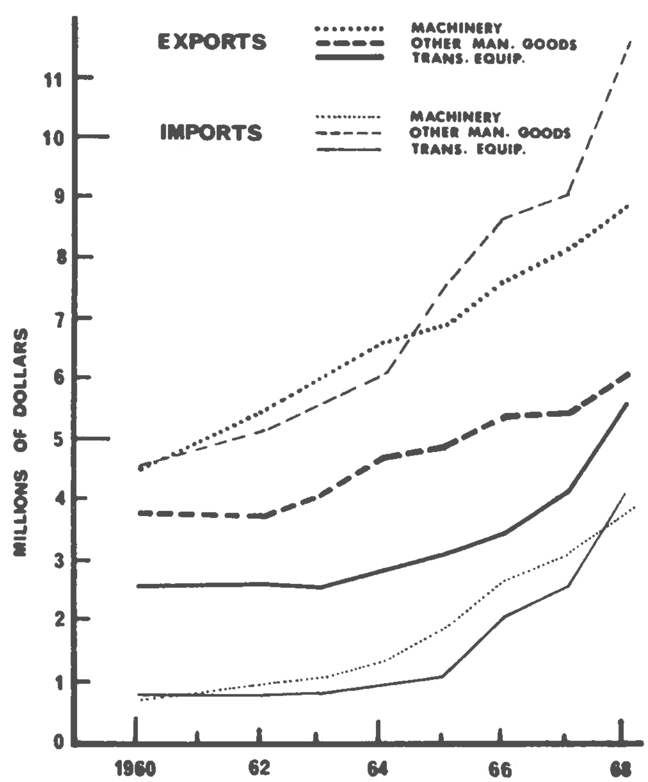
WAR PROFITEERING

Looked at in terms of earnings per share of stock, the largest defense contractors do not stand out as strong performers. Many have clearly had difficulties, and those that have done well seem to have relied more heavily on non-defense markets. Douglas Aircraft was acquired by McDonnell; Lockheed and General Dynamics have had cost overruns and faulty products; General Electric has recently sold its computer business, just when it was returning a profit, in order to obtain working capital; United Aircraft and Raytheon have maintained their profits primarily through diversification into non-defense lines. Whether the second-rank defense contractors or the welter of minor contractors and subcontractors have profitted unduly is hard to say in the aggregate, but it is clear that receiving defense contracts does not automatically mean enormous profits.

A number of explanations can be offered. First is the lumpiness and riskiness of defense work, aggravated by the government's overt and covert reinforcement of the impression that the war has been almost over for the past five years. Firms never get tooled up to the appropriate scale of production, since additional fixed capital requires time to amortize and this is not worthwhile in the short run. Aerospace and weapons system research firms may have done much better in this respect, since the expenditures have been fairly steady over some period of time. Many firms, however, have been forced into uneconomic production schedules (requiring overtime and overuse of facilities) by the war's demands.

Second, some firms appear healthier, measured by return on investment, but this is due to the fact that these firms are using government capital, both fixed (land, plant, and equipment) and working capital. (Lockheed's request for a government grant of half a billion dollars was of this type.) While this should lead to a higher paper return on investment, the direct managerial control exerted by DOD on these firms does not allow them to operate as efficiently as they would if they were competing in a private market. Because there is only a very small open market for defense prod-

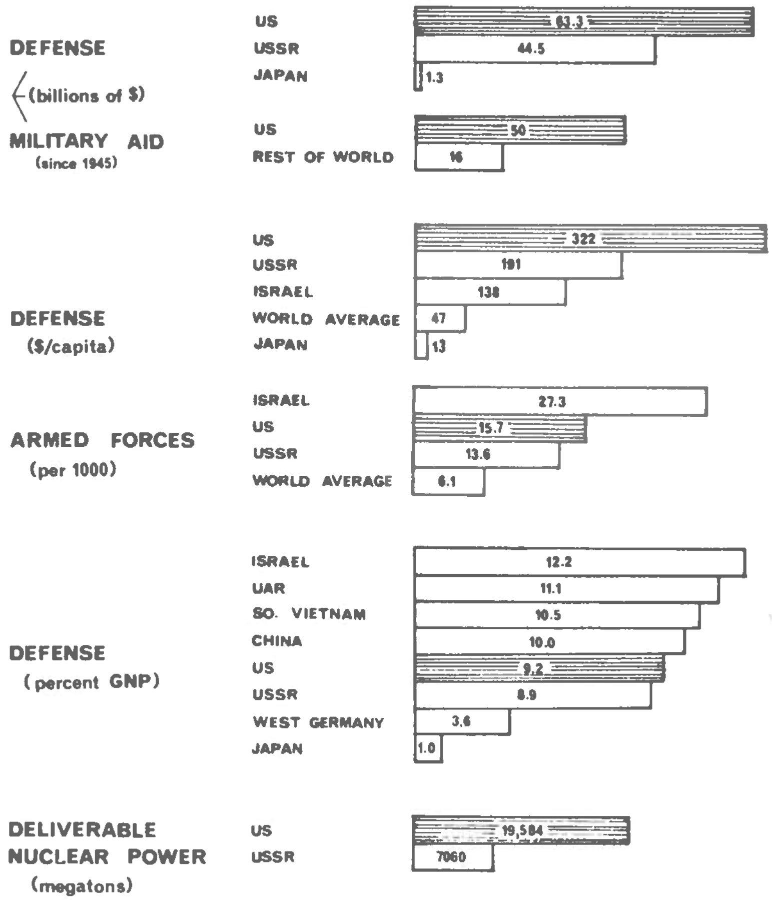




Two indicators of our balance of payments problem are the level of our gold reserves and the amount of short-term (less than one year for repayment) loans the government owes. The gold stock has dwindled inexorably since 1950, particularly since 1955, and is now approaching statutory limits. Short-term liabilities have risen rapidly over this same period, with an even more rapid increase since the escalation of the war. Currently, these notes must be refinanced at unusually high interest rates, unnecessarily adding to the burden of the national debt.

Another indicator of our trade position is the difference between exports of merchandise and general imports, referred to as the trade balance. Although we have maintained a favorable (somewhat spurious) balance in this component, even it has eroded away to almost nothing. In most of the major manufacturing categories, both exports and imports are increasing in current dollar volume, but imports are increasing proportionately faster while still smaller in magnitude (machinery, transportation equipment) or are both larger in magnitude and increasing faster (other manufactured goods). The deterioration is partly due to inflation and partly to stagnation, with the major changes occurring since 1965.

Source: Statistical Abstract of the United States, 1969 *(Dept. of Commerce).*



The United States leads in almost all indicators of militarism that can be measured or estimated. We spend far more for defense, whether measured in total or in per capita terms, than the Russians, who are in second place. We have more men per capita under arms. We give more military aid and have the largest arms exporting business. Because the United States is the most fully industrialized large country in the world, we are relatively more wealthy and can support such heavy defense effort with less sacrifice—although the sacrifice is larger than is presently perceived in this country.

Israel—a country for whom national security is an immediate and urgent problem—devotes approximately the same share of resources to defense as the United States. Japan and West Germany—countries that are rapidly cutting into our foreign and domestic markets, despite their small size—are not wasting their economies on defense. An impartial observer looking at these data would conclude that (a) the United States is irrationally worried about external attack, or (b) the United States is determined to be world leader in the technology and production of weapons systems and military hardware. The U.S. has, in fact, supplied most of the arms used by both sides in almost all of the fifty-six wars that have occurred in the world since 1945. Since these data are for 1966, they understate the current U.S. advantage.

Sources: Emile Benoit, "The Monetary and Real Costs of National Defense," AER, *58 (May 1968), 398–416.* Pocket Data Book USA 1969 *(Dept. of Commerce, 1969). Institute for Strategic Studies, London. George Thayer, "American Arms Abroad,"* Washington Monthly, *1 (January 1970), 62–73.*

ucts, this control may be necessary. Present procurement policies, however, are less than perfect.

This suggests the other side of the coin from profits: whether we are getting the best we can for what we pay, or simple efficiency in expenditure. Waste and mismanagement, both in the public and in the private sectors, can make a weapons system extremely expensive without showing large profits for the contractor. This kind of inefficiency seems to be widespread in the entire war effort and even extends to black market activities by military personnel in foreign countries.

RESEARCH AND DEVELOPMENT

The war has drained off funds from a wide range of research areas, including social research programs, cancer research, work in the physical and natural sciences, aerospace, military weapons systems, and private industry. (The National Institutes of Health are allowed to spend \$1.3 billion per year, while Edgewood Arsenal gets \$2.6 billion for chemical and biological warfare.) To the extent that new research is generated, it is directed at defense production problems and is imbedded in production contracts. Thus, we are presently sacrificing long-run productive capacity in favor of short-run output, since research and the development of technology constitute essential investment, in addition to plant, equipment, and social overhead capital (such as transportation and education).

Beyond the inter-temporal effects of the war, there is the question of the balance between different areas in research and development, regardless of the total expenditures. While the military has given up some of its research funding, no projects have been eliminated; if the war stops, DOD will be ready and able to allocate the surplus funds to weapons systems and aerospace research and development without leaving much of anything to either the private sector or what is left of the public sector. Altering research priorities will require more than simply ending the war.

Even without the war, the private sector has not been keeping pace with the rest of the world in developing and applying research. Industry by industry, the competitive position of the U.S. in world markets is being eroded and replaced by foreign producers. Steel and automobiles are hard-hit. American management has become very conservative in developing new production techniques and new designs, yet investment of U.S. private capital in foreign markets has been very high. We have become experts in managing large conglomerates and other kinds of complex systems, but our productive capacity has deteriorated. Our most sophisticated products for export are aerospace and weapons systems and in specific areas like computers and road-building equipment. What it will take to revitalize American entrepreneurship while retaining American management capacities is impossible to say at this point.

STATE CAPITALISM

When the national government provides much of the capital used in a large sector of the economy and controls not only the quantity and quality of the output but the management and production process itself, then the result is obviously much closer to socialism than it is to capitalism. Independent of whether this form of economic organization is appropriate for the particular industry or this particular country, public policy should not be based on the assumption of a free market private enterprise system. (The Department of Defense owned $196 billion worth of property in 1967, of which $40 billion was real property.) Because of the dominance of the defense sector over the economy as a whole, structural relationships developed in that sector will tend to characterize the economy.

In its characteristics, the defense industry is far from our free enterprise ideal. It is a "monopsonistic" industry because it has only one buyer, the government. The path to government sales is not through advertising, marketing, salesmanship, or product differentiation. That path is strewn with signs of influence-peddling, lobbying, wire-pulling, and control of key committees. Markets are hard to hold, for the industry is vulnerable to strategic shifts, electoral results, and personal whims of politicians. To secure every advantage in this dangerous game, defense firms employ as officers ex-generals, colonels, and purchasing agents. Yet despite personal setbacks and losses of particular firms, the industry as a whole hangs together. This is partially due to the virtual interchangeability of industry personnel. Executives switch companies freely, and technicians belong to the floating defense-aerospace labor pool, centered in Los Angeles, rather than to any one company which tomorrow might lose out to a competitor on a big contract. The danger is that this mode of doing business, however inefficient and wasteful, has become the dominant mode for American business. If it persists, our historic and heralded industrial superiority will be a hollow shell.

Prospects for Conversion

In view of the deep structural changes in our economy produced by our "permanent" wartime footing, what are the prospects for converting our economic system to a full peacetime economy? For whatever the prospects, we see no long-run alternative to peace. If the Nixon Administration were to end the Indochina war, as promised, it would need to take charge of the economy and direct resources so that the war's corrosive effect on the economy could be diminished without sudden instability or hardship. Some sacrifices would necessarily attend this set of moves, but they need not be more than those occurring through normal growth and change in the economy. Personal consumption might be cut back for a time, while investment was shifted into non-defense industries, and taxes should be raised in the interim. The redirection of resources would harm some individuals while benefitting others. Since employment-maintaining expenditures are a necessary component of a war-reduction program, the government would, for a time, be competing with private capital. None of these effects need be of serious magnitude.

If the government should begin by reducing the commitment of resources to Indochina, it should follow as soon as possible with full withdrawal. In the transition, the government must seek to prevent either inflation or recession, especially the latter. Taxes should favor investment in consumer goods. Strong efforts should be made to reduce costs of exports and to induce application of new technologies in private production. Since technology will continue to be labor-saving, investment in education, manpower training, housing, and the services sector (especially public services) must be encouraged.

Indeed, a major problem of the transition is the diversion of resources from the military, largely into the public sector. The Department of Defense has projects underway or planned that would use up all the savings that might result from ending the war. It will be difficult to pry loose these funds, given the strength of the military in the public budget. But the government would have a golden opportunity to show its commitment to ending poverty, racism, urban decay, environmental pollution, and defects in public services. (An income maintenance program that would eliminate poverty would cost about $16 billion per year. The fiscal year 1967-68 budget for the poverty program was $1.7 billion.) In these programs, real income must be given priority over money income. Many services in these categories are outside the market mechanism. The government might consider ways to transfer funds directly to consumers of these services and to build up "markets" for them.

The prospects for effective administration of such funds are not now good. There is nothing in the performance of existing public bureaucracies, inside and outside of the war apparatus, to give us optimism. Present delivery systems are full of inflexibilities, inequities, waste, and leakage. Nothing short of a massive reconstitution of government service would make possible the effective application of huge new programs. The problem is not one of lack of targets. In a work conducted in 1958 and published in 1960, Dyckman and Isaacs estimated the potential development and redevelopment bill for American cities at about a trillion dollars to be spent over twelve years. In the twelve years since that book was written, the military establishment has spent more than that amount. But the military delivery system is simplified by the fact that it is delivered to "clients" outside the country. The institutional and behavioral shifts necessary for effective application of such funds in domestic programs are formidable. Our internal divisions of interest and values stand in the way almost as much as does the power of the military.

To make matters worse, the problem has been regionalized. Impact of conversion would fall unequally on states in the federal system. No simple block grant formula based on population would be equitable compensation. Whole industries would be expected to lobby for their lives. In fiscal year 1962, 72 percent of the value of the military prime contracts was awarded to 100 corporate contractors. The number accounting for this share has since been reduced by almost a quarter. These remaining firms and institutions, moreover, are the economic "base" of their communities. While the relationship of Boeing to Seattle is notorious, other contractors are in much the same local situation. Whole regions, notably the Gulf Crescent and Southern California, would be disaster areas if war contracting shut down without replacement. We should remember that California and Texas have powerful congressional delegations. It is not wholly accidental that they have produced the last two presidents.

Yet in the face of the alternatives, should we not risk these costs? The uncounted costs of the Vietnam war probably exceed the direct expenditures. The official kill of "Vietcong" since the war began is over half a million, which includes, as we now know, many old men, women, and children. The cost of this killing, out of our pockets, is about $115 billion. But to this should be added the costs of some 45,000 American lives lost, 100,000 South Vietnamese soldiers killed, plus at least 1,000,000 "friendly" civilians "accidentally" killed. At cost, a Viet Cong is worth $207,000, since we pay more than that to kill him. At that price, and we cannot conceive that American lives are worth less, the cost in lives to the U.S. has been $9.3 billion—not much in reference to the cost of planes lost. At the capitalized value of life earnings of these young men, the price would be much higher.

Over 150,000 U.S. soldiers have been hospitalized as a result of the war, at unknown cost to them. Some 500,000 troops are fighting in Indochina; this represents earnings forgone of about $3 billion annually. Working in the domestic peacetime economy these earnings would increase national welfare and might make a dent in poverty. It costs $90,000 per year to train, equip, and support a front line soldier in Vietnam; it might cost as much as $45,000 to pay the full cost of an eight-year education for a high-school graduate, and he could have a Ph.D. at the completion. One infantryman in Indochina for eight years would have cost $720 million, after which time he might well be ready for a mental institution or permanent custody.

At least 10,000 American young men of draft age have gone to Canada to escape the war. Another several thousand have refused induction and accepted the penalty (imposing costs on the courts and jails) when local boards could get around to prosecution—they sometimes cannot. The desertion rate of U.S. soldiers in Vietnam is about 80,000 per year, with 10 percent failing to return. But the widespread disaffection of youth is even more costly—the cost of replacing "dropouts" from an America in which they have lost faith is staggeringly high. The loss of the future contributions of many of these people, who are often promising and talented, is priceless.

In the face of these considerations, we have much to gain and little to lose, even in that least sensitive of human measurement, economic cost, by reconstituting the U.S. economy on a peaceful, non-garrison basis.

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