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Inflationary Impact of the Vietnam War

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It is more than fifteen years since the US withdrawal from the Vietnam War. Enough time has passed to sort out the historical record concerning the war and its economic impacts. Like all wars, though, there will continue to be controversy over interpretations of it and its effects. There is widespread recognition of the economic costs of the war and its responsibility for stimulating inflation in the 1960s. The increased spending for the war during the economic prosperity of the mid-1960s produced pressure on prices. Because economic policymakers failed to institute corrective policies, inflation accelerated by the late 1960s and laid the basis for the inflationary spiral of the 1970s. The economic consequences of the Vietnam War were among the major factors in creating the economic difficulties faced by the United States during the 1970s.

In the 1980s, however, President Ronald Reagan sought to reinterpret the history of the war. He labeled it a "noble cause" and tried to jettison the "Vietnam syndrome", the critical reevaluation of US foreign policy that suggested caution toward military intervention. Some economists, also echoing positions from the war years, have recently suggested their own revisionist version of the economic impact of the war. They argue that the economic burden of the war was trivial, that it produced only minor inflation in the 1960s, and that it cannot be held responsible for the inflationary spiral of the 1970s[1].

In this article, I will confront this challenge and reexamine the economic consequences of the Vietnam War and whether it caused an acceleration of inflation in the late 1960s. Such analysis should contribute to our understanding of recent economic history and of the possible economic effects of military expansions — which could presumably inform current and future economic policy.

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INFLATION IN THE 1960s

Table 1 presents data on various measurements of annual rates of inflation from 1960 to 1971. This data demonstrates the source of the conclusion by most professional economists and the public that the acceleration of inflation was linked with the Vietnam War.

For the period 1960-1964, the Consumer Price Index, the Producer Price Index and the GNP deflator all show relatively low and stable rates of inflation in a range of less than 1 percent to less than 2 percent. The average annual changes in these three different measures of price increases were barely above 1 percent. This trend continued the low rates of inflation experienced in the late 1950s. But with the escalation of the Vietnam War in 1965, there was an acceleration in the rates of increase in all of these measures of price levels.

From December 1964 to December 1965, the unadjusted CPI increased by 1.9 percent, up from 1.2 percent the previous year. This was followed by an increase of 3.4 percent in 1966, 3 percent in 1967, 4.7 percent in 1968, and 6.1 percent in 1969. A similar pattern of accelerating inflation emerges in the year-to-year, adjusted CPI changes. The annual percentage increases in the GNP price deflator

Table 1
Inflation During the Vietnam War Period, 1960 to 1971

Year	Change in Consumer Price Index, December to December, Unadjusted	Change in CPI, Year-to-Year, Adjusted	Change in Producer Price Index, December to December, Unadjusted	Change in PPI, Year-to-Year, Adjusted	Annual Change in GNP Implicit Price Deflator
1960	1.5	1.6	1.8	0.8	1.6
1961	0.7	1.0	-0.5	0.0	0.9
1962	1.2	1.1	0.1	0.3	1.8
1963	1.6	1.2	-0.2	-0.3	1.5
1964	1.2	1.3	0.5	0.4	1.5
1965	1.9	1.7	3.3	1.7	2.2
1966	3.4	2.9	2.2	3.2	3.2
1967	3.0	2.9	1.6	1.2	3.0
1968	4.7	4.2	3.1	2.8	4.4
1969	6.1	5.4	4.8	3.7	5.1
1970	5.5	5.9	2.2	3.5	5.4
1971	3.4	4.3	3.2	3.1	5.0

Source: *Economic Report of the President, 1982:* 237, 295, 302.

also accelerated from 1965 to 1969 — 2.2 to 5.1 percent. In the two series for producer prices, there were marked jumps in the annual rates of change in 1965 and 1966, a slowdown in their rate of increase in 1967 (due to "growth recession"), and renewed acceleration in 1968 and 1969.

Walker and Vatter contend that the data on inflation don't demonstrate an acceleration in inflation until 1968. They base this conclusion on an analysis of quarterly changes in annual rates for the CPI and the PPI and on the assertion that changes in the price indices of less than 3 percent are not significant[2].

First of all, the quarterly data on the rate of inflation during the period of the Vietnam escalation can be used to measure short-run movements in prices and don't necessarily show inflation. But I would argue that quarterly data do not provide adequate information on the trend in the rate of inflation in the period prior to the escalation, during it, and after it. The relevant period is not simply the escalation but rather the period surrounding increased spending for the Vietnam War. For this more extended time frame, the changes in the annual rates of inflation are superior. When economists measure inflation over five to ten year intervals, they rely on the annual changes in price indices. Secondly, Walker and Vatter refer to a statement in an introductory economics textbook about a 2 to 3 percent margin of error in the CPI and conclude that any change in it of less than 3 percent amounts to "no inflation"[3]. They transpose this *range* of uncertainty to 3 percent as *the* standard and use it as an absolute test of the existence of inflation. The fact that the CPI is based on a survey and has a margin of error does not mean that it cannot be used to identify patterns of change in consumer prices. It is a consistently measured series over time, and economists rely on statistical technique to ensure its ability to reflect trends in the prices of goods and services. If economists were not allowed a 3 percent margin of error, there is not much that we could say about the economy with any degree of confidence.

The Timing and Impact of the Vietnam War Escalation

Both economic theory and history suggest that wars usually have an inflationary impact. During all of its major wars, the United States has experienced increased rates of inflation[4]. The connection between war spending and inflation is based on both conventional micro- and macro-economic theory. Increased war spending stimulates the demand for labor and raw materials used in war production. Increased price pressures develop for these factors of production in proportion to the tightness of their markets. These price increases can then spread from market to market. The macro-economic effect

Table 2
The Estimated Incremental and Full Costs of Direct American Military Involvement in Indo-China, Fiscal Years 1965-1975

(Billions of Current Dollars)

Fiscal Year*	Incremental Costs[a]	Full Costs[a]
1965	.1[b]	.1[b]
1966	5.8	5.8
1967	18.4	20.1
1968	20.0	26.5
1969	21.5	28.8
1970	17.4	23.1
1971	11.5	14.7
1972	7.3	9.3
1973	6.2[c]	7.9[c]
1974	4.1[d]	5.0[d]
1975	2.0[d]	2.5[d]
Totals:	$114.3	$143.8

*The US Government Fiscal Year for all these years was from July 1 through June 30, e.g., Fiscal Year 1965 was from July 1, 1964 to June 30, 1965.

[a]Full costs cover all forces, baseline and additional, and equipment and materials used in the war. Incremental costs cover the added costs of fighting the war over and above the normal costs of operating the baseline force in peacetime. These are the two methods of cost accounting for the war supplied by the Pentagon.

[b]The figures for Fiscal Year 1965 are most likely too low to cover the buildup of troops in 1964-1965 and the stepped-up air activity in response to the Gulf of Tonkin Incident (August 1964) and the Pleiku attacks (February 1965). Some of this may have been financed with the funding for military assistance for South Vietnam. Or it may have involved the use of already existing baseline forces. However, this activity still had a cost and should, at the very least, be indicated in the full cost of the war. Some baseline forces were diverted to Vietnam for the 1964-1965 buildup —— the ships that were in the Gulf of Tonkin, the aircraft that was at Pleiku, and the planes that retaliated against the North as a result of both of these incidents — and probably accounted for costs in excess of $100 million. Consequently, the cost figures largely derived from Department of Defense accounting which are presented in this table must be regarded as *conservative* estimates of the actual costs of the war.

[c]These are estimates based on the original and revised budget submissions of the Department of Defense. They reflect the combined effects of the US response to the Spring 1972 Offensive of the North Vietnamese, the US bombing of North Vietnam in December 1972, and the ceasefire obtained at the end of January 1973.

[d]Estimates based on the costs of US military assistance to Indo-China and the continued presence of US air and naval forces in Southeast Asia.

Sources: Riddell, Tom. *A Political Economcy of the American War in Indo-China: Its Costs and Consequences*, unpublished dissertation (Washington, DC: The American University) 1975: 98-99; and, US Department of Defense (Comptroller), *The Economicss of Defense Spending* (Washington, DC: US Government Printing Ofice) 1972: 149.

results from the stimulation of aggregate demand in the economy as a whole. Government spending to prosecute the war effort is added onto total spending in the economy. The new spending creates demand for war goods, as well as higher incomes throughout the economy that will be spent on non-military goods and services. The increased demand for both military and consumer products contributes to inflationary pressures in the economy. The inflationary impact of the war will depend on the state of the economy, the manner by which it is financed, and wartime economic policy. If the economy is close to full employment, *ceteris paribus*, increased war spending will have a larger inflationary impact. If the war is financed by printing money or by the Federal Reserve lending directly to the Treasury, there will be higher inflation. If the government does not increase taxes (or decrease non-military spending) to pay for the war, its inflationary impact will not be checked.

The issue here is whether the Vietnam War caused increased inflation in the 1960s. The analysis will rest on an investigation of the impact of the war (taking into account the magnitude and timing of the buildup for the war), the state of the economy at the time, how it was financed, and wartime economic policy.

To examine the impact of the war, we must identify the period of time when the war made extra demands on the resources of the society. Walker and Vatter have determined that the escalation period was 1966-1967 when national defense purchases of goods and services as a percent of GNP increased[5]. There are two problems with this definition — one of substance and one of measurement.

The US involvement in the war was an unusual event in the history of the country; it was an extraordinary occurrence. In this light, the effect of war spending lasted for the entire period of time during which it was making an extra claim on the society's resources. Table 2 presents information on the annual costs of the war from Fiscal Year 1965 to FY1975. The full costs of all forces, equipment and materials used in the war amounted to over $140 billion; and the incremental costs of fighting the war over and above the normal costs of using baseline forces in peacetime were over $110 billion[6]. While it is true that the war placed accelerating demands on resources during the 1966-1967 period, it is also true that the war made an extra claim on resources throughout its tenure (subject to countervailing fiscal policies). Walker and Vatter focus only on the period of escalation. Whether inflation is engendered by an *escalation* is certainly a relevant question; but it is not the only question in determining the inflationary impact of a war.

Furthermore, from an examination of the data that they present, as well as Table 2, it is possible to identify a different and longer period of escalation. Table 2 shows war spending increasing in every Fiscal Year from 1966 through 1969. Walker and Vatter note that defense purchases as a percent of GNP began to increase in the 3rd quarter of 1965 (at 7.1 percent), continue to increase in every quarter to the 2nd in 1967 (9.0 percent), and then decrease in the 3rd quarter of 1967 (8.6 percent). This brought the "escalation" to a close. However, there are two important qualifications to this dating of the escalation. From the 4th quarter of 1967 to the 2nd quarter of 1968, defense purchases go back up to 9.0 percent of GNP. The dating by Walker and Vatter of the end of the escalation seems to be at least questionable and certainly arbitrary. Based on these figures, it could be argued that the escalation lasted into 1968; only after the second quarter of 1968 were there consistent decreases in defense purchases as a percent of GNP[7]. In fact, one could argue that the escalation lasted until defense purchases as a percent of GNP went back to their pre-war level. By this criterion, the escalation would last until the 3rd quarter of 1970 based on quarterly data and 1971 on annual data (it was 7.2 percent in 1965, 9.0 percent in 1967, 7.5 percent in 1970, and 6.6 percent in 1971).

The history of the war itself also substantiates the conclusion that Walker and Vatter have incorrectly specified the timing of the escalation. Spending on the war reached its peaks in FY1968 and FY1969. Recalling the initial escalation of direct American military involvement in the war, the Gulf of Tonkin incident took place in August 1964 and was followed by an intensification of US bombing of North Vietnam and by a massive increase in the number of US military personnel in Vietnam. From August 1964 to May 1965 (during FY1965), an additional 50,000 troops were sent to Vietnam.

At the end of July 1965, President Johnson announced that the administration needed additional funds to wage conflict and that a further supplemental appropriation would be required in January 1966. By the end of 1965, 100,000 people were added to US forces in Vietnam, bringing the total to more than 180,000. By the end of 1966, there were 385,000 US military personnel in Vietnam. The number continued increasing until the end of 1968 when the total reached 538,000[8]. The timing of the escalation has much longer boundaries than 1966-1967.

The Economic Impact of the War

To adequately measure the economic impact of the war and the effect that it had on increasing inflation, it is necessary to supplement national defense purchases of goods and services with other indicators of defense activity.

Table 3 presents some data that will help to measure the economic impact of the Vietnam War. National defense purchases record payments made by the federal government to individuals and businesses; it is a *final* indicator of defense activity in the economy. Progress payments outstanding represent early payments by the Department of Defense to contractors for work in progress; it is an *intermediate* indicator of defense activity. The other measurements in Table 3 are all *advance* indicators. They measure the volume of commitments and contracts that DOD makes with the private sector for military goods and services. Military prime contracts, gross obligations incurred, and manufacturers' new orders all register activity undertaken in the private sector at the behest of the federal government and in

Table 3
Indicators of Defense Activity, Annual Amounts
Billions of Current Dollars, 1964 to 1970

Year	National Defense Purchases of Goods and Services	Defense Department Military Prime Contract Awards	Defense Department Gross Obligations Incurred, Total
1964	49.0	26.6	55.0
1965	49.4	29.9	58.3
1966	60.3	40.2	73.2
1967	71.5	42.4	81.8
1968	76.9	42.3	87.0
1969	76.3	35.2	81.3
1970	73.5	33.5	80.0
	Defense Department Gross Obligation Incurred, Procurement	Manufacturers' New Orders, Defnese Products Industries	Defense Department Progress Payments Outstanding
1964	15.6	27.4	3.2
1965	16.6	32.2	3.9
1966	23.6	39.1	5.5
1967	26.5	44.9	7.5
1968	28.3	46.7	8.5
1969	20.9	43.1	9.8
1970	20.1	42.9	9.4

Sources: US Department of Commerce, Bureau of Economic Analysis, Defense Indicators (November 1972): 36; (October 1976): 31; (October 1977): 31, 33; and, (Novemberr 1977): 31, 33.

advance of actual payment for the work completed. Consequently, during periods of military buildups, the advance indicators are the first to signal the impact of the increased demand for military goods and services in the economy[9].

An examination of the relative changes in these measurements of defense activity compared to changes in GNP during the period 1965-1969 provides information about the timing of the impact of increased military spending on the economy. Table 4 presents the annual rates of change for these defense indicators. All of the indicators, with the exception of gross obligations incurred, total, decreased in 1964. In 1965, along with the escalation of the war, all of the indicators increased. The advance indicators all increased by much more than national defense purchases, which increased by only .8 percent. Military prime contracts (12.5 percent), manufacturers' new orders in the defense products industries (17.5) percent, and progress payments outstanding (21.9 percent) all increased at a rate

TABLE 4
ANNUAL RATES OF CHANGE IN DEFENSE INDICATORS, 1965 TO 1969

Year	GNP Current Dollars	National Defense Purchases of Goods and Services	Military Prime Contract Awards	Manufacturers' New Orders, Defense Products Industries	Department of Defense, Gross Obligations Incurred
1965	8.4%	.8%	12.5%	17.5%	6.0%
1966	9.4%	22.1%	34.0%	21.4%	25.5%
1967	5.8%	18.6%	5.5%	14.8%	11.8%
1968	9.2%	7.6%	-.3%	4.0%	6.3%
1969	8.1%	-.8%	-4.8%	-7.7%	-6.6%

Year	Department of Defense, Gross Obligations Incurred, Procurement	Defense Department Progress Payments Outstanding
1965	6.4%	21.9%
1966	41.8%	41.0%
1967	12.5%	36.4%
1968	6.6%	13.3%
1969	-25.9%	15.3%

Source: *Economic Report of the President, 1983*: 233 for GNP growth rate. All others from Table 3. Percentage changes all calculated.

significantly in excess of the growth rate of current GNP (8.4 percent). The other advance indicators registered increases only slightly below the increase in GNP. In 1966, the pace of the buildup accelerated. The annual rates of increase in all of the indicators were larger than the rate of increase in GNP — with the increases in most of the advance indicators being the largest of all. The buildup slows down somewhat in 1967, but the rate of increase of defense purchases, manufacturers' new orders, gross obligations incurred, and progress payments outstanding are all larger than the growth rate of the GNP. In 1968, the indicators (with the exception of progress payments) show the beginning of the end of the escalation period. Military prime contracts actually decrease; and defense purchases, manufacturers' new orders, and gross obligations incurred (total and procurement) continue their increase but at a rate below that of GNP. The indicators for 1969 (except progress payments) all decrease.

The leading indicators point to the acceleration of defense activity in 1965. This activity took place primarily in the private sector as military contractors expanded their inventories and their demands for raw materials and personnel. The impact of the escalation was intensified in 1966 and 1967; in fact, increased military purchases accounted for 16.8 percent and 25.9 percent respectively of the increases in GNP for these two years. The end of the escalating economic effect of the war is somewhat more problematic. The leading indicators indicate a deceleration in 1968; but the data on war spending (Table 2) show a continued increase through FY1969. Although it is not an inarguable proposition, I would date the period of escalation from 1965 through the 2nd quarter of 1969. This was the period during which military activity in the private sector and actual spending for the war was increasing.

The Inflationary Impact of the Vietnam War

The general effects of wartime escalations — increased demand for resources, a stimulus to aggregate demand, and the timing of the impact — all lend support to the hypothesis that the war stimulated inflation in 1965, 1966, and 1967.

The war increased demand for raw materials, metals, and industrial products. The impact on prices is indicated in a comparison of the wholesale price indices for all commodities, metal and metal products, and machinery and equipment. For the period 1960-1964, all of these indices declined or increased minimally. In 1965 and 1966, with the beginning of the war, all showed substantial increases. From 1965 through 1968, the wholesale price index for all commodities increased by 8.2 percent. The index for metals and metal products increased by

9.2 percent, and the index for machinery and equipment increased by 11.2 percent. Tightened labor markets due to economic expansion and the drain of the military draft led to accelerated wage increases after 1965. The annual increase in average hourly compensation averaged just under 4.0 percent for the 1960-1965 period. But in 1966 average compensation increased by 6.1 percent; and the average annual increase through 1971 was about 7 percent. The bargaining position of labor unions reflected tight labor markets. From 1961 to 1964, negotiated settlements produced average annual increases in hourly wages of about 3 percent. But, beginning in 1965, the annual increases in negotiated wages began to accelerate. The increase in 1965 was 3.7 percent and accelerated to an average annual increase of 6.6 percent from 1966 through 1970. In addition to these price and wage pressures from the extra demands of the war, the context of the economy, the financing of the war, and wartime economic policy contribute to an interpretation of the culpability of the war in stimulating inflation throughout the economy.

The State of the Economy

The closer the economy is to full employment, the more inflationary the impact of a war is likely to be. Table 5 contains data on the general state of the economy for 1964-1970. In 1965, the ratio of actual to potential GNP was 100.1 and remained above 100 through 1969. Actual GNP is the current value of output in the economy and potential GNP is the value of output if all the resources of the society were fully employed. If actual output exceeds potential output, the economy is operating above its capacity to produce goods and services. Similarly, the unemployment rate was relatively low, given post-World War 2 experience, and had been decreasing since 1961. In 1965, the capacity utilization rate for manufacturing was at its highest level since World War 2 (in excess of rates during the Korean War). These data indicate an economy operating near or above its capacity and in which unanticipated increases in aggregate demand could be expected to stimulate inflationary pressures. The war, moreover, coincided with both the 1964 tax cut to stimulate the economy and the launching of the war against poverty. From 1965 to 1969, actual GNP exceeded potential GNP, the capacity utilization rate for manufacturing remained in the high 80s, and the unemployment rate continued to decrease to 3.5 percent (the lowest it had been since World War 2 except for the Korean War years). The war escalation took place in an expanding economy. It was in this context that the extraordinary stimulus of the war contributed to inflationary pressures in the mid-1960s.

TABLE 5
MEASURES OF THE GENERAL STATE OF THE ECONOMY, 1964-1970

Year	GNP Actual/ Potential	Rate of Unemployment	Capacity Utilization Rate, Manufacturing
1964	98.2	5.2	85.6
1965	100.1	4.5	89.6
1966	102.1	3.8	91.1
1967	101.2	3.8	86.9
1968	101.9	3.6	87.1
1969	101.0	3.5	86.2
1970	97.2	4.9	79.3

Sources: Actual/Potential GNP from US Department of Commerce, Bureau of Economic Analysis, Survey of Current Business (April 1982): 25. Unemployment rate and capacity utilization rate from Economic Report of the President (1982): 266, 283.

FINANCING THE WAR

But to demonstrate that the war was a source of inflation, it must also be shown that the manner in which it was financed accommodated increased war spending and that wartime economic policy did not take purchasing power away from other sectors of the economy. Revisionists have argued that during the war "tax increases" did reduce inflationary pressures, that other federal spending was reduced, and that monetary policy was not excessively expansionary[10]. They identify two sources of tax increases during the period 1965 to 1968. The first was the combination of increasing tax collections in a progressive tax system during a period of rising incomes and scheduled increases in social insurance taxes. The second was the 1968 surtax passed by Congress to help finance the war and relieve inflationary pressures in the economy. However, the surtax wasn't passed until July, 1968 and after that federal taxes' share of GNP actually decreased. Until the passage of the surtax, tax rates did not change during the first three years of the war; and there was no significant decrease in personal consumption expenditures and disposable personal income as a percent of GNP, which would signal the contractionary effect of increased taxes[11]. Also, the impact of increased social insurance taxes is not so clear.

Walker and Vatter argue that the increases in social insurance taxes were in excess of increased social insurance benefits and consequently that this "is unequivocally anti-inflationary"[12]. They are correct in arguing that social insurance tax collections were increasing; they increased their share of total federal receipts from 19.1 percent in 1965 to 23.0 percent in 1970[13]. Social insurance contributions account for about 80 percent of federal trust funds receipts, and throughout the duration of the war these trust funds experienced surpluses. These surpluses are anti-inflationary only if they are not made available to other agents of demand in the economy. However, they were made available to the Treasury through the only thing that the Social Security Administration, for example, is allowed to do with its surpluses: purchase US Treasury securities. The amount of federal debt held by other government accounts actually increased more than the amount of debt held by the Federal Reserve during the 1965-1969 period. From December 1965 to December 1969, total federal debt increased by $47.3 billion. The Fed's holdings increased by $16.4 billion, the private sector increased its holdings by $1.5 billion, and other government agencies increased their holdings by $29.3 billion[14]. This fact diminishes the potentially anti-inflationary impact of increased social insurance taxes.

In fact, the contribution of the federal trust funds surpluses helped to finance increased war spending. When the Fed lends to the Treasury, it creates money. When other federal agencies lend funds to the Treasury, it does not directly create money because it merely transfers purchasing power from the public to the Treasury. However, if the receipts were withheld from circulation, it could have a contractionary effect on the money supply. Walker and Vatter present data to show that the possible monetary impacts of the war were minimal and that there was no excessive money creation in the escalation period[15]. In addition to their neglect of the increase in federal debt held by government agencies other than the Fed, the data on the growth of the money supply could be interpreted in a different way. From 1960 to 1964, the money supply had been increasing at an annual rate of less than 3 percent. However, with an increasing federal debt, the rate of increase of M1 accelerated to 4.7 percent in 1965. In 1966, as a result of a Fed decision to tighten up on monetary policy in response to the inflationary effects of the war, M1 grew at a rate of only 2.5 percent. When the Fed's attempt at contraction was abandoned, money supply growth took off to rates of 6.6 percent in 1967 and 7.7 percent in 1968[16].

Walker and Vatter also argue that federal non-defense purchases helped to reduce the inflationary impact of the war because they decreased as a percent of GNP during the escalation. Regardless of the period of escalation, they are correct. But the contribution to reduced aggregate demand was minimal, the GNP share of federal non-defense purchases decreased from 2.6 percent to 2.4 percent — a 7.7 percent fall in its share, whereas the share of defense purchases increased during the war buildup by 28.2 percent.

There is one additional factor that must be analyzed in assessing the inflationary impact of the war: the role of wartime economic policy, or, rather, the failure of economic policymakers to institute any effective constraints on aggregate demand. As Keith M. Carlson, writing in the *Federal Reserve Bank of St. Louis Review* in February 1967, pointed out:

> At times of high employment and near-capacity levels of output, a resource transfer from civilian 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 buildup in late 1965 and 1966. Instead a 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.
>
> Overall price increases thus operated as a silent tax in the absence of more restrictive fiscal or monetary actions[17].

The question thus becomes: what was the economic policy response to the war and why did it fail?

The Economic Policy Failure During the War

There are two questions relevant to an assessment of economic policy during the war. One concerns the awareness of policymakers to the inflationary effects of the war. The other concerns the lack of an effective policy to counter those impacts. Both economic theory and history suggest that wars induce inflation. In all its previous wars, the United States adopted a variety of measures to dampen inflation. These have included increased individual and corporate income taxes, excise taxes, wage and price controls, and rationing[18].

In the case of the Vietnam War, there was a failure to adopt appropriate and sufficient wartime policies to reduce inflationary pressures. This failure was primarily a result of the politics of the war. The war escalated slowly and was initially referred to as the Vietnam "conflict". Initial cost estimates for the war were outrageously low. President Johnson was reluctant to engage in a public debate about economic restraint due to the war and, concurrently, about the war itself. Furthermore, Johnson wanted to preserve his commitment to the

Great Society from any budget restraint associated with increased spending for the war[19].

The war began without a formal declaration. The administration introduced increased numbers of troops into Vietnam gradually. And it consistently underestimated war costs in its budget submissions to Congress. Johnson decided on a path of slow escalation, but one which included flexibility[20]. During Fiscal Years 1965, 1966, and 1967, the original budget requests for the war were eventually exceeded by more than 100 percent in supplemental requests for funds[21]. Since there was no "war" and since the original requests for funds did not foresee a massive increase in spending for the war, the Johnson administration did not need to introduce any comprehensive wartime economic policy measures.

Nevertheless, there were a number of responses to the increased inflationary pressures brought about by prosperity and the effect of the Vietnam escalation. Table 6 contains a summary of policy measures or proposals to restrain demand in the economy from 1965 through 1968. One of the first instances of an administration concern with the inflationary effects of the war was a December 1965 CEA recommendation to Johnson that he consider a tax increase to help pay for the war[22]. But Johnson refused because he didn't want to adopt wartime economic measures for fear of touching off a debate on the war of losing some of his Great Society programs[23]. Throughout the remainder of 1966 and 1967, mild policies of restraint were utilized. Johnson relied on the CEA's wage-price guideposts and patriotic appeals to dampen inflationary wage and price movements. Scheduled reductions in federal excise taxes on telephone service and automobiles were rescinded and collections of some federal taxes were accelerated. In his *Economic Report of the President* for 1967, Johnson suggested that he might call for an income tax surtax to restrain the economy. Finally, in August 1967 he formally proposed a 10 percent surcharge on income taxes. Congressional hearings were held on this proposal in August, September, and November 1967 and in January 1968. In these hearings, virtually all of the administration officials and others who testified acknowledged the responsibility of the war in making the surtax necessary. But the proposal stalled over congressional desires to cut non-defense federal spending and Johnson's unwillingness to compromise over his Great Society programs. In early 1968, the economic environment deteriorated with accelerating inflation, a massive increase in the budget deficit, and an international monetary crisis. At this point, congressional leaders and administration officials worked out a compromise that called for the income tax surcharge in return for a commitment to cut non-defense federal

Table 6
Economic Policy Responses to the Impact of the Vietnam War, 1965 to 1968

Date	Policy Action
December 1965	Federal Reserve raises discount rate from 4% to 4 1/2%. Council of Economic Advisers sends tax increase request to Johnson, which he rejects.
January 1966	President Johnson proposes accelerated corporate and individual income tax collections and a revision of the scheduled eliminations of the federal automobile and telephone excise taxes.
March 1966	Johnson holds meetings with Congressional and business leaders in which they back his reluctance to raise taxes to finance the war.
September 1966	Federal Reserve sends letter to commercial banks urging restraint in business loans. Johnson announces restraint on federal non-defense spending and requests a 16 month suspension of the 7% investment tax credit and of accelerated depreciation on business construction.
Fall 1966	Administration fails to release a Midyear Review of the Budget.
January 1967	Johnson proposes a 6% income tax surcharge on corporate and individual income.
March 1967	Johnson requests the reinstitution of the 7% investment tax credit.
August 1967	Johnson firms up his tax surcharge request and asks for a 10% surcharge on income taxes.
January 1968	Johnson proposes broad series of measures to directly control increasingly difficult balance of payments problems.
March 1968	Johnson holds another series of meetings with business leaders in which the economic impact of the war is more forthrightly discussed than previously. Johnson withdraws from the approaching 1968 Presidential election and announces steps to negotiate an end to the war.
June 1968	Congress finally enacts the 10% income tax surcharge to help finance the increasing costs of the war.

Sources: *Economic Report of the President*, 1965 to 1970; and, Riddell, *A Political Economy of the American War in Indo-China*: 333-334.

spending by $6 billion in the FY1969 budget. The surtax finally became law on June 28, 1968.

Some measures of economic restraint were used during the escalation period, but they were inadequate. Why? The war was escalated slowly and by stealth. Within the administration, there were predictions and plans for a much longer and costlier war. Yet, in public, the posture was confidence in a contained, successful and "cheap" conflict. As Johnson himself quotes one of his major advisers, McGeorge Bundy, in his memoirs: "At its very best the struggle in Vietnam will be long. It seems important to us that this fundamental fact be made clear and our understanding of it made clear to our own people.... (T)here is no shortcut to success in Vietnam."[24] This evaluation of the reality of US involvement in Vietnam and where it was likely to lead was not shared with the public (at least not until the publication of the Pentagon Papers). Consequently, there was no public reason to ask for typical wartime economic measures. The lack of adequate economic policy measures and a war stimulus that was larger and would last longer than was admitted in public went hand in hand. As Walter Heller (Chair of the Council of Economic Advisers during the Kennedy administration) has put it, there was "an unwillingness to loose the flood of debate on Vietnam for which a tax proposal would provide the tempting occasion"[25]. And Lyndon Johnson wanted very much to protect his Great Society:

> We are a rich nation and can afford to make progress at home while meeting our obligations abroad — in fact, we can afford no other course if we are to remain strong. For this reason, I have not halted progress in new and vital Great Society programs in order to finance the costs of our efforts in Southeast Asia[26].

Throughout 1965, 1966, and 1967, it would be guns and butter both. Not until late 1967 and 1968 did the debate about the war and wartime economic policy get the public airing it deserved given the economic impacts of the war. In fact, Johnson himself reaped the harvest of secrecy when he renounced the Presidency in March 1968 as a result of the political and economic ramifications of his conduct of the war.

Charles Schultze, Director of the Bureau of the Budget during the Johnson administration, summarized this policy failure in congressional testimony in 1970 on the economic effects of the war:

> ... our earlier inflation is in part due to the fact that we wouldn't cover the financial costs of the war in taxes and finally in turn, one of the reasons we wouldn't cover the financial cost of the war in taxes was because it was basically an unpopular war.... (T)he inflation that we are trying to stop originated from a combination of the Vietnam war on the one hand and our political inability to finance it on the other[27].

The Vietnam War stimulated inflation in the mid- and late-1960s. This result was a combination of the economic impact of the war, the state of the economy at the time, the manner in which the war was financed, and the conduct of economic policy. Given the structure of the economy and the institutional power of large corporations and labor unions, this inflation produced further cost-push sources of inflation. This inflationary experience laid the foundation for the increased difficulties with inflation in the 1970s — the price-wage spiral, the productivity crisis, energy price increases, excessive monetary growth and easy credit, and so on.

Conclusion

Walker and Vatter concluded in their analysis that the Vietnam War was an "economically trivial event" and posed the question of what the effect would be if the nation really engaged in a massive military escalation. "The profession needs to tell the nation that the economic barrier to war, its appalling economic costs, has been destroyed by the tremendous size of our economy. Consequently, we'd better erect stronger political and social barriers or we will have more war."[28]

I have shown that the Vietnam War was by no means a trivial economic event. It increased the percentage of the nation's resources going to defense purposes by only 2 percent of GNP, but it also lasted for almost a decade and cost the Treasury almost $150 billion. It induced accelerated inflation. The nation continues to bear the economic costs of that war in interest payments on the debt incurred during the war, programs for Vietnam veterans, and lost output from disabled and disoriented veterans. There were and are economic burdens of the Vietnam War — to go along with the political, social, and cultural upheavals it unleashed in the United States in the 1960s and 1970s. It is a lesson that economists bear a responsibility for sharingIt is also a lesson that has relevance to the current massive peacetime military buildup of the Reagan administration Through FY1990, this escalation calls for military spending of almost $2.7 trillion[29]. The defense share of GNP will increase from 5.6 percent to 7.1 percent of GNP. But that 1.5 percent share of GNP involves a significant amount of spending and the opportunity cost is always the other things that those resources could have been used for — education, tax cuts, public works projects, job training programs, etc. There is still a choice between guns and butter. To argue that this buildup is trivial minimalizes the burden that it places on the country's resources. The revisionist position on the economic effects of the Vietnam War also feeds into recent attempts to undermine the "Vietnam syndrome" and to pursue more aggressive interventionist foreign and military policies like those of the Reagan administration in Central America and the Middle East. Walker and Vatter are correct to urge strong political and social barriers to the pursuit of war. But US citizens also need to be aware of the substantial economic burdens associated with military buildups in times of war and peace.

[1] For example, see Walker, John F.; Harold G. Vatter. "The Princess and the Pea; or the Alleged Vietnam War Origins of the Current Inflation," *Journal of Economic Issues* 16 (June 1982): 597-599.
[2] *Ibid.*: 599, 604.
[3] *Ibid.*: 598-599.
[4] Riddell, Tom. *A Political Economy of the American War in Indo-China: Its Costs and Consequences* (Washington, DC: The American University) 1975: 209-211.
[5] Walker and Vatter: 598.
[6] These direct budgetary costs are all in current dollars. The costs of military assistance to South Vietnam are included in the figures for 1966-1975. Estimates for all of the economic costs of the war, including economic assistance to South Vietnam, foreign and military assistance to other Southeast Asian countries, future veterans' benefits, losses from deaths and injuries, interest on the debt, etc., have placed the total at close to $700 billion. See Riddell, Tom. "The $676 Billion Quagmire," *The Progressive* 37 (October 1973): 33-37.
[7] US Department of Commerce, Bureau of Economic Analysis, *Defense Indicators* (Washington, DC: US Government Printing Office) 1977: 32.
[8] Westmoreland, William C. "Report on Operations in South Vietnam, January 1964-June 1968" in Admiral USG Sharp and General WC Westmoreland, *Report on the War in Vietnam* (Washington, DC: US Government Printing Office) 1968: 95-109.
[9] Weidenbaum, Murray L. "The Inflationary Impact of the Federal Budget," *Financial Analysts Journal* (July-August 1966) in Joint Economic Committee, US Congress, *Economic Effects of Vietnam Spending*, 2 vols. (Washington, DC: US Government Printing Office) 1967; 2: 498-501; and Weidenbaum, Murray L. "Impact of Vietnam War on American Economy" in Joint Economic Committee, *Economic Effect of Vietnam Spending*; 1: 193-236.
[10] Walker and Vatter: 606.
[11] Garrison, Charles; Anne Mayhew. "The Alleged Vietnam War Origins of the Current Inflation: A Comment," *Journal of Economic Issues* 17 (March 1983): 175-186.

[12] Walker and Vatter: 606.
[13] Office of Management and Budget, Budget Review Division, Fiscal Analysis Branch, *Federal Government Finances, 1983 Budget Data.*
[14] *Economic Report of the the President* (Washington, DC: US Government Printing Office) 1971: 277.
[15] Walker and Vatter: 602-604.
[16] *Economic Report of the President* (Washington, DC: US Government Printing Office) 1982: 303.
[17] Carlson, Keith M. "The Federal Budget and Economic Stabilization," *Federal Reserve Bank of St. Louis Review* (February 1967) in Joint Economic Committee, *Economic Effect of Vietnam Spending;* 2: 588-589.
[18] Riddell. *A Political Economy of the American War in Indo-China*: 320-330.
[19] *Ibid.*: Chapter 5.
[20] Johnson, Lyndon B. *The Vantage Point* (New York: Popular Library) 1971: 142-146.
[21] Joint Economic Committee, *Economic Effect of Vietnam Spending;* 1: 70-99, 175-192, 360-361.
[22] Ackley, Gardner. "LBJ's Game Plan," *The Atlantic* 230 (December 1972): 46-50.
[23] Halberstam, David. *The Best and the Brightest* (New York: Random House) 1972: 606.
[24] Quoted in Johnson, *The Vantage Point*: 127.
[25] Heller, Walter. *New Dimensions of Political Economy* (New York: W.W. Norton) 1967: 94.
[26] *Budget of the United States Government, Fiscal Year 1967* (Washington, DC: US Government Printing Office) 1966: 7.
[27] Schultze, Charles. Statement to the Senate Foreign Relations Committee, US Congress, *Hearings, Impact of the War in Southeast Asia on the US Economy* (Washington, DC: US Government Printing Office) 1970: 232-233.
[28] Walker, John F.; Harold G. Vatter. "Demonstrating the Indemonstrable: A Reply to Garrison and Mayhew," *Journal of Economic Issues* 17 (March 1983): 195.
[29] Defense Budget Project. *The FY 1987 Defense Budget: Preliminary Analysis* (Washington, DC: US Government Printing Office) 1986.