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Author(s): Dean Baker, Robert Pollin and Elizabeth Zahrt
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The Vietnam War and the Political Economy of Full Employment

Dean Baker, Robert Pollin, and Elizabeth Zahrt

In a provocative article, the authors maintain that defense spending during the Vietnam War helped create America's prosperity during those years. They believe this history suggests that government spending can stimulate growth again and that this time inflation can be controlled.

DEAN BAKER is a macroeconomist at the Economic Policy Institute in Washington, D.C. ROBERT POLLIN teaches economics at the University of California at Riverside and is a Research Associate at the Economic Policy Institute. ELIZABETH ZAHRT is a doctoral student in economics at the University of California, Riverside. An earlier draft of this paper was presented at the conference, "The Long Shadow: Legacy and Memory of Vietnam, 1975–1995," Harvey Goldberg Center for the Study of Contemporary History, University of Wisconsin at Madison, September 14–16, 1995. We thank conference participants and Jeffrey Madrick for helpful comments on that draft.

The United States war in Vietnam was responsible for millions of deaths and permanent disabilities, including both Vietnamese and U.S. soldiers. It also destroyed Vietnam's natural environment and physical infrastructure. Compared with such horrors, the effects of the war on the U.S. economy were small. Nevertheless, a fundamental idea about U.S. economic policy-making emerged from the Vietnam experience—one that continues to carry great weight in policy-making circles today—that the large-scale government spending associated with the war engendered uncontrollable and debilitating inflation. As such, the Vietnam experience contributed significantly to the demise of a view that grew out of the 1930s Depression, World War II, and especially the postwar competition with communism: that enlightened capitalist governments could and would achieve sustained full employment and widespread prosperity through the application of modern Keynesian economic theories.

Moving forward from the Vietnam years, the commitment to full employment and other egalitarian policies has yet to be recovered. Today, U.S. macroeconomic policy is primarily concerned with eliminating the federal deficit and permanently contracting the size of government. To the extent that active interventionist policies are pursued, the principal concern is to prevent another Vietnam-like buildup of inflationary momentum rather than achieving full employment and widespread prosperity.

There is considerable irony in the way the economic legacy of Vietnam has been molded into a cautionary tale on the failures of large-scale interventionist policies and the overriding dangers of inflation. It is, of course, true that the escalation of the war beginning in 1965 was associated with a rise in inflation. But to focus on inflation alone ignores the other side of the same experience: that Vietnam-War spending also contributed to an enormous advance in social and economic progress by creating an almost fully employed labor market. Full employment brought with it higher wages, better working conditions, and less job discrimination

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against women, African Americans, and other minorities. As Arthur Okun, member of the Council of Economic Advisors under President Johnson, wrote about these years: "Prosperity has been the key to the reduction of the number of people below the statistical poverty line from 40 million in 1961 to 25 million in 1968. It has meant jobs for those formerly at the back of the hiring line. . . . It has made economic security a reality to millions of middle-income families."

Vietnam-War spending created an almost fully employed labor market. Full employment brought with it higher wages, better working conditions, and less job discrimination against women, African Americans, and other minorities.

Why has this positive economic legacy of the Vietnam War been neglected? We can think of three basic reasons. To begin with, the purpose of the Vietnam escalation was to fight the war, not to promote full employment. The spending was not, therefore, a conscious test of the effects of high levels of government spending on labor market conditions or any other domestic economic target. Indeed, in 1965, policy makers were not even clear as to how much was being spent on the military.

In addition, because the war was widely condemned as immoral, it was difficult to focus on its economic benefits. Many of the strongest opponents of the war, such as Martin Luther King, Jr., were the same people who were in the forefront of the fight for social and economic justice in the United States. Such people were unlikely to give credit to the war for advancing their aims, even to make the case that the gains achieved through the war-induced full employment were reproducible through other forms of large-scale government job creation and spending.

Finally, and perhaps most important, not everyone in society benefited from the full employment conditions induced by the war. In particular, big business and finance suffered losses. Creditors saw earnings drop as the real return on loans was eroded by inflation. The rate of profit on corporate investment also began to fall from a 1965 peak, though rising international competition rather than inflation was primarily to blame for this.

It is not surprising that those who perceived themselves as faring badly from the war-induced full employment economy would want to present the economic legacy of Vietnam in strictly negative terms. It is unfortunate, however, that the positive economic legacy of the war has not been more widely circulated. In our current environment of stagnating or declining living standards for the majority, increasing racial polarization, and assaults on the very idea of a public purpose, important lessons for today can indeed be extracted from the Vietnam experience. In particular, Vietnam provides a means for contemplating a crucial question: how to achieve full employment and greater social justice without having to pay such horrible costs in the process.

WAS VIETNAM NECESSARY FOR PROSPERITY?

In 1970, the antiwar critic Robert Eisner confronted what he termed the "myth" that "the American economy in some sense 'needs' the war in Indochina." He found that this myth was pervasive among both supporters and opponents of the war: "Critics see economic interest in prolonging the war as a major obstacle to their efforts to end it. Supporters, particularly some trade union leaders, have even stressed publicly that millions of jobs are dependent upon our defense program."

In challenging those who saw a connection between the war and U.S. economic prosperity, Eisner raises a fundamental question that needs to be clarified here: How is the performance of the U.S. economy affected by military spending? This question is itself a variation on a broader and more venerable controversy as to the relationship between military spending and prosperity in capitalist economies. In fact, there is no easy answer to the question, as the briefest reference to some prominent case studies makes clear. It is undeniable, for example, that spending on World War II succeeded spectacularly in ending the Depression in the United States after Roosevelt's New Deal had attempted and failed at many other remedies throughout the 1930s. It is also true, however, that after World War II, the Japanese and West German economies flourished, even though they were destroyed by the war and operated without a military–industrial complex throughout the postwar period.

These widely disparate experiences are representative of a much wider range of relevant examples

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and as such make clear that across countries and time, no unique relationship exists between military spending and economic performance. We can appreciate these widely varying experiences with military spending by briefly considering some basic demand- and supply-side effects of military spending.

An increase in government military spending will, of course, increase aggregate demand, everything else being equal. But what will be the effect of this demand increase? It depends on whether there are unsold goods to be bought and available resources to be mobilized. If so, the increase in military spending will be a stimulant, promoting growth at least in the short term. If there are no unused resources, then the increased demand will simply raise prices on the resources already available, bringing inflation.

But the notion of a fixed supply of resources (i.e., people and productive equipment) is itself ambiguous, even in the short run, and thus also is the relationship between increasing demand in a fully employed economy and inflation. For example, we define full employment only in relationship to the total number of people who have made themselves available on the labor market. When job opportunities improve through an increase in demand, more people are likely to enter the labor market, expanding the total labor supply. Certainly during the Vietnam War, a substantial supply of untapped labor existed in the economy as full employment was approached. There were two primary reasons for this: the low rates of labor market participation by women, and the discrimination faced by women, blacks, and other minorities, which limited their ability to search for jobs, obtain adequate training and credentials, or receive fair treatment in hiring decisions.

If we assume that increases in military spending will stimulate employment and demand under most circumstances, this does not, however, suggest that there is something unique about their capacity to achieve that end. A given increase in government spending on education, health, or civilian research and development will almost always create at least as many jobs as an equivalent increase for the military.

This, in turn, raises the supply-side question: whether committing public money on the military is benefiting the economy over the long term as much as would alternative uses of funds, such as, for example, education, health, or civilian research and development. This question is obviously loaded politically; one's answer depends on one's assessment of the contribution to national well-being of the U.S. government's enormous expenditures on the military. But even controlling for such biases, the issue remains clouded by the fact that there have been major spillovers from the military to the civilian economy. Ann Markusen and Joel Yudken, for example, have shown that the three most dynamic civilian sectors of the U.S. economy over the postwar period—aerospace, communications, and electronics—have been built on the foundation created by military research. At the same time, the Japanese government nurtured the growth of a dynamic high-tech manufacturing sector through a purely civilian-based industrial policy.

Here we approach the crux of the matter. Either as a source of short-run demand stimulus or as the basis for a long-run industrial policy, there is nothing uniquely effective about government spending on the military. At least in the United States, however, outside of pure transfer payments such as Social Security, military spending has been in the form of large-scale government spending, which has been most agreeable to the political and economic elite. There is no evidence that these elites have ever been willing to support a sustained full employment policy on its merits. The Vietnam escalation just happened to emerge at a time when conditions in the economy made sustained full employment a real possibility.

So, returning to Eisner's question, the U.S. economy did not "need" the Vietnam War in any absolute sense as the basis for a full-employment jobs program or an industrial policy. Yet no other form of government spending capable of bringing the economy to full employment has won the support—either in the 1960s or since then—of the political and economic elite. This is the only sense in which the Vietnam experience provided a unique laboratory in the economics of full employment prosperity.

VIETNAM IN THE 1960s EXPANSION

A few basic indicators will initially make clear the extent to which the 1960s were a period of unequaled prosperity, especially in terms of the egalitarian spread of well-being. The average GDP growth rate for the decade was 4.1 percent, compared with 2.8 percent for the 1970s and 2.6 percent for the 1980s. In today's economy, a 1 percent increase in GDP growth means that the average person would get an additional $260 in income per year. The decline in annual growth from 4.1 percent to 2.6 percent between the 1960s and 1980s would thus mean nearly $400 in lost income per year for everyone in the country.

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The unemployment rate averaged 4.6 percent in the 1960s, then rose to 6.1 percent in the 1970s and 7.2 percent in the 1980s. In today's labor market, the difference between a 4.6 percent and a 7.2 percent rate of unemployment is that 3.5 million more people—the entire population of Los Angeles—would have jobs.

The average real wage for nonsupervisory workers increased in the 1960s at an annual rate of 1.4 percent but has been falling since, declining by 0.3 percent in the 1970s and 1 percent in the 1980s. At the end of the 1960s, the average nonsupervisory worker earned $465 a week in today's dollars, while by 1989 she or he earned only $409. And as Arthur Okun noted in the passage cited above, the number of people in poverty also declined dramatically in the 1960s, from 40 to 24 million between 1960 and 1969, or from 22.2 percent to 12.1 percent of the total population. As of 1989, the percentage in poverty had risen back to 12.8 percent, or 31.5 million people.

In the United States, outside of pure transfer payments such as Social Security, military spending has been in the form of large-scale government spending, which has been most agreeable to the political and economic elite.

For several reasons, the Vietnam War could not possibly have been solely responsible for the economic achievements of the 1960s. To begin with, there were several important factors underlying the 1960s boom that did not relate directly to Vietnam. The most important was that the United States emerged from World War II as the unquestioned world leader in producing manufactured goods for exports, and this momentum carried into the 1960s. U.S. exports were also greatly bolstered by policies, such as the Bretton Woods monetary system and the Marshall Plan, that promoted a United States–led free trade regime throughout the capitalist world.

Concurrent with this export boom was the development in the United States of new industries for both the domestic market and exports. As noted above, one major area of expansion came from industries growing out of the wartime developments in aerospace, communications, and electronic products. A separate source of new industrial growth came from the expansion of the automobile industry and the allied sectors of oil, rubber, glass, road building, and the development of suburbs. Another factor strengthening the United States in the 1960s was the robust financial system, as both businesses and households came out of World War II carrying little debt. This gave them considerable latitude in increasing their level of indebtedness to finance investment and household durable purchases.

Finally, the stated economic policy priority at that time, in the United States and among the advanced capitalist countries, was to attain a full employment growth path. Throughout the West, it was considered incumbent upon governments to demonstrate that capitalist economies could achieve full employment prosperity and thus counteract the claims to superiority coming from the Soviet Union. After all, Nikita Khrushchev's 1956 boast that the Soviet economy would "bury" the West was taken quite seriously at the time, since the Soviet economy experienced no unemployment during the 1930s Depression and had been growing at more than double the rate of the U.S. economy through the 1950s.

It was in this spirit that in 1962 Walter Heller, chairman of the Council of Economic Advisors under President Kennedy, proposed a tax cut that would stimulate the economy by increasing the federal deficit, and thereby move the economy toward full employment. Due to the skepticism of the opinion elite—although not among the economics profession—it was not until 1964 that what was then the largest tax cut in history was signed into law. The economy responded quickly, with growth rising from 4.1 percent to 5.3 percent between 1962 and 1964 and unemployment falling from 5.5 percent to 5 percent. As a source of government stimulative spending, the rise in the military budget was an important factor contributing to the 1960s boom. Prior to 1965, however, increases in the defense budget were not motivated by the situation in Vietnam but rather the general post-Sputnik intensification of the cold war.

There has been some confusion and associated controversy as to when the major escalation of military spending on Vietnam actually began. As Murray Weidenbaum showed soon after the escalation, the source of the confusion was the presence of lags between the time military orders were placed and the time they were delivered and paid for. When such considerations are accounted for, Weidenbaum showed that the increase in defense orders actually began rising rapidly during the second quarter of 1965, from $51 billion to $55 billion between the first and

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second quarters of 1965, then again to $59 billion and $62 billion in the subsequent two quarters.

This escalation came on top of an already expanding economy, which is the central point for understanding the economic impact of Vietnam. Because of this, its effect was to push the utilization rates for both productive capacity and people beyond the point that had been experienced at any time over the post–World War II period. In this sense, Otto Eckstein, working from his Data Resources econometric model, concluded that "from 1965 through 1971, the principal movements of the economy can be explained by the Vietnam War."

THE BENEFITS OF THE VIETNAM BOOM

We have referred to the figures on aggregate unemployment, wage growth, and poverty during the 1960s. While these data are indicative of the gains of this period, there is much to be learned by considering some of the more detailed statistics tracking this period, as well as by following some contemporaneous accounts of developments in these years. We rely on *Business Week* magazine (hereafter *BW*) as a relatively neutral journalistic reference for the period.

Returning briefly to the aggregate data on unemployment, what does not emerge from the decade's average figures is that the gains in reducing unemployment come entirely from the 1965–69 years—that is, after the start of the Vietnam escalation. Thus, the average unemployment rate for 1960–64 was 5.7 percent, exactly the same as that for the full 1950–89 period. By contrast, over 1965–69, unemployment averaged a postwar low of 3.8 percent.

But even these aggregate figures do not adequately convey the changes in labor markets that resulted from the Vietnam escalation. An additional crucial development was the widespread prosperity. The dramatically improved employment conditions did not occur merely in a few regions with heavy concentrations of military-related industries. Rather, to an unprecedented extent, prosperity was spread throughout the country. Thus, *BW* reported in December 1966 that "the Labor Department's Bureau of Employment Security released a proud statistic this month: 65 major industrial centers are now classified as low-unemployment areas, the largest number ever" (December 17, 1966, p. 64). ("Low unemployment" means that the unemployment rate in the area is less than 3 percent.)

The unemployment rate for African Americans and other minorities also reached a post–World War II low of 7.2 percent during 1965–69. The figure for the first half of the 1960s was 10.8 percent, which, again, is the same as the average rate for the full 1950–89 period. In addition, the ratio of nonwhite to white median income rises sharply between 1965 and 1969, from 53.8 percent to 59 percent, a five-year gain that has yet to be equaled. The rising employment opportunities for African Americans also led to a surge in blacks joining integrated labor unions. This was occurring throughout the country, but especially in the South and, as *BW* noted, "despite a rising tide of separatism in the ideology of the Negro movement" (November 21, 1968, p. 120).

The dramatically improved employment conditions did not occur merely in a few regions with heavy concentrations of military-related industries. Rather, to an unprecedented extent, the prosperity was spread throughout the country.

This is not to suggest that that the Vietnam boom was solely responsible for the gains made by blacks in the 1960s. Other important factors include the northward migration of southern blacks, the gains in educational opportunities, and the Civil Rights Act of 1964 and its subsequent enforcement. It is difficult to isolate the relative contributions of these and still other factors, especially since many of them happened concurrently. The fact that the most rapid advances were begun and then sustained over the second half of the 1960s, however, supports the notion of the Vietnam boom's central influence. By contrast, northward migration by blacks had begun in earnest in the 1940s, and its effects were more gradual. Improvements in educational opportunities similarly brought substantial gains, but over a period of decades. The Civil Rights Act was passed in 1965, but it produced only a legal framework in which blacks could pursue employment opportunities. As has been seen increasingly since the 1960s, such legal claims to equal employment opportunity offer only limited benefits when the demand for labor is slack, especially for those with fewer credentials and connections.

It is on the basis of this type of logic that an exten-

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sive study by James Smith and Finis Welch determined that of all the factors contributing to the economic progress by African Americans over the post–World War II period, economic growth alone accounts for roughly half of the advances. They conclude their study by warning that "until we restore the growth rates of the 1960s, further long-term improvements in black economic status will not materialize."[1]

It is not surprising that the most direct employment benefits of the Vietnam-led expansion flowed to young people, especially young men of military age. Between 1964 and 1969, the number of men in the civilian labor market expanded by 33 percent, from 2.6 to 3.9 million. In addition, military enlistments expanded from 2.6 to 3.5 million in those same years. Poor people gained the most directly from this search for new enlistees, as the enlistment rate for young males living in poor communities was disproportionately high. In general, however, the Vietnam escalation made young, inexperienced job seekers increasingly valuable to employers.

We cannot overlook the less benign aspects of the opportunities created by the war-induced expansion. Because many young men, especially the poor, lacked other prospects, they were forced to both put their lives at risk and to become legal killers in an immoral venture. African Americans, additionally, faced patterns of discrimination in the military similar to those in the civilian labor market, as they were placed disproportionately in low-skilled jobs and received fewer opportunities for advancement.

In this context, we should finally consider the relationship between the two wars of the Johnson administration, the War on Poverty as well as the Vietnam War. The Johnson administration had firmly committed itself to advancing equality and opportunity through its War on Poverty, and there were advances through programs such as the Job Corps, College Work-Study, and, especially, Head Start. The funds dedicated to this domestic war were, however, paltry compared to those for Vietnam. At the peak of the War on Poverty in 1968, for example, Congress appropriated $1.7 billion for these programs, which amounts to one-seventeenth of the $28.8 billion spent fighting in Vietnam that year. Moreover, as Vietnam escalated, the Johnson administration conceded that it could not finance both guns and butter, so butter would have to be sacrificed. Thus, as Anthony Campagna argues, "the anti-poverty program that was initiated with such fanfare became an early casualty of the Vietnam War." At the same time, as we have seen, the full employment conditions created by Vietnam became a force for egalitarian social progress far beyond what any politically viable budget for the War on Poverty could have attained.

FULL EMPLOYMENT, INFLATION, AND INCOME DISTRIBUTION

Given the widespread benefits of the war-induced boom, why is the Vietnam experience so widely viewed as having inflicted serious damage to the economy? The most common answer, of course, is that the war set off an inflationary spiral that could not be contained, leading to the stagflation and high unemployment of the 1970s. It is undeniable that inflation accelerated in the second half of the 1960s. After having averaged only 1.2 percent from 1960 to 1964, it rose to 1.9 percent in 1965 and then averaged 4.4 percent from 1966 to 1969.

Some economists argue that the Vietnam escalation could not have been responsible for the accelerating inflation of the late 1960s because, relative to the size of the economy, spending on the war was too small to have produced so large an impact. This view is simply a restatement of a more general position that assigns little significance to the war in explaining the boom of 1965–69. Because we believe the war-induced, full employment conditions did play a decisive role in fueling the boom, we must then also acknowledge the war's role in generating inflationary pressures.

But a more fundamental question needs to be asked: Assuming the war-induced full employment was a major cause of inflation, how serious were the problems that either led to the inflation or were caused by it?

The first issue to consider is whether the boom created severe difficulties for businesses in finding qualified workers to hire. Certainly, the tight labor market forced businesses to be more aggressive in their methods of recruiting workers. In April 1966, for example, *BW* reported that "U.S. employers are finding that the tight market for labor is forcing them to use gimmicks to lure sorely needed workers from other companies—and other countries as well." Among the specific strategies employed, the article notes, "Ford and other employers have combed Appalachia and the Ozarks, looking for workers among coon and squirrel hunters. They've come up with, at most, a handful."

Over time, however, businesses became increasingly adept at operating in tight labor markets. Thus,

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the February 1968 *BW* article, "A Tight Labor Market that Doesn't Really Hurt," described "the proved talent of business for living in a tight labor market." It reported that "after three years with unemployment near or below 4 percent, business knows how to get the labor it needs. Companies are importing, upgrading, and training labor with increasing facility and ingenuity." The story detailed ways in which businesses were increasingly recruiting women, blacks, and other minorities, expanding their job training programs, and providing more opportunities and incentives for promotion.

But what of the costs of the inflation emanating from the tight labor market? Despite the widespread opposition to even moderate inflation from central bankers and other elites throughout the world today, there is little evidence showing that overall economic performance is harmed by moderate rates of inflation. This view has been confirmed most recently in research led by Michael Bruno, chief economist of the World Bank. Studying the relationship between inflation and economic growth for 127 countries between 1960 and 1992, Bruno and his colleagues found that average growth rates fell only slightly as inflation rates increased to between 20 and 25 percent. Of particular importance for our concerns here, Bruno found that between 1960 and 1972, economic growth on average *increased* as inflation rose from negative or low rates to the 15 to 20 percent range. This is because, as Bruno explains, "in the 1950s and 1960s, low-to-moderate inflation went hand in hand with very rapid growth because of investment demand pressures in an expanding economy."

Such growth-led "demand-pull" pressures were clearly the source of the rise in inflation in the United States between 1965 and 1969. As we have seen, the benefits of this growth were widespread. Why then should the accompanying moderate inflation be regarded as a debacle?

The real problem occurring in the second half of the 1960s was not inflation per se, but rather that the distribution of national income had shifted in favor of working people and the less wealthy and the profitability of U.S. businesses was declining. Yet these are not generalized problems for the economy as a whole; indeed, it is not obvious, to say the least, that they are problems at all for working people enjoying a rising share of national income. Moreover, these developments were only partially connected to the onset of inflation. Nevertheless, by focusing on inflation as such rather than the issues of income distribution and profitability, the priorities of a small segment of society (i.e., the wealthy) acquired the status of a nationally shared concern.

Capital income—including corporate and business profits, interest payments, and rent—rose throughout the second half of the 1960s, but the rate of increase was somewhat lower than in earlier periods, despite the booming economy. Thus, in the latter half of the 1960s, working people made substantial gains in the distribution of income. Wages as a share of national income jumped from 68.1 percent in 1965 to 72.4 percent in 1969, an unprecedented increase and one that has not been equaled since. Overall income distribution among families also reflects this trend.

Despite the widespread opposition to even moderate inflation from central bankers and other elites throughout the world today, there is little evidence showing that overall economic performance is harmed by moderate rates of inflation.

What is the relationship between these distributional shifts and inflation? To begin with, the distributional shifts did not result primarily from accelerating wage increases. The rise in real wages for nonsupervisory workers between 1965 and 1969 was 1.2 percent. This represented a decline in wage growth from the first half of the 1960s, when wages rose by 1.7 percent, and the 1950s, when real wage growth averaged 2.6 percent.

There were, rather, three other sources of distributional shifts. The first was that full employment and the accompanying expanding labor market simply converted a higher proportion of the population into wage earners. This change was connected with inflationary pressures only indirectly, inasmuch as full employment produced both the inflationary pressures and the relative increase of wage earners in the labor market.

The second source of the distributional shift was more closely associated with inflation. When inflation is not anticipated, creditors will lose real income relative to debtors since interest rates will not be indexed to inflation. The U.S. credit market was not indexed to inflation in the 1960s, and creditors experienced some real income losses as a result.

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The final cause of the distributional shifts was that even though wages were rising only slowly, the rate of profit of U.S. businesses was, by a broad range of measures, in actual decline. Could full employment or inflation explain this profitability decline? We clearly cannot explain the profitability decline by a wage squeeze alone because, as we have seen, real wage growth had slowed during this period. However, aggregate productivity growth also began to decline in these years, and to the extent that productivity growth was slower than wage growth, this would contribute to a profit squeeze.

The fully employed labor market may have played a role in generating the productivity decline. First, the average level of job experience and skill likely declines as the strong demand for labor induces new entrants into the job market. In addition, full employment may have created an environment in which workers felt more secure in their jobs and consequently reduced their level of effort. But these explanations suggest a pattern of declining productivity growth that is consistent across industries, while in fact, the decline was heavily concentrated in utilities, transportation, and especially construction, which experienced an absolute decline in productivity between 1966 and 1973. Thus, declining aggregate productivity relative to real wages did contribute to the fall in profitability, but it is unlikely that full employment conditions were primarily responsible for the productivity decline itself.

A separate and more generally applicable explanation for declining profitability in the United States was that U.S. dominance in export markets was starting to erode by the mid-1960s. In particular, the West German and Japanese economies had entered a phase of post-reconstruction boom, as productivity in both countries rose rapidly while wages were far below those in the United States. Thus, even though real wages in U.S. manufacturing did not increase in this period, unit labor costs were growing in the United States at a rate almost double those of Germany and almost triple those of Japan. As a result, U.S. manufacturers could not raise their prices as fast as their nominal wage payments and other nominal costs were rising. Their profitability subsequently declined.[2]

Note here that although the fundamental problem was the inevitable decline of U.S. economic hegemony, one could conceive of a "solution" to the problem in which U.S. wages would have fallen to a level comparable to those of Germany and Japan, which in turn would have eliminated the economy's inflationary pressures. This would have required U.S. workers to relinquish all the gains they had achieved throughout the entire postwar period. Certainly, eliminating the war-induced full employment as well as aggressively attacking labor unions would have been necessary to achieve these ends. In this sense, therefore, full employment could be held "responsible" for the profitability decline.

In any case, the moderate inflation that emerged in the late 1960s was itself never the problem with the war-induced full employment economy. Even from the standpoint of manufacturing capitalists, financiers, and other capital-income receivers, the issue was rather their declining relative fortunes. Eliminating inflationary pressures by ending full employment may have helped eliminate these difficulties, but only by attacking the well-being of the great majority who were benefiting from full employment. Other solutions were feasible, but unfortunately never attempted.

WHY CONTROLS COULD NOT WORK

In the admittedly tepid form of wage/price guidelines, the Council of Economic Advisors under President Kennedy had sketched some initial outlines of an approach to sustaining full employment while addressing problems of distribution and competitiveness as well as inflation per se. The real breakdown of policy began only when it became clear that such policies could not be made workable in the political environment dominated by Vietnam.

President Kennedy's 1962 *Economic Report of the President* included a simple plan for controlling inflationary pressures while the government pushed the economy toward full employment. Because the Council of Economic Advisors believed that the rate at which aggregate productivity could grow in the economy was approximately 3.2 percent per year, their 1962 report argued that wage increases should also rise by no more than 3.2 percent annually. Although productivity in some sectors of the economy would undoubtedly increase by more than 3.2 percent, wage increases in those sectors could not exceed the economy-wide average, or else workers in the more slowly advancing sectors would also demand faster wage increases, which would then generate inflation.

The guideposts were widely regarded as having succeeded in reducing inflation by about one-third in the early 1960s, even though there were no legal

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enforcement mechanisms behind them. But unemployment was relatively high in the early 1960s, and thus the ability of the guideposts to reduce inflationary pressures in a full employment economy was not tested in these years.

As the Vietnam boom gathered force, it became clear that such general and informal guidelines were incapable of dealing equitably with the distributional issues posed by the full employment economy and the rise of West European and Japanese competitiveness. A broad range of policy intellectuals did recognize the inadequacy of the guidelines and the need for more comprehensive measures if full employment were to be sustained.[3] The Johnson administration, for its part, made some significant attempts to coalesce such initiatives. In the end, though, all these efforts failed. Understanding the sources of this failure explains much about why the war-induced full-employment economy was unsustainable.

A separate and more generally applicable explanation for declining profitability in the United States was that U.S. dominance in export markets was starting to erode by the mid-1960s. In particular, the West German and Japanese economies had entered a phase of post-reconstruction boom, as productivity in both countries rose rapidly while wages were far below those in the United States.

We must first dismiss the notion that there is something intrinsic to capitalism that led to the failure of the wage/price policies. It is true that for such policies to have succeeded, the fundamental issues of the relationship between full employment, income distribution, and international competitiveness needed to be seriously addressed. This implies that the government's involvement in the economy would have had to expand to incorporate industrial policy and a more active role in influencing income distribution, in addition to the government's then-growing commitment in the area of macroeconomic growth and stability.

In fact, when the United States was first implementing wage/price guidelines in the early 1960s, more comprehensive approaches of this kind were being developed throughout Western Europe. In the Nordic countries in particular, wage/price guidelines were developed as part of a broad social contract over planning for full employment. Among other things, wage/price guidelines in the Nordic countries were not written and handed down by the equivalent of the U.S. Council of Economic Advisors; rather, the policies were the result of extensive negotiations by business and labor in addition to government representatives. Wage bargaining to sustain full employment, in short, became a central feature of the "social corporatist" model that evolved among the Nordic countries as well as a few other countries, such as Austria. The result was that these countries maintained nearly full employment throughout the 1970s and 1980s, long past the time when U.S. policy was paying even lip service to a full employment.

Within the United States, the equivalent political coalitions never existed to introduce a social corporatist policy approach. Capital opposed the guidelines for evident reasons. Experiencing the realities of full employment firsthand, they saw little advantage to continuing it. Their perception was that full employment was cutting into their profits, and they tended to accept the assessment of an economist quoted in *BW* in June 1968 that "you have to keep unemployment high enough so that workers don't get too greedy." This view prevailed despite the fact that real wage growth had diminished by the mid-1960s and wages were actually falling in manufacturing.

Labor was similarly unenthusiastic. To a significant extent, the attitude of labor was fostered by their experience in the first half of the 1960s. During that period, profits were rising well beyond the 3.2 percent guideline for wage increases, causing Council of Economic Advisors Chair Gardner Ackley to warn business in May 1966 that "labor cannot be expected to continue honoring the guidelines as well as it has when it sees prices and profit margins continually rising." At the same time, labor had not attempted to involve itself broadly in the formation of economic policy. Unlike in the Nordic countries, the U.S. labor movement did not articulate a desirable and feasible set of policies that would be needed to complement expansionary policies for full employment. In particular, if it were true that some degree of wage restraint was necessary in expansions, the labor movement never developed a view as to what types of quids pro quo to insist upon in exchange for wage restraint.

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Finally, there was the problem of the war itself. Because full employment was the byproduct of the war, it was difficult to conceive of full employment as having been a positive achievement of conscious government policy that might also be sustained by further policy interventions. Moreover, the natural supporters of full employment policies on the left were also the strongest opponents of the war and were, therefore, not well situated to consider how the existing war-induced, full employment conditions should be sustained. The war also divided the left from what would otherwise have been its natural allies in the labor movement, which had long supported the cold war consensus on foreign policy.

The war also destroyed the legitimacy of the Johnson administration among the left and weakened the government's political power among both business and labor, all important steps in the path toward Johnson's political demise in 1968. Johnson is undoubtedly the last U.S. president who was willing to argue that "if rising prices are a problem, they're a lot better than a stagnant economy and high unemployment."[4] But Vietnam rendered him incapable of transforming full employment from an accident of war into a sustained commitment of public policy.

CONCLUSION

The Vietnam War demonstrated that the U.S. government has the capacity to direct the economy to achieve and sustain full employment. In reviewing the experience from 1965 to 1969, we see also that tremendous benefits accrued from such conditions. We have argued that the full employment economy was the single most potent tool delivering increasing well-being and widespread opportunity during these years. Strong evidence in support of this view is that the pace of egalitarian social progress slowed dramatically when full employment ended and has yet to recover the momentum achieved in the 1960s.

Of course, the motivation for creating a full employment economy was not to advance social progress in the United States but to fight an imperialist war that killed millions and destroyed Vietnam in the process. There could be no more malign "policy instrument" for achieving social progress in the United States. Because there were no technical barriers to deploying more benign policies on behalf of full employment, such as expansionary policies focused on health, education, and civilian research and development, it was never the case that the U.S. economy "needed" the Vietnam War.

The problem was that working people and the poor, the primary beneficiaries of the tight labor market, did not have sufficient political power to force through a full employment program on its own merits. This was true despite elite opinion in the 1960s that capitalist economies could outcompete communism by delivering a higher standard of living to ordinary people. This priority, however, carried less weight when the distribution of income turned against the recipients of capital income, and especially when the profitability of U.S. corporations began to decline. The fact that elite opinion elevated the rising but still moderate inflation to a problem of crisis proportions is an important indicator of the shift in their concerns and in the political weakness of the forces with the most to gain from sustaining full employment.

Moving into the 1970s, a fundamental realignment occurred in mainstream thinking on economic policy. Free-market proponents such as Milton Friedman had never accepted the consensus view of the 1960s that expansionary government policy was necessary to achieve full employment. The Friedmanite position was that free markets bring full employment and that misguided government policy is responsible for all departures from full employment. In 1968, Friedman crystallized his position through developing the concept of a "natural rate of unemployment"; when government does not interfere with market activity, that rate is effectively zero and everyone thereby receives the wage that the market determines they deserve. Friedman claimed that government efforts to promote full employment artificially would only bring inflation.

This Friedmanite perspective increasingly gained ascendancy in the 1970s, as inflation and unemployment both increased. Although full employment and prosperity were actually attained in the 1960s through government expansionary policy, this is not the legacy to which policy makers refer with respect to Vietnam. The lesson that is instead carried forward is that this government-induced (i.e., "unnatural") full employment period was unsustainable and that it inevitably led to a destructive inflationary spiral. We have tried to show that the war-induced inflation was hardly destructive and, in any case, was not inevitable. It was a politically determined outcome of the environment created by the war. Vietnam, in short, brought both full employment and the decline of the political forces that might have fought to sustain it.

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NOTES

1. Other studies do assign far greater weight to other factors. For example, Donahue and Heckman acknowledge that the most rapid period of progress began in 1965, but they argue that this was due to the passage and aggressive enforcement of civil rights laws, especially in the South. However, they make no attempt to disentangle the relative effects of the changing legal environment from the war-induced full employment conditions that also emerged in 1965. Indeed, they make no attempt at all to measure the contribution of full employment to the progress they observe.

2. This account of the causes of declining corporate profitability draws from Brenner. Alternative perspectives on this question are developed in Moseley and Wolff.

3. Indeed, looking back on this period from the 1990s, when full employment is considered a rather shrill and unrealistic demand of the left, what is remarkable is the extent to which so broad a consensus of analysts, including many conservatives, were committed to at least thinking of how active government policy could serve to promote full employment with price stability. An impressive piece of evidence in this regard is a volume from a 1966 conference on the wage/price guidelines. The conference was held at the Graduate School of Business at the University of Chicago, then as now a bastion of conservative thinking on economic policy. Indeed, the conference volume (Schultz and Aliber) was co-edited by George Schultz, then Dean of the school and later to become Labor and Treasury Secretary under President Nixon and Secretary of State under President Reagan.

4. *Business Week*, August 6, 1966.

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