THE WAR IN VIET NAM AND THE "WAR" ON POVERTY

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Generations of students have learned from their professors of economics that productive resources are limited, and that, as a result, everything cannot be done at once. Producing more of any one good or service generally requires that less of some other(s) be produced; such is the venerable law of scarcity. Societies, unable to do everything, must somehow choose what things to do first; scarcity requires "economizing," or choosing the best use of limited resources.

A superficial reading of recent economic thought might appear to qualify this law. The presence of unemployed labor and capital makes it possible to increase outputs of some things without diminishing the outputs of anything else. Thus it might seem that under conditions prevailing in the 1930s or, to a lesser degree, in recent years, the law of scarcity fails to hold.

This is, as we have suggested, only a superficial view. A closer examination of the matter will reveal that the necessity for choice still stands. Under conditions of general unemployment of labor and capital, most present-day economists would prescribe monetary, fiscal, and other policy actions designed to raise the effective demand for goods and services, and thus put idle productive resources to work. Various monetary and tax devices, for example, might be (and recently in the United States have been) used to increase private business investment. Other types of tax reduction can stimulate consumer demand, while governments, particularly the federal government, may directly increase the demand for produced goods and services by raising government spending for collective consumption or investment.

In other words, there are many different ways to increase demand and put unemployed productive resources to work. Even though unemployment means that we have room to expand demand and thus get more of everything, we must still make a decision as to more of *what*; the necessity for choice is as urgent as ever. We may have more consumer goods, more capital goods or more public goods, but we must somehow choose how much of each. As usual, choosing more of one thing involves choosing less of another. Every selection of policies to increase demand and to reduce unemployment is also a choice as between various kinds of goods: public or private goods, consumer or investment goods. In summary, when the economy is at full employment, the traditional view of scarcity prevails; spending more on something (say defense) means spending less on something else (say poverty

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programs). With unemployment, the same necessity for choice is present, but it appears in the selection of policies to increase demand.

Viewing matters in this light, much of the recent public uproar over military spending for the war in Viet Nam versus spending for the "war on poverty" seems misleading in at least two ways. First, many writers seem to be saying that spending for poverty programs may have been all right when there was "slack" in the economy (or, as we would prefer to put it, when there were unemployed resources) but now that we are approaching full employment, we can no longer afford poverty programs. It would be much more accurate to say that the human and material resources put into antipoverty efforts could have been directed toward other ends all along. If we think that they are being misused now (in the sense of being directed toward less urgent ends), then they were probably being misused all along. Of course, the movement to a limited war footing may reorder priorities; in this sense it would be accurate to say that we can no longer afford any particular set of goods or services. Further, as we shall stress below, there is the possibility of a greatly expanded war effort; any decisions as to spending should take into account possibilities of rapid future shifts as well as present priorities.

A second misleading aspect of the present public discussion is the implication that poverty programs compete for resources only with military uses. No great intelligence is required to see otherwise; any one use of productive resources competes to some extent with all other possible uses. Military spending and poverty programs compete with private consumption and private investment, as well as all other objects of public expenditure.

The return of something like full employment does, of course, focus attention on the choices to be made. Indications seem clear that some types of spending, public or private, must be curtailed or we are likely to witness a considerable acceleration in the rate of price increases. We shall assume that, whatever the merits of the Viet Nam situation, military spending will take first priority. This does not necessarily mean that spending for poverty programs must be reduced, but it does certainly suggest that some spending for something must be reduced if inflation is to be avoided. What is indicated is that poverty programs and all other objects of public expenditure need to be carefully re-evaluated with respect to their costs and their benefits.

We may state, as a general principle, that any public programs for which benefits exceed costs should be retained, and paid for with higher taxes, if necessary. This is much easier to state as a general principle than to implement in any particular case. It does make clear, however, that the increase in military spending does not automatically require a cut in federal non-defense spending. If any programs are thought to be more useful than the expenditure on private goods of an equivalent sum, the principle of optimal resource use indicates raising taxes and continuing the programs. If government programs, poverty or otherwise, cannot meet this test, they should be dropped.

Resources employed in the poverty program, to repeat, have alternative uses. If they bring higher returns in their antipoverty uses than in producing other public or private goods and services, they should remain where they are. Further, there are frequently several different ways of accomplishing any given end, a truth of which our military establishment has been persuaded (with great effort) by Mr. McNamara. Businessmen would, and anyone should, naturally choose the least costly of several equally effective methods. These two considerations suggest what it is we need to know about the poverty programs, with more precision than has been yet offered.

First, what are the expected returns from the outlays? They are, of course, partly monetary and partly intangible. In the latter area we can proceed only by value judgments, but this need not preclude efforts to identify and estimate monetary returns to individuals, to the government, and to the economy. We must also bear in mind that costs of the programs include earnings foregone by participants in addition to direct government outlays. Quite possibly, some outlays might be justified by monetary returns alone, with all non-monetary benefits as clear gain to the economy. Or all outlays may so greatly exceed any conceivable monetary benefits that even over-generous allowances for intangible benefits could not justify the programs. How, for example, does the cost of retraining workers, on the average, compare with estimated additional earnings? With respect to the Job Corps, how much outlay per enrollee would be covered by estimated higher lifetime earnings? What percentage of success has been attained with the first classes, and which way does this percentage move with subsequent classes? At what percentage of success does the program "break even," given present costs and estimated higher earnings? One could readily design a full research agenda of similar questions for each phase of the program.

A second research agenda relates to alternative means of accomplishing desired ends. To some extent, rising demand and employment in themselves open exits from poverty income levels, even without special programs. In fact, widespread prosperity in some small measure works against some poverty program objectives by raising earnings of unskilled workers and encouraging marginal students to leave school. For each poverty program, what other means might accomplish each desired end? Could not more youths simply be taken into the armed forces even if mental and physical standards were relaxed somewhat? To the (possibly considerable) extent that inexperienced workers are "structurally" unemployable because of minimum wage legislation and other employment costs, might it not be profitable to erase such barriers and, if necessary, supplement low earnings in various other ways? What, in short, are other possible means of diminishing poverty, and what are their costs?

We must also keep in mind the possibility of a sudden acceleration in military spending and the resulting present need to maintain maximum flexibility in resource use. Further, the returns from antipoverty efforts may be far in the future; the appropriate rate for discounting them to the present may vary with the changing military situation.

We might pause at this point to consider in more detail questions of inflation and full employment. Full employment does not, of course, mean that measured unemployment is zero; there are always some people moving between jobs or temporarily unemployed (voluntarily) for other reasons. Such "frictional" unemployment is widely agreed to be unavoidable, even desirable, for a well-functioning market economy. There is much dispute, however, as to how much frictional unemployment our economy requires. Full employment, then, means measured unemployment of two per cent, four per cent, or whatever is the appropriate frictional level, with the further understanding that the number of jobs open and in the process of being filled is roughly equal to the number of unemployed persons in the process of moving between jobs.

In recent years there has been much discussion of "structural" unemployment, by which is usually meant that unemployed persons lack the skills or abilities to fill jobs that are open, or could be opened by an expansion of demand. To the extent that our remaining unemployment in the United States is frictional or structural, expanding demand by monetary or fiscal policy will largely raise prices without doing much to eliminate unemployment. Some of the poverty programs, incidentally, as well as earlier manpower training legislation, are aimed at reducing structural unemployment via education and training for persons now in low-income families.

There is some evidence from past experience that the level of unemployment—frictional, structural, and all other kinds—is inversely related to the rate at which wages and prices creep up. With a sufficiently vigorous demand for goods such as existed during World War II, virtually everyone can be employed, including those whom we would now regard as structurally unemployable. The penalty is, of course, rapidly rising wages and prices which serve, in part, to overcome minimum wage laws and other cost barriers to the employment of low-productivity workers. At the other extreme, there seems to be some level of unemployment at which wages do not rise at all so that rising labor productivity could result in gradually falling monetary labor costs and, possibly, falling prices of goods. Postwar data seem to indicate that unemployment of five per cent to six per cent is required for price stability (rising wages are absorbed by rising labor productivity) whereas an unemployment rate as low as three per cent is likely to be accompanied by price level increases of 3½ per cent to 4½ per cent per year.[1]

[1] For rough estimates of this nature, see Samuelson & Solow, *Analytical Aspects of Anti-inflation Policy*, 50 AM. ECON. REV. 177 (1960). Their estimates are based on data from the teens, twenties, and postwar period. Including the 1930s would greatly increase the estimate of unemployment consistent with price stability.

The enormous expansion in the output of goods and services during the period 1961-1964 was accomplished with virtual price stability. The broadest index of output prices that we have[2] advanced 1.3 per cent per year on the average, a figure well within the range of statistical errors or unrecorded quality improvements in output. However, unemployment remained above five per cent throughout the period. The rate of price increase rose in 1965 to 1.8 per cent while unemployment fell to 4.1 per cent at year-end. This recent behavior is quite consistent with the functional relationship between unemployment and the rate of inflation on which the above estimate of likely inflation at three per cent unemployment is based.

The President's Council of Economic Advisers is more optimistic (excessively so, one fears) about avoiding inflation. The Council's latest annual report[3] predicts unemployment of 3¾ per cent by December 1966, with an increase in the price level of 1.8 per cent to 1.9 per cent. The year-end prediction of unemployment has been revised downward to 3½ per cent by the Department of Labor, according to recent press reports, thus bringing the small size of the officially-expected price rise under further suspicion. The Council's expectation that low 1966 unemployment is consistent with less inflation than our past record would predict stems from five allegedly changed factors. First, it is argued that the composition of demand has been growing and will continue to do so in a "balanced" fashion, *i.e.*, without such drastic shifts in composition as have characterized some postwar inflationary periods. Second, labor productivity gains are expected to be larger and more widely distributed than in other post-war periods, thus permitting more union pressure on wages without cutting business profit margins. Third, the Council finds more responsible attitudes among business and labor leaders with respect to key price and wage decisions. Also cited are increased foreign competition and various manpower development policies which aim at reducing structural unemployment.

In evaluating the Council's position, one is tempted to skepticism. Specifically, it seems likely that increases in government spending are understated, as are expected increases in private fixed investment and inventories. One may also doubt whether spending for residential construction will remain at 1965 levels, though the rise in interest rates on mortgage credit will certainly contribute to this result. Total demand, therefore, may well rise more than the Council expects, and, to the extent that expectations of inflation spread, demand may rise by much more. This development would push unemployment rates lower and prices higher than the Council forecasts.

Skepticism is also in order as to the balanced nature of additional demand. The shift toward investment and military spending is reminiscent of the 1955-1957 experience, which period also marked the most rapid price level increase in the postwar period apart from the Korean build-up and the immediate post-war buying binge. Reliance on foreign competition, unfortunately, has ominous implications for our

[2] The implicit price deflator for gross national product.
[3] COUNCIL OF ECONOMIC ADVISERS, ANN. REP. (1966).

balance of payments. It may also be true that unions and businessmen might avoid price and wage increases in the face of mounting (and possibly understated) demands, but this remains to be seen. Our own experience to date has not been reassuring, and the experience of European countries with "income policies" is even less so. We must also face the possibility of a greatly expanded war effort without the idle resources of 1941 or (to a lesser extent) 1950. Any sudden rise in military spending beyond the levels now foreseen could rapidly touch off still other inflationary forces. Consumers and businessmen are sufficiently liquid to increase expenditures sharply for construction and inventories. A further consideration suggested by the present uncertainty is the need to avoid committing resources to long-range projects (such as construction) which cannot be quickly reversed.

It would appear, then, that our choice lies between a very likely rise in the price level of three per cent to four per cent (with the possibility of steeper rises following an expanded war effort), or some action to curtail demand.

A price level increase of, say, four per cent per year may seem like a modest enough figure; yet such a rate, if sustained, would double the price level in about eighteen years. The inequities of inflation are well known, but we should perhaps reiterate here some of the most important problems. The systematic provision for retirement in both public and private funds is a major activity in the United States, and eighteen or twenty years represents a rather short span in calculations which normally deal in forty to fifty year periods. It is difficult to imagine the destructive impact on our pension machinery of widely held expectations that prices might double every eighteen to twenty years, or increase four- to six-fold during the normal period of calculation for the accumulation and disposition of funds for retirement.

Worst of all, the burden of inflation falls in large measure on those who are already poor, or on those at income levels already close to the "poverty line." Poverty or near-poverty living involves a majority of the aged living on public or private pensions with fixed dollar incomes. This group is, incidentally, beyond the scope of the poverty programs, and stands to suffer most from inflation. To the extent that rising prices force down demand and thus help slow down the rate of inflation, the segment of society least able to afford lower real incomes (the aged poor) is called upon to make the largest sacrifice.

The question of poverty is indeed a complex one. Though we should all like to see poverty disappear, we may well disagree on measures to abolish it. The war in Viet Nam focuses attention on inflation as a problem which is more serious than at any time since 1957. There is the strong possibility that some element of aggregate demand will have to be restrained, so that spending for poverty programs, along with other types of public and private spending, becomes a target for potential restraint. We have suggested a cost-benefit test for all types of spending including the war on poverty; decisions as to where to reduce demand should be based on such tests. We should face realistically the threat of inflation and its impact on millions of the poor.