THE ECONOMICS OF VIETNAM
By
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War is seldom rational and, from an economic point of view, calculations of costs and benefits seldom make much sense to direct participants. But there are different kinds of wars and some are more open to economic analysis than others.

An all-out war involving homeland territory tends to be particularly irrational, from an economic point of view. The burdens are enormous, unevenly distributed, and often appear senseless, in retrospect. At the same time, some individuals and companies may benefit greatly from war. The economic rules of the market generally continue to be followed during war, although in modified form; with victory (or defeat), all economic rules are temporarily suspended and to the victor go the spoils (or as many of them as he wishes, depending on how he wishes to structure the post-war world).

A brush-fire war, from the point of view of a major power, is a different matter. The domestic economy is only slightly affected; economic calculations are possible and desirable. The personal burdens, of life and limb, will still be unevenly distributed among the total population, although in recent years most major powers have tended to use only professional soldiers and volunteers to police their empires. (The United States is the exception.)

Under Secretary MacNamara, the Department of Defense has applied the calculus of the marketplace to the business of defense and war.

Some of the finest market economists (generally from the Chicago School) have adapted profit maximizing techniques (referred to as cost effective or cost benefit analyses when applied to public works) with considerable success. Generally speaking, these new techniques permit government agencies to try to achieve their objectives through minimum cost.

The war in Vietnam began as a limited brush-fire operation, well suited to economic calculation, and has progressed to the point where it verges on an all-out effort. A cost-benefit analysis applied to Vietnam is appropriate before the conflict moves into the economically irrational sphere.

After World War II, the French, attempting to re-assert their colonial rule (against President Roosevelt's better judgement), quickly found themselves over-committed economically. Secretaries of State Acheson and Dulles, after the Korean experience, supported the French economically, when France indicated the financial burden was too great to continue fighting. The total United States aid to France in Vietnam grew rapidly from $150 million per year in 1950 to over $1 billion in the fiscal year of 1954, when the United States was underwriting 80 per cent of the cost of the war. The Marshall Plan aid to France just about compensated her for her other "empire" costs, but this meant that France derived little net benefit from the Marshall aid.

Since the time when the United States took over primary responsibility for Vietnam, the economic and military aid has been substantial.

U.S. ECONOMIC AID TO SOUTH VIETNAMESE GOVERNMENT, 1955-1965
(including Public Law 480 aid, which excludes U.S. uses)

U.S. Fiscal Year		U.S. Fiscal Year		U.S. Fiscal Year	
1955	$325.8 millions	1959	$207.1 millions	1963	$197.5 millions
1956	216.3	1960	180.5	1964	230.3
1957	281.1	1961	144.6	1965	278.5
1958	192.1	1962	143.2	Total	$2,397.1 millions

Source: U.S. House of Representatives, Supplemental Foreign Assistance Authorization Fiscal Year 1966, 89th Congress, 2nd Session (Washington, 1966) quoted by Kahin & Lewis, The U.S. in Vietnam, 1967, New York, p. 73.

The impact of the American economic aid was summed up by an economist with the Michigan State University program as follows:

> "The most important and controversial part of American aid has been the 80 per cent which entered Vietnam through the commercial import program. About two-thirds of the commercial imports under American aid in 1955 consisted of consumer goods, a reflection of the strong relief function which the program served. In 1960 consumer goods constituted only a third of the total American-aided imports, the rest consisting of industrial equipment and machinery (one-half) and raw materials, fuels, and what the American aid mission calls 'other essentials'.
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> "Although most Vietnamese have benefited from American consumer imports, the greatest beneficiaries have been the urban dwellers, especially the small middle and upper classes. Thus, American aid has functioned to accentuate the distinction between the well-off and the masses. It has also led the Vietnamese government to depend on a foreign power instead of its people for its own support."
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> Source: Robert Scigliano, South Vietnam (New York, 1963, 1964), pp. 124-126.

In addition to this substantial economic aid, massive military aid has gone to South Vietnam. Scigliano writes: "American aid to Vietnam in the past has, to use Senator J.W. Fulbright's words, 'been too heavily weighted on the military side.' Not only has the lion's share been used to support Vietnam's military budget, but most of the rest has gone for projects closely related to military security, like highway construction." (p. 127. The quote from Senator Fulbright is from the Congressional Record, June 29, 1961, p. 11704.)

It does not seem unreasonable to estimate the overall military and economic assistance from the United States to South Vietnam from 1955 to 1965 at roughly $5 billion, which, when taken with the $2 billion extended during the French occupation, adds to a total of $7 billion--up until the major build-up of the war in 1965.

The current costs of the Vietnam conflict can be calculated in two main ways. First, the way the government has been applying the "incremental" costs--just those costs that are additional to the ongoing DOD expenses. Second, the "Total Cost" approach--incremental costs plus a pro-rata share of all other DOD costs. For example, the Seventh Fleet would have the usual ongoing costs of salaries and ship maintenance regardless of whether there was a conflict going on in Vietnam. The "incremental" cost calculation would add only the additional costs specially attributable to the war--additional ammunition, aircraft losses, special pay allowances, etc. The "incremental" cost approach is justified if one assumes that ships of the Seventh Fleet are not fully occupied in Vietnam, but are also available for other duty elsewhere. In contrast the "total cost" approach would attribute the entire Seventh Fleet's cost, plus additional training of personnel in the United States, and elsewhere, to the Vietnam conflict. The "total cost" approach assumes that the tying up of those

ships of the Seventh Fleet in the Vietnam situation, makes them unavailable for use elsewhere. The crisis in the Middle East gave considerable support to the "full cost"method. Business Week of May 27th reported in its Washington outlook:

> "The United States would be hard put to augment its naval forces in the Middle East by any significant amount. Most U.S. vessels are already committed to the Vietnam war, one way or another." (p. 45)

For fiscal 1967, total defense spending will run at least $71 billion; for fiscal 1968, it is estimated at over $80 billion. Using the incremental approach, Vietnam's cost to the United States is presently about $25 billion. Using the total approach, the cost increases to about $40 billion. If the Vietnam build-up is assumed to be straight-line, then the cost for fiscal 1966 is about $10 billion (incremental) and about $20 billion (total). Through 1967, the cost of the entire United States involvement in Vietnam since 1950 comes to between $37 billion (incremental) and $67 billion (total).

Vietnam Costs to the United States
1950-1967

	Incremental	Total
1950-1965	$ 7 billion	$ 7 billion
1966	10 "	20 "
1967	20 "	40 "
Total	$37 "	$67 "

These figures considerably underestimate the true cost of Vietnam to the United States. The reconstruction costs are not included. The veteran's costs are also omitted, as are the interest costs on the new federal debt. Then, too, the costs of those serving in the armed services are understated since their "cost" is their present salary, and

not the civilian salary and future earnings they are foregoing (particularly for those who do not return or return wounded and maimed). In addition, the Great Society programs involving poverty, core cities, air and water pollution, education, crime, health and beautification are all being slowed down and postponed. The costs of these programs increase, the longer they are postponed, because the problems are cumulatively worsening. Still another reason the money costs understate the true costs is that the war has become the pre-occupation of many people in science, research and development, in government, on campuses, and those eligible for military service. Bitter acrimony and hostility has replaced "reasoning together"; the politics of alienation has replaced the politics of "consensus." Constructive and productive preparation for careers, interest and inspiration to solve scientific and social problems, have generally been replaced by lives punctuated by frustration and disillusionment. Finally, there are two additional costs of Vietnam that require further exploration--our worsening balance of payments position and the distortions and strains on our economy.

After World War II the dollar replaced the pound sterling as the basic currency of world trade and world capital movements. (This transition was begun as far back as World War I, when the British were forced to weaken seriously their international economic position by liquidating a substantial portion of their overseas investment to help pay for the war.) In 1945 the United States opposed Lord Keynes' initiative to establish a world currency. Instead, the dollar became the world's central currency, buttressed by the pound, the International Monetary Fund, and other free-market international monetary institutions (such

as the BIS--Bank for International Settlements in Basel, Switzerland). The benefits to the United States from being the world's banker have been considerable, and are growing, but so are the responsibilities. Vietnam has placed unusual strains on this position and has added "costs" that may be incalculable but are indeed most serious.

The basis for all world currencies remains gold. Gold fulfills two major functions--it acts as the reserve for national currencies and it can be used to settle inter-national debts and transfers. As the new supplemental international currency, the American dollar has served these same functions, in most instances, because there isn't enough gold in the world to do the total job. Total gold reserves of all central banks and governments come to about $44 billion. Gold production throughout the world is estimated at about $1½ billion per year, but in recent years almost all of that production has gone into private holdings and has not increased official gold reserves. The United States, with $13 billion in gold, holds about 30% of the gold reserves of the world, and has relatively more gold than any other nation. However, the uses of gold (to underpin national currencies and settle international world trade imbalances) have grown so much faster than the gold supply, that the world currency which Keynes tried to promote in 1945, is long overdue.

For example, the United States national money supply now totals about $175 billion, and is increasing each year at roughly 3%. Total United States foreign trade (goods and services) is about $40 billion and is increasing each year at a rate close to that of the expansion in total world trade--7%. All industrialized nation's currencies are expanding rapidly, as is their world trade. Yet the official gold

reserves on which all of this is ultimately based, at present, are barely increasing. This growing disparity between gold reserves, on the one hand, and currencies and world trade, on the other hand, is no cause for alarm, as long as things proceed smoothly. The gold is, practically speaking, of no use to anyone. It simply serves as a basis for the money rules that govern world trade and currencies. We have never had sufficient gold to satisfy all claimants, if they had insisted on actual gold payments; however, no one wants gold for its intrinsic use (aside from dentists and jewelers, that is). Gold is symbolic and serves as a guide to "keep us honest" in terms of the rules of international money. It is another example of the bank being sound as long as no one starts a run on the bank. But Vietnam brings into serious question the wisdom, stability, and dependability of the world's banker--the United States. Needless to say, the position of the world's banker has usually gone to the most powerful nation militarily and economically. Vietnam also calls into question the overwhelmingly powerful United States position on these two counts, an observation which certainly requires expansion.

The main problems likely to confront the world's bankers in the coming decades are: 1) re-integration of the Communist nations into world trade and the world economy; 2) provision of adequate lines of credit (and good relationships) to developing nations; 3) provision of adequate and reasonable adjustment room to permit continuance of the exceptionally high rates of economic growth enjoyed by the industrialized nations in post World War II. The actions of the United States in Vietnam do not give convincing evidence that the world's leading banker

nation is able to cope with these three major problems, without precipitating a third world war, which would completely destroy the world's economy, if not life itself. Stability and wisdom, the two attributes so required of good bankers, appear in short supply in the United States, at least temporarily. Thus, recent moves, which would follow in Lord Keynes' footsteps toward a newworld money system, have met with considerable foot-dragging. If the decision-making apparatus of the United States permits (even encourages?) entanglements of the Vietnam type, then the world money machinery requires a new look. Our partners will insist (and deserve) more important roles, relative to the United States' role.

The immediate occasion for this re-examination is the United States balance of payments crisis. When the banker lives beyond his means, depositors grow restless. The United States has lived beyond its means for more than a decade. At first this was considered healthy, because our deficits provided the European (and Japanese) economies with surpluses. They gained "reserves" (gold and dollar balances and international financial deposits) at our expense. The United States had far too much reserves and they had far too little. However, by the time President Kennedy was elected, it was generally agreed by the world banking community that the United States' deficit balances required attention and correction. Kennedy drew up and implemented a comprehensive program to permit the United States to earn more foreign currencies (and use less) without much disturbance of the United States' world economic position. It is always possible to correct such imbalances by using more drastic measures (restricting tourism, import restrictions, export subsidies, etc.). However this would hardly do for the world's

banker and for the dominant economy. Many other, less drastic, steps were available and were adopted. These were generally quite successful and today, if it were not for the Vietnam conflict, our balance of payments would not be in crisis.

Several years ago, when it became clear that Vietnam precluded a return to a more healthy balance of payments position, President Johnson initiated two moderately drastic measures to slow down the outflow of American capital abroad. The first, the Interest Equalization Tax, which makes it a bit more expensive for foreign borrowers to float issues on the New York money market. Since Canadian borrowers were exempted and since interest rates in foreign markets are today far closer to New York rates than in earlier years, the IET has been only marginally effective. The second measure has been more important. It establishes "voluntary" guide-lines for banks and corporations to limit their capital flows abroad. Last year's tight money policies, with these two governmental programs, resulted in the smallest net outflow of American capital since 1959. The gross outflow was great, but it was offset by the increase in borrowings abroad by United States firms. The following table gives one an idea of the magnitudes involved:

U.S. Balance of Payments, 1964-66
(In billions of dollars)

	1964	1965	1966
Exports of goods and services--Total	40.0	39.0	42.9
Imports of goods and services--Total	-28.5	-32.0	-37.6
Remittances and pensions	-.9	-1.0	-1.0
U.S. Govt. grants and capital flow, net	-3.6	-3.4	-3.4
U.S. private capital flow, net	-6.5	-3.7	-3.9
Foreign capital flow, net (to U.S.)	.7	.2	2.2
Errors and unrecorded transactions	-1.0	-.4	-.6
Balance onlliquidity basis	-2.8	-1.3	-1.4

Source: Federal Reserve Bulletin, April, 1967, p. 678.

Without a detailed breakdown of DOD spending, direct and indirect purchases by nation of origin, it is impossible to estimate the exact foreign-currency drain of the Vietnam war. However, it is clear that it is greater than the $1.4 billion imbalance of payments on a liquidity basis. For Japan alone, it is more than $½ billion. A recent report by the Japan Association of London, representing British businessmen with interests in Japan, credited Japan's recovery from recession to direct and indirect earnings arising from the war in Vietnam. "Vietnam has been a very important factor," the report said, "and some estimate that the direct and indirect effect of this on exports (by Japan) was as high as $1.2 billion. In addition to this, special procurements by the United States forces amounted to $577 million."

The purchases of foreign goods and services for the Vietnam war are minimized by the DOD because of the U.S. balance of payments crisis, but they are still considerable. They include outlays for transportation, for goods and services that are cheaper to purchase in Asia or abroad (to save transportation costs from the United States), for servicemen's leave, for Vietnam pacification programs, for harbor and warehouse and airfield construction throughout Southeast Asia, for South Korean and Philippine troop payments, and for dozens of other similar expenses that require foreign currency. The withdrawal of 35,000 troops from West Germany helped ease the foreign currency drain by the DOD, as does the sale of military equipment to foreign nations. However, the Vietnam foreign currency outlays continue to mount as the war widens and intensifies. United States corporations and banks have been most cooperative with the government guidelines on capital exports, but this does not necessarily mean that such limitations are wise. The result

of such limitations is that American firms can invest less abroad, earn less abroad in future years, and generally export less capital abroad. If anyone must pay the foreign currency costs of the Vietnam war, then restrictions on capital outflows are certainly the most just. In World War I and II, the European nations were forced to liquidate their foreign holdings, to help defray the foreign currency costs of those wars. Today, the new banker of the world must likewise limit the export of United States ownership abroad to pay for the Vietnam war's foreign currency costs. And, today, with the Vietnam war and the weaker United States position, our European banking partners are demanding greater safeguards and more important roles for themselves.

The final economic cost of the Vietnam war is potentially the most troublesome of all; it is the distortions and strains that the war is causing to our domestic economy, and what these portend for the future of the longest prosperity in the history of the United States. Despite, or perhaps it is because of, the United States emerging from World War II as far and away the most powerful nation economically, we have been slow to learn the Keynesian lessons of the Great Depression. Western European countries (except for England) and Japan quickly moved into a super-full-employment climate to rebuild their war torn economies. After re-building, they found they thoroughly enjoyed the high growth rates that accompanied these managed, full-employment economies. Labor was a bit rambunctious in a sellers market situation, but was quieted with higher living standards. The higher growth rates provided so much more economic wherewithal that the increased pay-offs to labor still left far more than ever before for property owners and managements and governments.

The United States did not seriously try to join the "fast achievers" until President Kennedy shortly after his inaugusration dispatched his chief economic advisor, Walter Heller, to Europe to discover their "secret" growth potion. It was hardly a "secret." It was all in Keynes' 1936 book on the depression and the European economists and benkers had been trying to get the message through to Washington for some time. Keep aggregate demand slightly ahead of supply. Keep investment growing slightly faster than savings. Let purchasing power pull the economy along at truly full employment. Prices tend to rise under these conditions and wage increases have to be limited, but the advantages of higher productivity and full employment far outweigh the disadvantages of a 2-5% annual price increase.

Heller brought back the full employment "secret," and preparations were begun for the 1964 tax cut. The "balanced budget" concept was modified: balance the budget only at full employment levels; to try to balance the budget over the entire business cycle meant that the fiscal drag (as income rises, taxes take more purchasing power from the economy than return to it as government spending) tended to slow the economic expansion well short of full employment. At the same time, American businessmen gained more confidence in the economy's ability to sustain prosperity. More and more corporations undertook long-range (even five year) plans for future expansions and development. Private investment rose nicely, the economy expanded, consumers spent a steady and high proportion of their increased income, and an early pause in the prosperity was quickly overcome. Further investment incentives were added to the federal tax structure and the 1964 tax reduction was planned to

give the economy a needed additional lift, when it might be slowing down in its expansion. The economic forecasts proved accurate. The economy continued its rapid 5% per annum growth. There is nothing like success to reinforce beliefs and confidence. At last it appeared that the Keynesian lesson of the Great Depression might be accepted at technical and governmental levels. It would take longer to live down "fiscal responsibility" on the hustings.

This was the economic picture in mid-1965, a half year after President Johnson was swept back into office--an occurrence not unrelated to the long prosperity. As the Vietnam buildup gathered momentum, the economy seemed to go from plateau to higher plateau, with the economic advisers completely at the mercy of the military "needs." Within this context, several major missteps have begun to undermine the earlier confidence. The longer the Vietnam war continues, the greater is likely to be the erosion of economic control and confidence.

The erosion stems in part from a misunderstanding of the nature of the economic impact of military spending, and in part from being forced to react to the exigencies of the Vietnam demands. For example, within a few months after temporary repeal of the 7% investment credit and accelerated depreciation allowances, to help cool down the economy, it became clear that the super-tight money imposed by the Federal Reserve was "over-correcting" the economy. The Administration requested repeal as soon as possible, a 180° reversal in half a year. Another instance of possible confusion is the unbalanced control the Federal Reserve has been exerting on the money supply and interest rates (generally on the conservative side). Fiscal policies (taxes and government spending)

should be coordinated and balanced with monetary policies. When so much of the fiscal policy is dictated by military exigencies, this becomes more difficult. In addition, it appears that some Administration economists are interested in lowering the unemployment rate well below its present 4% level. The Fed (which controls the monetary side) has indicated that it considers 4% as low as the unemployment rate ought to go. The high federal deficit caused by Vietnam has strengthened the Federal Reserves' hand. The Fed's drastic tight money policy (not only slowing down the rate of increase in the money supply, but actually reducing it absolutely after June 1966) and high interest rate policy helped our balance of payments situation temporarily but was of questionable value in allocating resources to fulfill the Vietnam war needs. Now the reverse swing of the pendulum has almost run its course. A swing back to tight money is in the offing. For the past quarter the money supply has been expanding. Government spending has speeded up, wherever the obligational authority permitted--in highways, support of the mortgage market, and even some of the Great Society programs. These easy money and fiscal policies will have some effect, but it is on the rapidly expanding Vietnam expenditures that most authorities are counting for the major expansionary thrust during the second half of 1967. The economic lull that began in the last quarter of 1966 has, according to most experts, run its course and the six year-old prosperity is well on its way through its seventh year. The Fed is again making some moves toward tighter money. The stock market remains unconvinced about future prosperity and, according to a number of its leading analysts, would welcome the orderly kind of expansion associated with peace.

Each turn of the military screw tends to increase the federal debt, tends to frighten the monetary authorities (toward tight money), and leads economists to overestimate the buoyant impact of the military spending on the economy. By the end of 1967, it is estimated that the federal debt will be increasing at the annual rate of from $10 billion to $30 billion. The reason for the great spread is partially the result of uncertainties about war spending and tax collections, but mainly because of our inability to estimate accurately the impact of the increased Vietnam spending on the economy. The monetary authorities and economists are overestimating the boost given the economy by Vietnam spending because they overlook several characteristics of military spending.

Keynes taught us to think of spending in several different ways. Savings is income not spent. Unless this savings is returned to the purchasing power stream to support private investment, it leaks out, reduces demand, and slows the economy. Most economists treat government spending as "neutral" in this savings investment balance, yet it is far from neutral, depending upon the type of government spending. Military spending gives the economy the smallest boost of any government spending. This is because military spending "induces" or causes very little private investment, of the type that uses private savings and puts them back into the purchasing power stream. At the same time, military spending actually creates a fair amount of private savings. Thus, military spending skews the private savings-private investment relationship strongly in the direction of savings, which dampen the economy. Let us explore in more detail the effect of military spending on private investment and private saving.

Military spending results in a great investment in missile plants, helicopter factories, and ordnance works. But all of these investments are paid for by the government--and thus by taxpayers. None of this investment puts back into circulation private savings. All of it uses taxpayers' purchasing power to build plants (that may be privately owned) which are built to produce weapons, aircraft, missiles, electronics, etc.

There are roughly three types of military spending--salaries, procurement, and operating supplies. The procurement spending is what requires special investment paid for by the government and induces little private investment. The salary component can result in some induced private investment, although this is minimized by officers' clubs, PX's, base housing, etc. It is only the operating supply type of military spending that could result in substantial induced private investment. The exact amount depends primarily on the capacity utilization at the time of the increase in orders, and the expectations regarding future orders. For example, the increased clothing required for Vietnam might well result in additional investment by clothing and textile and sewing machine firms, depending on capacity and their expectations about future orders. Overall, the induced investment, privately financed out of private savings, is not going to be very great from all military spending. In recent years, each $1 of expansion in consumer spending induced about $2 of privately financed investment. The ratio for the expansion in Vietnam military spending was far less than this.

At the same time that military spending does not induce much privately financed investment, it does create more than an average amount of private saving. Senator Douglas' committee (investigating the pyramiding of profits on such contracts as the Nike project, as well as other procurement practices involving the purchase of supplies) indicated profits substantially above the competitive level. In fact, when calculated on a rate-of-return (on invested capital), the profits are exceptionally high. Because there is so little private capital invested in most military procurement contracts, the private savings created is much higher than average. As for the important salary component of military spending, there is greater than average savings here as well. Officers, and even enlisted men, tend to save a higher proportion of their cash income, than do civilians in the same income bracket. In part this undoubtedly reflects a different proportion of "in-kind" services and goods provided by the employer, in part it reflects a different way of life, in part a different retirement outlook, and in part different savings habits and opportunities. The total shift to private savings that accompanies a billion dollar increase in military spending cannot, with the data now available, be estimated. All that can be said is that the substantial increase in military spending in Vietnam, of some $40 billion in the past three years, has resulted in a marked increase in private savings and a considerably below-average increase in induced investment, (which would put back into circulation the private savings). Thus, the boost to the economy from Vietnam has not been nearly as great as it would have been if a comparable expansion of private spending had taken place.

Because economists and bankers overestimated the buoyant impact of military spending, they tightened the money screws too much and reached too fast for the fiscal brakes. Now that they have relaxed these controls, there is a danger that they will not relax them enough. I am fully aware of the almost unanimous opinion among economists that the 1966 "lull" is over, but they may be caught by surprise. If they are, it will be most unfortunate if they do not recognize that the increase in Vietnam spending is one of the major reasons for the slowdown in the seven year prosperity.

In summary, the economic costs of Vietnam are considerable. So far, about $67 billion has been expended there, and the annual cost is now running about $40 billion. By comparison, the total Marshall Plan cost was $13 billion (with present prices this would mean about $16 billion.) There is no question about the fact that military diplomacy is far more expensive than economic diplomacy. Our military diplomacy has been costly to the United States' balance of payments position and has restricted the flow of private capital abroad. It has called into question the leading role of the United States (and the dollar) in world banking and economic circles. Finally, the Vietnam spending has introduced new elements of uncertainty into our domestic economy, interrupting and reversing the steady progress that has been made during the longest prosperity in the history of the United States toward stable, high-level growth. Traditional monetary and fiscal tools have not worked as anticipated and we may well enter the 1968 election period while running a high federal deficit. All of this bodes ill, economically, if the Vietnam spending continues. In contrast, as the stockmarket analysts have pointed out, peace will be bullish. Return to more normal levels

of military spending will permit continued full-employment prosperity, as well as use of our resources for constructive ends.

Counterposed against these considerable economic costs of Vietnam must be placed the economic benefits. Primarily this involves the protection of American investments in that area, and perhaps throughout the developing world, where national liberation movements might threaten. It is also true that certain regions of the United States and certain companies are far more profitable and prosperous as the result of Vietnam. This only means that other areas and firms are far less so, and overall the nation (and its people and firms and regions) sustain a net loss.

The latest figures on United States investment abroad, and foreign investment in the United States, are shown below:

INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES, 1950, 1964, 1965
(billions of dollars)

				Western Europe and Canada		Latin American Republics		All Other Foreign Countries	
	1950	1964	1965	1964	1965	1964	1965	1964	1965
Total private investment	19.0	75.8	80.9	44.4	47.1	13.8	14.4	14.7	16.2
Direct investment	11.8	44.4	49.2	26.0	29.1	8.9	9.4	10.6	12.1
Indirect investment	7.2	31.4	31.7	18.4	18.0	4.9	5.0	4.1	4.1
U.S. Gov't. credits & claims	12.5	23.3	25.1	8.2	8.4	3.5	3.8	9.6	10.9
Foreign assets and investments in the United States	17.6	56.9	58.9	41.6	42.3	5.5	6.0	7.0	7.9

Source: Survey of Current Business
September, 1966

The "net" ownership of assets abroad by the United States residents, firms and government came to about $14 billion in 1950 and rose to about $47 billion in 1965--an increase of some $33 billion in fifteen years, or more than $2 billion per year. Thus, although the United States

gold position may be weakening, the United States overall ownership position vis-a-vis the rest of the world is strengthening rapidly. United States ownership of foreign assets is increasing at a far faster rate than foreign ownership of United States assets. However, almost 60% of United States private investment is in Canada and Western Europe. Of the remaining 40%, much of it is invested in developed nations, such as Japan and Australia, and about half of it is invested in petroleum and mining.

There is a detailed breakdown of United States investment abroad only for direct investment--investment by United States firms directly in plants and equipment abroad. As can be seen from the preceding table, direct investments account for almost 3/4'ths of private investment in the "other country" category, which would include the Far East.

VALUE OF U.S. DIRECT INVESTMENTS AND DIRECT INVESTMENT EARNINGS
IN THE FAR EAST
1963, 1964, 1965 (millions of dollars)

	Direct Investments			Direct Investment Earnings		
	1963	1964	1965	1963	1964	1965
India	206	234	253	14	12	14
Japan	472	591	676	49	31	50
Phillipine Republic	415	469	529	38	28	25
All Other Countries	423	438	563	81	77	121

Source: Survey of Current Business

Included in the "all other country" category for the Far East are Indonesia, Malaya, Thailand, Hong Kong, Laos, Cambodia, Taiwan, Burma, Singapore, and Vietnam. The total United States direct investment in all of these countries comes to about $600 million, or about 6 days cost of the Vietnam war. If indirect investment is added to direct investment, then at most the cost of eight days fighting in Vietnam is

involved in the entire "all other country" category of the Far East. From a direct cost point of view, the Vietnam conflict is not rational. United States economic interests are simply not great enough in that part of the world (or, for that matter, in the entire developing portion of the world) to justify an annual outlay of some $40 billions.

There are two replies to this argument. First, the United States is the leader of the free world in its fight against communism and as such must spend whatever is required to stop the spread of communist revolutions. Second, the long-run potential earnings from these nations is much more significant than just the current picture. (Think of the economic potential that England gave up when she was unable to keep the United States in the 1780's.)

There is some validity to both these arguments, but application of them to Vietnam shows that neither holds with much force there. The capitalist-communist relationship has been evolving for half a century--since 1917. Throughout these 50 years, economic as well as political-military considerations have guided decisions. A brief review of the half-century highlights will provide a background for placing Vietnam in perspective.

No one can claim that diplomatic policy is solely a question of economics. At the same time, no one can deny that economics plays a major role in all diplomacy. The following brief review of recent diplomatic history which emphasizes economics, does not purport to present a balanced picture. It highlights the economic considerations to allow us to evaluate rationally the economic benefits and costs of Vietnam.

From an international politics point of view, it is ironic that the country most responsible for the success of the communist revolution in Russia is Germany. Confronted during World War I by the combined resources and manpower of the Allies, Germany (and her allies of Turkey, and the old Austro-Hungarian empire) became desperate, especially with the increased involvement of the United States. To take Russia out of the war, or at least neutralize the eastern front, Germany did what she could to help Lenin and the Bolsheviks. German nationalism overcame German hostility to Bolshevism. The Allies did their best to promote the "white" counter-revolution and the Kerensky socialist "middle" forces, but finally decided the cost was not worth it. World War I had been unbelievably bloody and costly to all European contestants. Revolutions at home, while not a serious threat, might well have become serious, if a large-scale counter-revolutionary force had been sent into Russia. Finally, Russia was in such a mess, and was so weak, divided, and debilitated, the Bolsheviks would have their hands full with internal problems and could be "settled" once Europe had recovered from World War I--assuming the "little" counter-revolutions all failed. It became more important to devote resources and energies to economic re-building, to colonial empires, and to the re-arranging of power between the two major European nations (England and France) and the two newcomers--the United States and Japan. The rapid rse of world economic power of the United States during World War I resulted from her advantageous position as the neutral supplier to both sides during the early years of the war. The combatants had to pay for their shipments from the United States. At the beginning of the war, foreign investments

in the United States totalled $7.2 billion and United States investments abroad totalled $3.5 billion. After the war the figures were almost exactly reversed, with foreign investments in the United States reduced to $3.3 billion and with United States investments abroad up to $7.0 billion. In the twenties, the English economy was sacrificed to the unsuccessful attempt by the British to reestablish the pound Sterling in its earlier world-dominating position. The Anglo-American "relationship" was evolving and with World War I and the twenties, it became clear that the junior partner had passed adolescence.

The world communist movement meanwhile became preoccupied with making Russia succeed as the great experiment. Independence movements against the European colonial powers were ebbing and flowing, in some cases with communist participation playing a small role, but the communists tended to be Moscow oriented. The Soviet Union, meanwhile, was emerging as an industrial power of secondary importance, but with enormous internal problems of a backward, divided, strife-torn, ostracized nation, surrounded by hostile neighbors. In the fateful thirties, European economies, convulsed by the Great Depression, became vulnerable to domestic radical movements. German revanchism under the Nazis, and similar fascist movements throughout Europe, were promoted as counter-revolutionary forces. In the case of Hitler, the double purpose was served--counter-revolution both at home and against Russia. The Spanish Civil War provided the dress rehearsal, where the allies (United States, England and France) left the duly elected Republican government to the mercies of Hitler and Mussolini, and left them to be helped solely by the Soviet Union. Stalin then turned the tables on the French and

British leaders and concluded his own reply to "Munich" in the form of the Nazi-Soviet pact. Finally, two decades of maneuverings culminated in World War II. Terrible as was the destruction in Europe, it was nothing compared to the destruction and suffering sustained by the Soviet Union. Once again, the United States economy was spared, although almost 300,000 lives were lost--an enormous figure, but when compared to the 10 to 20 million lost by the Russians, it comes to only 1½% to 3% of the Russian losses.

The war permitted the United States economy to blossom into full employment. Americans consumed more civilian goods when the war was at its height (in 1944 and 1945) than it did when the war began in 1941. In constant dollars (1958 dollars), personal consumption spending came to $165 billion in 1941, and rose to $171 and $183 billion in 1944 and 1945. By the end of World War II, there was no question about the economic position of the United States relative to all other industrialized nations. In addition, the atomic bombs at Hiroshima and Nagasaki clearly demonstrated to the Soviet that we had the power in Jimmie Byrnes' words, "to dictate our own terms" for the post-war structuring of the world. The Communists played a major role in winning World War II, and may have believed that "to the victors go the spoils." But the most they were able to salvage from their contribution to World War II was the set of Middle-European buffer states, from Bulgaria to Poland and East Germany; and neutralization of Finland and Austria (albeit with western oriented governments). The per dollar return on the United States involvement in World War II was enormous. Pax Americana, with full world economic leadership, was obtained at exceptionally low cost; in

contrast, the per ruble return on the Soviet's involvement was small, temporary survival and legitimacy was obtained at exceptionally high cost.

Immediately after World War II there was in Europe a situation potentially ripe for Communist restructuring. In France, and in most of the other occupied countries, the anti-Nazi underground depended, to a large degree, on the communists and the left. Secretary of State Jimmie Byrnes and President Truman decided to re-create dominant anti-communist center force in Europe. Assuming the cold-war premise, which was contrary to the Roosevelt-LaGuardia perspective, then the United States applied its overpowering military and economic position to obtain once again a high rate of return on the money and effort expended. From Greece, through Italy, Spain, France, Holland, Belgium, and into West Germany, leadership was bestowed on Catholic, Socialist, and even the old political leaders. In some cases, especially in Spain and Greece, Nazi collaboration was overlooked, and perhaps even viewed with favor. Economic re-building went forward with public funds (the Marshall Plan) and then with private funds. With only $13 billion spent in the Marshall Plan, Western Europe was firmly returned into the hands of status quo ante governments, but now anchored into the Pax Americana. It had taken the United States more than a decade to garner its first $10 billion of foreign assets (up to 1923), but it took only 10 years after World War II to add $30 billion more. The Marshall Plan and the post-war position of the United States not only closed the West European door on communism, but opened that door to American investment, and particularly opened the doors wide to all former colonial holdings in

Africa, Asia, and Latin America. Under cover of the atom bomb, the United States was able to benefit economically vis-a-vis Russia in two ways. We forced Russia to spend between 15% to 20% of her output for military purposes, while the United States spent only 10% of her own output. In absolute terms the sums were not too different, but Russia's output was roughly half that of the United States. Thus, by keeping the military pressure onthe Soviet Union, her economic growth was slowed considerably. At the same time, by demobilizing, the United States was able to join a full labor force to an industrial plant that was intact and which had not sustained war damage. Once again, assuming the cold war premises the United States wisely invested its dollars and reaped a high rate of return. The Russian breakthrough with Sputnick, and with her own atomic and hydrogen weapons, partially redressed the balance; however, experiences in Iran, Turkey, Lebanon, Suez, Berlin, and in other pressure points in Europe and the Middle East, made it abundantly clear that the promise of the United States to re-structure post-war diplomacy had become a reality. Containment of communism with the possibility of a rollback (liberation) was a successful policy of post-war United States diplomacy--assuming this was the proper policy for the United States--at an exceptionally low cost in dollars and manpower. The only exception was China, and then Cuba, and now Vietnam.

These three cases are important and instructive in any reevaluation of the relationships of the United States to the communist bloc nations and the developing nations. The early euphoria of the post-war American power subsided with Soviet achievements in atomic power and missiles. The Russian homeland, and the immediate surrounding buffer states, would

be recognized; even an uprising like the Hungarian one would not be supported by the United States, except perhaps through CIA. China presented a different problem. Chiang's defeat was so decisive, the military problems of invasion so people-intensive, and the expected returns on this investment so small and so remote, that once again the capitalist nation which ultimately was to challenge the communist nation (United States and China, in this case) decided not to challenge further the successful Communist revolution.

China's rapid recovery and development was most unexpected, but was followed by the Sino-Soviet split. The Chinese also suffered from a post-revolution euphoria and charged off in all directions attempting to spread its influence. After meeting with considerable initial success Asia and Africa, they have since learned about the dangers of over-commitment, particularly when one's home ground is undeveloped and vulnerable. In Korea, however, the United States was given to understand that invasion of the homeland would require an investment even greater than that estimated in 1948-49, and an area of temporary legitimacy was recognized by the United States (China and North Korea and North Vietnam). In Asia, as well as in Europe, it became clear that the major allies of the United States (Japan in Asia and the other NATO powers in Europe) were developing rapidly and were evolving foreign policies parallel to those of the United States -- but independent. One of the major points of divergence was in their attitudes toward the Communist countries, particularly their neighbors.

Cuba represents the key test and, hopefully, the last of its kind. With Cuba, the Soviets indicated (or appeared to indicate) that they would proceed to nuclear war, although Cuba was more than 6000 miles from their borders. A legitimate popular revolution on the United States doorstep would either have to be allowed to exist by the United States, or she would run the risk of nuclear war. Fortunately the decision situation was structured so that both sides could emerge "victors." The Russian missiles were withdrawn from Cuba and the Cuban revolutionary regime could exist. The price tag -- risk of nuclear war with the Soviets -- was too high. The expected rate of return of a Cuban invasion by United States supported

guerillas was much too small to warrant the risk of that kind of cost. The live-and-let-live policy between Communist states and the United States evolved from Korea through Hungary to Cuba. It became clear that relatively weak, democratic regimes, like that of Mossedegh in Iran, had little chance of success. Instead, the United States tended to promote quasi-military or conservative governments for non-communist countries; the Soviets then accomodated their policy and adjusted to them. The Soviets have proved themselves remarkably successful in their policies of accomodation, although the Chinese have bitterly condemned them for it. With such countries as Pakistan, Turkey, Iran, and many others, relatively small economic outlays by the Soviets, have brought handsome returns. These countries don't expect the kind of bounty they have received from the United States, and the Soviets have apparently a good attitude toward the developing nations. They have, generally, accepted their inferior place in the Pax Americana sun, and are making the most of it.

Vietnam presented a different problem and perspective than either China or Cuba. Having learned from Korea that the returns from this kind of engagement on the Chinese borderland were marginal, at best, the United States was leery about getting involved. Several challenges beckoned, however. First, here was a chance to try out counter-insurgency, with which, the British had succeeded in Malaya. Second, the French failures in Vietnam made the difficulties even more challenging. Third, South Vietnam is a relatively wealthy region and one that could easily yield high returns as a showplace. Fourth, the Chinese containment policy would have a gaping hole without South Vietnam in the United States camp. However,

things have not worked out for the United States in Vietnam. In poker terms the decision to be made is whether to continue to up the stakes and betting, even if our hole cards are very weak, or whether to continue pouring good money and men after money and men that have been lost. Should we concede we've lost this hand and go on to the next one, or should we keep upping the ante?

Obviously the United States will not go to war to fight communism wherever it raises its head. Not only is the Soviet homeland relatively free of fear of invasion, but the buffer states and Cuba as well. Then, too, there are different degrees of allies, including Pakistan, Mali, Guinea, Algeria, Afghanistan, and even India, where the United States permits some type of friendly relationships with the Soviets and/or China to exist, without fear of armed reprisal. Full fledged Communists are allowed to be elected into the legislatures of such staunch allies of the United States as Iceland (with NATO bases) and Italy. The question is not whether the United States should fight communism wherever possible, but to recognize that even the most economically wealthy nation and the most powerful military nation has limited resources. Is expansion of the Vietnam war a wise way to expend these limited resources?

The shape of Vietnam on the map resembles a fish-hook: The Red River delta forms the top loop; the Mekong delta forms the lower hook. It may be that the United States is so firmly hooked on Vietnam that it cannot extricate itself. In that case, the cost will mount ever higher and the returns are likely to decline. The earlier side benefits, such as increasing the friction between China and Russia, have diminished.

The longer the Vietnam war escalates, the more the Chinese analysis of the United States foreign policy is validated, and the more the Soviets are being forced to surrender their peaceful-coexistent position.

The second question poses the economic issue, can we afford to give up all the future potential earnings of the developing nations by giving up Vietnam? Two misconceptions are involved. First, we would not have to give up all future earnings from even Vietnam itself, if a settlement is made. The way Soviet Russia has adjusted herself to her diplomatic "defeats" in Turkey, Iran, Pakistan, and elsewhere, shows that it will not be difficult to re-enter and invest and trade in all these developing countries, including Vietnam. Second, and far more important, is the real strength and prosperity of the United States economy lies in our own people's training and work and education. As Switzerland and Sweden and Japan have shown, it is the productivity of the work force and the wisdom of internal investment (public and private) that will in the long run determine the nation's economic greatness.

The second benefit claimed for continuing to expand the Vietnam war is the considerable experience we are gaining in guerrilla warfare and pacification efforts. The results in Vietnam point to just the opposite conclusion. We have botched the job there. Will we do better by increasing our efforts, or by disengaging and re-evaluating the reasons for our lack of success? Economically speaking, the latter course would be far less costly and appears to be far more sensible. We can still settle in Vietnam with a face saving return to the Geneva Agreement. Soon this may no longer be possible.

In summary, there are two perspectives to use to evaluate the cost/benefit relationships involved in Vietnam -- the short run, assuming the Byrnes-Johnson cold war crusade, and the long-run, assuming a basic detente with the Soviets. In the short run it is difficult to imagine a more costly campaign than Vietnam, with as few benefits. The distance, the type of warfare, the superb organization of the opponent, the terrain, the diseases, the weather, and above all, the history and role and position of Vietnam in the Communist camp and in Asia -- all of these make the war against a relative handful of Vietnamese an exceptionally costly effort for the United States. Also contributing to making it even more expensive is the way the United States is being forced to fight it. We are being forced to rotate most troops on an annual basis; we are trying to make the men feel as comfortable as possible while in Vietnam and while on leave; we are trying to minimize the political impact at home; and we are fighting what is probably the most capital intensive war in the history of warfare. By "capital intensive" economists mean the amount of capital (tanks, airplanes, carriers, hospitals, ships, half-tracks, inventories) per soldier. Since we do not want to use many men in Vietnam, we are using a fantastic amount of capital. No exact figures are available on this capital intensive aspect, but a conservative estimate points toward at least $100,000 per man, and probably more accurately $500000 per man. In contrast, the auto industry has about $15,000 in assets per employee, and the chemical industry about double that, $30,000 per employee. In contrast, the Vietcong are fighting a very labor intensive type of war, despite their small population (approximately 30 million for both North and South Vietnam). All

of this contributes to making the Vietnam war extremely costly for the United States and, strangely enough, minimizes many of the potential benefits. The object of the Vietnam war, after all, is to influence the minds of the Vietnamese toward the benefits of capitalism. When we use capital the way we are using it in Vietnam, the task of persuasion becomes quite difficult. As so many Vietnamese themselves have put it, "You are forcing us to become communists, if we want to save our nation and our self-esteem."

In the long-run, which assumes a detente with the Soviet Union, the Vietnam war deserves an extremely low benefit/cost ratio, perhaps even a negative one. The Vietnam war validates the Chinese analysis of United States' actions and goals. The Chinese claim that "peaceful coexistance" is so much wishful thinking, that the United States' "rulers" are out to destroy "Red" China. They reason that just as the Byrnes-Truman decision ... drop the atom bombs on Japan, the present decision-makers will use them again--on orientals. These arguments undermine and erode the reasonable coexistence positions (and actions) that the Russians have exhibited for more than a decade. The Russians are being forced to join the Chinese -- and on the Chinese terms! The more costly we make the Vietnam war, the more we escalate it, the more it proves the basic Chinese analysis. One can hardly imagine a more counter-productive effort.

One final economic fact. By next fiscal year, the federal government will be collecting taxes and spending over $120 billion on past and present wars, out of a total budget of about $140 billion. This means that 6/7'ths of the federal government's business is war. Any organization, to be effective, must be designed and built for its function. The wonder is not that the Great Society programs have done so poorly. The wonder is that they have done so well, considering that the entire non-war side of the federal government occupies only 1/7'th of its attention and talents.

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