HW - Keynsianism file

Arms Funds: Use Not Always Stressed

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When large, costly military projects go way over budget, the money involved is far from being the only consideration to defense planners.

Thus, when a General Accounting Office study suggested that the Pentagon's new B-1 bomber project was turning into a procurement fiasco, it came as no surprise to those intimately familiar with the economic and geopolitical budget strategy of the Nixon administration.

According to knowledgeable insiders, two major siderations influenced the White House judgment on spending plans. One was a fear that a continued downtrend in arms outlays would be misread by the Soviet Union as an index of American weakness. The other was the soft economy which was thought to require a fiscal stimulus.

Thus, spending more defense dollars this year was regarded as at least as important if not more so than precisely how well they were spent.

Shultz vs. Packard

The decisive battle over the defense budget was waged last fall behind closed doors. It pitted George Shultz and his Office of Management and Budget against David Packard, the deputy defense secretary, and the Pentagon establishment. Defense Secretary Melvin R. Laird, Packard's superior, is said to have been on both sides of the argument.

OMB, it is understood, argued on traditional grounds, questioning major systems like the B-1 on their utility, cost effectiveness and the like.

But OMB was overriden, for example, in its effort to restrain the B-1, because of the two overriding considerations.

The first was global politics. The White House was troubled about the falling level of defense spending. For two years in a row, it was declining. The high water mark came in the 1969 budget year when national defense outlays for goods and services reached $81.2 billion. The next year, outlays slipped to $80.3 billion and for the year ending this June 30 were estimated at $76.4 billion.

False Signal to Soviet

Continuation of this trend, it was argued, would provide a false and misleading signal to the Soviet Union. A third year of reduction, it was said, would lead Moscow to think that the United States was not only withdrawing from Vietnam but shrinking from commitments in other parts of the world. Thus, it was contended — successfully — that planned outlays for the next budget year, ending June 30, 1972, must rise. The size did not matter; the direction did. So, for this budget year, national defense outlays are planned at $77.5 billion.

The second crucial concern was the economy. In the fall of 1970, the nation was experiencing a mild recession. Republican presidential parties have been implicit if cautious Keynesians at least since the Eisenhower tax cut of 1954. Mr. Nixon has defied GOP Congressional party doctrine —as opposed to practice—by openly declaring himself a subscriber to Keynes' "The General Theory of Employment, Interest and Money."

Kennedy Method

The conventional Keynesian solution for unused resources is fiscal stimulus, increased government spending, reduced taxes to generate more private spending, or both. Mr. Nixon is doing both, cutting taxes by giving business faster writeoffs for equipment and enlarging spending in several areas, including defense.

There is nothing new in this. President Kennedy met the slump that confronted his first year in office with precisely the same specific.

His very first State of the Union message called for an investment tax credit for business and he primed the expenditures pump with a much heavier outlay on defense. Indeed, his $3.7 billion increase in arms spending in his first budget year was not only more than three times as much as the increment, it represented an increase of almost 8 per cent over the previous year's defense spending and nearly 3.5 per cent of his total budget. In contrast, the

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projected Nixon defense increase amounts to only 1.4 per cent of the previous year's defense spending and less than half of one per cent of his total budget.

But the very modesty of the Nixon increase meant that Schultz's OMB might win its battle against more nuclear aircraft carriers but stood little chance in also holding back such dubious projects as the F-14 fighter or the B-1.

The use of defense spending as an anti-recession weapon is enormously tempting to any President. Increases in arms spending appeals to those on the right political who would otherwise balk at government intervention in what they regard as a free market system. To announce new spending programs for jobs or welfare, on the other hand, invites attack. At the same time, labor unions with few and generally unimportant exceptions also will support enthusiastically increased defense outlays.

Southern California

Moreover, the recent two years of defense cutbacks have struck with especial force in Southern California, a region that has both political and sentimental significance for Mr. Nixon. The logic of a B-1, an F-14 and others thus became well-nigh irresistable.

Given this climate, it is understandable why the GAO has found that the bomber program has been pushed ahead without regard to the management ground rules established within the Pentagon. Settling on an avionics system, cranking in inflation estimates, assuring that the armament "interfaces" or fits with the aircraft, meeting performance standards—all these things go by the board. The point is to spend.

An economist or a budget examiner's sense of propriety might be offended by all this, but that is a secondary concern. According to the GAO study, for example, the Pentagon did work out an inflation estimate for the research and development portion of the B-1 program —as contrasted with the actual production of planes—but it is remarkably capricious. It counts on stable prices from June, 1970, through June, 1971, (wholesale industrial prices actually rose nearly 4 per cent through May alone); it estimates price increases of only 27 per cent from 1970 through 1977; and then inexplicably forecasts a 0.4 per cent drop in fiscal 1978.

Indeed, the decision to spend has been carried out with such zeal that Packard has ordered the plane's developers to reduce the performance characteristics in order to hold down the skyrocketing costs.

Goal: Jobs, Output

But all this is beside the point. The weapons system will do its job if it adds to employment and output.

The other day, Mr. Nixon's chief economist, Paul McCracken, was explaining the administration's reluctance to increase its fiscal stimuli.

"There is a lot of coal under the boiler that hasn't burned yet," he said. Presumably, defense outlays constitute some of these smouldering coals. Pentagon experts think spending will continue to drop through the next six months. That means it must rise even more sharply in the first half of 1972 to meet the White House goal of a year-to-year increase.

The difficulty with all this, as Mr. Nixon and his predecessors have discovered, is that we now live in a post-Keynesian world. A modest, Republican stimulus yields an equally modest improvement in employment and inflation persists. A more generous, Democratic stimulus provides more jobs and even faster price increases.

Conventional economists throw up their hands before this dilemma. Their training tells them that increased spending, public or private, should put unemployed resources of men and plant to work and should not push up prices until full employment is reached. But instead of the classical model, we are confronted with a real world in which prices do indeed rise and resources remain unemployed.

A few economists, notably Gardiner Means, have been cutting through this dilemma for almost a generation but little heed has been paid them.

In Means' world, stagflation, the simultaneous existence of unemployed resources and rising prices, is no mystery and results from the character of the modern market. Typically, industry is not marked by a large number of competitors, no one of them big enough by himself to influence output and price—the classical model. Instead, Means has observed what most non-professional citizens have taken for granted, that industries typically are dominated by three or four large concerns on the production side of the market and one union on the labor side.

Thus, the few competitors and the one supplier administer their prices. Output is tailored to support the price level sought. If this means unused plant and unemployed men, so be it. In this world, a tax cut for business or increased outlays for a B-1 will have some effect on jobs and plant use. But it will also push up prices, and the inflation effect may exceed the employment consequences.

Two Possible Answers

Diagnosis of this problem is simpler than prescription because prescription revolves around power. In crude terms, there are two polar answers: break up unions and large corporations and restore classical competition in product and labor markets. Just to state this solution is to expose its lack of political reality.

At the other extreme, the answer is the regulation of prices and wages where concentrated power exists. But this too implies an interference with powerful institutions that few, if any, will tolerate.

The Kennedy administration never openly espoused the Means analysis. But it did so implicitly with its pressure on steel wages and prices and its enunciation of wage and price guidelines. These, in effect, are indirect controls, controls through suasion.

The Nixon administration, through its new economic spokesman, Treasury Secretary John Connally, has said flatly that it will not resort to guidelines. But clearly the argument is not over. The chairman of the Federal Reserve Board, Arthur Burns, a conservative of impeccable credentials and an economist for whom Mr. Nixon has wisely entertained a high regard since the 1950s, has tirelessly campaigned for an "incomes policy." This is another name for guidelines and an implicit recognition that Means, and not Adam Smith nor Maynard Keynes, comes closest to describing the present world.

Whatever the value of increased defense spending as a "signal" to Russians, its dubious use as an instrument in the flight against stagflation could provoke a different set of arguments in this fall's fight over the budget. If the B-1, the F-14s and the others turn out to be not only procurement fiascos but marginal economic weapons, Connally's firm pronouncement could turn out to mean much less than it proclaims.