IMPACT OF THE WAR IN SOUTHEAST ASIA ON THE U.S. ECONOMY

HEARINGS BEFORE THE
COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE
NINETY-FIRST CONGRESS
SECOND SESSION
ON
IMPACT OF THE WAR IN SOUTHEAST ASIA ON THE U.S. ECONOMY

PART 1

APRIL 15 AND 16, 1970

Printed for the use of the Committee on Foreign Relations

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1970
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(III)
IMPACT OF THE WAR IN SOUTHEAST ASIA ON THE U.S. ECONOMY

WEDNESDAY, APRIL 15, 1970

UNITED STATES SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, D.C.

The committee met, pursuant to notice, at 10:05 a.m., in room 4221, New Senate Office Building, Senator J.W. Fulbright (chairman) presiding.

Present: Senators Fulbright, Sparkman, Gore, Symington, Case, Cooper, and Javits.

The CHAIRMAN. The committee will come to order.

OPENING STATEMENT

The committee is meeting this morning in the first of a series of hearings to examine the impact of the Vietnam war on our society and more especially, this morning, upon our economy.

Throughout the course of the war this committee has directed its attention to policy matters and to the development of factual information about the situation in Southeast Asia. Until now, it has not examined in depth the impact of the war on the everyday lives of the American people, and on the forces which shape our society.

The cost of the Vietnam war cannot be measured by statistics alone. The fact that approximately 49,000 American servicemen have died as a result of the war, and that it has cost some estimated $105 billion—I have seen it estimated as high as $120 billion in direct spending—tells little about the true impact of the war on the American people. These statistics do not tell us of the deep divisions in our society caused by the war, of the severe strains it has imposed on our economic system or of the distortions it has created in our national priorities.

The Congress has a responsibility to inform itself and the public concerning the overall cost of the war to the American people in terms of both economic and human resources. That will be the purpose of this series of hearings.

SCHEDULE OF HEARINGS

In the hearings today and tomorrow, the committee will examine the effects of the war on our economy in general. During the week of April 27 the committee will examine the impact of the war on specific problem areas; that is, the cities, education, housing, Federal programs, and others.
The third phase of the schedule for May 5 and 7 will consider the general impact of the war on American society.

In the final hearing on May 13 this committee will study the historical and political and economic effects of U.S. policy on the people of Vietnam.

**BIOGRAPHY OF THE WITNESS**

For this first hearing to consider the impact of the war on the American economy we are very pleased indeed to have as a witness Mr. Louis B. Lundborg, chairman of the board of the Bank of America, the largest private banking institution in the world. I believe I have been informed it has resources of approximately $25 billion. Incidentally, those total resources would finance the war in Vietnam for about 1 year, according to the way we have been running it. Therefore, every year an organization as great as the Bank of America goes down the drain in Vietnam.

Mr. Lundborg has had a long and distinguished career in the Nation's business affairs. He became a vice president of the Bank of America in 1949, executive vice president in 1959 and was elected chairman of the board in 1965. He also served with distinction over many years as a director, vice president and treasurer of the U.S. Chamber of Commerce.

In a word, I think Mr. Lundborg is an exemplar of the private enterprise capitalistic system at its best. It is men like our witness today who give our system its direction and account to a great extent for the efficiency of our great economic system. As one of the leading bankers of the United States and the world, he is well qualified to discuss the effects of the war on our economy, and we are very deeply grateful to you, Mr. Lundborg, for coming before us today.

Will you proceed, sir.

Mr. Lundborg. Thank you.

The CHAIRMAN. Mr. Lundborg is accompanied by his economist, Dr. John B. Ross.

**STATEMENT OF LOUIS B. LUNDBORG, CHAIRMAN OF THE BOARD, BANK OF AMERICA N.T. & S.A.; ACCOMPANIED BY JOHN B. ROSS, ASSOCIATE ECONOMIST, BANK OF AMERICA**

Mr. Lundborg. Thank you, Mr. Chairman, gentlemen of the committee.

I am Louis B. Lundborg. I am chairman of the board of Bank America Corp. and of the Bank of America N.T. & S.A. I am pleased to respond to your request that I testify here today.

My testimony this morning will be on some of the economic aspects of the war in Vietnam. In preparing this testimony I have had the benefit of the best thinking of the staff of the bank's economics department, as well as that of many other officers of our bank on the economic impact of the war.

In this testimony I will confine my remarks to the economic impact of the war. While I have strongly held personal feelings on other aspects of the war, I do not feel it is appropriate or proper to express these views as chairman of the board of Bank of America.
The thrust of my testimony will be that the war in Vietnam distorts the American economy. The war is a major contributor to inflation—our most crucial domestic economic problem. It draws off resources that could be put to work toward solving imperative problems facing this Nation at home. And despite the protestations of the new left to the contrary, the fact is that an end to the war would be good, not bad, for American business.

There is, I think, a pernicious, but widely held belief that war generally has been an agent for economic growth, and therefore good for business. My plan this morning is to spend a few minutes discussing that belief and then to move on to the specifics of Vietnam where it is possible to speak, not only in general terms, but to back up our conclusions with specific economic statistics and indicators.

**WAR IS NOT ENGINE FOR ECONOMIC PROGRESS**

First, therefore, let’s look at the general proposition that war has been an engine for rapid economic growth. While it is difficult, if not impossible, to prove conclusively that on balance war has not been an agent for rapid economic growth, there are a number of carefully reasoned investigations into this subject supporting the position that peace is far better for economic development. Although these careful analyses tend to reject the assumption that war is a boon to the economy, the public is generally unaware of this and continues to believe that war contributes positively to economic development. It is time to set this record straight. Mr. John U. Nef’s book, “War and Human Progress,” systematically examines the interrelations of war and economic growth from 1494 down to 1950. His analysis indicates that the industrial revolutions of both the Elizabethan and Napoleonic periods were developed not in warring Europe, but in peaceful England; that the invention of gunpowder and of many other weapons of war was a by-product, not of military need but of peaceful industry, and that, certainly, pure and possibly even applied science has flourished most in peace and least in war.


In summary, he stated:

The preponderance of evidence supports the judgment that war, on balance, does not correlate positively with economic progress. Settlement by arms not only causes a great net waste of resources; it also retards industrial development and the division of labor.

Other authorities have shown (1) that rising expenditures for research and development may actually be reducing the rate of economic growth in the United States, and (2) that the process of transferring scientific and technological advances in space and military research and development is becoming increasingly difficult. To the extent that it can be shown that war in general is not good for economic progress, then it should be equally obvious that war is not good for business.

I could go on citing other expert testimony that war in general is not an engine of economic progress—but let me move on to the real issue—the war in Vietnam.
The CHAIRMAN. Do you mind an interruption for questions?

Mr. LUNDBORG. Not a bit.

The CHAIRMAN. Senator Gore would like to ask a question.

Mr. LUNDBORG. Yes, Senator.

INDUSTRIES INVOLVED IN DIRECT PRODUCTION OF WAR MATERIALS

Senator Gore. The general conclusion with which you close the last paragraph you have read, that war is not good for business, is a generalized statement. War is not only good for certain types of business, it is indeed the very lifeblood of certain types of business. Without war the armaments industry would not be as prosperous. Don't you think this must be broken down?

Mr. LUNDBORG. I will be touching on some of that, to a limited extent at least, but if not sufficiently perhaps we can go into it later but you will find later in my testimony I will make reference at least to those industries that are involved in direct production of war materials.

STIMULATION OF TECHNOLOGICAL ACHIEVEMENT IN SPECIFIED FIELDS

Senator Gore. One other thing that I would question as a general statement: War has stimulated industrial development in many aspects—atomic, for instance. Though the Vietnam war has been perhaps less the type of war which challenges technological superiority than any other, war does, as much as I hate it, stimulate technological achievement in many specified fields. In fact, a general war like World War II was a tremendous stimulus to technological advancement, although perhaps not the most beneficial type of advancement. However, I don't think that the general statement can be left without challenge. A modern war, such as World War II, does challenge and stimulate technological progress, and technological excellence and achievement in many specified fields. Would you challenge that statement?

Mr. LUNDBORG. I do not disagree, Senator, with your statement that it does in certain fields. I had started with the assumption myself that perhaps the fallout, as they sometimes refer to it, into civilian production, of some of the technological advances that come through defense-related research and development, might perhaps be responsible for a great deal of our forward thrust in economic development. I was rather surprised when I looked into this with the help of Dr. Ross, who has accompanied me here and who has done a great deal of the research as background for my testimony here. We found, and it is the consensus of those who have been addressing themselves to the total effect of technological development growing out of military research and development that it is reaching a point of diminishing returns and that the time and energy resources devoted to this type of development are not now proportionate, or the yield from it is not proportionate to the input and that it is not actually advancing the total economic good as much as we had been led to believe. Of course, there are specific techniques inevitably, as in aerospace and other fields in the current space exploration, where there is a fallout.
The Chairman. Is it a beneficial fallout? It may be a fallout, but in terms of "progress" does it really do any good?

Mr. Lundborg. Does it do any good or does it do net good?

The Chairman. Yes.

Mr. Lundborg. The conclusion, at least my conclusion, is that net, it is not good. There are certain specific advances we have learned about electronics, and plastics, and other things I am sure we have learned from World War II. Is the net result of it in a space of time with the same time span and same dollars expended, would the same dollars expended during that time span have produced more net benefit to society, to the economy and society, and I am now prepared to say it would have been greater if it had not been war oriented.

Senator Gore. I will agree with you that war is not good, but I don't think we can concomitantly come to the conclusion that such expenditures would have been made without the stimulus of World War II. There was, I think, a very great stimulus to industrial achievement—mass production techniques, the introduction of new materials, new technology in transportation, in communication, in explosives, in industrial techniques—flowing from the stimulus and the drive resulting from the vast expenditures of World War II. I don't mean to make the argument that war is good. If judged, however, by this standard the Vietnam war would be the least productive of any.

Mr. Lundborg. Yes, I don't think, Senator, you and I are very far apart on this. I think there is no question there are advances made in many fields of technology and let's generalize under technology. There are product and technique developments. I have addressed myself here rather to the total health of the economy, the total vitality of the economy, and I would have to say there without any question that the total net effect on the economy, on business in general, is bad. Specific businesses perhaps otherwise.

Senator Gore. Thank you. I think this colloquy does bring us very close together.

VESTED INTERESTS OF INDUSTRIES BENEFITED BY WAR

I would like just one addendum, if I might impose upon the committee. These specialized industries, specialized interests that benefit from war and from the armaments industry, build into our economy a tremendous vested interest in armaments. For instance, ABM deployment: I have reached the conclusion now that except for the fact that political leaders are stuck with an archaic concept, and except for the additional fact that vast financial interests and personal interests are involved in the deployment, ABM deployment would not now be suggested. Yet this momentum, this interest, becomes influential, becomes vested, and becomes powerful and difficult to stop.

Thank you, Mr. Chairman.

BENEFITS OF WARTIME TECHNOLOGICAL ACHIEVEMENTS QUESTIONED

The Chairman. I don't mean to pursue this, but I don't quite agree with the Senator from Tennessee, although we generally agree on nearly all these matters. He is talking about some very specialized things that stimulate, as he says, technological development. Actually
World War II didn’t really stimulate the development of the principle of atomic energy. Einstein had thought of that 20 or 30 years before. The war was the reason that they made available the amount of money necessary to technologically develop it. I am not at all sure that was progress. It is change, but I think we have to wait to see whether that was really an achievement of benefit to humanity, or even this country, or the economy.

Today there are great protests being leveled at the installation of atomic powerplants. There is one under dispute in Florida near one of the President’s homes, Biscayne Bay, and there are questions about them in other places. A lot of these things brought on prematurely under the stimulus of the war proved to be real hindrances to the advancement of our society. They are not thought out. Their timing is bad. They are done helter-skelter. Even this morning I see there is a big drive by some women out in Ohio to stop using a detergent that has phosphates and go back to soap because of the terrible pollution of the water. There are a lot of things that we thought were advances brought on by the war that we are learning are very questionable indeed. The distortion which you have mentioned more than offsets I think, the advances.

If you weigh, as you say, the net advance, I don’t think there is the slightest doubt that the war is a great disaster to all of us. There are just these specialized advances. I am impressed by the fact that the great contractors are in trouble. Look at the trouble at Lockheed Aircraft today. Here is one of the great beneficiaries, manufacturer of the C-5A, and they are broke and are asking the Government to bail them out with a grant of nearly $500 million. Ling-Temco-Vought is another exponent, and General Dynamics, the great maker of the F-111. They are also in great trouble and it is only by virtue of a Government handout that they are kept alive.

It is true that some individuals like Mr. Ling made a lot of money and put it in the bank somewhere, but that certainly is not any advance to our economy or to the country. It is the least kind of justification for the war that I can think of.

You prompt me to say that the propaganda of the Government generally has persuaded people war is a great benefit because certain things take place. Most of these things are not advantageous to the community. I think you are absolutely right. I hadn’t thought of it quite until you began this discussion, but the more I think of it the more I am persuaded you are absolutely right.

Mr. Lundborg. I think there is just one further word perhaps that should be dropped in here. I did not include it in my written testimony because it is very difficult to quantify. You speak, Senator Gore, of the companies that exist entirely on the military. There are, I think, fewer and fewer of those. More and more industries now have realized that there are great economic pitfalls in that, the situation with Lockheed is an example. Other companies involved in military and non-military activities have found their military activities have been less reliably profitable than their civilian and nonmilitary.

Senator Gore. Mr. Chairman, may I say I certainly would not philosophically defend war as good. It is bad, very bad. On the other hand, we cannot deny that the vast human effort, the vast economic effort, the vast expenditure of funds resulting from war does bring
great stimulus to development. Perhaps it is sometimes in inadvisable ways, but it is many times in very beneficial ways.

The Chairman. What are the beneficial ones I will ask the Senator.

**DEVELOPMENT OF NUCLEAR ENERGY**

Senator Gore. The distinguished chairman has cited the development of nuclear energy. It is true that Einstein had a theory, but it took several billion dollars of expenditure and a very concentrated, intense effort to develop the technique, to separate the uranium, to develop the fission and fusion into practical application. This could not be accomplished without vast expenditure. How long civilization would have delayed the development of this vast new source of energy so necessary as fossil fuels were exploited and dissipated, I do not know. But I do cite this as one beneficial byproduct of war. War is bad; I won't argue that. But I cannot agree that the vast expenditures which result from it do not have many beneficial results. Call it fallout, if you wish.

Senator Sparkman. Mr. Chairman, may I add to this discussion?

The Chairman. Senator Sparkman.

Senator Sparkman. If I may add, I find myself to a great extent in agreement with my friend and neighbor, Senator Gore. I don't share the feeling of the Chairman that the development of nuclear power may not have been a good thing.

The Chairman. I don't know. I think history will tell.

Senator Sparkman. You said that. You said it may not have been. I think it is a wonderful thing. I want to add to what Senator Gore has said about the splitting of the atom. It did require tremendous sums of money that probably would never have been appropriated had it not been for the necessities of war. I happened to be on the Military Affairs Committee of the House of Representatives at that time, and I recall quite well General Marshall and General Somervell coming before a closed meeting of that committee to ask us for an authorization of, I believe, $2 billion. That isn't an excitingly large amount these days, but in those days it was a very large amount. I remember they said to us: “We hope you will not ask us to give you details about this, that you will trust us, when we tell you that both the Germans and we are working on this thing, and the one that gets it first is the one that is going to win the war.”

In other words, we had the absolute compulsion of necessity to win the war behind that.

**BENEFITS AND DRAWBACKS OF WARTIME DEVELOPMENT**

In addition to that, I don't think it is quite right to generalize the whole thing, either regarding the benefits or the bad parts. I think there are some of both. Before we could generalize a statement, we would need to draw up some kind of a balance sheet. I can think of a good many things. I remember during World War II going to, I believe, Aberdeen and seeing the beginnings, so far as practical use was concerned, of radar, and a good many other things that we developed. I think the airplane industry certainly received a tremendous boost as a result of World War II. So many other things that have been developed in peacetime received their impetus from the research programs that
were engaged in during World War II. I think it started us on a field of research and development that we had never dreamed of before that time, and it carries on even today. So I think we ought to be very careful of assessing the good and the bad.

Mr. Lundborg. Mr. Chairman, and gentlemen of the committee, you are getting into areas here which are extremely interesting and I am sure they are pertinent to what the rest of your hearing is going to address itself. It is not a field about which I was requested to talk; and with your permission, I think we should at least get all of that out before us.

As far as I am concerned let me rest by saying while I am sure there have been technological advances that have been beneficial themselves I would say on balance, I would say the net effect of war has always been distorting to the economy. It is unbalanced.

Mr. Lundborg. In real fact; no. Any such spending as that, of funds that have not been saved is by nature inflationary.
about the need to save in order to spend, in order to get people to buy
securities and whatnot but you don't have to do that if you don't want
to; do you?

Senator JAVITIS. Your government.

The CHAIRMAN. Mr. Lundborg, this is a very interesting subject. I
am reluctant to leave it. I may come back on it, but I want to give you
the opportunity to testify.

Mr. LUNDBOG. You are the best judge of what your calendar will
permit here today. I don't mind this at all. I think it would be helpful
if I got before you the full text of my statement.

Senator Gore. Just one word, you used the word "calendar." Senate
debate is ruled by the calendar.

Mr. LUNDBOG. By the calendar and not by the clock.

The CHAIRMAN. Go ahead, sir.

BUSINESS COMMUNITY PROFITS FROM VIETNAM WAR DOUBTED

Mr. LUNDBOG. Yes; I was just about to say that in moving from
the general subject to the war in Vietnam specifically, many of you,
I think, know that our president, Mr. Clausen, very specifically re-
jected the charge that we as an institution, the Bank of America, had
supported and profited from the war in Vietnam and he further stated,
"This bank has consistently pointed out that an end to the war in Viet-
nam would be good, not bad, for American business." I would like to
elaborate on this point a bit. Some of what I will now say in my pre-
pared testimony will duplicate what we have been saying but for con-
tinuity, if you don't mind, I will still go through it.

There have been reckless and often deliberately malicious charges
that the U.S. business community has supported the Vietnam war in
an effort to reap huge profits. Let's look at the record. In a very nar-
row sense, it is certainly true that individual firms which supply ma-
terial and services to the military have made profits. In our market
economy, the Federal Government purchases most of the goods and
services it requires from private firms, and those firms must be profit-
able in order to survive. This is true whether the firm is contracted to
build a highway, produce a postal delivery truck, construct a school,
improve a slum, or produce a military aircraft. But as Mr. Hudson B.
Drake pointed out in the January-February 1970 Harvard Business
Review, the Government has established elaborate procedures to assure
that profits on Government contracts are not excessive, and in general
these procedures have been effective.

I recognize that it is statistically impossible with the data available
to calculate what portion of various firms' profits are generated by de-
mands for goods and services needed to prosecute the Vietnam war.
In an effort to get some rough approximation of the profitability of
corporations doing substantial business with the Government, I did
some checking on the corporations receiving the largest amounts of
funds from Government contracts. Actually, I took the list from a
publication of a "peace group" who proclaimed these firms to be war
profiteers. The top 10 firms for which we had data had a pattern of
profits after taxes per dollar of sales quite similar to the national aver-
age. This means that the firms did better in the 1962-65 period than in
the post-escalation years. It is also interesting to note that except for
1962 the average profits after taxes per dollar of sales for the 10 firms was below the comparable national average for all manufacturing industries or durable goods industries. When I checked the 25 largest firms their profit after taxes per dollar of sales figure was also below the national average.

I realize, as I said before, that these figures are inadequate to prove any case conclusively. They do, however, cast serious doubt on the extravagant claims we have heard about war profiteering.

**ESCALATION OF VIETNAM WAR HAS DISTORTED AMERICAN ECONOMY**

We do have more than adequate data to demonstrate that the escalation of the war in Vietnam has seriously distorted the American economy, has inflamed inflationary pressures, has drained resources that are desperately needed to overcome serious domestic problems confronting our country, and has dampened the rate of growth in profits on both a before and after tax basis. In the middle of 1964 when the Vietnam escalation began, the economy was in quite good shape. We had at that time an uninterrupted economic advance of 52 months—a peacetime record. Unemployment averaged 4½ percent; the consumer price index had increased only 1.2 percent during the first 6 months of 1965; and the average operating rate of industrial capacity was at 90 percent. There had been considerable success in maintaining Federal expenditures for goods and services below 11 percent of GNP from 1960 through mid-1965. In fact, the Government had even been able to change the composition of its spending by deliberately shifting emphasis from defense to nondefense spending.

The expenditures related to the Vietnam war, added to the near full employment economy that existed in mid-1965, generated severe inflationary pressures. Consumer prices began increasing rapidly as the Federal deficit grew. While there is room for a wide range of opinion covering proper tax policies during this period, especially over the timing and magnitude of tax increases, and the proper role of monetary policy, the basic cause of the inflationary forces was a sharp increase in Federal spending associated with the escalation of the conflict in Vietnam.

(The following information was supplied for the record.)

**Federal budget surplus (deficit)**

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>Federal budget surplus (deficit) [in billions of dollars]</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>(1.6)</td>
</tr>
<tr>
<td>1966</td>
<td>(3.8)</td>
</tr>
<tr>
<td>1967</td>
<td>(8.7)</td>
</tr>
<tr>
<td>1968</td>
<td>(25.2)</td>
</tr>
<tr>
<td>1969</td>
<td>8.2</td>
</tr>
<tr>
<td>1970</td>
<td>1.5</td>
</tr>
</tbody>
</table>

1 Estimated.


The inflation, the growth in inflationary psychology, and the very stringent antiinflationary monetary policies have combined to produce serious distortions in the U.S. financial markets and resulting distortion in the economy. These distortions include the sharp drop in residential construction and the sharp growth in investment spending.
The facts clearly show that the Vietnam war has not been good for business profits. During the 4 years prior to the escalation of the conflict in Vietnam, corporate profits after taxes rose 71 percent. From 1966 through 1969 corporate profits after taxes rose only 9.2 percent.

The Chairman. Is that the gross amount percentage? Does 9.2 percent relate to all corporate profits in the United States?

Mr. Lundborg. The gross profits of corporations reported. Am I correct in that, Dr. Ross?

The Chairman. Is the 9 percent from the whole period of 1966 through 1969?

Mr. Ross. Yes.

Mr. Lundborg. Yes.

The Chairman. It is only at the rate of about—

Mr. Ross. Yes, sir, we have tables which we will be glad to add to the testimony.

The Chairman. I wish you would. I am not quite sure how to interpret that figure.

Mr. Lundborg. We will be glad to provide the statistics.

(The information follows:)

### CORPORATE PROFITS (PERCENTAGE INCREASE)

<table>
<thead>
<tr>
<th>Year</th>
<th>Before taxes and investment adjustments</th>
<th>Change over entire period</th>
<th>Change over entire period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1962</td>
<td>10.7</td>
<td>14.7</td>
<td></td>
</tr>
<tr>
<td>1963</td>
<td>5.7</td>
<td>8.0</td>
<td></td>
</tr>
<tr>
<td>1964</td>
<td>12.0</td>
<td>16.0</td>
<td></td>
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<tr>
<td>1965</td>
<td>14.8</td>
<td>21.1</td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>8.3</td>
<td>11.3</td>
<td></td>
</tr>
<tr>
<td>1967</td>
<td>-3.8</td>
<td>-5.2</td>
<td></td>
</tr>
<tr>
<td>1968</td>
<td>11.0</td>
<td>5.3</td>
<td></td>
</tr>
<tr>
<td>1969</td>
<td>9.9</td>
<td>2.0</td>
<td></td>
</tr>
</tbody>
</table>


### PROFITS PER DOLLAR OF SALES

<table>
<thead>
<tr>
<th>Year</th>
<th>Profits after taxes of: Corporations listed as 'war profiteers' by a peace group</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>10 largest (percent sales)</td>
</tr>
<tr>
<td>------</td>
<td>---------------------------</td>
</tr>
<tr>
<td>1962</td>
<td>4.5</td>
</tr>
<tr>
<td>1963</td>
<td>4.7</td>
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<tr>
<td>1964</td>
<td>5.2</td>
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<td>1965</td>
<td>5.6</td>
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<tr>
<td>1966</td>
<td>5.6</td>
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<td>1967</td>
<td>5.6</td>
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<td>1968</td>
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1 Firms in this category for which data were available.
The CHAIRMAN. It rose only 9.2 percent, not for the year, but for the 3-year period?

Mr. LUNDBORG. For the entire period.

The CHAIRMAN. That is practically nothing.

Mr. LUNDBORG. It dropped down to 2, slightly less than 2 percent.

The CHAIRMAN. I didn't realize it was that drastic a drop.

Senator CASE. You are comparing two 4-year periods!

Mr. LUNDBORG. Yes, sir; that is correct.

The CHAIRMAN. I see. Proceed.

Mr. LUNDBORG. You see we actually had 1 negative year of 5-percent drop in the after tax profits from 1966 to 1967, and so combining the 4 years, 1966, 1967, 1968 and 1969, it totals out to, believe it or not, cumulatively only 9.2 percent increase for the period.

The CHAIRMAN. Yes.

Mr. LUNDBORG. Now, to avoid any thought that the recent tax increase may have fudged the figures, I also have similar corporate profit figures on a before tax and inventory adjustment basis. These figures show corporate profits rose 51.3 percent from 1962 through 1965 but the gains in profits were dampened to a 16.6-percent increase during the postescalation 1966-69 period. I might note, too, that all of this is in current dollars. If this had been adjusted to so-called real dollars the comparison would have been even sharper.

It should be clear from these figures that what is good for the economy is good for business.

IMPACT OF VIETNAM WAR ON U.S. BALANCE OF PAYMENTS

Most of the concern about the upward pressures on prices and costs originating in expenditures associated with the Vietnam war arises from recognition of the damaging effects of inflation on the domestic economy. This should not lead us to neglect the important impact on our position in international markets and the balance of payments. This is not to lay the blame for our balance-of-payments problems entirely on the recent period of inflation or on the Vietnam war. Inflation and the war-associated expenditures, however, have made the problem more intractable and solutions more difficult. These difficulties with our balance of payments have postponed indefinitely any relaxation of the restraints and controls under which international business has been forced to operate for the past several years in particular.

It is important, therefore, to comment briefly on what has happened to the U.S. balance of payments in the past few years, specifically with reference to the impact of the Vietnam war. Perhaps the first point that should be made is that the official measures of the balance of payments deficit have been misleading. The view, for example, that the balance of payments in 1968 was satisfactory because there was a surplus of $168 million and that the balance of payments in 1969 was very unsatisfactory because the deficit exceeded $7 billion is unacceptable. In fact, the greatest deterioration in the payments position in recent years occurred in 1968. The difference between the 2 years may be accounted for largely by massive flows of foreign funds in opposite directions which had very little to do with the basic balance of payments position.
The best measure of what happened to the longrun position is the balance on current account, that is goods and services plus private remittances and payments of U.S. Government pensions. This balance declined from a surplus of $7.8 billion in 1964 to about $4 billion in 1967, and $1.4 billion in 1968, and less than $1 billion in 1969.

A good part of the progressive deterioration in this position over the years since 1964, the year before the major acceleration of the Vietnam war, may be accounted for by the large increase in foreign exchange outflows associated with military expenditures. These rose from less than $3 billion in 1964 to nearly $5 billion in 1969. This, however, is not the only measure of the impact of the war and the subsequent inflation on the balance of payments. The more important impact and the one which is likely to have the most long-lasting effects is on our competitive position in international and domestic markets, reflected in the rapid rise in the rate of importing of goods and services. In 1964 merchandise exports exceeded merchandise imports by nearly $7 billion. By 1968 this excess of exports over imports had declined to less than half a billion dollars. With moderation in the rate of inflation and inflation-induced expenditures, our trade balance may be expected to improve this year and in subsequent years.

It is too early to tell, however, what permanent damage to our international competitive position the recent period of inflation has induced. It generally takes several years, perhaps 4 or 5, before the full effects of excessive increases in price and costs show up in the competitive position, and the effects are not confined to world markets where our products compete with those of other Nations, but also in the United States where foreign products compete directly with U.S. products.

DOMESTIC EFFECTS OF VIETNAM WAR

So much for balance of payments considerations. Let us return to the domestic scene.

I do not think there is any doubt that the resources used toward the Vietnam war effort could have been put to work toward solving imperative problems facing this Nation at home. In the 5-year period prior to the Vietnam escalation, defense spending in the United States averaged $50 billion per year. If we assume that this level would have been maintained over the most recent 5-year period in the absence of escalation, the increase in actual spending totaled $118 billion. I was told this morning that figure could be corrected to $120 billion, but this will be close enough for this purpose.

During the past 4 years, total spending for residential construction in the United States totaled only $112 billion.

When we survey the very real needs in our economy in the areas of housing, urban transit, environmental pollution, et cetera, it is clearly evident that we do not need to create war-related demand for resources in order to maintain full employment. Our problem now is one of establishing meaningful priorities to meet the quality of life demands of our citizenry. We obviously cannot do everything at once; we need to start strategic planning and action now if we hope to resolve these demands.
There is another point that at first blush might not appear to be an economic issue. But it is in real fact a very basic one: The war has divided, confused, and bewildered Americans. Some Americans are strongly in favor of the continued prosecution of the war. Others are strongly opposed. But for many, the war and the issues surrounding the war are a source of confusion and bewilderment. As a result of this confusion and bewilderment, many people are losing trust in the institutions, both public and private, through which we govern ourselves and run our economy. Such loss of trust is destructive of the cohesion necessary for an economy's ability to function at maximum effectiveness. To the degree banks, industrial firms, corporations, State and local governments, Federal Government agencies and universities are under attack or suspicion for their alleged part in the war in Vietnam, they lose some of their effectiveness as institutions that can provide for the common good. In the case of Vietnam it is my belief that the sum total of such loss of effectiveness is very great indeed and, while unmeasurable by any known economic indicator, this loss of effectiveness produces a very real drag on the economy.

NEGATIVE INFLUENCE OF VIETNAM WAR ON U.S. ECONOMY

Gentlemen, I deeply regret that the frustrations and misunderstandings arising from this conflict make it necessary to testify that overall war is not a stimulator of economic development, nor is the war in Vietnam good for U.S. business. I find it repugnant, even if necessary, to have to add that I would not support our role in the war in Vietnam even if it could somehow be made profitable for American firms.

The thought that war would be initiated or sustained for a single day because it might stimulate the economy should be abhorrent to any decent human being. And yet there are those who say that American business is helping to do just that.

We do know that aggressive war has been waged, all through history, to gain territory. Certainly that was war for economic gain.

But even that kind of war, that purpose for war, has been so outmoded by the experience of this century that I would like to be able to say to potential aggressors all over the world, "If you want to profit, if you want to own the world, don't dissipate your energies in wasteful warfare—follow the example of Japan and Germany since World War II and be economically aggressive."

War is, as we would say in business, a low yield operation. I think from all this it is obvious that Vietnam is a negative influence on our economy. Let me conclude by restating my initial premise. The war in Vietnam distorts the American economy. It is a major contributor to inflation—our most crucial domestic economic problem. It draws off resources that could be put to work toward solving imperative problems facing this Nation at home. And despite the protestations of the new left to the contrary, the fact is that an end to the war would be good, not bad, for American business.

The CHAIRMAN. Mr. Lundborg, I think that is a very fine statement. If I understand the beginning of your statement, you were speaking and testifying as the chairman of the board of the Bank of America. We all, of course, appreciate the role that this testimony plays in the limited aspects of the war.
You intimated that you might possibly have private views as a private citizen which you cannot attribute to or in any way associate with your role as chairman of the board. I wonder if you would be willing to speak more along the line of personal views about the war and not as chairman of the board of the Bank of America?

Mr. Lundborg. Yes, Mr. Chairman. I would be willing to do that, but first I would want to make it absolutely clear that I am not now speaking for the Bank of America institutionally nor for any of my colleagues in the bank. Rather, as you put it, Senator, I am speaking as Louis B. Lundborg, private and concerned citizen.

Because I anticipated that I might be called upon to testify on a personal and private citizen basis, I have committed my thoughts to writing and am prepared to enter my personal testimony into the record.

**VIETNAM WAR IS A TRAGIC NATIONAL MISTAKE**

In my judgment the war in Vietnam is a tragic national mistake. I see no profit to the country in trying to fix the blame for what is past. No matter who initiated the first involvement or subsequent expansions, the rest of us have gone along pretty supinely. If anyone is to blame, it is people like me for not speaking up and speaking out sooner—for not asking “What goes on here?”

The fact is that collectively, as a nation, we have made a mistake, a colossal one. In any other context of life, when a mistake has been made—whether by a person, by a company, or by a nation—there is only one thing to do: face up to it. No amount of cover-up—rationalizing, alibiing, or ducking the facts—will avoid the inevitable day of reckoning; it only compounds the cost.

If a company in private business were guilty of making such a bad judgment as we have made in Vietnam and then of pursuing that judgment until so large a part of its total resources were committed to the ill-starred project, the management of the company would be under attack by the directors and ultimately by the shareholders of the company.

In my judgment, it is time the shareholders of America—the people—begin to call for an end to the squandering of American blood, morale and resources on what is in essence an Asian war of nationalism.

Because many who have condemned our involvement in Vietnam have also wanted to abolish such things as ROTC—and because, consequently, many people have come to equate anti-Vietnam with military weakness, let me say that it is precisely because I want us to be strong— militarily as well as economically, politically, diplomatically— that I do not want to see us dissipate and squander that strength in such misguided ventures as this Vietnam war.

I want us to have military strength. I just don’t want the use of it to be dictated entirely by the military.

The revulsion against our posture in Vietnam has been so strong that it has colored and distorted the attitude of our people, and particularly of our young people, toward military service of any kind. It is easy—too easy—to dismiss that as an indictment of our young people—as an evidence of the “weakening of their moral fibre.”
It is sufficiently more complex than that that I would not want to be equally guilty of over-simplifying in the opposite direction, but certainly the disillusionment of the young over our whole Vietnam experience has weakened their willingness to follow adult leadership in anything.

I shudder to think of our being confronted by a real military threat—a direct and immediate one—to our own national security while our youth are in this mood.

UNITED STATES AS UNILATERAL WORLD POLICEMAN

Unlike Korea, this does not represent the banding together of the major nations as a group, under the leadership of the UN, to protect any established principle. It is a unilateral action, in which we as self-appointed militia have seen fit to inject ourselves into an internal fight between two parts of a single country. Even from an ideological viewpoint it was questionable, because we drove Ho Chi Minh into the arms of a Communist China that he hated.

The overriding question is this one—"Does the United States from either a practical or moral viewpoint have either the right or the might to set itself up as the unilateral policeman for the world? My answer to that question is that such a position is morally indefensible and practically unsustainable.

Because I have had no reason to doubt the good faith of the withdrawal plans announced by the President, I might have continued to remain silent. But when I read 12 days ago that the President is under pressure to expand our military role in Asia, it seemed to me that the time had come to speak out, and to say "Our meddling has gone far enough."

CORROSIVE DOMESTIC EFFECT OF VIETNAM WAR

Vietnam has had a corrosive effect on our country, on our society, on our national morale. Only in part because it has been the most divisive issue of our time—nothing in this generation has so divided our people.

Division per se would not necessarily be bad for us, if it were a good healthy controversy that people could argue about and try to resolve. But this has been an issue that has left our people confused and bewildered, with no clear sense of direction; no clear sense of national purpose, no confidence in the morality of such national directions as are apparent.

I suspect that a sense of national purpose is not a very active ingredient in the conscious daily life of the average citizen. And yet the lack of such a national purpose—or the existence of a distasteful one—can have a corrosive effect on the spirit of our people.

A parallel to private business may be pertinent: an employee may not spend many minutes of his life consciously saying to himself or to others "I am proud of the company I work for"—but if he isn’t proud of it, it will show up in his work. The thing we call morale is variously defined, but by any definition it includes an element of pride in the job.

National morale is in no way different. If people are not proud of their country, their morale as citizens will suffer, and their worsened morale will ultimately damage the country.
SUGGESTED POSTURE FOR UNITED STATES AS FREE WORLD LEADER

So it is time that we took stock of ourselves, nationally, and asked ourselves if we are pursuing directions and purposes of which we can be proud.

Our country arrived so suddenly at the position of being the No. 1 nation that we have had difficulty in adjusting ourselves to the new role. Even more basic than that, we have had a hard time deciding and agreeing among ourselves as to just what our role is, or should be. When we were told, and told ourselves, after World War II that we were now the leader of the free world and that we had the obligations of leadership, I doubt that there was much of a consensus as to what those words really meant.

That is not surprising. It is hard enough for a single individual, or a single company, that arrives at influence and prominence and respect, to know just how to use those assets—let alone a nation of 200 million persons. I have a view on what our posture should have been and should yet be; and since it is germane to the Vietnam issue, I would like to express it, if I may have your permission.

I can perhaps express it best by first drawing another parallel to business, in this case my own business. It was about 25 years ago that we became the largest nongovernmental bank—roughly the same time span as we are talking about in our Nation's history. The question of how we should conduct ourselves, now that we are the biggest, has confronted us constantly since that day. If I told you that we had arrived at a rationale—a philosophy—I wouldn't want you to think that it was arrived at spontaneously or easily—without many hours of debate, many false starts, and a few barked shins along the way. It is far from perfect even now but here, for whatever pertinence it may have to the question of our country's foreign policy, is the stance we have evolved:

We are vigorously competitive—we know that our customers, our shareholders and our competitors would expect that. So we do not neglect our corporate self-interest in any of the other things we do. But we know that it is in our self-interest—call it enlightened self-interest if you want—to see that our industry and the communities we serve, are also healthy and vital.

So we try to help keep our trade associations strong and the communities we serve healthy both nationally and in California. We do not try to dominate those associations or communities in any way—we don't seek high office in the associations or the communities we serve, although we will accept those places if it is clear that we are needed for a special reason.

Do you see a parallel here, to the posture of our country? Our foreign policy must, of course, first protect and promote our national self-interest. That is the first duty of all governments, and particularly in their foreign relations. Then our enlightened self-interest dictates that we help other countries in their economic development—countries that can be expected to trade with us and to be generally cooperative with us.

But it does not dictate that we try to force upon them any of our political or social beliefs or practices. In fact, it does not dictate that we meddle at all in the internal affairs of another country.
Nor does it dictate that we set ourselves up as the self-appointed and solo policeman of the entire world. Quite apart from the fact that even our vast resources cannot stretch over every trouble spot on earth, our injecting ourselves into every conflict everywhere cannot help being resented, and thus ultimately defeats the very purpose of our intervening.

We must remind ourselves that, big and powerful as we are, we are only one nation among many.

This in essence is our mistake in Vietnam. We have somehow lost the vision to see that economics—not ideologies and not military operations—is the key to favorable world development in the latter third of the 20th century. There is only one way out of our current dilemma and that is the elimination of the war in Vietnam.

The CHAIRMAN. Thank you very much, Mr. Lundborg. I think that is a very eloquent statement with which I certainly agree, speaking in my individual capacity and regardless of the views of the committee. I think it is very useful for a great businessman to have given as much thought to this as you have and to come and express it in public.

WAR DISTORTS TIMING OF TECHNOLOGICAL DEVELOPMENT

Coming back to some of the earlier questions, I cannot refrain from making one comment. I don't want to prolong it, but I didn't get to say a word about the matter of whether or not these technological developments are beneficial. I am prompted in my remarks by the Strategic Arms Limitation Talks. Much has been said about the importance of the SALT talks. When Mr. Brandt, the Chancellor of Germany, was here last week, he emphasized the significance of SALT talks. There is a feeling in some important quarters that this is a kind of watershed, that if we do not make some progress in the SALT talks, we are in for an extremely dangerous period of further escalation.

What occurs to me about nuclear weapons, and nuclear power, which, for that matter, are the subject of the SALT talks, is the timing of it. Consistent with what the Senator from New York said, World War II brought on this tremendous increase in the development of matters which would certainly have come along. Specifically, nuclear power would have because the basic thoughts and basic principles had been developed already by such people as Einstein long before that war. What war does is throw everything out of balance. We were given tremendous power of destruction and also tremendous economic power before we had developed the maturity to know how to control it. Today the irrationality of the way we approach arms control, the way we have approached our own problem with the ABM, are examples. We have had testimony within the week before the committee by such people as Dr. Wolfgang Panofsky and Dr. Adrian Fisher and Dr. Herbert Scoville. It seems to me perfectly clear that we are engaged almost in an absurdity in this arms race.

What is the matter, it seems to me, is that war distorts the timing, if nothing else, of the development of some of these things. If we had not achieved this kind of power until we had had a little more political experience and possibly developed a workable international system, similar to the United Nations, it would be one thing. But to have
brought us into this position of great power far ahead of our time confronts us with the possibility of real, almost complete destruction. The very issues that will be presented at the SALT talks are almost unimaginable in their danger if we do not deal with them properly.

I think war does distort everything about domestic business, as you put it so eloquently, but it also distorts in this broader sense that we have new capacities and powers which really none of us know how to control. I am not speaking just of the United States. I think the Russians and other countries are confronted with the same difficulty.

It doesn't mean that nuclear power has no value, but I think World War II did bring it on prematurely. It certainly did that and far sooner than it should have if we were to have an orderly development. Many of the other things that are causing the distortions in our economy, the pollution, came too fast. For example, the airplane has come on too fast and I think they are bringing on the Super Sonic Transport too fast because it is confronted with great difficulties of congestion and problems of today that are plaguing the country.

I don't want to pursue that any longer, but I wanted to merely throw it out that it is much more complicated than just saying, "Well, I think a nuclear power station is a good thing." That isn't all there is to it at all. It is a much broader question as to what the war did in many different directions.

VIETNAM WAR UNDERMINES PRIVATE ENTERPRISE SYSTEM

The main thrust of your principal testimony is that the war is very bad for the capitalistic system, the private enterprise system. Is that not correct?

Mr. LUNDHÖR G. Yes.

The CHAIRMAN. You were talking about the balance of payments, which is a very serious matter. Why is this not as serious a matter, say, to the Russians, to that kind of an economy, as it is to us? Why is it of such significance to us? You seem to think it is of great importance and I think it is. I wonder if you could translate it into simple terms to avoid some of the confusion which you so correctly said afflicts us?

Mr. LUNDHÖR G. I don't have and I am not sure that we have available—you would know better, Senator, than I do, whether we nationally have available statistics on the Russian payments position. Of course their entire monetary system is different from ours.

The CHAIRMAN. That is what I mean. It is a very different system and it hasn't nearly the same role. The effect of our balance of payments on a free economy or relatively free economy is very important.

Mr. LUNDHÖR G. Yes, sir.

The CHAIRMAN. If we were a closed or controlled economy it would be another matter.

Mr. LUNDHÖR G. Right. The very fact that we don't deal with an open market, their trade internationally is not typical market trade, it is largely barter exchange.

The CHAIRMAN. That is right. They don't have that then?

Mr. LUNDHÖR G. They don't have the monetary system that we have. The ruble is not a reserve currency used in the settlement of international balances.
The CHAIRMAN. If we want to preserve our private enterprise system, which we think has great merits, then we have to deal with the balance of payments problem and we cannot deal with it as long as the war is going on. That is the point I was trying to make.

As I interpret your testimony, I think what is happening is that we are not in this war saving the private enterprise system and democracy. We are undermining it. This is the best way I know to destroy it. We can destroy it this way much more surely than the Russians or anyone else can militarily.

Mr. LUNDBOG. I happen to agree with that.

The CHAIRMAN. That is all I meant. I think the confusion you mentioned is in what is going on and how it affects us. As you said so eloquently, this is weakening our country. You are not against the war because you want us to be weak, but because you want to maintain our strength. Yet it is sold the other way. It is sold to the people by innumerable organizations around this country that to be strong you have to build more weapons and to have a bigger military establishment. I have heard the leaders of this Congress say publicly and privately that "Whenever I am in doubt," and they usually are, "I come down to the side of more security." I mean on the side of security and more arms. That is what has happened in the last 10 or 20 years.

I think to show the effect of the war upon the values that the American people really do cherish is the great merit of your testimony. It has to be done. They do not understand it. You correctly said they are confused about it. It is a great tragedy, but I won't lecture any more.

I will come back to you after my colleagues have asked their questions. That was inspired by your remarks, Senator, in that first opening.

Senator SPARKMAN. I was just following up on what the Chairman had said.

The CHAIRMAN. Senator Gore preceded you.

Senator SPARKMAN. Mr. Lundborg, I thought your economic statement was very fine, clear, and helpful, and I surely think that you have given us something to think about.

1968 AND 1969 BALANCE OF PAYMENTS DETERIORATION

There is just one question I want to ask you about it, dealing with the balance of payments. My friend, Senator Symington from Missouri, is the expert on balance of payments and probably I should leave this to him. I don't quite understand why you say that the worst year in balance of payments was 1968, even though 1969 showed a greater deficit in balance of payments. That is correct, isn't it?

Mr. LUNDBOG. That is correct. I would like, with the chairman's permission and with your permission, gentlemen, to ask my associate, Dr. Ross, who is the economist in our bank and much more technically versed in the entire balance-of-payments question than I am, if he might elaborate on that one question.

Senator SPARKMAN. Dr. Ross, will you give your full name to the reporter?

Mr. Ross, John B. Ross.

Senator SPARKMAN. And your title?
Mr. Ross. Associate economist.

Mr. Lundborg. Associate economist, Bank of America.


Mr. Ross. In this regard as Chairman Lundborg pointed out, the deficit in 1969 was $7 billion, but this was on a liquidity basis and reflected an awful lot of flows of funds that are of a temporary nature. We had a basic deterioration in our balance of trade in 1968 even though we had an overall surplus at that time. So if you look at the fundamental factors which we are most concerned about; namely, the competitive factors, you will see we had a much worse deterioration on our balance of goods and services at that time, as he points out in the testimony. I don't think there is much doubt and the bank has taken a position and we see with the climbing price of gold up until a few months ago that the dollar is the key currency in the world and its strength is not challenged at this time, but we are, of course, concerned about our export balance of goods and services.

Senator Sparkman. Of course we are all concerned about our export-import balance, and we are also concerned with the balance of payments. However, we are reminded constantly in the Joint Economic Committee and by our economic experts that while the export-import balance has an effect on balance of payments, it is not tied directly to it. There are many other factors that enter into the balance of payments. Isn't that right?

Mr. Ross. Yes, this is true, but it depends on how you do the accounting. We do our accounting on a system which makes our balance-of-payments position look much worse, for example, than the European countries. They look basically at their current account. So when you talk about the balance of payments you should ask, "Well, what do you mean, which balance are you talking about," and if you are looking at the balance which is most directly affected by long-run economic factors, then in 1968 the deterioration there was much more severe than the fact that we had a $7 billion——

**EFFECT OF U.S. EURO-DOLLAR BORROWING ON BALANCE OF PAYMENTS**

Senator Sparkman. You mentioned that in 1969 a lot of the exchange was of a temporary nature. What time limit do you put on the term temporary?

Mr. Ross. I think some of the factors which shifted flows of funds are already beginning to reverse themselves now in the first quarter of 1970.

Senator Sparkman. I am talking about 1969 at the close of December 31.

Mr. Ross. I am saying that some of the forces——

Senator Sparkman. How did you know how temporary it was going to be? Let me ask if this is correct. Isn't it true that our people in this country borrowed a great deal of money in Europe, and those funds came in here, I suppose you say, on a liquidity basis and, therefore, ought not to be placed——

Mr. Ross. I didn't hear the first part of your question.

Senator Sparkman. I said it is true, isn't it, that our people in this country borrowed a great deal of money from European institutions during 1969.
Mr. Ross. We did borrow funds in the Eurodollar market, certainly.

Senator Sparkman. Do you not count that as affecting the balance of payments?

Mr. Ross. Certainly. We also found there were large volumes of foreign funds coming in at various times for buying in our stock market. The stock market performance has not been such lately as to encourage too much flow of funds. [Laughter.]

Mr. Lundborg. That is an understatement. I think part of what Dr. Ross is saying now and part of the answer to your question, Senator, to go back to my own testimony, that the difference between the 2 years may be accounted for largely by massive flows of foreign funds in opposite directions. Probably a large part of this would be the Eurodollar borrowings that you are referring to, Senator.

Mr. Ross. Yes, sir.

Senator Sparkman. That did represent moving of foreign money into this country, didn't it?

Mr. Ross. Both ways.

Senator Sparkman. Then I just cannot see where that is not involved in the balance of payments.

Mr. Ross. It certainly is involved in the balance of payments. We wouldn't want to suggest for a moment that the key role of the dollar is not important. The dollar is very important; it is the only really important reserve and trading currency at the present time and there is no alternative to the dollar.

U.S. HOUSING COSTS

Senator Sparkman. Let me ask about something else. I am rather heavily involved from a legislative standpoint in the field of housing. I am very much concerned about it. You know housing has caught a terrific beating during this money crunch. In fact, Governor Maisel of the Federal Reserve Board has testified at different times before our committees that even though housing had only about a three and a half percent impact on our gross national product, it absorbed 70 percent of the impact of the 1966 crunch and probably just about as much this time.

Is there any relief on that, or to what do you attribute that and the tremendous interest rates, which I was glad to see the Bank of America reduced quite early in the game. I hope they may continue a trend in that direction. I commend and congratulate your establishment for exercising the leadership that it did. As a matter of fact, I believe the first thing you did was to drop the discount points 4 points.

Mr. Lundborg. That is correct.

Senator Sparkman. Then you followed that up very shortly with an increase in interest rates.

Mr. Lundborg. Decrease.

Senator Sparkman. I mean a decrease in interest rates, certainly.

Would you care to comment on whether or not we can expect that to continue and on any effect that carrying on the Vietnam war might have on that and on the scarcity of mortgage funds.

Mr. Lundborg. Senator, I would hope and I think probably it is implicit in everything that I said in the economic part of my testi-
mony that, yes, by all means. One of the really serious and I think tragic consequences of the distortion that I referred to in our economy has been in the effect on housing. It has worked both ways. It not only has made money scarce, interest rates as you so well know are simply a reflection of the market, scarcity or availability of money, and because of the pressures on the monetary system the cost of money has gone up and the availability has gone down, but also the other costs that enter into housing, virtually everything that enters into the cost of a house has been inflated in the same process so without any question housing has probably taken the brunt of this again as in 1966 more than any other single part of the economy.

Outlook, certainly we need to do two things. I am sure we need to end Vietnam in order to get inflation more nearly under control. Whatever we have to do beyond that to get inflation under control is critical, of course, to the future of adequate housing for people of low and moderate incomes. The two things are just inseparable.

Senator Sparkman. I understand from some of the leading builders of the country that the single-family housing unit is practically out of production at the present time because of these very factors that you have named.

Mr. Lundborg. There are many efforts to bring substitutions in. The mobile home and things of that kind, which are single family in a sense, but they are different from what we have thought of as a traditional fixed location.

Senator Sparkman. That is correct, and until April 1, when President Nixon gave a statement on housing, we had never included mobile homes as a part of the units started. However, last year we passed legislation authorizing the Federal Housing Administration to insure mobile homes on a somewhat different basis from their regular insurance. It is at a much lower cost and a lower loan value ratio, but nevertheless we did recognize it and authorized the insurance of it.

I could go on a long time. I may say that as a matter of interest, we have on the Senate calendar now five different titles of one bill seeking to help mortgage financing end of the housing industry. Four of them I count as being more or less emergency measures and they are scheduled to come up tomorrow afternoon and Friday. That has nothing to do with this, but I thought you would be interested in that statement.

Mr. Lundborg. I am very interested. You and I could spend a lot of time talking about this whole housing apart from this and I hope we will.

DIFFICULTIES IN ENDING VIETNAM WAR

Senator Sparkman. I want to make just one comment on your supplementary statement. I agree in great part with it. I do think, though, in all frankness, that in dealing with this subject it is so easy to suggest a remedy. It is much more difficult to execute it.

Mr. Lundborg. I am aware of that.

Senator Sparkman. You mentioned three things. One was the elimination of the Vietnam war. We are all in favor of eliminating it, but how and over what period of time is a very important matter upon which people have not been able to agree. The President has announced a program and is carrying it out. Numerous other things
have been mentioned, but I don’t think any of them has met with what we might call a general consensus. I think it would help a great deal, although a great many of our economists are warning us that we are expecting too much of a good thing right when the war ends. They say it is going to take time to make adjustments, and to work up priorities. Be that as it may, we are all in favor of elimination of the war. I don’t think there is any question about that.

Then you mentioned meddling with internal affairs. I think you are a hundred percent right, and I don’t think we can continue to police the world.

I don’t think it is up to us to say what kind of a government any other nation is going to have. Yet many of those who advocate elimination of the war carry with it as one of the essentials that we establish another government in South Vietnam and throw this one out.

NATIONAL SELF-INTEREST SUBJECT TO INTERPRETATION

Then there is the question of national self-interest. I don’t think that is easy to answer. As a great and powerful nation, I think we must have interest in the whole world. I don’t think we can overlook it. Therefore, I think mentioning the national self-interest is something that is subject to many interpretations. I just wanted to make that comment on it.

Mr. LUNDBORG. Yes.

COMMENDATION OF THE WITNESS

Senator SPARKMAN. I appreciate your giving us the statement. I think there is a whole lot of good in it.

Mr. LUNDBORG. Thank you, Senator.

Senator SPARKMAN. Thank you very much.

The CHAIRMAN. The Senator from New Jersey.

Senator CASE. Thank you, Mr. Chairman.

I join my colleagues, Mr. Lundborg, in thanking you for your testimony and for your appearance here.

I can’t help but say that your supplementary statement of your own personal views and your own philosophical attitude toward the war is the thing which has stirred me most.

HONORABLE SOLUTION TO VIETNAM WAR DOUBTED

Did you read an article in a New York magazine about two months ago by John Paton Davies.

Mr. LUNDBORG. I don’t recognize it.

Senator CASE. Well, the thrust of it was that our policies in general had been wrong in that we had gotten away from the basic reliance on the balance of power in international affairs. And had moved over too much into a belief in a universalist system in which as a second step we would have the obligation of enforcing the right and wrong over the world.

But he said this about the Vietnam war: that there is no honorable way out, and that this is what we are all blinking at and that this is what our national frustration is basically resting on. He suggests that those who are called doves, who urge that all we have to do is
negotiate with the other side and we will come up with some kind of a tolerable peace, are fooling themselves—that there is nothing that the North Vietnamese accept except an agreement in which their domination of this whole area is inevitable. He said that those who urge that withdrawal is the way—even though everyone pays lip service to the idea that they don’t believe in precipitate withdrawal—even though reasonable time is fixed or one that we say is reasonable, there is no prospect really that there will be at the end of the road anything except the same result, and in either case slaughter of tens or hundreds of thousands of people who have come to rely upon us. Now, this I think is true. I am not sure where it leads me, and it is enormously complicated by the fact that if we say we will take this dishonor—because we made a mistake some time back and all the way, and everything we have done has been wrong and it is better to acknowledge this and to take the consequences and the humiliation not only in the world’s eyes, but in our own of doing a dishonorable action now, dishonorable because the cost will be borne mostly by others than ourselves—even so we will be faced then with the questions: “Why did you allow 45,000-plus American lives to be lost? Were their lives lost in a vain and mistaken cause?” And this is almost intolerable, not only for the country but for all of the individuals in it, to bear. This is why I say we can’t just lightly say end the war. Senator Sparkman made this point. But I think we ought to look at it in some depth because this is the measure of the difficulties. In fact what now seems to me almost the impossibility is any honorable solution of the matter, and I think Davies is nearly right. If he had any other idea of a solution he surely would have said it, and anyone must.

Have you any comments on this?

QUESTION OF DISHONOR IN ENDING OR CONTINUING WAR

Mr. LUNDBORG. One is to ask what is the alternative. This is a troubling thing, a very deeply troubling thing. The question of which is the more dishonorable, whether there is not some question about our honor when we are in the questionable and dubious posture we are now. These are all elements, and I have reached my conclusion, as I have stated here, and it is not an easy one to reach. I have reached it because I think the alternatives are as bad as the affirmative one I have reached.

The timing, of course, people who are more expert than I am, I profess I have no military expertise at all, the method by which we extricate ourselves, the procedure and method and sequence, would have to be left to others. I simply would advocate that it would be our decision that we are going to do it rather than we must continue forever because we are there. This in any circumstance, I tried to say in my testimony is never to me a productive, fruitful posture. If we have made the mistake, and I think we have, then we must face that, and recognize that the cost in any case is going to be a great one. I think it will be less if we move in the direction I have indicated than if we do not move in that direction.

Senator CASE. Well, in general your suggestion is we withdraw.
Mr. LUNDBORG. Yes.

Senator CASE. And as to time you are not specific about it?

Mr. LUNDBORG. I couldn't be. I would be presumptuous.

Senator CASE. I have no alternative and I am not baiting you, believe me.

Mr. LUNDBORG. I know you are not.

Senator CASE. It is just that I think, despite what you have said, that you still have to realize that the cost in this country and abroad may be enormously greater than we are willing to face up to.

Mr. LUNDBORG. I happen to feel we are paying a tremendous cost now—

Senator CASE. Of course we are.

Mr. LUNDBORG. For doing nothing. I say oftentimes in my own business that to do nothing is a decision. When people say they are not making a decision, I say, "You are making a decision when you do nothing," and I think in a sense we are making a decision now.

Senator CASE. We are losing thousands of men a year still.

Mr. LUNDBORG. Right.

Senator CASE. We are not doing nothing.

Mr. LUNDBORG. No, but I mean—

Senator CASE. And so just to continue what we are doing is intolerable also.

Mr. LUNDBORG. Believe me, we are choosing between some very painful alternatives. It is not easy to come here and talk about this. Anything you do is difficult. I happen to have made my decision and am willing to share it with you recognizing my own human fallibility in doing it.

Senator CASE. Well, our discussion is based upon mutual acceptance of the seriousness of the insolubility of this problem in any decent terms, and the necessity for this country to face dishonor and if you have anything further along these lines later as a result of this further discussion of it I would be very glad to have you present it.

Mr. LUNDBORG. I would be very happy to keep in communication with you and other members of the committee.

Senator CASE. Mr. Chairman, I don't think I have any further questions.

DISHONOR OF U.S. MISTAKE QUESTIONED

The CHAIRMAN. I am bound to say I don't consider it dishonorable to have made a mistake either as an individual or as a country. I don't see why this should be put in such context. I don't know about the Bank of America, but nearly every bank has made a bad loan and it is not dishonorable to make a bad loan.

Mr. LUNDBORG. We have made several.

The CHAIRMAN. It is just a mistake one makes. I don't want to rehash how we got into this war, but I do not consider it dishonorable. It is unpleasant, and it may be embarrassing to certain individuals who may have played a major part, to have made the mistake. I forget who it was who always said that to say you have made a mistake is merely another way of saying that today you are wiser than you were yesterday when you made the mistake. It is not a dishonorable attitude.
Senator Case. Mr. Chairman, I must insist that I be allowed to make it clear, as I hoped I had before, that I was not questioning the honor or dishonor with which we had gotten into this mess. I was raising the point, which I think is true, that our frustration is based upon the fact that there is no way out that is honorable, that is to say, no way out that we can find that will not involve hurting people beyond this country, if you will.

The Chairman. It will hurt them less than to continue. That is the point Mr. Lundborg is making.

Senator Case. I am not disagreeing with this, Mr. Chairman. You and I have understood this, I think, for quite a while and are in substantial agreement with it, but I cannot allow the suggestion that we can with any ease get out of this thing by following any one of the possibilities that seem to be open here.

Mr. Lundborg. If I may interject just one time more, I really have very little to add, I think we must recognize that there is no easy way about this. It is a choice between very painful alternatives, certainly more than painful, very difficult ones.

The Chairman. I agree.

Senator Symington. Thank you, Mr. Chairman.

Mr. Lundborg, it is a pleasure to see you.

Mr. Lundborg. It is nice to see you.

COMMENDATION OF THE WITNESS

Senator Symington. Sometime ago you sent me a brochure about general economic conditions. I started reading it and couldn’t put it down; and wrote you a letter.

As things are going, your testimony this morning could be the most important testimony given before this committee in a long time.

VIETNAM WAR CONTAINS SEEDS OF DESTRUCTION OF UNITED STATES

What you are really saying is, if we don’t get out of Vietnam, regardless of whether it would be on an honorable or not so honorable basis, this latest military venture on our part has in it the seeds of the destruction of our economy; and therefore very possibly the people of the United States. Is that a fair statement?

Mr. Lundborg. I think that is a fair statement. That is perhaps stronger than I had made it but I do not disagree with that. Correct.

Senator Symington. Thank you.

The public address system would appear on the blink, so I will talk louder.

Mr. Lundborg. I can hear you very well.

Senator Symington. Thank you.

The Chairman. They are using that microphone for the camera, so still use it.

Senator Symington. Thank you.

As an aside, if your economist would be good enough, to submit a paper you approve on the 1968–69 difference in the balance of payments. Would you be good enough to do that?

Mr. Ross. Certainly we will prepare one and submit it.

Mr. Lundborg. Yes.

Senator Symington. Please submit it for the record.

The Chairman. Yes.

(The information follows.)

FOREIGN EXCHANGE COSTS AND BALANCE OF PAYMENTS EFFECTS OF THE VIETNAM WAR

BY ROBERT H. SHAFFER—SENIOR ECONOMIST, BANK OF AMERICA N.T. & S.A.

In interpreting the analysis of the balance of payments effects of the war in Vietnam, it must be recognized that any presentation of the balance of payments may be misleading. The public is faced with a variety of measures of "the deficit" which sometimes portrays the balance of payments as good, sometimes as bad, and worse, sometimes both at once.

The years 1968 and 1969 offer remarkably striking examples of this confusion. The balance of payments on liquidity basis shifted from a surplus of $3.6 billion in 1968 to a deficit of $7.1 billion in 1969. The balance on official reserve transactions basis was in surplus both these years, the surplus actually increasing in 1969 to $2.7 billion from $1.6 billion in 1968. The difference between the two measures of the deficit amounted to nearly $10 billion in 1969.

Last year, in fact, the balance of payments position was neither as bad as the deficit on liquidity basis would seem to indicate, nor as good as portrayed by the official settlements balance. Nor were the shifts between the two years as dramatic as the changes in the measured deficits.

There was a much more serious deterioration in the position in 1968 than that occurring in 1969. The surplus on goods and services account, the difference between exports sold to foreigners and imports from foreigners, declined from $5.2 billion in 1967 to $2.5 billion in 1968. The decline in that surplus in 1969 was only $443 million to $2.1 billion.

The apparent improvement in the balance of payments—as measured by the liquidity deficit—was almost entirely accounted for by a sharp increase in the inflow of foreign nonliquid capital from $3.4 billion in 1967 to $5.6 billion in 1968. (All capital figures in the balance of payments account are net.) Conversely, an equally sharp decline in these inflows in 1969 was responsible for a large part of the apparent worsening of the liquidity deficit in that year. Shifts in these flows from year to year have little to do with the strength or weakness of the basic balance of payments position, and are related instead to changes in relative interest rates and the relative attractiveness of portfolio investments, mainly as between the United States and Western Europe.

Another reason for the misleading portrayal of the balance of payments position is the mode of recording eurodollar transactions on the liquidity basis. A large part of the funds that went from this country into the eurodollar market was returned by U. S. banks through borrowing from their foreign branches. This circular flow of eurodollars has no great significance for the balance of payments position, but the accounting procedures resulted in a large and arbitrary increase in the deficit. The inflow of eurodollars was also responsible in part for the large reduction in foreign capital inflows, as funds borrowed by U. S. banks were not available for other forms of lending and investing in the United States.

These caveats, however, in no way imply that there has not been a serious worsening in the balance of payments position in recent years. And that worsening is in part related to the Vietnam war.

Military expenditures on balance of payments account amounted in 1969 to nearly $4.9 billion in foreign exchange. A small portion of this was provided
by the State Department out of the proceeds of foreign aid operations (mainly PL480 sales of agricultural commodities in exchange for local currencies), so that only $4,735 million actually represent the flow of U.S. dollars through foreign exchange markets. These expenditures were partially offset by $1,462 million in net funds received for U.S. arms exports negotiated through the Department of Defense, mainly with Germany as part of its agreement to offset U.S. expenditures for troops stationed there. Only those arms sales officially arranged through the Defense Department are included in this category, as arms sales not so channeled are considered autonomous and are, therefore, included among commercial exports.

The net payments outflow due to the Government's military operations, after declining from $2.6 billion in 1960 to $1.7 billion in 1965, rose rapidly for the following three years, increasing by almost 90%, mainly because of rising Vietnam expenditures. There was an almost continuous rise in military expenditures on balance of payments account to countries in Asia and Africa other than Japan, Australia, New Zealand, and South Africa. By far the larger part of military expenditures to this group of countries is accounted for by Southeast Asia. These expenditures increased from less than $500 million in 1968 to over $2 billion in 1969.

The source of the increase was the change in total expenditures, as the offsets, which are related mainly to European troop costs rather than those in Southeast Asia, have remained relatively stable since 1962. The slight decline in net payments outflow in 1969, however, was accounted for by a 50% increase in the offset, and despite a nearly 7% increase in expenditures.

These figures purport to show only the direct net impact of U.S. military operations on international payments. The ultimate balance of payments effects of these military operations is, of course, much greater than shown. Because U.S. imports are attributed to the purchaser-of-record, rather than to the ultimate user, merchandise imported by military contractors for manufacture into products for sale to the Department of Defense are classified as being of a commercial rather than of military nature. Other factors also work to under-report the deficit on military account and correspondingly to overcharge other components of U.S. Government transactions. Total post exchange sales are credited against military spending abroad, even though not all sales are to military personnel. Under current accounting practices, some overlapping occurs between military related expenditures in the category of foreign aid. In addition to the treatment of military loans as foreign aid, substantially expenditures of a quasimilitary or peace keeping nature are recorded as non-military grants and loans, especially those related to the war in Southeast Asia.

Finally, the balance of payments effects of the Vietnam conflict are understated to the extent that the rise in military expenditures was responsible for the inflationary excess demand in the economy, which has lead to the dramatic upsurge in imports of goods and services. Between 1965 and 1969 imports, not including military expenditures, increased by over 70%—a rise in those four years equivalent to that in the preceding nine years, that is, from 1956 to 1965.

And to the extent that the excess demand was reflected not in rising imports but in increases in domestic costs and prices, the balance of payments effects are likely to persist for many years. It takes several years for increases in domestic costs relative to foreign costs to show up fully in the damaged international competitive position. We are just beginning to feel, that is, the balance of payments effects of the loss in competitive advantage from the recent bout of inflation.

The longer the excessive balance of payments deficits persist, the longer will they provide the excuse to maintain controls over foreign investment, lending, and trade. The longer these controls are maintained, the more entrenched do they become in distorted markets, and the more difficult it will be to relax them.

The war in Southeast Asia cannot take the blame for the whole of our inflationary and balance of payments problems, but it is obvious that it must share a larger part of the blame.
### MILITARY TRANSACTIONS AND THEIR ASSOCIATED PAYMENTS FLOWS

#### [In millions of dollars]

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<td>(2,460)</td>
<td>(1,828)</td>
<td>(1,834)</td>
<td>(1,718)</td>
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<td>Overseas military expenditures, net...</td>
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<td>(2,859)</td>
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<td>(2,785)</td>
<td>(2,782)</td>
<td>(3,629)</td>
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<td>(2,961)</td>
<td>(2,880)</td>
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<td>138</td>
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<td>967</td>
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<td>657</td>
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<td>Net receipts of principal repayments of past credits...</td>
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<td>43</td>
<td>110</td>
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<td>Net increase in U.S. Government liabilities (payments received on deposit)...</td>
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<td>4</td>
<td>470</td>
<td>347</td>
<td>233</td>
<td>306</td>
<td>346</td>
<td>64</td>
<td>(137)</td>
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<td>(1,539)</td>
<td>(1,562)</td>
<td>(1,340)</td>
<td>(1,828)</td>
<td>(1,002)</td>
<td>(905)</td>
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<td>1,539</td>
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1 Not available.

DIFFERENCE BETWEEN UNITED STATES AND RUSSIAN CURRENCY

Senator Symington. With respect to observations of the distinguished Senator from Alabama about relationship of the currency, the Soviets don't have their currency laced in in any manner to the value of gold.

Mr. Lundborg. That is correct. It is not a reserve currency, it is not a trading currency at all as the dollar is. Basically the whole problem of balance of payments is the fact that the dollar is the international reserve currency and that the ruble is not that kind of currency at all.

Senator Symington. I remember one time President Eisenhower gave me a line I used in a speech, namely, in a totalitarian state the coin of the realm is the order of the dictator. That would seem clear as to the difference.

EFFECT OF U.S. MILITARY VENTURES ON NATIONAL DEBT

I have been thinking a long time about this problem of inflation. I was in business before coming into this business; I am not a banker although I have served on various bank boards and have looked at plenty of balance sheets. As I remember it, our national debt is about $60 billion more than the debt of all the other countries in the world put together. The interest on that great debt in itself is a crushing burden to the American taxpayer.

We often justify this gigantic debt to our people by saying, "After all, we owe it to ourselves."

You mentioned the fact we have put a hundred billion dollars into this escalation of the Vietnam war. Wouldn't it be rather difficult, as an economist, to justify how we could owe that hundred billion dollars to ourselves? And if you add what we have put in Europe, where we have now had hundreds of thousands of troops for over a quarter of a century, to what we have put into the Far East, you come up with a figure that is considerably more than the current national debt.

I would illustrate part of the problem this way. When the Secretary of the Treasury, an able commercial banker, came up before the Joint Economic Committee, I asked if he felt it was essential to the economy of the United States to continue the surtax. This was in an open hearing. He said "Yes." I told him we figured the surtax, 5 percent from the 1st of January to the 1st of July, would bring in about $2 billion. He thought that about right, a billion seven from individuals and $300 million from the corporations. I said, "We figure in my office that is about a hundred dollars a second we are lifting from the taxpayer," and he said that was probably right if I said so; he didn't know. So I presented that, based on the $80 million a day we had been spending in Vietnam, we were taking over $900 a second from the taxpayers for our Vietnam cost alone; therefore, how could this surtax be of such great importance one way or the other to the economic position of the United States. Secretary Kennedy just shrugged his shoulders. He had no answer.

Isn't this pertinent to the position you are presenting this morning?

Mr. Lundborg. If it does not completely, it is completely consistent with it. I am sure what Dave Kennedy undoubtedly had in mind was
that as small as the surtax was it was part of the difference between a balanced and unbalanced budget. In terms of inflation, strictly speaking, the unbalance is a very powerful part of the inflationary force, that is what, part of what, he had in mind. The rest of your statement is certainly valid.

Senator SYMINGTON. I was not criticizing his testimony. The more he can get, the better for the Nation’s balance sheet.

Mr. LUNDBORG. Right.

U.S. FOREIGN MILITARY EXPENDITURES AS BASIC CAUSE OF INFLATION

Senator SYMINGTON. Speaking of balance sheets in the days when I was in business, on the left side you have cash and what is owed you, plus land, buildings, machinery, and equipment, if you have a generous board of directors they often let you put in a little for good will. On the right side you express what you owe people, plus the value of your stock, debentures, and so forth; correct?

Mr. LUNDBORG. That is correct.

Senator SYMINGTON. But in a government you don’t have any assets; you just have the debt. You just have the debt. But that debt represents assets such as the Defense Department, our Interstate Highway System, all our dams, Federal buildings, Federal departments, and so forth. It is justified, as I mentioned, by people saying, “We taxpayers owe it to ourselves.”

Isn’t the basic reason for this crippling inflation the vast amount of money, which now runs well over a hundred million dollars a day, for these various military investments and adventures abroad? We can’t say we owe that cost to ourselves. Isn’t that the basic cause for this continuing inflation, as you see it?

Mr. LUNDBORG. Yes, basically the whole debt you referred to has been built up largely from the financing of wars, present and past ones.

LIMITING DEFENSE EXPENDITURES TO VITAL SECURITY INTERESTS

Senator SYMINGTON. For some reason, and I must say I think the recent marked change in this attitude on the part of the Congress is a healthy recent development. Up until recently the cost of anything that had to do with defense just went right through the Congress. People in many other departments knew they would have a better chance of getting the appropriation they wanted if they could say it contributed to national defense.

Yesterday I was in a hearing where the new cost of the ABM was given, $12 billion. Regardless of whether this system is right or wrong, it takes a lot of business to create the profits and income to in turn create the tax source necessary to get that $12 billion. As a banker you would agree to that. At one time the Air Force came up with a plane. They wanted 150 airplanes. The total cost of those 150 was estimated as high as $10 billion. This morning I was in a hearing that had to do primarily with the cost of modern aircraft carriers. The cost of one without planes, or oil or the required escort vessels is now over $800 million for one ship. So we do have a serious problem of how to distribute our increasingly limited resources, do we not, in these various high Government costs?
Mr. LUNDBORG. That is correct.

Senator SYMINGTON. And if it is essential to buy such equipment for protection against the obvious real enemy, then the sooner we get out of military expenses not vital to our security the better, if we are going to preserve the economy. Would you agree?

Mr. LUNDBORG. There is no question about that.

Senator SYMINGTON. Now I would run through, if I may, some of the points in your testimony, which to me is impressive testimony.

EFFECT OF RESEARCH AND DEVELOPMENT EXPENDITURES ON ECONOMIC GROWTH

We have run into a somewhat peculiar application of research and development in budgets of the past, where, at least to some extent, the supplier to the contractor is the decider as to where and how the money should be utilized.

Therefore, when in your statement you say, "Other authorities have shown that rising expenditures for research and development may be actually reducing the rate of economic growth in the United States," especially because of the emphasis or fallout incident to a lot of this research and development, could we have some more detail on that?

Mr. LUNDBORG. We would be glad to supply that.

Senator SYMINGTON. Thank you, sir.

(The information follows.)

INDUSTRIAL RESEARCH AND DEVELOPMENT: ITS CONTRIBUTION TO SOCIAL AND ECONOMIC PROGRESS IN THE SEVENTIES—BY ROBERT J. OSTER, ECONOMIST, BANK OF AMERICA, N.T. & S.A.

America is transcending from a quantitative to a qualitative economic objective. In the "Socially Sensitive Seventies", improving the "quality of life" will be paramount and increasing the quantity of goods and services will be secondary. In this emerging environment, the social benefits of industrial-military research will be sharply reduced unless they are explicitly sought after, rather than left to the chance of nonexistent or increasingly difficult to obtain research spillover.

Can industrial research and development, with its heavy emphasis on defense, advanced weapons systems and space exploration, meet our basic social and economic needs in the Seventies? Not unless it is redirected to meet head-on the challenges placed before us by a generally labor scarce, inflation prone economy and by a fundamental shift in our national economic objective to one of improving the "quality of life". It is not clear that rising expenditures for research and development are conducive to economic growth or that scientific and technological advances in space and military R and D can be readily transferred to the benefit of the private economy. Indeed, a growing body of empirical evidence, together with the results of the research presented here, suggests that the opposite may be true. In any event, the common sense dictum that a straight line is the shortest distance between two points implies that research and development directed specifically to meeting our growing social and economic problems will be more beneficial than reliance on the "spillover" from military and space-oriented R and D.

AMERICA IN TRANSITION

The major social transition of the century may well be underway. It is a transition to a new, higher "quality of life" objective. Because public interest is aroused and the economic climate is right, this shift from a national objective...
of quantitative living standard increases to improvements in the quality of living is fundamental and far-reaching, not superficial or ephemeral.

During the past five years aggravated by the war in Southeast Asia, our basic long range economic problem has changed. Our problem of stimulating demand to increase production and provide more jobs is rapidly shifting toward a problem of stabilizing excessive demand for services, money, goods and manpower and increasing productivity so that we may keep costs and prices under better control and make the qualitative progress that we desire.

Now that we have sampled full employment, the economic objective of the last forty years, we have come to realize that inflation can become as chronic a problem as a recession. I have confidence in our ability to maintain reasonable levels of employment and production over the long pull. Indeed, we can now begin to divert more of our individual and collective energies to reducing the costs of achieving that goal.

Public interest is aroused, especially among the young. Their own personal needs for economic security have been generally satisfied. They've turned now to more qualitative demands to satisfy public needs, and, for example, have catapulted "the correction of environmental pollution"—in the broadest sense—into a top spot among our major social and political issues. In addition, businesses are coming to recognize their own legitimate social responsibilities to help satisfy these qualitative demands. They are coming to view "social performance" as a relevant complement to "profit performance."

We must recognize, however, that social, qualitative progress has its costs. In the generally fully employed economy of the Seventies, this means that hard choices must be made—we must say "no" to some demands if we are to satisfy others. We can't do everything at once. Priorities must be established, not left to chance or the naive assumption that none are needed.

Establishing and maintaining these priorities will sorely test the skills of public and private managers. For public decision makers, there will be endless demands for "immediate action" on a host of individual and community problems in the face of limited financial resources and taxpayers' revolts. For private business managers there will be the never-ending price-quality demands of customers, the incessant wage demands of employees, the persistent profits demands of stockholders and the new and growing social performance demands of the public.

Resolving these apparently conflicting demands will require the dedication of countless individuals and businesses. Achieving the desired results of increased productivity and qualitative progress will require determination and public and private cooperation, leadership and planning.

**CAN INDUSTRIAL R. & D. LIVE UP TO THE CHALLENGE OF THE SEVENTIES?**

The social and economic hallmarks of the Seventies, then, will be productivity and quality. They suggest the avenues by which industrial-military research and development can make its contribution to progress. Does industrial R & D contribute to economic productivity or growth potential? Robert Solo, in an important article in 1962 [6], demonstrated that rising expenditures on research and development seemed to bear little relationship to overall economic growth. If anything, R & D outlays to that time appeared to be detrimental to the pace of economic development.

Solo founded his position on the following points: First, a comparison of generally accepted measures of growth (such as GNP or output per man-hour) with spending on R & D showed no relationship between the two. From 1953-1962, spending on R & D skyrocketed, but the index of output per man-hour trended downward. Second, a large part of R & D was directed to outer space exploration and advanced weaponry and thus was not immediately growth-oriented at all. Third, in an economy of growing labor scarcity, increased spending on research and development required a reduction in the quantity and quality of labor devoted to civilian purposes in private industry.

My own investigation of the relationship between economic growth and R & D spending through 1967 confirms Solo's initial findings. Exhibit I compares the rates of real growth in total industrial research and development, aircraft and missiles, and electrical and communications equipment R & D with rates of growth in real GNP, output per man-hour and real per capita disposable income from 1957 to 1967. Beyond the simultaneous cyclical movements that appeared to affect the data early in the period, there is no apparent relationship between increased spending on R. & D and quantitative economic progress.
A more technical evaluation of the relationship between these growth rates based on accepted statistical methods implies that, to the extent that a measurable relationship exists, it is negative! Additional spending on R & D may have actually retarded economic development.

In any case, it’s clear that Solo’s original contention still stands: “The evidence does [sic.] show that the effect of the national R. & D. effort on economic growth cannot be taken for granted.”13 Certainly a more detailed investigation than that presented here might reveal a complicated structure of lead-lag timing that relates industrial-military R & D to national economic development. However, proof of the existence of such a structure is the burden of those who assert that R & D must necessarily accelerate economic progress.

Of course, there have been tremendous benefits of industrial R & D to individual companies or industries. In fact, some foreign observers have attributed most of our postwar economic success to industrial research and development. Total federally sponsored R & D has probably had a significant effect on economic development. But the empirical evidence implies that these company and national benefits may have been offset by undetermined costs related to R. & D.

On this score, reference to the research on the sources of productivity change by Jorgenson and Griliches is helpful.

In a controversial article [2], Jorgenson, and Griliches show that when real factor outputs and inputs, including both capital and labor, are measured correctly, almost all of the growth in output can be accounted for by growth in input. Of the 3.59% annual rate of growth in real output from 1945–65, 3.47% can be accounted for by increased input, leaving only .10% to be explained by increased productivity. They conclude that advances in knowledge—human capital accumulation, the accepted source of productivity growth—are governed by the same economic laws as other capital accumulation—growth benefits from the accumulation of knowledge are not costless. These results imply that the social costs of return from research and development investments are similar to the returns from other types of investment. This further implies that “transference” or “spillover” effects of industrial-military R & D (see below) must be included in their benefits package if the social benefits of these investments are to match the social benefits of other types of investments. If these benefits are not forthcoming, then industrial-military R & D will yield lower social returns than other investments.

If the contribution of industrial-military R & D to productivity growth is suspect, then perhaps it can meet the challenge of the Seventies by contributing to qualitative improvements in living conditions. Certainly there has been a tremendous quality impact on the private economy from defense related research in the past. There have been numerous developments in techniques of economic analysis, production and inventory management, air and water transportation, chemicals, metals, electronic components and other materials; not to mention, the most popular examples of Teflon, transistors, and computers. But can we expect the same degree of “spillover” or “transferability” in the future?

A negative answer to this question is motivated by several considerations. Much of the industrial-military R & D is related specifically to high technology space exploration. The gap between this research and its private industrial application is much greater than it has been in the past and it is widening rapidly. The speed of scientific and technological advancement through aero-space research is much faster than our ability to assimilate it for private development; witness, for example, the impending problems of the supersonic transport. It may

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1 For example, a standard linear regression of growth in real per capita disposable income (PDI) on growth in real aircraft and missile R & D (AMRD) for 1950-67 yields the following results:

\[
\begin{align*}
\text{PDI} & = 5.19 - 0.19 \text{ AMRD} \\
R^2 & = 15. \text{ D.W. } = 1.61
\end{align*}
\]

In terms of annual real dollar flows, the results are:

\[
\begin{align*}
\text{PDI} & = 161.14 - 33.37 \text{ AMRD} + 68.92 \text{ (time trend)} \\
R^2 & = 45.94 \text{ D.W. } = 1.90
\end{align*}
\]

The negative coefficient for AMRD is indicative of the negative relationships estimated. The details of other experiments are given in the appendix.

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Solo [8], p. 59.
Jorgenson and Griliches, [2], p. 54.
Park, p. 68.
take the next decade of applied research just to develop and apply our existing storehouse of technical knowledge.

Finally; except; for a limited number of cases where scientific developments have had direct and immediate industrial applications, space and military R & D represents an untapped reservoir of opportunities. It would seem that the companies that have made these scientific achievements would be best able to exploit them for private social benefits, but such may not be the case. In part because of the well-known inefficiencies of the federal government contracting and production system, many of these companies have had difficulty in developing the creative management expertise necessary to exploit their scientific developments under the cost and price competition of the market place and for the improved quality of life of the general public. As Exhibit II indicates, from 1957-1967 over 50% of industrial R & D was financed by the federal government. In aircraft and missiles and electronics and communication equipment, the figures were roughly 80 and 60%. Significant differences in management and production techniques between space-military and civilian business organizations make it increasingly difficult for the former to communicate the fruits of their research to the latter in an understandable manner that facilitates transferance of military research to private social benefits.

I conclude, therefore, that the present scope, direction and conduct of industrial research and development, especially military-space R & D, will seriously impair its effectiveness in meeting the productivity and quality challenges of the Seventies.

NEEDED: A NEW STRATEGY FOR RESEARCH AND DEVELOPMENT SPENDING

In the Seventies, the American economy will be characterized by a scarcity of qualified labor, continued inflationary pressures and relatively tight money. The resulting strains on our human, natural and financial capital will be heightened, as they have been of late, by the differences in attitudes between young and old. "Prosperity-scarred" youth are optimistic about their own personal economic security and pessimistic about our collective chances for qualitative social development. "Depression-scarred" older people tend to be pessimistic about their personal economic security and optimistic about our ability to solve our pressing social problems if only we are patient and employ reason and understanding in their solution.

In this environment, mental manpower will not be a free commodity. Its application to the solution of one set of problems means that another set of problems must go untreated, unless there is a transferance effect. For industrial-military research and development, this effect will be severely limited in the future. Consequently, we must reevaluate and redirect our research efforts if they are to be useful in meeting the social and economic challenges ahead.

This does not mean, of course, that government or the private sector should eliminate basic scientific research, but that we must understand explicitly how much human, physical and financial capital is devoted to its conduct and why. Many private corporations already seem to be reappraising their own R & D programs for these same reasons. The allocation of resources to basic research must be done explicitly and in accordance with clearly understood priorities, not left to chance or the naive assumption that no priorities are needed. The social costs and benefits of applied research in the areas of urban renewal, environmental control, welfare, low income housing, etc., must be carefully weighed against the costs and benefits of research in the interests of national security and space-exploration. If the former set of problems should head our list of priorities (given some minimal national security needs), and I think they should; then addressing them directly is far more efficient than relying on nonexistent or increasingly difficult to obtain spillover from research that is directed elsewhere.

At the federal level, Congress can directly alter the flow of federal financing for R & D to the solution of different sets of problems. Perhaps this could be aided by public referenda on priorities for public expenditures, especially in "quality of life" areas. At the private level, the companies doing the research can be provided with incentives (positive and negative) to develop and/or communicate the private industrial applications of their military-space research. All this may well require a change in the current government contracting and production system to one incorporating more of the elements of private cost-price competition. Government agencies should play a much greater role in the
communication of research results to private industry. In fact, the program of defense-space R & D should have built in a parallel or concurrent program to develop and exploit the breakthroughs for general public social benefit. Finally, civilian oriented industry has the responsibility to capitalize on this research. Its profit and social performance objectives can be efficiently served—to the nation's benefit—by exploiting this storehouse of scientific knowledge.

EXHIBIT I.—RATES OF GROWTH IN SPENDING ON INDUSTRIAL-MILITARY R. & D. AND SELECTED ECONOMIC INDICATORS

[Percent change, $ 1958]

<table>
<thead>
<tr>
<th>Year</th>
<th>Research and development</th>
<th>Economic indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Aircraft and missiles</td>
</tr>
<tr>
<td>1967</td>
<td>3.7</td>
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</tr>
<tr>
<td>1966</td>
<td>6.6</td>
<td>4.0</td>
</tr>
<tr>
<td>1965</td>
<td>5.1</td>
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<td>1957</td>
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1 See [3, 4] Data have been deflated by the implicit GNP deflator (1958=100)
2 See [1]

EXHIBIT II.—PROPORTIONS OF RESEARCH AND DEVELOPMENT EXPENDITURES THAT ARE FEDERALLY FINANCED

<table>
<thead>
<tr>
<th>Year</th>
<th>Total R. &amp; D. spending (billions)</th>
<th>Proportion R. &amp; D. spending (percent)</th>
<th>Aircraft and missiles (billions)</th>
<th>Proportion R. &amp; D. spending (percent)</th>
<th>Electrical equipment and communications (billions)</th>
<th>Proportion R. &amp; D. spending (percent)</th>
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<td>5.098</td>
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Source: See [3, 4, 5].
EXHIBIT III.—STATISTICAL RELATIONSHIP BETWEEN INDUSTRIAL-MILITARY R. & D. AND ECONOMIC GROWTH
(LINEAR REGRESSION COEFFICIENTS)

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<th>AMRD</th>
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<th>IRD</th>
<th>AMRD</th>
<th>R²</th>
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Source: See exhibit I, II.
Note: Figures in parentheses are t statistics.

APPENDIX: STATISTICAL RELATIONSHIPS BETWEEN INDUSTRIAL RESEARCH AND DEVELOPMENT AND ECONOMIC GROWTH

A number of attempts were made to estimate a statistical relationship between spending on R & D and economic growth. In general they validated the conclusions in the text. The results of these attempts are presented in Exhibit III, where the following definitions are used:

- GNP—Gross National Product
- PDI—per capita disposable personal income
- IOPM—index of real output (man-hour)
- HIP—index of industrial productivity
- IRD—industrial R & D spending (deflated by the implicit GNP deflator)
- AMRD—aircraft and missile R & D (deflated by the implicit GNP deflator). A bar over a variable refers to the rate of growth.

Some simple distributed lags were also tried. The results warranted no change in the conclusions implied in Exhibit III.

BIBLIOGRAPHY

EFFECT OF ESCALATION OF VIETNAM WAR ON AMERICAN ECONOMY

Senator SYMINGTON. The basic thrust of the importance of your testimony is where you say in your statement,

We do have more than adequate data to demonstrate that the escalation of the war in Vietnam has seriously distorted the American economy, has inflamed inflationary pressures—

I am not getting into whether the war is right but getting into the economy——

Mr. LUNDBORG. Right.

Senator SYMINGTON (continues reading):

has drained resources that are desperately needed to overcome serious domestic problems confronting our country, and has dampened the rate of growth in profits on both a before and after tax basis.

Then you give an illustration of employment before the Vietnam military escalation of 1965, and the operating rate of industrial capacity. To me, those are most impressive figures.

Along with them, you point out in your statement that corporate profits during the 4-year period prior to escalation in Vietnam rose 71 percent; whereas in 1966 through 1969 they only rose 9.2 percent. I presume you are sure of those figures.

Mr. LUNDBORG. This was before you came in, Senator, that one of the others of the committee questioned those. We had them year by year. That is a fact. That is total net increase from 1966 through 1969 partially resulting from the fact that while none of the years was very high there was one year in which there was actually a net decline in total corporate profits from 1966 to 1967. The year 1967 it was down. Then again we can amplify in the paper we will prepare.

Senator SYMINGTON. It would be fine if you do so.

(The information referred to appears on p. 12.)

U.S. HOUSING PROBLEMS

Senator SYMINGTON. Senator Sparkman, one of our greatest authorities on housing, brought up what all this has done to the housing industry. I mentioned on the floor the other day, in discussion about improving the lot of some of our lower paid people in this country, that I just read on the ticker we are planning to build 10,000 homes for the families of South Vietnamese military. I live just outside a town of 665,000 people. In that town of 665,000 last year we built just 14 single-unit homes. That illustrates what is in your mind, does it not?

Mr. LUNDBORG. Oh, yes, indeed.

Senator SYMINGTON. You must see all this in your position as head of the largest bank in the country.

Mr. LUNDBORG. Yes, not only the bank but anybody who lives and works in a community, as we all do now. Bankers seem to be in the midst of all of the urban problems. We find ourselves hardly able to even get to the bank because we are spending so much of our time on problems that have grown up in our crowded cities, and housing is right at the heart. All of the problems of the congested city are pressing in on us. I don't like to spread scare but this next summer can indeed be a very difficult summer because pressures are building up in our cities, and housing is certainly one of the elements in that problem.
Senator Symington. If you have a community of 665,000 people, every one of whom would like to own a home, and you only build 14 single-unit homes, to me that is the best illustration of your point I know of.

DEMAND FOR MEANINGFUL PRIORITIES IN UNITED STATES

One sentence that stands out clearly in your testimony is:

Our problem now is one of establishing meaningful priorities to meet the quality of life demands of our citizenry.

Based on the business I am now in, you might say to meet the quality of life "demanded" by our citizens. Would you agree that is in the wind?

Mr. Lundborg. Very much so, the same meaning that I attempted to convey.

U.S. MILITARY POSTURE HINDER ECONOMIC COMPETITION

Senator Symington. There is another line in your first statement which intrigued me. I used to get pleasure out of making things and trying to sell them in a competitive market. You say, if you want to profit, if you want to own the world, don't dissipate your energies in wasteful warfare. You have this in quotes. Who said it?

Mr. Lundborg. I was saying it.

Senator Symington. Then you say,

Follow the example of Japan and Germany since World War II and be economically aggressive.

We said we would be in Europe for a maximum of 18 months, but we have been there for a quarter of a century. We have been in Korea for 20 years come next June. We are spending now 8½ to 9 percent of our gross national product, if you add it all in, on national defense. As to the two countries mentioned, Japan and Germany, 25 years ago not considered our friends, one of them, Germany, is spending half of that, 4.4 percent, and the other, Japan, is spending less than 1 percent. Now switching over to your personal statement, if it is really important for the United States military to be in all these places all over the world defending the free world, wouldn't you think such countries as these two, and others, would be more interested in this defending, and would come to our assistance in the effort, in some substantial fashion?

Mr. Lundborg. I would think so. There is no question but what we have been holding an umbrella, as we say in the banking business we have been holding a shield, around one of those two countries and for all practical purposes the other one, too, while they have been pursuing the economic aggression which is really, I think, the wave of the future.

I think for one thing we have got our sights mixed as to what the real strategic weapons of the future are, and those two countries are moving ahead very rapidly and very effectively with their economic development because they are not dissipating their energies, partially of course because we are supplying that shield for them.