preceding documents relate to Quadriad as well but are less interesting (basically just agendas)

THE SECRETARY OF THE TREASURY
WASHINGTON, D. C. 20220

October 9, 1967

MEMORANDUM FOR THE PRESIDENT

Subject: Quadriad Meeting -- Conversation with Martin

You will be getting a separate memorandum from Gardner containing suggested agenda items for the meeting which we have been discussing.

This memorandum is to provide you with background information on my luncheon meeting today with Bill Martin (who returned to the country over the weekend) and Governor Robertson of the Fed.

I gave them a full review of events leading to the present situation with the Ways and Means Committee, including; the position Mills took in the Executive Session of Ways and Means Committee on September 21, the developments the following week in connection with the rejection of the continuing Resolution and the Bow Amendment, the meeting in Executive Session of the Ways and Means Committee last Tuesday, October 3, when the Watts motion was adopted, your statement to the press on Thursday, the Mills statement on Friday, and your exchange with the Federal Home Loan Bank Board Presidents on Friday.

While I related the fact that you had authorized me to advance certain procedural proposals to the Ways and Means Committee last Tuesday which I was not given an opportunity to present and keyed Martin to the paragraphs in your statement and in the press conference on Thursday concerning your willingness to explore procedural alternatives consistent with your Tax Message, I did not discuss the substance of any of the proposals nor did I refer to the meeting or area discussed in Mr. Califano's office Saturday.

Both Martin and Robertson indicated that the pressures on the Fed to take some action were intensifying, particularly from some of the regional bank presidents. However, they were able to avoid any decision and maintain the status quo at the meeting

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last Tuesday of the FOMC which concluded just prior to the action of the Ways and Means Committee. They further indicated their judgment that it would be a mistake to take any action in the way of a change from a policy of monetary ease at this time despite these internal pressures. Apparently, they will take another look at the situation on October 24 (the next meeting date of the FOMC) which happens to be the day following the termination of the present continuing Resolution on appropriations. My own hunch is that there is a good case for maintaining the status quo at least until after our Treasury financing which will be out of the way in early November -- although some tentative decisions could be taken prior to that time.

You may be interested in reading two of the market letters which came in today which are attached. The one entitled "Reporting on Governments" is by Sylvia Porter. The many problems confronting the Fed in changing its easy money policy are summarized neatly in the second paragraph of the attached Lanston letter.

Henry H. Fowler

Henry H. Fowler

Attachments

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Reporting on Governments
WEEKLY ANALYSIS AND FORECAST ON U. S. GOVERNMENT SECURITIES, WASHINGTON MONETARY POLICIES AND TRENDS IN INTEREST RATES

Editor, S. F. Porter • Publisher, G. Sumner Collins
TWO FIFTH AVENUE, NEW YORK, N.Y. 10011

Washington, October 6, 1967

Dear Sir:

Prospects for a tax increase are fading, and that fact is the dominant influence in credit markets.... The outlook for debt securities, bearish for so long, will deteriorate further unless the tax plan is revived....

Despite the tax deadlock, the Federal Reserve refuses to give up hope for fiscal action.... For the time being, the money managers can be expected to continue operating on the assumption that Congress will raise taxes....

1) President Johnson's surtax proposal is almost, but not quite, dead for this year.... Only a slim chance remains for bringing it back to life, according to the members of Congress who control the situation....

Ever since the President's Aug. 3 tax message, we have reported that the tax increase plan faced a tough fight.... "Congress may refuse to raise taxes at all," we warned Aug. 18.... "The President's proposal for tax increases is in grave trouble," we said Sept. 15.... We reported starting Sept. 15 that the House Ways and Means Committee probably would shelve the tax issue unless the administration recommended sharp spending cuts.... "President Johnson's tax increase proposals are in deep trouble," we said last week, adding: "The committee may decide before long to lay the tax program aside"....

That's what the committee did Oct. 3, in a staggering blow to Johnson.... By the lopsided vote of 20-5, the committee "temporarily" tabled the tax proposals and decided that "further consideration (will) be deferred until such time as the President and the Congress reach an understanding on...more effective expenditure reduction and controls as an essential corollary to further consideration of a tax increase".... Chairman Wilbur D. Mills, D-Ark., inspired the motion....

Rep. Al Ullman, D-Ore., the committee's strongest advocate of a tax increase, seconded the motion, which was offered by Rep. John C. Watts, D-Ky.... Ullman explained that he hoped the committee's action would convince the President that he must come through with spending cuts to save the tax bill.... Mills said "it's hopeless" to try to push a tax increase through the committee or the House unless spending is reduced.... Even if Johnson cuts spending sharply, Mills said, there's no assurance that Congress will raise taxes....

Although the committee has made its position on spending perfectly clear, the President has refused so far to yield.... Again at a news conference Oct. 5, he said Congress should take the lead by cutting appropriations bills, and then he will review them in search of spending reductions.... He insisted that Congress proceed with a tax bill in the meantime.... Mills and most House members refuse to

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The FOMC can confer and take policy actions by phone between meetings, of course, but probably does not consider the situation critical enough to require such emergency procedures.... The tax outlook and other factors will be re-examined closely at the next FOMC meeting Oct. 24....

Conclusions reached then will depend on the status of the tax fight and the latest reading of the inflation barometer.... Barring a clear-cut rejection of the surtax, the money managers will be inclined to keep hoping.... The Ways and Means Committee has been careful to keep the door open to a tax increase in case the stalemate over spending reductions softens....

3) The central bank has been reluctant to tighten credit partly because it wants to avoid the appearance of pressuring Congress on taxes, which could backfire.... More fundamentally, the Federal does not believe monetary policy can be an effective substitute for fiscal restraint now....

The main source of inflationary pressure now is the huge potential budget deficit, according to the money managers' analysis.... Therefore, they feel, the rational, direct way to fight inflation is to slash the deficit by raising taxes and reducing expenditures.... Even if a tighter monetary policy curbed borrowing and demand in the private sector, a stimulative fiscal policy would more than cancel out the restraining effects.... Besides, the Federal agrees with the critics who complain that tight credit is inequitable and dangerous....

This reluctance to rely heavily on monetary policy does not mean the central bank believes it has no role to play in fighting inflation.... The money managers expect to play a supporting role to fiscal policy.... They were worried about the rapid expansion of the money supply and bank credit earlier this year, and realized it could not be sustained safely.... This expansion has moderated significantly in recent weeks, mainly because demand for credit has slackened, rather than as a result of pressure on the supply of reserves.... The central bank is pleased about the moderation, and perhaps has encouraged the trend through a form of passive rather than positive tightening.... Relying on market forces, the Federal has allowed high interest rates to deter borrowing slightly....

4) If Congress refuses to raise taxes, the Federal may be forced to take more vigorous action to restrain inflation, despite the conviction that tight credit would not be very effective.... The objective would be to curb the excessive private demand generated by fiscal stimulation....

An administrative budget deficit approaching $29 billion would require massive Treasury borrowing.... Interest rates would shoot up and many potential borrowers would be shouldered aside, regardless of monetary policy....

Market stringency would be so severe if Congress rejected a tax boost that the question of whether to tighten monetary policy might be almost academic at first.... Instead of acting immediately to intensify the market's tightness, the Federal might have to cushion the impact by augmenting reserves for a while.... It could be a matter of picking up the pieces in an effort to prevent disorderly conditions.... Even with the Federal working to alleviate the stringency, credit would be tighter than in many years and interest rates would soar....

The threat of severe credit stringency if taxes are not raised has inspired a new flurry of conjecture about credit controls - either formal, compulsory controls or guidelines patterned on the "voluntary" balance of payments program....

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accept this approach.... While trying to trim appropriations, they demand that the President take the initiative by sending Congress a new list of program priorities - recommending at least $5 billion of reductions in planned expenditures this fiscal year out of funds appropriated this year and in past years.... Alternatively, the economy bloc wants Johnson to accept an expenditure ceiling that would force him to reduce nondefense spending by $5 billion or more this year....

There's hypocritical buck-passing on both sides in the spending squabble.... Nevertheless, deep reductions are the price demanded by the economizers for seriously considering a tax increase, and they are in control.... Johnson apparently has misjudged their tenacity.... And he has hurt his chances for getting a tax bill by failing to maintain personal contact with Mills and his committee, according to congressional sources.... They said this week that he had not phoned or called in committee members to talk about taxes since his Aug. 3 message.... Committee members resent this standoffish attitude.... Puzzled by Johnson's tactics, a few Congressmen suspect that he really does not want a tax boost....

What are the chances for breaking the stalemate?.... Johnson could yield and send Congress a list of recommended spending cuts.... If Congress balked at deep reductions in popular programs - which probably is what would happen - the President at least would have called the bluff and the tax plan might be saved.... But Johnson has been so adamant that it would be hard for him to reverse himself .... The House may pass an expenditure ceiling when the issue arises again later this month, but the Senate probably would reject it.... Although the House Appropriations Committee will recommend reductions, the Senate is likely to balk - and the total savings would not be enough to satisfy the economizers, anyway.... Johnson's own efforts to cut spending - exemplified by the Pentagon's Oct. 5 announcement of a freeze on some construction - likely will fall short of the House target, too....

Even if the impasse over spending somehow is broken, the time is growing late for enactment of a tax increase this year to take effect Jan. 1.... With miraculous speed and a sudden surge of good will, the House could conceivably pass a bill in early November, though it's doubtful.... Then the bill would face a fight in the Senate, at a time when adjournment fever will be gripping Congress....

It is difficult to escape the conclusion that Congress will not enact a tax increase until 1968, if then.... By next year, perhaps, the predictions of accelerating inflation and soaring interest rates may come true, persuading Congress to raise taxes.... At the moment, however, there is little prospect even for approval of a tax bill by the Ways and Means Committee, which is the essential first step.... An influential member of the committee put it bluntly: "Don't be surprised if there's no such thing as a temporary tabling of a surtax"....

2) The Federal Reserve is so firmly convinced of the need for a tax increase that the money managers cannot believe Congress may reject the proposal.... They still hope the surtax will be saved - putting the main burden of fighting inflation on fiscal policy and allowing monetary policy to play a subsidiary role....

By coincidence, the Federal Open Market Committee held its regular meeting on the same day that Ways and Means shelved the tax issue.... The FOMC meeting ended before Ways and Means acted, and the money managers apparently did not know what was coming.... Apart from other considerations, therefore, it is most unlikely that they voted for any overt shift of policy Oct. 3....

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The idea is that the Federal would try to allocate inadequate supplies of credit as equitably as possible among deserving borrowers....

All this talk about selective credit controls originates in the markets, not at the Federal.... The situation could change, but right now the money managers and the administration show no interest in controls.... One reason is that controls create nightmarish administrative problems, with imperfect results at best.... The second, more important reason is that selective controls would not attack the main problems confronting the credit markets....

A letter from the Federal to banks asking them to curtail business loans – the approach taken in September 1966 – seems rather pointless now, when business loan demand is almost sluggish.... A capital issues committee to screen proposed bond offerings would make little sense, either, since new corporate issues appear to be slowing down a bit.... Similarly, the growth of consumer credit is moderate, so it is difficult to argue for controls in that area....

The basic problem facing the credit markets is the threat of excessive borrowing by the Treasury to finance a huge budget deficit, and the Treasury is not susceptible to credit controls....

5) The bond market retreated early in the week because of the tax program's troubles, and in disappointment at the lack of any dramatic new peace initiatives in the President's Sept. 29 Vietnam speech....

Even after the latest price decline, the market remains a long way from fully discounting a rejection of Johnson's surtax plan.... The market, like the Federal, still has hopes.... If Congress finally and clearly refuses to raise taxes this year, bond prices will drop further....

In the Treasury's Oct. 3 auction of tax anticipation bills, subscriptions for the June taxis barely covered the $3 billion offered.... Banks and others apparently found the April taxis more attractive.... Subscribers acquired a lot more of the June taxis than they expeoted or wanted, but bill purchases and repurchase agreements by the Federal helped bolster the market.... The crucial Federal funds rate has held generally below 4 1/16%, a level which could arouse expectations of and trigger a sharp rise in money market rates....

The Treasury probably will need $4 billion to $5 billion of new cash – including any participation certificates it can sell – by mid-December.... Rep. George H. Mahon, D-Tex., chairman of the House Appropriations Committee, predicts the House will reverse itself and agree with the Senate to authorize the full amount of PC sales requested by the administration.... The debt managers probably will rely on coupon issues for the balance of direct Treasury borrowing in 1967.... They may raise part of this cash in conjunction with the Nov. 15 refunding....

Yours very truly,

S. F. Porter

Washington Bureau

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RESEARCH DEPARTMENT

In testimony before Congress and in speeches and comments on the economic outlook, a number of Fed officials have stated with eloquence and deep conviction their concern about current inflationary tendencies, their apprehension about the spreading inflationary psychology, and their fear that these developments will intensify over the months ahead. Most of the financial community shares these views. There is, therefore, a solid expectation in the credit markets that the Fed must ultimately move away from its policy of credit ease. Yet the expectation is almost as solid that the change is still well in the future.

There are many problems that confront the Fed in changing the easy money policy right now. There is the distortion in the business figures due to the auto strike; the hope that something will be done about a tax increase or about Federal spending (and the danger that a credit policy change might jeopardize such actions); the concern about the impact of a policy change on savings flows and on our savings institutions; the fear that the housing industry would be hurt; the recognition that a change here would have repercussions abroad and would probably force an increase in the British bank rate; and the threat that a shift from an easy policy would hinder the Treasury in financing the deficit. All of these—and there are others—make it hard for the Fed to move and provide reasons and excuses to defer a difficult decision.

But barring a miracle in Viet Nam or elsewhere, they must be brushed aside or somehow resolved, and the sooner the better from the standpoint of our long-range economic and financial stability. Some probing into a less easy monetary policy is needed at minimum if we are to make a start in combating the notion, now gaining grassroots acceptance at an alarming pace, that inflation is guaranteed and that those who keep savings in fixed-income form rather than in "growth" equities or in some quick-turn scheme are only misguided unfortunates who do not understand what is being written on the financial wall. As the President is reported to have said last week in discussing the need for a tax increase, "If you see a little fever developing, you don't want to wait until it gets 105° before you take the proper medicine".

It is evident from the Fed Figures that such a policy shift has not yet been started. The monetary authorities went out of their way late in the last statement week to supply reserves and to maintain a level of free reserves in excess of $250 million. This has signaled to observers of Fed activities that no change was made at the meeting of the Federal Open Market Committee last Tuesday in the Fed's policy of promoting monetary and credit expansion. Since the Treasury will decide on the terms of its November refunding during the last week of October, the Fed seems in effect to have elected to fight deflation, not inflation, at least through November 15.

AUBREY G. LANSTON & CO. INC.

October 9, 1967

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