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INTERVIEW II

DATE: December 21, 1971

INTERVIEWEE: WALTER HELLER

INTERVIEWER: DAVID McCOMB

PLACE: Dr. Heller's office, the University of Minnesota, Minneapolis, Minnesota

Tape 1 of 3

M: To start off with sort of a problem about the mechanics of government. Were you the originator, or were you in on the beginning of the so-called Troika and the Quadriad?

H: Yes. Let me tell you a little about that. Again, I may not have the exact dates, but these can be checked out from the memos in the Kennedy period. We, fairly early in the Kennedy Administration in 1961, developed a pretty good working relationship among the Treasury, Budget Bureau and the Council of Economic Advisers. At first, it wasn't at all apparent that these three were working on an equal basis, because during the preceding administrations it is pretty clear that the star of the council had fallen, especially after Arthur Burns left. And one of the things I had to do during the early days of the Kennedy Administration was to get the council re-established on a parity with the other two agencies.

The council is a very different organization than the Budget Bureau. An enormous amount of material has to pass through the Budget Bureau on its way to the President and on its way back from the President down to the agencies, but except for preparing an annual economic report, the Council of Economic Advisers per se has by law nothing but a kind of cord suspending it from the President's Oval Office, nothing flowing up through it to the President. There's nothing that forces the President to use it other than having to prepare the annual report.

M: Well, then your work in, say, the Troika was to give more prestige or more influence to the CEA?

H: I had at first to establish the position of the council, along with my fellow council members, Kermit Gordon and Jim Tobin. With people like that working with me we had the horses, so to speak, to do it. And after some months we got established, I think, reasonably on parity, which didn't exist right away, with the Treasury and the Budget Bureau.

Then came the question of how would we regularize and systematize those relationships? We decided that there ought to be a structure that would give the President the joint product of our analyses, in other words, the fiscal, economic and financial. These analyses ought to be served up to the President in some coordinated form rather than coming to him in scattered fashion from different parts of the government. So Doug Dillon and Dave Bell and I decided to form the Troika. The name obviously came from the Soviet Troika, suggested by the Treasury Department, as I recall.

So here was the Troika. You probably know the structure of it. It was these three agencies. In addition, it had three layers: a staff layer; a council-member and undersecretary layer; and then finally, at that time, the Bell-Dillon-Heller layer. This served both as a kind of factual agent to give the President something like a quarterly review--I don't know that we were quite that systematic but that was the objective--of the economic and budget and financial situation and as a policy advising group. Typically, when we gave him the facts, we would also say, "These are the policy implications," and so forth.

Now there was obviously one element missing, and that was the Federal Reserve Board. I found that Eisenhower used to have meetings with the four men who headed these four organizations. And I also got the impression that it was a rather sometime thing. It struck me that both to give the President the four-ply coordination that was needed and to bring the Federal Reserve a little more into the act, because we were very queasy about what Bill Martin was going to do, that we ought to not only continue whatever it was that Eisenhower had, but we ought to put it into again a somewhat more systematic, I don't want to say formal, type of mold.

So I suggested to the President that we do that, and he accepted this suggestion. We began to have occasional meetings, usually at my call. Now unlike the Eisenhower Administration, which tended to put committee meetings on a rigid schedule, the Kennedy Administration groups, committees, et cetera would meet when there was a reason for them to meet. Under the Eisenhower fixed-schedule approach, I'm told that as far as the economic committee meetings are concerned, there was a loss of interest and intensity. Often subordinates would go and the President would delegate authority to somebody else, and so on.

My practice was to have the Quadriad meet, this group of four, at such times as it seemed that it could serve a positive purpose. The most frequent purpose was to nudge Bill Martin into line and to get the Federal Reserve broadly to go along with the President's policies. In those days we were having a hard time getting the Fed to put money into the long-term bond market. We had what we called the "monetary twist," where we were trying to hold short-term interest rates up, so that not too much money would flow overseas, and hold long-term interest rates down, so that there would be a stimulus to domestic investment activity. We sometimes found the Federal Reserve rather reluctant on this.

Now as to naming it. For some time when I'd write the President a memo or call Ken O'Donnell and say, "I think it's time the President got this group together," I'd talk about "the economic-fiscal-financial group." It got to be such an awkward handle that I one time decided that if we had the Troika, which had already been named, the least I could do was get a new handle for this group of four. So I looked it up in the old Webster's Unabridged Dictionary that had been sitting there ever since 1947 when the council was formed--I'm just putting in a plug for how frugal we were. I looked up under "quad," "quartet," et cetera, and I finally came across this wonderful word, "quadriad," and the definition was "group of four--rare." I sent Kennedy a memo, saying in effect "We've had this awkward handle for this thing, how about calling it the Quadriad?" I gave him the definition, "a group of four--rare," and added, "Boy, that's us!" He was amused, and from then on it became the Quadriad.

But just to show you how history goes, about a year ago I read a little item in the paper saying "President Nixon called a meeting of the Quadriad which was formed and named during the Eisenhower Administration."

M: That brings up the point that under Johnson, these--I hate to call them institutions--organizations, Troika, Quadriad, they continued operating?

H: They not only continued, but I think he used them even more systematically than President Kennedy. That may be [an] overstatement. I'm not sure that he met with them as often, but he recognized them as structures that he should work with and through.

M: Your conflict with the Federal Reserve System would seem to indicate that there's a greater need for coordination in fiscal and monetary policy and the institutions that control that. Do you have any reflections on that, since you had to work with that problem?

H: I'm very glad that you've given me a chance to say more about that, because I don't want to give the impression that we didn't resolve the conflicts pretty successfully. One of the characteristics of both the Kennedy and the Johnson Administrations that I think is in great contrast to the Nixon Administration is the way in which conflicts, differences in point of view, sometimes even personal contention, but not a great deal of that, among the economic policy formulating individuals and bodies in the government were resolved without mayhem and without public displays of conflict and so forth. Really, I'm convinced that there's a sharp difference between the way things were resolved by the appropriate use of the Quadriad and the Troika, and occasionally other bodies like the Cabinet Committee on Economic Growth--which the President had me head up in order to reconcile the differing positions on the tax cut back in 1962--[and the way they are resolved under Nixon].

We might start from rather different points on the compass, but by the time it got to and through the President, and I'm talking now about both Presidents, there was a coalition position which, as far as the public was concerned, was the position of the entire government. Historians will surely note that in looking at the public comments about economic policy in those two administrations there was very little appearance or fact of deep irreconcilable conflict. It came about by a general problem of consensus, give and take. I don't want to idealize it, but I believe this is an appropriate description.

Whereas in the Nixon Administration, you had the feeling that he had contending forces, maybe he'd have Shultz and Stein over here, and he'd have the Treasury over there, and Mr. Burns perhaps in between somewhere. Then he'd have to finally cut the Gordian knot, gavel the group down, so to speak, and say "This is the way it's going to be." Yet there were always dissidents; you always had the feeling, so far, that there were always people who didn't really believe in the policy that was finally decided on. There were winners and losers. Now, I'm not saying there weren't winners and losers in the sense of emphasis in the Johnson Administration and in the Kennedy Administration. But at least you came out to a coordinated policy by, as I say, essentially a process of consensus. This was in part because of the personalities of the advisers and in part the personalities of the Presidents.

Sure there were conflicts, don't misunderstand me. But there might be an inclination to say, "The reason you weren't conscious of that on the outside, or that there was not an impression of conflict on the outside, is not because Kennedy and Johnson suppressed any appearance of conflict, but because what was going on behind the scenes was being done in a spirit of accommodation and a spirit of trying to reach compromise positions rather than having the thing bucked up to the President and the President forced to choose between the groups."

At times, of course, he had to. Especially on international financial matters--balance-of-payment policies--the Treasury and council saw the problem differently, and the President had to decide--in Kennedy's case, more often than not, in the Treasury's favor on those international issues. And there was friendly contention with Bill Martin. He was always more concerned about inflation than about unemployment. We learned that from the very beginning in 1961. At the moment there was some recovery in the second quarter of 1961, he began telling the President he better start worrying about inflation.

As Kermit Gordon may have indicated in his interviews for this same project, one of the reasons that we initially got going on the wage-price guideposts was to assure President Kennedy that if there was any danger of inflation in those days, when there was so much unemployment and so many unused resources in 1961 and 1962, that it surely wasn't aggregate demand, or a demand-pull inflation. It was clearly a cost-push. And if we're going to deal with cost-push, we ought to have some kind of an incomes policy, some kind of a guidepost to cope with it.

We had to tell Kennedy way back in June of 1961, "Don't get agitated about Bill Martin's warnings about the imminence of inflation. It just ain't imminent." He remembered that later, and told us, in effect, "You're the fellows that first got me straight on this."

Coming back to the Quadriad, as I say, it met at my call during the four years that I was there.

M: Incidentally, did you serve as a spokesman for it?

H: Not really. Typically, I sent the President the necessary background or briefing memo for the meeting often with specific suggestions or questions to ask Bill Martin. But once we got with the President we were all equals in his eyes. I would sometimes open the meeting by saying, "We thought we ought to discuss this or that, Mr. President," but when I say "met at my call" what I mean is, if I were able to persuade Ken O'Donnell or--let's see, who would have been doing it early in the Johnson Administration? Would it have been Busby?--

someone close to the President was persuaded that we have a meeting. But it met in that sense on my initiative, I guess would be a better way to put it, than on my call. And [let me explain] just very quickly what happened in 1961-62. The main occasion for calling the Quadriad together would often be when the "New York desk" of the Fed, where they do the open market operations, was lagging. The idea would be for the President to get Martin to instruct them to buy more long-term government securities and thus put more money into the long-term money market in order to provide more stimulus to the economy. At one time Jim Tobin charted the activity at the New York desk in terms of when we held meetings. Every time we were about to hold a meeting, the activity, those purchases at the New York desk of U.S. bonds and so forth, to get money into the market, would rise. And sometimes it would continue for a while after the meeting, and then it would sag until we called another meeting. So Jim Tobin finally evolved the general principle that you didn't actually have to hold the meetings; you just had to call them to have the salutary effect on the Fed.

But really, the meetings themselves were generally not too strained. Bill Martin knew how to strike a balance between safeguarding his independence and yet being a team player, especially when it was put to him in the right way. He felt he was having some influence on other policies of the government, especially fiscal policy, and we felt that we had a right to have some influence on the Federal Reserve policies. The exception was that occasion, which we can talk about later, when he got off the reservation late in 1965, and the President was mighty sore about it. Except for that kind of an occasion it was a very good working relationship. And I, who went to Washington thinking we ought to end the independence of the Federal Reserve, came out after working with the Fed under both Presidents with the conviction that it isn't too bad an arrangement, provided there is good will, competent people, and reasonably systematic consultation and presidential participation.

M: In the Quadriad, was there the interchange with lower staff people, like there was in the Troika?

H: Yes, but not so systematized. You see, in the Troika it really was systematic. The staff members would meet and start working on the numbers, and then the next level would meet, and finally the summit of the Troika would meet. The Quadriad, I don't want to call it quite "catch as catch can," but there, since we didn't have anything like scheduled quarterly meetings or anything like that, it was a good deal more flexible as to when we met, as to subject matter, as to the way in which the instrument was used. There were contacts, of course, among staff members, but they again were not on a systematized basis.

We did, however, have exchanges, lunches, although I very seldom was in a position to have the Federal Reserve people over to the White House staff mess. But in the Kennedy Administration continuing into the Johnson Administration, as Ackley and Okun I'm sure will have indicated even more precisely, there was regularized and systematized sometime during the Ackley-Okun administrations of the council. But we had been doing it ever since about 1961. We'd go over to the Fed and meet with the Board of Governors, the three council members, I'd say on the average of every three weeks or something like that. And then our staff people were, not on any agreed basis but just in the natural course of events, in touch with each other.

M: One of the major themes while you were head of the council under Johnson was this business of the tax cut.

H: Yes.

M: In the previous tape you mentioned some of the preliminaries of this and some of the work under Kennedy, and your persuasion of Kennedy that this was necessary. And you mentioned that Johnson was receptive to the idea of a tax cut. What we need to get into are some of the details of how that was worked out and the trade-offs with Congress in regard to the budget cut that went along with it.

H: Well, you're talking now about the time after President Johnson became president?

M: Right.

H: Let me just talk a bit about that and add to what I said in our February 20, 1970 interview. I'm first of all going to speak a bit from the notes I wrote concerning my first meeting with President Johnson the day after the assassination, after we'd come in from that aborted trip to Japan the night before. Then the President asked to see me, and I spent about forty to forty-five minutes with him Saturday evening, November 23, beginning at 7:40 p.m. I think I went in between Ted Sorensen and Bill Wirtz, and as I mentioned last year, Mr. Manchester apparently missed this meeting completely in his account.

We covered a great deal of ground. Perhaps I should just read a little bit into the record from this [Heller reads intermittently in the next few paragraphs]. He had just been with Ted Sorensen, and he told me of fifteen domestic crises he was facing that had to be resolved by the time of the messages, [he] had gone over the entire domestic picture with Ted. Before Ted went in, he, Ted, told me that he was going to hit particularly hard the theme that we had to have a tax cut or else risk a slowdown and recession before the election. He was going to hit hard also the theme that we had to keep expenditures moving on up. Which reminds me, that at the door as I left, the President showed the response to treatment by Freeman, Galbraith, and Sorensen, by saying also, "I'm no budget slasher, I understand that expenditures have to keep on rising to keep pace with the population and help the economy."

When Ted came out he said they had really only covered the list of problems and not the solutions. Ted was only in a very few minutes. As a matter of fact, I'm quoting from the draft of my memo on this and not from the final version of it.

The first major subject in our discussion was the message. He said he wanted to give mainly a general feeling in his message--to be given before the two houses of Congress, but really aimed at the country--to make clear that the object and desire of the administration is to get rid of this tragedy; to promote justice, equality, and plenty; that we should not look back; that we are a growing nation that must have a growing budget; that the tax bill is essential to our continued economic health; that we must have a forward-looking foreign policy, and so forth. Then I took up with him the attack on poverty and that of course we covered earlier, so I won't try to cover that at this particular point.

We then talked about the Troika exercise and the fact that we try to bring him a coordinated budget, revenue, and economic picture every month or two, [and] that we thought it was high time right now to get together with him on it--Dillon, Gordon, and Heller. He immediately said we should set up a meeting for Monday, and as I wrote this memo I said, "We have a tentative meeting for around four on Monday afternoon, but they will call us." That reminded him that he had wanted to see Kermit, and he thought Kermit was still coming in this evening. So it was now nearly 8:00 p.m. When he found that Kermit had gone home he said not to disturb him, he would see him on Monday.

He asked me about the stock market--do you want that here or later?

M: You might go ahead while you're right there with it.

H: All right. He wanted to know how many points it had dropped; I told him. I believe it was a 5 per cent drop. He was anxious to have us follow it very closely. I told him that we were going back to the period of the Eisenhower heart attack to get some feel for what had happened at that time. He asked whether there was anything he should do about it. I indicated that no one really knows how to understand the market or influence it. We would be reassuring in our low-key discussions of it, but he probably should say nothing about it for the time being.

I might just interpose here that when I think of what Mr. Nixon said about the market last spring, I was again reassured in my thought that presidents are better off not saying anything about the market. Because it dropped right after Mr. Nixon said that he'd buy. I noted that the stock market always reacted to crisis and uncertainty by losing a lot of ground. He, in turn, said that the important thing was to create a general sense of confidence and assurance that we were going to move forward and not slide backward. He felt that would do more for the stock market than anything else, and I agreed. Then he told me that he had appreciated the memos that we had done so quickly for him. We had stayed up most of the night Friday night and worked virtually all day Saturday and gotten some things to him, and he had already glanced at them.

I indicated that we wanted to set up efficient working relationships with his office as soon as possible if he would designate whom we should see when he himself was not available or should not be disturbed with a problem as yet. He asked me how we did it with President Kennedy. I described very quickly the relationship between Ted Sorensen and CEA, and also the direct contacts with the President.

He was obviously quite conscious of the latter, and he indicated to me that I should get in touch with him whenever I had a problem that I thought deserved his attention. He said I should not hesitate.

Now to the Troika meeting with President Johnson, Monday, November 25, 1963. These are notes by Gardner Ackley I'm going to quote a bit, just to save time and to be more accurate, from the notes that Gardner Ackley did at my suggestion and which I edited concerning the meeting with President Johnson on Monday, November 25, 1963, which was re-set from the four o'clock time to eight forty-five. We got in at nine-fifteen and the meeting lasted about an hour. Those present were Dillon, Fowler, Gordon and Staats, Heller and Ackley. Moyers was in at the beginning but was called out.

Let me refer just to the parts that dealt with the tax bill. The President asked Dillon, "What about your tax bill?" Almost immediately the President himself answered his own question by saying that we don't have the votes to get it to the floor unless we tell them that the budget will be about 100 billion dollars. There was some discussion about various individuals votes, the President indicating pretty clear knowledge of every vote, and he said he'd been checking up on it. Not too directly, he noted, that would be beneath the dignity of a president. And so he went on to say, "It is as simple as this. If you want to get an 11 billion dollar tax bill, you're going to have to give up a billion and a half dollars of expenditures. Which would you rather have?" Heller said the question was easy if that was really the choice, but you had to keep the support of the liberals, too, and be sure you had to go below 100 billion, Dillon thought a figure above 100, but not close enough to round up to 101 would do it; say 100.6 or 100.7.

Now just let me interject here that this was such a charade, because, of course, we were talking about the administrative budget which was virtually meaningless except as a symbol. It had none of the Social Security accounts in it, and especially as one looks back at it, it is almost ludicrous to have been arguing about whether we ought to hold that administrative budget down to below 100 or 101 or something like that. It had no substantive significance. Consequently, as I look back at it, I'm a little surprised that we held out as much as we did for not cutting the budget, since it was simply such a symbolic exercise. The part of it that was substantive was that we were afraid, obviously, that if you let the Harry Byrds of the Congress dictate the terms, the danger was that badly needed expenditures would go down the drain. We needed not only the expenditures for their own sake, but for the expansionary force that those expenditures would have.

M: So as a symbol, it's still very important?

H: So as a symbol it was still very important, and I don't mean to say that it was at all useless. In the last analysis we felt it was so important to get the tax cut in order to stimulate the economy and provide a better economic setting for financing a more generous program of federal expenditures, that we gave in, in a sense, to the Treasury and I would have to say, LBJ position, that is, their position that in order to satisfy Senator Harry Byrd we'd better bow low to the 100 billion dollar ceiling. Even though it went against our short-run grain, we felt it would serve our long-run objectives and priorities as far as expenditures were concerned.

Dillon had talked with McNamara, I'm reading again from my notes, the Ackley-Heller notes, and making modifications as I go along, who said that he probably could cut off another half billion. That, plus Gordon's special techniques which the President knew about, would about do it. Gordon did point out what it meant in terms of the cut-backs, such as cutting down all new irrigation starts, cutting back reclamation and REA and so forth. The President said he knew what 101.5 billion dollars meant. He'd been hearing about it from Freeman, Wirtz, and company, and, he interpolated, "all of Heller's liberal friends." Half-jokingly but pointedly he said, "Tell them to lay off, Walter, tell them to quit lobbying. I'm for them. I know they have good programs and that the economy needs to have that money pumped in. I want an expanding economy. The budget should be 108 billion. They don't need to waste my time and theirs with their memorandums and their phone calls." Later the President said that cabinet was made up of nine salesmen and one credit manager! This is just absolutely vintage LBJ humor.

Heller said that the President could defend a 101.5 billion dollar budget, and handed over his eight points. Before looking at it the President retorted, "I can defend 101.5; you take on Senator Byrd." He had talked with Ike, with Bob Anderson, with Congress and then said, "Unless you get that budget down around 100 billion dollars you won't pee one drop." That was what Evans and Novak picked up, by the way. That's why I figured they must have seen this memo! Reading my memo defending the 101.5 budget the President said, "This represents my philosophy, but you're writing about what's desirable. Mr. Dillon is writing about what's possible." Then he read at length from Dillon's memo, and Heller retorted, "I'm writing about what's defensible." The President said he assumed that it wasn't only defensible but desirable too, and Heller agreed.

Of course, LBJ continued, you could try to take it to the country. FDR tried that with his tremendous majority and got licked. It wouldn't work. You had to give something to buy off Byrd. Yet, if his advisers all tell him that he should go in with 105 he would do it, but they should know what the price was and ought to be willing to take the responsibility for paying it. Dillon agreed that you had to pay the price to get the tax bill, but it was worth it. Then when you have it you could do what you want, like Ike did, the President said, "talked economy and then spent."

At the end I said to the President that if there were a real choice between a tax bill right away and a one and a half billion dollar expenditure cut, I would have to agree on economic grounds that it was worth the price. And so the President said that he would tell Congress that the budget should be 108, but he would cut it down to 100. This might be too tight. He might be forced to come back later for a half or three-quarters of a billion more, but he'd try it out. In the meantime we could spend at a rate of 101 billion, and after the election, come in for a billion or so more in supplementals. Gordon warned that Byrd wouldn't be satisfied with just the numbers, he'd want to see the details. The committee knows how to spot the gimmicks. Well, there's more in this memo, but I'm sure this memo will surface elsewhere in the proceedings. I will be glad to make a copy of it available.

Now we should take it from there, however, to one of the incidents that I thought was both significant of itself in the tax cut undertaking and a rather interesting commentary on how decisions are sometimes made, and how you sometimes get the situation where an economic goal is satisfied side-by-side with a political goal. This has to do with what may seem a rather technical decision, but it was a very important one. We had wanted to get the income tax withholding rate cut as much as possible the moment the tax cut went into effect because the economy needed the stimulus. We were running well below full employment, and this is now in January 1964, when it looked as though the tax cut would be enacted at a point where it was uncertain whether the "correct" withholding rate--in terms of collecting the correct liability for the year--should be 14 per cent or 15 per cent.

We wanted it to be 14 per cent, because one percentage point less withholding on the entire taxable wage and salary bill in the country is a considerable stimulus to consumer spending. But we weren't really getting anywhere with it. The Treasury wanted it held at the more conservative position at 15 per cent. Then one day the President called me over to his office and said, "Walter, to cut the deficit in fiscal 1965, I need a billion dollars more revenue in that fiscal 1965 budget." This is now January of 1964. I gulped, and said, "Mr. President, where am I supposed to find it?" And he said, "I don't care where you find it. Just find it and report back in an hour."

By the way, we had just exactly this kind of a give and take working relationship, one that, as I indicated previously, was different from, but in a sense even closer than, the working relationship with Kennedy. I don't want to suggest that the working relationship with Kennedy wasn't close and highly satisfactory. Naturally every adviser has his misgivings about relations with a new president. But we found that the working relationships with President Johnson were superb.

All right, now here we are. I've got to find a billion dollars in one hour. I don't normally produce a billion dollars an hour! And he wasn't really kidding. So suddenly I remembered that Charlie Schultze had told me that moving the 15 per cent withholding rate to 14 per cent would shift the revenues enough to produce eight hundred million dollars more of revenues in the fiscal 1965 budget. Now why? Well, it would somewhat undercollect, that is, the final liabilities would be somewhat undercollected in April, May, June, that is, in fiscal 1964--ending June 30, 1964. People would be paying somewhat too little in fiscal 1964, and the consequence was that in setting up their final liability in April of 1965, which was still in the fiscal year 1965, they'd have to pay more.

So this was a way of shifting about 800 million of revenues out of fiscal 1964 into fiscal 1965, which was fine with him, he was not worried about the 1964 deficit. He was worried about his commitments for 1965, which was <u>his</u> budget; 1964 was still Kennedy's budget. So that gave me eight hundred million dollars of his billion that he had asked for. Then I called Kermit Gordon and said, "Kermit, I've got eight hundred million that the President asked for, but I need two hundred million more." And Kermit said, "You know, isn't that funny. I was just looking at the estimate of miscellaneous receipts and had just been on the verge of deciding that those estimates were two hundred million dollars too low!"

I'm sure you know Kermit, with his marvelous sense of humor, was putting me on. He knew it and I knew it, so we had the billion dollars. Within an hour I went back to the President and said, "Mr. President, I've got your billion dollars. Now I suppose we'd better check this out." I told him, "Kermit Gordon was in on it and agrees, and now we ought to check it out with Doug Dillon." His reply to that was, "Doug Dillon is down vacationing on Hobe Sound, and if he wants to have his rest or his leisure on Hobe Sound he can have it, we're going ahead." And that was that. Now this was a case, you see, where a political need was satisfied with an economic good. I call that happiness for an economist. And we did, we implemented it, and it meant more stimulus for the economy and it meant more revenue in fiscal 1965.

M: In this whole process, did you have to deal with Congress?

H: Yes, some. But not a great deal. I had friends in Congress going way back. I'd known Wilbur Mills, for example, since 1942 when he was still, I think, a freshman congressman. I was working in the Treasury on the wartime tax program and got to know him back in those days. I would occasionally--this started in the summer of 1962--have lunch or a session with Mills, trying to persuade him that the tax cut was badly needed and that the faster we got it the better it'd be for the economy. He was a very reluctant dragon. He was very, very chary.

And this, then, also occurred later on in the surtax battle to get the President ten per cent surtax, a battle that started in 1967 and ran, as you know, through half of 1968. [Mills was] very chary of economic forecasts. It's really only in the last year, in the period when Mills has thought of himself as a presidential candidate, that he's gotten more modern in his economics. I'm not saying that he wasn't highly intelligent, or that I don't respect his thinking. He really was extremely difficult to persuade on the broad economic sweep of taxation and on economic forecasts.

M: Did you have to deal with Harry Byrd?

H: No, I never dealt personally that I can remember with Harry Byrd.

M: Now once the budget cut was passed, it went through Congress and it's in effect. Did you have a responsibility of follow-up on that, or keep your eye on it?

H: Do you mean tax cut? You said budget cut.

M: I meant tax cut.

H: Well, yes, and I have noticed as I've flipped through the memos I wrote to the President that he was extremely interested in the economic impact of the tax cut. I suppose there are two or three things worth saying there. The first two or three months after the tax cut was enacted, we, I must confess, were a little nervous because there was no quick reflection of the tax cut in increased retail sales. Before I get any further, I want to say that as Arthur Okun has shown in his analysis of the tax cut, it worked out as well as any major economic measure in history in terms of delivering the goods, delivering what it was supposed to deliver.

But those first two or three months were a period of some misgivings. We didn't really let them get to us, but after all, the twelve billion dollar tax cut had been almost exactly what I had recommended to President Kennedy in terms of total amount. We had persuaded the Treasury that eleven or twelve billion was far better than their two or three billion. What I'm really saying adds up to the proposition that the heads of economists were on the chopping block as never before in American history. So we were a little nervous.

And for the first two or three months, nothing. Retail sales absolutely dead in the water. And one day Johnny Lewis, who was then a member of the council--which he was only briefly and then he went on to India as head of the AID--brought in a clipping from McClean's column in the Daily News in Washington which said, "Waiters are reporting an enormous increase in tips since the tax cut." Lewis wrote underneath, "Now I know what's wrong. They haven't been spending it, they haven't been saving it, they've been giving it away!" That kind of broke the tension. Well, you know, the thing of course started rolling.

The other incident I should mention is when I went in in April 1964 to tell the President that I would have to leave. I think it was one of the earliest, maybe even the first "walk around the oval drive" there, behind the White House. That was when he said, "Now, Walter, you know I'm kind of an old-fashioned economist," and went on--as I noted in our earlier interview--to say that I had sold him on it and he would hold me directly responsible for it.

Well I breathed such a sigh of relief a year later--when I was back in Minnesota--when actually the first half of calendar 1965 we were running a three billion dollar surplus in the budget, unemployment was coming down each month, and "inflation" was running at only 1 1/2 per cent per year. It did deliver precisely what we had wanted. But it was interesting that the President said that he was not entirely yet reconciled intellectually, in terms of his previous moorings in economic matters, to the tax cut. This is a month after it was enacted. And just saying, "It just better deliver." Well, thank heaven, it did deliver.

M: That would indicate that he had great faith in you.

H: Well, I'd like to think that. Of course, also, I have said before and I think should say again in this context, that the tax cut illustrated a difference between the Kennedy and the Johnson approach.

Kennedy felt that the way to get the tax cut was to educate the Congress and the country and persuade them to go for it. I'm not passing any judgment on this, but, you know, clarion calls, TV programs, et cetera. Johnson's idea was, "Let's get the damned thing passed and demonstrate to the country what it can do." That as it happened, was probably an ideal combination, where Kennedy had done much of the educational work, and then Johnson used his incomparable technique to get the thing through. Then the country's opinion-makers were persuaded that modern economics worked, because of course there had been this strong prejudice against having a tax cut on top of a deficit budget in an economy that was already expanding.

This reflected a new approach to national economic policy, saying it's the gap between where we are and where the economy could be at full employment that should govern economic policy, and not the old anti-cyclical approach, which says, "Always lean against the wind." If the economy is going up, you lean down, and if the economy is going down, you try to push it up. Here we had gotten across, starting with Kennedy and really confirmed by Johnson, that the criterion was whether the economy was living up to its expanding full employment potential. That has now become a bipartisan test of policy.

M: That brings up a question I should ask you. Where did this idea start, where's the genesis of it? I know it's back in the Kennedy Administration, but whose idea is this about a tax cut and the effect it will have on the economy?

H: This I suppose was as clearly a Heller idea as any purely economic measure in the Kennedy and Johnson Administrations.

M: How do you get this idea? What goes into your mind that brings this up?

H: Let me tell you how this developed, very quickly. It goes back even before the Kennedy Administration started. There was the Samuelson Task Force. The task force said there ought to be an anti-recession program, and if necessary a tax cut. I discussed this with Kennedy early on, and he in effect said, "With my calling for sacrifice, how can I go to a country that doesn't understand why you would want to cut taxes under these circumstances with a big budget deficit? How can I tell them that? I'm not going to hand you a tax cut on a silver platter!" So he said, "It's out." And indeed it was.

By the end of 1961 we had begun, I thought, to get Kennedy fairly well educated on modern economics. And so, at least within the Council of Economic Advisers, we were, in December-January, wondering whether we should still try to get the President to have an anti-recession tax cut. It was at that point that there was a big surge of gross national product, a big surge of activity in the last quarter of 1961. My partners on the council, who felt that we might make it to full employment even with what I regarded as an over-burden of taxes, I must say, prevailed upon me. And we had a unanimous report saying it looked as though the economy could make it. We just goofed on the economic forecast for 1962. We were too optimistic; not quite as bad as Mr. Nixon's forecast, because they never believed it. We believed it. We thought that we could make $570 billion in 1962, but GNP came in at only about $555 billion.* And this is important to the genesis of the tax cut idea.

M: Let me push you back a little bit further. I realize you brought this idea and implemented it in government to the conclusion that it becomes in effect a law, that it's passed through legislation. What I would like to know is, where do you get this idea? Now I know you implement it, and so forth, but does this come out of research that you've done? Does it come out of a task force? Where does the idea come from?

H: Fundamentally it comes out of modern Keynesian economic theory and policy.

M: It builds on that?

H: Right. The fundamental analysis on the basis of which the tax cut of 1964 was finally enacted really stems from Keynes' General Theory back in 1936. Now it took a long time before that was translated into the specifics of economic policy. Let me modify that. In World War II we applied a lot of Keynesian economics. As a means of restraining purchasing power, we put in as many tax boosts as we could get through the Congress. That was Keynesian, but under the pressure of the war. Then in the post-war period, already in the 1945-1950 period, you can find statements of economists, and one joint statement about stabilization and full employment policy in which leading

* Revisions since then have brought it to $564 billion.

economists agreed--that tax cuts and tax increases should be used for stabilization purposes: tax cuts in recession, tax increases to try to fight inflation. That's the basic theoretical analysis and research relating past tax actions to what then happened in the economy, and so forth, all done back in the forties. Then in the fifties there began to be some acceptance of this.

By the way, Herbert Stein in his interesting book on the fiscal revolution attributes more acceptance of demand-management economics in national policy in the fifties and less of a policy revolution in the sixties than is actually the case. As I view it, that doesn't begin to give the credit to Kennedy and Johnson for providing the absolute essential of a national policy revolution, namely, the conversion of the President of the United States--and the conversion of leading thinkers, "men of affairs," opinion makers--to these concepts. That revolution did not take place until the sixties, and nothing that Mr. Stein adduces in his well documented and apparently careful historical work can establish, for me, the proposition that the country had accepted the philosophy that lay behind the great tax cut of 1964. I'm referring to the philosophy and analysis of conscious use of budget expenditures and tax policy for economic stabilization, for full employment and related policies.

M: Okay, would you use that phrase that you just gave as a definition of the "new economics"?

H: The "new economics," as the press called it, of the Kennedy-Johnson days? Yes, in considerable part. The conscious and active use of tax and expenditure policy, that is tax cuts and tax increases, expenditure speed-ups and slow-downs, for purposes of trying to develop a full employment, reasonably non-inflationary economy. That's part of it. But you see, another thing happened during the sixties that had never really been part of the economies of the fifties. It was not only the kind of approach that was at long last adopted by presidents, and consciously so. It was also the language of the 1962 and subsequent presidential economic messages that finds no parallel in earlier economic reports.

I remember saying to President Kennedy the first time I had drafted language in which he openly espoused the use of deficit financing under certain circumstances, "You are aware that no president has ever said this before." Economists had been talking about it for twenty-five years, but there's a vast gulf between economists being able to do that and a president being able to do it and not get penalized for it. That's what I mean when I say that our "new economics" really took hold in the White House only in the 1960s. Eisenhower in his final speeches was still talking about the public debt imposing burdens on our grandchildren.

Nowadays it's standard procedure to accept deficits. President Nixon's approach was, "Oh, don't worry about twenty-six to thirty billion dollar actual deficits, because we're going to have a balanced budget at full employment." We introduced the balanced-budget-at-full-employment concept into White House rhetoric and thinking in 1961.

Now, it wasn't just the approach and the language that changed. We also translated the "new economics" into specific numerical goals. It was done under Keyserling and Truman, but only fleetingly and never fully accepted by Truman. But Presidents Kennedy and Johnson accepted 4 per cent unemployment as an explicit goal; they accepted 4 to 4 1/2 per cent growth rates as a goal. They pitched their economics, on our advice, to the growing full employment potential of the economy instead of worrying about every wiggle in the economy and trying to flatten out the curves of the business cycle. And this is a quite different orientation, a growth, expansion-type of orientation that had never been accepted before. As I say, no matter how careful the documentation of Herbert Stein's book, you cannot prove to me that there wasn't a major advance on the atmosphere and presidential acceptance of modern economic analysis and instruments of policy in the 1960s over anything that had gone before.

Tape 2 of 3

M: All right.

H: We've gone back to the philosophy and economic underpinnings of the tax cut idea. Then let me return to the translation and implementation part of it. As I say, a first phase was our hope that we could convince Kennedy to make a tax cut part of his anti-recession program. The council put together that anti-recession program in the first ten days of the Kennedy Administration, working until three, four, five every morning. We were sort of in the command post, but we couldn't get the President on board because of the point I mentioned earlier about the sacrifice approach. We couldn't get him to sign on. We talked about the possibility later in the spring, and then the economy turned up and that's when the President got somewhat less interested in the economy, when it seemed like a little less of a crisis. That's true, of course, with presidents. That's when they had the Bay of Pigs. Maybe if he had kept his mind on the economy. . . . Who knows?

Then in the summer of 1961 we began to get some of this philosophy applied when the council built a backfire against the proposal that there be a three billion dollar tax increase to finance a three billion dollar emergency Berlin mobilization, increase in defense expenditures. We were a lone voice in the wilderness against the tax increase until in a dramatic incident one weekend we prevailed. And President Johnson was somewhat involved in that as vice president. I referred in our earlier interview to the meeting I had with Kennedy and Johnson in the Mansion. Would you like to have me expand on this?

M: Go ahead, yes.

H: I had started the backfire from Dallas, where I was speaking at SMU on a Friday in July of 1961, trying to get the President to reverse his tentative decision to ask for a three billion dollar tax increase to finance the Berlin build-up. His cabinet was unanimously for it, both because they felt they wanted people to feel a sense of participation through the taxes, and because they were in considerable part more or less traditional budget balancers in that they felt, "If you're going to spend three billion more, you better finance it by tax increases."

Jim Tobin called me and said, "We just can't let this happen with so much slack in the economy." And I said, "I know. Ted Sorensen is representing our point of view in these matters." He said, "Well, we'd better try to get more directly to the President." To make a long story short, I got in touch with President Kennedy the moment I got back to Washington on Saturday morning, and I got Paul Samuelson to go over to see him at Hyannis Port. Paul then flew down to Washington with him. I had a couple of conversations with the President, and we sent up some memos, and the President held an emergency meeting of the relevant cabinet officers and so forth. I felt that by the end of that meeting we had him persuaded to cancel the idea of a tax increase to finance the Berlin expenditures. But I wasn't sure, and he was not giving me a final answer until he had conferred with the Vice President because he wanted to talk to him about the political implications of it. At least this is the way I perceived that incident.

Before I left for that OECD session in Paris, I wanted to get the final word on Kennedy's decision so that I would know what to tell our partners in the OECD the next morning. And here I hadn't gotten the final okay from the President. He said, "Well, I have to discuss it with Lyndon Johnson." Then I finally told Ted Sorensen, "Ted, I'm kind of desperate because this makes a significant difference in terms of our sophisticated economic partners in Paris, in terms of what I can tell them as to what our government is doing about financing the Berlin crisis expenditures."

So Ted said, "Okay, I'll arrange for you to go over and see the President." I went over, and there he and Lyndon Johnson were sitting together alone. The three of us discussed very briefly the politics and economics of not having the tax increase that had been tentatively decided upon, and when I left for Paris, unfortunately I still didn't have a final answer. LBJ was saying that, as I recall it, he could understand the reasons for not increasing taxes, and I got every indication that it was not going to be done. But I didn't actually know until I got to Paris that the President had then decided not to do it. Well, so much for this footnote.

Now, in the first three months of 1962 the economy was just not responding to treatment the way it should have. Oh, by the way, the President--this is Kennedy now, in the summer of 1961--made a very costly pledge at the time that he decided not to have a tax increase. He pledged that he would present a fully balanced budget in January of 1962, and some people think that that caused us to raise the GNP estimate so he could get more revenue. I don't know that that subconsciously or psychologically might have entered, but it certainly didn't enter as a direct booster of the GNP forecast. I don't mean to say we were holier than thou about it. The range of forecasts we were talking about ran from 565 to 570, and we probably put it at the upper end of the range under this sort of psychological influence.

M: But still a legitimate forecast?

H: Oh yes. When Dillon was asked, "Do you think it is realistic? Or do you think it is optimistic?" he said, "I think I'd call it optimistic realistic." And this represented, I'd say, a fair characterization of it. But then it became apparent that it was too high. By March I was convinced that I had been right after all in late 1961 in my initial feeling that we couldn't struggle to full employment under this heavy overburden of taxes. At the same time, we were failing to get economic stimulus by the expenditure route. The White House was butting its head up against a brick wall as far as spending programs were concerned.

This is something I underscore because some amateur historians say we just folded under and decided to give in to the conservative forces in the country and forego the expenditure route. Nothing could be further from the truth. The expenditure route had been tried again and again. Kennedy said, "Look, I'm not against spending money. If you fellows can figure out a way for me to get the programs out of Congress, let's go to it." But a) we were unable to do it that way; b) it became apparent that we urgently needed some additional stimulus to the economy; c) it was true that with income tax rates still running up to 91 per cent at the top and with rates at the bottom starting at 20 per cent, the tax structure needed correcting. In other words it finally came out fourteen to seventy instead of twenty to ninety, which is certainly a more viable tax structure. There were a number of loopholes that needed closing. We didn't get much of that done in the 1964 act of course, because essentially the tax reform part of it got jettisoned fairly early in the game, except for a few remnants.

Finally, we had to sell modern fiscal policy to an unbelieving and highly suspicious public. One way to sell it--and this I guess was a fringe benefit of going the tax route--was to get business on board to help sell modern economics through a tax cut, which was dear to their hearts. They'd always previously said, "You can't have a tax cut until you've got a surplus in the budget." Here we sold them deficit financing through a tax cut, and they in turn helped sell it to the country. It took a long time to cover this, but I have to go into this because of the fact that there has been so much controversy about whether it was wise or unwise, in the long-term perspective, to have had that twelve billion dollar tax cut in 1964, rather than boosting expenditures.

I am completely persuaded that anybody who looks at the unsuccessful efforts to get expenditure increases out of Congress in that period has to conclude that if we forswore tax cuts we were simply condemning the economy to a long period of sluggishness, and that full employment would have been a very distant objective. I had to say to Ken Galbraith one time, "The way to get to your objective of more expenditures most rapidly is through the tax cut route. This is one case where the long way around is the short way home." And Lyndon Johnson's Great Society programs in 1964, and especially the 1965 expenditure expansion for domestic programs, were based essentially on the expansion accelerated by the tax cut. So that I feel that economic history has rendered its verdict on our side. But there are some observers--Galbraith, Lekachman, Keyserling and others--who have not yet accepted that. That's one reason I underscore it in this context.

Okay, now back to the specifics. The economy was falling well below its potential and well below the path that we had laid out. So in March of 1962, I did a memo [appended] to get the ball rolling in the CEA and then in May of 1962 I wrote the opening gun memo to the President, saying, in effect, "What I feared would happen and hoped wouldn't, is happening. The economy is falling well below its potential path of growth. It's falling well below our forecasts. We aren't getting anywhere with expenditure increase proposals except for some military increases. It's high time that we took the tax route."

At that time I wasn't sure that I had fully persuaded my colleagues, Tobin and Gordon, but we always worked by consensus in both the Johnson and the Kennedy Administrations, and they were soon on board. There was never any conflict or problem. So we started plugging for a ten billion dollar tax cut by May and June of 1962. The President made his first commitment--in language that I worked out with Ted Sorensen--to a permanent net tax cut in a press conference of June 6 or so.

Then we had a big battle about whether we should have am immediate tax cut because of the near-recession of 1962. I brought in people like Solow and Samuelson and others. We had a good go-around, and the President finally decided not to try the quickie first installment of a permanent tax cut, which I had been urging, but did decide to go for the tax cut in 1963. He pledged himself on August 13, 1962, to a major tax cut in 1963. In other words, that was the first real major commitment of a United States president to a truly modern fiscal policy, involving as I say a tax cut in the face of deficit financing, a rising budget and a rising economy.

We had, as I say, a running battle with the Treasury, not over the idea of a tax cut but over its size. The Treasury only wanted two or three billion dollars of tax cut to lubricate tax reform. Tax reform was their main interest, getting the individual income tax base restored. Our approach was, "Goodness, we hate to pass up any opportunity for tax reform, but the important thing here is to get a big tax cut for economic stimulative purposes." We were always a little apprehensive about the excess baggage of the tax reform. Our heart was in it, but not our head--in terms of the urgency of the tax cut to get the economy moving again. And eventually, interestingly enough, the Treasury shifted from the position that it wanted just enough tax cut to lubricate tax reform to the position--I remember vividly the way it was put--that tax reform would help lubricate the tax cut. Well, that was a reversal which we didn't mind, because our objective was to get that tax cut. But I have no doubt that the tax reform part of the package slowed it down.

We ideally would have liked to have had--and I once made this proposal to Kennedy--about eight billion dollars of tax cut fast.

Save the other four billion to couple it with tax reform because we felt that we couldn't really get tough tax reform, increasing some people's tax liabilities, without coupling it with an overall tax cut. But what finally happened was, for all practical purposes, and to the dismay of the Treasury and Mr. Mills, at a meeting with the Committee for Economic Development--CED--only a few months in 1963, Kennedy all but jettisoned the tax reform part of the program when he in essence said, "This part is not the key part; it's the tax cut." Well, I know that's more than you really need for background, but on the other hand it is important in the sense that one ought to understand where that tax cut stood as of the time of the assassination.

M: To what do you attribute Johnson's quick acceptance of this? Now I know you mentioned on the other tape that you passed memos to him, and apparently you were one of the few people in the Executive Office at that time that was doing that. Now is that part of the education process?

H: I think it is. And another part was the press briefing breakfasts before President Kennedy's news conferences. I was just looking at my schedule of meetings a while back and noticing how regularly the seven or eight of us would meet in the President's little private dining room in the Mansion for breakfast. As I mentioned in last year's interview, the standard group that would meet for breakfast before the President's press conferences consisted of Lyndon Johnson, Rusk, Sorensen, Bundy, Salinger, Heller, Feldman. This group would meet at 8:45 and go until about 10:00 a.m., and we would review all the subjects that we thought might come up at the press conference.

Three quarters of the time we spent on foreign policy and about a quarter of the time on domestic policy. I would always bring in a set of questions and answers for the President, or would have sent them over the night before. And Lyndon Johnson would always expect me to hand him a copy. That was a regular part of the ritual, and I always sat next to him. Kennedy sat on one side of the table and Johnson right across from him, and I always sat at Johnson's left. You know how these things tend to develop. There aren't any place cards, but you tend to get into fairly regular patterns. At those meetings we often would have a chance to exchange a little intelligence on taxes, but in addition he was sitting in and listening to the discussion that went on at those sessions.

M: To leap forward into the Johnson period. Once you got through successfully a tax cut, and it was seeming to work, why not further tax cuts?

H: As a matter of fact, of course, there were further tax cuts. These were the excise tax cuts. Let's carry that story a little bit further. The tax cut, as I say, did deliver superbly both in terms of speeding economic expansion and in terms of thereby helping to generate a three billion dollar budget surplus* in the first half of calendar 1965, a surplus calculated on the national income and product

*At an earlier point, I said "cash surplus," but it should have read "NIA--national income accounts--surplus".

accounts basis, which is the one that economists go by rather than administrative or unified or cash budget or what have you.

By the middle of 1965 the record will show, and I happen to have gone over some of the materials two or three days ago, in which the record does show that there began to be concern about a new recession. This is generally forgotten in the annals that I have examined. I should say, by the way, I'm getting a little bit ahead of my story because one has to weave in the 1965 excise tax cut. That excise tax cut was designed to sweep away all these myriad miscellaneous excise taxes that had been, for the most part, enacted in 1933 as temporary excises taxes, and here it was 1965! This is an antecedent to another point I'm going to make in a few minutes. And so we were strong for getting rid of them. The economy was still not at full employment. You have to remember that at the beginning of 1965, unemployment was only then coming below 5 per cent. Now it had tended to come down about a tenth of a point for most of 1965 every month, so that it dropped to four by the end of 1965.

In other words, we were moving under the more or less gentle zephyrs of the 1964 tax cut. We were moving so nicely towards full employment, and with very little price inflation. What there was, and again I was looking at some of Gardner Ackley's analyses a couple of nights ago, was almost all in farm prices, which is not a function of over-all aggregate demand. Farm prices have a certain life of their own, so that there was no real inflation. This is what I regard, frankly, as one of the economic tragedies of Vietnam; the great experiment in economics was rudely interrupted. I don't mean to say that we would have gotten to full employment without any inflationary pressures. No modern industrial economy ever has. But instead of having 6 and 7 per cent inflation at the peak, we probably could have held it to around 3 per cent, 3 1/2, just half as much. The Vietnam escalation just knocked things into a cocked hat because it superimposed about twenty-five billion dollars of expenditures that no one had factured into the economic plan on a program that was essentially a full-employment program to begin with.

The full-employment program coupled the big tax cut of 1964 with this excise tax cut of 1965, sweeping away, as I say, the real cobwebs of ridiculous excise taxes. And then, even so, there were signs of weakness in the economy in June of 1965. The President and we, that is, my successors at CEA, began to discuss whether we shouldn't have some sort of a little income tax cut at the bottom of the scale for the lower income people if these quivers in the economy turned into a softness, and again, a growing gap and so forth. This is significant because it's really one month before decisions on escalation on Vietnam.

At that point we have to shift to the Vietnam setting of the economy. If you want me to go on with it I can talk about the President's consideration of fiscal and monetary policy in December of 1965 when I went down to the Ranch.

M: Might just as well.

H: Because it does continue the tax theme essentially.

M: Yes, go ahead.

H: Well, during the fall of 1965 we were all of course operating under at least a partial misapprehension. We had no concrete idea how much Vietnam was going to cost. First, I think fundamentally it was being underestimated to begin with. And, second, some of the estimates were somehow or another not getting across the Potomac from the Pentagon to the Executive Office Building, at least not to the council's part of the Executive Office Building. Anyway, the council was operating partially in the dark. But one could feel that the economy was getting a very considerable stimulus. Towards the end of 1965, after escalation of Vietnam began, one began to see the price indices moving up somewhat. It was at that point that Mr. Martin broke the traces and raised the discount rate without the acquiescence of the White House, and the President was sore.

Bill Moyers called me here in this office on Friday afternoon in December of 1965 and said, "The Boss would like you to come down to the Ranch tonight." This was early afternoon. I said, "There's no way, Bill, I can't get there." He said, "Oh, yes, there is, he's diverted a Jetstar and it's on its way up to Wold Chamberlain Field in Minneapolis. He expects you to be there." I said, "Okay, so I'll be there." And I was. This Air Force Jetstar flew me down to the landing strip. There was President Johnson and Judge Moursund on the little electric cart to pick me up, and we went into just a marathon discussion of economic policy. I was there for twenty-two hours, spent about thirteen of those twenty-two with the President in this sort of typical, fascinating, all-encompassing way of his.

You know, when he has something on his mind, you discuss things with him while he's having his massage, while he goes to the bathroom, while he's driving Lynda Bird and George Hamilton over Lynda's back two thousand for deer hunting. The two of them in the back seat with rifles, the President and Heller in the front seat discussing economic policy, in that white Continental convertible. It's quite a scene. And it's actually during that trip to Lynda's two thousand to go deer hunting from a white Continental convertible and back again that we were discussing the question of whether he should reverse himself on the excise taxes.

I said, "Mr. President, how do you propose to reverse yourself, it's law?" Well, he said, "Call a special session, bring Congress back, rescind the excise tax cuts." At that stage of the game, in mid-December of 1965, it's hard for me to conceive that he really was seriously contemplating that, but at least he was testing me, and also showing his understanding of the fiscal needs of the situation. I said, "Mr. President, those excise tax things we just got rid of were such miserable and illogical taxes. It's such good riddance of taxes that had been called temporary in 1933 by FDR that no, by no means should you do that!" I said, "Oh, you might want to rescind a couple of big ones, gasoline and telephone." And he did later on. He did that retroactively, with the help of Congress.

But I said, "What we really need is a surtax on the individual income tax." And indeed, I thought we had sold him on it. Bob McNamara, who was very active in economic policy and a very great ally, to my way of thinking, to sound modern economic policy as espoused by the Council of Economic Advisers, called me one day in Minnesota and said, "I think we've got him sold. I think we'll have the proposal for a 5 per cent surtax on the individual income tax." This is December of 1965. So I was quite disappointed when he was not sold. Of course the President himself has said many times since, "My economic advisers were unanimous in advocating a tax increase, but I tested it on both sides of the aisle and in both houses of Congress, and I didn't have more than a handful of votes. I just wasn't going to go up there and get slapped down."

I personally think that one has to reckon also with a little thing called Vietnam; that the President would have had to fight the Vietnam battle on the backs of the tax increase; that it would have aired some of the fiscal implications of Vietnam in a way in which the President was perhaps not ready to air them at that time. So that it was not a pure economic decision, nor was it a pure vote decision. I think there was a basic Vietnam problem injected into the President's decision.

M: The surtax that finally came, did you play a role in that?

H: Oh yes. I strongly urged it. I kept urging the President.

M: You'd write him memos?

H: I'd write him memos, yes. He had me come into the White House several times. The most notable case being in September of 1967. Throughout 1966 he resisted any move to have a tax increase. Then, of course, as 1967 heaved into sight, the economy was slowing down some because the Federal Reserve had had to step in and tromped hard on the brakes. I think they deserve credit for that rather than the criticism that was heaped on their heads by the monetarists, by Milton Friedman and others. The Fed was very courageous.

We had to step so hard on the monetary brakes because we hadn't stepped on the tax brakes. As a result, housing was frightfully hard-hit. After all, monetary policy has very uneven impacts, and because we didn't have an evenhanded tax and monetary policy working hand-in-hand we had a very serious monetary crunch. Housing was hard-hit, and it was perfectly apparent that the economy was going to slow down some in the first halfof1967. So what we urged, I urged privately, and then also publicly, was that the President not try to implement the tax increase in the first half of 1967 but rather in the second half, when we were quite sure that the economy would be moving up again, and that inflation would then really be in danger of breaking out. That proved to be an absolutely on-target analysis.

As it happened, in December 1966, I came out for such a tax cut in my National City Bank--of Minneapolis--forecast letter. I had not consorted in any way with the President's advisers in Washington and had no knowledge that he was going to do this. I came out and said that the logical thing to do was to propose a tax increase now, but not try to put it through Congress until summer. And that's precisely what the President then did in his budget message. I don't know whether he suspected that there had been some leakage, but there wasn't. The reason I'm underscoring this is that it was such a logical thing to do in political economy terms.

Actually, we would have been much better off if we could have started the tax increase through the Congress early in 1967. But in an environment where the economy was softening and inflation was temporarily abating it wasn't politically realistic to do it. So then the President did launch it at the end of July or beginning of August. He and I had had a conversation during a luncheon for Ludwig Erhard, the West German chancellor. I'd been invited to come in. And I sat with the President and Erhard, and the President asked me to discuss the tax increase in Erhard's presence. I mention this because there are so many different ways, so many different opportunities that you've got to exploit in trying to influence the President, and this happened to be a marvelous vehicle. I did it through the things I was telling Erhard, you know, because in the process I was trying to get across to Mr. Johnson.

M: Was this all translated in German? Did Erhard speak English?

H: Erhard understood English well enough; he couldn't speak it very well. I could speak both German and English, so I may have served as a bit of a translator in this kind of an instance. But, no, he had his translator there. This is just a bit of a detail, but, I remember her very well, I think she was translating in situations where it was important to understand precisely what was being said. She sat right behind him and whispered into his ear, so to speak.

Then things were obviously going nowhere on the Johnson proposal. He called me in for a couple of days to the White House later in 1967 to help in several ways. One, to help on another message itself--or was it a speech?--also, to meet with the Democratic liberals. I did that for LBJ several times on the tax increase, that is, meet with the Democratic Study Group in the House. In the 1967-68 context I'm talking about the proposed surtax. And [finally] to test out the tax increase, for example, with the members of the Federal Reserve Board, as I mentioned to you earlier before we were on tape.

The President said, "Now I want you to check this out with your four appointees to the Federal Reserve Board." What he was referring to was the fact that I had sold Mr. Kennedy on the appointment of George Mitchell and had played a role in the appointment by President Johnson of Andy Brimmer, and the reappointment of Robertson and the appointment of Sherman Maisel from California, who's about to retire. So I did play that role in trying to help him sell the tax boost, especially to the liberals in Congress. I also talked with Wilbur Mills, but Wilbur was quite intransigent.

I don't know whether any other interviewees in this project have brought it out, but it's an important part of economic history, that part of the opposition to the tax increase and to LBJ and his economists on this issue were the chief economic editorialists at that time of the New York Times and the Washington Post. There was a constant drumfire kept up by Murray Rossant of the New York Times, who, by the way, had pretty consistently clobbered us on tax and economic policies ever since 1961. That was pretty hard to take, believe me, to have the New York Times editorialist in economics [against us]. One man makes a difference in these things.

The Washington Post editorialist in economic matters, Harvey Segal, not only had been converted to the monetarist point of view, and not only was writing editorials bitterly critical of Johnson and the Economic Advisers, but believe it or not as late as January of 1968, was saying there was little or no evidence of inflation in the economy. I thought it was a disgrace for the Post even to print such an editorial.

But what was worse was that he and one other man of similar persuasion had the ear of Wilbur Mills. These two men, history should someday record, both because of their direct impact on Mills and because of the constant drumfire in the two editorial columns most read by the congressmen, are in part responsible, it seems to me, for the opposition, foot-dragging, lack of conviction in Congress that the Johnson surtax was really needed. Those who know the ins and outs of this story will corroborate that. Check with Pechman, check with Okun, Ackley. They will, I'm sure, corroborate the fact that these people played an essentially destructive role as far as President Johnson's surtax is concerned.

M: To shift the subject a little bit. Now have we explored the tax?

H: I think as much as I can contribute. I some day am going to check those notes that I wrote about my visits to the White House when I actually had the privilege of staying in the White House overnight, meeting with the President when he was still in bed for breakfast, and things like this. I've written those up, and I'll have to take a look at them and see if they can't be made available in some form to this project.

M: Good. Well, then, to shift the subject, what about these wage-price guidelines? What role did you play in that, and how far back does that go?

H: Well, that goes back to 1961. I'm assuming that Kermit Gordon will have told the major part of the story of the origination of them and so forth, because to my mind Kermit was more responsible than any other single person for the actual development of the guideposts. He and I, by the way, did what I regarded as a very useful and I think high-fidelity account and fairly complete account of this for the Kennedy interviews.

M: Will this be part of the Kennedy Library?

H: This will be a part of the Kennedy Library, and it gives all of the details of the origination. But to give you a quick synopsis: when recovery started in 1961, I had noted earlier in this conversation that Bill Martin worried about inflation. We got across to Kennedy that there was no demand-pull inflation, cost-push was the only possibility. In June-July of 1961 the steel companies started saying when the third installment of the previously negotiated wage increase came through in October they'd have to increase prices, which was ridiculous. Kermit started tracking individual price increases in the major market-power industries. The steel magazines kept saying, "We've got to have this price increase."

One of the most interesting incidents was when we mobilized a group in Congress, in the Senate, to spend a day in the Senate on this whole subject of unwarranted price increases and market power and so forth. I got Senator Albert Gore together with Kennedy, in Kennedy's office. Kermit went over with me, and we mapped out the strategy. Later on the President wrote a letter to the steel companies saying in effect, "If you play ball on this I'll help get labor into a more receptive mood on a reasonable settlement in 1962." Then, of course, they had the reasonable settlement, and then Blough busted the whole thing wide open with his shocking six-dollar-a-ton price increase. Then they had the big steel crisis and so forth.

But in between that September when the letter went out to the steel companies and that April when there was the first steel crisis in the Kennedy Administration, there had been a lot of quiet work done within the council, particularly under Kermit Gordon's guidance and with Bob Solow's aid, to develop general principles of non-inflationary wage and price behavior. These constituted the final chapter in our January of 1962 report, and they're still a classic, frankly. Mostly, as I say, Kermit's and Solow's work; Kermit was responsible for that chapter. We had a great deal of difficulty clearing it with some of the other agencies, particularly with the

Labor Department. Not that we couldn't write what we wanted to, but when it had tremendous policy implications we didn't want to publish it as part of the council's report unless it had the approval of especially the Labor Department.

So, as a matter of fact, it wasn't until four o'clock in the morning, literally, in my office that we signed off on that chapter. Because it was so extremely delicate and difficult to do, and we put it last on the document. The way that fantastic Government Printing Office works, we finished the Economic Report manuscript at four o'clock in the morning, and two days later it was a book. A light note: the really critical decision was whether to call them "guidelines" or "guideposts." That's where I entered and exerted my executive authority and decided it should be "guideposts."

This is relevant really to the Kennedy-Johnson continuum on this, and I believe I said some of this in my book, New Dimensions of Political Economy, those Godkin lectures. But during the Kennedy Administration I believe it's fair to say that John F. Kennedy never fully embraced the guideposts as his own. He somewhat warily referred to them as "the council's guideposts." Of course, he didn't walk away from them. I mean in the steel fight, obviously, he backed them up 100 per cent, but he was quite chary about them. This is my impression. Yes, they were used; yes, that was the government's policy, but it wasn't so much his policy as, if you can distinguish this, the council's policy. You could find his references to the Council of Economic Adviser's guideposts.

When Johnson became president, they were tailor-made for his kind of approach to policy, his kind of personality. He embraced them. He gave them a real bear hug. And from then on very quickly when he understood what was going on, I think he had already understood it during the John Kennedy Administration, they were his guideposts. They were an integral part of his policy, and we could then go out with confidence that we had the full backing of the President in trying to intervene in a light-handed way in major wage and price decisions.

M: Did you have a chance to see him persuading people to stick to those guideposts?

H: Oh yes. Most of the time, of course, he'd say to me, "Look, you do it with my authority." But part of the time it would be a matter of his picking up the phone. Gardner Ackley saw much more of this than I, because by then, you know the first year, we were particularly preoccupied with the tax cut. There was one incident that ought to get, however, into the account, and maybe Kermit Gordon has recorded this. That was the attempt to work out a deal with Reuther on car prices and car wages. Does this ring a bell with you at all?

M: No, it doesn't.

H: What happened was that Walter Reuther had always taken the intelligent position that if we could get the automobile companies to cut their prices and thereby influence the cost of living in the economy as a whole--because this is after all a bellwether pattern-setting industry--that he would be willing to take a smaller wage increase to his members. This struck us as an absolutely splendid idea. We had tried a little bit of this kind of business in 1961, and that's the point at which Walt Rostow played a major role. He went to see Reuther on behalf of President Kennedy, and the philosophy was expressed at that time. And so, again, we sounded out Reuther, and he said, "Yes, if you can deliver a price cut." The guidelines really called for a price cut, because where productivity rose faster than the average wage increases, you're supposed to cut prices.

So we began some preliminary conversations. I had some contacts, some sort of subterranean contacts through the business community. McNamara was in on the deal, a fellow named Hal Korda--he died two or three years ago of throat cancer--

M: How do you spell that?

H: K-O-R-D-A. He himself is a fascinating chapter. He actually got to see LBJ a couple of times. He was one of these somewhat shadowy figures, not in the bad sense of the term but the good sense, of getting a feel for what was going on in the business and financial community, transmitting and conveying it to us, and in the process raising his own stature. Sure, he was getting something out of it too. Many of us who knew Hal personally were extremely fond of him. But he was sort of a go-between, he was telling us something of the thinking of automobile management.

We thought that we could strike some sort of a bargain with the automobile management that would have really a lasting impact. Not forever, these things don't last forever, but would have a terrific bellwether impact on the economy if we could only get them to cut prices and then take a very modest wage settlement. So we were working hard at this. I thought I had the President's blessing to go ahead with this, and for a while I did. I said, "Mr. President, now it's up to you. We've gone as far as we can with your backing; we've gone as far as we can." This is in June now, 1964, "If there's going to be a deal in which they pledge to cut car prices and you get Walter Reuther to take a modest settlement, you have to do it. We've gone as far as we can." Well, he wanted to think about it, and finally he said, "No. I don't think I should do it."

Now I tried it once more. McNamara, Korda, Wirtz, who was reluctant but sort of went along, and I, Kermit Gordon--no. I guess Kermit by then was Budget director, and I don't know that he was so directly involved. I guess he wasn't directly involved. That may be why he didn't bring this into his conversations with you. We tried once more, and I took it to the President and he said, "Walter, I thought I told you I didn't want to hear any more about that subject." He was sore. He didn't explode, but he just was very final and very positive about it. We always regarded that with great regret. Now what had happened, I don't know. There are two speculations, and I'm not claiming that either one is correct. Number one: that he concluded that he couldn't get it, and that therefore there was no point in striking out. Number two: Henry Ford was an awful good friend of his in the election of 1964, a mighty strong supporter. Well, who knows?

In any event we didn't get it, and as a result we were not able to negotiate the kind of a settlement that the guideposts in a sense really called for, and I thought it was a great opportunity lost. Now with the intervention of Vietnam it wouldn't have made that much difference, because Vietnam pumped up the level of economic demand so much that the guideposts, per se of course, cracked under the weight of the airline mechanics settlement in 1966. That's a battleground the President never should have selected. That was one of his few tactical, or maybe even a strategic, mistake in this area. Then of course he never relented on jaw-boning, but he no longer had a viable set of guideposts, where you could talk about a 3.2 per cent wage policy and so forth. He kept jaw-boning, as I think he should have, to keep the prices down of steel and aluminum and the like. You know how they shot up after Nixon in his very first press conference in effect said, "School's out, boys, I'm not going to touch a hair on the head of wage and price decisions."

Well, I sometimes say that the history of the guideposts you have to divide into their conception in 1961, and about nine months later they were born. Then you did have that period of genesis and the early post-natal problem of the steel crisis in April of 1962. Gradually they grew to maturity in 1963, 1964, and 1965 and had, I think, both by observation, by interview and by econometric analysis a decided effect on slowing down wage and price increases in a very strong expansion. Then came their death, really, in July of 1966, with that airline mechanics strike and decision. That was part of what you might call "death and transfiguration." They were transfigured into just a jaw-boning policy. And then finally they had an indecent burial by Mr. Nixon that was totally gratuitous. He needn't have done that. He gave himself so much trouble by that gratuitous comment that he wasn't going to interfere, he wasn't going to follow any guideposts. After all, this was early 1969, they'd been dead for two and a half years. He needn't have indulged in this public burial. But he did, and then of course he had to disinter them, indeed, go well beyond then in August, 1971 with his wage-price freeze and subsequent controls.

M: Now did you have trouble resigning?

H: Yes, sure. I've also written a memo about that. It's the kind of trouble you like to have, don't misunderstand me. As indicated earlier, I had a very close working relationship, and I think good rapport, with the President. I had no trouble making the transition. After all, I am sure I was not one of those he ever referred to as "the ones whose hearts belonged to Kennedy," or whatever term he used. I was a great admirer of Kennedy's. My views on Kennedy developed from knowing him and working with him, and I think had he lived, [he] would have been a great president. No one is going to disabuse me of that with some of the tinhorn criticisms I see of him in revisionist histories.

But leave that all aside. Nevertheless, I was not, how shall I say, committed in the way that some of the long-time Kennedy people were; committed in such a way that I was committed to the man and not the office, and that I couldn't transfer my loyalty, as it were, to the job and to the President, to Lyndon Johnson. So we got along just famously as I view it, and I think as he views it. As I've noted he didn't like my revenue-sharing plan, and that's another chapter. But that was all within the rubric of a generally very constructive interrelationship between the two of us. I found working with him an extremely rewarding experience.

M: So, why did you decide to resign?

H: First of all, let me say that I had already sent my family home to Minnesota before the assassination. In other words, my family were back here in Minnesota, on the assumption that I was going to leave government at the end of either my third year there or sometime during my fourth year. As a matter of fact the presumption was, although I must say it was a very reluctant one on my part, that I would leave after my third [year], after the January, 1964 annual report. I hadn't had the guts, I guess, to say anything to Kennedy or Sorensen, about this, but that was our family agreement. I had originally, when I went to Washington, committed myself to my family to stay only three years. Kennedy assumed unless you told him differently that you were staying four years. We had promised our second son--our first son was already in college--and our daughter that they could finish high school out here in Minnesota. So Mrs. Heller, preparatory to my coming back sometime within the following year, had already transplanted herself back to Minnesota that fall. And so I was in that sense on a commuting basis. I'd gone into an apartment from the house we had rented over in Virginia. Ted Sorensen said to me, "Kennedy would never have let you go." Well, I was flattered that that was Mr. Johnson's disposition too.

Second, I felt that if I wanted to maintain essentially an academic career I ought to go back after--frankly, in my opinion it was after four years; in my family's opinion it was after three years. It was an unresolved question at the time of the assassination. I had been enjoying every minute of it. The first year had its bumps--I'm talking now about Kennedy--but after that it was just a superb experience in which I felt I was using my highest potential. In that sense I wanted to stay for a considerable period of time. But I did not want to become a long-term government honcho, if you will. I felt that four years was about as long as you could stay without giving too many hostages to the political environment. If you wanted to go back to academic life and be an academician, four years was kind of the outside limit.

Third was a financial problem and fourth was Mrs. Heller's health.

Tape 3 of 3

H: Now what I'm going to do in a moment is to not exactly read from, but use the notes I made on May 18, 1964 concerning my meeting with the President in late March or early April, concerning the fact that I would have to leave. I was saying at the end of the last tape that I had had this conviction that I really ought to go back to academic life within four years if I wanted to remain an academician. I didn't think that was a reason that President Johnson would understand very well. It's one that President Kennedy did understand better. It's the sort of reason that Jim Tobin used after a year and a half. I recall Kennedy's looking at him and saying, "You mean to tell me that you find educating those callow youths up at Yale more intriguing that sitting here in the White House?" Jim stuck by his guns, said, "Yes."

But I had the additional problem that Mrs. Heller had lupus erythematosus, which is a disease most people don't know about. But it's a collagen or connective-tissue disease that's related to the rheumatoid arthritic diseases, and she had been in the hospital a couple of times with it. She was taking cortisone, and still is. She takes cortisone every other day. This was a real problem which the President hadn't understood.

Then there was also a financial problem. I had been going in the hole about five thousand dollars a year when I was in Washington. We had our home out here rented out for a pittance, and we had to rent a very expensive home down there. People like to think it's entertainment expenses, but we never had much time for entertainment. So it wasn't entertainment expenses; it was sheer living expenses.

Thereby, by the way, hangs another tale having to do with the way the President used my departure as one of his levers in getting the executive pay increase. If you want to make a little note about that we'll talk about it later. A situation that wasn't entirely comfortable for me, I might add, but it's kind of humorous. But the humor was at my expense.

So there were a lot of pressures. In talking to the President, by the way, I didn't invoke my "4-F syndrome." This is something that I invented for Kermit Gordon when he was once about to leave Kennedy, and then used it in another context. I said, "Kermit was suffering the "4-F syndrome!" Kennedy asked me, "What was that?" And I said, "Family, finance, fatigue and frustration." But I wouldn't mention that to LBJ because he wouldn't have any patience with the fatigue aspect, and I couldn't honestly claim frustration in the Johnson days. Well, finally, I decided I just had to face this issue with LBJ. It was a tough one because I did not want him to think that I was deserting the ship. I did not want him to think that I had a "Kennedy syndrome" which was causing me to leave Johnson, because that was not in any way, shape, or manner the case.

So it was a tough one. And also, he didn't know the other members of the council [well] at all. He knew me. I, after all, as I think we talked about before, was the first professional economist that he'd ever worked with close up. To this day, by the way in that connection, Eliot Janeway still thinks that Walter Heller alienated Lyndon Johnson from him.

M: You mentioned this before.

H: It's the most ridiculous thing. So I finally screwed up my courage when I was told by Al Otten that he was going to have an item in the Wall Street Journal, I think it was Friday, April 10, and that Bart Rowen was going to have an item in the following week's Newsweek about the fact that Heller wanted to leave. Now, how they got it is a mystery to me, but anyway they got that impression. I told Jack Valenti and Bill Moyers that I really had to see him before any stories like this began to appear. So I came over on a gorgeous day in early April, as I remember.

When I came into his office he knew perfectly well what I was coming for. He said, "Well, Walter, isn't it a gorgeous day. What can I do for you this beautiful day?" and so on, just making it as tough for me as he possibly could, and obviously, I'm sure, having some fun doing so. He said, "Come on out on the veranda and let's talk." I said, "Well, I've been going through a pretty agonizing period of decision-making." I wanted to talk to him about it. He said, "Well, let's walk around the oval drive." And as I say, it may have been the first one because it was very early spring. But anyway, you remember those walks around the oval drive there got to be pretty frequent and famous later on.

Well, for the first turn around the oval I told the President about the family problems, and the health problems and the financial factors involved, and he listened very closely. He only broke in once. This is very interesting. When I noted that my family was already permanently relocated in Minnesota, he said, "If I'd known that, I wouldn't have complained about your being out in Minnesota on weekends." He used to kid me about it. He hadn't really understood that partly for health reasons and partly for education reasons Mrs. Heller and the youngsters were out here. And when I was through he just said, "Walter, you can't go. I'm your commander-in-chief, and if you go I'll have you inducted into the army and order you to stay here!" Then he quickly coupled that with an entirely voluntary proposal, that he would make it easier for me to get out to Minnesota on weekends, in the light of my wife's ill health and so on, and I should take off the whole month of June, give him four-day weeks. He was nice enough to say that I got more done in four days than most people did in seven anyway. But by all means, stay until November. He wanted me in telephone earshot, so to speak, at all times. So he was responsive, you see, to my circumstances.

He then went on to say how important and essential the council's work was. A couple of days later he said, "Frankly, the material you provide me from your little office"--and I use a direct quote--"is more useful than the material I get from all the cabinet officers put together, except McNamara." And a couple of years later, when I saw him in the White House, about three years later, he told me the same thing about Gardner Ackley. A year after that when Hubert and I were in to see him one morning, and I was staying at the White House, he said in just absolutely unequivocal terms--and I know that Art Okun had a somewhat bad patch with him at the beginning about some briefings at the White House before he got quite the hang of it--"Art Okun and his fellows over there are turning out more good stuff than any other agency in government, bar none. Not even my own White House staff can match the contributions they are making."

So this says a good deal about these continuing good relationships with the council, and their relationships with him. Then I thought it was very interesting that the President in talking to me about this noted that he often thought of leaving the presidency and its heavy burden, and said it very eloquently. And then said, of course, one had to serve one's country in the highest capacity one could. Then he went on to stress how heavily he leaned on my advice. He cited various situations, we were walking about the oval now three or four times, in which he had in effect to choose between the course, at least the emphasis of Martin and Dillon on one hand and Heller on the other, and hadn't he always gone my way?

M: You must be feeling worse and worse by this time!

H: Oh boy, he did not make it easy! He also went into the philosophy of the tax cut. I mentioned this earlier, and here I want to read directly from my notes: "He noted that while he didn't initially buy that philosophy, he was rather old-fashioned in these matters, and didn't see quite how one could expect that much stimulus without dangers developing from the deficit, nevertheless he drove it through Congress anyway on faith arising largely out of my thinking on the matter. He was becoming convinced that it was going to work. And then somewhere he indicated that I had promised him a balanced budget out of it and full employment. If the tax cut didn't deliver that he said he was going to come out to Minnesota and get me." And so on. Somewhere in the midst of the conversation he said, "I just can't let you resign. I won't accept your resignation. You've got to stay until November." Well, we worked out what was a quite reasonable accommodation, and I stayed until November. I was very glad I did. Now, do you want to talk a little about the succession to Gardner Ackley?

M: Yes. Do you want to put it on this?

H: I said that one of the other conditions that I had to satisfy in the course of that day's conversation, you remember now it was in April of 1964, was that Gardner Ackley would have to know his fate. He had been on leave from Michigan for three years, including two at the council, and was scheduled to go back after the summer of 1964, that is, for the opening of the fall term. We'd have to make a commitment then and there to Gardner to take over the chairmanship of the council when I left, if we were going to be able to have a basis for his extending his leave from the University of Michigan.

Well, he said he was favorably disposed towards this but didn't know Gardner very well, wanted me to bring Gardner over and talk it over with him, size him up and so forth and so on, and wanted to be sure that they hit it off well personally. Then six days later Gardner and I did get in to see the President. I recall he'd just had a news conference; he looked tired. But after a bit of give and take, he said to Gardner, "Walter Heller says you're the man I want, and the material you have been producing in the council is superb." In other words, he popped the question then and there, and it was settled. He said if he were re-elected in November he wanted Gardner to serve as chairman. Then I note at the end of my little memo on this, "As far as I was concerned that did it." I made my commitments to stay, and a few days later at the Chamber of Commerce speech and later in the Rose Garden the whole world learned of my financial and personal plight.

Let me just give you a quick footnote on that. We had been running about $5,000 a year in the red. When I say "we," I mean most of the presidential appointees, in that approximately $20,000 a year bracket--that's all the council paid, $20,500 to the chairman and $20,000 each to the members. When we compared notes with people like Carl Rowan, or whoever was in it, we all found that we were having to borrow about $5,000 a year. I told the President about this in the course of our walk around the Rose Garden. I said, "Mr. President, I have gone $16,000 in the hole in my three years here." And he said, "Well, I've just never heard of a better argument for this executive pay increase," in which the council chairman's pay, by the way, went up to $30,000. He got it on July 1, so I enjoyed it for three or four months anyway.

He was speaking to the Chamber of Commerce, I think the next day, but within a very short memory span. You never told anything to LBJ without running the risk that the world would soon know about it, and so in talking to the Chamber of Commerce he departed from his script in which he is making a plea for an executive pay increase and said, "I have some specific examples." He said, "I have one man in my administration, one of my most valued advisers, and on the salary we now pay him he has had to run $16,000 into personal debt while he's here." He made quite a thing of it. So later that afternoon in the Rose Garden the reporters naturally asked him, "Who is this fellow that's run $16,000 into debt." He said, "It's my economic adviser!"

You can imagine the fun that the press had with that. The letters I got, you know, "Deficit financing has caught up with you at last." I really got a lot of letters on that from people who were obviously delighted that the economic adviser was going $16,000 into debt. And I've sometimes said I concluded that you should never tell people your troubles: half of them could care less, and the other half think it serves you right! But LBJ did use my case as a lever, and he gathered some other cases, and he did get the executive pay increase out of Congress.

M: Well, now we've come to the place where we have to tie up any loose strings. Are there other things involved in your relationship with LBJ that I need to ask you about that I haven't? Anything else that you want to say? For example, this argument about revenue sharing.

H: Well, the revenue-sharing thing is really--yes, I think this is not a loose end. I think this is very important actually, and I will try to run through it just as quickly as I can because I have a very vivid memory of this whole thing. In April of 1964, I wrote the President two memos. One said, in effect, "It seems to me we have the prospect now for the first time of some revenues, I won't say that we don't know what to do with, but some revenues available for other purposes if the tax cut works as we think"--now this was pretty presumptuous in April, being so sure that the tax cut would work, but it, thank heaven, was right.

We were turning to other initiatives, and I argued pretty much as follows: "It seems to me now that the tax cut, the federal tax cut, has been enacted the fiscal problem that most bears in on people's pocketbooks and mentalities and brings about the most woes is the state and local fiscal problem. And we ought to find some new way of sharing some of the federal riches with the poorer state and local governments. One way we could do this is simply to set aside a share of the federal income tax for state and local governments in some new way that does not involve all the strings that are attached to grants-in-aid. Something that would preserve their independence, promote their independence and vitality at the same time that you give them some money." And that was all. I didn't even put it at that length in a memo.

I said, "Are you interested in this?" And he said, "Yes, tell me more." I said, "Well, it seems to me that it's worth having a task force." At the same time I also proposed in the second memo that we have a task force on how one could use, from there on out, the fiscal system more positively. I had in mind standby tax powers and so forth, which we'd persuaded Kennedy on some time before but had not persuaded Johnson on. The Congress could care less, and by that I mean they didn't respond at all. I said, "We ought to have an investigation of how to use the fiscal system for a more successful stabilization of the economy now that we have accepted the modern economics of fiscal politics." And so he was interested in that too. He checked both of them as "go ahead."

Then when Kermit Gordon got copies of these memos, he said, "Walter, I have a whole series of subjects on which I'd like task forces." We went over together and saw Johnson. The dating would have to come from someone else, I don't remember precisely whether this was late April or early May. And Kermit said, "Mr. President, I've got eleven more that I want on the same basis as Walter's idea. You seem to have accepted the concept." And that's where the task forces were born. We went to see LBJ in the morning, late morning; we didn't know whether he was responding favorably or not. Bill Moyers came into the White House Staff Mess a half hour or an hour later and said, "Fellows, you've really started something. The President wants me to set up a batch of task forces." That was the beginning of the LBJ task forces. This, if Kermit hasn't recorded it, would be corroborated by him.

Now on the revenue sharing itself. I then had an interview with U.S. News and talked about the "fiscal dividend," the fact that we would have some extra revenue and that we ought to use it as required for expenditure increase, for further tax cuts perhaps, although the tax cut need had been met, and perhaps for some sharing the revenue with states in some new way. And about this point, Goldwater was coming along with the proposition that we supplant the grant-in-aid system by a revenue-sharing system. It was a totally different proposal. He wanted to share the revenue with the states by origin;

the rich states getting the rich return, and the poor states getting the poor return. Where it was collected, it would go back to. If you want to differentiate, some people have called that tax sharing, whereas the per capita sort of thing is revenue sharing. My approach was to distribute it on a per capita basis with few strings attached.

Then the President did set up the task force. Joe Pechman of Brookings was head of the task force that developed the system. A number of elements that I had not put into it, they did, and that's why it's called the Heller-Pechman Plan. The President seemed to like it. Everything was going along just fine. Indeed, just before the election we were getting out a series of economic policy statements. The President left no stone unturned in pointing out how well we were doing in economic policy. In one of the statements, we said that, as to relationships with the states, "we ought to develop a new method of sharing revenues with the states in a way that would not only support the state treasuries but promote their independence." We had revenue sharing in mind. Now shortly before the election I decided that this issue was so sensitive, and that the President had seen so little of that task force report he was sitting on--of the actual chapter and verse--in the pressure of the campaign, that I had better clear this with him.

So I said to Walter Jenkins, "Walter, I would like to see the President about this." "Well," he said, "he's seeing a number of people tonight. Why don't you stick around, and I'll plan to get you in." And it's now 9:00 p.m.; it's 9:30 p.m., and I finally said to my secretary, "Doris, we'd better do a memo to the President." So I set up a memo saying that I felt I had better check my understanding about revenue sharing with him. Referring to the campaign statement, I noted that it pretty clearly implied that we should have some sort of a revenue-sharing system with such and such characteristics. I kept my memo to one page, and then I had below the customary "approve, disapprove, tell me more."

I didn't hear from Walter Jenkins, and finally at 1:15 a.m. I called his office, ready to go home, and he answered just as if it were 1:15 p.m. This was typical of the Johnson Administration. Neither one of us said anything about it being 1:15 a.m. instead of p.m., and I said, "Walter, what happened tonight?" "Well," he said, "The President was tired and kind of grumpy, and he didn't want to see anybody except me. I simply took up all these questions with him." I said, "Walter, did you take up the revenue-sharing issue with him, and did you point out specifically what I said there? Because that's a pretty firm commitment." He said, "Yes, I did, and the President said, 'Okay, go ahead.'"

Now I will never know anything more about this because the next day was when Walter Jenkins was apprehended. I never had a chance to talk to him about it again in context, no chance. But I tore up the memo to LBJ, thinking I had a clear-cut answer. I was mighty sorry about that later on from the standpoint of the record and from the standpoint of Lyndon Johnson's understanding of why I went on to do what I did. Had I gone ahead to send the memo, the

President then would have had either a chance to stop me from going any further with this or he would have endorsed it in writing, and it would have been on the record. I had been told that he had orally endorsed it.

Well, this was in the context of doing everything possible that we could to get across the difference in Lyndon Johnson's approach from Goldwater's approach. And Goldwater had this reactionary proposal to eliminate or reduce drastically the grant-in-aid system and, as I said, to follow a path of "to him who hath shall be given," by returning money to the rich states, et cetera, et cetera, on an origin basis. I thought that I had pretty clear signals from the President to move ahead. We got a relayed message when he was up in Air Force One out over the West Coast one time. "This is the time we ought to do everything we can to show the superiority of the Johnson over the Goldwater policies."

So I had an off-the-record session with Ed Dale of the New York Times about the revenue-sharing plan because I thought I had pretty specific authorization to do this. Ed said, "I've been getting some inklings of this from the task force. I've got a pretty good idea what it's all about, but I've got to talk with you before I do my story." I said, "Okay, Ed, here are the ground rules. Obviously, you don't divulge the source; and secondly, you do not in any way suggest that the President has signed on to the specifics of this plan. He hasn't even seen them!" I was double-crossed. Headline story righthand column New York Times, front page the next day something like "It has been learned that President Johnson has signed on to the following revenue-sharing plan, A, B, C."

I can only say: then the you-know-what struck the fan! It was pretty bad. Meany called LBJ, Wirtz called. Labor has been dead set against this from the beginning for reasons that one can only guess at. I mean the real reasons, regardless of what they said.

The President was really sore. He felt it had been botched. He once used it as an example to a group of correspondents how not to get a policy adopted. Now what were his real reasons for opposing it? He said it was the way it was botched, the way it was mishandled. Who knows? I think that he felt he had so many things to do at the federal level and the Great Society, et cetera, that as he thought about this he wasn't about to hand it out to the governors and let them get the political credit for the expenditures that he so desperately needed to make at the federal level. That is my somewhat self-serving psychoanalysis of Lyndon Johnson on this subject. But he never let me forget--either through third parties and occasionally in mild reproof personally--that I had mishandled the matter. I wrote him a couple of memos about the issue after I left, but that's a point on which he and I never agreed.

Well, as far as revenue sharing is concerned, that's the story of my relationships with Lyndon Johnson.

M: Okay. Now, are there other matters we ought to touch on?

H: Well, someday I might want to make available the more detailed stories of the appointments. The reappointment of Robertson to the Federal

Reserve Board and the appointment of Brimmer, because they are kind of fascinating sidelights on the President. But I'm not prepared to do that now.

M: Do you want to make any comment about the standby tax powers?

H: Well we wrote a fairly strong standby tax power paragraph into the January, 1964 economic report, but President Johnson had us water it down to next to nothing.

M: He was never sold on that?

H: Never sold on that until he left office. You remember he had a very strong recommendation for that. Oh yes, the last year, finally, he thoroughly endorsed it.

M: All right, is there anything else we should touch on, or any one final comment that you wish to make?

H: As I said on an earlier tape, Johnson was an extremely responsive student of economic policy. He wasn't as interested in the penetrating envelopment of the subjects that Kennedy was, and I'm not sure that a president has to have that. Did we talk about this before? We probably did.

M: You made some comments about Kennedy versus Johnson on this.

H: He followed economic events very closely, and I never had the feeling that on any fundamental economic policy matter that he wasn't getting it. He got it. Of course, he also liked the style, as you have probably heard, the way in which we put it across. Bill Moyers at first felt that we were a little wordy. Then I developed this very staccato style, and the President held up one of my memos to the cabinet and said, "This is the way I want it done." I always figured that was the way to lose friends and alienate people. But he'd say, "I get these long, unbroken paragraphs from the Treasury, and I fall asleep over the damn things." He said, "That stuff that you send over here, it's short, to the point, and you've got generals and majors and privates." You know, we put it in outline form and underscored. You know those memos. And Ackley and Okun followed and perfected the art.

Oh, I'm sure there were just lots of other things. We haven't touched on the international situation, not that there was all that much during my period. What I should do is go over the notes that I was able to write from time to time, not so often during the last year when I was at work with the President, because I was literally working an eighty to ninety hour week, and I seldom had a chance to dictate notes. But I had enough contacts with him afterwards when I was serving as a consultant to the Executive Office, unpaid, but very proud to have the relationship. Some of the notes that I wrote in those days are still very rough. But I think there are some things there that might be of interest to the history project.

M: Let me call this interview to an end then. Thank you.

H: Good. Thank you.

[End of Tape 3 of 3 and Interview II]

OPTIONAL FORM NO. 10

White copy

UNITED STATES GOVERNMENT

Memorandum

TO : Messrs. Tobin and Gordon

DATE: February 20, 1961

FROM : Walter W. Heller

SUBJECT: Eventual Memo to the President on Tax Cuts

It seems to me that somewhere along the line, possibly using our consultants meeting as a peg on which to hang it, possibly waiting until we are closer to the April deadline date, we need to do a brief but outspoken memo on the tax cut issue. The basic theme would be why you "can't go wrong," economically, with a tax cut, with an implicit or explicit pointed question: "Is good economics bad politics?"

The pieces I would have in mind in this story might be along the following lines:

1. A sharp demonstration of our economic slack, showing how far below our potential we are now as compared with the trough of the 1958 recession (and putting it in the perspective of the weakness of the 1960 peak against the strength of the 1957 peak).

2. Emphasis on our high powered tax system--both the absolute power of the system, which completely rules out \$12 to \$13 billion deficits, and the growing relative power of our tax system in the light of budgetary and economic developments--in other words, showing that we won't get enough of a deficit without a tax cut. Much of this story, possibly without the conclusion, should also be told for our hearings.

3. Reference to the constraints on monetary policy, both (a) intrinsically, because of the balance of payments situation and (b) institutionally, because of the reluctance and caution of the monetary authorities.

4. Mention of the constraints on spending, both political (Congressional unwillingness) and institutional (Congressional and administrative slowness).

5. The sizable feedback of revenues from a tax-cut-stimulated economy or "you <u>can</u> take it with you."

6. Emphasis on the difference it will make in unemployment, together with some assurance on other factors that will pick up the tempo when the cut ends. On the unemployment percentage, the President was unfavorably impressed with the small difference between his aggressive and his moderate expenditure programs as we had it factored out on the early set of alternative budget figures.

7. Possibly, a little excursion into the politics of the tax cut: (a) is it really true that Congress won't go along with it; and if they don't, doesn't it have some advantage in pinning the blame? (b) emphasis on the fact that the Kennedy program took care of the neediest first—the unemployed, the aged, widows, etc.—and now the tax cut is politically more palatable in terms of the "naive bias against a tax cut;" (c) the important thing is the level of economic activity in 1962 and 1964, not the size of the deficit in the next few months.

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON

March 21, 1961

MEMORANDUM FOR THE PRESIDENT

From : Walter W. Heller

Subject: Retroactive Income Tax Cut for 1960

Some of the political objections to future income tax cut on 1961-62 income might be overcome by applying a retroactive income tax cut to 1960. Such a cut also has certain economic advantages. The idea would be to give 1960 taxpayers a once-and-for-all rebate on their 1960 income tax before July 1.

It would have the following advantage over a cut applying to the 1961-62 income:

1. There would be no danger of it becoming permanent since it is a one-shot affair.

2. It could and should be paid out before July 1, thereby worsening the fiscal 1961 deficit, but not touching the 1962 deficit.

3. With no inroads on the flow of future revenues, this kind of a tax cut would be much less of a club against your expenditure programs.

4. The stimulus would be concentrated now, when we are still at or near the bottom of the recession, and most obviously need a shot in the arm.

5. The rebate form of tax cut would strike many people as being more equitable than a reduction of tax on current incomes--it would be paid to those who earned income last year and are now unemployed, as well as to those who have been fortunate enough to hold on to their jobs.

How would such a tax cut look? The Administration would ask Congress to grant a retroactive reduction on individual income taxes paid on incomes received during calendar year 1960. At this stage, the important specifications of such a rebate seem to be: (a) that it should be large--say of the order of $3 or $4 billion; (b) that it be concentrated as much as possible in the lower and middle income classes, where it is most likely to be spent; and (c) that it should be paid out promptly, certainly no later than June 30 of this year.

In rough terms, a $4 billion tax rebate on 1950 income would be of the order of 20 percent of last year's tax liability up to a maximum of $50 for single persons and $100 for married couples.

Secy Douglas Dillon - 6/6/62

Budget-1c-1 June 62 V-71

The Current Economic Situation and Proposals to Meet It.

1. The economy is still moving forward. Based on past experience and a review of all information available to date, it can be expected to continue to advance throughout this year and into 1963, provided there are no further shocks to confidence such as the May 28 fall of the stock market. There is no doubt that the stock market panic temporarily reduced general business confidence. Our objective should be to restore business confidence as promptly and as effectively as possible. This requires a calm and confident attitude on the part of the government, as well as an indication that government is prepared to act as and when necessary, but no more than necessary.

It is also clear that our recovery is not as strong as we would like to see it. In all probability unemployment next December will still be between 5 and 5-1/2%. It is even possible that it could go slightly above 5-1/2%. If the economy is to continue to move ahead some further stimulus will be needed in 1963.

2. With these thoughts in mind the following actions would seem to be called for:

(a) The President could confirm at his next press conference the fact that the administration contemplates an overall restructuring of the income tax next year which will involve a top to bottom reduction in individual income tax rates, and which will also deal with the corporate income tax. It would be helpful if he could state that any reductions should take effect as of next January 1.

Thought might also be given to the President's announcing that next year's reform should include some overall net reduction in taxes. The advisability of such a statement at this time is not clear since our proposals are not yet far enough advanced for decision. It would be unfortunate to be pushed prematurely either into giving any figures as to the amount of net reduction in tax take or into discussion of the offsetting proposals to broaden the base of the tax structure.

(b) After the general outlines of next year's tax reform have been agreed, which will probably be some time around the middle of August, the President should submit it to Congress. It would be advisable not to submit the new proposals until the current tax bill has been enacted. This should not involve any considerable delay in view of the above schedule.

The transmission to Congress by the President of the general outline of next year's tax program will in and of itself provide a substantial stimulus both to business and to the attitude of consumers in general.

(c) The Treasury will soon be ready to promulgate the new administrative reform of depreciation, hopefully by the end of this month, and in any event by the middle of July. A major effort should be made to accompany the technical announcement with a simple, easily understood description that will make a real impact on business throughout the country.

(d) It would be useful if the President could hold a series of 5 or 6 luncheon meetings over the course of the next two months with business leaders. There should not be more than 10 or 12 businessmen at each luncheon. The business guests should be given the opportunity of raising matters that interest them.

(e) We should attempt to persuade the Federal Reserve Board to reduce margin requirements to 50% as soon as the market has quieted down and volume has dropped back to normal.

(f) Another special dividend on veterans' life insurance policies should be announced in routine fashion for payment in July.

(g) We should exert whatever pressure we can to ensure and expedite passage of the investment credit and the accompanying provisions which break important ground in restructuring our tax system on an equitable basis.

3. Actions such as these should serve to restore business confidence without giving the appearance of undue concern or hasty action. This is highly important, not only for domestic but also for foreign reasons in connection with our balance of payments. There would be widespread acceptance abroad of a carefully-thought out program of tax reform involving reductions in income tax rates even though it included a loss of revenue and a substantial budget deficit, provided it was understood that this was geared to an effort to improve the overall state of the economy. Contrarywise, any indication of over-hasty action or undue concern at this time would only serve to increase foreign doubts as to the course of the American economy and could well lead to very dangerous reactions on our balance of payments. The same would be true if an impression was allowed to grow that the government was in the process of losing control over expenditures.

A temporary income tax reduction, personal or corporate, or a withdrawal of insistence on the renewal of war-time excises and corporate rates, or a publicly avowed new or increased expenditure program, or a postponement of the postal rate increase, or agreement to a federal pay raise bill departing substantially from the President's pay reform proposal, would constitute danger signals of a loss of control, discipline or nerve that might have a counterproductive effect on confidence in the economy at home and the dollar abroad.

CDDillon/db
June 6, 1962.

V-10

July 13, 1962

MEMORANDUM FOR THE PRESIDENT

Subject: The Economics of 1962 Tax Reduction

This memorandum summarizes a longer document which has been circulated to those who will participate in the July 13 meeting on the economic outlook and tax policy. It deals with the tax reduction question -- economic impact, associated expenditure policy, size of tax cut, form of tax cut, relation to other revenue legislation, and considerations of timing and phasing.

Economic impact -- Reduction in the personal income tax could add speedily and significantly to consumer purchasing power, and past experience tells us that increases in purchasing power are translated promptly and rather reliably into higher consumption spending. As the added disposable incomes due to tax cuts are spent and respent, they boost production and employment by a multiple of the original cut. More consumer buying helps to create the added profit incentives and the sales-pressures to stimulate investment in inventories and in expansion of plant and equipment.

Although personal tax cuts are the primary instrument for quick stimulus, corporate tax cuts can also play an important role. Evaluated on purely economic grounds, a dollar of corporate tax reduction probably generates less income and employment under present conditions than a dollar of personal tax reduction. Yet a corporate tax cut would raise yields on new investment projects, and would help generate broader political support for tax reduction, especially from the business community. To have a meaningful effect on confidence and on plans for future investment, corporate rate reduction probably has to be regarded by businessmen as permanent. At the present time, while temporary tax cuts make sense for individuals, they do not seem appropriate for corporations, which have a long planning horizon.

The returns in added GNP from a tax reduction would be influenced by psychological reactions. Would a tax cut proposal boomerang by frightening the public? On balance, this seems unlikely: Many people are fully aware that the economy has not been performing well, and while the tax cut proposal might initially accentuate some persons' fears, the reassuring effects of decisive policy action and the tax benefits themselves would lead on balance to a net favorable impact. The chief danger to confidence lies in the likelihood of continued headlines reporting bad economic news.

Expenditure policy -- Questions of expenditure policy arise along with consideration of tax reduction. An acceleration in Federal expenditures could add to the stimulus of a tax cut, but there may be political and psychological disadvantages to visible increases in expenditures. Moreover, opportunities for expenditure acceleration today appear to be fairly limited.

Business advocates of a tax cut are urging a simultaneous cutback in Federal spending. It is hard to find realistic economic merit in this proposal. A symbolic small reduction of expenditures would give credence to the cliché that government programs are unproductive and inefficiently managed. A significant cutback would both dilute the stimulative effect of a tax cut and impair needed public services. (But as is clear from the strongly favorable business reactions to the recent "McNamara economies", it would seem desirable to respond to this insistent theme in business thinking by extending the DoD program and announcements to other agencies.)

Size -- The total tax reduction should be big enough to create a significant stimulus to demand and should come soon enough to avert a recession. A tax reduction that may be big enough to prevent a decline might be too small to reverse one, if it comes too late. A tax reduction that is too little and too late would run the risk of discrediting fiscal policy for years to come.

(The necessary and desirable size of the tax cut depends on the environment created by other government policies, such as (i) whether or not action is taken to postpone the scheduled increase in social security payroll taxes amounting to nearly $2 billion effective January 1, 1963; (ii) the degree of ease or tightness in monetary policy; and (iii) the extent to which Federal expenditures are accelerated or increased.)

To or under

A prompt and powerful stimulus can drive output up against capacity limitations and release the added expansionary force of private investment demand. The tax reduction needed now to meet these requirements is considerably larger than the $3 billion of permanent net tax reduction now projected for next year's tax reform program. Most of the proposals set forth in recent weeks advocate a reduction of $8 to $10 billion. A smaller program would run serious risks of being inadequate.

The Budget Bureau has estimated the budgetary impact of a $9 billion tax cut program taking effect on October 1, 1962. Allowing for economic "feedback," it would increase the 1963 deficit by an estimated $3-1/2 to $4 billion. If it succeeded in heading off a decline in economic activity, the immediate cut could pay for itself in higher revenues for fiscal 1964.

Form -- Tax cuts should take a form which will be economically effective while causing the least controversy and delay in enactment. A simple across-the-board reduction in all personal tax rates -- a 3 to 5 percentage-point cut in all brackets -- probably best meets these requirements. This form has already been endorsed in the standby tax proposal. It is the approach least likely to touch off long debate on equity and tax structure.

From the standpoint of immediate economic impact, dollars of corporate tax reduction are probably less effective than personal tax reductions. But support for a tax-reduction bill would undoubtedly be broadened if a cut in corporate tax rates were made part of the legislative package. A 3-point cut, from a 52 percent to a 49 percent corporate tax rate, would have the psychological merit of making the government a junior rather than senior partner in business earnings. A 4-point cut, matched against a 4 percentage-point personal-tax reduction, would also be economically tolerable. (One must remember that, point for point, a corporate tax drop costs only $1/2 billion as against $2 billion for an individual tax cut.)

Other revenue legislation -- Any proposal for tax reduction in 1962 creates problems of coordination with other major pieces of tax legislation. A proposal for immediate tax reduction should be formulated and presented in the way best calculated to give the 1962 Revenue Act maximum support. Similarly, the announcement and timing of a tax cut proposal should be geared to the plans for tax reform in 1963, so far as this is possible. But rate reduction as part of the tax reform, even if retroactive to January 1, 1963, is no substitute for immediate action. Past experience suggests that reform legislation is unlikely to be enacted before the summer or fall of 1963, too late for economic stimulus to have its optimal effect.

Timing -- If a prompt tax cut is made effective in 1962, determination of the length of time for which the cut is to be effective must take account of transition to the rate structure planned in the tax reform program now being developed.

We assume (i) that a temporary tax cut could be made to take effect by October 1, 1962, and (ii) that major parts of the 1963 tax reform program cannot be made effective before January 1, 1964.

Of the many timing alternatives for a personal income tax cut taking effect later in 1962, we have identified four for consideration:

1. Rates reduced for 9 months -- October 1, 1962 - June 30, 1963. Present rates then to take effect automatically until January 1, 1964, when tax reform measure would take effect. This possibility seems to us unacceptable on a number of grounds. Most importantly, it would result in first a cut, then a rise and finally another cut in rates -- an undesirable jumping around of taxes.

2. Rates reduced for 9 months -- October 1, 1962 - June 30, 1963. Rates embodied in the tax reform legislation (as opposed to base-restoring) to take effect as of July 1, 1963. Since it seems highly unlikely that Congress will have completed action on the tax reform proposals by June 30, this would mean the new rates would be effective retroactively from the date of enactment to July 1, 1963. Stop-gap legislation would be needed during this interim, and then would be superseded by the permanent reform law. This procedure would be complicated administratively and in the public mind.

3. Rates reduced for fifteen months -- October 1, 1962 to December 31, 1963. Tax reform measures to take effect January 1, 1964. This alternative makes economic sense if continued stimulus is needed throughout 1963. Its appeal is that it would call for only one change in tax rates and structure and it is clear-cut and simple. Furthermore, it would eliminate the need for the President to ask the Congress to consider the tax rate issue during the next session except in the context of the major reform measure.

4. Rates reduced for nine months -- October 1, 1962 - June 30, 1963, with the intention that next spring the President would recommend rates which seemed called for by the level of economic activity at that time, such rates to be effective from July 1, 1963 until the permanent reform legislation would come into effect, presumably on January 1, 1964. The economic situation next year may call for an extension of the temporary cut, higher rates, or perhaps even lower rates. In a sense, this approach is similar to that of the standby tax-cutting authority requested this year.

It seems to us that both alternatives (1) and (2) must be eliminated for the reasons indicated. A case can be made for either (3) or (4).

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON 25, D. C.

June 16, 1962

MEMORANDUM FOR THE PRESIDENT

Subject: The Strategy of Tax Reduction and Tax Reform

This memorandum [illegible] main issue still before us in regard to taxes: Should cuts in [illegible] tax rates for corporations and individuals be enacted at the current session of Congress? The answer will depend on an assessment of the economic situation as it develops, and also on an appraisal of the prospects for obtaining tax reform legislation next year if some of the rate reductions involved are enacted this year.

You have announced that the Administration will propose later this year, for action by the Congress next year, a program of tax reform. You have made clear that this program will involve net tax reduction and that at least a part of the rate reductions will be effective January 1, 1963. Further rate revisions and other reforms --closing loopholes and broadening the tax base--would presumably take effect January 1, 1964.

This announcement does not, of course, preclude a decision later this summer to ask for tax rate cuts to be enacted at the current session, effective during 1962 or on January 1, 1963. Such cuts would be gauged to the needs of the economy for stimulus at the time. They would be within the limits of rate reductions envisaged in the long-range reform package so that they would not have to be reversed. They could be temporary in form, in order to retain leverage for the tax reform bill next year.

Several questions are pertinent to this decision:

1. What would we lose, for the economy, by postponing enactment of tax reduction until next year?

2. What would we lose, for the prospects of tax reform, by enacting tax cuts this year?

3. Which risk is more serious?

1. <u>What would we lose, for the economy, by postponing enactment of tax reduction until next year.</u>

1.1 The stimulus of tax reduction is needed this year, 1962. Next year may be too late. The economy may be already in recession before the tax reform is enacted. It is much harder to arrest a recession once it has begun than to keep a recovery going.

1.2 To be an effective stimulus, tax reduction must be certain and soon.

For individuals, the important thing is an actual increase in take-home pay; the promise that take-home pay will be greater next year will not increase consumer spending significantly now.

For corporations, the important thing is the certainty that the tax rate will be lower next year. The only way to convey that certainty is to enact the reduction at this session of Congress. The promise that the Administration will ask that rate reductions, when enacted by Congress in 1963, be effective as of January 1 cannot be sufficient to induce consumers and businesses to spend more money before the law is enacted.

1.3 Neither the Administration nor the taxpayers can be confident that a tax reduction-tax reform package will be enacted in 1963, or ever. As experience with the present tax bill, proposed in 1961, amply demonstrates, the Administration proposes and Congress disposes. The new bill will be more palatable than the present one since it will embody net tax reduction. But the loophole closing and base broadening provisions will induce loud screams and strong pressures from interests that stand to lose. Those interested in a comprehensive tax reform will be even more numerous and ubiquitous than the opponents of items in the limited bill now before the Congress. Indeed the reform part of the package will scarcely be worthwhile if it does not step on many toes. The controversy and negotiation which results can delay enactment until late in the 1963 session or until 1964 or later.

1.4 Neither the Administration nor the taxpayers can be confident that tax reductions will be retroactive to January 1, 1963. Debate on the investment credit has revealed strong Congressional opposition to retroactive reduction of corporate taxes. As the eve of enactment of a new bill approaches, Congress will be reluctant to give away revenues that have already been collected. The longer Congress deliberates, the more unlikely it is that the rate reductions will be retroactive to January 1, 1963.

2. What would we lose, for the prospects of tax reform, by enacting tax cuts this year?

2.1 Tying all tax reduction to tax reform may increase the Administation's leverage for obtaining tax reform. But it would do so only if the President is prepared to veto a tax cut bill which does not embody the reforms he wants. It is now clear to all that the Administration is prepared to accept net tax reduction for calendar 1963. Once the proposals are presented, it will be clear how much. Then if the going gets rough on loopholes and base broadening, Congress will be sorely tempted to present the President with a simpler bill reducing revenues by the accepted amount through rate reductions with little or no reform. The President will then have to choose between this offer and rejecting all tax legislation at a time when the economy needs a tax cut.

2.2 Some observers of the Congressional tax scene believe that the prospects for tax reform are better in a balanced package of rate reductions and loophole closings than in a package involving net revenue loss. The reasoning is that the discipline of keeping the package balanced will force Congress to adopt the loophole-closing proposals in order to be able to vote attractive rate reductions, including those for the highest brackets. Without this discipline, Congress will be able to vote rate reductions without closing loopholes. This argument concludes that the prospects of tax reform would actually be enhanced by enacting tax reductions separately and in advance.

2.3 There is a high probability that, prior to the enactment of the Administration's reduction-reform package, the onset of a recession will make emergency tax reduction necessary. In that event, the tie between reduction and reform would be broken; and the leverage for reform which postponement of tax cuts is supposed to gain would be lost. (It might indeed be lost altogether. If an emergency tax cut proposal were thrown next year into the midst of Congressional consideration of the tax reform package, Congress might simply abandon altogether its work on the tax reform proposal.) Meanwhile recession would be upon us. In this event, it would clearly have been preferable to enact the tax cut in 1962 when it would have done the most good for the economy.

2.4 The Administration has asked for stand-by executive power to make temporary cuts in individual income tax rates. If Congress had granted this power, the occasion to use it would be almost certain to arise either this year or next. There is a strong argument that it has already arisen. The use of this power would leave the Administration in the same position, with respect to leverage for comprehensive tax reform, as an ad hoc temporary tax cut enacted by Congress at the request of the President.

2.5 Any arrangement under which tax reduction comes before tax reform faces the psychological and political difficulty that some taxpayers, after having their tax liabilities reduced, will have them partially restored in later years. This difficulty arises whether or not tax cuts are tied in the same legislative package with tax reforms. A similar situation would exist if the President now possessed and exercised the discretionary authority to cut taxes he has requested.

This consideration is relevant, therefore, not to the <u>time</u> at which an advance tax cut occurs but to its <u>magnitude</u>. And it should not be weighted too heavily in that connection. The number of taxpayers whose liabilities rise again will be larger the deeper the initial cut. But even if the initial cut is held to the limits of the permanently acceptable net loss of total revenues, there will be a large number of taxpayers who are in this position. The temporary tax cut needed for economic stimulus may well be larger than the permanently desirable revenue loss. This, after all, is the theory of the stand-by tax cutting authority proposed by the President; that authority could never be used if the principle that taxes may fall but never rise were accepted as overriding. If a taxpayer who is to be faced willy-nilly with a certain tax liability for 1964 were asked whether he would rather have his taxes in 1963 (and 1962) lower or higher, he would surely prefer that they be lower.

3. <u>Which risk is more serious?</u>

Full recovery is more important than tax reform. The risks to the economy from postponing tax cuts are greater than the hazards to tax reform involved in early tax reduction. If we fail to take stimulative action in time, we may be doomed to another incomplete recovery, to the persistence of unemployment rates above 5 percent, to prolonging and confirming the world's image of the U.S. economy as tired and weak. The political and economic consequences of this outcome are predictable -- extremism will grow in strength on the right and on the left, labor unions will become disenchanted and uncontrollable, a Democratic Administration will be tagged with the worst postwar record of unemployment. While closing tax loopholes and broadening the tax base represent a desirable tidying-up of an irrational system, the stake of the nation and the Administration in tax reform is small compared to their stake in economic expansion. Finally, postponement of tax cuts increases only moderately the prospects of tax reform, while seriously endangering the chances of full and sustained recovery.

The Council of Economic Advisers

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