

INTERVIEW II

DATE: October 2, 1989

INTERVIEWEE: JOHN T. CONNOR

INTERVIEWER: Michael L. Gillette

PLACE: Secretary Connor's residence, Cotuit, Massachusetts

Tape 1 of 1, Side 1

C: With respect to the tax proposal situation early in 1966, after discussions with Chairman [William McChesney, Jr.] Martin in which we agreed that because of the impending cost escalation for the Vietnam War, there should be an income tax surtax proposal, I advanced reasons for the necessity of such a proposal, as I recall it, at a cabinet meeting, but particularly in discussions with the President and his economic advisers, Gardner Ackley and some others--Charlie Schultze. Then we had a discussion of the matter at a cabinet meeting in which the President concluded by saying, in effect, "Well, Secretary Connor, if you're so smart about this why don't you go up and discuss the situation with Chairman [Wilbur] Mills? And Gardner, you seem to be going along with this idea; you go along with him. And Secretary [Henry H.] Fowler, you go along sort of to see how things go."

That very day the President arranged with Chairman Mills for us to go up and talk about it. Gardner and I gave Chairman Mills the reasons why in our opinion a tax increase

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was necessary--the sooner, the better--because it was already clear that with the rising Vietnam costs on top of everything else, we would have a budget deficit which would be quite inflationary because the costs were going to continue to escalate. And if there was a deficit, that would be highly inflationary because the economy was operating at full steam, and there was a strong capital investment program going on within industry and more than full employment, according to measures at that time. And unless some steam was taken out of the economy--and a tax increase would seem to be the best way to do it--we would be in for some real trouble ahead in the form of high inflation with labor shortages and other very discouraging aspects.

A good part of the problem, in the minds of Chairman Martin and myself, was caused by the fact that Secretary [Robert S.] McNamara, apparently acting with the authority of the President but in a secret way, had gone ahead and had taken fifteen billion dollars out of other defense appropriations, as I understand it, and was using them for an acceleration of the Vietnam War effort with the idea that the fifteen billion dollars would not be requested of Congress at that time, which was in September of 1965, but would be covered by a request for a supplemental appropriation sometime in the spring of 1966.

Chairman Martin and I felt that that deficit spending would be the trigger that would set off this inflation bomb,

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and coupled with everything else that was going on in the economy that was going at full blast, it would be highly inflationary and, therefore, there should be some measures [taken]. And the repeal of the investment credit tax could be helpful, but that would be long-term in its effect.

Of a more immediate help would be an early surtax on the income tax rates which might be considered to be in the nature of a war tax. Part of the reasoning was that in asking for it, it could very well be labeled as necessary for the conduct of the Vietnam War, with the full explanation to Congress and the public of what the plans were for accelerating the effort in Vietnam. Then as part of a later debate with the Joint Chiefs of Staff, even calling for the calling out of the National Guard and the reserves, which of course would result in a big public and congressional discussion of the aims of the Vietnam War but would result, if passed, in a full public participation in the war effort.

I particularly thought that something like this was needed because our escalation of the Vietnam War effort had been done by the President, not only surreptitiously in the early months, but also in a way that was contrary to what he had told the voters in the summer and fall of 1964 when he was running against [Barry] Goldwater for the presidency. In my opinion he had made it quite clear to the public that he would not support any acceleration of the war effort in Vietnam and certainly [would] not send American boys to do

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the fighting which should be done, as he put it, by the Asian boys. It soon became apparent in early 1965 that he really made those commitments in bad faith, or the situation had changed and he felt that he had to go back on his word, but do it silently and quietly without informing the public and Congress as to why we were doing it, what our objectives were in the war and inviting full public participation in the war effort.

This is all part of the discussion background. It was all background in the--well, it didn't come to the fore in that discussion with Chairman Mills. But Chairman Mills pointed out that as a political matter it would be impossible to get a favorable vote, even out of his Ways and Means committee, for an early tax increase at this time. With the congressional elections of 1966 looming, his committee members, including key Democrats and probably including himself, would not favor putting the facts on the table with respect to the Vietnam War expenditures and the inflationary prospects at that time, but rather would keep the whole matter under wraps and not excite the public about the whole Vietnam situation.

In any event, he gave the opinion before we left that it would be impossible to get such a bill out of his committee and certainly it would never get a favorable vote on the floor of the House if it did come out of committee. [Further], that the President would suffer politically merely

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for the request for such a measure because it would involve a full public discussion of the whole Vietnam War situation which would, in Chairman Mills' opinion, not be timely.

G: Did Mills address the question of a need for a tax increase or was it simply a matter of what was legislatively feasible and what wasn't?

C: I don't recall that he went into the substance of the situation at all. His reasoning in the discussion was purely on political grounds, that it wasn't timely.

G: How did you and Bill Martin become aware that this fifteen billion dollars was being added to the Vietnam [inaudible]?

C: That was a very interesting story. Apparently the Department of Defense budget people were not even coming clean with respect to what they were doing with the transfer of the fifteen billion dollars, and certainly Secretary McNamara was not coming clean with his cabinet colleagues on it. But within the government they have some in-house committees within committees and that sort of thing. And we had an informal cabinet committee on some of these economic matters, particularly the wage and price problems, somewhat as a subcommittee of that committee, but probably it had gotten started independently and was operating independently of the cabinet committee. In any event, as a factual and practical matter it was an informal committee of the sub-cabinet-level economists. Dr. Andrew Brimmer was the assistant secretary of commerce for economic matters and he

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was the representative of the Department of Commerce on that informal subcommittee or group.

That group had a meeting, as I recall the date, early in September of 1965, in the Pentagon. After the meeting Dr. Brimmer rushed into my office and said, "Mr. Secretary, do you know what's going on with respect to Vietnam War expenditures?" And I said, "No." He said, "Well, at our meeting"--I said, "Well, I guess this has to be confidential"--"we were told by my opposite number in the Department of Defense that they are taking fifteen billion dollars out of other appropriations and using them to accelerate the Vietnam War expenditures." I was shocked and I found it hard to believe. As we talked, I finally said, "Well, it couldn't have been done by Secretary McNamara without the approval of the President. It just would be unthinkable." And he said, "Well, I agree." But I said, "Did Schultze know about this?" Schultze then was director of the Bureau of the Budget and being an economist was also one of those present at the meeting--or his deputy. And he said, "No, the budget people didn't know about it." I said, "Well, that just throws everything into a cocked hat and it certainly affects the planning for the budget for the coming year."

At that time the budget was on a calendar-year basis as I remember it, so work was already being done in the fall of 1965 with respect to the budget that would be proposed by

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the President around the time of his State of the Union Message in 1966. Brimmer said, "Well, of course it will." By the way, Andrew Brimmer is someone you should talk to if you haven't done it already. And Chairman Martin is still alive, I understand.

G: I have talked to him.

C: You have talked to him. Well, he knows the background of this tax situation thoroughly.

In any event, after Dr. Brimmer told me about this I did discuss it with Chairman Martin. And apparently the Federal Reserve people hadn't known about it, but he also had a representative at that meeting and got information about it at that time. Well, in our discussions it became inescapably clear that our whole fiscal program would be dis-torted, [and] that even before the President went forward with a supple-mental defense appropriation request the increased spending rate for Vietnam would throw everything out of balance. And the inflationary pressures which were already building up because of the defense expenditure program, on top of a full blast peacetime economy, would just send things roaring ahead. [It] would increase the demand for skilled people--and the unemployment rate among skilled people was negligible--and therefore would put more pressure on wage increases. As a result of increased wages and more pressure on price increases we would be off to the races. So to us it seemed that the only affirmative way to

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proceed was to have a higher income tax rate picture, probably in the form of a surtax, on corporate and personal income taxes.

That's how it all got started and it was triggered by our delayed information about the fifteen billion-dollar extra expenditure for Vietnam.

G: Did this expenditure ever come up in the cabinet meeting?

C: No.

G: How did the meeting with Mills affect your own position?

C: I left that meeting--and the subsequent report to the President in which he said in effect, "Well, I told you so"--in a very discouraged frame of mind. I won't say that I had a defeatist attitude but it was pretty close to it. It seemed to me that a tax increase was something required by logic and by the force of events. If the President really wanted to act as a true leader of the country in a very important emergency situation, then he should be willing to go ahead and explain the need for an increase, fully and frankly, to the American people and to Congress. And if he did, being a very persuasive salesman on projects of interest to him, he could get approval and the inflationary danger would be thwarted.

But beyond that it would lead to a much better public understanding of the whole Vietnam War situation, because by that time it was clear that we were in a war situation. It wasn't just a question of putting out a fire or trying to

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maintain a military balance or anything else. It was becoming, and could already be seen to be, an out-and-out war situation. But the President being unwilling to do that, in what I considered the most important public problem of the day, left me in a very discouraged frame of mind. And from then on, these puny efforts to have something that was called tax legislation in the form of investment tax credit suspension, and then a couple of other minor, little facesaving moves was a question of too little, too late and couldn't possibly be effective.

So from then on I was--as I indicated--sort of out of the loop and didn't get involved in the procedures with respect to congressional hearings and internal government discussions. Secretary Fowler, my good and old friend, took the laboring over and he did a very effective job as the President's agent, doing what the President wanted to do and no more. In other words, Secretary Fowler was a supreme advocate of the President's position and a very successful one, but they didn't get down to the guts of necessary tax legislation until long after that.

G: Was there anyone else--?

C: There was one other incident that happened and I think I may have mentioned it to you. The President did have a meeting in the White House with business leaders and I think it was this date that you're talking about here.

G: March 30--

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C: Of 1965, whatever [1966]. But if it wasn't that date it was along in the fall. But at such a meeting--and I think this is covered in the President's book, *The Vantage Point*--he discussed several public policy issues and presented his point of view to the business leaders. Then at a certain point he said in effect, "Secretary Connor thinks we should have a tax increase at the moment. I don't think so." He gave his reasons why it wasn't necessary and then he said, "I'd like a show of hands. How many of you would favor a tax increase at this time? Raise your hands." Of course, there were no hands that went up. It was what I would call a loaded question. In a meeting like that no business leader is going to take issue directly with the president of the United States in a matter of that kind. In any event, their inclinations would be all against any tax increases except in dire emergencies. He didn't even try to make a case that this was a dire emergency situation. And that is recorded, I think, in his book. Well, he succeeded in ridiculing my position on the matter, and a lot of my friends in the business community said in effect, "Have you gone off your rocker or something, advocating tax increases?" I was in no position to make a public defense of my position, which I did not do.

But that was all tied in with the President's determination not to reveal the Vietnam War plans, or any necessary funding for it, and how it would affect the roaring economy

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and the possibilities of inflation and so forth. He just didn't want any discussion of those issues at that time with the congressional elections coming up in November.

G: Was there anyone else in the cabinet that sided with you on this issue?

C: No, not directly. No other one. I think the President says that in *The Vantage Point*.

G: Okay. In terms of the specifics of the Tax Adjustment Act, despite the fact that you felt a more significant tax was necessary to stop inflation, did you have any thoughts on the particulars therein; whether or not the acceleration of corporate tax payments and the reduction on auto and telephone excise taxes . . . whether any of these specifics were counterproductive or simply ineffective or--?

C: I thought that they would be counterproductive in the anti-inflationary fight because they would add to the corporate costs. Those corporate cost increases would have to be passed on to customers in the form of increased prices, which in fact they were. So you weren't taking money out of the economy by doing this. You were adding costs which got into product prices and caused consumers to pay more. This would put pressure on consumers to get higher wage and salary payments to make up for their increases in the cost of living; both corporate and individual increases. So I felt that it was not only not going to be helpful but it would be counterproductive. And it would

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be sand in the eyes of everybody. It was just a camouflaging attempt to try to show that something was being done, an admission of the inflationary problem. But in fact it would be futile or counterproductive.

G: But wouldn't increasing corporate income tax have had the same effect on business or--?

C: Well, increasing the corporate income tax payments would make less money available to the corporations for further capital investment programs, and it would reduce net income so that they couldn't go forward with other expansion plans. It would have a dampening effect on their capital and personnel and other expansion plans generally. In the long run, if there was a continued build-up of government military and other expenditures, those would take the place of increased corporate and personal expenditures, and the net result would be continued inflationary pressures, yes. But of course, I was hoping that a full public debate on the wisdom of the Vietnam War plans would lead to some conclusion about curtailing them or containing them in some way, which would, if done, take a lot of steam out of the whole government expenditure program.

It was a delicate situation at best, and I'm not sure that corporate and personal income tax increases would have the necessary effect, and probably they wouldn't in the absence of some kind of a curtailment of Vietnam War plans. The two objectives were sort of tied together, and of course

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President Johnson was smart enough to see that any public debate about Vietnam might cause trouble for him if he asked for increased income in the form of surtax--

(Interruption)

C: As this chronology makes quite clear, my name is not shown as participating in these meetings.

G: On the investment tax credit suspension?

C: On the investment tax credit and the other related things which I didn't think were very important. Because of my views and because of my advocacy of income tax increases, for corporations and personal--I was just cut out of the loop, as they say in Washington, as happened to Secretary [George P.] Schultz in the Iran/Contra controversy. When you get cut out of the loop, you really don't know what's happening. And I didn't really know what was going on. I'm surprised, as I see now that there were some meetings with business leaders and so forth; but I wasn't involved.

G: That June, 1966 you did send a letter to some 26,000 U.S. corporations' chief executives asking for voluntary restraint in spending programs. Do you recall that?

C: Yes. I think that was my last participation. Our balance of payments program was on a voluntary basis and it was being quite successful. In fact, it was very successful for about two and a half years or so. It was while our balance of payments program was going on that I sent that letter to the participants, who were by and large all the important

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business leaders in the country, asking for a voluntary slowing down of their capital investment programs.

But so far as I can see from this chronology, I didn't have any further participation and certainly none in the legislative efforts. I suppose there would be concern that in any hearings I might press forward with my own view that these proposals were quite inadequate and that we still needed an immediate income tax increase; corporate and personal.

(Interruption)

C: As the memos attached to the chronology indicate, I did send a letter to 26,000 U.S. corporations asking for their restraint in capital expenditures, in view of the inflationary pressures within the economy. And I reported to the President that I received from many hundreds of business and financial leaders responses committing themselves to moderate inflationary pressures and ensure the continued orderly expansion of the nation's economy.

As I said to the President in my letter, "You are aware that different companies have different situations and that you are asking each businessman to follow his conscience in doing what is wise and necessary for our country. I particularly emphasize the importance of eliminating or postponing less urgent capital expenditures, to reduce demand. Expansion of capacity is very beneficial in relieving pressure and prices but it produces distortions in the economy to

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overly concentrate capital expenditures in too short a period of time." Yet this request was well received by the business community, but I'm afraid it was a little late in the game because capital investment programs are usually long-term in nature. They get voted on at one time and they run a course of two, three, four, [or] five years and they just can't be turned off like a water spigot. They will go forward whether there is the capital investment credit or not. And that's what happened. I don't think that many ongoing capital investment programs were or could be turned off instantaneously, and that meant that it was not an effective program for pulling money out of the economy. The only effective program that some of us could see at that time was to take it out in the form of tax increases.

G: That's a good point. There was a lot of discussion, as I recall, about the effective date of the suspension of the tax credit, and I think one of the airlines perhaps had made a big purchase or was planning to. So perhaps some corporations did have an interest in having the date be somewhat later than the administration had in mind. Do you recall that aspect of the issue?

C: The date was very important because a capital investment program already approved by the board of a corporation, and under way, that would take five years for completion, probably involved commitments already made for the expansion of the contractor's labor force and the purchase of materials

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and so forth. And you just couldn't terminate those commitments without considerable loss in the way of damages and so forth. So any corporation--and the airlines would be one--that had a long-term capital investment program under way wanted the effective date to be as late as possible.

G: During this time there was a problem in the housing industry, sort of a flat period in housing. Was there a way to encourage the housing industry at the same time you were trying to put the brakes on the economy in capital investments in other sectors?

C: You're talking about private housing?

G: Right.

C: There was a lull in the number of housing starts and it did appear at that time that part of the explanation was that construction costs were going up rapidly and also that the necessary skilled labor for housing starts was all used up. More [were] working on larger capital programs for industry and for the government--the road building program, other things still going forward. There was just a limited pool of skilled labor available. So these commercial and governmental construction programs were outbidding the private home construction industry for the necessary skilled people. As I recall it, I think that was the reason, and the only way you could maintain a balance for the benefit of private housing was to discourage the expansion of industrial and governmental capital investment programs.

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This is the point. The governmental capital investment programs, both for military and road building and other civilian purposes, would not be affected by the suspension of the investment credit suspension. That tax feature had no effect either way on the governmental programs, which were all done by congressional authorization on recommendation of the executive branch. And as I recall it there was no thought that the governmental programs, not just military for the Vietnam War and other military purposes but for other governmental purposes, would be curtailed. You were trying to skin a cat by just taking the skin off its nose and not its body.

(Interruption)

C: My basic problem with the President's tax proposal affecting investment credits and not going for an income tax increase for corporations and people, and the necessary Vietnam War discussion that would authorize that or not, was my deep concern that we were acting in an unconstitutional manner. That having failed to request a declaration of war with respect to the Vietnam problem, but instead moving into an active war situation on a large scale, the President was not following the constitutional directive of asking Congress to declare war. If he had, of course, that would have precipitated a broad public debate on the wisdom of accelerating the war in Vietnam and committing so many of our troops, and making the appropriations for the necessary war material as

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well as bases and so forth. All the acts that are associated with a large-scale war effort would have been up for debate in Congress. That debate would have reflected the views of many segments of the public, including the young people being drafted or about to be drafted. It just seemed to me that that was the right way to go, that we shouldn't proceed with the acceleration of the effort in Vietnam just by the authority of the President to the United States, who in this respect was acting as a dictator. This is the word that kept cropping up in my mind all the time. Because once you get acting like a dictator with respect to increasing troop commitments and war measures, then you act like a dictator with respect to trying to impose wage and price controls without authority of Congress and do other things to restrain or try to restrain inflation. You get into deficit spending which by definition is inflationary. One thing leads to another when you get going down this unconstitutional path. I kept saying to myself and to others that we are a government of laws, not of men, and to me this was a basic, basic constitutional matter. It was the reason for my ultimate discouragement and finally after a couple of years [my] retirement from the scene of action, because quite frankly I just couldn't take it any more. I began to fear for my mental and physical health, being in a state of constant turmoil with the President of the United States. Finally, that situation led me to tell the President one day

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in the Oval Office that I just didn't want to work for him anymore. After pointing out to me that I served at the pleasure of the President, he finally agreed that it would be his pleasure, as well as mine, for me to leave after the 1966 congressional elections.

End of Tape 1 of 1 and Interview II

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