INTERVIEWEE: FREDERICK L. DEMING (Tape #1)

INTERVIEWER: DAVID G. MC COMB

January 7, 1969

M: First of all, to identify the tape: This is an interview with Mr. Frederick L. Deming, who is the undersecretary of the Treasury for monetary affairs. The interview is in his office in the main Treasury Building in Washington, D.C.; the date is January 7, 1969; the time is 11:40; and my name is David McComb.

Mr. Deming, I'd like to know something about your background, where you were born, and when.

D: I was born in Des Moines, Iowa, September 12, 1912; my father was a school teacher, taught history in a high school. They went to northern Michigan when I was 2½, and came down to St. Louis when I was 8 years old where I lived until I went to Minneapolis in 1957. I went through school in St. Louis, including Washington University, where I got a Ph.D. in 1941. I joined the staff of the Federal Reserve Bank of St. Louis as the assistant manager of the research department in August 1941, and continued at that bank until the 1st of April 1957, moving successively through manager, assistant vice president, vice president, and first vice president.

M: Was your education in economics?

D: My education was in economics; my doctorate is in economics, I had a master's degree in history.

M: That sounds like a valuable combination.

D: It was a useful combination because I did a doctoral thesis on the history of a bank.

M: Then you served for quite awhile in the Federal Reserve System.

D: Yes, and I went from April 1st 1957, I became president of the Federal Reserve Bank of Minneapolis and served there technically until the end of January 1965, and practically until the end of December 1964.

M: And was it from that point that you came to Washington?

D: I came down to Washington officially on the 29th of January 1965; but on the 9th of December 1964 was invited down by then Secretary of the Treasury Douglas Dillon, who took me over to the White House where the President asked me to become undersecretary of the treasury for monetary affairs. I can remember vividly that day because we had gone over for what was supposed to be a fifteen minute interview at approximately one o'clock, and I got away at six. He wasn't with me all that time, of course, but in the course of the day the man to become secretary of commerce Jack Connor was in there and so were the members of the troika, and it was a most interesting day. It's probably typical of the President that when I--it was along toward five o'clock before we actually got down to his request of me to come in. I said, "Can I think about it?" And he said, "Of course, just let me know by tomorrow," which I did.

M: And then you were appointed?

D: I was nominated. I guess the news that I was to be appointed came just after Christmas; I've forgotten the precise date. I came down effectively to the Treasury right after New Year's although I wasn't sworn in until the 29th of January.

M: Had Dillon already announced that he was leaving?

D: No. Secretary Dillon had not announced that he was leaving, and I simply don't know for sure when his letter of resignation went in. It was perfectly clear that he wanted to leave and intended to leave, but I don't think there was a termination date set, and I simply don't know whether he had officially sent his letter over to the President--I know the President hadn't officially received it as of that time.

M: Had you met Secretary Fowler?

D: I didn't know who would be secretary of the treasury, of course, at that time. I knew Secretary Fowler, from various contacts in the past, favorably by reputation, but I didn't know him very well. But it was not clear, and I don't know if it was clear to anybody at that point in time who was going to be the incoming secretary of the treasury.

M: Now, Fowler was appointed not too long afterwards.

D: My recollection is that Secretary Fowler was appointed around the middle of March, and that Secretary Dillon left the 1st of April. I'll have to check that for the record--it was around that point in time. I know that the announcement of Secretary Fowler's appointment came when both Secretary Dillon and I were in Princeton at a meeting. Secretary Fowler came up to Princeton to that meeting--I guess he wasn't even confirmed by that time--but what you might say [it was] his first official act as Secretary of Treasury.

M: Was there any necessary adjustment for you to make from Dillon to Fowler?

D: No, not really. Secretary Fowler had lunch with me, I guess within a day or two after his appointment was announced. We talked, and I found the working relationships with Secretary Fowler very pleasant, most agreeable. He and Secretary Dillon were two distinctly different personalities of course, but I had no difficulty in working with either of them. They are both fine men, both with a very profound understanding of the problems that they were facing, and I think both extremely agreeable to work with, and extraordinarily good secretaries of the Treasury.

M: Now the position of undersecretary for monetary affairs apparently has broadened in scope in the past several years, starting perhaps before you came in. Just what all do you get into?

D: Your statement is fully correct. There have only been four undersecretaries of the Treasury for monetary affairs. The position was created in 1954. The first incumbent was Randy Burgess, the second was Julian Baird who was from St. Paul, the third was Bob Roosa from New York, and I was the fourth. Initially the work of the undersecretary was almost exclusively devoted to the domestic affairs with essentially debt management, economic policy, participation in economic policy formulation and so on. As the United States' position with respect to the international financial community changed, it became steadily more important for the undersecretary to become involved in some of the international financial business.

Up until 1957 the United States was in a preeminent position with respect to its economic power and its international financial power. It had spent the entire period from the end of the war in attempting to rebuild the world. By 1958 it had pretty well succeeded, and the world had moved, in Europe especially, to what you'd call a convertible currency position, which meant that the United States no longer had to carry the entire burden of the adjustment. Given that fact and the fact that the United States' balance of payments moved into a fairly sharp deficit in '58, '59, and '60, it was necessary for the United States to get more and more into cooperative arrangements with the other powerful financial and industrial countries of the world that had strengthened their position because of this post-war rebuilding project. Up until that time the United States cooperated. It was the most both altruistic and intelligent member of the international community, and in effect unilaterally helped rebuild the world. From 1958 onward it was no longer necessary for the United States to be in that unilateral position which meant that we were moving more and more into a whole series of arrangements and meetings in an international framework. And beginning in 1961 with the Kennedy administration, the United States began to participate actively in meetings of the Organization for Economic Cooperation and Development which is headquartered in Paris. The United States was instrumental in getting that organization established.

M: Let me ask you this. With this shift coming in the late '50's, was it necessary then to restructure international finances and organization?

D: It was necessary to restructure our international relationships to some extent; the restructuring of international finance was a sort of a product of those changing relationships. And perhaps I can explain this best this way. Recognizing that the European nations had been used to an American position which in effect was all give and no take, and that it was no longer necessary for it to be that sort of a situation, and as a matter of fact it not only was no longer necessary, but the United States could no longer afford to carry all this burden alone, it was desirable for the United States to sit down with its major financial and industrial counterparts and gradually work toward accommodations and arrangements and agreements which would shift some of the burden to the rest of the world.

One vehicle for that was the Organization for Economic Cooperation and Development, which is composed of roughly twenty nations. It has under it a committee called the Economic Policy Committee. Part of the Economic Policy Committee had established under it a series of working parties, one of which is called Working Party Three which has representatives from the major countries of the world--the United States, the United Kingdom, Sweden, Canada, Japan, and the Common Market--France, Germany, Italy, Holland, and Belgium. Representatives from other international organizations such as the IMF and the Bank for International Settlements attend the meetings, and so does the representative of the Swiss National Bank. That committee had as its primary function an evaluation of the balance of payments position of the individual countries, and means of financing surpluses and deficits. And over its evolution during the past eight years--it's chaired by the Treasurer General of the Netherlands Emile VanLennap --it has gained a great deal of expertise under his leadership and with the full participation of the members of the working party. There are approximately forty people that meet about every six weeks to take a look at what you might call the international financial and balance of payments situation, give broad-scale advice to countries in both deficit and surplus as to how they can best in the interests of the world and themselves come to a better adjustment with their balance of payments position, [and] discuss methods of financing such as deficits and surpluses. Over this period of time it has obviously gotten to be more informed, more intelligent, and more savvy about the affairs with which it deals. It is out of this group that has come the full-scale realization that it's arithmetically impossible--this may sound awfully simple, but it took a long time for it to get understood--for a country that's in balance of payments deficit to come into equilibrium unless countries that are in balance of payments surplus also come into equilibrium. And a study done in 1966 indicated pretty thoroughly the understanding of this group that the responsibilities of both deficit and surplus countries were there when you were trying to come to an adjustment of payment and balance.

[interruption]

M: Dr. Deming, we're talking about this Working Party Three, and I wanted to ask you--did the personnel remain substantially the same in this working party?

D: It has remained substantially the same. Remember this point: This organization of the OECD and its working party didn't get established until I guess it was 1961--it may even have been 1962. At that point in time Bob Roosa was undersecretary of the Treasury for monetary affairs. He came out of the Federal Reserve Bank of New York and had a wide acquaintanceship already with some of the people that he was going to meet with in Europe. VanLennap is one that I have mentioned; Ottmar Emminger of the Bundes Bank is another one; Rinaldo Ossola of the Bank of Italy is another one; Denis Rickett of the British Treasury is another one, and so on.

It became perfectly natural for the undersecretary of monetary affairs--really just Bob Roosa--to meet with this group as the United

States representative, chairing the American delegation to Working Party Three. In the bigger economic policy committee where all of the countries were represented, Walter Heller, who was the chairman of the Council of Economic Advisers, was the chairman of the delegation, and Roosa was, I guess you might almost call co-chairman. At any rate Heller and Roosa sat together at the table.

Now when I came into the Treasury in 1965, partly because I had some acquaintance with those people, and partly because Roosa and I had been friends and colleagues for twenty years I suppose, I had a sort of an immediate introduction and an immediate acceptance from the group. It was relatively easy to continue the American representation through this office. It might have been just as logical to have started this with the assistant secretary for international affairs in the Treasury, except it didn't get started that way. It may be that at sometime in the future it will shift there. But this in one sense is a kind of a highly personal relationship, and it just didn't seem logical and might have been counter-productive to have tried to have shifted the work from this office. Most of our international affairs are under the general supervision of the assistant secretary for international affairs with whom I work very closely of course. His staff really backs up the work that is done in Working Party Three, and in the Group of Ten for that matter.

The Group of Ten I might mention at this point. It was founded in '62, a group of the ten industrial countries of the world who banded together and agreed to make available to the International Monetary Fund an additional six billion dollars in their currencies should the fund need to borrow it--called the General Arrangements to Borrow.

Now it was partly coincidental that mainly because the ten countries are the important countries, that the Group of Ten--

M: Now, these are the industrial nations of the world.

D: These are the industrial countries, the same countries that I just mentioned before. The Group of Ten was established to perform this function. The so-called deputies of the Group of Ten, because the Group of Ten is essentially an organization of finance ministers and governors of central banks, turned out to be exactly the same people that were the members of Working Party Three. The meetings of the Ten tended to be back-to-back with the meetings of Working Party Three because the group was together. They had different chairmen, but for the United States, Governor Daane of the Federal Reserve System and I represented the United States at Working Party Three, and at the Group of Ten. Sometimes there were differences with respect ~~to the Federal Reserve representation. For Germany it was~~ Emminger of the Bundes Bank, Van Gocht of the Ministry of Economics and then his successor Hannaman; for the Netherlands it was VanLennap of the Treasury General, and Kessler of the Netherlands Bank. There are a pair in each case and they sat in both meetings. And except for the subject matter which wasn't all that different either so to speak, and the fact that you sat a little differently around the table--that is, you had a different chairman, and consequently it was a somewhat different arrangement--it would have been very difficult for an outsider to have told when he was in a meeting of Working Party Three as against a meeting of the deputies of the Group of Ten.

M: Do all these personalities, having worked together for a long time--is this good that they were the same people?

D: There have been some changes because some people have retired. Denis Rickett has left the British Treasury, has retired, and so they have a new man from the UK Treasury now, whose name is Frank Figures. Roosa left and I succeeded him. Krister Wickman, who used to sit for Sweden, is now the minister of finance, and so another man comes for Sweden in his place at the deputies meeting and Working Party Three meeting. But it is a distinct advantage for the group to know each other, and you get past in relatively short order the formalities of having to sort of present your credentials each time. It is quite possible--as a matter of fact, a lot of business is done this way--for me to call Emminger of the Bundes Bank just on the telephone. I don't have to explain to him a lot of background; we've been in close contact for a long time. One of my colleagues, once, in listening in on a conversation like this, said, "I don't really understand how you communicate." But the point about it was that Emminger and I knew just what we were talking about. Just as you do wish with anybody else, you can use a certain shorthand, and you don't have to have a long conversation to come to a conclusion.

It's an invaluable attribute of these meetings that you've gotten to know the people as well as you know them. Don't misunderstand what I'm saying, that doesn't make them patsies or make you a patsy, but it does mean that you've got a respect for the integrity, and the analytical ability, and the intelligence of the man with whom you're dealing. You don't have to do a lot of probing to determine that he is intelligent and has integrity and analytical ability. You take that for granted. I wouldn't call them deals exactly, but arrangements can be reached pretty quickly when you know each other that well.

M: Would you conclude then that a long tenure is valuable in this particular area of work?

D: I would conclude this: That it is important for the man who is sitting in this office, and who is dealing in the international scene--that he shouldn't be changed all too often. A long tenure, you don't need permanent tenure in these positions, but the length of time Roosa was here, the length of time I was here, looks about right in this. It takes a little time to get acquainted but not a great deal if you're properly sponsored as I was. Now this may have been a unique situation because I came out of the Federal Reserve System, which has a certain amount of respect in its own right. I knew some of these people to begin with; I'd been on a program with them for example on a couple of occasions. Roosa gave me a good send-off just before he left, and with that kind of background and sponsorship, it wasn't all that hard to make the transition. It is important to get your lines reasonably firmly cemented in as short order as you can, because the relationships are somewhat personal. We all call each other by our first names, and we know each other pretty well. On the whole the group temperamentally gets together and gets along pretty well.

M: In these meetings such as the Group of Ten or Working Party Three, are the various members--or at least, do they feel equal to one another?

D: I think they do.

M: The United States doesn't dominate this?

D: No, and doesn't attempt to. This is perfectly true. The United States is the most powerful country in the West, and in the world for that matter. When the United States says something, people listen to it perhaps more attentively than if a little country says something. Two small countries in this group are, I guess you'd say, Sweden and Belgium. I haven't observed any inhibitions on the part of the Swedish representative and the Belgian representative to say to the United States, "I don't quite agree with what you're saying." I would say that people around the table will listen as attentively to the representatives of these smaller countries; their weight in international affairs is obviously not as great as that of the United States. So what we say probably carries more weight, but it doesn't get any more attention, if I can put it that way.

M: Do you have to be careful not to intimidate smaller countries, or is that a problem?

D: I don't think that's a problem at all. We've not attempted to intimidate them; we've tried to approach this rationally; and I haven't observed any problems at all in this respect. These people, in the international financial sphere, are pretty important in their own right. They've been around for a long time, and they have great respect outside their own countries. They have excellent reputations, and as individuals, the weight of their opinion is probably as heavy as the weight of an individual representative of the United States. The difference would lie in the power behind the United States as against the power behind, say Sweden, in this case. The United States simply cannot take irresponsible action without it having great repercussions throughout the world. Sweden has not taken irresponsible action, but it wouldn't have the impact if it did, and it's in that sort of context.

Joe Fowler, in testifying before one of the committees in Congress a year or so ago, was asked a question as to why the United States had to always be pure and live up to its agreements and not invalidate any of them whereas others sometimes were not quite so pure. I thought Secretary Fowler's response was classic and it earned him understanding from the committee. He said, "When you're number one, you have to act like it." And I used that as an opening theme in a speech, I said, "When you're number one, you have to try harder," and you really do. The United States has 50-percent and a little more of the entire GNP of the OECD countries, and there are twenty of them. Now, you simply can't do something that is irresponsible or improper in that atmosphere. The only intimidation I'd say we have is the intimidation that anybody who is big and important has, that he simply can't take an irresponsible course of action.

M: How often do these groups meet?

D: The Economic Policy Committee of the OECD has been meeting approximately three times a year, every four months. The original schedule for the Working Party was to try to meet both at the time the EPC met and once in between. Actually the Working Party I suppose has met somewhere around seven, maybe eight times a year, close to six weeks, seven week intervals. The Group of Ten originally was meeting at about the same frequency as the Working Party simply because everybody was there. When we got engrossed in this liquidity negotiations that led to the special drawing rights in the International Monetary Fund, we met with considerable frequency much more often than the Working Party met. I would say that we must have met at least once a month on the average from the period of the fall of 1965 until the spring of 1968. Once the agreement was reached at Stockholm, the Group of Ten deputies had less to do and I think there have been perhaps two or three meetings of the Group of Ten as such in the last eight months. The Working Party has continued on its schedule, and sometimes there have been abbreviated meetings of the Group of Ten to activate the British drawing to lend money to the fund for the French drawing and so on. But the long and hard negotiating sessions of the Group of Ten are at least over for the time being.

M: Can any member request to call a meeting?

D: Oh, yes. But it isn't all that formally structured. You tend to come to an agreement that it's necessary to have a meeting. If I called up the present chairman of the Group of Ten who is Rinaldo Ossola of Italy, and said, "Rinaldo, I think we've got these things to talk about, and we ought to plan a meeting some time in the course of the next month," his normal process would be to check with the rest of the members of the group. Unless he ran into some objection, they'd say, "Yes, I think it's appropriate to have a meeting at that time." Now, that is hardly a right to call a meeting--it's just that this represents the kind of acquaintanceship and cooperation I've been talking about.

Some of these meetings of the Ten have been extraordinarily long, and have begun, let's say, at nine o'clock in the morning and lasted until one o'clock the next morning. They're long sessions. We had three days in Frankfurt in the summer of '66. The first day as I recall it we started at ten, and we ran through until about eight. The second day we had a lot more to do so we met at nine, and ran through until about nine-thirty. The third day we started at eight in the morning, and ran through, I think that meeting lasted until midnight. So these were long sessions. They're complicated business and long sessions, and it's credit to the group that by and large everybody preserved his good humor during the course of these discussions.

M: Is there any particular meeting place, or do you move from one spot to another?

D: The Working Party normally meets in Paris because the OECD headquarters are there, and this is just perfectly natural. Occasionally it has met outside the country, most frequently at the time of the IMF meetings when they're anywhere they happen to be--two years out of three they were in Washington. And normally since the people would be coming to that, that's a convenient date to schedule a meeting on or around the IMF annual meeting. It has also met on occasion in various other capitals. The Ten had no real home. Since it was started and since it tended to meet with the Working Party, it has met most frequently in Paris. But it can meet any place, and it has held meetings that I can recall in Frankfurt, in London, in Rome, in Washington, I guess in Stockholm, in the Hague. But it has had a lot of meetings and even after reciting that list, it would be still much more frequently in Paris than anywhere else. We used to meet in the Louvre, which is the French Ministry of Finance, and most recently when we've met in Paris we've moved out to the office of the OECD simply because there's a more convenient room to meet in.

M: Has this work in international monetary affairs absorbed a great amount of your time?

D: It has absorbed an extraordinarily great amount of my time, and perhaps right now is the time to note the other part of this assignment which is the domestic--economy and debt management. As I said, when Randy Burgess and Julian Baird were in here, at least until close to the end of Julian's term, the domestic side absorbed I'd say 90 to 95-percent of the man's activities. Financing the federal government is a job in and of itself. With Roosa in here, and even more so when I came in here, the international negotiations absorbed progressively more of my time, and I would suppose that I spent perhaps 70-percent of my time on the international side.

M: Part of this is due to the changing world situation.

D: That's right. A lot of it due to the changing world situation--the drive for the new liquidities and to the need to negotiate and work with these countries, and to pull the world payment system together. Now the responsibilities on the domestic side are certainly as great, obviously--I said the United States was 50-percent of the whole OECD--much more important in certain senses. Fortunately, I have two key helpers in that area. One is the deputy undersecretary for monetary affairs who presently is Frank Schiff and who used to be Peter Sternlight, who is now back at the Federal Reserve Bank in New York, and before that was Paul Volcker; and a special assistant for debt management who presently is a man named Duane Saunders.

Now they have carried more direct responsibility, at least during my term, for the debt management operations. Until Roosa was here, there wasn't a deputy undersecretary for monetary affairs. There was a special assistant for debt management, but that two-man team has carried more responsibilities for debt management, and has represented the Treasury in various aspects of domestic policy formulation. I've done the same thing when I've been here because theoretically and practically, for that matter, there has been no debt management operation since I've been in here, and I'm sure there wasn't one when Roosa was in here, in which the undersecretary didn't participate fully. He didn't under either of these regimes do as much of, I guess what you'd call the analytical work, on his own because he had the services of these two people. But the decisions, subject of course to the Secretary's approval and the President's approval, are still made here; the press briefings come out of this office, and so on.

Participation in the work of the troika and quadriad has been as extensive from this office, but not always from this man, as was the case before. The troika and the quadriad are relatively new inventions too. A lot of these things go back just to the Kennedy-Johnson administrations.

M: Before we get into that, let me ask you--is it important in your work, to have a foot both in domestic affairs and in international affairs?

D: I think it is absolutely critical. There have been some suggestions made that it would be useful to split the two. I said earlier that it might have been useful to have the assistant secretary of international affairs do the negotiating. In a good many things, I think that would work. But in terms of these relationships with the people I meet with in G. Ten and the Working Party, I think it's critical to have a foot in both fields, for these reasons. Most of them do. VanLennap is not merely concerned about the international affairs of the Netherlands, but he puts together the Dutch budget. Now the international affairs of the Netherlands are much more important, relatively speaking to the Netherlands than the international affairs of the United States are to the United States. My recollection is that some 60-percent of the Netherlands GNP is related to their balance of payments, their international trade position, and so on. So the sort of proportion that I have spent in this office on international affairs is perfectly normal for VanLennap, because the Dutch economy operates that way. And Emminger [Ottmar] participates just as fully in the domestic councils of the Bundes Bank as he does in the international.

It is highly useful in dealing with the international side not only to know what's going on in the United States, but to participate in what is going on in the United States, as I say, because your colleagues do the same thing. And I think it's highly important in your participation in the formulation of economic policy and debt management policy in the United States to know what's going on in the international monetary sphere so that you can sort of come to a balance in these two areas. So I would say, and have noted this to the incoming Secretary of the Treasury, that I think it's important that both phases be undertaken from this office. But it is of equal importance then that you have back up from a deputy undersecretary and a special assistant for debt management and back up from the staff of the Office of International Affairs here.

M: I suppose in these international programs your own domestic developments are of prime importance too.

D: Of course they are. Every meeting of Working Party Three when they're talking about a particular country, they always want to talk about the United States, because as I say what the United States does has a great effect on them. You need to know, and you need to be able to talk about, what's happening in the domestic economy of the United States. You need to know something about monetary policy and its formulation. You need to know something about debt management policy and its formulation. Otherwise, you can't speak with any real authority. If you're just dealing with the international side and you get a lick and a promise on the domestic side, I think you're probably less effective.

M: Is it fair to say then that the domestic economy of the United States --the line of the domestic economy is very much blurred today in regard to, say, world economy?

D: No, I wouldn't say that so much. One of the real problems for the United States and for the world, for that matter, is that the U.S. is the biggest exporter and the biggest importer in the world. But relative to its gross national product, its exports and imports are a pretty small proportion. We have a gross national product in '68 that's going to be about I guess eight hundred and sixty billion dollars. You add our exports and imports together, and they're about seventy billion dollars. So it's less than 10-percent of the total if you take both of them together. As I said, to the Netherlands it's a relationship of two-thirds rather than somewhere around 8-percent.

Now it is not critical for the domestic economy whether you export thirty-three billion or thirty-five billion--it may be critical for the balance of payments of the United States, but as far as the domestic economy is concerned, this is not an absolutely critical factor. And so you have to in formulating economic policy take into consideration the great power of the American economy as a domestic economy, as well as its great power relatively speaking as an international economy, but it's very small power relatively speaking against its own GNP in international trade and so on. And obviously we do better if we can manufacture and export more goods. But as I say, it isn't an absolutely critical factor as to how much we export because it's such a small proportion of our gross national product. We get most of our drive from the domestic side. What that means is that the classic remedies for balance of payments adjustment are simply not completely feasible for the United States. If the Netherlands is in a balance of payments deficit, it can compress its economy a little bit and theoretically the exports go up and imports go down.

M: You mean some kind of austerity program?

D: Yes, but it doesn't even have to be all that austere. It's just what you call demand-management. So that you might reduce the GNP by a half of 1-percent and get enough adjustment. I don't mean to say that you'd even have to reduce it in absolute terms. You'd just have to reduce the level of growth by, say, half of 1-percent. Now in the United States if you followed a strong deflationary policy for purely balance of payments reasons, I don't know how this would work out, but you might have to reduce the American GNP by fifty billion dollars to get an adjustment of, say, two billion dollars in its balance of payments. The world won't stand for that. You can't deflate the American economy to this amount. Not only won't the United States stand for it, but the world won't stand for it. So that you can't use the classic demand-management approach in my judgment to correct the American balance of payments.

That's one reason the program that the President announced last

January 1st, that it was the first order of business to get our domestic affairs in order without a surcharge, and to keep the economy from running it too high and at too inflationary a speed. In addition to that we've had to seek means of neutralizing our military expenditures overseas which grossed four-and-a-half billion dollars, and we wanted to remove some of the trade disadvantages we have because of these border tax arrangements that some of the countries have. Because we wanted to keep from exporting at this time quite so much capital gross is the reason for the direct investment program and the federal reserve program. We had to do these things simply because it wouldn't be good adjustment policy either from our point of view or from the world's point of view to try to take it all out on the domestic economy.

I think the general proof of part of the sophistication that has come out of these last eight years of discussions, and partly because of the understanding of the other members of the Working Party and the Group of Ten have, that there was general approval of this kind of a balance of payments program from the United States in order to bring our payments into close to equilibrium, and a recognition that you couldn't do it all with demand-management. Two of the central bankers of Europe who are not noted for their radicalism told us when we went around in early 1968--we left here New Year's Day for a swing of a week around seven countries--that they thought that this was well balanced and to be sure not to deflate the American economy too much.

M: Then these other international bankers well understood our problem?

D: Oh, they understand that. Now you understand the international bankers thought we should have had the tax in effect when the President proposed it in the summer of 1967 rather than wait until the summer of 1968. And they were unhappy that it took so long to get the tax passed. We got no criticism because they understand the political process. It made them nervous because the system was under more pressure than they thought it should be. They were heartily in favor of the tax being enacted. I know they didn't raise much question; they felt the amount was perfectly justifiable. From their point of view they didn't care much whether you got the fiscal restraint by expenditure reduction or by taxation. They know from their own experience that it's pretty hard to get expenditure reduction. Therefore, usually when you're talking about a country in this area, you talk about the total amount of fiscal restraint, and you don't say you ought to reduce government expenditures, or you ought to increase taxes, because it doesn't make much difference in a sense which way you go. But as a practical matter, it tends to be a tax increase rather than an expenditure reduction. They welcomed the expenditure reduction that was written into the law, but they didn't ask for that. They didn't say government expenditures were running out of control. What they said was that your government budget is out of control and that you need to have a tax so that you don't have such big and stimulative budget deficits.

M: Is this a prime example of international concern with the domestic economy?

D: Yes. There is far more international concern with the course of domestic developments in the United States than there is anywhere else. Now over the course of the past several years, there has been considerable concern over developments in England, more recently in France, in Italy, in Germany, in Canada, in Japan, because any country that is running either too much deficit or too much surplus is a destabilizing factor in the whole international financial arrangement, and the international trading world. So there have been lectures to Germany, "Get that surplus down." There have been lectures to the UK, "Get that deficit down." And so on. But none of them are as disturbed about the other countries as they are about the United States if it's running too hot or too cool. It's necessary for the United States to run about at optimum levels for it to make them happy, and in a sense they're selfish about this.

But you don't get counsel, "Squash it down," and you don't get counsel, "Goose it up," unless you're in a position where it ought to be expanded, or where it ought to expand at a somewhat smaller rate of increase.

Now, they've been concerned about sterling, because the sterling devaluation as predicted shook the international monetary system pretty savagely. They'd have been much happier had the UK been able to run its economy somewhat better than it turned out to be run. They were disturbed about the French situation. No country that's important in the world can really operate as though it's an island to itself. It has an effect on all of its partners. So that concern runs to the other countries too, but it runs sort of doubled in spades to the United States.

M: We'll probably get into this a little bit deeper later. Let me ask you now about the troika and the quadriad development.

D: You're familiar of course with what the two organizations are supposed to do. The troika, which is treasury, budget bureau, and council, has as its principals the Secretary of the Treasury, the Director of the Budget, and the Chairman of Economic Advisers. Its focus is really on the longer run economic situation.

M: Now this is an informal organization?

D: Not set up by any statute if that's what you mean. It's quite simple for them to work together. The budget bureau until 1934 or so was in the treasury; we obviously are interested in the expenditure level, they're obviously interested in the revenues level; the council is interested in the course of the economy; so it's perfectly natural for the three to work together. But it is not a statutory body set up by the President. And its staff is sort of an amalgam of the staffs of the three institutions. Now it makes projections of the course of the economy, and attempts to determine what would be the proper fiscal posture of the government. The two basic economic tools that you have for making the economy run at maximum speed are fiscal policy and monetary policy. Fiscal policy tends to be long-run, so that the projections that are made by the troika are sort of long-run projections. They try to look a year ahead or a year-and-a-half ahead to determine where the economy will be. And it uses various techniques to determine what the optimum course of the economy would be. It builds really econometric models and puts them through a computer.

There is a sub-troika representation from Treasury, Budget Bureau, and Council, and then the staffs pull together the projections. The general counsel that the troika gives to the President comes as a reflection of meetings that the principals have had after they get some of the data from the sub-group. And from time to time they meet directly with the President. Now when I've been in this country, which hasn't been all that frequently, I have sat with the troika principals and at meetings with the troika with the President. But I suspect that I have missed on the sessions with the President two out of three on the average simply because I haven't been in the United States. I've done more participating in the meetings with the troika principals without the President than that.

Now when you begin to look at what you might call the immediate situation, I'm oversimplifying this a bit but not too much, the troika becomes a quadriad because the Federal Reserve is added. The Federal Reserve, deals with monetary policy which is supposed to be and is a more flexible economic tool. It wants to look ahead as far as the troika does, but it doesn't make its policy decisions that far ahead. If you think that the economy is going to run out of control on the upside in the spring of 1970, you don't begin to tighten monetary policy necessarily in January of 1969. You keep watching it, because you can reverse it. So the consideration the quadriad has is what's ahead sort of in the immediate future, the next two or three months or so.

M: Short run.

D: That's right. The Federal Reserve of course enjoys independence within government for its monetary policy actions. It has to report to the Congress annually, but it has its own independence as to what it does with monetary policy. By and large it exercises that independence responsibly. It exercises it I think best when it's familiar with what the projections are, what are the prospects for fiscal policy. You work these things pretty much in tandem.

As a practical matter, Bill Martin really meets with the troika principals when you're discussing the long-range thing so that the distinction between troika and quadriad is more formalistic, as I've described it here, than it is in practical working matters. The troika staff is, as I said, Treasury, Budget Bureau, and Council. They always talk to the Federal Reserve staff, and I think their director of research participates in the final findings. You might say he isn't bound by them although if he thinks that their--You don't have to have an agreed document for a troika forecast, that is agreed by the Federal Reserve. But by and large they do agree. Normally any memorandum that goes down to the President or any discussion that is done in the quadriad setting would have concurrence by all four members.

And the quadriad has met pretty much on call; it hasn't had any regular session. The troika attempts to do a forecast about once every quarter--a formal one. The Federal Reserve does this too, but in terms of monetary policy formulation. The quadriad may meet three times in two months and then not meet for six months. It really depends on the situation. And part of that reason is that we've got some other even more informal arrangements with the Federal Reserve that have been going on for years, because the Chairman of the Board of the Federal Reserve System comes over here to lunch every Monday. And I take the Treasury debt management staff, four or five of them, over to lunch at the Federal Reserve every Wednesday. Now this is not a hundred percent certain, but it's true fifty weeks out of fifty-two. And we are in constant touch with the open market desk. I suppose we talk to them a dozen times a day.

It's a very careful line that is walked by both sides in this case. We don't tell the Federal Reserve System what we think they ought to do, and they don't tell us what they think we ought to do. They recognize the areas of responsibility. But we do consult about these things. And we normally know what Federal Reserve policy is at present and is in prospect. They normally know what we are planning in the debt management field, and what we're planning to do with the tax policy. Bill Martin I guess made as many calls on congressmen and senators in trying to get the tax bill through as Joe Fowler did. So it's a fairly close working relationship.

Now we also have a luncheon every two weeks with the Budget Bureau and the Council of Economic Advisers. The Council of Economic Advisers goes to lunch every other week with the Federal Reserve System. Now these are sort of informal arrangements, they're essentially intelligence sessions. I want to underline this point, that nobody is really trying to preempt the responsibilities of the other people in this area, but it obviously makes for a better working relationship if you have some glimmer of an idea about what everybody is going to do. And it's worked reasonably well. There have been suggestions that this be more formalized. Since I'm not very formal, I kind of like it this way. It has been an effective instrument. There's just constant conversation between Budget, Council, Federal Reserve, and Treasury around-the-horn.

M: This would suggest that the independence of the Federal Reserve System might well be a hindrance.

D: I don't really think so.

M: Now, you've been on both sides.

D: I've been on both sides. I think the independence of the Federal Reserve Systems is useful. It's structured so as to be independent of day-to-day congressional pressures. It is not independent of congressional opinion completely by any means. It obviously reads the election returns and can't get too far out of tune with what the country wants. It would be only by mistake, I don't think they'd make this kind of a mistake, if the Federal Reserve were to try to inflate the economy against the country's wishes or try to deflate it too savagely against the country's wishes by means of monetary policy. Knowing what the government was doing, the administration was doing, the Federal Reserve could try to fits its policy to supplement and complement that.

There are times when this has led to something less than perfect management. For example, I'm sure had everybody realized that the Congress was going to take as long to enact this last tax bill, that you would have had more movement by the Federal Reserve System in the fall of 1967 than you had. In a sense almost every week it was perfectly clear that you ought to take some restraining action, but a restrictive monetary policy coupled with a restrictive fiscal policy didn't look like the dosage that was recommended. Now while I say if monetary policy is flexible, and it is, you can't flex it every day. Now this was the Federal Reserve judgment, it wasn't the administration judgment. Nobody was pushing the Federal Reserve to stay easy during this period. It was their judgment that affected their policy decisions, and you simply couldn't tell as to whether you were going to get action on that tax bill in August, September, October, November. In a sense I think the Federal Reserve each month said, "Well, gee, maybe it'll come next month." And consequently they didn't take restrictive action, when in retrospect if they'd have known it wasn't going to pass until June, they probably would have done something.

M: Wasn't there a conflict between the troika and the Federal Reserve System in 1966?

D: No. There wasn't so much conflict in the summer of '66. The conflict came in the fall of 1965, toward the end of 1965.

M: Didn't they raise interest--the discount rate?

D: Yes. What was reflected in that action was this: At the time the best judgment of people inside the government was that the military expenditures for Viet Nam would not go up as much as they did. Now that turned out to be a mistake in judgment. But nevertheless that was the judgment. It was felt at the time by the administration that more restraint was needed on the economy. The question came as to whether you'd get this all by taxes or all by monetary policy or part by both. The argument with the Federal Reserve, whose action took place as I recall it on the 5th of December, was should you wait for an overt move on the discount rate until you saw what the budget was and what the tax program was--and you couldn't do it the way this government functions; you didn't know what the figures were as of December 5, 1965--or whether the action should be taken beforehand. Really, the argument and the focus of this was whether you should do something now or in two or three weeks. That's basically what it came down to.

The decision to raise the discount rate was a four-to-three decision by the Federal Reserve Board, which obviously showed that there were some people on that board that thought that it would be well to wait two or three weeks. I don't think anybody really was arguing substantively that you shouldn't have restraint; the real question was what should the mixture be. And the problem was that until you get the budget numbers more solidly in mind, it was difficult to make a judgment as to how restrictive monetary policies should be.

As it turned out, the action at that point in time didn't produce a credit crunch, partly because we were going down with some tax legislation when the final budget figures were in. The Federal Reserve really raised the discount rate and didn't tighten up very much on the availability of credit. It wasn't until the spring that they began to tighten up the credit side. Their raising of what we call Regulation Q, which is the interest level which banks are permitted to pay for savings and time deposits, led to an aggressive bidding for those funds on the part of the commercial banks, put some pressure on the whole interest rate structure, and took money away from the savings and loans and mutual savings banks, which produced a crunch in the housing market, and produced a crunch in the credit markets.

Now during the summer of '66, I don't think there was all that much disagreement between the administration and the Federal Reserve System as to the course of policy. What you were trying to do at that stage was to sort of unwind the crunch that occurred. And it got unwound. I don't recall any basic disagreements. Oh, I'm sure that in the course of the discussions on particular days and particular technical aspects there may have been some differences, but I don't think there was all that much difference between them in the summer. Now the difference really ran in terms of the timing of the move in December 1965.

M: Would you consider that credit crunch very serious, or mildly serious?

D: It looked a whale of a lot more serious at the time than it actually turned out to be. We were able to unwind the impact on housing faster than I think most people thought it could be unwound. Two things: I don't think it was realized that housing starts would go down as fast as they did as a result of this credit crunch. In other words, nobody really foresaw the amount of disintermediation that would occur. Once it had begun, the measures that were taken to unwind it took effect much more rapidly than I think one would have forecast. Partly that was due to the fact that the economy in the fall and winter of '66 was weaker than had been projected, so that you could not only unwind, by various legislative acts and market acts, the impact of this disintermediation and the impact on housing, but [also] as the economy got a little softer, interest rates fell of their own accord. And so we came out of that fairly quickly, but in the summer of '66, the crunch was heavy enough so that there were people calling up here--people whose judgment I respect, I'm not talking about wild men, but people in the financial community--who were scared to death. I think had the Federal Reserve tightened up more in the summer of '66, you might have had a real crisis on your hands instead of one that wasn't as bad as had been anticipated. But at the time it looked pretty bad.

M: In reflecting on such situations, would you desire more flexibility in fiscal affairs?

D: Yes. As a concept, it's highly desirable that the executive have somewhat more latitude in terms of fiscal policy than he has. But to put this in a little perspective too, we went down with a tax program in the early part of 1966 that was admittedly and on its face and presented as such, as a temporary program. It was based on a presumption that the Vietnamese war would be over, and if it were over, you wouldn't want an excessive tax burden on the economy. Therefore the measures that went in were extensions of the excise tax, and an acceleration of corporate tax payments. Admittedly a one-shot operation in the acceleration thing, and admittedly not all that much on the excise thing. In terms of quantities, as I recall it, the whole package was about ten billion dollars, but it wasn't a package that was going to last and it was designed to be a package that wasn't going to last. Now that forecast was not as solid as it should have been; quite obviously the war is still going on in Viet Nam in 1969 now. But it was based pretty much on that presumption, and was so presented. There wasn't anything dishonest in their presentation, it was admitted to be such as it was.

Now in retrospect it would have been far better to have put in the kind of surcharge that we finally got in June '68 in effect in January or February of 1966. Now you ask about flexibility. The Congress acted on that tax legislation with remarkable speed; it took thirty days as I recall it. There wasn't any real delay in that. It acted fast. When we took off the investment credit in the fall of '66, which retrospectively was not very wise and which the treasury on balance didn't like to begin with, they acted fast on that. When you put it back in, they acted fast on that. What took a long time was the big tax reduction bill back in '62-'63. President Johnson's first major achievement of course was to get that thing done, and to get this tax surcharge on. That's what took so long. Now had the executive had the power to put in this 10-percent income thing, which the CED has recommended, I assume under the conditions that he would have exercised that. In that case you would have had this in effect in July, or August, 1967, when we really should have had it into effect. But even under that provision, the recommendations of the CED, the President could put it into effect unless the Congress disowned it. The thirty day period as I recall the recommendation runs, if the Congress then votes against it, you can't get it. The presumption is that the Congress finds it much more difficult to vote positively for a tax increase than not to vote at all. And I suspect that would have been used.

I'm not at all sure, given the reading in the early part of 1966 that there would have been at that time a recommendation for a surcharge of 10-percent. It might still have fallen back on the package that went down. But that was based on this erroneous assumption about the course of the war in Viet Nam. I suppose nobody will ever really know all of the factors that entered into that erroneous assumption, but I think it was a perfectly honest appraisal. It was just a mistake in appraisal. And I've heard Joe Fowler say, he was the Director of Defense Mobilization back in the Korean war, that the only safe assumption to make about any war you're in is that it's going to continue, and it's going to expand. And if that precept had been followed, I suspect we would have been better off.

M: As an economic tool, would you be in favor of a President having the power to, say, put on a surcharge?

D: Yes, within limits. I don't think that it's very likely that the Congress is going to grant a President that power. The House is very jealous of its prerogatives in this respect, and it delegates certain taxing authority to the President from the Constitution. The House Ways and Means Committee is very jealous of its responsibilities in this area. From the standpoint of an economist, I would say this would be a fine thing to do. Maybe one day it will be done, but I don't see in the immediate future any real prospect of it.

M: From what you've suggested, the Congress can work with dispatch.

D: It can work with dispatch. It is quite obvious that at times it doesn't work with dispatch. It is quite obvious that in the discussion of the surcharge beginning in August of '67, there were all sorts of reasons for opposing this. There were the people who were forecasting deflation, and a tax would accent it. There were the people who objected to Viet Nam and didn't want to make it easier to finance the war. I think they were dead wrong, but nevertheless that was their position. There were the people who hoped the whole problem would go away; there were the people who said, well, do it with monetary policy, and so on. There was an election coming up the next year. There were all sorts of reasons. The net result was that you didn't get any action on this proposal until finally in the summer of '68. I think myself that the prime mover in getting action was the fact that the international monetary system seemed to be going to hell in a handbasket. We had the gold crisis and the gold rush, and you established the two-tier system, and you could talk all you liked about forecasts. Secretary Fowler made this point all the way along--you could forget about the forecasts, what we've got is trouble now. And I think that had a profound effect in changing public opinion.

And it's an interesting commentary incidentally on the politics in this. One of our men here, Joe Bowman, who is the assistant secretary, but had the responsibility for the last four years for our legislative programs in the Congress, did an analysis of the election returns in terms of the tax legislation. And as you know there was very little change in the Congress anyway. As far as you could see, the tax bill had absolutely no effect on the election whatsoever. There were some cases where districts were changed, and you really had two incumbents running against each other. In some cases both would have been for the tax bill, in some cases both had been against it. But in the cases where there was one for it and one against it, I think there were more cases where the fellow who voted for it won than the fellow who had voted against it. As a matter of fact I think there was only one case where the fellow that voted against it beat the fellow who had voted for it. And in none of those elections did it seem to be any issue whatsoever. Bowman's conclusion is that the political repercussions of voting for a tax increase in an election year, in 1968, simply weren't there. That the country was far more concerned about other issues and far more concerned about running the economy better so that the guy that was voting for a tax increase didn't get penalized at all. That took I think a little time for the congressmen to recognize when they voted for the tax bill back in the spring. I think in general most of the congressmen I've talked to idly about this would agree with that. It just simply wasn't an issue.

M: You've got a one o'clock appointment. Why don't we break at this point and I'll make another appointment to see you.

D: Okay.

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By Frederick L. Deming

to the

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