INTERVIEWEE: FREDERICK DEMING (Tape #3)

INTERVIEWER: DAVID G. MC COMB

February 17, 1969

M: This is the third session with Frederick Deming. I am now in his home in Washington, D.C. The time is 2:25 in the afternoon, and the date is February 17, 1969, and I am David McComb.

We were going to talk a little bit about taxes, and you were in office about the time of the excise tax reduction in the middle of 1965.

D: I think that's a good place to start. Perhaps we ought to take one jump farther back. You will recall that in the period from '62 through '64 there was a lot of attention being paid to the desirability of reducing taxes, and there was a massive tax reduction, individual and corporate income taxes, that President Kennedy sent down. The legislation actually didn't get passed until President Johnson came into office. But it took a great chunk out of federal revenues. Following on, in addition there were some adjustments made in the depreciation schedules and in what I guess you'd call the general field of corporate taxation that further reduced taxes beyond the legislation of the Tax Reduction Act of 1964--whatever it was called.

Continuing on that kick it was decided it would be desirable to reduce excise taxes. The forecast from the end of 1964 through 1965 was for an economy that wasn't going to be terribly weak but one that wasn't going to be awfully strong either. No one at that time could foresee that Viet Nam was going to kick up as much as it kicked up. And so it was deemed desirable to have some further tax reductions. Now those excise taxes had gone on in World War II as "temporary" taxes. But they'd hung on, and it's always difficult to take taxes off because you need the revenues and you really have to find out some way to get some additional revenue. But when the economy was going strongly enough, the massive tax reduction of '64 had done what it was supposed to. It had generated more revenues really rather than less because the economy had gotten stronger, and so you could make a move to take some of the excise taxes off. I don't remember the figures precisely, but the excise tax reduction was voted to take effect partly at the time, and partly later on. For example, the tax on automobiles, the tax on transportation, the tax on telephones, was scheduled to go off in steps. I'd have to refresh my memory as to the precision of that. That went through.

Then beginning about the middle of 1965 the economy began to run hotter. I think it began to run hotter for two reasons: one was Viet Nam and probably the principal one. But it hadn't been as weak as had been expected generally anyway. So that by the time you came to the first part of 1966, or the latter part of '65, it was quite evident that you needed some sort of restraint. And the amount of restraint that was necessary depended on one's judgment as to how much Viet Nam was going to really affect the economy. The official guesses about Viet Nam where budgetary policy was being handled was that the war would be over without definite terminal date, but nevertheless in terms of the budget you were projecting no real increase in expenditures in Viet Nam. You use up the stuff that's in the pipeline and so on. You budgeted through the middle of 1966 for an increase, but not as much of an increase as actually occurred.

It was recognized, however, that more restraint was needed. The

Federal Reserve took some action in the monetary field, and the administration went down with a tax increase bill which was essentially in two pieces. It deferred the further cuts in the excise taxes and again put them on a schedule--just pushed them off a year really, the deferments--and it sped corporate tax collections. There wasn't any increase in tax liabilities. They were just required to pay their taxes more quickly. Altogether, that, plus the social security taxes that were coming in, added about ten million dollars in fiscal restraint in calendar 1966. And that legislation was passed very rapidly. My recollection is it went down at the end of January, and by the end of February it was through, which was a partial answer to those that talked about giving the administration authority in both taxes without going to the Congress, or perhaps an amendment to that would be to invoke new taxes and if the Congress didn't disapprove them, they'd go into effect. But here the Congress acted very rapidly.

M: What was your role in all of this?

D: No more than general economic analysis and the obvious need for more fiscal restraint which I pushed and did some legislative lobbying work and some talking to Congress and went down with Secretary Fowler when he testified on these things--that sort of thing. Nothing beyond what you'd call a broad economic approach to it.

You must recall that in the atmosphere at that time you had two choices. One was that you could put in what you might call real taxes that would go on for a period of time, or the other--you could use a temporary tax for the thing, and that it would run off. You'd just collect the money faster. But if Viet Nam went off, if you did have peace in Viet Nam, it would be expected to have some sort of a depressant effect on the economy, so that at that stage you wouldn't want to have further taxes.

Now those that were pushing for more regular taxes simply challenged the idea that Viet Nam would end. They turned out to be right. They challenged the idea that you should do this by a temporary tax measure, and said in effect that what you were really doing was not taxation. You were really just collecting it faster and consequently putting pressure on the monetary system, and in effect it was leading to a tight monetary situation which it did in the summer of 1966.

Recall again, however, that in the latter part of 1966 the economy softened up some, and did in early 1967. So that going down for a tax increase at that stage may or may not have been good economic policy. I happen to think it would have been good economic policy, in retrospect, to have done it in the latter part of 1965. But you're past the latter part of '65 and you're into '66. And there was some question as to whether, when this temporary tax measure was going to run out. You see, it was really operative during fiscal 1967. It was going to run from mid-'66 to mid-'67 basically in its impact, so there were some arguments about whether you could have a tax increase.

[telephone interruption]

In the debate on taxation that could be used to further cool down the economy, although as I said, it was not running as hot in the latter part of '66 and early '67 as it was thought, what was actually done was to remove the investment credit. Almost as soon as it had been removed, the economy got softer and so then the game was to put it back on again. And it went off, as I recall, in November and was back on again in February. When I say off, of course, it's really a tax increase, and when I say on, it's a tax decrease because the investment credit operates that way.

By early '67--

M: Incidentally, did you have any trouble explaining this to Congress?

D: A great deal of trouble explaining it to Congress. There are two points that I suppose should be noted here. The Congress still thinks basically in terms of taxes for revenues and balancing budgets, or reducing deficits, or building up surpluses. It is highly suspicious still of taxation as an economic policy instrument--partly suspicious of this because the forecasts haven't been all that good all the way along, but partly it's just suspicious about what you might call fine-tuning the economy. The tax writing committees by and large think that taxes ought to remain basically unchanged so that business can plan around in that case. That doesn't mean you shouldn't have tax reform, that doesn't mean you should never change taxes or never raise them or lower them, but they think in terms of raising or lowering them more in terms of the government financial problem than they do in terms of economic policy. That may change, but this is the Ways and Means Committee's basic approach at any rate from what I have seen in talking with the members and testifying before them.

By early '67 it was quite apparent that you couldn't tell when Viet Nam was going to end, the expenditures were increasing, and all the forecasts were for a pretty strong economy certainly by mid-year. So the President's budget message in January '67 asked for a 6-percent surcharge that would go into effect about mid-year. Now in terms of legislative procedure, he actually had to send a specific bill down, but the budget message did call for this.

M: Was this 6-percent surcharge discussed by Treasury people?

D: Oh yes. This was run straight through the Troika and with the Federal Reserve people participating in it, and the Council and the Budget Bureau and the Treasury.

M: Were you in agreement with this?

D: Oh yes. I was in agreement with the 6-percent. If you will recall, I said in one of these earlier interviews that part of my personal problem in connection with this was that I was away so much that a lot of the discussions that were carried on about this, I literally wasn't in the United States. When I was in the United States, I took part in them; when I wasn't in the United States, I didn't.

Here again, the question of forecasting what the economy was going to do proved to be a pretty difficult thing to sell. The Council and the general body economic, in terms of the academics and the professional forecasters, were agreed that the economy was going to go up, but there weren't any real signs that it was going to move up all that rapidly. And it's pretty hard to sell the chairman of the Ways and Means Committee and the various other members of the Ways and Means Committee that something is going to happen when you haven't got anything that you can point to right now to indicate that it is going to happen. Secretary Fowler made a series of talks and a series of presentations before the Congress which attempted to make the case that even if the economy weren't rising as high as some of the forecasters had said, that we were running a pretty substantial budget deficit and you needed some action right now. And they paid some attention to that, but not enough.

At any rate, by the time the legislation went down in August--very early August, the 3rd as I recall it--it was a 10-percent tax surcharge. The estimate of the economic heat had been raised, and it was decided that you needed more taxes then rather than the 6-percent. It went down and languished. The history of that period is so well known that I don't need to do anything more than summarize it in capsule form. There were hearings, there were some other hearings--

M: Were you in on some of these hearings?

D: Oh yes, in a great deal of this, and in a great deal of the talks with individual congressmen. But Secretary Fowler himself carried the major brunt of this. He saw I don't have any idea how many individual congressmen; he was a regular evangelist on this theme, and he buttonholed everybody.

Incidentially, I might say right here that I think he's due more credit for the passage of that surcharge on corporate income than anybody else in the country, and due it more than most people give him credit for. I haven't any idea how many individuals in terms of Congress and people that he got to talk to congressmen and other --how many of those interviews he had. But he spent an extraordinary amount of time on this.

But it languished. And as it languished--

M: You did the same sort of thing?

D: Yes, but nothing like as much as he did. He practically lived with President Johnson and Wilbur Mills during this whole period. I haven't any idea how many times he saw Chairman Mills. A good many times I went down to see Chairman Mills and talked to him in terms of what was happening to the debt limit, what was happening to the budget deficit, what was happening abroad, what the Europeans thought of us for not taking fiscal action. We even took down on one occasion in the spring Emile VanLennap, who was the chairman of Working Party Three, and who happened to be over here on a visit. We took him down to talk to Chairman Mills. Everybody in the world was telling us that we ought to have fiscal action. And after all, we ended up with a budget deficit that was more than twenty-five billion dollars, so it was perfectly evident that you needed to do something.

M: Incidentally, do you have some opinion of the capabilities of Wilbur Mills?

D: I think he's an amazingly capable man, and he thoroughly understands the problem. But there were wheels within wheels in connection with this. The Ways and Means Committee doesn't have any jurisdiction over appropriations. It can fume about appropriations, but it can't do anything about them. Back in, I think it was in 1946 or '47 there was an act that Congress passed which in effect said this: "When the President's budget comes down to the Congress, the Congress should study it, evaluate it, the appropriations sub-committees should do their work; but after all the appropriations sub-committees have done their work, you add up what those appropriations are and then you bring them back down en toto to what the Congress has decided it wants to do with the President's own budget." Now that puts the responsibility on the Congress.

It was never done. It's too difficult to do, and the different subcommittees in the appropriations process are pretty much feudal kingdoms of their own. Nobody pays much attention to the budget total. I don't mean to say that they're not doing their job on their particular segment, but if their particular segments add up to more than demanded, nobody ever does anything about that. So part of the problem in getting this tax legislation passed was getting some sort of control over expenditures. And in doing that here is where, again, Secretary Fowler performed yeoman service because he brought together in effect the appropriations committee under Chairman Mahon and the Ways and Means Committee under Chairman Mills and the same thing in the Senate, so that they were working a bit more closely together. His job then was to try to convince the Congress that they shouldn't try to cut expenditures too much because this is not practical to cut them too much, and Mills and Mahon understood this; and to convince the President that he had to have some budget cuts himself if he were going to get the taxes.

The whole game, if you can call it that, was to get an adequate packet of fiscal restraint which was partly tax increase and partly expenditure reduction. Now a lot of people on the outside all thought, and you've even heard some people in the Congress argue, "Well, you could do it all with expenditure reduction." As a practical matter, that just won't work.

They finally settled on a 10-6 package--six billion dollar cut in expenditures and about a ten billion dollar increase in taxes. And that tax package involved not only a surcharge on individuals and corporations, but again deferment of the excise taxes. But it languished in the Congress, it was not passed finally and signed until the very end of June 1968, so it was roughly a year in the process. And in that year we ran a deficit of 25.3 billion dollars. And that meant that the Treasury had to finance that.

M: Is there any way to determine whether that surcharge act was a victory or defeat for the administration?

D: I think it was by all odds a victory for the administration, a victory for the whole process of democratic government, because you needed fiscal restraint. Now there is no question but what the President was unhappy at taking as much of an expenditure cut as he took to get the surcharge. He was willing to take certainly four billion, maybe five billion--six billion he thought was too much. The President wanted to have some expenditure cut, there was no question about that. It got down to a question as to whether it was going to be really, four, five, or six. And so in that sense there was a long delay. That he couldn't make his writ run for almost a year, I'm sure annoyed the President a great deal, and he regarded that as an infringement of his own authority and position. But I think in the final analysis that you'd have to class this as an administration victory because the total package by and large was a pretty good package.

M: Incidentally, did the Internal Revenue Service get in on this to any extent?

D: You mean in terms of policy? No. The Internal Revenue Service's major contribution to this was in working out all of the details, the forms, the withholding tax, and that sort of thing.

M: The mechanics--

D: The mechanics of it. By and large the Internal Revenue Service in matters such as this doesn't enter into the discussions. Now, Sheldon

Cohen was in close touch with Stan Surrey and with other people in the Treasury and he may have had personal views of whether you ought to have more corporate tax and less individual tax, but that isn't the Service's function. It's an operating agency more than anything else. They do make rulings, of course, that affect individual taxpayers' liabilities, without any question. And they in effect make rulings that affect the broad aspects of classes--business groups etc. tax liabilities. But it isn't tax policy as I am talking about it here.

The thing that I really think made the final difference, once the administration and the congress agreed that there would be an expenditure control portion of this act, as well as a tax motion, was that th international system got so bad. We had the gold market blow up and sterling devaluation and we lost a lot of gold, and then we had two-tier gold system. And it became quite evident that if I were talking to any member of the Ways and Means Committee that I had something to talk about when you could see what was happening abroad on this. And the chorus from all over the world was that the United States really wasn't running its economy very well. And why couldn't you get some fiscal restraint when we lectured everybody else about doing these things--why couldn't we get it done ourselves!

M: Was this a persuasive argument to use with Congress?

D: In the initial phases, I don't think it was very persuasive. But when the international monetary system looked like it was on the verge of blowing up, it became quite evident that this wasn't a group of people that were just crying "wolf," it was there. We lost a lot of gold from our reserves, and the whole system was under pretty violent speculative attack. There wasn't any question about Chairman Mills' believing this all the way along--he understood the problem here--but the average Congressman I don't think did until it was brought home in that sort of dramatic fashion.

We also worked very hard with various groups--labor, business, academics, etc, to get them to support the tax measure, and they all did.

M: When you say "work hard," you meet with them in appointments, you give speeches--

D: That's right. But we met explicitly with them. For example in May, towards the end of this fight, there was an American bankers' meeting in Puerto Rico which Treasury people normally go to, and there are roughly a hundred of the heads of the biggest banks in the country there. Joe Fowler came down there and we set up a series of meetings with bankers from various sections of the country--you had New York, you had California, you might have Michigan, Minnesota, Illinois together, that sort of thing. I think there were nine or ten sessions where he just gave them a fairly long lecture on the importance of the tax bill, and said, "Now you get out and work." And they did. And they did a pretty good job on it.

M: And they would talk to their congressmen?

D: They'd talk to their congressmen, they'd talk to other bankers who would talk to their congressmen, and there was a regular reporting service on how well they were doing so you got some sort of a count on how the Congress felt, not merely from our talking to them but how others did.

M: Is this sort of contact common in a major effort?

D: Yes. It's quite common. I must say this, however. Fowler is a regular genius at this sort of thing. He has done this kind of thing before. He has been in and out of government for the last thirty years. He was undersecretary of the Treasury, which meant he carried the major legislative load before he was secretary. He knows all the members of the Congress, and I think they have respect and affection for him. He never tells them anything except the straight and absolute truth. He has got a wide acquaintance in the business community. He has been active with business council people, and he knows how to organize. He has been active politically in this same sort of thing, and he knows how to organize this kind of an effort. And it is a massive effort, and it's lobbying--there's no question about it. I happen to think it's lobbying for the right thing. There certainly aren't any selfish interests involved in doing it this way, nobody really wants to pay more taxes. But it was a very effective effort. And he outlined it. Others of us did some work on this, but he outlined it and did an awful lot of this contacting himself.

M: In organizing such an effort, would he delegate people for you to see, say, for other people--

D: Oh yes. But in the Treasury, we met every morning at a quarter-of-nine --sort of a small group in the Treasury, a half dozen people--to determine what needed to be done. This was not merely in terms of the tax bill. We did it always. Delegation is perhaps a stronger word to use--in talking about this, you just sort of share it out, what you were supposed to be doing.

M: It's more informal than that then?

D: That's right. And on the checkout of the bankers, since I happen to know bankers probably better than other people in the Treasury, these people would call in to me and say, "We've seen Congressman So-and-So, we're convinced that he's for the tax bill. We've seen Congressman So-and-So, we think he's against the tax bill." And you just kept a running record of this. They called in from all over the country on what was done.

M: And I suppose sometimes you'd call them?

D: Oh yes, I should say! The calls went back and forth. I'd talk particularly in terms of what the international attitude was. I did a lot of talking to various congressmen on this matter. Fowler carried the testimony directly always--this is an old tradition at Treasury, the secretary does the talking most of the time. But it was a common effort. All I'm trying to say is that Fowler is a genius at this sort of an organization. He can say, "We need this kind of a group to get in here too." He did himself a great deal of the business organization on this. A lot of those people came out of the old business committee for Johnson and Humphrey, and a lot of them had been participating on the old committee for tax reduction, and now there was a committee for tax increase. Henry Ford, Sidney Weinberg, I mean people like this, that would work on this. And that didn't absolve the Treasury, however, from the regular nitty-gritty of having to do its own talking to the Congress.

It eventually got passed, and the bill had no more than been signed when people began to worry about fiscal overkill--that it was too much. I can remember saying to Joe Fowler in April, I guess it was--maybe it was in March, April, May, somewhere around in there--that there was a lot of talk that sixteen billion might be too much, that you'd have ten billion in taxes, four billion expenditure reduction was about right, and sixteen billion would be too much and it would turn the economy into a tailspin. There was a lot of talk of this--not many in government, outside government too from economists. And I said to Joe one time, "My guess is that you can't get passed through the Congress a total package of taxes and expenditure reduction that's too big for the economy. Theoretically, you obviously can have too much, but practically I just don't think you can have too much that you can ever get through the Congress itself." Well, that quite obviously has proved to be the case. The economy was stronger than I think most of the analysts gave it credit for being. I think the tax bill is going to work fine, but it wasn't going to throw the economy into the tailspin that most of the people [thought]. Again I'm not talking purely about the government economists, I'm talking about people outside--the academics, and the business economists, for that matter. But what it accomplished, what's accomplished so far, it cut the GNP increase which had been running at roughly twenty-two billion in the first two quarters of the year and the last quarter of '67 down to eighteen billion in the third quarter, down to sixteen and a-half billion in the fourth quarter. I don't know what it's going to be in the first quarter this year, but it looks like it's going to be somewhere around fourteen to fifteen billion, and it's operating I think quite well.

One other point ought to be noted here, and it's in connection with the debt-management operation. With the federal government having to borrow in fiscal '68 twenty-five billion dollars to finance the deficit, we obviously put a lot of pressure on the markets. We did a little chart for our own internal use and you could see on that chart--I wish I had a copy, I could show it to you--you could see on that chart that when it looked as though the Ways and Means Committee was about ready to take affirmative action on the tax bill--we ran it all the way back to '67--the interest rates went down, and the stock market strengthened. And when it looked as though they weren't going to do something, interest rates went up and the stock market weakened. In other words, the markets were saying, "If you don't get the tax bill passed, we can see that inflation is coming hard. You're obviously going to have to borrow more money --and that means interest rates are going to be up." And while you might think that this would strengthen the stock market, what they were afraid of was the economy would go into a decline after this and therefore they were scared. I can remember showing this chart to Chairman Mills one time--we didn't ever put it in the public record--he said, "I know that. I can see it myself that a statement would be made that you'll never get it. Bang! You go this way. A statement will be made that it looks like you're going to get it, and then it'll go the other way."

You were in this sort of peculiar position--everybody almost knew that you had to have this. Nobody could conceive of the government of the United States not doing what was necessary in this case; what they couldn't really understand was why it took them so long to do it. And my foreign colleagues simply never could get through their head why we couldn't get this passed. Now, they have trouble with taxes. They understood this. But they couldn't understand why when it was so obvious that something should be done, why you couldn't get the Congress to move on it.

But as I say, it got passed, and it has worked reasonably well. Perhaps there should have been more fiscal restraint. Certainly it should have come earlier. It undoubtedly had a pronounced effect on our trade balance because the economy ran too hot and we sucked in imports. It undoubtedly had an effect on confidence in the dollar internationally and domestically. It undoubtedly let inflation get ahead of us. And this on-again, off-again operation that went on for a year led Federal Reserve policy to being too easy, too long. I think I mentioned this before, but the central bank was in the unenviable position of knowing that you needed more restraint, afraid that if it put monetary restraint to work hard that it might let the Congress off the hook and you wouldn't get the fiscal restraint, and so you'd get another monetary crunch. Or if they put it on too hard and then you got fiscal restraint, you'd get too much. So it vacillated probably longer than it should in retrospect, although if I'd been running it I'm not sure I wouldn't have done the same thing. Each month it sort of looked as though you were going to get it, and so they'd sort of defer their tightening-up policy. I think the Federal's major sin was reading what everybody else was saying about the economy softening up too much from the tax impact, and relaxing monetary policy after the tax bill was signed too quickly. This is what most people are criticizing them for now at the present time. With the result that by relaxing the monetary policy, they sort of offset some of the fiscal policy action. And given the underestimate of the strength of the economy is one reason why you've had the economy running somewhat hotter than it probably should have run. The pattern would probably have been better if it had gone from twenty-two instead of to eighteen to, say, fifteen, then to thirteen instead of sixteen-and-a-half, then to ten in the first quarter of this year. That would have been a better pattern.

M: Is there any major turning point in the passage of this surcharge act in your mind?

D: I think two things were critical here. One, when you came to a meeting of the minds between the President and the Congress that there would be an expenditure reduction of approximately this six billion dollars, and that didn't come until around about May; and secondly--

M: What brought that about? Just a matter of compromise?

D: Just constant shuttling back and forth by the Secretary of the Treasury between the White House and the Congress. And the second thing that made the Congress, I believe, firmly convinced that you needed it was the gold rush. That I think put them in the frame of mind that you had to do something. Then the details as to what you were actually going to do got worked out when the President and the Congress finally came to an agreement. There were, I suppose--and I don't know about all of these because I wasn't in on all of them --but I suppose there were lots and lots of sessions between the President and the leadership. I know there were between Secretary of the Treasury and the troika and the President, and the Secretary of the Treasury and Treasury people with the Congress. There were just all sorts of sessions in which you were trying to hammer out some sort of a possible compromise. And I think in the final analysis what they came out with was pretty good. It was painful to do the six billion dollar cut. The Congress, as soon as it had got it done, began exempting things that didn't count in this cut, but I think it achieved a workable arrangement.

What may be more important over the longer pull, it may have achieved the sort of thing that the Congress was thinking of twenty years ago when they said that you ought to put the appropriations and the spending and the taxing committees together. So that there is some hope, I think, for the future of working out a budget in a little more coherent fashion rather than going through the process that I described where the appropriation subcommittees were taking their own actions and whatever the total turned out to be that was what it was, and without regard to how you were going to finance it. If you can get them together and working together, it ought to be a better system.

M: Meanwhile you had a problem of debt.

D: Well, the financing, as I say, put the pressure on the markets. We were hung on a limitation of seven years on securities on which we could pay market rates of interest so that we couldn't sell any securities beyond seven years. There's a four-and-a-quarter percent ceiling on that, and obviously with interest rates much higher you couldn't sell them. So we had to confine our financing to the under seven-year area. We had to be pretty constantly in the market in borrowing money, and this tended to push other would-be borrowers off the bench. Because unless you let the central bank just run rampant as an engine in inflation, you have at any given point in time--any given year--a sort of a pool of savings that can be borrowed. The central bank can increase that by making credit to do the six billion dollar cut. The Congress, as soon as it had got it done, began exempting things that didn't count in this cut, but I think it achieved a workable arrangement.

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In any given year the total amount of funds that are available run seventy-five to eighty billion to ninety billion dollars. Now if the Treasury is taking out two-and-a-half billion dollars, that's a fairly small proportion of it. If it's taking out twenty-five billion dollars, it's a big chunk of that total pool for the year. So it puts not only pressure on interest rates in general, but it takes money away from people who would like to borrow it in the private sector. I'm defining in the private sector, everything except the federal government. State, municipalities, and federal agencies, and so on.

So that it became a difficult financing job. We did it fairly well, I think, but interest rates did move up. Part of the problem of this higher interest rate that I've mentioned, that you'd see go down and then go back up as the market was interpreting what the Ways and Means would do, it never quite came back down to where it was before. So that you had a steady movement upwards, a ratcheting upwards of interest rates, which was intensified by the strength of the Treasury borrowing. And you got a higher rate structure.

I think that if the tax bill had been passed a year earlier you would have had a somewhat lower level of interest rates today than you have at the present time. Now, this is awfully hard to document or prove, and I don't know how much it is, but I'm sure that interest rates would be lower today if the action in Congress had taken place earlier--half a point maybe. The last Treasury financing which has just gone out went with a short issue at 6:42.

a fifteen-month issue, which is the highest since the Civil War. And a seven-year issue at 6:29 or 6:30, which is terribly high--we thought we were paying high rates, but my successor Paul Volcker broke in on a brand new plateau here. It isn't his fault. He didn't have anything to do with it. He had just been in there three days when he had to do this financing. But it has led to a very high rate structure.

For the next year--for this fiscal year--there's going to be a surplus of two and a half billion; next year, three and a half billion. So that the Treasury financing job is going to be easier for the next two years than it was in fiscal '68. And heaven knows, it ought to be! I don't think anybody should have to go through a financing experience like '68. Because normally if a budget is in balance, you get roughly 45-percent of your receipts in the first half of the fiscal year--the last half of the calendar year--and about 50-percent of your expenditures. And then you reverse this. You get 55-percent of your receipts in the second half, mostly in the fourth quarter of the fiscal year, and about the same amount. So even if the budget is in balance, you will find the Treasury borrowing in the fall and repaying in the spring, just the way the revenue flows come in.

Now this year, Treasury debt went up almost ten billion dollars in the six months, June 30-July 1 to December 31st, even with the tax bill operating. But the Treasury will pay down about thirteen billion dollars in the first half of this calendar year. Most of that pay-down will come between April and June, and it's anticipated that we'll stay withint the debt limit of three fifty-eight by

June 30, although they may need some relief right at this point in time. That telephone call that [just came], I was just talking to Ed Snyder about the debt limit problem. Because the revenues coming into the trust funds now from the employment taxes and so on are running so much higher than had been anticipated. It doesn't pose a cash problem for the Treasury because it sells special securities, but it does pose a debt limit problem which is purely seasonal and I think purely temporary but they may need some relief right now rather than sometime next fall.

M: Do you still find congressmen and outsiders worrying about the total amount of debt?

D: I don't think you find anybody nowadays who's very sophisticated who worries about the debt total. Talk about paying off the debt--you just don't hear it very much. The idea that you've run a budget deficit is not regarded as mortal sin any more. Now what is regarded as mortal sin is twenty-five billion when you should not be running it. But the compensatory fiscal policy is, I think, widely accepted now. What isn't accepted is that you can forecast and use your tax policy in the future to adjust the economy in the future. That has not been accepted yet. But the idea of running surplus as when the economy is running strong and running deficits when the economy is running weak--that I think is accepted. And I think even this principle of the new economics that it's a good idea to have tax reduction to strengthen the economy even though it produces a deficit --that's accepted.

The other half of that proposition is what didn't get sold--that if the economy is running too strong that you ought to have a surplus and that you can do this on a forecasting basis, that part they didn't do. So as my friends Walter Heller and Gardner Ackley would say, "There's nothing really wrong with the new economics if anybody would apply it." But implicit in the new economies is that you would have tax increases when you needed them as well as tax decreases when you needed them. And it took Congress, don't forget, two years to pass that tax reduction too. But the principle of deficits is not really argued very much any more, that you should never have a deficit. And certainly there is no great concern about the level of the federal debt. It's viewed in the proper perspective as relative to the gross national product, relative to the national income, and it isn't regarded as sinful to have a big public debt. That doesn't mean that if you have a surplus you shouldn't pay some of it off. But it is not regarded as being the be-all and end-all of policy. I think by and large most people, [agree] let's say, that if you ran a surplus in the federal revenues, you ought to share it in three ways: maybe some debt reduction, some tax reduction, maybe some expenditure increase for worthy projects.

M: Would they ever give a rebate to the states as was once done?

D: I think that that probably is something that will take place. What form it will take, I simply don't know. But I suspect that some manner of sharing federal revenues with the states--which has been done of course, through grant programs and so on. But some--shall I say more scientific method--of sharing with the states probably will be in the picture before too long. In a sense this proposal for an urban development bank tends to do that. You could do this by providing certain interest rate subsidies which would be in the federal budget, and let the states and municipalities come in and borrow from the urban bank, which then would sell its securities in the market. That's a revenue sharing device in one sense. But fund rebate of direct taxes to the states, the Heller-Pechman plan, I wouldn't be surprised if that came along. I don't think it's going to come this year necessarily, but it'll come along I suspect.

M: Is there anything that we should talk about that we haven't talked about?

D: I can't think of anything that hasn't been covered. We've done the debt management; we've done the taxation; we've done the international; the gold.

M: We've talked about your office--the evolution of it.

D: Yes. I think it's reasonably well covered.

M: Good. Before I close this interview, I'd like to ask you about a story I heard about you and see if it's true or not. Apparently shortly after you took office--a week or so--De Gaulle was making a speech, and there was supposed to be some sort of presidential response to that.

D: I remember it very vividly, yes.

M: Would you mind telling this story?

D: It ran like this: I think it was on the 5th or 6th of February. There wasn't anybody else in the Treasury. We had no undersecretary, and we had no general counsel at that stage. Dillon was on his way out. He'd been trying to get out, and the President hadn't named his successor, and he was testifying up on the Hill when De Gaulle came out with this statement. The President was having a press conference. And he called up, and it was the first time I had ever talked to a President on the telephone.

M: This was about a week after--

D: Yes, this was in early February. We knew he'd need something. And when he called, I said, "Mr. President, I'll be right back. We'll have a statement for you within three or four minutes," because it was going to be very short--just something that he could say. And we drew it up--I had some help--we drew it up, it was very short, and I called it over to George Reedy. The President had said, "Call me back with it," but I didn't really think that you could call a President back. [laughter] And I called it to George Reedy, and then went in the Secretary's office to watch the television show. And nothing happened for awhile. And about five minutes later the phone rang, and it was the President again, and he said, "Why didn't you call me!"

And I said, "I called it back to George Reedy."

He said, "I don't care who you called it to. I told you to call me. Now, let me have it." And he wrote it down apparently in pencil there. He was obviously annoyed.

And George Reedy called me back right after the press conference and said, "I'm sorry. I was standing with that. I had it written out but the President wouldn't listen to me."

And I said, "I didn't know that I was supposed to call the President back directly."

He said, "Well, that's what he likes, so the next time you call him back directly, and don't just call me." [laughter]

That's perfectly true. It blew over--there wasn't anything to it, but I suspect that had Dillon been there he would have called it in to the President or else I would have--he'd have told me to call it in. But it just never occurred tomme that you picked up the telephone and called him directly at that stage. I learned that later.

M: With that story then, this would be a good point to end the interview, and I thank you for the time.

D: I've enjoyed it.

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By Frederick L. Deming

to the

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