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INFORMATION

THE WHITE HOUSE
WASHINGTON

Tuesday, November 21, 1967
11:40 a.m.

Mr. President:

Herewith for your diary are
Ed Fried's clear, terse notes on
your November 18 leadership meeting
on the sterling devaluation and tax
increase.

W. A. R. Rostow

MEMORANDUM

THE WHITE HOUSE

WASHINGTON

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Sunday, November 19, 1967

NOTES ON THE PRESIDENT'S MEETING WITH THE LEADERSHIP

SUBJECT: Sterling Devaluation and the Need for Tax Increase --
November 18, 4:30 to 7:00 P. M.

PRESENT:

The President	Senator Mansfield	Speaker McCormack
Secretary Fowler	Senator Long	Representative Boggs
Chairman Martin	Senator Anderson	Representative Ullman
Under Secretary Barr		
Under Secretary Deming		
Budget Director Schultze		
Walt Rostow		
Joe Califano		
Ernest Goldstein		
Art Okun		
Ed Fried		

Secretary Fowler -- Discussed actions to be taken in defense of the dollar during present crisis.

- The President's statement -- designed to remove any uncertainty regarding U.S. intention to stand firm.
- Financial diplomacy -- getting all other major countries to hold their rates with us and prevent a chain reaction.
- Building confidence in the dollar through demonstrating fiscal responsibility and other constructive measures to improve the balance-of-payments position. Read concluding portion of statement he made at November 16 press conference announcing programs to strengthen U.S. balance of payments. Stressed that enactment of President's tax increase program at this Session of the Congress was the single most important and indispensable step the nation can take now to protect the dollar, safeguard the international monetary system, and stop the interest rate escalation that threatened our domestic and international position. The devaluation of the pound now brought the requirements for fiscal action and the tax increase into even sharper and more critical focus.

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Chairman Martin -- Stressed the great uncertainty that currently plagues the securities market and the cost it is exacting in higher interest rates. He cited recent examples: a Nova Scotia bond that required a 7 1/4% yield; postponement of the U.S. steel issue when financing was not obtainable at 6 3/8%; a Treasury 5 3/4% that sold below par.

Essential to stop and reverse the trend of accelerating deficits or inflation would get out of hand. Sterling devaluation complicated the situation and made it all the more important to restore a position of confidence -- which required evidence of fiscal responsibility.

Under Secretary Deming (The President said Deming had been sent to meetings in Paris during the week in an effort to mobilize a multilateral support operation to save the pound.)

Deming noted two points:

1. Situation in London was black; nobody wanted to see the pound go, but in the end they could not see any feasible alternative.
2. U.S. last year, in its financing operations, paid back \$11 billion to the market in the second half of the year. This year, we would only be able to put back 2 1/2 billion -- even with a tax increase. This tremendous swing from last year would greatly tighten credit conditions.

Under Secretary Barr -- In the credit crunch, the big fellows would manage to meet their requirements but the smaller borrowers, the institutions, and housing will get squeezed and suffer.

Director Schultze -- Discussed possible expenditure reductions totalling \$4 billion:

- \$1 3/4 billion Congress had already made or would make in the 14 appropriation bills (of which 12 already completed);
- \$2 1/4 billion Administration could make in withholding expenditures if Congress prepared to stand the pressure.

The President -- Prepared to cut actual expenditures by one dollar for each dollar of tax increase. Secretary Fowler had been ready to offer 4 different proposals to achieve this end to the Ways and Means Committee, but the Committee acted without giving him the opportunity to put these proposals before it.

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We will rue the day if we fail to face up to these critical responsibilities. If we don't act now it will not be possible to undo the harm that will result. Every day's delay is costly.

He had had nine discussions with Chairman Mills.

He was trying to convince those members of the leadership he could -- but the President cannot act for the Congress. He was prepared to accommodate his views to theirs and to this end advance proposals for a cut of \$4 billion in expenditures.

Secretary Fowler -- Senator Williams had written him a letter on November 7, which he has not yet answered. The letter is essentially a campaign document designed to hurt the Democrats if it were answered under present circumstances. (Fowler read letter which made two central points)

1. A tax increase bill has not been introduced in either House.
2. Uncertainty is causing financial disruption with serious consequences for the economy and our international position.

Senator Mansfield -- Williams' argument is spurious. There is no indecision on the part of the Administration -- it had constantly advanced its tax increase proposals.

Rep. Boggs -- Normal to work from proposals. Was willing, ready, able and happy to introduce bill.

Speaker McCormack -- Need for tax increase. In his view President not asking for big enough tax increase.

Secretary Fowler -- Read his proposed answer to Senator Williams with stress on concluding portion outlining Administration's new proposal to break deadlock between spending and tax powers of the Congress.

Package would:

- reduce administrative budget deficit by \$11 billion in Fiscal '68, and relieve credit market to this extent;
- increase income taxes of individuals by \$3.9 billion;
- reduce actual expenditures (counting actions taken by Congress on appropriation bills) by about \$4 billion;
- increase corporate tax receipts by \$3.1 billion (\$2.3 billion surtax -- \$.8 tax collection speedup).

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Extending excise taxes could add \$.3 billion.

Stressed again that expert opinion overwhelmingly supported need for tax increase. Same with major organizations -- the Chamber of Commerce has now come around in support.

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The President -- He had reviewed the answer to Williams and the new proposal yesterday with Mills in light of the pending sterling devaluation and its serious potential consequences. He told Mills he wanted to review it with other members of the leadership. (He noted other members who had been invited to today's meeting, but were not available.) Mills had been unable to stay in Washington over the weekend.

The President summarized the situation. He said the President cannot impose reductions on the Congress. He is prepared to act and to share responsibility with the Congress if the Congress is prepared to accept its share. He does not want to cut expenditures, but each day of inaction brings increased costs and makes the situation worse. It will lead to some slippage in revenues and to automatic increases in expenditures (higher interest costs, more farm loans, etc.).

The Mills-Ford line is hard to break. Of course the public does not favor tax increases. Nobody likes them. But the leadership must accept its responsibilities or face far more serious difficulties. If reductions in appropriations are not adequate and there is no tax increase, then it will be necessary to impound expenditures -- notably for highways, public works and other areas where the Congress will immediately feel repercussions. (He noted highway expenditures now were a billion dollars over any previous figure and were feeding inflation.)

But do we start or not? The President doesn't want to make the decision alone. Last year the leadership accepted the responsibility of impounding expenditures. If we have to make reductions they will be drastic and they will have to be made soon. This should be done with the full knowledge and approval of the leadership.

If we don't act soon, we will wreck the Republic. The President can't spend what the Congress does not appropriate. The Congress has now acted on appropriations, and now the President must act. He then reiterated the need for the proposed package of expenditure reductions and tax increases.

Rep. Ullman -- Said he favors a tax increase, but a tax increase could not solve the situation alone. When Schultze testified before the Ways and Means there were ambiguities in expenditure reduction proposals.

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The President -- Cited instances where he had made clear the Administration was prepared to match tax increases and expenditure reductions dollar for dollar. He referred again to the Committee's unwillingness to hear Fowler's four alternative proposals to achieve this objective. He set the record straight on Schultze's testimony.

Rep. Ullman -- Sterling devaluation made this a new ball game. There is no point in recriminations. Said he believed there would be widespread repercussions on Monday throughout the economy. Repeated that he did not believe expenditure reductions had been adequately spelled out. But we should now try the new formula.

Secretary Fowler -- Reviewed formula again, together with proposal for President to set up special group to go over programs and prospective expenditure cuts.

The President -- Pointed to need for clearance from Government Operations Committee on \$4 billion expenditure reductions.

Rep. Ullman -- Important to try to put package together in next few days -- before Thanksgiving. The sterling crisis should be a vehicle for getting it done.

The President -- Asked for the views of the leadership on the proposal and on any alternatives they had to deal with the situation.

Senator Long -- Asked Rep. Ullman whether the Committee would report favorably on the tax bill without Mills' support. Answer -- probably not. Senator Long then said that Senator Talmadge doubted that the bill could be passed either in the House or the Senate. Said it would be even more difficult in the House, because the members had to run next year.

The President -- Said any action taken would be unpopular but it would have to be done.

Rep. Ullman -- The situation would be worse if we don't pass the tax bill. Unable to know the outcome beforehand.

Secretary Fowler -- Said it is essential to report out the bill and put it in the glare of domestic and international publicity. Then vote it up or down so everyone would know where each stood.

Rep. Ullman -- Said he would give every support he could.

The Speaker -- Made following points:

1. No tax bill is popular.

2. We are faced with desperate situation and the Congress is on trial.
3. He had personally taken public position in favor of tax bill.
4. It should be possible to get bipartisan support and to begin through action by Mills and Mahon.

Senator Long -- Reserved judgment on his own position but suggested following procedure to break impasse:

1. Sit down with as few people as possible.
2. Heart-to-heart talk between the President and Mills.
3. If the House sent the tax bill over, the Senate would take a look but he was not in favor of the expenditure reductions part of the package.

The President -- Said this was not facing facts and pointed again to the consequences of sterling devaluation.

Senator Long -- Repeated that it was important to get together with Mills, but said Mills could not lay down conditions on which he can't deliver.

Director Schultze -- Pointed out that the tax increase bill provided for \$7 billion during the remainder of this fiscal year, and \$12 billion over the next fiscal year. It was essential to keep the latter in mind.

The President -- Pointed out that the Defense budget for Fiscal '69 that had now been received came to \$98 billion. If Congress did not act on a tax increase, then it would be necessary to start thinking not about a \$4 billion expenditure cuts, but about cuts of many billions of dollars.

Rep. Boggs -- He had given thoughtful consideration to the possibilities of the bill. He pointed out that the Poverty Program had come out much better than anyone had guessed three weeks ago. His judgment is that if the Chairman supports the bill, it would be passed in the House.

Rep. Ullman -- It was necessary to talk to Mills not only about the situation this year, but next year as well, and the consequences of a \$98 billion Defense budget. Also said that Ways and Means cannot originate action on the bill where other Committees have jurisdiction. It's different when the President proposes the bill, and next year's situation is clearly critical. In his view, if the bill gets to the Floor, it will have bipartisan support, but Mills' approval is essential. Mills is critical of a tax

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increase and his speech on Monday is in that vein but the speech does not close the door on action on a tax bill.

The President -- Asked when can we get the Committee to act.

Rep. Mahon -- The House voted by continuing resolution to cut expenditures by \$7 billion which was equivalent to a cut of \$14 billion in appropriations. In his view, expenditure cuts were worse than a tax increase.

The way to get a tax increase was for the President to stick his neck out and cut expenditures by \$4 billion -- even without a tax bill. The cuts should include programs which he considers among his best programs, e. g., Federal Aid to Education.

Mahon would then try to get his Committee to endorse those specific cuts.

He recognized the risk -- that the President would make cuts on his own and then end up without a tax bill.

Secretary Fowler -- Reviewed the formula proposal for making cuts under which responsibility would in fact be shared. (Use of either of the following, whichever is lower: (a) a cut of 2% in personnel and 10% in program; or (b) the difference between the original appropriation request for each program and what Congress appropriated.)

The President -- Stressed the need to work from the package proposal: the tax bill, the expenditure cuts (with the formula) and a review group. The need was to get the Committee to move now.

The consensus that emerged was to organize a meeting with the President Tuesday morning -- which was the earliest it would be possible to get Chairman Mills back to Washington. Speaker McCormack and Secretary Fowler would try to get in touch with Mills. Others at the meeting might include the Speaker, Representative Mahon, Senator Mansfield and Senator Long.

 W. W. Rostow

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