C. Douglas Dillon Oral History Interview – JFK#10, 08/20/1964
Administrative Information

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Dillon, Secretary of the Treasury (1961-1965) discusses issues with balancing the national budget and Treasury work with other economic agencies, among other issues.

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JFK OH

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BY DOUGLAS DILLON

TO THE

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a) Transcripts of ten (10) personal interviews approved by me and prepared for deposit in the Library;

b) Ten (10) tapes, containing the interviews, from which the transcripts were prepared;

c) An unclassified subject index to the transcripts (attached herewith and labeled "Index I"); and

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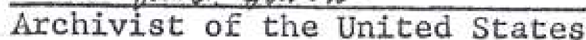
Accepted: 
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Date: Feb. 26, 1965

January 5, 2004

Allan B. Goodrich
Chief Archivist
John F. Kennedy Library
Columbia Point
Boston, MA 02125

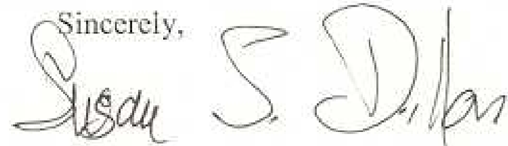
Dear Mr. Goodrich:

This is in reply to your recent letter regarding the interviews my husband, Douglas Dillon, did for the John F. Kennedy Library Oral History Project in 1965.

I have looked over the documents you enclosed with your letter, and I agree that there are no longer any reasons to restrict access to the transcripts. As authorized by his deed, I hereby annul the clause that closes Mr. Dillon's interviews for a period of five years following his death that was originally stipulated in the deed.

This letter authorizes the Kennedy Library to open his Oral History interview tapes and transcripts for general research use without restriction.

Sincerely,



Susan S. Dillon

C. Douglas Dillon – JFK #10

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Tenth Oral History Interview

with

C. DOUGLAS DILLON

August 20, 1964
Washington, D.C.

By Professor Seymour Harris

For the John F. Kennedy Library

HARRIS: One of the points you made was that a tax cut which would increase deficits temporarily would ultimately induce smaller deficits than a "do-nothing" policy which would bring recession and declining revenues and large welfare expenditures. (This is a new record, Seymour Harris interviewing Secretary Dillon on fiscal policy, a continuation of the earlier record. At the end of the earlier record I made this comment, that a tax introduced to contend with wartime inflationary pressures was not appropriate for the sluggish economy of the 1960's.)

DILLON: That's quite correct because of course our tax system was modified, with the rates substantially increased during World War II, somewhat reduced thereafter, but then increased again during the Korean War, and each time with the objective of drying up demand and allowing us to meet the tremendous strains of wartime. Obviously, this sort of a tax system was not appropriate for peace time.

HARRIS: Let me repeat again the next item, that a tax cut which would increase deficits temporarily would ultimately induce smaller deficits than a do-nothing policy which would yield a recession, declining revenue and large welfare expenditures.

DILLON: Yes, that's the feeling I've had which I think is correct. A series of

recessions following one right after another with the reduced revenues that always accompany a recession would result in deficits that are just as large, if not larger, than would be the case by a conscious attempt to stimulate the economy so as to get it back to full employment. You would have the deficits, and you would have the recessions with them and more unemployment instead of having at the most similar and more likely even smaller deficits coupled with better employment and no recession. The choice is obvious.

HARRIS: The tax program was primarily a try to accelerate growth but should recessionary forces prevail a tax cut would help to contain them. In other words, it works on both frontiers.

DILLON: Well, that's correct. I think this was brought up because some people felt that a tax cut was proposed to avoid a recession. It wasn't; it was proposed to stimulate our long run growth. But perfectly obviously it would have a stimulating effect which would help avoid a recession if one was in the making.

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HARRIS: With the improved conditions of early 1963 the case for a tax bill was strengthened. Do you remember the context of that?

DILLON: Yes. The long run case for the tax bill was strengthened. While you could use tax reduction to fight a recession, the kind of tax reduction you would use would be different than we were suggesting in this basic tax bill for this long run tax cut. The kind of tax cut one would use to fight a recession would be temporary. It would be designed to stimulate demand at the bottom and taxes would be restored when the recession was over. In 1963 the economy was moving forward broadly and the type of across the board tax cut we had in mind would help the economy to move still faster which would mean that we were more likely to get to full employment. Because of the growing economy our deficit would be smaller because our revenue would be larger. So in that fashion we thought the case for a long range tax cut was stronger than it had ever been.

HARRIS: In other words, with this improvement it was more likely the tax cut would have some effect, whereas otherwise there was some risk in the tax cut.

DILLON: That's right.

HARRIS: A sound tax approach was stressed with reduced marginal rates to increase incentive and support for consumption, e.g., large concessions for the masses of consumers.

DILLON: That's what we had—an across the board tax cut that provided help everywhere. It helped investment by reducing the high marginal rates. It helped business managers by reducing the high marginal rates that weighed on them, gave them incentive to take risks. At the same time it provided for a substantial increase in demand by reducing the rates at the bottom thus channeling funds into the hands of those who would consume it properly.

HARRIS: On August 17, 1962, you made a statement that covers most of these items. On May 7, 1963, the Secretary warned

the Chamber of Commerce of New York that the tax program "will not cure unemployment overnight but it will generate the higher levels of economic activity we need….It will not guarantee us against recessions, but it will alleviate their impact….It will not put an immediate end to budget deficits, but it will ultimately produce increased government revenues to balance future budgets. It will not solve our balance of payments disequilibrium by itself, but it will help by enabling our industry to produce more, better, and newer goods at more competitive prices –…" This is in general in relation to the point that will be ultimately made that we expected too much of the tax cut and you were trying to meet these criticisms.

DILLON: Yes, I think that was the case. Often the tax cut was criticized by saying it wouldn't do everything. Of course, it wouldn't do everything, but it was a basic long run program that was highly important.

HARRIS: One general point. You remember Heller's [Walter Wolfgang Heller] speech recently in which he said that the differences among businessmen, economists and the public generally are gradually being narrowed so that in general there is a greater belief in deficits as a stimulus, deficits when you have unemployment, attempts to relate the debt to the GNP [Gross Natural Product], tax cuts on top of deficits—do you think this is generally true?

DILLON: Well, I think that there certainly has been a narrowing of differences. I don't think that differences have disappeared by any means. But certainly the fact that a great broad cross section of business strongly supported and lent their names to supporting the tax reduction bill, the Revenue Act of 1964, at a time when we were in deficit, and did support the theory that this would bring better business, which would in turn mean increased revenue, indicates to me that the feeling of business generally has moved and changed considerably. When this was first suggested there was no such consensus, and it only developed over a period of about 18 months of vigorous persuasion, vigorous debate, and finally argumentation in the business community itself, which then finally came to accept this point of view.

HARRIS: Would you say that majority of the businessmen believe in modern

fiscal policy today?

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DILLON: Maybe not totally modern but they believe in a different kind of fiscal policy than they believed in 10 or 15 years ago. I think there is no doubt about that.

HARRIS: How about the average American? Do you feel that they have made much progress here?

DILLON: Well, to a lesser extent, I think they don't pay too much attention to the fiscal policy of the government. They don't like deficits. They equate a government deficit with a private deficit. On the other hand, they don't like bad business and they don't like bad economic conditions and if conditions are good they will, I think, not worry too much about the fact that there is a deficit. Moreover, I think they feel very strongly, and I think they are right in this, that they want to be certain that there are no wasteful expenditures. That is a good thing and it is important. If you are going to have a more active use of fiscal policy, you can only do so if you make very clear that you are only going to spend funds for projects and programs that are good and worthwhile in and of themselves.

HARRIS: From 1961 to 1963 we had a fairly prosperous economy. Would you be willing to go so far as to say that limited government intervention has helped?

DILLON: Oh, certainly, I think that the government—of course, that was the theory that was adopted with the Employment Act of 1946—the theory that all governments of Europe operate on, and I think it is the correct theory, that government can influence the course of the economy. In fact, it is the government's duty to try and influence it in a favorable direction. If the government does not make that effort, I think the chances are the economy won't just run itself. This was of course the philosophy that we believed in a generation ago, that if the economy was left strictly alone it would run itself pretty well. But some of the difficulties we got into, and particularly the Great Depression of the thirties, changed that sort of thinking very considerably.

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HARRIS: Isn't this true even though the fact remains that part of the governmental intervention under Kennedy [John F. Kennedy] was an intervention directed toward increasing the relative command of resources by the private economy?

DILLON: That's correct. Intervention by government—or influence of government—doesn't necessarily mean control by government. They are two entirely separate things. Influence by government means that government should try to do what it can to create a climate in which the economy can function well. And that means, as long as you have a free enterprise economy, you have to have a climate in which private business and the private economy can operate well, can feel confident, and that's the only basis on which that type of an economy can work well.

HARRIS: Would you like to add a word or two on the general program of the effectiveness of fiscal policy in relation to the objectives in the Kennedy Administration?

DILLON: I think it has been quite effective. I don't think we have had the success that President Kennedy had hoped for in conquering unemployment, but we have done something that had not been done before and that is—gone for four years without a recession. We reversed the trend of increasing unemployment. We have improved the situation and are continuing to improve it but more slowly than we would have liked. I think this is largely due to the fiscal policy of the administration.

HARRIS: What I end up with is by saying that I hate to think what would have happened these years if we had had Messrs. Snyder [John Wesley Snyder], Morgenthau [Henry Morgenthau, Jr.], Anderson [Robert B. Anderson] or Humphrey [George Magoffin Humphrey] as Secretary of the Treasury. You can take that out if you don't want to leave it in, but I'd like to see it in.

DILLON: Well, I won't comment on that.

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HARRIS: This is the third session and we are going to discuss money and the management of the debt. I could start, Mr. Secretary, by pointing out that under the Eisenhower [Dwight D. Eisenhower] Administration the rise of the GNP was about one and a half times the rise of prices. In the Kennedy Administration the ratio was four or five to one against one and a half to one. I was wondering, especially since the Democratic Party is called the party of inflation, how you explain that much better record under Kennedy.

DILLON: In the price area, I think we were operating with certain advantages from the price point of view. There was excess capacity, the surge to make up the unmet demands of wartime had apparently been largely met in the mid-fifties. And this led to the situation which we were facing, which was quite different. There was more or less chronic slack in the economy, rather than pressure to meet demand. Naturally, there was less pressure on prices. In addition to this, I think the guideposts and the strong position taken by the President in the steel case and the very clear

understanding of his position by the leaders of labor tended to reduce the tendency to raise wages too rapidly and to offset this with increased prices.

HARRIS: I think that hits it pretty well, Mr. Secretary. Now, how about the problem of the effectiveness of the fiscal policy which resulted in the much greater rise of the GNP?

DILLON: Because of the difference in the situation—the economic situation, that we were facing, the problem being one of slack, we had entered on a policy of fiscal expansion. We didn't think we could use monetary tools to the same extent. This was just not possible because the balance of payments situation meant that low interest rates were not as practical as they had been before. Funds would flow out of the country. Also in looking at the way the economy had functioned, we early reached a consensus that it was most important that we should try to operate our policies on what might be called a more moderate basis, or a steadier basis, and try to avoid stop and start results such as had occurred in the preceding years with substantial stimulation leading to booms followed by very restrictive policies which brought recessions to their train. We tried to see if we could not work out a policy of stimulation which, while moving

the economy ahead, would not put it into an immediate boom to be followed promptly by a recession. I think we have been fairly successful in that. As you know, we will have gone four years without any recession which will be an all time record in length. It certainly already is in growth.

HARRIS: That's a very good explanation. Now, you are aware of the fact that under Eisenhower the supply of money only increased about one percent and under Kennedy about three percent a year and yet you have this difference in the price history. In other words, you might have expected on the basis of a simple economic theory that you would have a larger price increase under Kennedy than under Eisenhower. And yet it did not happen.

DILLON: Well, possibly. There is another aspect to this and that is the supply of money, of course, had to be related to the growth of the economy, and the economy has been growing on a steady basis much more rapidly in the last four years, and therefore over the period of the four years there had to be a more rapid growth in money supply to stay even. There also is something to the point that has been made from time to time that substantial quantities of excess liquidities were available right after the end of the war, and those were gradually used up. The time certainly had come when they were no longer available and money supply tended to grow and had to grow. Certainly credit policy has been much more steady in the last four years as a result of the close understanding between the Treasury in particular, the whole Kennedy Administration, and the Federal Reserve Board, which has carried on a policy of allowing the money supply to advance in step with the economy. They have had a goal—they can't reach it exactly—but

they have had a continuing goal of an increase in credit of something like at least three percent a year. They have apparently been able to meet that goal and it has probably been one of the reasons why our economy has moved along as steadily and as well as it has.

HARRIS: Isn't what you are really saying is that the increase in the supply of money of three percent contributed toward a rise in GNP and then the rise in GNP in turn required more money?

DILLON: That's right.

HARRIS: I just want to remind you of a figure that you are very well aware of, because I want to discuss the rate of interest for a minute in a different context. If you compare 1960 and July 1964, the yield on triple A corporate bonds is exactly the same, 4.41% and 4.41%. The short term three-month Treasury bills went up about a half percent in that period for the reasons that you indicated the other day. Now the high grade municipal securities are down from 3.73% to 3.16% and the FHA new mortgages are down from 6.18% to 5.44%. Isn't that rather a remarkable stability or even decline in the rate of interest during a period of great recovery over such a long period?

DILLON: Yes. I think so. When we came in to the Treasury and looked at our problem, which was one of slack in the economy, we agreed with the assumption that credit had to be readily available, that the interest cost on long term borrowing, particularly for housing, should be lowered if it possibly could be so as to stimulate that area. The Federal Reserve Board agreed with us on that. On the other hand, we felt that short term rates had to go higher to protect our balance of payments. And we felt there was no contradiction between these two goals, although many more traditional minded people, both on the liberal and on the conservative sides, joined forces in believing that this was not a practical goal. It turned out that our judgment was right. We have been able to reach this goal because short term ninety-day government rates are a full percentage point of more higher now than they were in early 1961, whereas all these other rates are actually lower or level. They are lower in the case of mortgage rates, lower in the case of state and local bonds, slightly lower in the case of new issues of corporate securities and about level in the case of bank borrowings.

HARRIS: I would like to remind you, Mr. Secretary, of a statement you made on July 8, 1963, on this very subject. You may recall that the Bank for International Settlements wanted a higher long term rate of interest and you said: "The approach taken in some quarters abroad that a drastic effort should be made by public policy to raise the entire structure of long term rates by a sizeable amount, enough to slow down the outflow of long term capital, does not seem to me to be realistic. It fails to recognize both the practical difficulties of reversing the current pressures of saving flow in seeking outlets from this country and the great hazard for the domestic economy implicit in

any such attempt."

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DILLON: That's very true because it is totally impossible to do with without a very drastic restriction on credit such as the type of restriction that had taken place in late 1959 and 1960. Certainly that sort of restriction would have been entirely out of place in the slack economy that we had been experiencing. We were determined to avoid this and there never was any feeling, any substantial feeling in the Federal Reserve System in favor of this sort of operation. They had learned well the lesson of the '59-'60 period and didn't wish to repeat it.

HARRIS: Would you also agree, Mr. Secretary, that the Kennedy Administration made it possible for most people to forget about the danger of inflation and because most people became reassured there was not to be any inflation, this in itself would tend to bring the rate of interest down?

DILLON: I think so. I think there was a certain amount of skepticism when short term rates went up, but gradually people realized there was not going to be inflation. Greater confidence in stability has come, has permeated the markets and, I think that has been a help. I think I ought to say one other thing about this interest rate problem and inflation and supply of credit. One reason why it probably has been easier for the Federal Reserve to maintain a relatively plentiful availability for so long is that during the 1960-61 recession they did not force the availability of credit to the extend they had in earlier recessions. The short term interest rate never went below, except maybe just for a week or two, an area of about 2-1/4 percent. This compares, as I said on an earlier occasion, with a half of one percent in earlier recessions. So when business began to move ahead there never was any excess credit to be absorbed. The Federal Reserve had to continue supplying it, and was able to continue supplying it without creating an over-supply. They in effect adopted a much more moderate policy here which would seem to indicate a feeling on their part that a steadier policy, both on credit and interest rates, probably is better for the economy over a long period of time than the sort of stop and go policy that characterized the 1950's. Judging by the results, this is probably true.

HARRIS: You mentioned the availability of credit. Isn't it true that the situation in the money market depends not only upon the rate but upon how much money is made available at that rate and there was a greater availability of credit during this period?

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DILLON: That's correct. We never heard from anyone a criticism or a statement that credit was not available, and actually the rates at which it was available for borrowing from the bank by individuals never changed even though our short term interest rates moved up. In fact, the Federal Reserve was largely

responsible for the lower interest rates for state and municipal borrowing which were heavily influenced by the modification of their Regulation Q which allowed commercial banks to pay higher rates on savings deposits. This led to a great increase in savings deposits in the commercial banks which in turn wanted to put the money to work. Since they felt it was more permanent, they put it to work largely in the mortgage area and in state and local bonds, which put downward pressure on those rates, which was noticeable.

HARRIS: Do you think the abandonment of the bills only policy contributed much to that general monetary situation?

DILLON: I think it did contribute something, but its primary advantage was that it gave the Federal Reserve greater flexibility and allowed them to avoid putting downward pressure on bill rates when they had to supply reserves at times when we didn't want the bill rate to go down for balance of payments reasons. It enabled them to buy in the longer term area. I don't think personally that their actions in the longer area could have much effect on long term interest rates. I have always believed that unless there was a major effort, billions of dollars literally put into the long term government market area, that the long term government rate had no very major effect on other long term rates. This is contrary to some beliefs that have been conventionally held. My reason for this is that the total supply of long term governments is so small as compared to the total volume of the long term mortgages, long term state and local bonds, long term corporate bonds, that the effect cannot by very great. It is quite different in the short term area where government securities dominate the market. I think this theory has been proved, at least to some extent in the last few years, because we have extended the debt, by increasing our sales of long term governments. This put upward pressure on rates for long term governments and they have moved up. But they moved up at the same time, as we said earlier, as other rates stayed level or moved downward. All that happened is that the spread between long governments and other long term securities were considerably narrowed. I think it's a healthy and a more normal spread today than it was before.

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HARRIS: I was going to ask about the short term and long term rates, but you have already covered that and a number of our economists had observed in the last few years that there seemed to be a looser relationship between the two than there used to be so when you get the short term rate up the long term rate doesn't respond nearly as much as it did in the 1950's. You said the other day about why we had to have a high short term rate because of the international situation. There has been a great reduction in the differential as compared to 1960.

DILLON: Oh, yes, there has been a very substantial reduction. Our 90 day bill rates are about 3-1/2 percent or slightly over, and our longest term bonds are now selling on about a 4.20 basis with the average of the longer term bonds down around 4-1/8, so that's really quite a narrow differential of less than 5/8 of a point, whereas in early 1961, as I recall, the difference was between 2-1/4 percent

and 4 percent, or about a point and three quarters. That differential has been greatly narrowed. The point is that while the 90-day rate has gone up, none of the rates that affect individual or business borrowers from the banks, whether they be for short term or longer term, have changed at all in the process.

HARRIS: Did you have a feeling that the European central banks were cooperating with us or did their decline of rates more or less reflect their market condition?

DILLON: Oh, no, I think they were definitely cooperating with us. Not only just because they wanted to do us a favor, but because they had learned that, in a convertible era, this is a necessary policy. They had found out and this was particularly true in the case of Germany, which had pursued a policy of restriction in late 1960, that it just didn't work. All it did was to suck in a lot of money from outside. It had no effect except to disrupt the balance of payments of the world and to give them an unwanted surplus. Therefore, for their own reasons these countries decided that payment problems and their own domestic problems had to be attacked more carefully than they had been in the past, and they had to be attacked in a cooperative manner. I think that has been very evident. They don't always do everything exactly the way we would like, and we don't do everything the way they would exactly like. But there is a real measure of continuing cooperation and understanding.

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HARRIS: A strong dollar is of great importance to them.

DILLON: I think that's well understood.

HARRIS: On August 17, 1962, you said in the Joint Economic Committee, "…the Federal Reserve and the Treasury together—and I want to emphasize the continuous cooperation and close working relationships that have developed between these agencies—have had a common interest in assuring the availability of an ample supply of funds to finance domestic investment…" Would you like to say something about how this operates? You have the Council, the Budget Bureau, Mr. Martin [William McChesney Martin, Jr.] at the Federal Reserve and the Treasury. You have occasional meetings, don't you, to discuss these issues?

DILLON: I think that the way this is really operated has been through a bilateral relationship between the Treasury and the Federal Reserve. There has always been a relationship there because naturally debt management and monetary management go hand in hand. But this relationship has been much closer in the three years of the Kennedy Administration—the last 3-1/2 years than it had been at any time since the war. It certainly is closer than it was during the period of the Eisenhower Administration, although that may be a rather surprising statement to some. The reason for this, I think lay in the fact that we in the Treasury felt very early that there should be close

cooperation. We made a real effort to develop that sort of trust and cooperation. There was also the fact that Chairman Martin had always believed that the Federal Reserve, although independent, should operate as part of the government in accord, to the maximum extent possible, with basic government policy. So he was only too ready to meet this idea of ours half way. The fact that I had personally known Mr. Martin for some 25 years, long before he ever came to work for the government, at the time when he first became head of the Stock Exchange in New York may also have been helpful. I knew him on a personal as well as on a business basis. So there was a confidence, a personal confidence, between us, which enabled us to talk freely and work well together.

We set up an arrangement, which we adhered to scrupulously, whereby Mr. Martin had lunch every Monday at the Treasury and after lunch stopped by my office to talk with me and Mr. Roosa [Robert V. Roosa], who joined us on these occasions. On another day of the week one of our top staff, which first was Mr. Daane [J. Dewey Daane], and later his successor as Deputy Under Secretary for Monetary Affairs, Mr. Volcker [Paul A. Volcker], and maybe one or

two other Treasury staff, would go over and lunch at the Federal Reserve. Mr. Roosa would often join them for this meeting. So there was a constant interchange of views.

The Monday meetings were particularly important because they came before open market committee meetings, which were on Tuesday, and whenever there was an open market committee meeting coming we would discuss the situation with Mr. Martin. We always would agree on a line so that what was done in the open market committee meetings throughout this period was always something either wholeheartedly agreed in or that we acquiesced in. There never was an action taken that was contrary to any strongly held views that we might have.

You asked about the Council and the Budget. Their relationships with the Federal Reserve were not as close as ours. There were some staff relationships. There were some relationships with some of the members of the Board. But they were not as close or direct or as frequent as the Treasury's relationships. However, they did have, both of them, very close relationships with us in the Treasury. So in that way the total administration thinking was fed in to the consideration of these problems. All the views had a chance to be expressed.

There was one place where the four of us did meet. This was the continuation of a procedure that had been set up in the Eisenhower Administration. This involved regular meetings, not at fixed times but once every six weeks or two months, with the President. The Chairmen of the Federal Reserve, the Secretary of the Treasury, the Chairman of the Council and the Director of the Budget all took part in these meetings. We had such meetings regularly with President Kennedy. I think they were very useful because as time went on Chairman Martin and President Kennedy came to know each other and came to have a mutual respect for each other and an understanding of mutual positions which was, again, very helpful in the handling of policy, and in keeping monetary policy attuned to the rest of the economic policy of the administration.

HARRIS: Isn't it true that on the whole the Council was more in favor of easy money than the Treasury was, and yet the Council apparently didn't have the influence with the Federal Reserve so that if there was any pressure for easier money or adequate money it had to come largely from the Treasury?

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DILLON: I think so, but the Treasury didn't have to exert much pressure because we never found the Federal Reserve feeling differently. They saw that our debt management policies fitted in with what they were doing, and short term interest rates were their chief concern. They didn't see any problem of inflating in the domestic economy. They weren't concerned about that. So they were concerned about balance of payments. They did what was possible. We all did what was possible in the short term area and that was that.

I do think that, particularly in the very beginning, the Council was more concerned, because they were aware of the history of the fifties. They were always afraid that the Federal Reserve would revert to that pattern. I think they were overly concerned about this, but I can well understand their concern because of what had happened before. They were probably not as aware as we were of Mr. Martin's beliefs and therefore had this greater concern, which turned out to be unnecessary. I think they also were less certain than we were that our policy of higher short term interest rates could be accomplished without a substantial effect on the long term market.

I remember there was an indication even as late as 1963 of that sort of feeling. That was when the Federal Reserve raised the rediscount rate for balance of payments purposes in July of '63.This had been discussed for a week or so before the final action, on a very confidential basis here in Washington. The Council was aware of the plan to raise the rediscount rate, and we at that time made some prognostications as to the effect we thought it would have on various other rates. The Council made their own prognostications. They thought the effect would be considerably larger than we thought it would be, but even they came to agree that it probably would not be very large. Also, having seen what had happened earlier, they were inclined to take our judgment and they acquiesced in it, I think with some concern. They were not as sure as we were that it would work, but here it is a year later, and it has worked and all of us are very pleased. They are, too, and it has worked even better than we had originally supposed. Instead of the rates going up, longer term rates in the area of municipal bonds, in the area of mortgages, are now no different than they were at the time of the discount rate increase. In the case of new corporate issues the increase has been less than 1/8 of one percent.

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HARRIS: Mr. Secretary, you may recall that in the Eisenhower Administration the Federal Reserve was fairly restrictive. This, I think, reflected Mr. Eisenhower's fear of inflation, that sort of thing. Now, in the Kennedy Administration they were much more inclined to provide adequate supplies of money. This could be explained by one of two things. One, that they had come to the conclusion that

inflation was not a serious menace and they could be more free with their cash. The other, I think, would be the pressure that was put upon them by the President and the Secretary of the Treasury who were very anxious to have adequate supplies of money. Would you say that each of these contributed something or do you feel that actually you and the President didn't have to demand easy money, or adequate supplies of money, that there was simply a change in the situation that assured the Federal Reserve there were no risks in providing adequate supplies?

DILLON: I think both of these things were important. But I would put a little different interpretation on them. I think that the Federal Reserve felt the situation was different this time, there was greater slack and the dangers were not as great. But I also think it was not really a question of pressure. This stems from the strongly held view, which I mentioned before, of Chairman Martin that the Federal Reserve should try to keep its major policies, to the maximum extent possible, in tune with those of the administration then in power. I think that that was a reason for the greater restrictiveness of the Federal Reserve in the 1950's, but I don't think it required any great deal of pressure to achieve that. Conversely, in the sixties, under the Kennedy Administration, very early on, Chairman Martin and the Federal Reserve Board realized that we had a comprehensive fiscal and financial plan that was aiming at certain goals, that we did not want inflation, that we were just as strong for price stability as anyone had ever been before, and that our plan contemplated continued availability of credit. There wasn't any necessity for any substantial pushing or changing of the Federal Reserve. They modified their position quite easily and quite readily and moved in this somewhat different direction. It is impossible, I don't think it will ever be possible, to untangle the various weights of these two elements in the Board's thinking. One difference from the way you posed the question is that I don't think we had to—President Kennedy had to really exert pressure on the Federal Reserve because they were only too ready to accommodate themselves to the administration views as long as they thought we were following a balanced and comprehensive plan, which they did.

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HARRIS: I gather your conclusion is that the difference in the Federal Reserve policy in the 1960's stemmed from the fact that the Kennedy Administration had a program of stimulating investment, maximizing growth, etc., and that required relatively easy money and that's what the Federal Reserve gave them.

DILLON: I think that's right, and also that they thought the Kennedy Administration was balancing this by a policy of price stability that was working.

HARRIS: I'd like to turn a bit to some of the issues of the national debt. On March 7, 1963, at Princeton at a Conference of the American Bankers Association you said, "Some observers have felt that we have been

over-zealous in our desire to maintain a debt structure that will avoid the danger of excessive liquidity and a future inflationary problem. But this view, in my judgment, underrates the continued availability of new savings in amounts more than adequate to meet the current borrowing requirements of business, individuals, and state and local governments, as well as the essential need to forestall any rebirth of inflation as the stimulus from the tax program takes hold. Moreover, the techniques available to us—and especially the device of advance refunding—have enabled us to attract longer term funds with a minimum of market disturbance." And I would like to point out here that in 1960 the average maturity was 4 years 4 months. In June '64 it was 5 years, and this is an improvement which hasn't occurred in a long time.

DILLON: And after the advance refunding which we have just carried out in July the average length of the debt is 5 years and 4 months. This is a very real achievement, and as I say, this was a sort of a complement to the continued ready availability of credit. We took advantage of that to lengthen out the federal debt, which we thought we could do without affecting other interest rates. We were always very careful in our advance refundings to watch the tone of the corporate bond market, the municipal bond market. We tried to time our actions to times when these bond markets were either rising or very healthy and when additional supply of long term governments would not have any effect on these particular markets. And I think the record has showed this. We also had the feeling that there might be times when a successful advance refunding, by showing that the demand existed for long bonds, might actually psychologically

strengthen the market by showing people that there was this sort of demand and so dispelling ideas that bonds were going to go down in price, and up in interest rates. I think that the results of our latest refunding were an example of that where the market is in probably a much stronger situation now, even though nine billion dollars of short debt has been moved out to various areas from five to ten, or even twenty-five years.

HARRIS: Would you mind just saying a word why you consider it necessary to lengthen the average maturity?

DILLON: The only reason for that is one of pure housekeeping. If one does not do that the whole debt, the whole marketable debt, that is, which is something over two hundred billion dollars, would rapidly shorten and finally would all be available in the under one year, or the under two to three year area. And this would make too much debt available in the form of quasi-money, or near money and would be inflationary. We have increased substantially the amount of bills outstanding at the same time as we lengthened the debt because we felt there was need, as this was expanded, for more of this sort of quasi-money. So we have made that available and we have added well over ten billion dollars to the bill area. Where we have lengthened the debt is by greatly reducing the quantity of debt that comes due in the area between, say, 18 months and 5 years. That we have taken and spread out into longer areas.

HARRIS: On the whole, this has worked pretty well and I'd like to perhaps say a word about the advance refunding. This was an Eisenhower invention, wasn't it? But you have developed it much further than Eisenhower did. There have been some criticisms made of advance refunding and I'd like to just raise one issue which I am sure you have been confronted with a number of times, the criticism that this is an expensive business for the administration on the grounds that you pay more for your money right now and that's all right on the assumption that later on the rates will not be very low. If they should become much lower than they are now it may well be that you'd lose some cash for the government, but this is a sort of matter of intuition, envisaging what the market is going to be like in the future, which makes you take this risk. You feel that the best guess is that this is going to be less expensive. Of course, it is always possible that the thing might turn out to be more.

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DILLON: That's right, the greatest criticism was extended against what was called senior advance refunding which were carried out first during the Eisenhower Administration, and we again had one, I think, in September of 1961, where we exchanged 25 or 30 year bonds for bonds that were due in 8 or 10 years, which bore very low coupons which had been wartime and early postwar issues, which were 2-1/2 percent issues in general. It was our feeling that as long as there was a free market for corporate bonds, that those sort of rates were extremely unlikely to even recur. Certainly there had never been such low rates in history, except under the pressure of wartime and special wartime monetary controls. And, therefore, we thought that a possible loss in interest cost was not too great. Actually, most of these extensions were made into 3-1/2 percent coupons which were outstanding, so the actual interest cost went up something like 1 percent. We had an extension from around 1970 to 1990, or from 20 to 25 years. We felt that the chances were that in 1970 when these issues came due you couldn't have refunded into that same sort of 20-25 year area for less than 4 or 4-1/4 percent so that actually, if you looked at the whole life of the issue, it probably wouldn't cost you anything. It had no effect on the market—far less than trying to sell long term issues for cash in the market. More recently, of course, we have been refunding issues that come due much closer, in one year, two years or three years, and sometimes we have refunded higher coupon issues with lower coupon ones, which was the case in the July refunding where we refunded some five percent and 4-7/8 percent coupons into considerably lower coupons. The reason for this was that they were coming due fairly shortly, and their holders thought that what we offered them was probably more attractive than they would get on the due dates, so they came in. But, overall, it was our feeling that if you were going to sell long bonds, which we believed was necessary for the reasons I've told you, that this advance refunding technique was the cheapest way to do it.

HARRIS: Yes, it interferes the minimum with the market. You may recall that under Eisenhower, particularly in 1958, there were large issues of long term securities, just as the recovery was beginning, and that tended, in

a sense, to interfere with the recovery. I think the Kennedy Administration never made that mistake, so that from that viewpoint the advance refunding is perhaps the most likely approach to issuing long term securities in a way that doesn't seriously compete with the private economy when it wants and cares badly.

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DILLON: That was our reason for using it.

HARRIS: How about the debt ceiling. I just want to say a word about it. It has always been one of those headaches for the Treasury and I just want to quote one thing you said on this. This was at the Loeb Award luncheon in New York on May 22, 1963. "….let no one labor under the delusion that the debt ceiling is either a sane or an effective instrument for the control of Federal expenditures. But this cannot be done by trying to exert controls at the tag end of the expenditure process, when the bills are coming due. The debt limit is not and cannot be made a substitute for the control of expenditures at the decisive stage of the expenditure process—when the funds are being appropriated."

DILLON: I have always thought that the debt limit, which we have had trouble with, was largely a political football. During the preceding administration, although there had been some opposition to it, the necessary increases in the ceiling had always had bipartisan support. We had some bipartisan support early in 1961, but after that there was a shift, at least in the House, and thereafter we never had the support of even one Republican in the House for the necessary increases in the ceiling. All the debt ceiling means is that after the Congress has voted funds, and appropriated them, and directed that they be spent, and after they are spent, it becomes necessary to find the funds to pay the bills. And if there is a deficit, and the funds are not available through tax revenues, the only other source is borrowing, and that requires an increase in the debt ceiling. So really by opposing an increase in the debt ceiling you are against paying bills that have already been incurred. The debt ceiling has no effect on the bills, because the bills have already been incurred as a result of the appropriations. I think it's perfectly logical to oppose appropriations if one feels that they are too extravagant, but it certainly is not logical to say that the United States should default on its bills. And that is in effect what one says when one votes against a needed increase in the debt ceiling. However, this debt ceiling debate does afford a time and an easy occasion to inveigh against expenditures, and it has been so used for political purposes.

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HARRIS: You don't think that to any extent, if the Congress does make the debt ceiling a rather annoying experience for the Treasury, because it involves so much time and effort, that this might perhaps have some effect on keeping appropriations down in the future?

DILLON: I think it has some effect. I don't think it's bad. I think it is foolish to do it two or three times a year. We had to do it three times last year, but the Congress, as a result of that experience, came to the same conclusion, and I might say that this year, 1964, the increase in the debt ceiling was the easiest experience we had. We had better vote margins, bigger margins. It was still used politically in the House. We got no Republican votes. But we had a better understanding on the part of the Southern Democrats, who had usually opposed it. We had more support, and therefore a bigger margin, and we got a perfectly adequate debt ceiling with less debate, quicker than we ever had before because I think the Congress itself became a little tired of this debate.

HARRIS: May I ask another question and that is whether the Federal government should borrow in a period when the rates are low, and to that extent perhaps interfere with the recovery? Or should they borrow when the rates are high, which is costly to the Treasury, but has the required effect on the economy?

DILLON: My feeling is perfectly clear on that, that the Treasury should subordinate their requirements for getting money at the lowest possible cost to the general situation of the economy, and the proper time to lengthen the debt is in a period of relative prosperity, paying whatever is the necessary cost. Now I would not carry that to the extremes, such as in a period of boom with great shortages of credit and interest rates sky-high. That's not a time to lengthen debt. But the time to lengthen debt is during such times as we have had during the last three years, when you have had steady growth, adequate credit, and a situation where you could lengthen the debt without hurting the economy. You certainly shouldn't try and do it in the midst of a depression, or a recession, when you are trying to stimulate the economy.

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HARRIS: I would just like to make a brief comment. One of the things that the Kennedy Administration has done is that they have taken a good look at the whole problem of government credit agencies, their integration, their failure to cooperate in the issue of new securities and that sort of thing. And there has been an inter-departmental committee report. Do you want to say a word about that?

DILLON: Yes, this was a committee which operated under my chairmanship. It came out with a report which was approved by President Kennedy, which said there should be greater cooperation among credit agencies. We have achieved that now. I think we do have somewhat better control. It also came out with the basic recommendation that any credit program that could be carried by private credit agencies should be so carried and that federal credit programs should be limited to those which could not be adequately carried in the private area.

HARRIS: And also they should cooperate more effectively with the Treasury as to when they issue these securities.

DILLON: That's right. I think that has been the case and we have had no complaint to make recently.

HARRIS: How about the general problem of whether the tax cut and the resulting deficit should be financed out of savings or out of manufactured money?

DILLON: I think this was a more or less semantic argument. It was quite an issue for a while. Actually, we have been financing the debt, one might say, out of savings since the increase in our debt has been in the longer term area, but there has been adequate credit available all that time, and so this worked perfectly all right. You could say we were financing out of savings. Those who opposed this felt that this meant there would be a restriction in credit and the Federal Reserve would not buy any securities. Of course, that hasn't happened at all. At the same time we were doing this, the Federal Reserve has been increasing their holdings in governments as they supply credit to the banking system, buying an extra billion and a half or two billion dollars a year. So you can both supply credit and finance through savings at the same time. Really, I think this was an argument where there was much ado about nothing because it was really a semantic argument and a misunderstanding about what was actually involved.

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HARRIS: I think Mr. Martin made the mistake of making a few statements he shouldn't have made on this issue.

DILLON: Yes, he made too categoric a statement at one time and then he tried to back off of it because he didn't mean what he was interpreted as meaning. He made clear that he didn't mean that, so the thing has worked perfectly well.

HARRIS: Actually, the increase in the debt, additional securities issued net, were not primarily purchased by the commercial banks.

DILLON: No, not at all.

[END OF INTERVIEW]

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