

C. Douglas Dillon Oral History Interview – JFK#9, 08/18/1964
Administrative Information

Creator: C. Douglas Dillon
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Biographical Note

Dillon, Secretary of the Treasury (1961-1965) discusses fiscal policy for the Kennedy Administration and issues with forecasting the Gross National Product, among other issues.

Access

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BY DOUGLAS DILLON

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Allan B. Goodrich
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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,

A handwritten signature in cursive script, appearing to read "Susan S. Dillon". The signature is written in dark ink and is positioned to the right of the word "Sincerely,".

Susan S. Dillon

C. Douglas Dillon – JFK #9

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Ninth Oral History Interview

with

C. DOUGLAS DILLON

August 18, 1964
Washington, D.C.

By Professor Seymour Harris

For the John F. Kennedy Library

HARRIS: This is the second day and we are discussing fiscal policy. Mr. Secretary, it is my understanding that the technical problems of taxation will be handled by Harvey Brazer [Harvey E. Brazer] so I shall not go into these. I shall only deal with tax problems insofar as they affect the general economy directly in terms of a broad implication of fiscal policy.

DILLON: That's correct.

HARRIS: Now, I might say at the outset, and in which you will agree, that because of the peculiar international situation that fiscal policy had to play a much larger part in the Kennedy Administration than ordinarily it had in the past.

DILLON: Yes, the situation was very different than it had been in the immediate postwar period because we had convertible currencies for the first time when we were in a recession. In earlier recessions when currencies were inconvertible, the government had used monetary policy to the extreme and, by easing credit, had succeeded in producing short-term interest rates that were as low as half of one percent for ninety-day government bills. This sort of thing was out of the question at this time because of the fact that we were having troubles with our balance of payments. With people getting more used to convertibility they were perfectly ready to hold liquid assets in

other foreign currencies, and not necessarily only in dollars. So it was very dangerous to have short-term interest rates in this country that were substantially lower than the short-term rates that were readily available in the money centers of Europe. Therefore, since we couldn't flood the economy with credit, although we kept it readily available for all needs, it was necessary to rely to a greater extent on fiscal policy to provide the necessary stimulus to get the economy moving back toward full employment which was the basic objective of President Kennedy [John F. Kennedy].

HARRIS: Mr. Secretary, isn't it true that the Secretary of the Treasury has a great influence in the budget partly because the Treasury has to manage the national debt and collect the taxes to pay the bill? Would you like to say something about your relations with the Budget Bureau and the President on problems of the budgetary message?

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DILLON: Well, yes, we have a very real interest in this matter, and the President always looked to me in my capacity as Secretary of the Treasury as being the chief financial officer of the government. So he expected me to advise him on the overall fiscal implications of budgetary policy. What that generally came down to was consultation regarding the overall size of the budget. I did not get into or work with the Bureau of the Budget on the budgets of individual agencies as sometimes had been the case in the past. But we did work closely together and did discuss overall figures with the President before budgetary guidelines were issued to the various departments. Then later as the budget was being firmed up, we continued to discuss the overall size of the budget, and the President always thought very carefully on my advice and of the advice of the Treasury Department on that aspect of preparing his budget. I think in general the decisions that were made were right in line with the basic recommendations that we had made.

HARRIS: The Treasury, Mr. Secretary, in general would not be as favorable toward large rises of spending as, for example, the Council would be. Wouldn't that be a fair generalization as a rule?

DILLON: I would think so, generally. But in this particular case the Treasury, of course, agreed that it was a matter of basic administration policy that first priority had to be given to strengthening our defense budget and our defenses by creating a greater ability in the army, in our ground troops, to fight limited wars without overly relying on a great nuclear exchange. That cost a lot of money and resulted in very substantial increases in the budget.

A little later in the spring of 1961 there was another major policy decision which was to go ahead with an expanded space program. That didn't leave very much room for expanding other programs. You can shift and change between programs, which we worked very hard at—diminishing those that were less important to find places where we could get extra funds to use in programs that needed to expand. With that background the Treasury did

not see how there was any room left for deliberately increasing spending over and above the rather substantial increases that necessarily took place in this area—increases that made the whole budget increase \$5 to \$6 billion a year.

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HARRIS: You may recall, Mr. Secretary, that when the Berlin crisis broke out in the summer of '61 that there were considerable discussions of the possibility of raising taxes to meet the additional expenditures involved. Would you like to say something about that particular matter?

DILLON: Yes, this was a question that came up rather rapidly and was discussed over a period of only a few days. I think our first inclination was, and it was also the President's first inclination because he was very desirous of working towards the presentation of a balanced budget the next year, that we would probably need to increase taxes to take care of this extra expenditure. At that time our economy was moving up rather rapidly, and we foresaw that, if this continued, very much larger revenues would be coming in during the fiscal year 1963 which would be the one for which the President would send his budget up in early 1962.

But when we got into these discussions and analyzed the state of the economy, the Council of Economic Advisers was strongly against any attempt to enact a tax increase to cover these extra expenditures. As we worked on the extra expenditures, they seemed to be less large than we had originally thought they would be. Also, it didn't seem to be very sensible to try to increase taxes at the same time that we were trying to pass a bill proposing an investment credit which in effect was a tax reduction. So after discussion there was complete agreement among all of us, and when I say all of us I mean all of the President's advisers, there was unanimity that we should not ask for any increase in taxes here, and the President agreed with our unanimous recommendation.

As an alternative and in an attempt to help with his objective of reaching a balanced budget, he asked the members of his Cabinet—that was a little later in the fall—to do everything they could to hold down and reduce expenditures in their respective departments. There was a considerable hold-down as a result of that and a considerable saving. This was quite a turn-around because in the early spring and late winter, when the administration first came into office, and we were in the depth of the recession, the idea had been to accelerate whatever spending was to be done. The discretion of the executive departments is not very large but they can marginally increase expenditures or decrease them. Marginally the push was to increase them in the spring and in the fall it reversed to decrease them and get back to normal. An example was the highway program where we

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released funds to the states ahead of time and so got ahead of schedule. We began gradually getting back on schedule in the fourth quarter of 1961. This argument or discussion was not a case where the President himself had to make a choice between differing concepts because as

this discussion proceeded, everyone came to agree that the Council of Economic Advisers' approach in this particular matter was the correct one.

HARRIS: Wouldn't you say in a general way that your views on spending in 1961 and 1962 were closer to the President's than the Council?

DILLON: Well, yes, I think they probably had a somewhat greater belief in the efficacy of public work programs and in the speed with which they could be implemented. I had, in the preceding administration, seen an attempt to make use of this sort of spending in 1958, and it did not work very well. What had happened was that expenditures had increased but by the time the money began to flow out the economy was well on its way up; it only added fuel to the fire and was a large part of the reason for the \$12 ½ billion deficit that occurred in fiscal year 1959, the year after the recession which was in '58.

HARRIS: Mr. Secretary, perhaps you ought to say a word about the 1963 budget which appeared in January 1962 because there was some difference between the Treasury and the Council as to what the GNP [Gross National Product] was going to be and how you could balance the budget. Do you recall that?

DILLON: Well, I don't think there was too much difference. We had felt at first the Council had been very optimistic on GNP. We had been optimistic too. When I say we—Treasury's estimates are made up by civil servants who do this estimating job regularly irrespective of administration. They were not quite as optimistic as the Council. Nevertheless, we finally reached a general agreement on the probable GNP and came out with a figure of \$93 billion as our expected income. This produced a narrowly balanced budget. It represented a very sharp increase in government revenues, but it was generally comparable to the increase that had taken place between fiscal years 1959 and 1960. So it was not unreasonable to make such a forecast for the second year after a recession with the economy moving ahead. You will recall that GNP rose \$14 billion, I think it was, in the fourth quarter of 1961, and we had those figures when we made this estimate. It was the general feeling that there was no reason why this rise shouldn't continue right on into and through 1962. This turned out to be a very bad mistake on our part, and

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on the part of the Council, as far as forecasting was concerned, but it was a mistake that was also shared by business economists generally. They all thought business was going to move ahead very rapidly.

What actually happened was that, at almost the very moment this prognostication and forecast were made, business stopped moving ahead, began to stagnate and rested on a plateau that lasted for six or eight months. Business didn't really begin to pick up again until the fall of 1962. That totally changed the picture, particularly in the area of corporate profits which affect government revenues very heavily, since nearly 50% of corporate profits come through into government revenues. As a result we turned out to be way off base in that

revenue estimate. But all our other estimates have been remarkably close. I've followed them very carefully, and our later estimates that year and the estimates we've made since then have, at all times, stood up very well compared to previous estimates. In fact, they have been considerably better than the average that was achieved during the preceding eight years.

HARRIS: Yes, I agree with that, Mr. Secretary. I do think you are a little modest here because my recollection was that the Council was more optimistic on the '63 budget than you were, and you finally agreed to the budget because they assured you that this was a reasonable estimate of the GNP and you went along with some hesitation, or am I wrong in that?

DILLON: I think that's correct because it seemed to me that the GNP estimate was high. Although I am no expert on revenue forecasting, my experts in the Treasury assured me that the revenue estimates based on that GNP were conservative. It was really a question of what the economy would do and the Council had this strong feeling that it would continue to move rapidly ahead. Experts in the Department of Commerce seemed to think the GNP estimate was reasonable. So, although I think everyone realized that it was an optimistic estimate and although I was a bit skeptical, I must say that I did not foresee any slowdown such as did occur in business. While I would not have been surprised if we missed our revenue goal by a billion dollars or so, I was quite surprised that we missed it as much as we actually did.

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HARRIS: About \$15 billion?

DILLON: No, something like \$6 billion, but that is a lot.

HARRIS: Perhaps you might like to say a word as to why we didn't achieve the rise in '62 as we expected. I think of the steel episode, the stock market, the dollar problem, and general loss of confidence.

DILLON: Well, it appears to me that something else happened to the economy because it stopped rising in January and continued just about at the December level; there was no noticeable rise in February; very little in March, and then came the steel episode. Apparently something had happened to make the economy want to take a breather. Maybe it was the very rapid rise of the preceding fall.

But then after this slowdown had occurred, we were hit with the steel crisis which did upset businessmen. It made them feel that the government was going to try to control prices generally, which of course was never the President's idea. The stock market, reflecting the slowdown in business which started in January, had reached its high in the end of December. It had started down beginning in January and, by the time the steel crisis hit, it had dropped very considerably. The crisis accelerated the drop, and then finally in May the stock market decline began to feed on itself, to become an item of news in and of itself and to scare

people. Foreign selling increased and we finally wound up with what might be called “the crash” which took place in the end of May, I think around the 28th of May.

Well that whole stock market episode never seemed to me to have any economic sense behind it, but nevertheless it scared people and probably slowed up business expenditures. But by this time the economy, having run flat for about 5 or 6 months, apparently developed its second wind. So instead of being pushed over by the stock market crash, it weathered it very well, very successfully, and began to turn around and move up. By late summer, and certainly by the time we got into the fall of 1962, it was very clear that we were moving ahead again in very good shape.

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HARRIS: Would you like to say a word, Mr. Secretary, about the Troika because this to some extent, I think, explains the forecast that we’ve had in the last few years.

DILLON: Well, I don’t recall exactly the date when we formalized and started this but it may have come as a result of the 1963 budget—the estimates that were made at that time. But after that we decided that we should have our staffs work very closely together, our staffs being the Bureau of the Budget, the Treasury and the Council. As part of this exercise our staff people drew on help for figures and advice from the Department of Commerce and the Federal Reserve. For the so-called Troika these 3 staffs worked together and came up with quarterly forecasts of GNP, business profits and personal income. The Treasury would then translate these forecasts into revenue estimates, and we would make these reports on progress to the President about every three months. At the end of each three months we would take our last forecast and see where we had come out and explain why things had changed on way or another and then make a new forecast. We found this was a very useful exercise and it has continued to this day. This process was always terminated with a session between the Chairman of the Council, myself, and the Director of the Bureau of the Budget. We signed a report to the President and then usually presented it to him. We would meet with him, and he would read our report and ask any questions he might have, and we would discuss it with him. So we did feel that we were working closely together. I think that our staffs developed confidence in each other and the gaps and the differences in estimating from that time forward were really very small. We never had any important differences after that.

HARRIS: Wasn’t it true that partly because of the 1962 mistake or bad estimate that there was considerable criticism of the government for going in for forecasting at all? Now what would your reaction be to that?

DILLON: Yes, the thing was that we had for the first time done publicly what all administrations had done privately before. What I mean by that is that every administration, every president, has been required by law to present a budget in January for the fiscal year beginning the following July and running for 12 months. To present such a budget he has to estimate what the revenues will be in the

coming fiscal year, which means he has to forecast his revenues based on business profits for 12 months ahead and 18 months ahead for personal income taxes, that is withholding taxes.

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The only way one could forecast those revenues was to have some forecast of gross national product. That has always been the case but this forecast had never been made public. So if there was an error in estimating no one quite knew whether the economic estimate was wrong or whether the conversion of that estimate to revenue was wrong or just what the problem was. There was, of course, a similar occurrence in fiscal year 1959. That budget was originally submitted in January, 1958. The revenues that finally resulted were about six or seven billion dollars less than had been estimated, a slightly larger error than our fiscal 1963 error.

HARRIS: And the expenditures were correspondingly more.

DILLON: They were about as much more. So there was a deficit of more than \$12 billion as against the balance which had been originally estimated. In the case of the 1963 episode we were nearly as far off on revenues, not quite, but it was practically the same, about \$6 billion, just a few hundred million dollars more accurate than that earlier estimate. We were much closer on expenditures so our deficit was nowhere near as great. Now it's true, as you say, that there was some criticism of this public economic forecast. But I think it's a good thing because it makes the forecasters work much harder. We've now brought many more people into it, and I think our economic forecasts are better now than when they were made sort of informally, without any great care and more by feel in earlier days. Now we draw not only on the Council and ourselves, but we draw in economists outside government, and we carefully correlate all the estimates of business economists that are made at that time of year as they become available. We try to come up with the best overall figure we can get, and then we publish it, and it's open for criticism by other economists and so forth. I think it's a useful tool for business and for the country generally to have that sort of thing.

HARRIS: And you adjust with the changing situation, you adjust your estimates.

DILLON: That's right.

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HARRIS: Now, Mr. Secretary, in the Kennedy Administration there has been an increasing amount of discussion of three different types of budget, not only the administrative budget, but the cash budget and the national income budget. Would you like to say anything about that and what its significance is?

DILLON: Well, I think we felt that the cash budget was probably a more accurate picture of the financial operations of the government. It shows the entire cash flow between the public and the government. The administrative budget does not show the trust funds and the trust funds have been increasing in importance over the years. I think that sooner or later it was inevitable that greater attention would be focused on the cash budget because of the growing disparity between the administrative budget and the cash budget. It's now something like \$25 billion—the difference in expenditures between the two. So it was natural and we did try to move it along faster. We also gave greater prominence to the national income budget because that is designed to give a better picture of the effects of the budget on the economy. It is a useful tool for that purpose although it is not representative of the fiscal affairs of the government with which the Treasury is really concerned.

HARRIS: Isn't it also true that the administrative budget sometimes shows you such a large deficit that certain parts of the business community become concerned which makes it difficult to pursue appropriate economic policy because you get too worried about the extent of the deficit which is really exaggerated by the administrative budget?

DILLON: Well, that is true because of the lags in collections. What happens is that when you have a recession your revenues hold up pretty well during the recession if it doesn't last too long. If it only lasts a year, which has recently been the case, revenues remain pretty high because you're still collecting revenues that arose during the preceding year before you were in the recession. Then as you come out and have your first year of good business—when everybody expects to see a balanced budget—then you are collecting revenues that were influenced by the recession, and you generally have the largest deficit. If you take that too seriously and don't realize the reason for the situation and that it is a one-time thing, you may make very bad mistakes as far as economic policy is concerned.

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HARRIS: Do you want to say a word about back-door financing?

DILLON: Well, a strong feeling developed in Congress against what is called back-door financing which means appropriations of funds by the Congress without going through the Appropriations Committee. This feeling was built up by the Appropriations Committee themselves which felt that any spending of money of any sort of even guarantee authority should be submitted to them as committees. So the phrase back-door financing was coined which doesn't have a very good sound anyway. It was strongly attacked and finally an end was put to it.

Congress refused to vote any more programs allowing what was called borrowing authority for someone to borrow from the Treasury. Such authority always had to be approved by the Congress so it was an appropriation, but it was an appropriation that didn't go through the Appropriations Committee itself. Now borrowing authority can be abused,

and it may well have been at some time. So there are two sides to this thing. There's a certain advantage in not having any back-door financing. However, there are certain types of programs where life is made unnecessarily complicated by having to pass laws twice, one a financing bill and another an appropriations bill for the same funds. I refer to something like the guaranty authority of the World Bank and the Inter-American Bank which will probably never be used and which ever since World War II has been handled simply by one measure—an authorization to borrow from the Treasury. Under the present procedure there would have to be two measures passed to do this. So in some cases it seems an unnecessary burden, but it does uphold this principle, and I can see benefits from that because there certainly were areas where it had been abused.

HARRIS: But actually the Congress doesn't have any part in controlling these expenditures, do they?

DILLON: Oh, yes, because there can't be any expenditure if it isn't approved by the Congress. It really was a question of the Appropriations Committee versus the other committees of Congress. The Appropriations Committee is large and powerful and consequently in the House this feeling was strong. The Senate never had the same feeling. The Appropriations Committee

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of the House is very strong, and this feeling developed there. The House simply made it a rule that all expenditures have to go through the Appropriations Committee.

HARRIS: Now we have put greater emphasis on fiscal policy, particularly on keeping spending down, and also on monetary policy to make sure we don't manufacture too much money. All this may be offset by inflationary ways in price policy. Do you want to say something about the relationship of price policy and fiscal policy?

DILLON: Well, one of the very first problems we faced with the balance of payments was that to obtain the needed improvement we had to improve the competitiveness of our exports. It was easy to look back and see that our competitive posture had suffered during the 50's. Our prices had gone up more rapidly than those abroad, and we had lost markets as a result of this in some areas and that just couldn't continue. So we tried consciously through tax policy and in every way we could to keep our prices competitive. As part of this effort we felt that we should emphasize this policy, which had also been a policy of the preceding administrations, to try to hold prices as stable as possible. The previous administration had not been very successful in this effort. We thought we had to do something new. The Council of Economic Advisers came up with an ingenious suggestion on price stability in their January 1962 report where they measured productivity increases over a period of years, recent years, and then took an average and said this was a guidepost for wages and prices. They pointed out that wages could not go up faster than productivity without having price increases. Since price increases

were undesirable, the average wage increase should therefore be held within the guidepost of the average productivity increase. That didn't mean there couldn't be larger increases in some areas—in some areas they'd have to be smaller. The overall objective was to help to maintain stable prices. Again this didn't mean that some prices couldn't increase but such increases should be offset by decreases elsewhere in the price structure. In this way the average could remain stable.

I don't know how much credit I give to this wage and price guidepost policy. We have continued to talk about these guideposts. No doubt it did put pressure on industry and held down

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increased prices. This was what was dramatized. This was the nature of the steel episode where first there was a steel settlement by labor with a rather small wage increase that did not seem to require any price increase. And then much to everybody's surprise it was followed almost immediately by a price increase across the board by the steel companies who indicated that they had needed an increase for a long time and just had not put it into effect until the wage negotiations got out of the way.

The President didn't feel that this was the right sort of thing and this was the reason for the whole steel episode and for his strong attack on that price increase which was then rescinded. This dramatized the issue of price stability in a way that it wouldn't have been dramatized otherwise. Well, this had some bad effects on business, scaring business people that there would be over-regulation, or over-interference by government. It also had good effects because it did bring home to businessmen, labor leaders, and everyone concerned a great importance which the government attached to price stability. I think that we did have, over the years, an important effect. We have maintained our price stability with the best price performance of any country in the world in the past six years. This has been very helpful in improving our competitive posture in the world and in holding down the increase in imports and allowing us to increase our exports and improve our trade balance.

HARRIS: Do you agree that in view of the fact that wages only rose about three percent a year under Kennedy and five percent under Eisenhower [Dwight D. Eisenhower] that this suggests that it might have had some effect?

DILLON: I do. I think that the guidepost policy had a very, very real effect both on labor, as to wage increases, and on business as to restraint regarding price increases even though business has been moving fairly rapidly and at a pace that in the past has usually given birth to numerous price increases.

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HARRIS: Now, Mr. Secretary, I would like to bring out some of your views on spending from the statements that you've made from time to time in speeches or statements before various committees. On March 7, 1961,

you said before the Joint Economic Committee, “There are, of course, inescapable physical limits on the speed with which our untapped reserves can be put to use. Nevertheless, the current recession makes a modest and temporary deficit not only inevitable, but actually desirable as a stimulant to recovery and the resumption of economic growth. The fact is that a budget deficit may prove helpful in a period of widespread unemployment such as the present one.” Do you want to comment on that or does that state your position pretty well?

DILLON: No, that stated it very well at that time. This was at that time a rather novel position. Although we had had deficits before in times of recession, no one had ever said they were actually a good thing. Looking back three years it’s probably rather surprising the broad area of agreement that has now arisen among economists and even in business circles. This almost certainly is the correct policy and there is now a broad acceptance of the idea that in a recession a budget deficit is not only inevitable but is something that can be positively beneficial. Any other course would mean cutting back government expenditures during a recession which would only increase the severity of the recession. The remaining difference today is over how one should measure a business cycle and how to define the moment when a budget deficit is no longer proper.

HARRIS: I also have a statement here that you made on television on February 4, 1963, in which you said, “Well, I’m deeply concerned about the deficit, too, and so is the President. It’s perfectly clear that we cannot and should not continue year after year with a very large deficit.”

DILLON: Oh, yes. Of course, it’s equally clear that we shouldn’t continue year after year with an economy that’s not functioning at full speed, that doesn’t develop the revenues that can make a balanced budget practical. So we have to develop a combination of methods and policies designed to stimulate the economy and keep it moving so that revenues will be large enough.

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At the same time one must be frugal in expenditures so that you can work toward general balance. The main point is that you simply cannot achieve a balance in your budget simply by cutting expenditures. You also have to have the other side of the coin which is adequate revenues and that requires a properly functioning national economy.

HARRIS: In fact, in your statement to the Platform Committee on August 18, you said, “Our only sure road to a balanced budget is through both expenditure control and rising Federal revenues—which can only be generated by strong and balanced economic growth. That is the road we have followed during the last three and a half years—....”

DILLON: I think that’s a very short and clear statement of my view.

HARRIS: Now, then another issue that played a great part in the Democratic policy these years was the question of increasing government revenues as the recovery proceeded. And you said on August 17, 1962, to the Joint Economic Committee, "The current rate structure siphons off so large a fraction of the increased income generated by business recovery that forward momentum is dissipated before full employment and full utilization of industrial capacity can be reached."

DILLON: Yes, this was in regard to tax policy. We had early decided that there should be a major revision of the rate structure. This was mentioned in President Kennedy's first tax message in early April, 1961, when the first tax bill which later became the Revenue Act of 1962 was sent forward. At that time we looked on that proposal as sort of an interim measure that would accomplish certain of the most important advances, particularly that relating to the seven percent investment credit. But the President's message also stated that it would be followed by a complete revision of the rate structure.

As we got into the study of overall rate reduction we found that this revision would necessitate quite a substantial reduction in overall taxes. We had not been sure of that originally; we had thought that maybe a good deal of the revenue loss could be made up by closing loopholes. But as we studied the matter further

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we found that there weren't as many substantial revenue-losing loopholes that might practically be closed as some of us had thought. So we realized that greater net tax reduction would be needed.

Also, the slowdown in the economy in 1962, which we talked about earlier, made it clear that this was needed. So, during the early summer of 1962, everybody, all of us, reached agreement that this revision of the rate structure that we had talked about a year earlier should take place and that it would involve a substantial reduction in revenue, although the exact amount was not known at that time. There was some pressure to try and accomplish this reduction in rapid fire fashion during that summer of 1962 so as to stimulate the economy after the fall of the stock market. You will recall that many people were afraid the economy would go into a tailspin. I and my colleagues in the Treasury Department resisted that effort very strongly. We felt that this was not necessary, and that the stock market drop had been a psychological phenomena that would wear off. We felt that we should first get the Revenue Act of 1962 enacted and then we should submit the following January a complete revenue program. There was discussion of which course to take during the summer and by early August the President had decided to follow the line recommended by the Treasury. I was, I think, indicating that line in my testimony before the Joint Economic Committee in the middle of August, 1962.

HARRIS: There's one reason for this difference between the Council's position and yours at that time. Weren't you a little more optimistic about the future economic trend than they were?

DILLON: Far more. They had been more optimistic, as you pointed out, than we were early in the year. They were much more concerned, I think, by the stock market collapse. Of course, they compared it with 1929, and recalled what had happened at that time. We, I particularly, from the experience I had in business, did not feel the 1962 drop was comparable to 1929 because there wasn't the same credit situation; people did not owe funds that they could not pay off in anywhere near the same scale. So there was no danger of a vicious cycle developing of bankruptcy leading to bankruptcy. All that happened really was that a lot of people profits that people had suddenly disappeared. Now that naturally

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would dampen their desire to spend, but I didn't think that the low level of stock prices was going to continue. Also, it didn't seem to me that there was anything that should actually slow down spending by the great mass of the people who were not in the stock market. Therefore, I thought business would be profitable and things would pick up. It turned out that our forecast or our judgment of what the effects of this stock market decline would be proved to be accurate. The effects were very passing and certainly I'd say four or five months after the stock market crash was over everyone looked back and wondered why they'd been so worried.

HARRIS: I gather the President was also worried about the size of the deficit in case we had another tax cut at that time?

DILLON: That's correct—I think that's correct.

HARRIS: Now, you also held a general view in that paper you gave the American Bankers Association on October 17, 1961, a view that's fairly widely held, but not generally by Secretaries of the Treasury, I might say, Mr. Secretary: "The budget should be in balance, with surpluses during times of full employment to offset the deficits—in times of recession.... This means a balanced budget for fiscal '63." In other words, you wanted a balance over the cycle, not each year?

DILLON: Yes, well I said at times of full employment and we at that time both expected and hoped that we would have full employment by sometime during calendar year '62. We were moving up extremely rapidly at that time, and we thought this would continue. Now we were not alone in that because the former head of the Council of Economic Advisers under President Eisenhower thought we were conservative and that the four percent unemployment level would be reached even earlier. That was Dr. Arthur Burns [Arthur F. Burns]. He made some speeches to that effect in the spring of 1961.

HARRIS: Now I think that you did take a more advanced position, you may recall, on February 7, 1963, before the Ways and Means Committee, and you said: "It is difficult to balance the budget over the business

cycle if that business cycle never gets to full employment at anytime during the cycle. Our difficulty is that we never have been able to get anywhere near full employment in the last 5 years.” In other words, you were saying you would have deficits even at the top of the cycle if the top of the cycle coincides with a fair amount of unemployment.

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DILLON: That’s correct. I don’t know that that’s different than saying over the cycle, but what I’d said, as you recall, to the bankers in 1961, was that we should have surpluses at full employment to offset deficits in recession. So there really is no difference expect the second statement to the Ways and Means Committee spelled the matter out more clearly. It may have been more advanced in the sense that, while the idea of surpluses to offset deficits over a cycle has come to be fully accepted, that general acceptance hasn’t gone so far yet as to fully accept the theory that it requires full employment or something close to it to produce a balanced budget or a surplus. But certainly I believe that that is what is required. I don’t see how you could hope to balance your budget consistently at less than full employment. If you do, you may be able to do it for one year but as a result of the restrictive fiscal policy involved you will probably succeed in bringing on a slowdown in business which will greatly decrease your revenues. The result will probably be that over a period of two or three years you’ll have as large or larger deficits than you would have under the other system and you would not have the same economic growth and you would have unnecessary unemployment. So you would wind up with equivalent deficits in a much worse economic situation.

HARRIS: Well, then Mr. Secretary, on October 17, 1961, before the American Bankers Association you presented this early point of view that you presented many times afterward: “I am confident that both inflationary price rises and a recurrence of the 1959 type of monetary stringency can be avoided at this time. This is mainly because we have substantial unused capacity, both in our plants and in our labor force—capacity that can easily absorb the increases in demand.”

DILLON: Well, I think that’s been true and we’ve said that time and again and we’ve run now for three and a half years and we’ve had relatively easy money; we’ve had no need to tighten monetary policy as had been done in past economic recoveries and yet there’s been no inflation, no increase in prices.

HARRIS: Yes, then you more or less repeat that statement on May 18, 1962, again before the American Bankers Association, “Under such circumstances, experience shows that a moderate deficit would not be inflationary, just as the rather substantial deficit of the past twelve months, with manpower and goods in ample supply, has not been inflationary....”

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DILLON: That’s right.

HARRIS: And again on August 17, 1962, “Fear of deficits is deeply rooted in our thinking—and that fear has its basis in the fact that deficits have sometimes led to excess demand and inflating. But in today’s economic environment—far from being a source of dangerous inflationary pressures—our deficit reflects our idle plant capacity and our overly large unemployment rolls.”

DILLON: That’s true. It means the deficit reflects inadequate revenues.

HARRIS: Now then the government’s been criticized a number of times for excessive expenditures but you pointed out on June 20, 1961, before the National Press Club, “Meanwhile, expenditures must keep pace with our ever growing population and our mounting national needs.” And again before the Business Council on October 20, 1961, “If the growth of our nation has brought with it a complex new problem then it inevitably increased the role and responsibility of the government.”

DILLON: That’s true.

HARRIS: This is a problem that arose also in the discussions of the tax cut in 1963, didn’t it?

DILLON: I think that’s right. We certainly felt that we had to hold down expenditure increases at that time when we were making such a large reduction in revenues, but you can’t hold down expenditure increases forever when the country is growing and its needs are growing. There has to be a certain amount of expenditure increase just to take care of that growth.

HARRIS: And the rise of prices and the increase in population.

DILLON: That’s right.

HARRIS: And then on February 27, 1963, you raised a point you made a number of times that actually in comparing the non-defense expenditures under Eisenhower and Kennedy that the Kennedy Administration had done better than the Eisenhower.

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DILLON: Well, that’s true that if you take the four years of Kennedy-Johnson [Lyndon B. Johnson] Administration from ’61 to ’65 as compared to the preceding four years, all expenditures, excepting only defense and space, had increased nearly \$2 billion less under the Kennedy-Johnson Administration than they did in the preceding four years.

HARRIS: And in general you time and again said that you must watch your expenditures and not be extravagant and all that sort of thing, but you also recognized the fact that to some extent some increases in expenditure were inevitable. You made such a statement on June 20, 1961, which I will not read. And then on October 18, 1962, before the National Industrial Conference Board, "There's no realistic prospect for the foreseeable future of reducing Federal expenditures below current levels. Federal expenditures are bound to continue to rise." You would still uphold that position?

DILLON: Yes, I think that's true.

HARRIS: Then we come to some general aspects of the tax cut –

DILLON: But the one exception on expenditures is that if there should be a major change in our defense posture and if it should no longer be necessary to keep the defense establishment at its present size. That would mean some sort of an end to the Cold War and then there would have to be quite a readjustment—a large reduction in expenditures accompanied by tax reduction.

HARRIS: As you delegate some of this expenditure to welfares and then also use part of the resources to cut taxes.

DILLON: That's right.

HARRIS: And then, "It is better to remove shackles of an oppressive tax structure rather than to try to make the economy function better by extra expenditures." That's Ways and Means February 27, 1963, where you state that you favor the tax cut approach rather than the rise in expenditure approach.

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DILLON: Certainly, although I think that is not necessarily true everywhere and always, but in our circumstances, having the highest tax rates in the world—the highest marginal rates—it was very clear that these high marginal rates were impeding the functioning of our economy, and that the first priority was to remove that drag on our economy so that the whole economy could function better.

HARRIS: And then on May 31, 1963, this is before Ways and Means, "Personally, I feel, and I think that for the amount of funds involved tax cut procedures have become effective much more rapidly than more expenditures and would be much more effective and much more important." Now I suppose you still hold that except would you still feel that tax cutting procedures are so fast?

DILLON: Well, it's much faster than expenditure increases, the reason being that once you pass the tax cut the effect is immediate; when you pass an appropriation bill the effect is not immediate; it takes a long time before the money is actually spent. I don't know, if you start from the beginning of the recommendation it may be easier to get an appropriation bill enacted than the tax bill and maybe that makes the time span somewhat more even, but I was thinking of the actual enactment when the tax cut takes effect. There's no doubt that it's more rapid in its effect than when a program of expenditure is voted and therefore can commence since it takes months of planning and months of contract letting before any dirt is actually moved.

HARRIS: And then you say something about the possibility of cutting budgets. This is June 18, 1963, before the National Coal Association Convention. The budget was tight. Over 40% of the budget involved authorizations already committed and many other items were not reducible, e.g., commitments on pensions, etc. Well, what you are arguing here was, and you took that position a number of times, mainly that these people who talk about sort of meat axe cuts in expenditures talk greatly and never really suggest how the job can be done.

DILLON: Yes, well, I think it's very clear there's never been, I guess, any harder attempt to cut back expenditures than the attempt that's in process now, and the best that could be done

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was a hope that in fiscal '65 expenditures would be a couple of hundred million dollars, which is two tenths of one percent lower than they were the year before. Even that took every ingenuity and every effort possible.

HARRIS: Wouldn't you agree, Mr. Secretary, that a cut in taxes does put some spending down?

DILLON: Oh, most certainly, most certainly. You can't do both at once.

HARRIS: But there are limits as to how much you can cut your expenditures and the Republican policy of suggesting that you cut your expenses as much as you cut your taxes is unwise.

DILLON: Oh, no, I don't think you can cut overall expenditures at all. You can hold down the normal increase so that either it is smaller than would normally be the case, or you can take the extreme case of what we are trying to do now this year because the tax cut was speeded up in its effect, no increase at all—maybe you can do that for one year but you can't do that for more than one year.

HARRIS: Would you like to comment on the difference between President Kennedy and President Johnson on the spending issue? Are these fundamentally similar programs?

DILLON: I think that they are far more fundamentally similar than is generally recognized. Both the men were by nature frugal; both men by nature felt strongly that there shouldn't be too many people on the government payroll, and both directed specific campaigns at this effort. President Kennedy in late 1963, just before his assassination, was able to announce that in the preceding 12 months government employment had actually decreased. That was the first time in some time that had been possible. President Johnson had carried that on and even intensified it in detail, in his effort to carry that sort of a policy through. On the other hand, I think both men were interested in expenditures that they thought really would be socially useful, such as the Appalachian program with President Kennedy and the poverty program with President Johnson, which are two very similar programs designed to meet the same problems.

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HARRIS: Now here's a general question that arises. You mentioned the investment credit before, but let me quote something that you said on June 4, 1962, "For the investment credit is by far the most powerful stimulant to profits of any of several possible forms of investment incentive. For each dollar of revenue lost to the government, it provides two to three times more stimulus to profits than any other practicable form of incentive." Now what I'd like to ask is this. In view of the difficulty in getting the rate of interest down because of the international situation, the only way of increasing investment is to improve the prospects for profits and this is an attempt to deal with the programs through increasing the prospects for profits as against a cut in the rate of interest.

DILLON: Oh, absolutely, and there have been some very interesting computations. I think Mr. Edward Bernstein [Edward M. Bernstein], who is a pretty good economist, worked one out where he figured out the seven percent investment credit provided more stimulus than a full one percent cut in long-term interest rates and that, of course, would have been out of the question.

HARRIS: Now in various speeches you raise a number of points about why it was necessary to have this tax bill. Let me just run over each of them and you might like to comment on any of them. Here are some of the points you made in behalf of the tax policy. "That the modern tax rates were too high and hence acted as a depressant."

DILLON: Yes, I think that's very true. I believe that, and I think that our tax rates were higher than the other countries, except England, and certainly England didn't have a very good record of economic growth.

HARRIS: "That the tax structure tended to destroy productive investment."

DILLON: That's the same thing because we did not have adequate provision for depreciation; we did not have any incentive, investment incentive, such as other countries had. So that there was no encouragement to modernization such as had worked very well in other countries.

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HARRIS: "That tax reforms that were needed to bring about more equitable and more effective tax system."

DILLON: Well, that's true. In the last three years the tax reforms we enacted raised revenues, raised three times as much from new sources as were raised in the entire period from 1942 to 1962. In addition, we made substantial changes, nearly a billion dollars worth of tax reduction that went to specific individuals and companies that we felt were unfairly taxed.

HARRIS: In other words, the idea that tax reform was abandoned in the tax bill is incorrect?

DILLON: Oh, totally. It was not abandoned at all.

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