


*An Administrative History of the Johnson Presidency Series*

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***Managing Macroeconomic Policy***  
**THE JOHNSON PRESIDENCY**

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ment. Strong, talented persons like McNamara will be relied upon by the White House when they are available and can contribute information or advice that will strengthen presidential decisionmaking.

#### *Outside Advisers*

Johnson frequently sought advice from a variety of persons outside the government. Clark Clifford, Abe Fortas, and David Ginsburg, lawyers and long-term members of the Washington establishment, were consulted on many important economic matters. They also served on ad hoc committees that made recommendations to the president on fiscal policies. Johnson apparently viewed them as broad-gauged, wise individuals who could give useful judgments on the wisdom and feasibility of economic proposals. Also, Johnson continued to draw upon Walter Heller and Kermit Gordon for advice after they left their positions with the Council of Economic Advisers and the Bureau of the Budget. Other economists were also called upon on occasion. Before he made major economic decisions Johnson often consulted business and labor leaders: "Particularly when measuring the value of divergent proposals, he would present the labor arguments to a Henry Ford and the business arguments to a George Meany."<sup>38</sup> Businessmen who were drawn upon included utility executive Donald Cook, financier Robert Anderson, and Beverly Murphy of the Campbell Soup Company. Such persons could provide useful judgments and information on policy proposals, and their subsequent support could be helpful in securing the enactment or implementation of administration decisions.

It is not possible to determine with precision how much impact outside advisers had on the president's decisions and actions. Clearly they were important—they helped provide the president with the broad range of economic and political insight and information he needed and desired in making decisions. From some he sought trusted judgments, from others political reactions and insights, from others good economic information. They also provided him with an independent check on the feasibility and political realism of recommendations coming from administration officials. Presidents cannot afford to limit themselves to official aides and advisers in the exercise of their powers and responsibilities, nor will they when, like Johnson, they have a calculating and skeptical style of decision-making. It was sometimes remarked by White House staff members that "the only person Johnson trusts is Lady Bird, and then only 90 percent of the time."<sup>40</sup>

#### **The Johnson Record: An Overview**

In March 1961, following a period of recession, the American economy began an expansion that was to last for the remainder of the Kennedy administration, to continue throughout the Johnson administration, and to persist for the first 10 months of the Nixon administration. Lasting in all some 102 months, this was the longest continuous period of expansion in the history of the American economy. Some of the glow was taken off of the expansion after 1965 by increasing inflation, brought on largely by spending pressures generated by the Vietnam War. Nonetheless, this represents an impressive economic performance, and it did not just happen. Efforts by the Kennedy and Johnson administrations to stimulate the economy and then to maintain full employment conditions while seeking to moderate inflation clearly contributed to the expansion. Major macroeconomic actions by the Johnson administration will be discussed in this section. Since the decade of the 1960s was the heyday of the "New Economics," it seems advisable first to present some of the major "new economic" concepts employed by economic advisers during the Johnson (and Kennedy) administrations in analyzing the economy and framing economic policy proposals.<sup>41</sup> This will be done in nontechnical fashion. We turn first to a look at the New Economics.

#### *The New Economics*

The New Economics, as it came to be called, was a mixture of optimism and activism, of the belief that government could and should act to influence favorably the operation of the economy.<sup>42</sup> The new economists had considerable confidence in their ability to manage the economy; indeed, Walter Heller at one point spoke enthusiastically of their ability to "fine-tune" the economy. He was later to acknowledge that this was a gaffe.

The new economists wanted to do more than merely prevent "boom and bust" in the economy. Dissatisfied with the high levels of unemployment during the late 1950s and early 1960s, they targeted full employment (or "sustained prosperity") as their goal. This goal was stressed in their concepts of "potential output" and the "gap" in gross national product (GNP). Potential output was intended to measure the level of GNP that the economy could attain if it was operating at a full employment (4 percent or less unemployment) rate. The GNP gap measured the difference between actual output and potential output. If actual output was less than potential output, then eco-

conomic resources were being wasted (not used) and an expansionary economic policy was called for.

Another concept of significance was that of the "full employment budget." This was intended to measure (at least more accurately than the actual budget surplus or deficit) the impact of fiscal policy on the economy. The budget both acts upon and is acted upon by the economy. A falloff in business activity, for whatever reasons, could reduce income and tax collections, and consequently produce a budget deficit, even though decisionmakers had not planned an expansionary fiscal policy. The full employment budget concept determines whether the budget would be in surplus or deficit given the existing set of revenue and expenditure policies. In assessing the impact of fiscal policy, it thus tries to hold the economy constant. At a high rate of unemployment the actual budget might be restrictive, even though in deficit, because if the economy were operating at full-employment conditions there would then be a budget surplus. It was this point of view that led the Council of Economic Advisers to advocate a tax cut in 1963, even though the budget was running a deficit, to stimulate the economy. The fiscal-policy target now became a balanced budget at full employment rather than a balanced budget every year or over the business cycle.

As economic activity expands and incomes rise, the existing revenue system, especially because of the operation of the graduated income tax, will bring in greater revenues. Indeed, revenues will tend to increase faster than employment declines. If government spending does not also increase, the result will be either a full-employment budget surplus or an increase therein, which will exert a restrictive influence on the economy and check the recovery. This condition is known as "fiscal drag." It is viewed as undesirable because it reduces growth of the economy, at least until the performance gap between potential and actual GNP is closed and inflation threatens.

To prevent fiscal drag from choking off recovery or growth of the economy, "fiscal dividends" should be declared. Those can take the form of either tax reduction or expenditure growth. As Heller has explained:

A central part of the job of fiscal policy is precisely this delicate one of declaring fiscal dividends of the right size and timing to avoid fiscal drag without inviting inflation. In an overheated economy, the fiscal drag that develops when fiscal dividends are not declared is a welcome antidote to inflation. When recession threatens, an extra dividend is appropriate. But in normal times

we must close the fiscal loop by matching the annual \$7 to \$8 billion of revenue growth with tax cuts, increased expenditures (including social security benefits), and more generous support to state and local governments.<sup>43</sup>

The new economists were also concerned with the impact of wages and prices on inflation. They developed the view that to be noninflationary, wages and prices should be related to the growth in productivity in the economy. This found expression in the wage-price "guideposts," which will be dealt with in detail in Chapter 5. As formulated in 1962, the guideposts initially held that wages should not increase more rapidly than did the average rate of productivity in the economy. In 1965 and 1966 this principle found more concrete expression in the famous 3.2 percent wage increase guidepost, which was the average increase in productivity for the years 1960-64.

Mention also should be made here of the Phillips Curve, which, although it has now declined in influence, was an important concept in macroeconomic-policy discussion and deliberations in the 1960s. Essentially, the Phillips Curve suggests that there is a trade-off between the rates of unemployment and inflation in the economy: the higher the rate of unemployment, the lower the rate of inflation, and vice versa. The short-run challenge confronting policymakers was using monetary and fiscal policies so as to achieve the politically optimum balance between the unemployment and inflation rates. The long-run challenge, since the Phillips Curve was not stable, was creating conditions in which both low unemployment and little inflation existed. (The 1970s demonstrated that the opposite—high unemployment and a high rate of inflation—is also possible.)

The New Economics probably differed from the old economics more in spirit and emphasis than in kind; many of its concepts are drawn from mainline economics. The new economists were really distinguished by their optimism and activism, their confidence that the economy could be successfully managed, and their actual use of the concepts summarized here in making policy recommendations and managing the economy. And for a few years, as will be seen in the next section, they were generally successful in their actions.

### *Policy Actions*

In January 1963 President John Kennedy requested that Congress enact a major reduction in personal and corporate income taxes, even

though the national budget was in deficit, in order to encourage economic growth and reduce unemployment. The tax cut bill did not meet with an overly warm reception in Congress, and it was stalled there in late November when Lyndon Johnson succeeded Kennedy in the presidency. By using his powers of persuasion, pledging restraint in government spending, symbolizing thrift by turning down the White House lights, and producing an administrative budget of \$97.9 billion (below the "magical" figure of \$100 billion), Johnson was able to get Congress moving. In late February he signed the Revenue Act of 1964 into law.

The act permanently reduced income tax rates for all individuals and corporations. Individual rates ranging from 90 to 21 percent were lowered to 70 to 14 percent, while corporate rates were reduced from 52 percent to 48 percent. The reduction was made in two stages: most of the total reduction of \$11.5 billion took effect immediately, but a small portion was delayed until 1965. The tax cut had the desired effect. Business investment and consumer spending increased and the unemployment rate, which had averaged 5.7 percent in 1963, dropped to 5.2 percent in 1964 and continued downward in 1965. Arthur Okun has stated that the long-run effect of the tax cut was to increase GNP by an annual rate of \$36 billion.<sup>44</sup> It was, in all, a textbook example of a tax cut.

In its *Annual Report* of January 1965, the Council of Economic Advisers stated that the administration's fiscal program for fiscal year [FY] 1966 called for several expansionary actions in addition to the stimulatory effects of past actions, particularly the Revenue Act of 1964. These included a reduction in excise taxes, a liberalization of social-security benefits, and an increase in federal expenditures, mostly for grants-in-aid and transfer payments. These were necessary, according to the council, to offset the full employment growth in revenues and to decrease the full employment surplus during calendar year 1965.<sup>45</sup>

President Johnson recommended a \$1.75 billion cut in excise taxes to Congress in January. When it became clear that there was strong congressional support for larger excise tax cuts, he increased his recommendation to \$4 billion. (In 1964 Congress had reluctantly extended the excise taxes for another year at the president's request.) As enacted in June, the law provided for a \$4.7 billion reduction in excise taxes on such items as appliances, radio and television sets, jewelry, automobiles, and telephones and communications services. The only major change made by Congress in the administration's proposal was a reduction in the tax on automobiles from 10 to 1 per-

cent rather than the 5 percent that the administration had requested. Reductions totaling \$1.8 billion took effect immediately, another \$1.6 billion reduction was scheduled for 1 January 1966, and the remainder was to be phased in over the next three years.

Legislation enacted in July 1965 provided for a 7 percent increase in social-security benefits retroactive to 1 January 1965. This was financed by expansion of the social-security tax base from \$4,800 to \$6,600 and a small increase in the payroll tax rate, effective 1 January 1968. The administration believed that the retroactive benefits would give the economy a needed boost in the second half of 1965, and that financing them primarily through a tax base expansion would create less drag on the economy in the first part of 1966. By the time the higher base had begun to yield more revenue later in the year, medicare benefits, also authorized by Congress, would begin flowing out.<sup>46</sup>

As 1965 wore on, however, the concern of administration economists shifted from preventing fiscal drag to the possibility of an overheated economy. In the summer President Johnson committed the nation to increased involvement in Vietnam, and defense expenditures increased by over \$3 billion in the second half of the year. In December the economy reached the interim goal of 4 percent unemployment. The Federal Reserve Board became concerned about inflationary pressures, and on 5 December they raised the discount rate from 4 to 4.5 percent. This action was criticized by administration spokesmen. (Hindsight has shown the FRB was correct.) There was, however, concern within the administration about the expansion in aggregate demand.

In December 1965, the president asked Ackley for his "private preliminary view of the policy implications of FY 1967 budgets of \$110 and \$115 billion." Ackley replied that "there is little question in my mind that a significant tax increase will be needed to prevent an intolerable degree of inflationary pressure" if the budget was \$115 billion. The question was more difficult with the lower figure, but "a tax increase would probably still be necessary."<sup>47</sup> In another memorandum a few days later, Ackley concluded there was a need for an individual and corporate income tax increase. "Tactically, it may be feasible to propose higher taxes later in the year. From an economic standpoint, it needs to be done as soon as possible."<sup>48</sup> There was general agreement among LBJ's economic advisers that a general tax increase was necessary.

In his January 1966 State of the Union Message, however, the president chose to ask Congress only for a "bits-and-pieces" revenue package:

I believe it desirable, because of increased military expenditures, that you temporarily restore the automobile and certain telephone excise tax reductions made effective only twelve days ago. Without raising taxes—or even increasing the total tax bill paid—we should move to improve our withholding system so that Americans can realistically pay-as-they-go, speed up the collection of corporate taxes, and make other necessary simplifications of the tax structure at an early date.

I hope these measures will be adequate. But if the necessities of Vietnam require it, I will not hesitate to return to the Congress for additional appropriations or additional revenues if they are needed.<sup>49</sup>

The Congress responded quickly, passing the Tax Adjustment Act in March by substantial majorities. It temporarily restored excise taxes on automobile and telephone services to their pre-1966 levels (6 percent and 10 percent, respectively), provided for graduated withholding of personal income taxes, accelerated the collection of corporate income taxes, and required quarterly rather than annual payment of social-security taxes by the self-employed. Altogether, these measures provided for a one-time-only boost of \$6 billion in revenue over the next fifteen months. Signing the measure, LBJ said it would provide funds to support the troops in Vietnam and “a careful measure of fiscal restraint to balance our economic expansion with reasonable price stability.”<sup>50</sup> In actuality, it proved to be inadequate for either purpose.

The failure of the administration to seek a general tax increase meant that other stabilization measures would have to carry the burden. Efforts to induce business and labor to go along with the wage-price guideposts were intensified. A substantial effort to cut back on non-Vietnam spending was made. Much of the burden of restraining the economy was borne by the Federal Reserve Board, which acted to tighten the money supply. This led to the famous “credit crunch” in the autumn of 1966, followed by an easing of credit later in the year.

Within the administration discussion of the economic situation and the need for a tax increase continued. Ackley and Schultz were strong advocates of the desirability of a tax increase. In a memorandum to the president in May 1966, for example, Schultz indicated that expenditures for FY 1967 were going to be considerably higher than had been estimated in January. Noting the strong inflationary pressures that were developing, he said that “uncertainty over events in Vietnam is not sufficient reason to prevent a tax increase.” His conclusion was unequivocal:

In short, under almost every conceivable circumstance—except a Vietnam settlement between July and November—a decision to raise taxes at least for the remainder of this year and early 1967 is clearly warranted. And even under that circumstance, the risks of serious inflation, in my view, far outweigh the dangers of having a tax increase extend a few months past the date of a possible Vietnam settlement.<sup>51</sup>

He favored a 10 percent income tax increase plus suspension of the investment tax credit and accelerated depreciation on buildings.

Not until September, however, did the administration propose action to restrain the surging economy. In a special message to Congress on fiscal policy on 8 September 1966 the president proposed a several-part program: (a) a reduction of \$1.5 billion in spending for lower-priority federal programs, (b) suspension of the investment tax credit until 1 January 1968, (c) suspension of accelerated depreciation on buildings until the same date, and (d) an easing of monetary restraint by the FRB because of the use of fiscal restraint.<sup>52</sup> Congress again responded quickly and on 8 November, the president signed into law a bill suspending the investment tax credit and the accelerated depreciation allowance. He noted that he would promptly recommend their reinstatement if it became necessary before January 1968.<sup>53</sup>

In the fall of 1966, economic forecasts became less bearish because there was a discernible slowing down of economic activity. The December Troika review indicated that the first half of 1967 was going to be sluggish economically. The policy implications of this situation included a need for new stimuli from fiscal and monetary policy to prevent the slowdown from becoming a stall. Monetary ease, action to revive the housing industry (which had been hard hit by the credit crunch), and restoration of the investment tax credit and the accelerated depreciation allowance were recommended by the Troika. However, an upsurge in the economy by the middle of the year was foreseen. To contain this, the Troika proposed a surcharge of 5 percent on personal and corporate incomes, to become effective on 1 July 1967.<sup>54</sup>

In December 1966 and early January 1967, several of the president's economic advisers held meetings to develop a fiscal program. In a memorandum to the president on 9 January 1967, they recommended a 6 percent surtax on personal and corporate incomes, suspension of the investment tax credit when necessary, a speedup in corporate tax collections, continuation of the interest equalization tax, and continued pressure for easy money.<sup>55</sup> In his State of the

Union Message the president called for the 6 percent surcharge. His request elicited little favorable response and the administration did not push it for the time being.

The nagging problem of an unfavorable balance of payments worsened in 1967. Export sales declined while capital outflows to other nations increased. To deal with the capital outflow problem, the president recommended extension of the 1963 Interest Equalization Tax Act which had been designed to increase the cost of money for foreign borrowers. Congressional action extended the tax for the two years that the president requested. The legislation also authorized him to entirely eliminate the tax or to set it at any level up to the equivalent of an interest charge of 1.5 percent. This is probably the first instance of congressional delegation of discretionary authority to the executive to vary tax rates. Legislation was also extended in 1967 that permitted the executive to grant antitrust exemptions to financial institutions entering into voluntary agreements, under supervision of the attorney general, to reduce the flow abroad of U.S. dollars and credits.

Concern over continued softness in the economy was stirred in March by the Department of Commerce—Securities and Exchange Commission annual investment survey, which indicated a likely decline in business investments. On 9 March, a couple of days after Fowler, Schultze, and Ackley recommended consideration of restoration of the investment tax credit and accelerated depreciation allowance, the president sent a special message to Congress requesting their reinstatement. Their suspension, he said, had accomplished the purpose of economic restraint and hence they could be restored.<sup>56</sup> That this action was intended to stimulate the economy was soft-pedalled by administration officials. Once again, Congress acted. The necessary legislation, which was held up for several weeks because of an extraneous dispute over a presidential campaign fund, was enacted in June.

What various members of Congress, including some administration supporters, saw as the administration's on-again-off-again tax policy was beginning to produce strong rumblings of discontent. Liberal Democratic Senator Albert Gore of Tennessee, although not alone in some of his sentiments, seemed especially provoked:

We are all Keynesians to some degree, and I am sure that every member of the Senate believes in the active use of the powers of government to help regulate the economy under certain circumstances. But are we capable of intelligently juggling our tax pat-

terns and tax rates? Are we not doing more harm than good with an on-again-off-again tax policy, the only constant being continu-ous and increasing deficits?

To begin with, forecasting is not sufficiently precise to allow policy to be pinpointed. And, second, timing will always be questionable when political activists must be counted on to arrive at decisions, and additional political forces must be called on to transform decisions into action.<sup>57</sup>

Gore preferred an "equitable tax system" with expenditure variations used for fiscal-policy action. Others, however, were more concerned that with a reduction of expenditures the economy would become resurgent in the second half of the year and a shift toward restraint in fiscal policy would become necessary.<sup>58</sup>

After much internal deliberation and consultation with outside groups and persons, a decision to seek a major tax increase was reached by the administration. A memorandum to the president initiated by Fowler, Wirtz, Trowbridge, McNamara, Schultze, Ackley, and Califano recommended a speedup in corporate tax collections, continuation of the automobile and telephone excise taxes, and a temporary 10 percent surcharge on corporate and individual income tax liabilities (to become effective on 1 July and 1 September 1967, respectively, and to continue until 30 June 1969, or as long as the Vietnam War required higher revenues).<sup>59</sup> These recommendations were incorporated in the president's special message to Congress on 3 August.

This touched off a ten-month struggle between Congress and the executive over the proposed tax increase. First, doubt was expressed in Congress that a tax increase was really needed at all. In the view of many members, since the economy was operating satisfactorily at the time, why monkey with it? Moreover, the public displayed no enthusiasm for a tax increase. Hearings were held, but no other action was taken by Congress in 1967. The necessity of action became clear after the turn of the year, as Arthur Okun reported:

The need for economic restraint became clear to the Congress and the public early in 1968 when the horror stories of the economic forecasts began to come true. Prices accelerated to a 4 percent rate of increase; interest rates rose far above their 1966 peaks; and our world trade surplus again shrank. The economy moved into a feverish boom with a huge advance in GNP of \$19 billion in the first quarter of 1968.<sup>60</sup>

Strong business support was expressed for the tax increase, but majority support in Congress could not be won until the administration agreed to couple it with an expenditure reduction. Enacted in June 1968 and quietly signed into law by the president, the Revenue and Expenditure Control Act provided for:

1. A 10 percent surcharge on individual income tax payments effective 1 April 1968, and on corporate income tax payments effective 1 January 1968. Individuals in the lowest two tax brackets were exempt from the tax. The surtax was slated to expire on 30 June 1969.

2. Continuation of excise taxes on automobiles and telephone service at existing rates until 1 January 1970.

3. Acceleration of corporate tax payments.

4. Reduction of budget expenditures by \$6 billion in FY 1969. In addition, there was to be a \$10 billion reduction in appropriations (new obligational authority) in FY 1969, and a rescission of \$8 billion in unspent prior-year appropriations at the end of 1969. Some spending and appropriations, such as for the Vietnam War, veterans' benefits, and interest on the national debt were exempted from the reduction requirements.

Congress subsequently reduced appropriations (new obligational authority) by \$12.5 billion, or more than the act required. Expenditures (or outlays) were reduced somewhere between \$3.5 and \$4 billion during congressional action on the 1969 budget. The remainder was left to the administration to cut, which it did in such areas as non-Vietnam defense spending, government loan programs (lending was shifted to private markets), highway project postponements, and non-Apollo space projects.<sup>61</sup>

The Council of Economic Advisers expressed concern that the combination of tax increases and expenditure reductions in the 1968 legislation would provide too much restraint on the economy. A Troika memorandum in August 1968 viewed the prospective slowdown of the economy in 1969 as excessive and asserted that monetary ease was necessary to moderate it.<sup>62</sup> The FRB acted to expand the money supply, thereby offsetting the restraint of the Revenue and Expenditure Control Act. As Okun later put it: "This turned out to be wrong policy because it was the right policy for what turned out to be the wrong forecast."<sup>63</sup>

Inflation continued to plague the economy through the remainder of the Johnson administration and became a problem with which succeeding administrations had to contend.

### A Concluding View

In many respects, the operation of the economy during the Johnson years was impressive (see Table 3). Prosperity reigned in the nation. GNP and per capita incomes expanded substantially (even when corrected for inflation). The economy operated close to its potential output level throughout the era. The rate of unemployment averaged less than 4 percent for 1966-69, and several million people were added to the labor force. Those who had predicted that high rates of unemployment would persist because of automation and structural problems in the economy were proven incorrect.

On the other hand, the rate of inflation in 1966-68 was the highest the nation had experienced since the Korean War years. This produced a decline in the net worth of large numbers of citizens and a loss of purchasing power for many others. When the Nixon administration took office in 1969, it confronted an inflationary economy. All, in short, was not rosy, although in retrospect the inflation of the Johnson years seems less severe than it once did, given the experience of the 1970s.

One can speculate that the Johnson economic record would have been better had there not been political resistance, based in part on opposition to the Vietnam War, to the administration's efforts at economic management, especially after 1965. Politics, however, constitute an important part of the environment of economic managers, as they should in a democracy. In the rest of this book we shall be con-

**Table 3. *The U.S. Economy: The 1960s***

Year	GNP (\$ Billions)	Consumer Price Index	Unemploy- ment Rate	Labor Force (Thousands)
1960	503.7	103.1	5.5	72,142
1961	520.1	104.2	6.7	73,031
1962	560.3	105.4	5.5	73,442
1963	590.5	106.7	5.7	74,571
1964	632.4	108.1	5.2	75,830
1965	684.9	109.9	4.5	77,178
1966	749.9	113.1	3.8	78,893
1967	793.5	116.3	3.8	80,793
1968	865.7	121.2	3.6	82,272
1969	931.4	127.7	3.5	84,240

Sources: CEA, *Annual Report of the Council of Economic Advisers, 1970, 1971*, Washington, D.C., Government Printing Office, 1970, 1971.