NO PRESIDENCY IN AMERICAN HISTORY had such exhilarating economic highs or such devastating economic lows as the Johnson administration. A generation of economists hailed the tax cut of 1964 as “the triumph of modern fiscal policy.” It was the high point of the “new economics,” the end of balancing the federal budget for balance’s sake, the rise of economists into unquestioned power in the White House, the final volley of “the fiscal revolution in America.” That triumph, however, proved to be disastrously short-lived. United States involvement in Vietnam grew enormously after June, 1965, but not until two years later did Lyndon Johnson submit a plan to increase taxes substantially, and not for another year after that did Congress finally pass the tax surcharge. Bill Moyers later called the delay in seeking the tax increase “the single most devastating decision in the Johnson administration.” By overruling his advisers, who argued for a tax increase as early as December, 1965, while insisting on their loyalty, Johnson helped to undercut the base of his internal support. “It was the beginning of the end,” Moyers said, “a time when he lost control of the administration, lost control of events.”

The three-year delay in getting a tax increase helped to fuel a booming economic growth and to unleash inflation, which had been relatively quiet since the Korean War. When the Federal Reserve Board triggered tight money to slow the boom, the economy started on a roller coaster that took another fifteen years to stop. The struggle over the tax surcharge was the keystone of Lyndon Johnson’s tragedy: great hopes, a stormy struggle for consensus, and dashed dreams.

Perhaps no account of this struggle is better known—or more harsh—than David Halberstam’s article in the September, 1972, Atlantic Monthly, “How the Economy Went Haywire,” which he repeated in The Best and the Brightest. To Halberstam, Johnson was “a magician who lied.” Johnson’s own economists, especially Gardner Ackley, chairman of the Council of Economic Advisers (CEA), called for a tax increase in December, 1965. But Johnson, fearing that if Congress had a choice, it “would give him the war, but not the Great Society,” de-
decided to "hold back on the real estimates of the cost of the war for a year," to weaken the otherwise obvious case for a tax increase. Robert S. McNamara cleverly planned, for budgeting purposes, that the war would be over by June 30, 1967, but he kept, according to Halberstam, the real dimensions of the war secret—"secret, it turned out, even to the President's own economists."5

Halberstam delivered a tough indictment: Johnson had lied to Congress, the American public, and his own staff about the real costs of Vietnam. Johnson sought, instead, guns and butter—heavy Vietnam spending, coupled with an expansive Great Society. It was a "living lie" that in the end created "economic chaos."6 Halberstam's account has become the conventional wisdom of the period. Other writers have repeated it,7 and Newsweek cited the widely understood knowledge that during the Vietnam build-up, "Lyndon Johnson actually hid the cost of the war from Ackley, thus blunting what could have been an earlier call for a tax increase."8

As the documents available at the Lyndon B. Johnson Library show, however, these fateful events traveled a considerably more complex path. The documents cast great doubt on the Machiavellian image of a deceitful Lyndon Johnson. His advisers were far more uneven in their support for a tax increase than Halberstam has suggested, and Johnson's reasons for not proposing an earlier tax increase were not as simple as the guns-and-butter theory that Halberstam spins. Johnson did indeed want his butter, as the documents show, and he did fear that Congress would prefer to choose between them rather than to grant a tax increase. But in the early stages, guns and butter did not seem like incompatible choices. At the later stages of the Johnson years, the explosion of American cities into flames and the expansion of combat in Vietnam, combined with the great investment of moral and political capital into both campaigns, made retreat on either front unthinkable. Only as retreat became less possible, however, did the economic costs become clear. This was the essential irony, the pivotal tragedy, of an administration that was rocked to its foundation at the very zenith of its power.

Most of John F. Kennedy's cabinet, including Council of Economic Advisers Chairman Walter Heller, were in a plane over the Pacific when they heard the news of the president's assassination. The plane immediately was turned around, and on the trip back to Washington the conversation turned to the new president's grasp of economics.
The cabinet members were not sure that Johnson understood the Keynesian theory behind the proposed tax cut: lower federal taxation to stimulate private expansion. "There was a great deal of apprehension" about Johnson, Heller later remembered. Heller went from the plane to his office and worked all night on a memo to Johnson, in which he outlined the state of the economy and the need for a tax cut.

Kennedy's Keynesian advisers in the CEA had had a very difficult time convincing the president to propose a cut in income taxes. Kennedy had come to office with a strong commitment to supporting the sagging dollar abroad, and that stance argued against easier money. He was fiscally conservative and hesitated to counter Eisenhower's old-time balanced-budget religion. Federal Reserve Board Chairman William McChesney Martin, Jr., furthermore, was preaching that the country's unemployment problem was structural, based upon shifts in the labor market, rather than cyclical, based upon the ups and downs of the economy. Extra money pumped into the economy to increase demand would put few of the unemployed back to work if they were unemployed because they lacked the skills a changing economy needed or because they lived in an economically declining region. Most of all, Kennedy was simply not convinced that the Keynesians were right.

In August, 1962, Heller finally convinced Kennedy and Treasury Secretary C. Douglas Dillon, and the president went on television to announce a $10 billion tax cut, to be proposed in January's State of the Union address. Once announced, however, the plan came under attack from liberals and conservatives alike. From the Left came complaints that the tax cut unfairly benefited the rich and would, in the long run, not stimulate economic growth. From the Right, some economists complained that the tax cut might fuel inflation or create deficits. The tax plan bogged down in the Senate and barely passed in the House in September, just two months before the assassination.

On the evening of the slain president's burial, Johnson surprised his inherited economic advisers by enthusiastically embracing the tax cut. But Ackley said later, "He frightened us at that first meeting": to ensure the passage of the tax cut, Johnson announced that he planned to keep the federal budget to less than $100 billion. The budget ceiling, his advisers acknowledged, would help solidify conservative support for the tax cut, but it would greatly dilute its stimulative effects. For Johnson, however, the tax cut served purposes other than economic ones. It was to be a demonstration of who was in charge and of the new president's skill in dealing with Congress.
Johnson quickly sealed his victory by signing the tax cut into law on February 26, 1964, just three months after the assassination.

For economic advisers who at first had been leery about the new president, the passage of the tax cut was the rite of passage into the “new economics.” Johnson proved to be an eager audience for his economic advisers, and he relied on them more than Kennedy had. Economic advice was built on the “Troika,” an informal group of three created during the Kennedy years and carried over into Johnson’s administration. It consisted of the secretary of the Treasury (first, C. Douglas Dillon and then, after 1965, Henry Fowler); the director of the Bureau of the Budget (Kermit Gordon, until 1965; Charles L. Schultze, from 1965 to 1968; and Charles J. Zwick, for the remainder of the administration); and the chairman of the Council of Economic Advisers (Walter Heller, who was succeeded in 1965 by Gardner Ackley and in 1968 by Arthur M. Okun). The Troika prepared regular forecasts for the president and supplied him with recommendations, especially during the intensive budget season in December.

Johnson developed an especially close relationship with the CEA. For Heller, Ackley, and their colleagues on the council, the White House was a seminar room, and Johnson was their only student. As Ackley explained, “We considered this one of our main responsibilities: to try to teach him economics.” And for the most part, Johnson proved “a very good student, a very interested student,” according to Ackley.\(^16\) The text for the seminar was the constant flood of memos with which the CEA deluged him. Johnson voraciously consumed them, good and bad news alike, and he carried his favorites around for days in his jacket pocket to show to those with whom he spoke. The memos were unusual in form and much different from the memos the CEA had prepared for Kennedy. They were more outline than prose, and the key phrases were underlined, so they could not be missed. “He wanted information that he didn’t have to work too hard to get,” Ackley later explained.\(^17\) Johnson complimented the CEA for the memos, and he even occasionally sent a dense Treasury Department memo to the CEA and asked for an “English translation.”

Johnson, the “new economics,” and the new economists were riding high in the saddle. Within recent memory the economy had never been rosier. Heller bragged to Johnson that the economy was “showing new vitality and promise,” with “no inflation in sight.”\(^18\) It was a triumph of economic planning, the first conclusive demonstration of the federal government’s ability to frame a fiscal policy to stimulate the economy; it was also the foundation for Johnson’s 1964
victory over Barry Goldwater. With the passage of Kennedy’s tax cut, Johnson wrapped himself in the martyr’s mantle. It marked, according to Rowland Evans and Robert Novak, the “epitome of Lyndon Johnson’s early presidency.”19 As Johnson put it in his memoirs, he became a candidate who promised “imaginative fiscal and monetary policies that would eliminate the old cycles of boom and bust.”20 During the fall campaign, Goldwater, having opposed the tax cut, had precious little room for maneuvering on the economic issue. Perhaps most important, the successful passage of the tax cut was a central symbol of political success and active attack on the nation’s problems, and that made Johnson a formidable presidential candidate.

The tide stayed high until June 1, 1965, when Federal Reserve Board Chairman William McChesney Martin surprised the financial community and shocked the White House with a speech suggesting “disquieting similarities between our present prosperity and the fabulous twenties.”21 Martin apparently was attempting to warn about the difficulty of keeping expansion within bounds, the need to apply properly timed monetary and fiscal medicine to economic problems, and the increasing interrelationship of the domestic and international economies. The administration’s economists, however, rejected the implication that the boom in the economy might end in a 1929-style bust. The CEA staff, in fact, was concerned mainly about the possibility of slower economic growth, rising unemployment, and the possible need for more economic stimulus late in 1966. Early projections suggested that the economy might slow down and need more, not less, governmental help, perhaps through another tax cut or through the enactment of the revenue-sharing plan that Walter Heller had championed.22

On the same day, Lyndon Johnson requested a supplemental appropriation for Vietnam. The early months of the Vietnam build-up did not worry the CEA; in fact, Ackley suggested that more military spending might provide a much-needed stimulus. “Our economy has lots of room to absorb a defense step-up,” he told Johnson on July 30. “Nobody can seriously expect that the kind of program you outlined is going to overheat the economy, strain industrial capacity, or generate a consumer buying boom.” He concluded that the “overall effects are most likely to be favorable to our prosperity” and to reduce the need for a further tax cut.23

As the fall went on, however, Johnson’s economic advisers viewed the step-up in military expenditures with growing alarm. In early September, Ackley condemned a column by Evans and Nowak that suggested Vietnam spending would bring inflation in 1966,24 but in early
November a special interagency committee warned that rising defense expenditures might produce "a significant and undesirable acceleration in the pace of overall economic activity."\(^\text{25}\) The Federal Reserve, in fact, was so worried that on December 6 it raised the discount rate—the rate that banks pay on loans from the system—from 4 to 4.5 percent, to try to slow the economy. Johnson angrily disassociated himself from the decision and said he regretted that the board had decided to act before the administration had completed work on the new budget.\(^\text{26}\) Administration officials had for weeks been putting pressure on the Federal Reserve to delay any action until January, when the budget picture would be clearer. Martin himself was scheduled to meet with Johnson within a few days to discuss the economic outlook. Some observers, in fact, speculated that Martin had acted preemptively to prevent Johnson from using the meeting to apply the "Johnson treatment." Johnson's economists were increasingly agreed on the need to apply the brakes, but they were not sure just how, when, or how strongly to do so. Martin had no such uncertainty; he pressed ahead.

By mid December, Ackley, as Halberstam has suggested, was vigorously arguing for a tax increase.\(^\text{27}\) After the first few months of the war, Ackley said, "We were becoming pretty clear about what was going on."\(^\text{28}\) On December 17, Ackley sent Johnson a memo that put the matter plainly: the economy was starting to heat up. If the budget were in the $115 billion range, "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 were $110 billion, "the question is more difficult," but Ackley suggested that a tax increase would probably still be needed. Johnson was concerned that even a hint of a possible tax increase not be leaked. He scrawled on Joseph Califano's cover note over Ackley's memo, "Caution them not to go into detail with staff & keep away from all reporters."\(^\text{29}\)

Ten days later, Ackley was even more emphatic. He wrote to the president: "The only conclusion I can reach is that an increase of individual and corporate income tax rates should be planned, whatever the FY1967 budget may be (within the limits we have heard discussed). Tactically, it may only be feasible to propose higher taxes later in the year. From an economic standpoint, it needs to be done as soon as possible."\(^\text{30}\) Johnson, in fact, was getting the same advice from many other members of his administration. Former CEA Chairman Heller, who had returned to the University of Minnesota, joined Charles Schultze, director of the Bureau of the Budget, in arguing for a tax increase.\(^\text{31}\) Even Defense Secretary McNamara suggested the need for
a tax increase and for estimating defense expenditures on the high side. Administration budget officials were considering two different estimates for the total defense budget: $57 and $60 billion. McNamara argued that the administration ought to use the higher figure to help preserve credibility on the budget.\(^32\)

In December, 1965, no one had a clear idea of how much the Vietnam War would cost. That, of course, is characteristic of war: no one knows in advance how big any war will be. The United States’ last major experience in wartime planning—Korea—had produced wildly unrealistic defense budgets. Defense planners had overestimated the cost of fighting the war: by almost 13 percent in fiscal 1953 and by more than 11 percent in fiscal 1954.\(^33\) Johnson’s economic advisers were well aware of the past record and were therefore hesitant to take too seriously the estimates for Vietnam. By the end of 1965, furthermore, actual defense spending was lagging far behind contracted obligations.\(^34\) The rapid expansion of the war was a firm possibility, but it was a danger that lay in the future. McNamara, furthermore, had struggled for almost five years to get military spending under control. He had brought the Planning-Programming-Budgeting System to the Defense Department to try to force the military chiefs out of their old interservice rivalries. The Vietnam build-up now created great pressures from the Pentagon for all sorts of military spending under the guise of “We’re in a war now.” But having struggled to gain some measure of control, McNamara was reluctant to hand the generals a blank check, and he shied away from making long-term predictions of a rapid military build-up.\(^35\)

Director Schultze of the Bureau of the Budget (BOB) therefore developed a two-pronged plan.\(^36\) McNamara would assume that the war would be over by June 30, 1967, the end of the fiscal year. The planning assumption, Schultze said later, put “everybody on notice, although nobody in the early stages paid much attention to it, that this budget was understated simply on technical grounds, but understated by an amount nobody knew.”\(^37\) Johnson was getting advice, especially from Congressman Wilbur D. Mills, chairman of the tax-writing House Ways and Means Committee, not to put the full cost of the Vietnam War in the budget; “people will really be startled,” he warned.\(^38\) Since nobody knew how much the war would cost, the budget simply would state that fact and would warn that more requests might be needed later.

The second prong of the plan was to request a supplemental Vietnam appropriation later in 1966, when the full picture would be clearer, and at the same time to ask for the tax increase. Although
Ackley pressed urgently in December for an immediate tax increase, Treasury Secretary Fowler and BOB Director Schultze were less sure about just when a tax increase would be needed. Coupling the tax increase with the Vietnam supplemental appropriation would, Schultze thought, improve the chances for congressional passage and would help to minimize attack on the Great Society programs in the meantime. Congressman Mills, Johnson was told, "clearly showed that he had no appetite for a tax increase bill in 1966." If the issue were opened then, Mills warned, both Democratic liberals and conservative Republicans "would start tearing at the budget instead."39

The tax increase in 1965 was therefore a tricky political matter. Johnson estimated that he could get a tax increase to pay for a big war, but if he asked for a tax increase, the Great Society would be an inviting target for those who opposed the social programs. Johnson, furthermore, wanted only a limited war. His problem at this stage came more from hawks, who pressed for a wide war, than from doves, who desired to reduce U.S. involvement. The president thus had a dilemma: he could get a tax increase, he thought, only for a war bigger than the one he planned, and then only at the cost of his Great Society. To keep the war limited and to save the social programs from attack, Johnson decided to forestall the decision on a tax increase in late 1965.40

The economic case, furthermore, was tricky. It was difficult to predict just how big a problem inflation might become so long as the full scale of Vietnam was unknown. Given the Korean experience and the possibility that the war would indeed turn out to be limited, Johnson's advisers were leery about jumping too quickly toward a large tax increase, especially since the much-vaunted 4 percent "full employment" goal was nearly at hand. The "new economics" offered the possibility of relatively easy stabilization: the federal government could pump up growth through increased spending and tax cuts; tax increases could slow a booming economy. In the models, each side of the stabilization equation worked with equal ease and accuracy. In the political world, Johnson and his economic advisers overestimated how easy it would be to apply fiscal stimulus—and underestimated how difficult it would later be to apply restraint.

For the administration in late 1965, the central question was how to restrain an overheating economy without disrupting the nation's strong economic growth. Johnson's economic advisers saw the puzzle in terms of fine tuning the demand, rather than in terms of waging an all-out war against inflation.41 The Federal Reserve's preemptive strike helped to forestall the need for immediate action. Some
administration officials believed that if the Federal Reserve had not acted, there would have been a better chance for a tax increase early in 1966, but others have suggested that the result probably still would have been the same even if the Federal Reserve had been persuaded to wait. Schultze argues that the administration, especially President Johnson and Treasury Secretary Fowler, simply did not have the stomach for a tax increase at the time.\(^{42}\)

The budget that Johnson finally proposed in January, 1966, was $112.8 billion, halfway between Ackley's $110 billion "probable" tax-increase level and his $115 billion "little question" level. The estimate for defense spending, $58.3 billion, was also in the middle of the $57-$60 billion range, with all estimates hinging on a projected end of the war on June 30, 1967. Johnson made clear in his budget message that the final budget would change as circumstances in Southeast Asia shifted. And to slow down the economy a bit, he proposed a $4.8 billion tax package to accelerate the collection of corporation income taxes, to change the withholding schedule for individual income taxes, and to postpone the scheduled reduction in telephone and excise taxes. Missing from the package was the major increase in corporate and individual income taxes that Ackley had recommended. The administration secretly went with Schultze's two-pronged plan, with a later tax-increase proposal to be tied to the Vietnam supplemental appropriation. The January budget won congressional support, and Congressman Mills agreed to back Johnson's small-tax-increase package.\(^{43}\) The package won speedy passage in March.

Johnson's advisers were hopeful that they could beat any inflation problem before it became a crisis. "If you can finance the Vietnam war with a minimum of stimulus," Schultze wrote to the president just after Christmas 1965, "this will be an accomplishment of equal magnitude to the Great Society legislative program."\(^{44}\) The decision to go with Schultze's strategy, however, laid the groundwork for charges that Johnson had lied about the cost of the war. The fiscal 1967 budget, announced in January, 1966, underestimated the eventual expenditures for defense by 16 percent, largely because Vietnam expenditures grew from $6 billion in fiscal 1966 to $20.6 billion in 1967. The administration later covered these extra costs through a supplemental appropriation, as Schultze had suggested. As the war wore on, however, the administration's budget requests came far closer to the mark. The fiscal 1968 budget underestimated the total expenditures for defense by less than 7 percent, and in 1969 the underestimate was less than 2 percent. By that time, however, the image of duplicity had already been formed.
II

The Johnson administration's hopes that it could fine tune any inflation quickly turned sour. The minor tax increase at the beginning of 1966 proved little more than a Band-Aid for the hemorrhage of military spending. Congress voted a $13.8 billion supplemental appropriation for Vietnam in the spring of 1966 and followed that with a fiscal year 1967 defense appropriation of $58 billion, the largest defense bill since 1943. Inflation, meanwhile, heated up. The consumer price index rose by 5 percent in 1966, the largest increase since the Korean War—a major shock after the relatively stable prices of the early 1960s.

Ackley and his council continued to campaign, in the early spring, for a tax increase. The CEA told the president that “a further tax increase is needed to counter inflation” because “the economy is breaking all reasonable speed limits.” The council members continued: “We are not facing an explosive situation. A little inflation won’t be fatal. But inflationary psychology and inflationary symptoms are taking root. If they do get firmly established, it will be hard to uproot them, and hard to resist pressure for overly-restrictive action.”

But Johnson again backed away from the tax increase, and he ordered his staff to stop issuing any public warnings about the state of the economy and the need for a tax increase.

In his memoirs, Johnson explained that he simply could not gather any support for the tax increase. His cabinet officers were opposed, and so were businessmen. At a meeting of one hundred and fifty leading business officials on March 30, 1966, Johnson asked for a show of hands: “How many of you would recommend tomorrow a tax increase to the Congress for the purpose of restraining our economy?” No one raised his hand. A similar question, posed to a group of labor leaders, produced a similar result. The House leadership, meanwhile, reported that of the twenty-five members of the House Ways and Means Committee, Johnson could expect no more than four votes for a tax increase—and Wilbur Mills, the most crucial vote, would not be among them.

Halberstam ascribes more sinister motives. Johnson, he said, could get no support for a tax increase because he consciously chose not to disclose the real cost of the war and the implications of not raising taxes. Halberstam charged that members of Congress “were asked to give estimates and projections on a step as important as a tax increase based on totally erroneous information.” It was “an extraordinary bit of manipulation,” Halberstam wrote, and he quoted a Washington reporter who said it was the “single most irresponsible
act by an American President" in the fifteen years he had been observing capital politics. Halberstam suggests that a rousing call to arms, if backed by a revelation of Vietnam's true financial costs, would have created political support for a tax increase. But Johnson was firmly committed to keeping Vietnam a limited venture, and the president's soundings in December convinced him that on those grounds he could not move the Congress and, especially, Wilbur Mills to action.

Ackley warned Johnson that without a tax increase, the Federal Reserve would further tighten money. For his part, Federal Reserve Board Chairman Martin left no doubt about what he would do. "The rise in prices has to be slowed down this year," he wrote to Treasury Secretary Fowler. If the job were not done with fiscal policy, Martin told Fowler that it would be done with monetary policy. He predicted that tighter monetary policy would mean higher interest rates, weakening of the savings-and-loan industry, harm to the municipal-bond market, and slowing of housing construction.

Martin proved to be a good prophet. In the spring the Federal Reserve moved to slow the expansion, and by summer the growth in the money stock had fallen almost to zero. Interest rates moved to historic highs. Rates for prime commercial paper averaged 5.55 percent for the year, the highest by far in the postwar years and nearly twice the 1961 level. Savings and loans became overextended, and mortgage money almost dried up. Rates on state and local bonds soared, and two leading bond houses, caught with large inventories of unsold bonds, almost failed. The monetary tightening helped to slow the boom, but it also produced a credit crunch, with high costs to some sectors of the economy. Johnson's Populist blood curdled at the high rates, but his advisers managed to keep him from denouncing the Federal Reserve by convincing him that some action had to be taken. The Federal Reserve, meanwhile, enjoyed the active but quiet support of the administration's economists.

As Johnson's advisers began in the fall of 1966 to consider the budget for the next fiscal year, they reached the first broad-based agreement on the need for a tax increase. On September 2, 1966, eight advisers sent a joint memo to Johnson, in which they called for immediate action to reduce spending and to ask "at an appropriate time in the future" for "whatever tax measures are necessary" to pay for Vietnam. Backed by, among others, Treasury Secretary Fowler, Defense Secretary McNamara, BOB Director Schultz, CEA Chairman Ackley, and presidential adviser Califano, the memo represented a remarkable meeting of the minds on a question that before had proven so difficult.
Johnson agreed, and on September 8 he sent a special economic message to Congress. He announced an immediate cut in spending of $1.5 billion and the suspension of the 7 percent investment tax credit. While he said he would not know the full budget situation until the implications of Vietnam were clearer and until Congress had completed its work on other appropriations bills, he did pledge, “This Administration is prepared to recommend whatever action is necessary to maintain stable growth and prosperity of the past five and one-half years and to pay for current expenditures out of current revenues, as we are doing.”

Indeed, at that point, the budget was not far out of balance; the deficit for fiscal 1966, just ended, was less than $4 billion.

Having finally joined forces on the tax increase, however, Johnson's advisers began to get cold feet three months later. The Federal Reserve's tight money had at least temporarily blunted the inflation, and the Federal Reserve had begun to back off. The administration's background studies had meanwhile begun to show “persistent and pervasive softening” in the economy. Housing starts had plunged, business investment had slowed, and automobile sales had dropped. "The economy clearly does not need additional total restraint," one staff report argued; "in fact, some modest additional stimulus is in order." It was easy to make an "old economics" case for a tax increase to balance the budget. If a tax increase were to be passed, however, the president's advisers feared that the slowdown in late 1966 might develop into a full-scale recession in 1967.

Just as in the debate over the previous year's budget, the president's advisers were unsure about what problems they faced. Some suggested that he request from Congress the authority to invoke a stand-by tax quickly if needed. Johnson's appointees to the Federal Reserve Board believed that the economy had been slowed down enough and opposed a tax increase, but Budget Director Schultze, Treasury Secretary Fowler, and the members of the Council of Economic Advisers favored a small tax increase, to go into effect no earlier than July 1, 1967. The economy would be too soft during the first half of the year, and they worried that a tax increase might weaken it further. In fact, Treasury Secretary Fowler suggested that a modest deficit, spurred by increases in defense spending, might nicely complement the Federal Reserve's easier monetary policy. Later, a moderate tax increase would start to soak up some of the economic growth before it could unloose inflation. To the advisers, however, the question was a close one, and former CEA Chairman Heller, in his Christmas message to Johnson, hoped that "you will get Divine guidance on the question of a 1967 tax increase,
since economic guidance gives you no very firm answer at the moment." In the next week, as the deadline for preparing the budget approached, Johnson's advisers decided that the economy would need a stimulus in the first half of 1967 and that any tax increase should wait until the second half of the year. By that point, they thought, the danger of inflation might be growing quickly enough to justify a small tax increase. "But," Fowler, Schultze, and Ackley wrote Johnson, "we need to keep the maximum degree of flexibility to back away from a tax increase—and even to release impounded spending—if the economy appears even weaker than we expect in the first half, or if prospects for a second half revival do not seem promising." This led to the plan that Johnson proposed in his fiscal 1968 budget message: a 6 percent surtax on individual and corporate income taxes, effective July 1.

To keep flexibility, however, the administration did not send a formal proposal to Capitol Hill. That would come later, when the economic advisers had determined that the danger of recession had passed and that inflation was reigniting.

The proposal was certainly not popular with the American people. A Harris poll in February, 1967, which circulated at the White House, showed that 65 percent of those questioned opposed the surtax, while only 24 percent approved, compared with a much smaller split of 49 to 44 percent a year before. Worries about inflation had cooled off considerably from the previous year; in 1967, 68 percent thought that inflation was heading up, compared with 92 percent the year before. Because the public saw inflation as a less serious problem, the urgency for the tax increase lessened; and given the choice, 75 percent of those polled would rather cut spending than increase taxes. To at least one White House adviser, the case was clear: Johnson had waited one year too long to propose a tax increase. For his part, Johnson was finally convinced of the need for a tax increase and said so in a May press conference. He exploded when one wire-service report said the administration was still not decided on the need for a tax increase. He ordered an aide to uncover the source for the story: "Find out who this is. This is not right. Wire me a report fast."

In June, Johnson's economic advisers were convinced that the time had come to revive the surtax. The dip in the economy that they had sensed in the late fall of 1966 had proved to be very shallow and short-lived, and by early summer the economy was heating up again alarmingly. Budget deficits were growing to levels unprecedented except in times of a major war. Inflation had started to rise, bringing the prospect of tighter money from the Federal Reserve and a renewal
of the previous year's credit crunch. There were early signs, furthermore, of a serious balance-of-payments problem with foreign countries. Domestic industries were expanding rapidly to fill the wartime demand, but Schultze warned Johnson that the boom could turn to bust when military spending would shrink at the end of the war. But while Johnson's advisers agreed on the need for a tax increase, they could not agree on its size or timing. In frustration, Johnson scrawled on one report of differences among his aides: "For God's sake get agreement."

That agreement finally came in July, on a plan to increase the earlier proposal for a 6 percent surtax to 10 percent, effective retroactively to July 1 on corporate taxes and to September 1 for individual income taxes. Both surtaxes would expire on June 30, 1969, and would produce two years of restraint. The fears of a grossly unbalanced budget and of galloping inflation finally led Johnson in July to ask Congress for the surtax, nineteen months after Ackley first had made the case for a tax increase. By then, evidence of an inflationary boom was unmistakable, and it was clear, explained Charles J. Zwick, Schultze's successor as budget director, that "you couldn't support both guns and butter without an increase in taxes."

Johnson's advisers had misread the scale of the dip in the economy, and the rapid upswing had taken them by surprise. They had misjudged, by an even larger margin, just how much more difficult it would be to pass a tax increase than a tax cut. The "new economics" logic of fine tuning thus developed a bias in favor of stimulus over restraint. Johnson himself finally agreed to the tax increase when the costs of not doing so became unmistakable. In his White House economics seminar, he understood the theory that his advisers argued, and he eagerly embraced the happy side of the Keynesian equation; but he hesitated in taking painful steps until the evidence was incontrovertible. By that time, as his advisers had warned, the inflationary demon had been unleashed.

III

The tax surcharge encountered immediate problems with Chairman Wilbur Mills of the House Ways and Means Committee. He could see no signs of an economic upturn in July when the administration was reviving the plan, and as Gardner Ackley's successor as CEA Chairman, Arthur Okun, wrote later, "Congress would not act on a forecast; it wanted facts." Califano warned the president, "Mills is going to be more difficult to sell this time than in the past." Mills
was making it clear that he did not like the tax surcharge and did not think it would pass Congress.\textsuperscript{70} His position was simple: Johnson would have to choose between guns and butter. Mills would move toward restraint, but he preferred cutting the Great Society programs to increasing taxes.\textsuperscript{71} To Budget Director Schultze, it was “clear that Wilbur Mills, many of the other Democrats, and all the Republicans on Ways and Means are going to try to hold us up” for bigger budget cuts.\textsuperscript{72}

At a meeting with congressional leaders a few weeks after Johnson had submitted his proposal, Congressman Hale Boggs made the point simply to Johnson: “With Mills you can get it out of committee, and without Mills you can’t.”\textsuperscript{73} Ackley meanwhile continued to warn, now in even harsher terms, about the implications of a failure to act. Without a tax bill, he wrote to Johnson on October 13, there would be “interest rates that will curl your hair, a new depression in housing, a new surge in imports” that would worsen the balance of trade and increase inflation in 1968 to almost 5 percent—with even worse to come in 1969. With a tax increase, inflation would be only about 2.5 percent, he said.\textsuperscript{74}

Despite the warnings, Mills was unmoved. The congressional liaison staff learned that Mills was feeling neglected by Johnson. The president, Mills hinted, had not called him to the White House for consultation since the tax bill went up.\textsuperscript{75} Despite the signals the president was getting, however, aide Larry O’Brien, Schultze, and Ackley all opposed making a bow to Mills.\textsuperscript{76} Mills then broached his own plan, through a staff member, to get the bill moving. He would support a tax increase if the administration would agree to a $4 billion cut in expenditures, with Congress and the president sharing the responsibility for selecting the cuts.\textsuperscript{77} The staff investigated this plan and thought they had a deal, but Mills subsequently backed away.\textsuperscript{78}

Johnson tried to rally his forces in late October and asked Califano to get the word out: “Let’s not give up yet.”\textsuperscript{79} But from many sources the president learned that Mills would not budge for the rest of the year. Congressman Carl B. Albert glumly reported, “Mills told me he would not report it out until the climate in the country is ready for it—whatever that means.”\textsuperscript{80} The president’s personal relations with Mills had soured, and Mills made it plain that he would not budge unless the president agreed to spending cuts.\textsuperscript{81} The very fact that Mills was trying to dictate spending cuts, however, enraged George H. Mahon, chairman of the House Appropriations Committee, in whose domain rested decisions on spending.\textsuperscript{82} Johnson believed, furthermore, that Mills did not want to sully his powerful reputation by reporting
the tax bill until he was sure he could get it passed. Mills used that excuse in turn to block the tax measure. He was "flim-flamming us," remembered congressional liaison J. Barefoot Sanders, Jr., later. Sanders was convinced that Mills could have passed the bill without large cuts if he had tried.83

Part of the bad blood, Budget Director Schultze speculated, had its roots in the administration's flip-flops on the investment tax credit. When the administration was looking for extra revenue in November, 1966, Mills backed the president in suspending the investment tax credit. A few months later, in March, 1967, Mills again backed the administration in restoring the credit when the economy dipped. "He felt he had been made to look like a fool," Schultze explained, and he was leery about going along with the economic forecasters once again—especially without the benefit of the solicitous LBJ "treatment."84 For his part, Mills made this explanation to the Johnson Library's oral history project: "All I was ever trying to do in respect to the 10 percent surcharge was to describe the circumstances that would have to be brought to bear in order to get the 10 percent tax increase passed. The President knew what I was doing. He couldn't buy it."85

By early 1968, the White House had become convinced that Mills did not want a tax bill at any price. He told the congressional liaison staff that he wanted the administration to assure him of at least 175 votes on the floor before he would report the bill. The congressional liaison staff, however, could win no guarantee that if they did round up that many votes, Mills would in fact report the bill and that if he did report it, he would not then insist on extra conditions, such as a ceiling on federal spending. That put the congressional liaison staff on the spot. They counted only 110 "will support" votes and 33 "will probably support" votes among Democrats in the House, and they doubted they would ever be able to round up more than 155 votes until Mills had reported the bill. Members of Congress did not want to commit themselves blindly to a tax increase, and as the 1968 election drew closer, the prospect of voting for any tax increase became less and less attractive.86 Treasury Secretary Fowler reported that neither Mills nor Mahon "want to block the parade," but "neither one is particularly anxious to assert the type of 'gung ho' boldness in leadership it may take" to get the bill passed.87

The impasse enormously frustrated Johnson. The cities were uneasy, the limited war was running beyond all expected bounds, the economy was heating up quickly, and he could not get firm action on any front. He badly wanted something that would cool the economy
but would not wreck his domestic programs. Just a few days after announcing that he would not seek reelection, he said to congressional leaders: “If I were a dictator, I would say I’ve got to have $15 of the $24 billion in taxes we repealed [in 1964] back again. When we cut taxes, we didn’t have a war and cities problem as we do now.”

His frustration boiled over even into Vietnam strategy. He wanted some “radical new ideas,” he told his staff, ideas that would lead to getting the troops out and to putting the money into economic development instead. With everybody withdrawing forces, perhaps there could be a United Nations-supervised election—and a reduction in the administration’s economic problems.

Administration officials began a new phase of negotiations with Mills. The administration suggested a 4:10:6 formula: $4 billion in immediate expenditure reductions, $10 billion less in further spending authority, and $6 billion less in present spending authority. Mills insisted on a 5:20 formula: $5 billion in immediate cuts and $20 billion in cuts in future obligations. Budget Bureau studies showed that the administration could cut no more than $4 billion without deeply hurting the Great Society. And even if Johnson were to accept the Mills 5:20 plan, there would be no guarantee that Mills would then accept the surtax.

Califano saw the battle as “a critical turning point in your [Johnson’s] Presidency,” where “the importance of winning the tax fight transcends the fiscal problems.” Without it, he warned on May 2, 1968, Johnson would lose all effectiveness in Congress and the executive branch, and he would have a far-harder time in leading the country. Califano urged Johnson to “give consideration to coming out fighting” and to “turn loose everything we have to take the Ways and Means Committee away from Mills.” At a press conference the next day, Johnson did indeed draw his guns. He said simply, “The Congress has not been that cooperative,” and he singled Mills out by name. Mills’s plan, Johnson hinted, “would injure the national interest instead of serving it.” He then argued, “I think we are courting danger by this continued procrastination, this continued delay. Don’t hold up a tax bill until you can blackmail someone into getting your own personal viewpoint over on reductions.”

When Mills still would not budge, the administration decided to outflank him. The constitution requires that all tax measures originate in the House, and House procedures required tax bills to originate in Mills’s Ways and Means Committee. Mills’s refusal to move thus had effectively blocked the bill for months. Senate leaders, however, worked with the administration to attach the surtax to a
relatively innocuous House-passed bill that extended soon-to-expire excise taxes. At this point, Mills could duck the bill no longer. The Senate passed the bill on April 2, and that led to a long and tumultuous conference. Mills continued to press for higher spending cuts than the administration was willing to accept. Meanwhile, an international gold crisis increased pressure for quick action on the deficit.

The conference committee finally came to agreement near the end of June, and on June 28, thirty months after Ackley had first made the case for the surtax, Johnson, without ceremony, signed it into law. The bill set a retroactive 10 percent surcharge on individual and corporate income taxes, with the individual increase effective April 1, 1968, and the corporate increase effective January 1, 1968. Both surcharges were to be effective until July 1, 1969. In addition, the compromise required a $6 billion immediate cut in spending and a further cut of $8 billion in unspent appropriations authority. The compromise thus favored Mills in current spending cuts, but the administration was able to escape with $11 billion less in cuts for unspent appropriations authority than Mills had wanted. Furthermore, Congress, for the first time in history, set a ceiling on federal spending of $180.1 billion for fiscal 1969, compared with the president's budget request of $186.1 billion. Congress told the president how much to cut—but not where.

IV

The last major decision that Johnson faced before leaving office in January, 1969, was whether to recommend that the surtax be extended an extra year, until July 1, 1970. The Vietnam War was showing no signs of slowing down, and the president faced a large budget deficit without the extension. But President-elect Richard Nixon refused to commit himself to the extension. Califano urged Johnson, "I do not want to see you leave office with a budget that will be attacked" for "gimmickry and budget manipulation" or for "failure to maintain the momentum you have spent 5 years building in social programs." Johnson agreed, and he recommended the one-year extension.

After making the decision, Johnson was in a reflective mood. In a meeting with members of the CEA staff and their families, he said to them: "If I had it to do over again I would not have changed much. I would have made the same decision to recommend a guns-and-butter budget to the Congress, and I still would have ignored the counsel of those who called for a breathing spell in the enactment of new
legislation." Those decisions turned out to be some of the most fateful in modern economic history. They helped to unloose a rampant inflation that proved unexpectedly difficult to quell, an inflation that persisted, to the consternation of economic theorists, even in the midst of recessions and high unemployment.

The roots of these decisions were far more complicated than the argument that Johnson lied to protect both Vietnam and the Great Society. White House economists underestimated the degree to which Vietnam was fueling the economy in late 1965, and they overestimated the slowdown that occurred in late 1966 and early 1967. The federal deficit grew rapidly, from $3.8 billion in fiscal 1966 to $8.7 billion in 1967 and $25.2 billion in 1968. Growth in spending for Vietnam—a $14.5 billion increase in 1967 and a $6.3 billion increase in 1968—added greatly to the deficit, but increases in Great Society programs and the slowdown in the economy significantly caused it to increase as well. The Federal Reserve rode to the rescue in 1966, with tight money that in the short run kept inflation from getting completely out of hand, but the system's stop-and-go policies had serious effects on some sectors of the economy, made the economy more unpredictable, and only worsened the basic disease. The success of the "new economics" during the early years of the Johnson presidency had been bright. The tax cut demonstrated that government could indeed deliver a well-timed stimulus, and the "full employment" goal of 4 percent was palpably close. But the future proved more difficult to predict than the president's economists had hoped. Once the future was clear, it became far more difficult to apply restraint than stimulus, and once the surtax had been enacted, governmental economists had overestimated the slowing effect that it would produce.

Johnson himself was quite naturally leery of embracing the harsh medicine that went with bad news until the implications were obvious. But even after those implications were painfully apparent, one of the last of the congressional barons, Wilbur Mills, remained intransigent. Only by outflanking the chairman was Johnson finally able to win congressional passage of the tax increase. For a president who had come to the job with an unquestioned reputation for skill in dealing with Congress and who had demonstrated his skill by winning a tax cut within weeks of taking office, the irony was painful.

The irony is part of the essential tragedy of Lyndon Johnson and his administration. He unquestionably had a deep philosophical commitment to federal action, both for peace in Vietnam and for the needs of the poor. Once committed, he felt inescapably bound to the goals. Bill Moyers tells a revealing story. Moyers once asked Johnson, "If you
could talk to anybody, just sit there with our shoes off and talk, who would you like to talk to?” Johnson replied, “I’d like to talk to Toynbee.” “Why?” Moyers asked. “He could help me understand what I’m up against in Vietnam. It’s that God damn slate that you find when you walk into this office. You know, it wasn’t written by Kennedy, and it wasn’t written by Eisenhower, it was written by history. And I just don’t understand it.” As Moyers reflected later: Johnson “fought that war because he felt that history had decided we should. Well, we know that history is what men make it.”

For Johnson, destiny and confusion among his advisers led him into an economic trap that he felt he could not escape from.

The biggest irony of all was that the tax increase proved to be too little and too late to rein in inflation. The Federal Reserve, in a hopeful reaction to Congress’s passage of the surcharge, eased back on the money supply in mid 1968 as it waited for the increase to take hold. The surcharge, however, created barely a ripple in the economy, and by the end of 1968 the Federal Reserve reluctantly concluded that the surcharge was a dud. After several cycles of ease and restraint, the Federal Reserve once again stepped on the brakes to slow the economy and thus further worsened the stop-and-go monetary policy that had existed behind the scenes since 1966.

By this time, the seeds of fundamental economic instability had been planted. War-induced inflation, accompanied by the expansion of social programs and left unchecked by a tax increase, led consumers to begin to expect inflation to continue. The longer it remained, the harder it proved to uproot, and inflation became brutally persistent. Complicating matters further was the growth of unemployment, first to uncomfortable and, later, to crisis levels. This cruel combination, which was christened stagflation, was the ultimate rebuff to the Keynesian economists who surrounded Johnson. Inflation and unemployment were supposed to be trade-offs, and Keynesian theory simply could not explain how the two could grow simultaneously. The unexplainable happened nonetheless, and the result was a decade of instability that spilled over into international crises as well. Meanwhile, the federal government had its last balanced budget in fiscal 1969 before beginning seemingly endless years of deficits. The attempts by Johnson and his advisers to manage the economy foundered on economic uncertainty and political reality as they unintentionally helped to steer the nation onto economic shoals.

Lyndon Johnson proved to be an able student in the economics seminar that his advisers ran for him. He was a quick study, but he found it hard to embrace the full implications of his lessons, especially
when the lessons were unclear. He found it difficult to deal with the uncertainty of economic predictions, to jump before the evidence was irrefutable. Johnson was a man of considerable subtlety in public policy. He attempted to fight a limited war when it would have been easier to fight a large one; he battled for the Great Society, even in the face of a widening war, when many members of Congress gladly would have cut the social programs. He was a president caught in his dreams, unable to control his destiny, and in the end he was destroyed by this conflict.

Notes


3. Richard L. Schott interview with Bill Moyers, June 20, 1978, pp. 38–39. Professor Schott is a faculty member at the Lyndon Baines Johnson School of Public Affairs, University of Texas.


6. Ibid., p. 56.


8. Newsweek, Nov. 6, 1979, p. 43.


10. Walter Heller oral history, Lyndon Baines Johnson Library (hereafter cited as LBJL), tape 1, p. 13. All subsequent oral histories and documents, unless otherwise noted, come from the Johnson Library.


15. Secretary of the Treasury Douglas Dillon urged the president to take this move for similar reasons [see Dillon to Johnson, memo, Nov. 25, 1963, WHCF EX FI 11-4].
17. Ackley oral history, tape 1, p. 12.
27. Halberstam says that the CEA sent Johnson a memo arguing for a tax increase on Dec. 10, 1965 (see "How the Economy Went Haywire," p. 57). A thorough search of the Johnson Library and of Ackley’s papers at the University of Michigan’s Bentley Library, however, shows no such memo.
29. Ackley to Johnson, memo, Dec. 17, 1965, WHCF EX FI 4 [emphasis in the original]. Johnson refers to this memo in his memoirs (see *Vantage Point*, p. 440).
32. Joseph Califano to Johnson, telex, Dec. 23, 1965, WHCF EX FG 110; see also Walter Heller oral history, tape 2, p. 44. Some have suggested that McNamara opposed the tax increase [see Golden, "‘No-Tax Decision," p. 190].
39. Ibid.
40. Johnson tells the story in his memoirs [see *Vantage Point*, p. 325].
41. See, e.g., Schultzze oral history, tape 2, p. 3.
42. Okun oral history, tape 1, pp 23–25; Schultzze oral history, tape 2, p. 6.
43. Henry H. Wilson, Jr., to Johnson, memo, Jan. 10, 1966, WHCF CF LE/FI 11.
45. Ackley, Okun, and James S. Duesenberry to Johnson, memo, Mar. 12, 1966, WHCF CF FI 11. Johnson acknowledges this memo in his memoirs [see *Vantage Point*, p. 444].
47. Johnson, *Vantage Point*, p. 444.
50. Martin to Fowler, memo, June 6, 1966, WHCF CF FI II-4.

52. In his memoirs, Johnson acknowledged, "The major burden of slowing the inflation was left to monetary policy in the form of higher interest rates" (see *Vantage Point*, p. 445).

55. Robert A. Wallace, Zwick, and Okun to Fowler, Schultze, and Ackley, memo, Dec. 12, 1966, CEA Administrative History, vol. 2, pt. 1. The memo was part of the regular Troika-II exercise, where the second-level officials from the Treasury Department, the Bureau of the Budget, and the Council of Economic Advisers prepared a forecast for their principals.


61. Califano to Johnson, memo, Jan. 4, 1967, WHCF EX FI 11. A surtax is a tax on a tax; taxpayers would calculate their tax liability and then would add another 6 percent.

64. Schultze to Johnson, memo, July 11, 1967, WHCF EX FI 11-4.
70. Surrey to Fowler, memo, July 2, 1967, WHCF CF FI 11-4.
75. White House notes, however, show that Mills met at the White House with the president and with Treasury Secretary Fowler on August 3 and that he joined congressional leaders at a September 9 breakfast meeting with the president (see Stan Ross to Califano, memo, May 7, 1968, WHCF EX FI).
76. Califano to Johnson, memo, Oct. 5, 1967, WHCF EX FI 4/FG.
78. Okun oral history, tape 2, p. 21.
80. Jones to Johnson, notes on Oct. 31, 1967, Congressional Democratic Leadership Meeting, Meeting Notes file, box 2; see also Califano to Johnson, memo, Nov. 11, 1967, and Sanders to Johnson, memo, Nov. 28, 1967—both in WHCF EX FI 11-4.
81. Barefoot Sanders oral history, tape 2, p. 44.
82. Johnson, Vantage Point, p. 445.
83. Sanders oral history, tape 2, pp. 41-44; see also Johnson, Vantage Point, p. 445.
84. Schultze oral history, tape 2, p. 20.
86. Sanders to Johnson, memo, Feb. 29, 1968, and Joseph M. Barr to Johnson, memo, Apr. 22, 1968—both in WHCF EX LE/FI 11-4.
89. Memo from Jim Jones, Apr. 19, 1968, WHCF EX SP.
90. Sanders to Johnson, memo, Apr. 27, 1968, WHCF EX LE/FI 11-4.
93. Califano to Johnson, memo, Jan. 6, 1969, WHCF EX FI 11.

A Bibliographical Note

The Johnson Library's holdings on economic policy constitute one of the finest parts of the collection, but they have been relatively little explored. The subject has escaped the closures for security or privacy reasons that afflict other parts of the papers. Johnson's economic advisers, furthermore, ran a seminar through the memos that they wrote for the president, so there is an unusually rich record of debates, arguments, and decisions.

In addition, the oral histories from the economic policy makers are valuable. The library's oral-history project has interviewed all of the main actors, and many of the histories are very helpful in interpreting the memos, in confirming perceptions, and in suggesting arguments that are not otherwise available. In addition, the library contains a "Meeting Notes File," which contains notes on meetings in which the president participated. These notes contain unusually frank comments not available elsewhere. Put together, all
of these sources support the accuracy of Johnson's memoir, which is itself an important document for studying these questions.

This essay touches on only a few of the vastly important economic problems with which the Johnson administration dealt. Other relatively unresearched issues on which the library contains rich holdings include the role of Johnson's Council of Economic Advisers, congressional strategy on economic policy, and the budgetary process—especially the Planning-Programming-Budgeting system that Johnson extended throughout the government.