

TO: PRESIDENT-ELECT CARTER  
FROM: ECONOMICS TRANSITION TEAM  
RE: NOVEMBER 22, 1976 MEETING WITH TREASURY SECRETARY SIMON  
DATE: NOVEMBER 20, 1976

WE UNDERSTAND THAT YOU WILL MEET WITH SECRETARY SIMON ON MONDAY, AND THAT HE INTENDS TO BRIEF YOU ON ECONOMIC, FINANCIAL AND OTHER MATTERS CURRENTLY AFFECTING THE TREASURY DEPARTMENT. THE PURPOSE OF THIS MEMORANDUM IS TO PROVIDE YOU BACKGROUND INFORMATION FOR THIS MEETING AND TO SUGGEST QUESTIONS WHICH YOU MIGHT ASK OF SIMON.

BECAUSE SECRETARY SIMON IS ONE OF THE MOST IDEALOGICAL MEMBERS OF PRESIDENT FORD'S CABINET, HIS OPINIONS ON DOMESTIC ECONOMIC POLICY ARE NOT LIKELY TO GIVE YOU A VERY BALANCED VIEW. WE BELIEVE IT WOULD BE MOST USEFUL TO DRAW HIM OUT ON INTERNATIONAL ECONOMIC PROBLEMS AND THE NEW YORK CITY SITUATION.

#### I. INTERNATIONAL ECONOMIC AND FINANCIAL PROBLEMS

MOST EXPERTS BELIEVE THAT A SERIES OF IMPORTANT INTERNATIONAL ECONOMIC AND FINANCIAL PROBLEMS MAY CONFRONT YOUR ADMINISTRATION IN ITS FIRST FEW MONTHS. THE ECONOMIES OF THE MAJOR INDUSTRIALIZED NATIONS ARE INCREASINGLY INTERDEPENDENT, AND THESE PROBLEMS THUS CAN AFFECT OUR OWN ECONOMIC RECOVERY.

FIRST, OPEC IS WEIGHING AN INCREASE IN THE PRICE OF ITS EXPORTED OIL AND HAS BEEN PLANNING A DECEMBER 15 MEETING TO ACT ON IT. THERE HAVE BEEN INDICATIONS THAT AN INCREASE OF 10% OR SLIGHTLY MORE HAS BEEN CONSIDERED. ECONOMIC MINISTERS OF MANY IMPORTING COUNTRIES HAVE

ARGUED THAT SUCH AN INCREASE COULD SLOW OR EVEN ABORT THEIR ECONOMIC RECOVERIES, AND IT OBVIOUSLY WOULD HAVE A NEGATIVE EFFECT ON GROWTH AND INFLATION TRENDS IN THE U.S. AS YOU KNOW, THESE MINISTERS HAVE BEEN TRYING TO PERSUADE OPEC TO DEFER ITS MEETING OR THE PRICE INCREASE ITSELF. THERE IS SOME POSSIBILITY THAT THERE WILL BE NO OPEC PRICE INCREASE THIS YEAR SO THAT OPEC CAN NEGOTIATE WITH A NEW ADMINISTRATION.

SECRETARY SIMON, FORMERLY ADMINISTRATOR OF THE FEDERAL ENERGY OFFICE, HAS HAD EXTENSIVE, PERSONAL EXPERIENCE IN NEGOTIATING WITH OPEC MEMBER COUNTRIES ON RECYCLING PETRODOLLAR FLOWS, BILATERAL ECONOMIC COOPERATION AGREEMENTS, ETC. YOU MIGHT ASK HIM:

1. WHAT ARE THE U.S. SOURCES OF NEGOTIATING LEVERAGE WITH OPEC?
2. WHAT IS THE POWER COMPOSITION OF OPEC -- IS SAUDI ARABIA DOMINANT; ARE IRAN AND/OR VENEZUELA ALSO HIGHLY INFLUENTIAL? WHAT DO THESE NATIONS SEEK FROM THE U.S.?
3. WHAT ARE THE POSITIONS OF OUR INDUSTRIALIZED ALLIES CONCERNING OPEC AND THE PROPOSED PRICE RISE?
4. WHAT OVERALL STRATEGY SHOULD THE U.S. PURSUE IN RELATING TO OPEC?

SECOND, BRITAIN AND ITALY CONTINUE TO EXPERIENCE SEVERE ECONOMIC CRISES, AND EACH IS NEGOTIATING WITH THE IMF FOR MULTI-BILLION DOLLAR LOANS. THE LEADERSHIP IN BOTH COUNTRIES HAS BEEN ENCOUNTERING GREAT POLITICAL DIFFICULTY IN PERSUADING THEIR LEGISLATURES TO SUPPORT NEEDED AUSTERITY PROGRAMS, E.G. INCOMES POLICIES, REDUCED PUBLIC SPENDING, ETC. INDEED, THERE IS SOME EVIDENCE THAT THE BRITISH LEADERSHIP

IS ENCOURAGING THE IMF TO INSIST ON SUCH AUSTERITY AS A CONDITION FOR THE REQUESTED LOANS.

YOU MIGHT ASK SECRETARY SIMON :

1. HOW SEVERE ARE THE FINANCIAL PROBLEMS OF THOSE TWO NATIONS? WILL THESE LOANS BE SUFFICIENT FOR ANY PROTRACTED PERIOD OR WILL FURTHER CREDITS BE REQUIRED?

2. HOW FAR CAN THE IMF PUSH THESE NATIONS CONCERNING AUSTERITY PROGRAMS WITHOUT CAUSING INTERNAL POLITICAL DISORDER?

THIRD, THERE ARE INCREASING INDICATIONS THAT NUMEROUS, LESSER DEVELOPED COUNTRIES (LCD'S) MAY BE UNABLE TO REPAY ON SCHEDULE THEIR EXTERNAL DEBTS. THE COMBINATION OF WORLDWIDE 1974/1975 RECESSION CONDITIONS AND HIGHER OIL PRICES RESULTED IN LARGE BALANCE OF PAYMENTS DEFICITS FOR MANY OF THESE, AND THEY RESORTED TO FOREIGN BORROWINGS. A SUBSTANTIAL AMOUNT OF THESE LOANS WAS PROVIDED BY THE U.S. COMMERCIAL BANKING SYSTEM.

IT MAY BE HELPFUL TO SOLICIT SIMON'S VIEWS CONCERNING THE LIKELIHOOD AND SEVERITY OF "LDC BANKRUPTCIES," (THEY PROBABLY WOULD TAKE THE FORM OF MORATORIA ON PRINCIPAL PAYMENTS) BOTH ON THE WORLD FINANCIAL SYSTEM AND ON THE U.S. BANKING SYSTEM.

FOURTH, MANY HAVE CALLED FOR AN ECONOMIC SUMMIT MEETING, IN THE IMMEDIATE POST-INAUGURATION PERIOD, INVOLVING YOU AND THE LEADERS OF THE MAJOR INDUSTRIALIZED NATIONS. TWO SUCH MEETINGS HAVE BEEN HELD DURING THE PAST TWO YEARS, AT RAMBOUILLET, FRANCE AND PUERTO RICO. SUCH MEETINGS WOULD SEEM CONSISTENT WITH YOUR CALL FOR CLOSER COOPERATION IN MACRO-ECONOMIC POLICY-MAKING AMONG THE INDUS-

TRIALIZED NATIONS. ON THE OTHER HAND, SUCH MEETINGS ARE OFTEN COSMETIC, AND YOU WILL HAVE LITTLE TIME FOR SUCH ACTIVITIES IN THE FIRST FEW MONTHS OF YOUR ADMINISTRATION. IT WOULD SEEM USEFUL, SINCE SECRETARY SIMON PARTICIPATED IN THESE SUMMITS, TO ASK HIM WHETHER THEY CAN BE GENERALLY USEFUL IN ACHIEVING COORDINATION IN POLICY-MAKING, AND WHETHER ANOTHER ECONOMIC SUMMIT MEETING WOULD BE ADVISABLE IN EARLY 1977.

## II. NEW YORK CITY ISSUES FOR SIMON MEETING

YOU WILL BE GETTING A MORE DETAILED MEMO ON THE NEW YORK SITUATION.

AS YOU KNOW, THE FEDERAL LAW ENACTED LAST YEAR FOR NYC PROVIDED "SEASONAL FINANCING LOANS." THIS SERVES ONLY TO TAKE CARE OF NYC'S CASH FLOW NEEDS -- I.E., TO PAY FOR ANTICIPATED REVENUE THAT DOES NOT COME INTO THE CITY'S COFFERS WHEN IT IS NEEDED TO PAY BILLS. THIS IS THE SAME AS REVENUE SHARING, WHICH COMES IN AT THE END OF THE QUARTER BUT IS NEEDED TO MEET COSTS DURING A QUARTER. THE CITY BORROWS AT THE BEGINNING OF A PARTICULAR TIME PERIOD AND PAYS OFF LOANS AS THE ANTICIPATED REVENUE IS RECEIVED. THERE IS AT THE PRESENT TIME A LIMIT OF \$2.3 BILLION OF SEASONAL FINANCING FOR NEW YORK CITY FOR THE PERIOD JULY 1976 TO JULY 1977. YOU SHOULD NOTE THAT THE FEDERAL GOVERNMENT ACTUALLY MAKES MONEY ON THIS SEASONAL FINANCING FOR NEW YORK CITY. THE FOLLOWING ARE THE MAIN QUESTIONS TO RAISE WITH SIMON:

1. WHAT IS SIMON'S GENERAL ASSESSMENT OF THE NEW YORK SITUATION?

2. WILL SIMON EXTEND THE SCHEDULED SEASONAL FINANCING FOR DECEMBER?

3. WILL SIMON EXTEND THE SCHEDULED SEASONAL FINANCING FOR JANUARY?

4. IF OTHER PARTIES TO THE CREDIT AGREEMENT, SUCH AS THE PENSION FUNDS, DO NOT MAKE THEIR EXPECTED PURCHASES, CAN SIMON PICK UP THOSE SEASONAL FINANCING NEEDS IN JANUARY?

5. WHAT IS SIMON'S GENERAL OPINION ON HOW TO HANDLE THE \$1 BILLION UNDER THE MORATORIUM THAT HAS BEEN DECLARED UNCONSTITUTIONAL BY THE NEW YORK STATE COURT OF APPEALS?

6. WHAT IS SIMON'S GENERAL OPINION ON HOW THIS DECISION ON THE MORATORIUM WILL AFFECT (A) THE MUNICIPAL MARKET; (B) OTHER CITIES; (C) THE ECONOMY AS A WHOLE?

### III. THE "PROCESS" OF U.S. ECONOMIC POLICY-MAKING

THERE HAVE BEEN NUMEROUS CHANGES IN THE ORGANIZATION OF OUR ECONOMIC POLICY-MAKING, BOTH FOREIGN AND DOMESTIC, WITHIN THE PAST SEVERAL YEARS. CURRENTLY, THE WHITE HOUSE-BASED ECONOMIC POLICY BOARD (EPB) IS THE PRINCIPAL MECHANISM FOR FORMULATING ECONOMIC POLICIES RELATING TO THE DOMESTIC ECONOMY. SECRETARY SIMON IS CHAIRMAN OF EPB, WHICH HAS SOMEWHAT SUPERSEDED THE MORE NARROWLY BASED "TROIKA" OF THE TREASURY SECRETARY, DIRECTOR OF OMB AND THE CHAIRMAN OF CEA.

CONCERNING FOREIGN ECONOMIC POLICY, THE "PROCESS" IS IN CONSIDERABLE DISARRAY. THE COUNCIL ON INTERNATIONAL ECONOMIC POLICY (CIEP), IS THEORETICALLY RESPONSIBLE FOR FORMULATING AND RECOMMENDING FOREIGN ECONOMIC POLICIES. YET, MOST OBSERVERS BELIEVE IT IS USED ONLY SLIGHTLY EVEN AS A CONSULTATIVE BODY. AS A RESULT, THERE ARE

MULTIPLE U.S. SPOKESMEN CONVEYING DIFFERENT POSITIONS ON IDENTICAL ISSUES INVOLVING INTERNATIONAL ECONOMIC AFFAIRS.

WE SUGGEST THAT YOU ASK SECRETARY SIMON THE FOLLOWING:

1. DOES THE PRESENT ECONOMIC POLICY BOARD REPRESENT A SUCCESSFUL APPROACH TO FORMULATING ECONOMIC POLICIES IN AN OPEN, COLLABORATIVE MANNER? WHAT IMPROVEMENTS MIGHT BE MADE IN THIS PROCESS?

2. HOW MIGHT THE PROCESS OF FOREIGN ECONOMY POLICY-MAKING BE REORGANIZED? HOW SHOULD THE TREASURY AND STATE DEPARTMENTS AND OTHER DEPARTMENTS, RELATE TO THE WHITE HOUSE ON IT?

#### IV. DOMESTIC ECONOMIC CONDITIONS

NUMEROUS LEADING ECONOMISTS ARE REDUCING THEIR ECONOMIC GROWTH FORECASTS FOR THE FOURTH QUARTER AND 1977. THERE IS NO EXPECTATION AT THE MOMENT, HOWEVER, OF A RECESSION NEXT YEAR. ALTERNATIVELY, AN AVERAGE GROWTH RATE OF APPROXIMATELY 5.5% (AND 6.5% NEXT YEAR) OVER THE NEXT FOUR YEARS HAS BEEN ESTIMATED AS NECESSARY TO EVENTUALLY REDUCE UNEMPLOYMENT TO THE 4-4½% LEVEL WHICH YOU HAVE DISCUSSED. IT IS INCREASINGLY QUESTIONABLE AS TO WHETHER THIS RATE NOW CAN BE ACHIEVED FOR 1977, WITHOUT ADDITIONAL STIMULUS.

WE SUGGEST THAT YOU SOLICIT SECRETARY SIMON'S VIEWS CONCERNING THE FOLLOWING. (IT SHOULD BE NOTED THAT HE IS QUITE CONSERVATIVE, IS HIGHLY INFLATION-SENSITIVE, AND HAS GENERALLY EVIDENCED SATISFACTION WITH THE "SLOW BUT STEADY" ECONOMIC PACE.)

1. HIS PERCEPTION OF THE CURRENT PACE OF THE ECONOMIC RECOVERY; WHY THE "PAUSE" HAS BEEN EXTENDED, WHY BUSINESS INVESTMENT AND UNEMPLOYMENT HAVE BEEN DISAPPOINTING, AND WHETHER THIS PACE IS ADEQUATE/INADEQUATE FOR U.S. ECONOMIC AND SOCIAL HEALTH?

2. HIS EXPECTATIONS CONCERNING THIS FOURTH QUARTER AND 1977; ECONOMIC GROWTH RATES, UNEMPLOYMENT AND INFLATION LEVELS, ETC., AND WHY. IN PARTICULAR, WHAT EVIDENCE EXISTS TO SUPPORT MR. GREENSPAN'S CONTENTION THAT THE PAUSE HAS ONLY "A SHORT TIME TO GO" AND THE OFFICIAL FORD ADMINISTRATION FORECAST OF 5.7% REAL GROWTH IN 1977.

V. POLICY ALTERNATIVES CONCERNING ADDITIONAL ECONOMIC STIMULUS

AS YOU KNOW, A POLICY DEBATE IS RAGING OVER WHAT FORM OF FISCAL STIMULUS MIGHT BE MOST APPROPRIATE AND EFFECTIVE. MANY ARGUE THAT ONE-TIME TAX REBATES OR CREDITS TO INDIVIDUALS CAN PROVIDE THE "QUICKEST" STIMULUS. OTHERS BELIEVE THAT ONE-TIME INDIVIDUAL TAX CUTS ARE PRIMARILY SAVED, NOT SPENT, AND THAT PERMANENT TAX REDUCTIONS ARE MORE EFFECTIVE. STILL OTHERS CONTEND THAT A MIX OF INDIVIDUAL AND CORPORATE TAX REDUCTIONS OR INCENTIVES, E.G. LIBERALIZED DEPRECIATION RATES, HIGHER INVESTMENT TAX CREDIT RATES, SHOULD BE USED.

OF COURSE, A SEPARATE SCHOOL OF THOUGHT ARGUES FOR SPENDING STIMULUS ALONE, OR A COMBINATION OF TAX REDUCTIONS AND INCREASED SPENDING. THE ONLY AVAILABLE APPROACH TO INCREASED 1977 SPENDING INVOLVES USE OF EXISTING PROGRAMS. THOSE RELATING TO COUNTERCYCLICAL ASSISTANCE, GIVEN THE PLIGHT OF CENTRAL CITIES AND DECLINES IN THEIR

PUBLIC EMPLOYMENT, HAVE BEEN FREQUENTLY MENTIONED. ADDITIONALLY, INCREASED SPENDING FOR PUBLIC WORKS AND MANPOWER TRAINING ALSO HAS BEEN RECOMMENDED.

IT MIGHT BE USEFUL TO OBTAIN SECRETARY SIMON'S VIEWS CONCERNING:

-- THE ADVISABLE FORM OF FISCAL STIMULUS; TAX POLICY ALONE, AND IF SO, WHAT FORM OF TAX INCENTIVES TO GROWTH; SPENDING POLICY ALONE, AND WHAT CATEGORY OF SPENDING; A MIX OF TAX AND SPENDING POLICIES, WHICH ONES AND WHY.

YOU SHOULD INDICATE TO HIM THAT YOU WOULD LIKE YOUR STAFF TO COOPERATE WITH HIS STAFF ON THE TECHNICAL QUESTIONS INVOLVED.





UNIVERSITY OF MINNESOTA  
TWIN CITIES

Department of Economics  
1035 Business Administration Building  
Minneapolis, Minnesota 55455

Nov 28 1 45 PM '76

November 17, 1976

MEMORANDUM TO: The Carter-Mondale team

FROM: Walter W. Heller

SUBJECT: Coordinating fiscal and monetary policy at the executive level

1. The problem of coordinating Federal Reserve monetary policy with White House fiscal policy (and wage-price policy) is partly a question of personalities and partly a matter of structure and procedure. And while the problem of keeping the Fed on the path of expansionary virtue would be easier with a Carter appointee than with Burns, let me underscore two things at the outset:
  - . In spite of a lot of anti-inflationary bravado in public, Burns has made clear -- partly in public but more importantly by private assurances to friends at Brookings -- that he intends to be "cooperative" and "pragmatic" in his relations with the new Carter Administration.
  - . If history is any guide, even a Carter appointee to succeed Burns will get more and more independent the longer he reigns in that "marble palace" on Constitution Avenue.
2. Although one does not want to be a prisoner of the past, the rather successful resolution of a similar problem -- and of potential conflict between President Kennedy and Chairman William McChesney Martin of the Federal Reserve -- back in the early sixties may be instructive. At that time, the tight money, anti-inflationary bias of the Federal Reserve under Martin's leadership seemed to be on a collision course with Kennedy's promises of getting the economy moving again. The conflict was avoided and a reasonable accommodation developed partly by skillful Presidential handling of the personal relationship with Martin and partly by organizational arrangements that brought the Fed into the Kennedy economic policy orbit.
3. A quick rundown on how the dilemma was resolved at that time may provide an insight or two on how, in today's setting, one might Carterize Burns:
  - . Well before the Inauguration, Kennedy had his CEA chairman-designate and later his Treasury Secretary sound Martin out. Martin readily and warmly assured us of his respect for Kennedy

and pledged his cooperation. (One can assume that President-elect Carter will get similar assurances from Arthur Burns.)

- . The instrument used to convert that pledge into reality was the "Quadriad" (Webster definition: "A group of four. Rare."): The "Troika" of (1) the Secretary of the Treasury, (2) the Budget Director, and (3) the CEA Chairman, plus (4) the Federal Reserve Chairman. This group was set up by memo rather than executive order.
- . The Quadriad had no fixed meeting schedule. The President asked me to keep an eye on monetary developments and set up meetings as needed when problems arose. These "problems" usually appeared in the form of Federal Reserve backsliding on expansionary policy (which in those days usually meant failure to buy enough U.S. bonds in the open market and thus to increase the supply and hold down interest rates on long-term funds).
- . Meetings averaged one every six or seven weeks. The key to success was that the meetings were with, and chaired by, the (well-briefed President (sometimes preceded by discussion among ourselves)).
- . The combination of (a) the President's prestige and persuasiveness and (b) the give-and-take between Martin and the other three members, was effective in promoting policy coordination without subverting the Fed's independence.

3. Granted, problems change shape, and coordination today has to embrace not only the White House and the Fed but also the Congress. Still, the executive branch needs its own instrument for coordination, for weaving the Fed into the fabric of a Carter economic policy. Something akin to the Quadriad could serve this purpose nicely:

- . It would give the President and his economic team a continuing channel for weighing in on monetary policy.
- . Burns or his successor would in turn have an internal platform for expressing his views on fiscal and wage-price policy. (One should not forget that Burns has often urged a strong incomes policy through a beefed-up Council on Wage and Price Stability equipped with powers to suspend outsized price and wage increases by concentrated industries and powerful unions.)
- . This process of cooperation rather than confrontation could facilitate policy coordination while maintaining the "independence of the Fed in but not of the Administration."



Walter W. Heller

November 22, 1976

MEMORANDUM

TO: Senator Mondale  
FR: Bill Smith  
RE: Tuesday's Congressional Meetings

This will supplement my memo before the Lovejoy meeting. Also attached is a copy of Mike Mansfield's memo to Carter following the Lovejoy meeting. Carter may not have seen it yet.

1. Meeting with Committee Chairman.

In addition to general assurances about working together, <sup>and</sup> prior consultation on legislative proposals before they are sent up, the Committee Chairman will be looking for specific information on the following:

- (a) The Transition: How is it organized and who is in charge of each operation? Who can they contact regarding jobs in the new Administration, to have an impact on policy and budget decisions, etc.?
- (b) Filling Jobs: Beyond what they've read in the newspapers about the selection of the Cabinet, what is the job screening and selection process at the Cabinet and sub-Cabinet levels? No members of Congress were on the initial advisory group. They'll want to know how they will be consulted.
- (c) Nominations: Each committee chairman should be at least advised, if not consulted before any public announcement with respect to nominees that will appear before the committee.
- (d) Government Reorganization: The new Administration's reorganization plans will affect most, if not all, standing committees. The chairmen are likely to be apprehensive about specific reorganization plans. What authority will be sought from Congress? The '49 Reorganization Act? What will be the new Administration's reorganization priorities? Will consolidation of energy agencies be first?

2. Foreign Relations Committee Meetings

- (a) Prior Consultation on Foreign Policy: The perennial thorn in the side of the Foreign Relations Committee members is that their consent is sought after decisions are made, but seldom, if ever, are they asked for advice. It is therefore important that they be told that the new Administration intends to make the advice part of the advise

and <sup>CONSENT</sup>~~consult~~ clause a reality. There needs to be developed a working institutional relationship, not just personal consultations.

- (b) Executive Hearings and Briefings: These have been Kissinger's snow jobs in the past. Executive branch witnesses have seldom revealed more than what's already been reported in the New York Times. They'll want some assurance that briefings will be given before decisions are made and action taken. They want access to information.
- (c) Nominations: Again, as with the committee chairmen, it will be helpful if some assurances were given about prior consultations.

3. Meeting with the Republican Leadership.

It is important to dispel any apprehensions that their relationship with the new Administration will be cosmetic. They should, therefore, be left with the impression that the new Administration will be working with and consulting them and seeking their support on important legislation. This should be coupled with a recognition that there will be occasions when they cannot support some facets of the Administration's programs.

The Dirksen example might be used. Dirksen was consulted by Johnson, especially on foreign policy matters, but also because he often held the balance of power in the Senate on many domestic matters, particularly civil rights' legislation.

United States Senate  
Office of the Majority Leader  
Washington, D.C. 20510  
November 18, 1976

MEMORANDUM

TO: President-Elect Carter  
FROM: Senator Mike Mansfield  
SUBJECT: Lovejoy Discussions

I would like to make the following suggestions:

1. Shortly after you assume office, you might consider the possibility of inviting the Members of the classes of 1977, 1975 and 1973, as a group, to meet with you to discuss your plans and to seek their advice. These are the Members who, like you, have been closest to the people, who will be most in tune with the times and who, I think, would be most appreciative of a get-together of this sort. It would be a recognition which would not easily or soon be forgotten.

2. Sometime thereafter, have a similar meeting with all the rest of the older Members of the Senate and do so on the same basis.

3. I would advise your being very circumspect in having Congressional Members on foreign trips you may undertake. It is my belief that this could be easily overdone, if carried too far and, therefore, I would think that only on the most important occasions should you consider the possibility of having appropriate Members along, and then, in the capacity of observers and/or advisers, only.

4. In the reorganization of the Executive Departments, which you set as your first goal, you made a very excellent impression on all the Members present at Lovejoy. The next step would be to follow up with the Committee Chairmen, as you expect to do before the Congress convenes, and it might be well to pay particular attention to the legislative committees which would be most directly concerned. I have in mind Government Operations, Budget, and so forth. You will also have to face up to the fact that certain committees have developed a vested interest in the departments because of agencies which come within the area of their responsibility. One which could have caused difficulty would have been Agriculture, but with Senator Talmadge as Chairman of the Agriculture and Forestry Committee on your side,



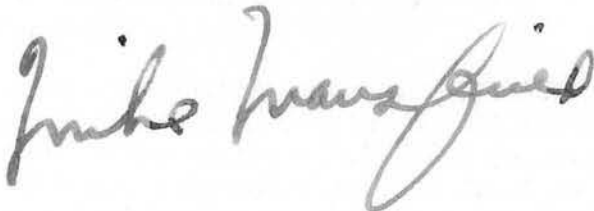
you have part of the battle already won. The same facts would apply to the Committee on Interior and Insular Affairs in its relationship with the Interior Department; Foreign Relations in its relationship with the State Department, and so forth.

5. In the drafting of legislation, your idea that the White House and the appropriate committees should work together is an excellent one. It will have to be done with tact and understanding on both sides, and it should always be kept in mind that in this, and all other instances, in the area of Presidential responsibility, that will be yours and yours only, and in the area of Congressional responsibility, that will be the area for the Congress to keep in mind at all times.

6. There is a line of demarcation between the Executive and the Legislative Branches of the Government. A President should not overstep that line, nor should a Congress. It would be my hope--and I expect it would be the case--that the Congress at all times will recognize your Constitutional responsibility as the President; it would be my hope--and I have no doubt about your feelings on this matter--that the President would not overstep the line either. In cases of doubt, it is essential that cooperation and understanding develop to the end that the interests of the Republic will always come first. You will be in a position to make the appropriate and right decisions at all times because you will, in the last analysis, be acting singly and alone; with the Congress and its 535 Members of diverse temperments, it will be more difficult. However, with the foundation you laid at Lovejoy, and with the bricks you will build on that foundation in the weeks, months and years ahead, I would anticipate smooth sailing, at least into the near and possibly the indefinite future.

With best personal wishes, I am

Respectfully yours,

A handwritten signature in dark ink, appearing to read "J. Edgar Hoover". The signature is fluid and cursive, with a large, sweeping "J" and a long, trailing flourish at the end.

cc: Honorable Walter F. Mondale

TO: Senator

FROM: John

RE: Meeting with Chairman Burns and Secretary Simon

Burns more important

It seems clear to me that Chairman Burns is the significantly more important person in this meeting. Burns will be Chairman until February 1978, and so it is very important to begin to work with him in the new Administration. Also, Burns is a better economist than Simon, and is quite a bit more influential in conservative circles. Therefore, I would recommend that most of the attention be paid to Burns.

Outlook for the Economy and the Need for a Stimulative Economic Policy

I think that it should be clear to everyone in the room that the current economic situation has deteriorated.

There are many indications of weakness in the economy. Real GNP in the third quarter of 1976 increased at only a 3.8 percent rate. Real consumption expenditures were up at only a 3.6 percent rate. Real inventory investment declined from a rate of \$11.1 billion in the second quarter to a rate of \$10.2 billion in the third quarter. Net exports declined from a rate of \$16.0 billion in the second quarter to \$15.3 billion in the third, although this tends to indicate that the rest of the world's recovery is even slower than ours, rather than simply being a reflection of domestic weakness. What strength there was came from investment. Real nonresidential investment rose at a 9.4 rate. Real residential investment rose at a 15.7 percent rate. What this says to me is that personal consumption needs a boost in order to justify further business investment. It also shows how a low rate of growth of real government expenditures is translated directly into lower rates of real economic growth.

The preliminary indications for the fourth quarter are generally not good. Industrial production declined in October for the second month in a row. From January to August industrial production had been rising at an average rate of 8.4 percent. In September industrial production declined at a 2.7 percent rate. In October industrial production declined at a 5.4 percent rate.

Housing starts fell in October from their September levels. New privately owned housing units were started in October at a rate of 1.792 million per year. This is down from the September value of 1.858 million per year. Although in October housing started are below September's value they are still above any other time in the last year.

Retail sales in October are currently estimated to have totalled \$ 54.062 billion in October. This is above the September value of \$53.918 billion, but is below the third quarter's average monthly rate of \$54.105 billion.

Manufacturer's new orders climbed from \$46.648 billion in September to \$48.044 in October. However, new orders remain below both the July and the August levels, and are only slightly above the third quarter value of \$47.607 billion.

All of these indicators suggest that the fourth quarter is not going to be significantly better than the third quarter. And this would imply that unemployment would remain approximately constant for November and December.

The recent news on inflation has been mixed. Industrial wholesale prices have been rising at a rapid rate, and the rate of increase has risen for five months in a row: 6.2 percent rate in June; 8.7 percent rate in June and again in July; 11.3 percent rate in September; and 12.7 percent rate in October. Rising industrial prices usually portend subsequent rising consumer prices. But so far these increases have not shown up at the consumer level. Infact the rate of increase of consumer prices has fallen over the last six months: 7.4 percent rate in May; 6.1 percent rate in June, July and August; 4.9 percent rate in September and a 3.7 percent rate in October. The GNP deflator shows only a 4.2 percent rate of inflation during the third quarter of 1976, compared to a 5.2 percent rate in the second quarter.

The Heller forecast currently shows real growth from the fourth quarter of 1976 to the fourth quarter of 1977 of 5.3 percent. This forecast was made before the evidence began to come in that the fourth quarter may be weak. Heller's forecast agrees substantially with the Wharton model -- which is run by Larry Klein -- which forecasts a real growth rate of 5.5 percent for the next five quarters. Arnie Packer believes that even these growth rates may not materialize without additional stimulative policies. A growth rate of 5.5 percent in 1977 will leave the unemployment rate above 7 percent by the end of 1977.

The indications of current weakness, along with the best forecasts showing no dramatic turnaround, have led many to advocate a \$15 to \$20 billion stimulative package. This package could boost the real growth rate by about 1 percent in 1977 -- which should be enough to make the unemployment rate drop below 7 percent in 1977. And it would produce its largest effects -- about a 2 percent additional rate of real growth -- in 1978. And all of the econometric models -- DRI, Wharton, and Chase -- plus the best judgmental economists estimate that the inflationary price for this approach would be very small.



### The importance of Burns

The actual effect of this package on real economic growth is partly in the hands of Burns. He can make a \$15 to \$20 billion package less effective by pursuing a restrictive monetary policy which would raise interest rates, hurt housing particularly, and prevent some nonresidential investment. Or Burns can make a \$15 to \$20 billion package fully effective by an accomodative monetary policy, which would hold interest rates constant, so that the increase in aggregate demand is not partially offset by reduced investment.

Burn's current attitude is not entirely clear. In his testimony before the Senate Banking Committee on November 11, he said: "In today's environment of deeply-ingrained inflationary expectations, traditional policies of economic stimulation might well be counter-productive." In his address to the United States Leagues of Savings Associations on November 18, he said: "I have been asked recently whether a tax cut is desirable at present. For the reasons I have already suggested, and also because I anticipate a resurgence of the economy, I see no advantage in a tax cut at the present time. My mind on this subject, however, is by no means closed. Later on, I will weigh the issue carefully if both economic conditions or expenditure economies seem to warrant a tax reduction. I might add that if it appeared desirable to attempt to stimulate the economy through a tax cut, among other ways, I would be inclined to favor the type of measure that President Kennedy recommended in the early 1960's -- namely, a broadly-based tax reduction for both individuals and businesses. Such a measure, on a responsible scale, would minimize social conflict and have the best chance of producing lasting benefits for our country."

"In the case of the housing industry, as in other sectors of the economy, we should be well advised to use the traditional measures of fiscal stimulation cautiously and to rely more on structural policies that can contribute to reduction of unemployment without risking a new wave of price increases or otherwise creating problems for the future."

Burn's recent actions also give off mostly but not entirely negative signals. He has cut back the projected growth path for  $M_1$  from a range of 4 1/2 to 7 percent to a new range of 4 1/2 to 6 1/2 percent. However, he has also raised the upper boundary of the ranges for the broader measures of money by one-half percentage point. The projected range for  $M_2$  is now 7 1/2 percent to 10 percent, and for  $M_3$  the range is 9 to 11 percent. Also, on Friday, the FED lowered its discount rate from 5 1/2 percent to 5 1/4 percent effective Monday.

What I derive from these statements and actions is that Burns may be willing to negotiate with Carter and arrive at a jointly agreed economic policy. Perhaps the ideal strategy would be to get

an agreement to an expansionary fiscal package of \$15 to \$20 billion in exchange for giving Burns some say in the composition of the fiscal package. The fall-back position -- or really the threat -- would be to pursue a significantly more stimulative fiscal package without monetary accommodation. (Whether this threat is credible is questionable, however.)

#### Stress anti-inflation commitment

Burns' primary concern with an expansionary fiscal policy will be that he fears the inflationary consequences. In response to this, not only could you ask him what econometric model (including the FED's) shows large inflationary costs, but you could also make clear to him that you are very much committed to anti-inflationary policies.

Burns has traditionally supported incomes policies, and would welcome some favorable comment about them from the President-elect. (Simon will not welcome such comments.) Burns would also welcome a commitment to tougher anti-trust policies. He favors many examples of deregulation, and you might mention transportation as an important area for study in this regard. Burns may also want you to weaken Davis-Bacon, and minimum wage laws, so that fully appeasing him will be impossible, but several indications that the new Administration is serious about inflation may help gain his cooperation.

Burns may also state that "traditional economic measures may have become counter-productive." If you should choose to dispute this, you could say that it certainly seemed to you that when the Nixon Administration tried to slow down real economic growth from 1969 to 1971, that it was very successful in its use of traditional economic measures; that when the desire to rejuvenate the economy arose, traditional economic measures worked well in 1972; and that the failure to apply traditional economic measures in 1974 allowed the deep recession of 1975 to develop, which was greatly improved by the measures taken finally in 1975. The lesson of the last eight years seems to me to be that we can control real economic and hence employment growth reasonably well, and that with appropriate incomes policies, and other anti-inflationary policies, we can control inflationary pressures as well.

Burns may flaunt monetary policy in 1975 and 1976 as having been appropriate, and claim that interest rates have actually fallen slightly during the course of the recovery, which is an atypical experience. One important point is that the recovery has not been nearly as vigorous as had been anticipated by most people, and this fact has probably contributed as much as any technological changes in the banking system, to the lack of a credit crunch in 1976.

Dealing with Simon

A discussion of tax reform with Simon might be productive, in that it might bring out that President-elect Carter and Secretary Simon share many common values with respect to tax reform. Attached is a note from Brad on Simon's tax reform ideas.

Also Simon would probably be pleased to hear Carter restate his pledge to hold federal expenditures to no more than 21 percent of GNP when the unemployment goal is met.

November 19, 1976

## SIMON'S TAX REFORM IDEAS

I doubt whether it would be productive for the participants to discuss specific tax reform proposals. However, it might be useful to discuss certain general tax reform objectives -- objectives that appear to be shared in theory by Carter, Simon and nearly every other person who has offered his notion of the ideal tax system.

Individual taxes. In December, 1975, Secretary Simon spoke at the Tax Foundation's 38th Annual Dinner. That speech received some public attention because it obtained an endorsement of an individual tax structure where "special deductions and credits, exclusions from income, etc., are eliminated or drastically curtailed." The result, according to Simon, would be a simple, progressive individual tax structure with rates ranging from 10-12 percent at the low end to 35-40 percent at the high end. Total federal revenues would remain the same. Reduced revenue through lower tax rates would be offset by an expanded tax base (amount of income subject to taxation).

Joseph Pechman, speaking during the campaign as a Carter tax advisor, stated that Carter's tax reform goals would also involve an expansion of the tax base through elimination of "loopholes" and a reduction in the tax rates. However, Pechman spoke of reducing the top tax bracket to about 50 percent, rather than the 35-40 percent figure proposed by Simon.

Although the range of tax brackets differs under these two theoretical proposals, it is interesting to note that both involve a progressive rate structure. At least one member of the Ford Administration, Russell Train, advocated in a Washington Post article that the present individual tax structure be replaced by a "loophole-free" tax code with a flat rate of tax. The tax burden on low income individuals would be relieved by more generous dependency exemptions or credits; but Train apparently feels that a flat rate structure offers the best possibility for simplifying the tax laws without offending the high income individuals who now use tax loopholes to reduce their effective rate of taxation.

The Treasury Department is currently conducting a tax simplification study. This simplification report is scheduled for release by the end of this year. At this point, it is unclear whether this report will approach the "Simon pure" simplified code or whether it will propose a more modest (and perhaps more realistic) tax reform scheme.

Corporate Taxes. Both Carter and Simon have endorsed an elimination of the so-called double taxation on corporate earnings. As you know, the present tax code taxes business income at the corporate level and taxes that income again when it is distributed as dividends to ~~the~~ shareholders.

There are several ways to integrate corporate and individual taxes. Simon has proposed one alternative that would cost approximately \$14.5 billion when fully effective. Carter would presumably espouse an integration plan that would be less costly and probably less advantageous to high income individuals who can often shield business income from high individual tax rates. I am sure that a discussion of the details of integration will be beyond the scope of this meeting.

TO: WFM

FROM: Bert *B*

SUBJECT: Friday Budget Briefing

[Nov. 1976]

I have talked with the people I know who are working with Bo Cutter's Budget Group. Apparently they are planning a fairly general overview briefing for Governor Carter on the FY 1978 Budget, to be held Monday in Plains. As far as I can tell, they do not propose to present specific options or to discuss controversial items in detail. The goal, as I understand it, is to acquaint the Governor with the extent to which budget decisions are already locked in, and to present some broad policy considerations. On other hand, there is no guarantee that the debate over some key questions will not be influenced by the way the briefing is shaped, or that the Governor won't proceed to make some decisions based on this briefing.

I suspect that Bo's purpose in asking for the chance to brief you Friday is (a) to develop a relationship and (b) to get a live audience for his dress rehearsal. I do not think that he is ready to suggest specific decisions, and therefore I do not think he is trying to get your endorsement.

#### RECOMMENDATION

I don't see any difficulty with the briefing. However, I also doubt that you will get enough out of it to justify spending 2 hours or so. I would suggest that you request the written materials they are preparing and that we review those. Then if you want to meet we can set up a more targeted meeting, or otherwise communicate on specific issues. It really comes down to whether you want to spend the time going over material much of which will probably not be new to you.

*Request written materials*





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