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The Political Economy of Wage and Price Controls: Evidence from the Nixon Tapes

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Abstract

On August 15, 1971, Richard Nixon imposed the first and only peacetime wage and price controls in U.S. history. The Nixon tapes, personal tape recordings made during the presidency of Richard Nixon, are now available to the public and provide a unique body of evidence to investigate the motivations for Nixon's macroeconomic policies. We have uncovered and report in this paper evidence that Nixon manipulated both monetary and fiscal policies to create a political business cycle that helped secure his reelection victory in 1972. Nixon was very knowledgeable about economic matters and understood the risks to the economy of his macroeconomic policy actions and the imposition of wage and price controls, but chose to tradeoff longer-term economic costs to the economy for his own short-term political gain.

JEL Codes: E6; E3; E58

Key Words: Wage and Price Controls; Political Business Cycle; Macroeconomic Policy

Introduction.

Over thirty-years ago, William Nordhaus (1975) initiated the literature on the opportunistic political business cycle, the idea that politicians regardless of their party affiliation try to maximize their chances for reelection by creating favorable economic environments in the run-up to elections. If operative, the opportunistic political business cycle should yield economic fluctuations that follow the election cycle. Nordhaus' work has spawned hundreds of papers, but support for his hypothesis has been far from unanimous. Alesina, et al. (1997), for example, report that the opportunistic model does poorly in explaining economic fluctuations in many countries. More recent work points to party-specific evidence for political business cycles (for example, Kraus and Mendez (2005) and Bloomberg and Hess (2003)).

The Nixon tapes, personal tape recordings made during the presidency of Richard Nixon, are now available to the public and provide unique evidence to investigate the existence of an opportunistic political business cycle. We have uncovered and report in this paper evidence that Nixon manipulated both monetary and fiscal policies to create a political business cycle that helped secure his reelection victory in 1972.

Nixon's New Economic Policy.

On August 15, 1971, President Richard Nixon, a self-proclaimed Republican "Conservative,"[1] announced the first and only peacetime program of wage and price controls in U.S. history. The wage and price control program was part of Nixon's New Economic Policy (NEP), a set of fiscal and regulatory actions designed to take aim at the

[1] Nixon tape conversation No. 607-11.

problems of unemployment, inflation and international currency speculation.[2] The NEP called for the suspension of the convertibility of the dollar into gold, a temporary tariff surcharge of 10 percent on all imports, a tax credit for investing in new equipment, the repeal of a 7 percent excise tax on automobiles and an accelerated schedule for increasing personal-income-tax exemptions. In addition to these expansionary fiscal policies, the president was simultaneously working to ensure that monetary policy would become increasingly expansionary (Abrams, 2006).

Table 1 provides background data on unemployment and inflation leading up to NEP. Over the previous two years, the unemployment rate had risen steadily, increasing from 3.5% to 6%. While the inflation rate moderated somewhat over the two-year period, it remained at 4.4% for the twelve months ending July 1, 1971. Phase I of the wage and price control program, initiated on August 15, froze wages and prices for 90 days. In November, Phase II was launched empowering a Pay Board and a Price Commission with authority to approve wage and price increases. The President confidently predicted that continued support for his economic program would cut the inflation rate in half.[3] Nixon proved to be a very poor economic forecaster. During the next four years, 1972-1975, the inflation rate surged to an average annual rate of 8 percent.

The NEP, in conjunction with the highly expansionary monetary policy, produced the expected increase in aggregate demand and output that was needed to reduce unemployment. During 1972, real output increased by 7.7% and the unemployment rate dropped from 5.9% to finish the year at 5.2%. In such a stimulated economy, did the

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[2] Transcript of Presidential address, New York Times, August 16, 1971, p. 14
[3] Television News Archive, Vanderbilt University, CBS Evening News for Monday, November 15, 1971.

President and his policymakers believe that temporary wage and price controls would be sufficient to tame inflation? Or were the decisions to impose wage and price controls made for purely short-run political gain?

Herbert Stein, a member of the Council of Economic Advisors in August, 1971, recalls the rationale used by some in the Administration to justify the price and wage controls: "The theory was that the inflation then underway (about 4% per year) was propelled by expectations of inflation, not by underlying demand and supply conditions. The 90-day freeze would shake those expectations, and then the economy would subside into price stability."[4] Thus, one possible line of thinking was that the aggregate demand stimulation would take care of the unemployment problem and the temporary wage and price controls would take care of the inflation problem.[5]

An alternative justification for temporary wage and price controls relies on opportunistic political behavior. At the time of the wage and price freeze, Richard Nixon's presidential re-election bid was less than fifteen months away. Any political gains that might be made in the run up to the election from reducing unemployment might be negated if the inflation rate accelerated. Temporary wage and price controls would conveniently disguise inflation until after the election.

Were temporary wage and price controls implemented and maintained in the run-up to the election to break inflationary expectations or were they the product of political opportunism? In what follows, we report on relevant conversations that provide an answer to this question.

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[4] Stein, "Wage and Price Controls: 25 Years Later," http://msjc.edu/econ/dpynn/article081902.htm
[5] Incredibly, Stein goes on to write: "It was a rather flaky theory, and we were not prepared for the possibility that it was wrong."

PRE-FREEZE CONVERSATIONS.

February 19, 1971 (Conversation Number 452 – 4) Nixon with a group of ten economists including Office of Management and Budget Director George Shultz and Council of Economic Advisors Chairman Paul McCracken.

Nixon notes that he worked in the Office of Price Administration in 1942 and that "…In my view… wage-price controls in peacetime on a broad basis will not work…If I thought they would not lead to a terrible smothering to enter on this whole free economy of ours, hell I'd be for it."

February 19, 1971 (454 – 4) Nixon, Treasury Secretary John Connally, Federal Reserve Board Chairman Arthur Burns, Shultz and McCracken.

Burns: "In my view the monetary authority… has laid the foundation for recovery. … What is holding back the economy now is not any shortage of money but a certain shortage of confidence. If we flooded the banks even more than we have I think you could have awful problems in 1972 and beyond."

Burns is against engaging in a more expansionary monetary policy. At the end of this meeting, Connally asks about an Administration position on wage and price controls and suggests his support. At the time, Congress was considering a bill to extend the President's authority to impose controls for another two years which was subsequently approved.

Connally: "What position do you want us to take? … We ought to have a position. … We ought not to be in a position of not wanting to use it."

Nixon: "We have no intention of applying them at this time."

February 22, 1971 (455 – 3) Nixon, Counsel to the President John Ehrlichman and White House Press Secretary Ron Ziegler. Shultz, Special Counsel to the President Charles Colson and Labor Secretary James Hodgson join at various times. Some leave at various times.

Nixon: "On this wage price freeze, Jim [addressing Hodgson] I'm not about to do a damn thing. … Davis-Bacon appeals to me more than a freeze."

Nixon hopes that suspension of the Davis-Bacon Act requiring all workers under federal contracts to receive comparable union wages would send a message to labor and break the wage spiral. Hodgson replies that suspension of Davis-Bacon would be viewed as anti-union and would not stop wage increases.

Nixon: "Here's my concern about the freeze…There is strong support for a wage board and wage-price controls and particularly from sources like Arthur Burns. … The difficulty with wage-price controls and a wage board as you well know is that the God damned things will not work. They didn't work even at the end of World War II. They will never work in peacetime."

Later,

Nixon: "Burns is not playing our game. … Burns used to be against controls. … He always was… up to 1968. … Now he says he's for a wage-price board. … [He knows]… I'm not going to have wage and price controls."

February 22, 1971 (455 – 22) Nixon, Shultz, and Ehrlichman.

The conversation focuses on controls, a freeze and suspension of Davis-Bacon.

Nixon: "I know the reasons, you do it [wage and price controls] for cosmetic reasons good God! But this is too early for cosmetic reasons."

Nixon doesn't believe that controls will work, but is now apparently willing to do something "cosmetic" that would help his re-election. A freeze or controls likely would be effective for only a short period of time and thus, if imposed, Nixon thinks they should be imposed close to the 1972 election.

Later Nixon and Shultz discuss Connally's upcoming testimony. They discuss Burns' recommendation for a Wage Stabilization Board. Nixon tells Shultz to convey the following to Connally regarding Burns' recommendation:

Nixon: "If he's [Connally] asked about that [wage and price controls], I think he should sink it. Give it the same disdain that Arthur gives everything we suggest."

Burns, up to this point, has been fighting Nixon's attempts to pressure him into adopting a more expansionary monetary policy. Nixon, still opposed to controls, uses Burns' support for wage and price controls to further paint him as the enemy. In a subsequent conversation, Nixon rants against Jews in government, including Burns, and believes Burns is a primary source of leaks of confidential information. In Nixon's mind, Burns now has more than three strikes against him.

March 5, 1971 (462 – 13) Quadriad[6] meeting with Nixon, Burns, Shultz, Connally and McCracken.

Nixon notes that inconsistent statements from Administration officials decrease the public's confidence in the Administration. Burns comes to the defense of McCracken's recent statements about unemployment, but Nixon expresses no sympathy.

Burns: "Paul McCracken has to interpret these figures [the unemployment rate] as an economist or he will lose credibility even next month."

[6] The Quadriad comprised Nixon's four chief economic advisors.

Nixon: "You say credibility with the press. First let us remember the press [garbled], the great majority couldn't give one stinking damn about whether we're credible or not. They just want us to lose."

Burns seems stung by Nixon's criticism and later Nixon flatters Burns. Later, Connally suggests that monetary policy should be used to lower interest rates.

Connally: "We need to drive this interest rate down."

Burns: "…..We could make matters worse by making money easier…..If anybody gets the notion, you see, that we are easing monetary policy further, that will intensify these fears of a rise in interest rates later on."

Burns clearly indicates his knowledge that expansionary monetary policy is likely to raise inflationary expectations and interest rates. At the end of the meeting, the others leave and Connally stays to talk with Nixon. Nixon praises Connally for stressing the need to lower interest rates.

March 5, 1971 (462 – 15) Nixon, Haldeman and Connally.

Nixon: "He's [Burns is] ruthless. He plays all the bureaucracy. He plays all the press. He does the leaks. He does everything else, John."

Connally: "He plays that Hill … in a big way. Both sides."

Nixon: "I'd be delighted to be the first President in 25 years to take the Fed on if it becomes necessary."

Connally: "He can force these interest rates down and that ought to be done."

Neither Connally nor Nixon is an economist, but they know the monetary policy appropriate for their political objective.

March 11, 1971 (466 – 2) Nixon and Connally.

Nixon: "Whenever you have anything to talk about, as you know … [Secretary of State Willim P.] Rogers can get through; [Defense Secretary Melvin R.] Laird can get through; [Attorney General John N.] Mitchell can and you can, that's all."

In less than one month, Connally has become one of the President's closest advisors.

March 16, 1971 (468 – 15) Nixon and Connally.

Nixon and Connally discuss Burns. Connally indicates his intention to tell Burns that he is getting into Connally's territory. Burns should stay out of wage-price controls and fiscal policy, even if he is knowledgeable about it.

Later,

Nixon: "…he is also wrong in terms of monetary supply, damn it! Everybody except Arthur thinks it ought to be higher [money supply] and let's just keep hitting him on that…..He [Burns] must not do things that are going to embarrass the Administration."

Nixon would have done well to heed his own advice.

March 18, 1971 (469 – 9) Nixon and Connally.

Connally reports to the President about his meeting with Burns and that he delivered the message to Burns that he is losing his influence.

Connally: [recalling what he told Burns] " 'If I read the tea leaves right … you are isolating yourself more and more.' "

In the ensuing conversation, Nixon states that a good inflation target is 3% and reveals his preference for the unemployment rate.

Nixon: "If we can keep the unemployment, to be perfectly frank with you, John, I'd just like to get it down to around 5 … I think to have unemployment around 3 it too low. The labor gets too damned cocky."

Shortly thereafter Connally discusses nominal interest rates:

Connally: "You don't want 'em down until next spring because they're volatile. We can't hold the interest rate on short-term Treasuries, in my judgment, down to 3.2 for God's sake…for eighteen months.

…You can't hold it to November '72. It's just gonna fluctuate.

…If you can get [un]employment down to 4%, its not going to stay there. It'll be going back up next year. Or if you get inflation down…it's going to go back up next year. Nothing stays flat as you well know."

Nixon: "It always moves."

Connally: "It always moves."

Since they did not believe that they could hold unemployment and inflation to their desired levels, the most important objective was to drive them down just prior to the 1972 election.

Importantly, Connally expresses his concerns abut the international situation and the balance of payments deficit. This issue will prove to be the tipping point that pushes Nixon to favor wage and price controls.

March 18, 1971 (469 – 13) Nixon, Haldeman and Ehrlichman.

Nixon [speaking about Connally]: "That's the only man that can stand up to Arthur. … You tell him what you want, he does it."

Nixon's admiration for Connally and disdain for Burns are both increasing.

March 19, 1971 (470 – 18) Nixon and Burns.

Burns warns of an impending international monetary crisis and uses it as an argument not to lower interest rates. Under a fixed exchange rate, the U.S. balance of payments deficit has caused losses of official reserves. Foreign governments that had been holding dollar-denominated financial assets have been going to the U.S. gold window and demanding gold in exchange for their dollars. Lowering interest rates further would intensify the desire by foreign governments to cash in dollar-denominated assets for U.S. gold.

Burns: "To drive interest rates lower would run the risk of accelerating an international monetary crisis."

Nixon expresses admiration for Connally and instructs Burns to develop a close relationship with Connally. Later, Nixon stresses that monetary policy should be geared towards reducing unemployment in 1972.

Nixon: "We've really got to think of goosing it … late summer and fall of this year [1971] and next year. As you know there's a hell of a lag."

June 8, 1971 (514-8) Nixon, Shultz and informal economic advisor Milton Friedman.

Friedman warns against using monetary stimulus to try to reduce nominal interest rates or unemployment. He observes that monetary policy was on the right course through January but has become inflationary. He welcomes an international crisis that would necessitate floating the dollar.

Friedman: "I'm not optimistic because you cannot avoid a rise in interest rates in the next six months…I don't know a thing about politics. But it does seem to me that nothing could be more damaging to you in 1972. …[than] if the price rise in 1972 is back up to 7%. I think in general unemployment is much more damaging politically than inflation. …but in the particular case of your administration and yourself it is even [tape skips] because we took extra measures to do something about it. And now it must pay off."

June 14, 1971 (519 – 11) Shultz, Burns, McCracken and Connally.

Shultz and Connally argue that rising nominal rates in the face of a rapid monetary expansion reflect strong real demand (income effects). Burns counters that lenders are asking for higher rates due to inflation. Burns feels inflation is rising and suggests energetic action on the wage-price front and a halt to fiscal expansion.

Burns: "You know I care more about unemployment than inflation…"

Connally: "I'm more concerned about the inflation than I am unemployment."

Based on previously revealed preferences, these two statements would be more credible if reversed.

Connally: "I would say some time between now and a year from now you're going to have to impose some kind of a freeze or a wage-price control."

Connally again suggests controls and will ultimately succeed in influencing Nixon where Burns cannot.

June 28, 1971 (531 – 16) Nixon, Connally and Burns.

Nixon [to Burns]: "... the Administration's signals on economic policy… we've got to have one spokesman and that is the Secretary of Treasury. …If we speak with many voices, that creates uncertainty.…If John [Connally] steps up and (garbled) something and then a story comes out from you [Burns] that indicates a different view…there is no way we can really cut it…"

Nixon has reaffirmed Connally's previous message to Burns. Burns has lost influence and is told to toe the line or keep quiet. Connally is in charge. Burns later argues that he is head of an independent agency, must maintain his credibility and speak his mind. He is clearly unhappy being stifled.

Nixon: "But I'm not going to go on the wage-price board. And I'm not going to go on the wage-price freeze… I'm not going to say never… I've got to indicate, Arthur, now, that right now this is what we're going to do and stick to it….I have to do something with regard to foreign imports."

Nixon still opposes any wage and price controls at this point, but has been convinced that the balance of payments problem and gold drain needs attention.

June 29, 1971 (530- 3) Nixon, Haldeman, Connally and Ziegler.

Nixon instructs Ziegler to make the following announcement.

Nixon: "The man who is the chief economic spokesman for this administration and frankly the President's chief economic advisor is the Secretary of Treasury."

Connally agrees that Nixon will not create a wage-price board or mandatory controls. Connally is apparently strategically agreeing with Nixon on wage and price controls at this point despite his personal view to the contrary.

July 21, 1971 (541 – 2) Nixon, Haldeman, Connally, Shultz, Ehrlichman and Colson.

The group discusses John Kenneth Galbraith and proponents of controls. Nixon remains adamantly opposed.

Nixon: "The way wage and price controls is gonna be taken on, I think what has to be done, John, is you might put some of your people to work on it is this; you have got to create a terrible (garbled) here. And the way you do it is talk up 50,000 OPA [Office of

Price Administration] cops, you know running around, telling everybody, messing in your face and so forth. Everything is fixed. You can't change jobs, you know. Rationing! Just, just, just point it out. What has happened abroad. …This is a socialist scheme, a scheme to socialize America."

July 24, 1971 (545 – 2) Nixon and Connally.

Nixon: "The man … that made the bold move on China, you think he's not going to be bold if necessary with regard to this economy?"

Nixon is asserting that he will be as bold in tackling domestic economic issues as he was on international relations. Nixon refers to Connally's program and states that he wants to emphasize "making America competitive again."[7]

July 24, 1971 (545 – 3) Nixon, Ehrlichman and Haldeman.

Nixon wants a story leaked through Colson about a recommendation to expand the Federal Reserve Board. Nixon also wants a second rumor to be leaked.

Nixon: "In view of the fact that the President has responsibility for full employment, the President is considering legislation to … the Fed has got to be brought in the …"

Haldeman: "in the executive branch."

Nixon: "The independence of the Fed…"

Haldeman: "is seriously in question."

Nixon and Haldeman discuss two pending vacancies on the Federal Reserve Board.

Nixon: "We're going to fill 'em both with basically easy money men."

[7] Taping began while this conversation was already in progress. Connally's presentation of his "program" is lost, although it is likely similar or identical to the program he discusses at length on August 2, 553-6.

Haldeman: "George (Shultz) said both he and Connally are under orders from you to find the easiest money man in town."

Nixon is now conspiring to do an end-run around Burns to get the expansionary monetary policy he desires.

July 26, 1971 (546 – 2) Nixon and Assistant to the President for International Economic Affairs Peter Peterson.

Peterson discusses the deterioration in the balance of payments and the high rate of unemployment. He asks for authority to work in top secret on a bold approach with an August announcement. Nixon recommends speaking to Connally and Peterson replies that he and Connally have discussed his ideas.

Nixon: "I've never seen anybody beaten on inflation in the United States. I've seen many people beaten on unemployment."

Friedman's earlier advice about the political costs of reviving inflation has had no impact on Nixon whose primary concern is reducing unemployment. When Nixon took office the unemployment rate was 3.3%. After efforts to reduce inflation resulted in a recession in 1970, unemployment rose to 6% and stubbornly remained there. As stated above, Nixon preferred a 5% rate.

July 27, 1971 (547 – 9) Nixon, Connally and Peterson

Nixon asks Connally to discuss his program with Peterson. Nixon wants to limit planning to the three of them, plus Shultz and McCracken. Paul Volcker, then Under-Secretary of the Treasury for international monetary affairs, is added to the planning group at some point, but Burns is kept out. Connally discusses his international concerns. Later, Connally: "There is a risk in imposing wage and price controls. No question about it. But there's a risk if you don't."

The tapes indicate that Connally always supported a wage-price policy, but never supported them publicly as Burns had. Thus, it was Connally who was finally able to convince Nixon to impose a freeze, not Burns who was excluded from the planning.

Later, Nixon discusses the Fed vacancy.

Nixon: "I want him [the new member to the Fed's Board] to be a guy that's more interested in the job front than the inflation front."

August 2, 1971 (553 – 6) Nixon and Shultz joined by Connally.

Nixon begins with criticisms of Burns and then turns to discussing industries with high wage-price push.

Nixon: "It seems to me that on a rifle-shot basis, symbolic, you could get in and do those, and then basically then you do have an incomes policy. …. Just do some stuff for symbolism?"

Nixon wants the public to think he is doing something about inflation, but his only real concern is unemployment, so a symbolic action against inflation is enough. Connally lays out his plan for closing the gold window (the institutional arrangement where foreign governments are permitted to convert dollars into gold at a fixed rate), floating the dollar exchange rate, placing limits on Federal spending, imposing a 10% tariff, a 7% investment tax credit, a cut of the excise tax on oil and a 90-120 day freeze on wages and prices.

Connally then appeals to Nixon's leadership desires.

Connally: “It ought to show the people that you have both an awareness of the problems that (garbled) in both the domestic and international field and show secondly and most importantly that you have the courage to face up to it. That you take a position before you’re forced to take a position.”

Nixon has doubts about the plan which they discuss. Connally reports that Peterson supports the plan as does McCracken. The plan apparently is not fully supported by Shultz who is present and by Burns who is not present. [8]

Connally wants to keep meetings secret from Burns (a major source of leaks, they believe). They discuss timing. Connally wants to act sooner and Nixon later. Connally’s concern is an impending run on U.S. gold reserves.

Nixon: “We must not talk to him [Burns] until we’ve decided we’re going to do it, because he will talk.”

Connally: “I know it.”

August 2, 1971 (268 – 5) Nixon and Haldeman, later joined by Connally and Shultz.

Nixon: “Well, we’ll have to look at this thing [Connally’s plan]….”

Haldeman: “Does Connally have the input on wage-price controls?....”

Nixon: “Oh hell yes. They’re the ones that are pushing it, Volcker, you know…”

After Connally enters, Connally argues that an international crisis or moment of truth is coming. He states that a wage-price freeze will prevent inflation from the plan’s proposed tariff. Nixon is reluctant to close the gold window, afraid that this would be perceived as a failure of his Presidency. Connally, Shultz and Nixon continue to discuss the proposed freeze, devaluation or floating and the tariff.

[8] There is no discussion of the nature of Shultz’s and Burns’ opposition in this conversation. In other conversations Shultz (553-6) is said to oppose the freeze, tariffs and suspension of the gold standard and Burns (273-30) the suspension of the gold standard and the tariffs (273-26).

When discussing the need to break the cycle of wage inflation, Connally makes the following interesting statement: "If you do all those things and you don't do something like this [wage and price freeze], then it seems to me you could really, throwing gas on the fire."

Connally knew his plan would stimulate the economy and that wage and price controls were the only way to keep inflation from increasing. He went on to argue that a psychological break was needed, and a freeze would provide it.

This August 2 meeting appears to be the key meeting that launched the NEP. Haldeman notes in his diary (1994, pp. 335-6) that [The President] "had a long session with Connally. The net of this is a huge economic breakthrough based on the international monetary situation…" and "[this breakthrough] becomes a rather momentous decision, and it will be interesting to see what develops."

All the tapes this day discuss Connally's plan. Nixon, the man who only a few days earlier said that wage and price controls would cause a "terrible smothering of the free economy" and were "a scheme to socialize America" is now prepared to impose a wage and price freeze as part of a bold plan to tackle domestic and international problems facing the economy.

August 4, 1971 (554 – 7) Nixon, Connally and Shultz.

Connally reports that Burns fears that Treasury is moving to take over the Fed. Connally told Burns it was not his goal. Nixon firmly supports the Connally plan for the New Economic Policy. Now the remaining decision is timing. Nixon claims that "..the best time to do it is the day after Congress gets back."

Labor Day was September 6 and Congress was in recess through September 8.

Looking forward, Shultz tells Nixon that something will be needed following the freeze.

August 12, 1971 (7 – 112) Nixon and Connally in a telephone conversation.

Connally states that he expects another bad day at the gold window and that we are "constantly losing the initiative". The reference is to the drain of gold from official reserves due to the conversion of dollars into gold.[9] The initiative that is being lost refers to the plan to close the gold window. He and Nixon discuss how to calm the international situation. They refer to the domestic part (freeze on wages and prices and import tariffs) and international part (closing the gold window and floating the dollar). They discuss the options of accelerating both or just one part and speculate as to what would do the most to calm the international situation.

Nixon: "I know that the cleaner way to do it is to do it all in one bundle, uh, et cetera. But, uh, if we're going to have to move our timetable up and uh try to explain all this thing you know, that's a hell of a hard thing to explain to people."

Nixon is leaning toward doing the domestic part first, and Connally agrees, but this may just be a strategic decision on Connally's part to agree with the President.

August 12, 1971 (273-20) Nixon, Connally and Shultz.

In spite of Connally's urging earlier that day to accelerate the program due to an impending international crisis, Nixon expresses his desire to call Congressional leaders back on September 7 and announce the program then. Connally agrees that waiting until September 7 is the wise thing to do but they cannot wait because they have lost over $3.6 billion of reserves during the first twelve days of August.[10]

[9] Haldeman (1994, p. 340) records that "…the British had asked for $3 billion to be converted into gold. If we gave it to them, other countries might follow suit. If we didn't, they might wonder if we had enough gold to support the dollar. In either case, it was a major crisis."

[10] Connally anticipates that Monday (August 16) was going to be a very bad day.

Later, Connally predicts that closing the gold window will not be the main focus of public attention.

Connally: "To the average person in this country this wage and price freeze – to him means you mean business. You're gonna stop this inflation. You're gonna try to get control of this economy. …If you take all of these actions…you're not going to have anybody…left out to be critical of you."[11]

A few minutes later Nixon agrees to accelerate the program.

Nixon: "I think we ought to go Monday [August 16, 1971] with the whole ball."

Later in the meeting Shultz suggests moving to Sunday night. This possibility is discussed briefly, but no change is made at this time.[12]

August 13, 1971 (563-6) Nixon and Haldeman.

Haldeman writes (1994, p. 340) that "As a result of last night's decision on the economic move…" a meeting was scheduled beginning that afternoon with the President, the Quadriad and other economic and political advisors at Camp David.[13]

The tapes reveal concern about leaks from Peterson and especially Burns. Haldeman asks Nixon if he intends to keep everyone "up there" and away from Washington until Monday. They discuss possible times to request TV time for the President's speech. It is clear that on Friday afternoon the announcement was still planned for Monday night.

[11] Regardless of his economic knowledge, Connally's political skills are impressive.
[12] Unfortunately, the tape quality is particularly poor at this point and the conversation becomes unintelligible.
[13] During conversation 273-20 (above) Connally recommends not revealing at the Camp David meeting that a decision has been made and conduct the meeting in a way that everyone feels that they are part of the decision.

Taping equipment was not installed at Camp David until May 1972, so the conversations were not recorded. However, Haldeman's diaries (1994, pp. 340-346) record the gist of the proceedings. The Camp David meetings began Friday late afternoon. The key sticking point was closing the gold window, which Connally and Volcker supported and Burns strenuously opposed. Although the decision was ostensibly made, Haldeman writes that Nixon vacillated on this point and did not finally decide to close the gold window until Saturday, August 14. There is no indication of when it was decided to move the announcement forward from Monday to Sunday, August 15.

August 15, 1971 (7 – 122) Nixon and Connally in a telephone conversation following Nixon's address to the nation.

Connally tells Nixon that he had watched all three channels and CBS had done a great job. Connally quoted the CBS correspondent: "This is the domestic visit to Peking."

Nixon is now being applauded for both his domestic and international initiatives.

September 11, 1971 (7 – 122) Nixon, Burns and Connally. Less than one month into the 90-day wage and price freeze.

Planning for the post-freeze period is a major topic. Burns voices his opinion that the freeze of Phase I should be followed by a thaw—a gradual transition to restoring free-market pricing. Burns also indicates "we've got to have some sanctions" in Phase II. Nixon says "I think the thaw idea is quite intriguing." Regardless of what will follow Phase I, Nixon notes that the Administration must "give the idea that we have a plan, that we know what we are doing," and that "we know what we're doing and we're going to do it."

September 20, 1971 (577-3) Nixon and Burns.

Burns: "If you pass an unfirm (?) freeze, the restoration of [pricing] freedom, you'll lose the people. You've got to do it gradually."

Nixon: "Don't worry. [garbled] As a matter of fact, I'd like the freeze on right through the election."

The men acknowledge that the freeze has been very popular with the pubic and going back to free-market pricing could prove politically damaging. Nixon indicates that labor needs to be restrained in their wage demands, "They [unions] play too rough." Nixon, once adamantly opposed to price controls, is now, perhaps half jokingly, ready to freeze prices until the election. This sets the stage for a continuation of wage and price controls under Phase II.

September 24, 1971 (578-4) Nixon, George Shultz and Milton Friedman. The 90-day wage and price freeze has been in effect for over five weeks.

Friedman: "Now on the domestic side, there are two questions or problems. One is the technical problem of how you unwind the price control. [garbled] But I think there is a more fundamental or basic problem. The great danger lies in the path we are now on, is that, under cover of suppressing the inflation, the true inflationary forces will be increased. That's the real danger. Because the Congressman says, 'Why do we have to worry about inflation? Here's the CLC [Cost of Living Council], they're taking care of it for us.' Now that's a very real danger, because we want to look forward…"

Nixon: "They'll spend more."

Friedman: "They'll spend more. The same danger with the Fed. When it sat down, it could print more. Now from your point of view and our point of view, we want to look forward, not only to '72, but beyond that. We don't want, we all want a victory in '72, but we don't want a victory which has to be followed by a course of action that puts the Democrats in power for 20 years."

Nixon: "Yeah."

Friedman: "[garbled]… If you let the inflationary pressure build up over us, we might be able to hold it down at least through the election [in 1972]. [Garbled] After this, you'll have a great upsurge in inflation. And there would be again pressure to stepping on the brakes, hard again. We will have thrown away the advantage, what we gained with the cost of the 1970 recession. You'll have to have an even worse recession. And, if in 1974, your fortune is to superintend a severe recession, that's going to put the Democrats back in for 20 years. Now that's a horror story and I don't mean to say it's [garbled]. It's possible. Now the question is how to avoid it. And the key to avoiding it is our friend Arthur [Burns], as I was telling you last night."

Nixon: "Uh, huh."

Friedman: "Because Congress will not be able to, I think, prevent from spending and we'll have a whopping [garbled] deficit. And if the Fed monetizes that deficit and increases the quantity of money at anything like the way it did in the first six months of this year, I'm afraid that the scenario I've described is inevitable."

Nixon: "Well, let's just hope we don't convince Arthur to do it too soon." (Friedman laughs).

Nixon is worried that a tight monetary policy applied "too soon" would adversely affect the employment picture prior to the election. Shultz and Nixon express concern that the Fed had engaged in monetary "contraction" in the previous month. Friedman asserts that the month-to-month money supply numbers are not very meaningful and assures them that a robust economic recovery is underway. Friedman predicts that unemployment will not be a problem for the 1972 election and restates that the real problem is to keep the money supply growth in the 4-5 percent range so that inflationary pressures will not build up.

Later in this conversation, Friedman indicates that he opposes any quantitative numbers as guidelines for wage and price increases following the 90-day freeze of Phase I. He suggests that the Wage and Price Review Board be given power to delay wage and price increases for 60 or 90 days. This would, he said, produce "a cosmetic influence on the price index which is what you really want."

George Shultz reports that Arthur Burns advocates a specific guideline of 4 percent for wage increases during Phase II. The men discuss various problems associated with managing wages and prices and especially the problem that would likely arise with the labor unions that already have higher-than-guideline wage increases on their bargaining tables. Friedman offers a solution: Appoint Arthur Burns to head the Wage and Price Review Board. After a few seconds of awkward silence, Friedman says: "This would be poetic justice. He's the person that is most responsible for building this box. He should be chairman of the Board for getting us out." [The men now get the joke and laughter ensues]

While Burns had been the most public supporter of the wage and price controls, it was actually Connally who had built and sold the box to Nixon.

October 5, 1971 (584-3) Nixon, Connally, Shultz, McCracken and Stein meet to discuss the proposed plan for Phase II.

The President is in possession of a memorandum from Connally, Shultz, McCracken and Stein for their Phase II proposal. Connally informs the President that prior to reaching their decision that everyone was given an opportunity to speak their minds. If there was no consensus, the group planned to take a formal vote, but this was apparently not needed. The four men had all agreed that once the President decided on a policy for Phase II the President's decision would "bind us all."

The proposed goal of bringing inflation down to 2 to 3 percent by the end of 1972 is discussed. Nixon, who previously acknowledged that price and wage controls would not work, worries about the consequences of failing to meet the goal. Connally craftily tells Nixon that the onus of achieving the goal of 2-3 percent will not be on the President, but rather on the Pay Board. If the goal is not met, the President can "take them on" and "set new standards."

The President worries about the unions and wage contracts that had previously been agreed to, but were deferred as a result of the wage and price freeze. He fears labor will strike if these contracts are not honored. Connally suggests that these deferred increases in wages be permitted and taken as a "lump." These would be permitted before the end of 1971 and wouldn't go into the statistical computations for 1972. Consequently, Nixon is told, the wage increases wouldn't adversely affect achieving the goal of 2-3 percent inflation by the end of 1972. The President is also told by Connally that the wording of the goal is to achieve an inflation rate of 2-3 percent *by the end of 1972.* The election at the beginning of November gives the President "a little bit of running room" because there will still be 60 days to go before assessing whether or not the goal was achieved. Thus, Phase II was constructed so that the President would be blameless if the wage and price controls failed to achieve their goal.

October 7, 1971 (10-121) Nixon and Burns on the White House telephone. Nixon will address the nation that evening and announce the plan for Phase II.

Nixon: "Hi, Arthur."

Burns: "Good morning, Mr. President."

Nixon: "You were in New York yesterday so I didn't get a chance to talk to you. But I wonder if (senior White House speechwriter) Bill [Safire] has talked to you yet?"

Burns: "Yes, he has."

Nixon: "Great, Great."

Burns: "And I've made a few minor changes in language."

Nixon: " I wanted you to check the language."

Burns congratulates Nixon on reaching a quick decision on Phase II and voices his strong support.

Nixon: "As you know, they did bend to your wishes on setting the target of 2 to 3 [percent per year for output prices]."

Later in the conversation,

Nixon: "As a safeguard, I will ask the Congress [for standby controls on interest rates]. Now, that doesn't bother ya?"

Burns: " No, no. Mr. President, I don't think you have much of a choice."

The two men discuss the likelihood that Congress would insist on some interest rate controls to go along with wage and price controls.

Nixon: "Even John McClellan came in to see me, Arthur, very Conservative and running this year and he said, 'You got to do something about interest.'"

Burns: "Well, that's it."

Nixon: "Well, I said…the gobbly gook that we're doing something. 'Well, no, the people don't think so.' Well, let's say it [that we're doing something] and hope to God they [interest rates] go down."

Burns: " I know it. Well, I was with bankers yesterday, New York bankers, and I told them that we'd probably will have to go that way [interest rate controls]. But, we'll try to keep it on a voluntary basis and a lot will depend on them."

Nixon: "And also they'll trust you. But on the other hand, Arthur, if you get on the phone to call somebody, it's gonna have more impact than anybody else in this country. So you just do it. OK?"

Burns: "Well, I'm going to help as much as I can. This is terribly complex."

Nixon: " I appreciate it. And I'm going to slug it to them on the high level tonight [Nixon's public announcement of Phase II] and you do it at the low level, you know. But if you need to, kick 'em in the groin. [Nixon chuckles]."

Burns: "Mr. President, I haven't read your speech but I hope, I hope, the rhetoric is strong."

Nixon: "Don't worry, it's very strong [Nixon laughs]. Probably too strong, but it's strong. It just basically says we are going to continue. ...I'm not calling it a new program but I'm calling it a continuation of the old."

Burns: "Well now, *that's* the right emphasis."

Nixon: "See, now, basically it is new, but I say we are going to continue the program of wage [garbled]. That was the key thing I thought had to be in there. Remember you recommended that and I put it in."

Burns: "Right."

Nixon: "But I've got some lines in there that you'll like."

Burns: "Well, wonderful. [pause] Now we're getting some good economic news."

Nixon: "Wholesale prices is good."

Burns: "Wholesale price index. Have you seen the unemployment figure?"

Nixon: "I understand a little down."

Burns: "Just a little. Not enough, but…"

Nixon: "At least it didn't go up." [Burns laughs].

Burns: "Good luck tonight."

Nixon: "Thank you." [End of conversation]

Nixon does his best to make Burns feel that he is part of the team by pointing to the adoption of the inflation goal that Burns favored and by giving Burns the opportunity to fine tune the President's public announcements. Tactically, Nixon needs Burns on his side in order to keep monetary policy expansionary. Both men would like interest rates to fall, but ironically, their expansionary monetary policy would eventually do just the reverse by raising inflationary expectations. Had an investor or banker trusted Arthur Burns and invested in a 10-year Treasury bond on this date, she or he would have lost over 22% percent of the investment in real terms over the life of the bond due to the forthcoming unexpected inflation that made the real interest rate on the bond negative.[14]

October 29 (607-11) Nixon and Arthur Burns. Fifteen days before the initiation of Phase II.

Nixon and Burns discuss the problem with getting the labor unions to go along with the wage and price control program and strategize an appropriate response.

Nixon: "I'm having one hell of a time with this son of a bitch [George] Meany…"

Burns: "Now this is the problem."

Nixon: "You have to play cards."

Burns: "You have to play cards."

Nixon: "[garbled] Suppose he walks out?"

Burns: "All right, all right."

Nixon: "What would you do?"

Burns: "Well, well, the…"

Nixon: "Fight?"

Burns: "No, then, then, the, you go before the country and you indicate that you will now… [garbled]."

Nixon: "Freeze 'em again?"

Burns: "That, no, not yet, not yet, but you establish strength in spite of this, if restraint [garble], you put on a freeze [garbled]."

Nixon: "[garbled] as late, close to the election as possible."

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[14] At that time the yield on new medium-term Treasury bonds was about 6.1%. The average rate of inflation between October 1971 and October 1981 was 8.6%. Thus, the ex post pre-tax, real return was approximately -2.5%. The continuously compounded return is e^{-rt}, where r is -.025 and t is 10 years.

Burns: "Yeah. And the blame will be, I think, Mr. President, that the country is sick and tired of arrogance."

Nixon: "Oh, I agree."

Nixon's wage and price freeze was politically popular and he sees another opportunity to demonstrate his strong leadership by re-imposing a freeze close to the election if the unions fail to play cards. As time would prove, the country indeed would become sick and tired of the arrogance of power, but not so much against George Meany and the AFL-CIO.

December 22, 1971 (640-3) Nixon and Shultz. The men are later joined by Burns. Five weeks into Phase II.

Shultz discusses a recent conversation that he has had with Arthur Burns who is not present. Burns, Shultz tells the President, is upset about the recent nominee to the Federal Reserve Board. Burns' favorite nominee was passed over in favor of the number three candidate. Nixon explains his decision to Shultz and adds:

Nixon: "…I would not put someone on the Board that he [Burns] was totally against. I would not do that because I would not want to harm our money's worth—that he [Burns] can't control [the last phrase given in a near whisper]."

Later,

Nixon: "Now what about the money supply?"

Shultz: "He [Burns] agrees that the money supply should now go up."

Nixon: " Is he going to do it?"

Shortly after, Burns enters the room. After exchanging pleasantries, Burns eventually says "I've got Federal Reserve problems" and discusses his disappointment in the new nominee to the Board and details his concern that John Connally's views influenced the decision. Nixon details the decision process, which involved various political considerations (nowhere mentioning an "easy money" man, however), and assures Burns that "your views will receive primary weight" and that Nixon would never appoint someone Burns vetoes. Nixon says that as a rule he never considers candidates that an agency or department head vetoes. He offers Burns a confidential story about a Supreme Court nominee.

Nixon: "Between you and me, *he* [Supreme Court Chief Justice Warren Burger] was the one mildly opposed to a woman. He [Burger] said, 'Look, you can't sit nine people around and have a woman there.'[15] Now maybe that's going to change someday, but maybe... [garbled]."

Nixon once again makes Burns feel important and offered him a rather controversial insider story about Burger. After the men finish the discussion about the appointment process, the meeting seems to be wrapping up when,

Nixon: "[garbled]…I'm not going to raise this point, but these people have asked me about the money supply. Burns can take care of it. Correct? [garbled]"

Burns: "Burns is on the line."

Nixon: "Arthur, [garbled]. You're independent! [Burns laughs]. Independent! You get it up. I don't want any more nasty letters from people about it. OK?"

Burns: "That [no more nasty letters], I can't guarantee."

Later,

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[15] This story was relayed to Nixon by Attorney General John Mitchell. Nixon also reveals that he did not think it appropriate for him to speak directly to Supreme Court justices as he did to Burns.

Nixon: "The whole point is, get it up [the money supply]. You know, fair enough? Kick it!"[16]

Three months prior to this conversation, Milton Friedman warned Nixon [Conv. No. 578-4 above] about wage and price controls and the temptation they would provide for engaging in expansionary fiscal and monetary policies under the illusion of price stability. Burns is now "on the line" and "playing cards." Burns and Nixon are now doing precisely what Friedman warned against.

After Burns leaves the room, Nixon disparages Burns to Shultz by calling him a "little man" in his complaining about the Board appointee and particularly about Burns' concern that John Connally played a role in sabotaging Burns' pick for the Board. Elsewhere in the conversation, Shultz and Nixon discuss the latest inflation statistics. Over the previous twelve months, the inflation rate was 3.5 percent. Shultz points out that the year-to-year number will fall going forward (as wage and price controls were now in place). Nixon and Shultz discuss problems with the operations of the Cost of Living Council and the Price Commission. Nixon firmly claims: "I am totally committed to getting rid of both of them." Obviously, he was referring to some time after the election.

Nixon and Shultz also discuss a letter from Milton Friedman that apparently took aim on the Fed's already expansionary monetary policy. They are concerned that this might influence Burns to retract his promise to further increase the growth rate for the money supply. With Phase II set to operate through to the election, Nixon now focuses

[16] Burns, in fact, succeeded in getting the Open Market Committee to agree to a more expansionary monetary policy (Abrams, 2006).

his attention on keeping Burns to his word about delivering on the money supply (Abrams, 2006).

Concluding Remarks.

The Nixon tapes clearly indicate that Nixon cared little about inflation and was most concerned about unemployment: "I've never seen anybody beaten on inflation in the United States. I've seen many people beaten on unemployment." Wage and price controls, in his words, would produce at best a "cosmetic" effect and at worst "a terrible smothering to enter on this whole free economy of ours." Yet, on August 15, 1971, Richard Nixon announced a 90-day freeze on wages and prices that would get the federal government involved in controls for years.

John Connally proved to be the key player in devising Nixon's New Economic Policy and especially in convincing Nixon that wage and price controls were needed in order to demonstrate Nixon's bold leadership in tackling the inflation problem facing the nation. Connally clearly allied himself with Nixon in pressuring Arthur Burns "to pump it up." Nixon was prepared to "take on the Fed" and destroy its independence if need be to achieve the expansionary monetary policy he desired. The resulting monetary policy and expansionary fiscal policies contained in NEP did indeed throw "gasoline on the fire."

Milton Friedman played the role of Cassandra. He foretold of the dangers of wage and price controls, but his sage advice went unheeded and the political and economic drama unfolded just as he predicted. Arthur Burns, playing the tragic hero, detailed the arguments against adopting a more expansionary monetary policy, but under pressure of being the odd man out and seeing the independence of the Fed threatened, played cards.

It is said that just because you're paranoid, it doesn't mean they aren't out to get you. Similarly, just because you have inflationary expectations it doesn't mean they aren't rational. Given the inflationary policies of the Nixon Administration, "s.o.b." George Meany and the AFL-CIO seem to be the ones with rational expectations. Nixon noted that labor gets "too cocky" at an unemployment rate around 3 percent. Given that the unemployment rate hovered near 6 percent, wage-push inflation was not an issue, at least in Nixon's mind. The hypothesis that wage and price controls were imposed to break unwarranted inflationary expectations receives little support in the Nixon tapes reviewed here. Rather, wage and price controls were born out of political expediency and persisted due to their political popularity.

While Nixon was initially reluctant to accept the wage and price freeze, he soon turned into an enthusiastic supporter: "As a matter of fact, I'd like the freeze on right through the election." He worried that Phase II's goal of a 2-3 percent inflation rate by the end of 1972 would not be achieved, but the design for the program was such that Nixon could plausibly deny responsibility for any failure. However inefficacious Nixon thought wage and price controls would be, they satisfied his political imperative to "give the idea that we have a plan, that we know what we are doing…and we're going to do it."

The following excerpt from a personal email received from Milton Friedman on September 25, 2006, offers his insights into Nixon's wage and price controls:

> …Nixon worked in the Office of Price Administration during World War II and got a very negative opinion of price and wage control so in principle he was strongly opposed to wage and price controls. But as we all know, Nixon had the capacity of rising above principle if politics demanded it.

> My explanation of why he adopted price and wage controls… hinges on the crisis in foreign payments and the gold market that developed in the summer of 1971….The obvious solution was to close the gold window, that is to say, to end the agreement by the United States to provide gold on demand at the fixed official price. However, if the President did nothing else but simply close the gold window, he foresaw that he would get all sorts of negative publicity; he would be called the negative President; he shuts down; he doesn't open up, etc. So he yielded to the suggestions of John Connolly [sic] that he offer a major program of stopping inflation of which one part would be closing the gold window and another part would be the imposition of price and wage control. Connolly argued that he could sell that proposal as a far-reaching imaginative proposal instead of as a simple negative reaction to pressure from outside.
>
> In short, had there been no gold crisis, I believe there would not have been price and wage control on August 15, 1971. …I met with Nixon only once after August 15, 1971. On that occasion he emphasized his own distaste for wage and price control and assured me that they would get rid of them.

The tapes support Friedman's interpretation. Treasury Secretary John Connally faced an impending crisis resulting from balance of payments deficits and loss of gold reserves. He persuaded a reluctant President to suspend gold convertibility by combining the suspension of convertibility and floating of the exchange rate with a package of policies intended to stimulate the domestic economy and hopefully reduce the stubborn rate of unemployment. Connally correctly foresaw that the public would pay far greater attention to the domestic changes, especially Nixon's bold approach to fighting inflation by imposing wage and price controls, than to the international changes.

Richard Nixon arguably remains most remembered for the infamous Watergate burglary and subsequent cover-up that led to his resignation, but his manipulation of macroeconomic policy in the run-up to the 1972 election proved far more damaging to the nation. The recessions that were needed to break the Nixon-induced inflation cost the country hundreds of billions of dollars, redistributed enormous amounts of wealth from creditors to debtors and raised the risk premium in financial markets for years to come.

Surely, the costs to the nation of the Watergate burglary and subsequent cover-up were minor in comparison.

Table 1

Unemployment and Inflation rates

Date	Unemployment Rate	Inflation Rate (previous 12 months)
7-1-69	3.5%	5.4%
1-1-70	3.9%	6.2%
7-1-70	5.0%	5.7%
1-1-71	5.9%	5.3%
7-1-71	6.0%	4.4%

Source: St. Louis Federal Reserve Bank website at http://research.stlouisfed.org/fred2/ and authors' calculations. The inflation rate is based on the seasonally adjusted CPI for urban consumers and for all items; the unemployment rate is for the civilian labor force.

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