The political economy of wage and price controls: evidence from the Nixon tapes

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Abstract

In late July, 1971, Nixon reiterated his adamant opposition to wage and price controls calling them a scheme to socialize America. Yet, less than a month later, in a stunning reversal, he 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, provide a unique body of evidence to investigate the motivations for Nixon's stunning reversal. We uncover and report in this paper evidence that Nixon manipulated his New Economic Policy to help secure his reelection victory in 1972. He became convinced that wage and price controls were necessary to grab the headlines away from the defeatist abandonment of the Breton Woods Agreement and the closing of the U.S. gold window. Nixon understood the impact of his wage and price controls, but chose to trade off longer-term economic costs to the economy for his own short-term political gain.

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1. Introduction

In 1968, the newly elected President Richard Nixon inherited an inflationary economy that would soon enter into recession. Inflation, however, was much less of a concern to Nixon than the unemployment rate. "I've never seen anybody beaten on inflation in the United States. I've seen many people beaten on unemployment," he told Peter Peterson, Assistant to the President for International Economic Affairs.[1] Thus, Nixon sought expansionary monetary and fiscal policies in order to boost employment to the neglect of the inflationary consequences (Abrams 2007; Abrams and Butkiewicz 2012).

In 1970 and 1971, Nixon came under increasing pressure from various advisers to adopt an incomes policy or some form of wage and price control. Nixon, who had considerable experience with wage and price controls during World War II, resisted adamantly. In late July, 1971, Nixon reiterated his strong opposition to wage and price controls calling them a scheme to socialize America. Yet, less than a month later, in a stunning reversal, he 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, provide a unique body of evidence to investigate the motivations for Nixon's stunning reversal.

2. Pre-freeze conversations

[1] From taped conversation 546-2, July 26, 1971, White House Tapes, Nixon Presidential Materials Staff, National Archives at College Park, MD. In addition to the recordings available at the National Archives and Records Administration, the Nixon tapes are also available online at the Miller Center: http://millercenter.org/presidentialrecordings.

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 Advisers Chairman Paul McCracken.

Nixon notes that he had 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 admits to having engaged in expansionary monetary policy in 1970, his first year as Nixon's appointee to the Fed Chair, and seems to be worrying about the inflationary consequences in 1972 and beyond should an even more expansionary policy be adopted. Table 1 provides evidence that during Burns' first year as Chair of the Fed that the growth in monetary aggregates accelerated. Notably, no mention of a foreign exchange problem is made. At the end of this meeting, Connally asks about the Administration's position on wage and price controls and suggests his support. At the time, Congress was considering a bill to extend for another two years the President's authority to impose controls. This extension 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.”

Connally, Nixon’s newly appointed Treasury Secretary, soon would become Nixon’s trusted adviser.

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 any wage-price 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 Congressional 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 resisting Nixon’s attempts to pressure him into adopting an even more expansionary monetary policy.[2] 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.

[2] Ironically, review of the 1970 and 1971 Federal Open Market Committee minutes reveals that Burns consistently pressed for a more expansionary policy in spite of the stiff resistance he met from several inflation hawks on the FOMC.

March 5, 1971 (462 – 13). Quadriad[3] 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."

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."

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

Nixon to Connally: "Whenever you have anything to talk about, as you know … [Secretary of State William 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 as Treasury Secretary, Connally has become one of Nixon's closest advisers.

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,

[3] The Quadriad consisted of Nixon's four chief economic advisers: Arthur F. Burns, Chairman of the Federal Reserve Board, Paul McCracken, Chair of the Council of Economic Advisers, John B. Connally, Treasury Secretary, and George P. Shultz, director of the Office of Management and Budget..

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."

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."

Importantly, Connally expresses his concerns about the international situation and the balance of payments deficit. This issue eventually will play a pivotal role in pushing Nixon to favor wage and price controls. In all the conversations up to this point, no one has linked the worsening balance of payments problem to the expansionary monetary policy pushed by Nixon and undertaken by Burns.

March 18, 1971 (469 – 13). Nixon, H. R. "Bob" Haldeman, Nixon's Chief of Staff 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 continues to resist taking a more expansionary monetary policy.

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

This conversation is the first mention by Burns linking expansionary monetary policy to the worsening international monetary crisis. A country on a fixed-exchange-rate regime that engages in a relatively expansionary monetary policy would experience a balance of payments deficit and loss of international reserves. To correct the balance of payments deficit, the deficit country could purse a tighter monetary policy or persuade its trading partners to pursue more expansionary monetary policies. Neither of these remedies was being pursued. Instead, the deficits were being financed with international reserves. Figure 1 shows that U.S. international reserves including its gold reserves were in long-term secular decline.

[Figure 1 about here]

Between 1957 and 1971, the U.S. lost approximately 60 percent of its international reserve assets. Figure 2 shows that the problem was intensifying.

[Figure 2 about here]

Between June, 1970, and March, 1971, the U.S. lost approximately 8 percent of its gold reserves. Burns now raises the issue to Nixon that an even more expansionary monetary policy would worsen the balance of payments deficit and further accelerate the outflow of international reserves.

June 14, 1971 (519 – 11). Nixon, 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 (The Fisher Effect). Burns knows inflation is a problem and suggests energetic action on the wage-price front and a halt to fiscal expansion. The inflation rate in 1970 exceeded 5 percent (Table 1).

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 sometime 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 would ultimately succeed in influencing Nixon where Burns cannot.

[Table 1 about here]

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…"

Clearly, Nixon views Burns and the Fed as part of his Administration. Nixon has reaffirmed Connally's previous message to Burns. Burns has lost influence and is told to toe the line or keep quiet. 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. Yet, the link between monetary policy and the trade imbalance remains unacknowledged.

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 adviser is the Secretary of Treasury."

Connally agrees that Nixon should 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 going 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."

Nixon understood that the failure to allow the price system to operate creates a problem of how to allocate scarce resources and likely leads to rationing.

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 a program proposed by Connally and states that he wants to emphasize "making America competitive again."

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 (Conversation 553-6).

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."

When Nixon took office the unemployment rate was 3.3%. After efforts by Fed Chair William McChesney Martin to reduce money growth and inflation in 1969, the economy entered into recession in 1970 (Table 1). Unemployment rose to 6% and stubbornly remained there. The recession "bought" a very modest reduction in the inflation 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 Monetary Affairs, is added to the planning group at some point, but Burns is kept out.[4] 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.

July 28, 1971 (549-12). Nixon and Ehrlichman.

Nixon comments that in the 1940s and 1950s trade policy served foreign policy. He now feels that it is time for trade policy to serve domestic policy. He expresses his desire to negotiate bilateral deals requiring reciprocity that benefits the U.S. He observes that Shultz and the Council of Economic Advisers do not buy this kind of "stuff."

[4] In an earlier conversation (542-4) Nixon did not want to include Volcker because the President was uncertain about Volcker's position as Volcker was a Democrat.

During this conversation Nixon expresses his lack of faith in markets: "We do not live in a world in which the market works anymore."

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 of which you're confronted 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. Shultz, who is present, remains silent in this conversation, but it is reported in other conversations that he opposes both the wage-price freeze and the closing of the gold window.[5] Burns, who is not present, opposes the closing of the gold window and the wage-price freeze (273-26 and 273-30).[6]

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.

[5] In conversation 553-6, Nixon tells Haldeman that "George [Shultz] is a free trader and he just hates to give up on the idea." Haldeman responds "the one that bothers George the most is the closing the gold window and his line on it is probably…[it] will put you in the position of having to campaign as the President who devalued the dollar." Shultz, in discussing the freezing of wages and prices, notes their political popularity but calls it an "administrative nightmare" dsstined to produce "serious distortions." (Shultz and Dam 1977, p. 69).

[6] Although Burns favored wage and price controls or an incomes policy, he opposed an outright freeze. Wells (1994, p. 63) quotes Burns: 'There are times when in the dead hours of night, I find myself even thinking about a price and wage freeze. But when I rise and have a cup of coffee, I still don't want one."

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 New Economic Policy. 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.[7] 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. [8]

[7] 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."
[8] 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."[9]

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.[10]

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

Haldeman (1994, p. 340) writes 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 advisers at Camp David.

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.

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

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[9] Regardless of his economic knowledge, Connally's political skills are impressive.
[10] Unfortunately, the tape quality is particularly poor at this point and the conversation becomes unintelligible.

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. William Safire (1975, p. 520), a speechwriter for Nixon, reports that Nixon decided on Saturday morning to move the announcement from Monday to Sunday, August 15, and that Burns opposed suspending the gold standard (pp. 513-4).

Nixon's televised address to the nation announcing his New Economic Policy (NEP) takes place Sunday evening, 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.

3. Discussion

Yergin and Stanislaw (1998) claim that Nixon responded to Burns' urgings to adopt wage-price controls and that the climax was the August 13-15 meeting at Camp David. These are popular misconceptions. The tapes reveal that by this time Burns was totally marginalized and had no influence with the President. Nixon and his staff spent countless hours devising ways to manipulate Burns.

The purpose of the Camp David meeting was to co-opt all of Nixon's economic advisers into supporting the New Economic Policy. Nixon had already agreed to

Connally's plan. In an August 12 (273-20) meeting with Connally and Shultz, the Treasury Secretary advises the President on the Camp David strategy.

Connally: "Discuss it (the NEP) … as though you had not made the decision at all. And don't tell them you've made the decision. And let them all sit there and let them discuss it. …Let them all feel they're part of the decision."

The tapes reveal that John Connally proved pivotal in convincing the President to adopt NEP, including the wage-price freeze and subsequent controls. It is also evident that the plan was largely devised by others. The name most frequently mentioned in the days before the Camp David meeting, although not a White House insider, was Paul Volcker, then Under-Secretary of the Treasury for Monetary Affairs.

In a personal conversation, Paul Volcker discussed his role in devising the NEP. He confirmed that he had been working on plans to suspend gold payments and other policy changes for Secretary Connally. He said that the basic outline of the plan was in place for quite a while. He did, however, disavow support for the tariff, saying: "The import surcharge was Connally's idea. I kept taking it out and he kept putting it back in."[11] Nixon's NEP came from Treasury, not the Camp David meeting of August 13-15, and the motivating factor was the collapsing Bretton Woods system. Suspending convertibility and floating the dollar was the one part of the plan the president was most reluctant to adopt, although he finally agreed.

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

[11] January 8, 2008 phone conversation between Volcker and one of the authors.

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 [Conversation 578-4]. On that occasion he emphasized his own distaste for wage and price control and assured me that they would get rid of them.

In the prior two years leading up to NEP, 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.[12] 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%.

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

[12] 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 Advisers 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."[13] 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.[14]

Paul Volcker, the Undersecretary of Treasury for Monetary Affairs, wrote (1992) that he also believed that a freeze was necessary to break inflationary expectations. Volcker also thought tighter monetary and fiscal policies to reduce inflation were essential.[15]

An alternative justification for temporary wage and price controls relies on opportunistic political behavior (Nordhaus 1975; Alesina et. al. 1997). 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

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[13] Stein, "Wage and Price Controls: 25 Years Later," http://www.wsj.com/articles/SB840060795168291000.

[14] Incredibly, Stein (Ibid.) goes on to write: "It was a rather flaky theory, and we were not prepared for the possibility that it was wrong."

[15] In a phone interview Volcker recalled that he was unaware of the pressure Nixon exerted on Burns for an easy monetary policy. He was unhappy with the Fed's policy, which he felt should be fighting inflation.

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 conversations that provide an answer to this question.

The Nixon tapes clearly indicate that Nixon cared little about inflation and was most concerned about 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, assisted by Paul Volcker, proved to be the key White House player in pushing for the New Economic Policy. Connally was especially successful in convincing Nixon that the wage-price freeze and later 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 [money supply] 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."

One month into the wage and price controls, Milton Friedman visited the White House and played the role of Cassandra, foretelling the dangers of wage and price controls [578-4]. He warned that, under the illusion of price stability caused by the controls, policies would become more inflationary. His advice went unheeded and the political and economic drama unfolded just as he predicted.[16] 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.[17]

Nixon, in another taped conversation, noted that labor gets "too cocky" at an unemployment rate around 3%.[18] Given that the unemployment rate hovered near 6%, 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.[19]

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."[20] He worried that the goal of a 2-3% 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.[21]

Milton Friedman wrote: "In short, had there been no gold crisis, I believe there would not have been price and wage control on August 15, 1971." The tapes support Friedman's interpretation. Treasury Secretary John Connally faced an impending crisis

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[16] Conversation 578-4, September 24, 1971.
[17] Abrams (2006) and Abrams and Butkiewicz (2012). Wells (1994, p.51) also notes that Burns resisted any threat to the Fed's independence.
[18] Conversation 469-9, March 18, 1971.
[19] Administration economists including Arthur burns, Herb Stein and Paul Volcker wanted a freeze or controls to break inflationary expectations, but Nixon's acceptance was politically motivated.
[20] Conversation 577-3, September 20, 1971.
[21] Conversation 584-3, October 5, 1971.

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.

One of the most remarkable aspects of the history surrounding the development of NEP is the failure of the Administration's policy makers to link Fed policy in creating the two most serious problems NEP sought to correct: inflation and the balance of payments deficit. Nixon had pressured Arthur Burns into adopting an expansionary monetary policy that exacerbated both the inflation problem and the balance of payments deficit. Surely, the economists in the Administration were familiar with the Mundell-Fleming model that clearly pointed to the primary cause of the problems: an overly expansionary monetary policy. Within the fixed-exchange rate Mundell-Fleming model, an expansionary monetary policy, other things equal, would reduce the domestic interest rate and throw the balance of payments into deficit, draining away official reserves. The drain of official reserves (e.g., gold) would continue until monetary policy was reversed or until other countries also became more expansionary with their monetary policy. The Mundell-Fleming model supported the widely accepted proposition that an independent monetary policy under fixed-exchange rates was problematic. Closing the gold window and adopting a flexible-exchange rate system allowed changes in the exchange rate to take care of the deficit problem but price controls failed miserably in halting inflation.

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 unexpected inflation redistributed enormous amounts of wealth from creditors to debtors. Price controls produced widespread distortions and inefficiencies, as Nixon predicted, including oil shortages and long lines at gasoline stations in 1973. The Nixon-induced inflation finally was tamed but the recessions that were needed to accomplish this cost the country hundreds of billions of dollars in lost output (Abrams 2013, p. 118). Surely, the costs to the nation of the Watergate burglary and subsequent cover-up were minor in comparison.

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Table 1. Growth Rates for Monetary Aggregates, Unemployment and Inflation Rates, 1964-1972.

Year	M1	M2	Unemployment rate (Beginning of year)	Inflation Rate (year)
1963	3.6%	8.2%	5.7%	1.6%
1964	4.6%	8.2%	5.6%	1.6%
1965	5.2%	8.1%	4.9%	1.1%
1966	1.7%	4.2%	4.0%	1.9%
1967	7.2%	8.3%	3.9%	3.2%
1968	7.8%	7.9%	3.7%	4.7%
1969	3.8%	3.6%	3.4%	6.2%
1970	4.5%	7.4%	3.9%	5.3%
1971	6.8%	13.4%	5.9%	3.3%*
1972	9.3%	12.9%	5.8%	3.6%**
1973	5.0%	6.1%	4.9%	7.5%

Source: All data from St. Louis Federal Reserve Bank website at http://research.stlouisfed.org/fred2/ and authors' calculations. Data for M1SL and M2SL (seasonally adjusted monthly data, from January 1 to January 1 of each year). Inflation rate calculated from January 1-January1 consumer price index for all urban consumers (all items); unemployment rate is civilian unemployment rate. *Partial price control year; **Full-year price controls in effect.

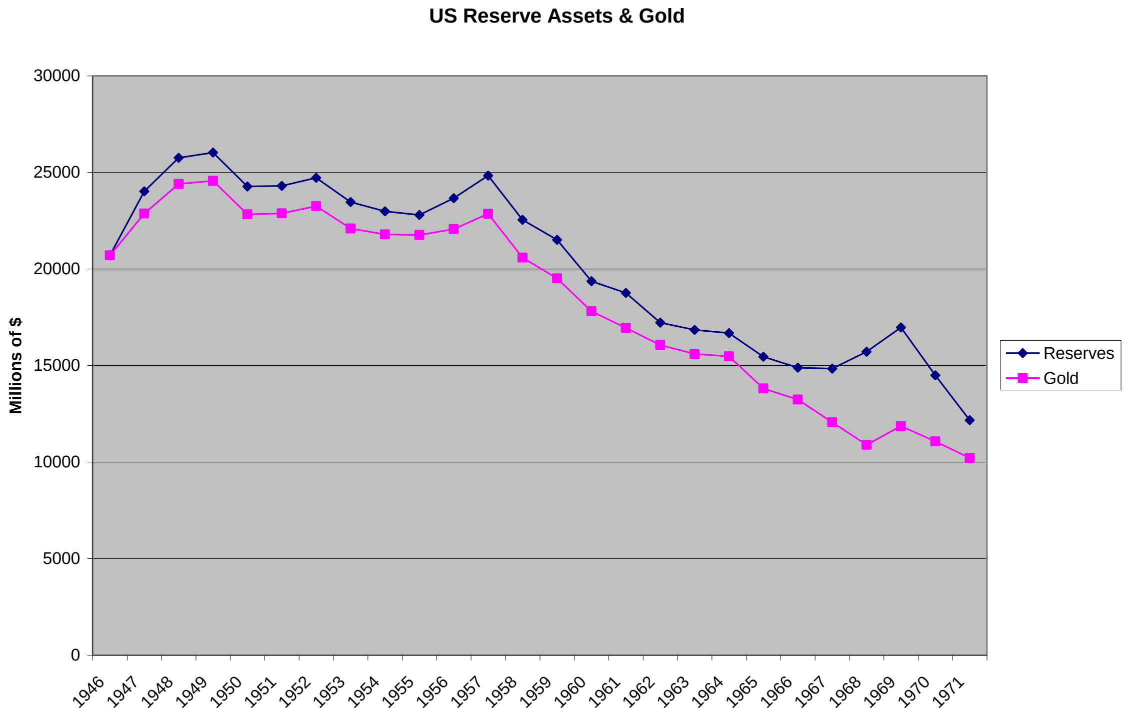
US Reserve Assets & Gold
Millions of $
30000
25000
20000
15000
10000
5000
0
1946
1947
1948
1949
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
1960
1961
1962
1963
1964
1965
1966
1967
1968
1969
1970
1971
Reserves
Gold

Figure 1

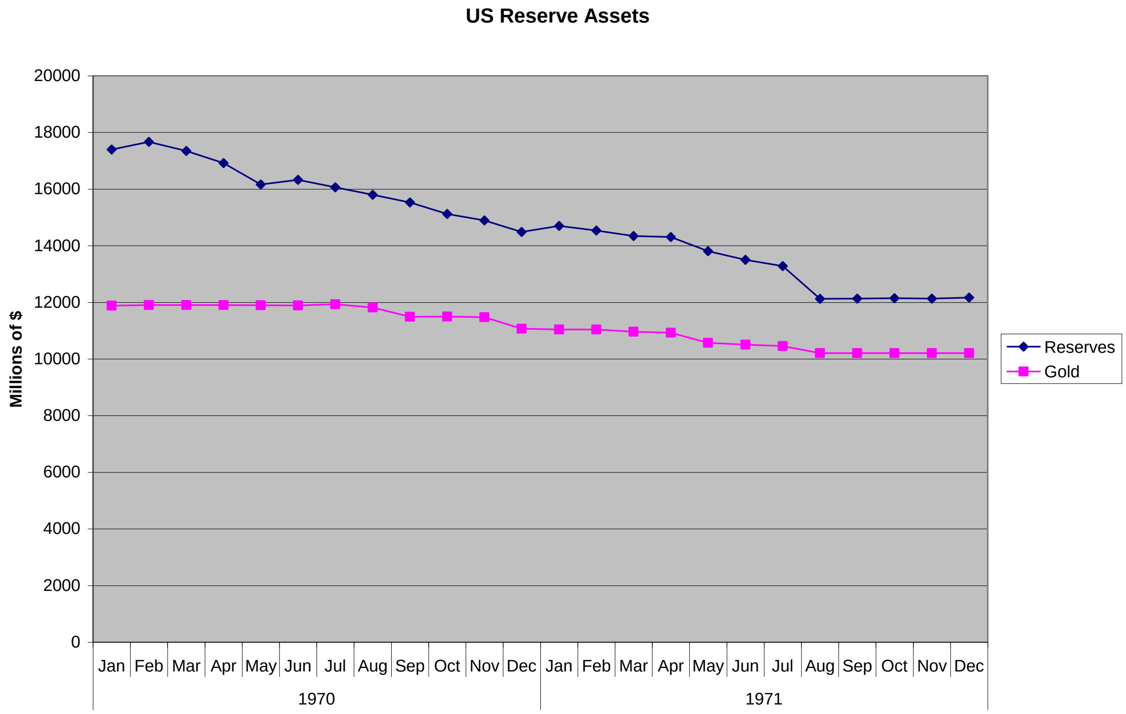
US Reserve Assets
Millions of $
20000
18000
16000
14000
12000
10000
8000
6000
4000
2000
0
Jan
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
1970
1971
Reserves
Gold

Figure 2