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THE POLITICAL BUSINESS CYCLE: NEW EVIDENCE FROM THE NIXON TAPES

By

Burton A. Abrams and James L. Butkiewicz

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The Political Business Cycle:
New Evidence from the Nixon Tapes*

Burton A. Abrams
abramsb@udel.edu

and

James L. Butkiewicz
butkiewj@lerner.udel.edu

Department of Economics
University of Delaware
Newark, Delaware
19716

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Abstract

Drawing from the personal tape recordings made during the presidency of Richard Nixon, we uncover and report in this paper new evidence that Nixon manipulated Arthur Burns and the Federal Reserve Bank into creating a political business cycle that helped secure Nixon's reelection victory in 1972. Nixon understood the risks that his desired monetary policy imposed, but chose to trade longer-term economic costs to the economy for his own short-term political benefit.

JEL Codes: E5; E3; E58

Key Words: Monetary Policy; Political Business Cycle.

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 (see, e.g., Alesina, et al., 1997).

Richard Nixon knew well the importance of economic conditions, especially unemployment, in affecting presidential election outcomes and blamed his narrow defeat in the 1960 presidential election on a weak economy. After winning the presidency in 1968, he became dissatisfied with secretarial minute-taking and secretly substituted tape recording devices in the White House. The tapes provide witness to the views and opinions of decision-makers that often conflicted with their public statements. The tapes reveal that Nixon, more than being a "Keynesian," as he once described himself, was a "Monetarist." He was well versed in the then-current monetary policy theory championed by Milton Friedman. He knew monetary policy's short-run effect on interest rates, its impact lag, and its longer-run effect on inflation. He believed firmly that monetary growth rates were crucial for changing aggregate demand and the unemployment rate in the short run. On the other hand, he and his close advisors showed little or no understanding of the effects of inflationary expectations on nominal interest rates and the distinction between real and nominal interest rates. Regardless, over the next several years, he obsessed about money supply growth rates and fought to get monetary policy sufficiently expansionary and nominal interest rates lower in a timely fashion to reduce unemployment prior to the 1972 election.

Since individuals visiting Nixon were unaware that they were being recorded, their views captured by the Nixon tapes are more likely to represent their true positions than their positions exposited in public forums. In this paper, we draw extensively from the Nixon tapes to reveal new evidence of successful presidential interference in monetary policy that produced an opportunistic political business cycle. The tapes reveal new details on how the Fed's independence was threatened and compromised to achieve Nixon's desired monetary policy for short-run political gain.

Monetary Policy 1969-1970.

In presidential-election year 1968, the unemployment rate finished low, but inflation was heating up (see Figure 1). With the election over and a Republican president in office, William McChesney Martin, Jr., chair of the Fed, tightened monetary policy by slashing money growth rates by approximately 80 percent (Figure 2) , but the inflation rate rose to over 6 percent. With tighter monetary policy in place, the economy entered recession in December of 1969. Martin's term with the Fed expired at the end of January, 1970 and President Richard Nixon appointed an old friend and party loyalist, Arthur Burns, to chair the Fed. Burns inherited an economy in the midst of an inflationary recession.

Burns' chairmanship, February, 1970-November, 1971.

In February, 1970, Burns took over the chairmanship of the Fed and monetary policy decidedly became more expansionary (Figure 2). Money growth rates for M1 and M2 in 1969, the last year of Martin's chairmanship, were 3.2 percent and 2.3 percent. In

1970, Burns' first year as chair, money growth rates for M1 and M2 accelerated to 5.5 percent and 8.1 percent.[1] By February, 1971, Burns had overseen a full year of monetary ease but Nixon pushed for still greater monetary expansion. Burns resisted.

February 19, 1971.

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."[2]

Burns is clearly acknowledging his view that further increasing the growth rates for the monetary aggregates in 1971 would worsen inflationary pressures in 1972 and beyond.

March 5, 1971.

Treasury Secretary John Connally joins Nixon in exhorting Burns to take a more expansionary stance, but again Burns resists.

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."[3]

Burns clearly indicates once again that he had, in his view, eased monetary policy sufficiently (despite the already inflationary environment) and acknowledges that

[1] These growth rates are computed using money stock measures reported in the March 1972 Federal Reserve Bulletin.

[2] Conversation 454-4, February 19, 1971. Nixon, Treasury Secretary John Connally, Burns, Shultz and Council of Economic Advisors Chairman Paul McCracken.

[3] Conversation 462-13, March 5, 1971. Quadriad meeting with Nixon, Burns, Shultz, Connally and McCracken. (The Quadriad comprised Nixon's four chief economic advisors.)

expansionary monetary policy would likely 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. Data reveal that rates had already fallen dramatically under Burns' chairmanship. The federal funds rate, for example, had fallen from over nine percent to under four percent (Figure 2).

Neither Connally nor Nixon is an economist, but they know the monetary policy appropriate for their political objective and that they want Burns to cooperate.

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."[4]

Nixon is clearly frustrated by Burns' independence and indicates he is prepared to "take on" the Fed to get his desired monetary policy. This is the first mention in the Nixon tapes concerning an explicit threat to the independence of the Fed. There will be more.

March 16, 1971.

Nixon and Connally discuss Burns. They discuss the need to rein in Burns and who should do it. Connally says he will talk to Burns and tell him to stay out of Connally's territory. He'll tell Burns, "If you want to maintain the independence of this Federal Reserve System, you oughtn't to be talking about wage and price policies and

[4] Conversation 462 – 15, March 5, 1971. Nixon, Chief of Staff H. R. (Bob) Haldeman and Connally.

fiscal affairs…it's not your business…sure you're knowledgeable about it, but what the hell, you're running the Federal Reserve now."

Also in this conversation,

Nixon: "…he is also wrong in terms of monetary supply, damn it! Everybody except Arthur thinks it [the money supply] ought to be higher and let's just keep hitting him on that…..He [Burns] must not do things that are going to embarrass the Administration."[5]

Contrary to Nixon's claim that "everybody" thinks the money supply should be higher, Nixon will hear (reported below) from Milton Friedman that monetary policy is already too expansionary. The embarrassment that Burns might inflict on the Administration is apparently to allow the unemployment rate to remain too high.

March 18, 1971

Connally reports to the President about his meeting with Burns. Connally's message to Burns was that Burns is losing his influence in the Administration. Connally told Burns, "If I read the tea leaves right, that isn't the way things are going. They're going the other way.' I said, 'you're isolating yourself more and more. … Normally the Treasury and Federal Reserve will be right together and that's the way I want it, but if you're going to isolate yourself, I can't go with you."[6]

Connally and Nixon are letting Burns know that he is rapidly becoming the odd-man out due to his opposition to increasing the growth rate of the money supply to stimulate the economy. Burns, by being too independent, is told he is isolating himself. Burns needs to get onboard with the Treasury (i.e., Connally) or face the consequences. One of the consequences, never explicitly mentioned, is that Burns' reappointment as Fed

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[5] Conversation 468 – 15, March 16, 1971. Nixon and Connally.
[6] Conversation 469 – 9, March 18, 1971. Nixon and Connally.

chair could be in danger. The position as chair is only for four years and Burns' term as chair would be up in February, 1974. Another consequence, one likely to have been of more importance to Burns, is a challenge to the Fed's independence.

Later that day, Nixon meets with Haldeman and Ehrlichman and praises Connally: "That's the only man that can stand up to Arthur [Burns]. … You tell him what you want, he does it." Nixon's admiration for Connally and disdain for Burns are both increasing.[7]

March 19, 1971.

Nixon stresses to Burns that monetary policy should be geared towards reducing unemployment in 1972 and that he is well aware of monetary policy's impact lag on economic growth and employment.

Nixon (to Burns): "We've really got to think of goosing it … late summer and fall of this year [1971] and next year [1972]. As you know there's a hell of a lag."[8]

March 19, 1971

Nixon and Burns meet. Burns is upset about criticism through press leaks. He emphasizes his loyalty to the President.

Burns: "I'm doing my basic job at the Fed [tape skips] I'm a dedicated man, to serve the health and strength of our national economy, and I've done everything in my power, as I see it to help keep pressing your reputation, your standing in American life and in history. I've never seen a conflict between the two. But I want you to know this, if a conflict did arise, the moment a conflict arises, I'm going to be right here [Burns bangs the table for

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[7] Conversation 469 – 13, March 18, 1971. Nixon and Counsel and Assistant to the President for Domestic Affairs John Ehrlichman.

[8] Conversation 470 – 18, March 19, 1971. Nixon and Burns.

emphasis]. And I'll tell you about it and we'll talk it out, and try to decide together where to go next."[9]

Burns is restating his loyalty to Nixon while acknowledging that policy differences exist between them. His tone suggests he might be amenable to compromise on his monetary policy stance. But for now, before "talking it out," he makes another pitch for rejecting a more expansionary monetary policy by introducing a new consideration.

Burns: "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 developing international monetary crisis. In terms of the Mundell-Fleming model, 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. Between 1957 and 1971, the U.S. lost approximately 60 percent of its international reserve assets. Between June, 1970, and March, 1971, the U.S. lost approximately 8 percent of its gold reserves. Burns worries that an even more expansionary monetary policy would worsen the balance of payments deficit and further accelerate the outflow of international reserves.

Under the existing Bretton Woods system where the U.S. dollar served as the reserve currency, other countries were obligated to absorb dollar reserves from U.S.

[9] Conversation 470 – 18, March 19, 1971. Nixon and Burns.

deficits, increasing inflation in these countries. Many expressed dissatisfaction with the U.S.'s refusal to adjust. In May, 1971, West Germany and the Netherlands floated and Switzerland and Austria revalued their currencies. This began a downward drift in the value of the dollar even before the floating of the dollar in August (Figure 3).

In his conversation with Nixon, Burns raises yet another justification for his resistance to easing monetary policy. He warns that lowering interest rates now would cause rates to increase during the election year, with the implication that the resulting damage to housing will hurt Nixon's reelection chances.

Burns: "If interest rates go down further through my actions…the probability as I see it is, they will go up later on in the year and in 1972. Housing which is recovering very nicely will go into a tailspin in 1972. Where will we be, as a country, and as a party and me personally?"

Again, Burns emphasizes the adverse longer-run effects on inflation and interest rates if the Fed eases monetary policy further. Interestingly, Burns doesn't indicate any distinction between real and nominal rates and it certainly isn't clear that rising rates caused by economic recovery or inflationary expectations would cause housing to go into a "tailspin." It is clear, however, that Burns does not want to conduct a more expansionary monetary policy and is coming up with as many reasons as possible to defend his position.

June 8, 1971.

Milton Friedman visits the White House for the first of two recorded conversations. He warns Nixon against using monetary stimulus to try to reduce nominal interest rates or unemployment.[10]

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."

Friedman's advice about the political costs of reviving inflation has no impact on Nixon whose primary concern is reducing unemployment. When Nixon took office the unemployment rate was 3.4%. The contractionary monetary policy in 1969 produced a recession in 1970 and the unemployment rate increased to 6% and stubbornly remained there. In July, 1971, one month after the Friedman visit, Nixon clearly reveals his interest in the unemployment rate and indifference to inflation by telling Peter Peterson, Assistant to the President for International Economic Affairs: "I've never seen anybody beaten on inflation in the United States. I've seen many people beaten on unemployment."[11]

June 14, 1971.

Burns, Connally, McCracken and George Shultz meet with the President. They debate the reason interest rates are moving up. Shultz and Connally both think the rates

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[10] Conversation 514-8, June 8, 1971. Nixon, Office of Management and Budget Director George Shultz and informal economic advisor Milton Friedman.

[11] Conversation 546-2, July 26, 1971.

are rising due to economic growth and that the Fed should keep rates lower to facilitate the expansion.

Shultz: "I guess I'm more in John's [Connally] camp than Paul's [McCracken] on what's happening in the economy … There is a good substantial expansion under way….To have a rise in interest rates in the face of the kind of monetary influx that Arthur's been providing means there's got to be a hell of a demand for credit. …That means there's something real behind it somewhere."[12]

Shultz reveals he thinks Burns has been providing a substantially expansionary monetary policy. Burns, rather than focusing on the economic expansion, chooses to focus on his inflationary fears.

Burns: "The lenders, fearing an intensification of the inflation rate are holding out for somewhat higher interest rates, because they'll be paid back in cheaper dollars." [13]

Burns' view is that inflation is rising and suggests energetic action on the wage-price front (wage and price controls were under consideration by the Administration) and a halt to an expansion in government spending. It's clear that Burns thinks the economy is overheating. The "old" Arthur Burns, author of *Prosperity without Inflation*, would have applied a tighter monetary policy, but he surely knows that this would have been vehemently opposed by Connally, Shultz and, most importantly, Nixon. Burns is shifting inflation fighting to tighter fiscal policy, constraints on increases in government spending, and to hoped-for wage and price controls.

July 3, 1971.

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[12] Conversation 519 – 11, June 14, 1971. Nixon, Burns, Connally, McCracken and Shultz.

[13] Shultz and Connally assert that the income effect exceeding the liquidity effect is increasing nominal interest rates while Burns feels rising nominal rates are due to increasing inflationary expectations.

Nixon and Shultz discuss a possible vacancy on the Federal Reserve Board. Nixon, wanting to increase the pressure on Burns, tells Shultz to inform Burns that he already has someone in mind for the position, although in fact he has not identified a candidate. Again Nixon seeks to manipulate the independent Fed chairman.

Nixon: "I'll tell you what I've done. I've told Connally to find the easiest money man he can find in the country. And one that will do exactly what Connally wants and one that will speak up to Burns… and Connally is searching the god damn hills of Texas, California, Ohio. We'll get a populist senator [sic] on that Board one way or another. …If you know of someone that's that crazy let me know too…I want a man on that Board that I can control. I really do. Basically that Connally can control…But Arthur's not going to name that man to the Board, George."[14]

The seven members of the Board of Governors are each appointed by the president to serve fourteen-year, non-renewable terms. A long term presumably allows a Governor the opportunity to put short-run political considerations aside when voting on monetary policy. Nixon's scheme to appoint a reduce-unemployment-at-all-cost Governor demonstrates how a presidential short-run goal can be injected into Fed policymaking.

July 24, 1971.

To further pressure Burns, Nixon tells John Ehrlichman and Bob Haldeman to leak a story through Charles Colson about a recommendation to expand the Federal Reserve Board, "Could you get one story leaked through the Colson apparatus about Arthur?... Recommendations are being made from among the President's economic advisors that ... recommended that the Federal Reserve Board .. the membership be

[14] Conversation 540 – 9, July 3, 1971. Nixon, Ehrlichman and Shultz

expanded…" Expanding the seven-member Board would weaken Burns' powers, especially if the additional appointees were loyal to Nixon.

Nixon also wants another rumor leaked, directly attacking the Fed's independence.

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: "Connally feels, John and Bob, that it'd be helpful… he thinks it might sort of worry Arthur a little."

While the Fed has considerable independence, its powers are derived from federal legislation. Laws can be changed and Nixon now spreads rumors that he may do so in a way that would reduce the independence of the Fed.

Nixon and Haldeman continue discussing two pending vacancies on the Federal Reserve Board. Nixon reiterates his desire to fill the positions with individuals who will support his desire for an easier monetary policy.

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

Haldeman: "George (Shultz) said both he and Connally are under orders from you to find the easiest money man in town."[15]

July 27, 1971.

Nixon reiterates his desire for a more expansionary monetary policy.

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[15] Conversation 545 – 3, July 24, 1971. Nixon, Ehrlichman and Haldeman.

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."[16]

August 4, 1971.

Connally reports to Nixon that Burns fears that Treasury is moving to take over the Fed. Connally reports that he told Burns it was not his goal. Nixon's leaked messages have gotten through. Burns is now clearly aware of threats to Fed independence, despite Connally's denial.[17]

August 12, 1971.

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 gold drain.[18]

Nixon is reluctant to suspend dollar convertibility and stalls:

Nixon: "…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."[19]

August 12, 1971

In spite of Connally's urging to accelerate the program, Nixon expresses his desire to call Congressional leaders back on September 7 and announce the program then. 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

[16] Conversation 547 – 9, July 27, 1971. Nixon, Connally and Peterson.
[17] Conversation 554 – 7, August 4, 1971. Nixon and Connally.
[18] 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."
[19] Conversation 7 – 112, August 12, 1971. Nixon and Connally.

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."[20]

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."[21]

August 15, 1971.[22]

Nixon gives a nationally televised address and announces his New Economic Policy (NEP). NEP's major provisions close the gold window, float the dollar, place a 90-day freeze on wages and prices and impose a ten-percent tariff on imports.[23] Although Arthur Burns was a supporter of an incomes policy that would include some form of wage and price control, the tapes reveal he played little or no role in the development of NEP. Connally, Pete Peterson and Paul McCracken were major supporters. The tapes reveal that Burns was strongly opposed to closing the gold window. Nixon who had long opposed price controls as unworkable was swayed by the political need to show something "symbolic" that he was fighting inflation and by the argument that the tariff on imports would adversely affect the inflation numbers. Importantly, the balance of payment and gold outflow problems were used by Burns to argue against Nixon's urgings to pursue a more expansionary monetary policy. NEP effectively eliminated this line of defense for Burns.

September 24, 1971.

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[20] Regardless of his economic knowledge, Connally's political skills are impressive.

[21] Conversation 273-20, August 12, 1971. Nixon, Connally and Shultz.

[22] Nixon and his economic advisors moved to Camp David that weekend to discuss a program that had already been decided upon. Taping equipment had not yet been installed at Camp David, so there is no indication of when it was decided to move the announcement forward from Monday to Sunday, August 15.

[23] While Connally is the leading advocate for the NEP, its true architect was Paul Volcker, except for the tariff. "The import surcharge was Connally's idea. I kept taking it out and he kept putting it back in." Telephone interview with Mr. Volcker by one of the authors, January 8, 2008.

Milton Friedman again visits the White House and warns of the inflationary consequences of the Fed's current monetary policy. Friedman's warns that NEP's wage and price controls would likely make the inflation problem worse.

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."[24]

Nixon: "Well, let's just hope we don't convince Arthur to do it too soon." (Friedman laughs).[25]

Nixon is worried that a tight monetary policy applied "too soon" would adversely affect the employment picture prior to the election. In this conversation, Shultz and Nixon also express concern that the Fed had engaged in monetary "contraction" in the previous month. Friedman asserts what later becomes conventional wisdom that 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. Friedman's advice falls on deaf ears.

Burns Blinks, November-December, 1971.

[24] Friedman proved correct in that the relaxation of controls and the 1973-74 energy crisis resulted in a surge in inflation. Slower monetary growth reduced inflation but contributed to the 1973-1975 recession that was a factor leading to President Ford's defeat. What Friedman could not foresee is that inflation and unemployment problems and the Iranian hostage crisis would undermine the subsequent Democratic President, Jimmy Carter.

[25] Conversation 578 – 4, September 24, 1971. Nixon, Shultz and Friedman. The 90-day wage and price freeze has been in effect for over five weeks.

Burns abruptly reverses his position on monetary policy and announces to a delighted Nixon two reductions in the discount rate on November 10 and December 10.[26]

December 22, 1971.

Nixon, ever distrustful of Burns' true intentions, queries George Shultz on his recent conversation with Burns.

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 (never mentioning the-easiest-money-man criterion, 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. 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."

[26] See Abrams (2006) for conversations announcing this change in policy.

Later,

Nixon: "The whole point is, get it [the money supply] up. You know, fair enough? Kick it!"[27]

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 ball. Burns and Nixon are now doing precisely what Friedman warned against. Burns' and the Fed's "independence" are now a source for jokes.

After Burns leaves the room, Nixon and Shultz discuss a letter from Milton Friedman that apparently took aim on the Fed's already expansionary monetary policy. They are concerned that Friedman's letter might influence Burns to retract his promise to further increase the growth rate for the money supply. With wage and price controls set to operate through to the election, Nixon now focuses his attention on keeping Burns to his word about delivering on the money supply (see Abrams, 2006).[28] Burns made good on his promise and continued the Fed's expansionary policies through 1972.

Concluding Remarks.

Richard Nixon craftily engineered credible threats to Burns' power and to the Fed's independence. By giving Nixon the monetary policy he desired, Burns removed the presidential threats to the Fed's independence. At the same time, the costs of engaging in a more expansionary monetary policy were reduced by Nixon's New Economic Policy (NEP) launched in August, 1971. NEP abandoned the Bretton Woods

[27] Conversation 640 – 3, December 22, 1971. Nixon and Burns. Burns, in fact, succeeded in getting the Open Market Committee to agree to a more expansionary monetary policy (Abrams, 2006).
[28] Conversation 640 – 3, December 22, 1971

fixed-exchange rate system. This meant that monetary policy could become more expansionary without further draining America's diminished gold supply, a previous area of concern for Arthur Burns. NEP's wage and price controls also meant that a more expansionary monetary policy wouldn't worsen reported inflation, at least in the short run. Arthur Burns may have believed an excessively expansionary monetary policy in the run-up to the election could be reversed after the election without seriously worsening inflation. Data reveal that the Fed indeed did reverse monetary policy in the year after the election by raising the discount rate in steps from 4.5 percent to 7 percent. But the reversal proved to be inadequate to extinguish inflationary pressures. Arthur Burns proved to be a good forecaster. In early 1971 he said, "If we flooded the banks even more than we have I think you could have awful problems in 1972 and beyond." The money supply surged in 1971 and 1972 and the stage was set for a decade of serious inflation.

The new evidence from the Nixon tapes presented in this paper provides support for the hypothesis that the excessively expansionary monetary policy conducted during the Burns-Nixon era was not the result of a simple policy miscalculation, but rather a politically motivated objective to reduce unemployment in the run-up to the 1972 election. The tapes reveal that Arthur Burns resisted accommodating Nixon's policy recommendations for many months, but suddenly acquiesced in November, 1971, after receiving various threats to the Fed's independence.

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Data Sources

Data for M2, the unemployment rate, the CPI inflation rate and the federal funds rate are from the Federal Reserve Bank of St. Louis – ALFRED database: http://alfred.stlouisfed.org/ ALFRED provides data series as of a specific date, or vintage.

M2 growth is vintage January 1975, and is computed using the original definition of M2, including currency, and checking, savings and small time deposits in commercial banks.

The inflation rate is computed using the vintage January 1975 CPI, 1967=100.

The unemployment rate is vintage January 1975.

The effective federal funds rate is never revised.

The G-10 exchange rate index is from the Board of Governors of the Federal Reserve System H.10 Statistical Release: http://www.federalreserve.gov/releases/H10?Summary/. This is the revised index as of 1978, which was discontinued at the end of 1998.

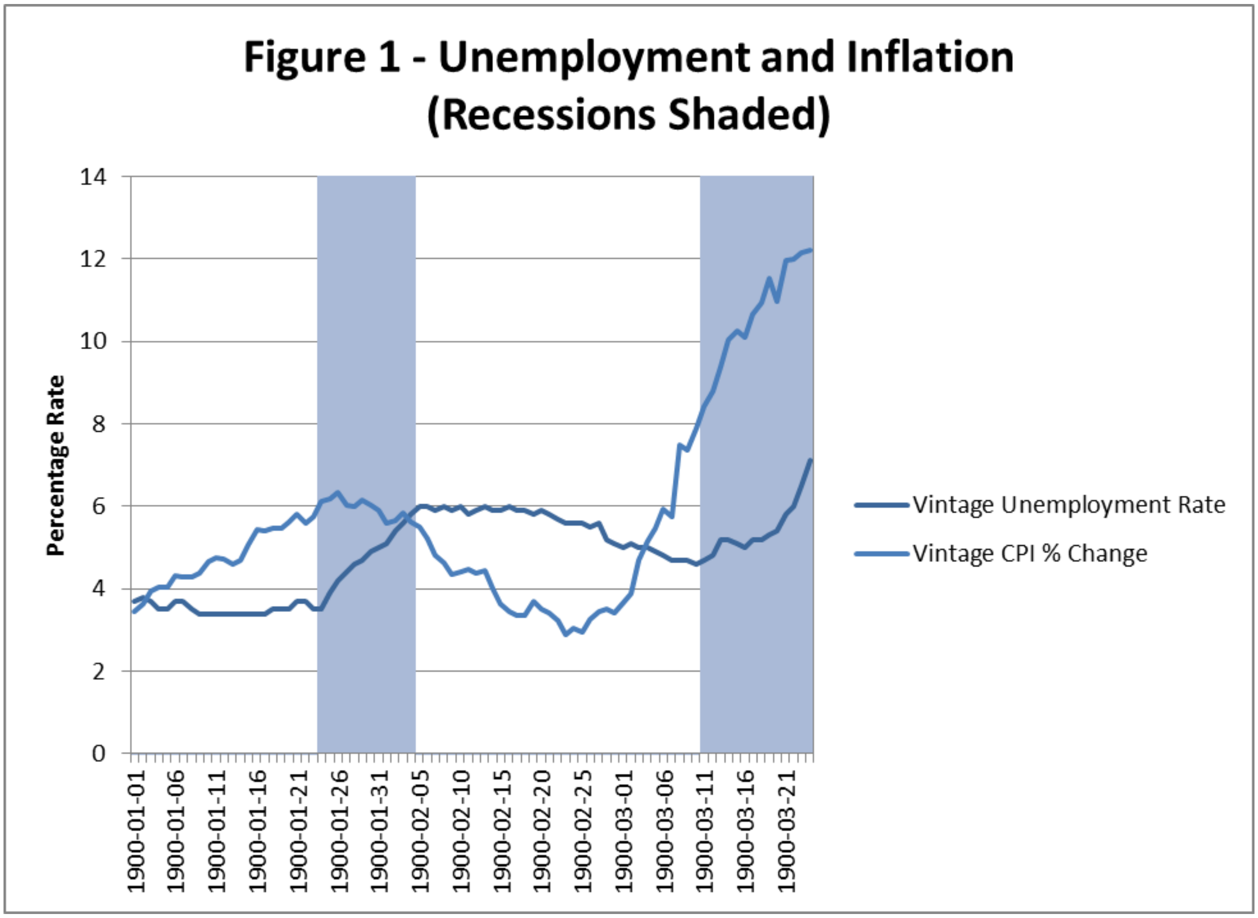
Figure 1 - Unemployment and Inflation
(Recessions Shaded)
Percentage Rate
14
12
10
8
6
4
2
0
1900-01-01
1900-01-06
1900-01-11
1900-01-16
1900-01-21
1900-01-26
1900-01-31
1900-02-05
1900-02-10
1900-02-15
1900-02-20
1900-02-25
1900-03-01
1900-03-06
1900-03-11
1900-03-16
1900-03-21
Vintage Unemployment Rate
Vintage CPI % Change

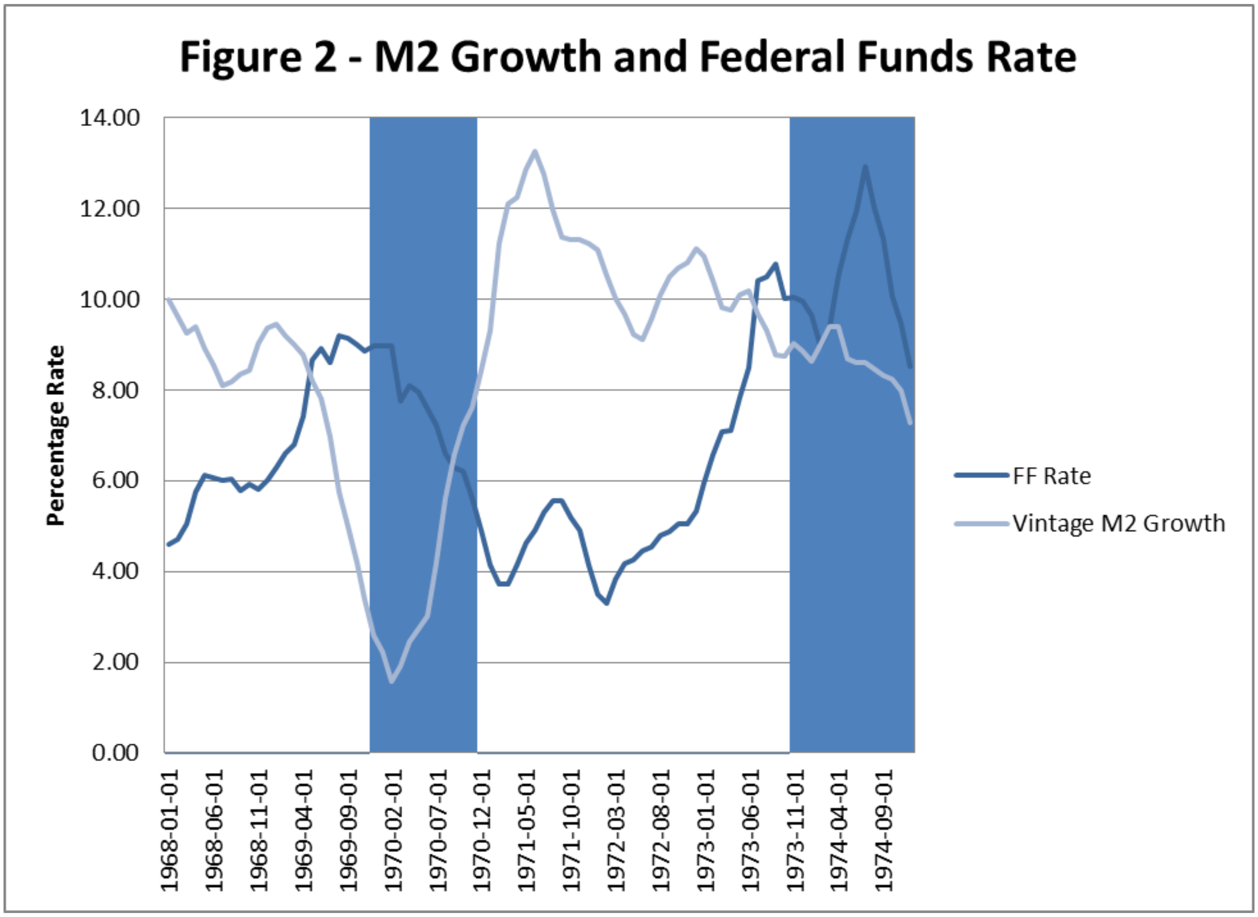
Figure 2 - M2 Growth and Federal Funds Rate
Percentage Rate
14.00
12.00
10.00
8.00
6.00
4.00
2.00
0.00
1968-01-01
1968-06-01
1968-11-01
1969-04-01
1969-09-01
1970-02-01
1970-07-01
1970-12-01
1971-05-01
1971-10-01
1972-03-01
1972-08-01
1973-01-01
1973-06-01
1973-11-01
1974-04-01
1974-09-01
FF Rate
Vintage M2 Growth

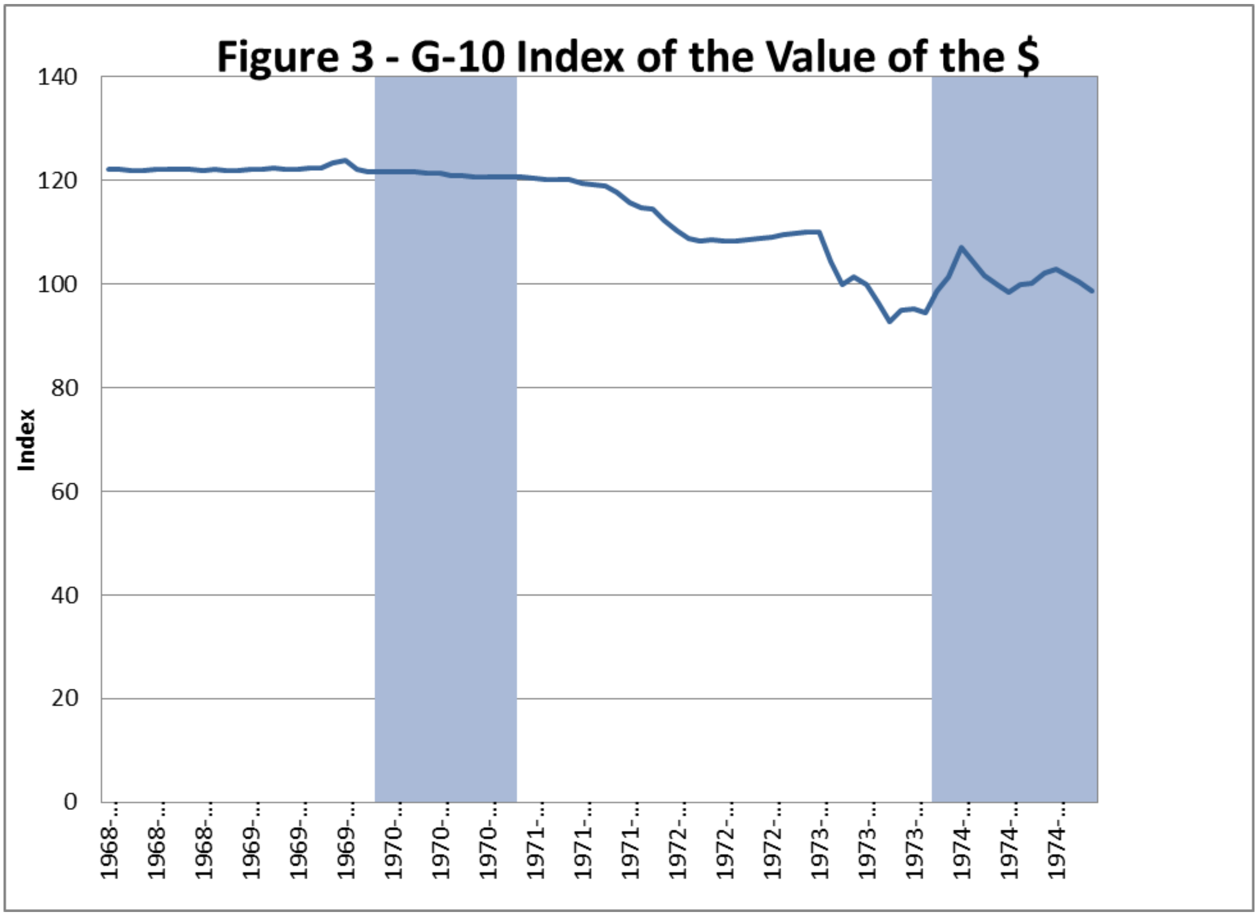
Figure 3 - G-10 Index of the Value of the $
Index
140
120
100
80
60
40
20
0
1968-…
1968-…
1968-…
1969-…
1969-…
1969-…
1970-…
1970-…
1970-…
1971-…
1971-…
1971-…
1972-…
1972-…
1972-…
1973-…
1973-…
1973-…
1974-…
1974-…
1974-…