Mitchell's Musings 10-15-12: Back Then the Question Was "What Now?"

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In past musings, I have taken advantage of the growing availability of "White House tapes" from the Nixon era.[1] Not surprisingly, given the history of the disclosure of the tapes during the Watergate affair, the focus of many tapes being made available involves that scandal. The search options provided are limited. It can be difficult to locate conversations dealing with subjects beyond Watergate or other "big" stories of the day such as the Vietnam War. Conversations dealing with economic policy can certainly be found but researchers must use proxies such as the names of participants who might have been involved in policy discussions or the dates when such discussions are likely to have occurred. Then it is necessary to look at online written outlines of the conversations – which often covered a variety of topics – to see if economic policy was actually discussed.

A major policy turning point occurred on August 15, 1971 when President Nixon announced in a TV address that he was unilaterally ending the Bretton Woods international monetary system of fixed exchange rates that had been established in 1944 at the tail end of World War II.[2] Bretton Woods was a fixed exchange rate mechanism under which all major currencies were linked to the U.S. dollar at set prices and the dollar was in turn linked to gold at $35/ounce. There are interesting historical reasons why the system was created in that format but the key point as of 1971 was that the dollar was overvalued at official exchange rates relative to other major currencies. That overvaluation required international authorities – central banks and treasuries – to intervene in the currency markets to buy up the excess dollars. As foreign authorities acquired a growing hoard of dollars, they were tempted to buy gold from the U.S. Treasury with those dollars, essentially speculating that the U.S. dollar would eventually be devalued and the price of gold would be raised. Thus, the American gold supply was dwindling.

Foreign authorities had agreed during the late 1960s to refrain from such speculative behavior but by 1971 their promises were being breached. Part of the August 15 announcement was that the "gold window" of the U.S. Treasury would be closed, so gold purchases could no longer be made there. Thus, the drawdown of the U.S. gold stock was halted. The dollar was allowed to float (presumably to depreciate) relative to other currencies. It was unclear what new agreement, if any, would be made with other countries on exchange rates. However, there was a general assumption that there would be negotiations through the International Monetary Fund (IMF) over a possible new system.

The other major element of the August 15 announcement was a change in domestic policy. In a dramatic change in direction, anti-inflation wage-price controls were imposed in the form of a 90-day freeze on wages and prices (Phase I). During the freeze, a new system of more flexible wage-price

[1] Not all of the tapes were recorded in the White House. Some were recorded in other presidential locations or are telephone calls.

[2] See http://www.youtube.com/watch?v=Wv4gpyfLF3s and http://www.youtube.com/watch?v=iRzr1QU6K1o.

controls was to be created. There were precedents for such a system from World War II and the Korean War and from foreign "incomes policies." In addition, the Kennedy-Johnson administrations had applied "voluntary" wage-price guidelines. However, it was assumed that the supposedly conservative President Nixon would eschew such interventionist policies. Indeed, on that assumption, the Democratic congress had given Nixon a legislative blank check to control inflation on the assumption he would not use that power. The notion was that in the upcoming 1972 presidential election, his failure to halt inflation despite the blank check would be an issue.

Given these two dramatic announcements in international and domestic macroeconomic policy, it might have been expected that five weeks after the change in course, there would be advanced planning underway a) to outline what a new exchange rate policy might be and b) to develop the details of the Phase II wage-price controls. In fact, however, a phone conversation of September 22, 1971 between then-OMB Director George Shultz and the President suggests that whatever planning had been going on was at an embryonic stage. I have posted the relevant excerpt from that conversation at http://www.youtube.com/watch?v=eQARcxRX0Kg

We learn five interesting things from the conversation. First, as noted, is the fact that five weeks into the 90-day period after which Phase II is supposed to come into existence, there was no Phase II. Shultz gently points out to Nixon that it will take time – once the conceptual details of Phase II are established – to create the necessary administrative machinery to operate the new program. Second, although there is no 90-day limit on creating a new world monetary order, the IMF was in fact meeting the next week. Presumably, the member nations of the IMF were expecting some kind of information from the U.S. on what would come next. But the President seems to view the IMF meeting as an interruption which would tie up key officials who might otherwise be doing more important things. So he suggests that everything (Phase II and planning on the international front) will have to wait until September 30 (six weeks into the freeze) after the IMF meeting is over.

Third, it is apparent that the President relies heavily on Shultz for counsel in economic matters although he has other economic advisors, notably Herb Stein, chair of the Council of Economic Advisors. At the end of the conversation, he indicates that Shultz might have Stein tag along on a plane trip in which some Phase II planning might be discussed. Stein is clearly to be involved in the planning but he seems to be less of an influence than Shultz.

Fourth, there are several references to Arthur Burns, chair of the Federal Reserve. Because of Federal Reserve independence, the Fed chair is not usually considered a part of the presidential administration even if he is appointed by the President. But Burns does seem to be expected to be involved in the ongoing economic planning. Indeed, Nixon indicates that Burns was a major driver behind imposition of wage-price controls and that whatever Phase II turns out to be will need to be sold to Burns.

A fifth component of the conversation involves gold. Prior to the Great Depression, private American citizens could hold gold. Gold coins were in circulation. However, during the early New Deal, President Roosevelt raised the official price of gold. To avoid giving windfalls to those holding gold, private gold was required to be sold to the Treasury at the old price and citizens could not hold gold (other than in jewelry, tooth fillings, etc.). During the conversation, the idea of ending the ban on private gold holdings is mentioned but the timing is said not to be right. This reference in the conversation suggests that although a new world monetary order had not been developed, the thinking in the Nixon administration was that in whatever might emerge, gold would no longer play a significant role. Whatever rationale there had been for the gold ban was now gone.

The world of expansive presidential economic power of 1971 seems quite different from the contemporary scene of much more constrained presidential authority. We noted in a prior post that the role of organized labor was viewed as important back then in the inflation process although – given the drop in unionization subsequently – no such view prevails today. If there is any similarity in that regard between then and now, it is in a reference to a dock strike on the West Coast which was underway at the time Nixon and Shultz spoke.

There are really only two industries nowadays in which a labor dispute could have a notable effect on the economy: longshore and railroads. Both sectors can disrupt commerce more generally by halting freight movement. Shultz and Nixon discussed the dock strike and the possibility of using a Taft-Hartley injunction to halt the strike.[3] (Shultz seemed disposed to let the strike continue without intervention because employers felt such federal involvement might weaken their hand in bargaining.) Some readers may recall that President George W. Bush imposed a Taft-Hartley injunction during a West Coast longshore work stoppage (a lockout) in 2002. But there is a difference, even in this seeming parallel, between the Bush and Nixon eras. In the Nixon era, the concern was partly over the more general disruption to commerce but also that a big pay settlement to end the dock strike could upset whatever wage controls might emerge in Phase II. Under Bush, there were no controls about which to worry and no thought that a big union settlement could cause inflation.

While it may be inevitable that the release of the Nixon-era White House tapes has focused on Watergate, it certainly would be helpful for those seeking to understand economic policy in that period if a more comprehensive search capacity was included. One view, of course, is that the past is the past and there are no lessons to be learned for contemporary economic policy. However, economic policy is often path-dependent and knowing where we came from can help us to understand where we are.

[3] The Taft-Hartley Act of 1947, enacted after a wave of strikes that followed the end of World War II, gives the President the authority – through a court procedure – to impose an 80-day "cooling off" period in the case of "national emergency disputes." Railroads collective bargaining is regulated by the Railway Labor Act which provides for a related procedure.