

# Creating More Fiat Money and Winning an Election

By  
Gregory Bresiger  
12/7/2001

Alan Greenspan is eulogized by media elites and many politicians as a magician who can create prosperity. But Greenspan, whose mentor was the disastrous Federal Reserve Board Chairman of the early 1970s, Arthur Burns, is playing a game that has come back to bite many of his predecessors.

Many of them either rigged monetary policy to serve political purposes or misread the monetary data and carried out policies that hurt the economy. Blundering, wrongheaded policies have been a trademark of central banks. In monetary policy, Greenspan believed, “it was very easy to be wrong even if you had virtually full knowledge. Someone who was right about 60 percent of the time would be very fortunate,”<sup>1</sup> he said.

Money mischief—a series of conscious or unconscious errors, errors often engineered by a manipulative Federal Reserve Board with the support of a president—will happen again sometime just as surely as there are periodic political scandals. Such is the nature of political power married to economic power that has existed as long as some well-connected banks were bestowed favors by politicians.

Politically oriented monetary policies and business cycles are the inevitable byproducts of the ultimate favored banking institutions, whose actions many politicians have seen as their savior as elections near. But more than pols believe in the powers of a central bank.

Implicitly, millions of Americans, many of whom have prospered from a bubble stock market in the 1990s that was created in part by the central bank, believe the Fed chairman and the Board of Governors are virtual magicians who can anticipate every contingency, despite Greenspan’s professed doubts. More important, many Americans believe that the nation’s top central banker expands or restricts the money supply in an independent manner; focusing only on what is best for the economy and that he is strong enough to resist political pressures.

But, like tens of millions Americans who were raised on the myths of the “successful” Social Security program and other canards of the modern American welfare state, so too many Americans do not understand that the controversial policies of the Fed have failed many times. These controversial central bank policies, which usually mean deflationary actions just after elections. They also entail the injection of a generous dose of inflation just before elections, which ostensibly results in short-term economic success.

This Potemkin Village effect leads to the re-election of a governing class because it appears to have the economic Midas touch. However, later, after the elections, comes the morning-after hangover: inflation runs amuck. The nation goes into a painful recession

---

<sup>1</sup> See *Maestro. Greenspan’s Fed and the American Boom*, by Bob Woodward, page 22, (Simon & Shuster, New York, 2000)

and usually the stock market crashes. Sometimes all three things happen at once. Whatever the extent of the damage, monetary policy is always the primary cause.

This cycle of disastrous money mischief has happened as presidents and Congresses have tried to rig monetary policies to coincide with their re-election campaigns. Traditionally, these pressures are exerted on the Fed Chairman by the president who put him in office. The president will decide if the chairman is re-appointed. Members of Congress will also exert their own pressure (the Fed, as a creation of Congress, is nominally responsible to it).

Congressional members often scream for the impossible: simultaneous low interest rates, low or no inflation, strong growth rates along with an absence of unemployment at the same time that government programs are expanding (a kind of the government can do everything mentality). But the greatest myth of our central bank is the idea that Federal Reserve chairmen are above politics; that the Fed pursues policies of an independent, apolitical central bank.

This is the story of one such episode of monetary mischief that occurred some 30 years ago. President Richard Nixon, one of his former aides wrote, agreed that this notion of the independent Fed was silly: “I know there’s a myth of the autonomous Fed,” the president said. Then Nixon barked a quick laugh, the aide reported.<sup>2</sup>

Richard Nixon—and the many pols of both parties who supported his push for expansive monetary policies in the early 1970s—had the last laugh on taxpayers, investors, foreigners holding lots of dollars that they thought were as good as gold, as well as those living on fixed incomes. All these groups would suffer during most of the 1970s and into the 1980s. It is also the story of how Nixon and others running for re-election in 1972 won elections that were paid for later through high unemployment rates, dangerously high inflation rates and a wrecked stock market that soured millions of investors on equities for a decade or more.

The inflation woes were conveniently blamed on the Arab oil producing nations, just as the spendthrift Christians in *the Merchant of Venice* blamed Jews for their habits of thrift. But it is ridiculous to scapegoat the Arabs for America’s inflation woes of the 1970s when the fault belongs with Nixon, the Congress, preferred big banks that profited from this political system and the politically-minded members of America’s central bank, all of whom, in various ways, poured gas on America’s inflationary fires.

In the disastrous aftermath of the monetary policies of the early 1970s, America would stumble through a decade of stagflation—low growth rates as well as high inflation rates coupled with high unemployment rates. That was something that Keynesian economists, the mainstream economic thinkers in post World War II America who were armed with the Phillips Curve, said could never happen simultaneously. Yet by the early 1970s that is precisely what happened.

---

<sup>2</sup> See John Ehrlichman’s *Witness to Power. The Nixon Years*, p 249, (New York, Simon & Shuster, 1982)

Stagflation came to America because the governing class, which wanted a quick economic fix, exerted pressure on the Fed for the 1972 election. The stock market didn't crash in one day, but it recorded a feral, slow deterioration. The market lost about 50% over an 18-month period of 1973 and 1974.<sup>3</sup>

This round of monetary policy through politics began when President Nixon, unhappy with the policies of Fed Chairman William McChesney Martin, who had followed a tight monetary policy, decided that he would not re-appoint him. Nixon opted to name his political ally, Arthur Burns, who had been serving as counselor to the president, to succeed Martin. Nixon blamed Martin for the recession of 1969 and 1970. Nixon was worried about his re-election in two years. Martin had also been Fed chairman in 1960. That's when tight monetary policies had caused a recession and cost him the presidential election, Nixon believed.<sup>4</sup> He thought it could happen again.

One of Nixon's economic advisers, Paul McCracken, was critical of Martin, saying, "they (the Fed) have a money supply expansion of 5%, but they keep missing—under shooting it."<sup>5</sup> This time Nixon was taking no chances. Burns' job as Fed chairman was to expand the money supply and create prosperity, or what might initially appear to the unsophisticated as apparent prosperity. However, even Nixon conceded there would be a price: "We'll take inflation if necessary, but we can't take unemployment."<sup>6</sup> In the end, of course, monetary mischief meant the nation suffered through high rates of both.

Burns became chairman at the Fed in early 1970. Almost immediately, Nixon started applying pressure. Commenting about the new Fed chairman, he told an audience that, "I respect his independence. However, I hope that independently he will conclude that my views are the ones that should be followed."<sup>7</sup> In private, Nixon's message was more blatantly political: Create more money.

"I must register with you, as strongly as I can, my concern that what really determines the result of an election is not interest rates, but unemployment statistics around election time.... [T] here is no doubt in my mind whatever that if the Fed continues to keep the lid on with regard to increases in money supply and if the economy does not expand...the blame will be put squarely on the Fed,"<sup>8</sup> he wrote the central banker.

Burns, a Republican, had few friends in Congress, which was controlled by Democrats. Nixon, who kept reminding Burns that he had appointed him, threatened to wage a public campaign against Burns if he didn't ease monetary policy. Stories were floated in the

---

<sup>3</sup> See *Stocks for the Long Run. A Guide to Selecting Markets for Long-Term Growth*, Jeremy J. Siegel, (Irwin, New York, 1994).

<sup>4</sup> *Monetary Policy and the Great Inflation in the United States. The Federal Reserve and the Failure of Macroeconomic Policy, 1965-1979*, Thomas Mayer, p 71, (Edward Elgar, Cheltenham, United Kingdom, 1999).

<sup>5</sup> Ehrlichman, p 251.

<sup>6</sup> Ibid, p 254.

<sup>7</sup> See *Secrets of the Temple. How the Federal Reserve Runs the Country*, William Greider, pp 340-341, (Simon & Shuster, New York, 1981).

<sup>8</sup> Mayer, pp70-71,

press that Nixon, taking a cue from FDR's abortive court packing scheme, was going to double the members of the Federal Reserve Board, which would have diluted the chairman's power. There was also a planted story that Burns wanted a \$20 thousand raise.<sup>9</sup>

The administration believed its policy of threats would be successful and that money creation would be faster in time for the presidential election. H.R. Halderman would privately brag in 1971 that, "We have Arthur Burns by the balls on the money supply."<sup>10</sup> Burns started to give ground.

Burns, several board members later said, would press for looser monetary policies in 1971 and 1972. The figures, which are available at the Federal Reserve Board's web site, confirm that the pace of money creation greatly expanded in 1972. Monthly money growth, which had averaged 3.2% in the first quarter of 1971, jumped to 11% in the same period of 1972. Money creation was 25% faster in 1972 compared to 1971.<sup>11</sup>

M1 currency, travelers checks, demand deposits and other checkable deposits, went from \$228 billion to \$249 billion from December 1971 to December 1972, a \$21 billion increase, according to Federal Reserve Board numbers. As a comparison, in Martin's last year, from December 1968 to December 1969, M1 rose from \$198 billion to \$203 billion. But the growth of M2 numbers---those measuring retail savings and small time deposits--was even more conspicuous. M2, between December 1971 and December 1972, jumped from \$710 billion to \$802 billion.<sup>12</sup>

By the middle of 1972, Burns and his allies at the Fed were flooding the market with new money. The Fed was going to do everything possible to ensure that 1972 would be a great year for the economy.<sup>13</sup> And it appeared to be a good year since the inflation rate---along with unemployment numbers---declined. Not only was "peace at hand"---the disingenuous phrase used by Nixon foreign policy adviser Henry Kissinger that led Americans to believe the war in Vietnam was over just before Nixon ordered a new round of bombing in December---but prosperity also appeared to be hand. Apparent peace and prosperity, of course, almost always benefit the party in power.

Nixon's Domestic Affairs Adviser, John Ehrlichman, later wrote that Burns understood what was wanted by the Republican administration: "Some economists are oblivious to political reality, but Arthur Burns was every bit as much a politician as he was an economist."<sup>14</sup> Sherman Maisel, a Fed governor in the early 1970s, said Nixon's pressure was heavy handed. "An election was approaching; from...[the Administration's] point of

---

<sup>9</sup> Ibid.

<sup>10</sup> Ibid.

<sup>11</sup> All these figures are available at the Federal Reserve Board site at [www.federalreserve.gov](http://www.federalreserve.gov).

<sup>12</sup> Ibid.

<sup>13</sup> Martin Mayer wrote recently, "The fact that the economic expansion stimulated by this rapid growth in the money supply helped Nixon win reelection was not, I think, far from Burns's mind." See Mayer's *The Fed. The Inside Story of How the World's Most Powerful Financial Institution Drives the Markets*, p183, (Free Press, New York, 2001)

<sup>14</sup> See *Witness to Power. The Nixon Years*, by John Ehrlichman, p 244, (New York, Simon & Shuster, 1982)

view, the faster the money grew, the better the monetary policy. This White House view seemed to affect some members of the FOMC who otherwise might have preferred a slower growth in money and higher interest.”<sup>15</sup>

While there is debate among some historians about whether Burns was compromised, there should be no disagreement on these points: Burns and the Federal Open Market Committee (FOMC) expanded the money supply much faster than under the prior leadership and, by 1973, the American economy was soon sputtering out of control because of high inflation rates.

Actually, only a month after the 1972 election—in which Richard Nixon had been re-elected, carrying 49 states and in which most Democrats in Congress were re-elected and all this well before the Arab oil boycott of late 1973—damaging double-digit rates of inflation were becoming apparent. At a speech in Toronto in December 1972, Burns said that, “the current inflationary problem has no close parallel in economic history. In the past, inflation in the United States was associated with military outlays during wars or with investment booms in peacetime. Once these episodes passed, the price level typically declined, and many years often elapsed before prices returned to their previous peak.”<sup>16</sup>

Burns said. Inflation would go to 8.8% in 1973, which was more than double the rate of the previous year. Later it would go to 12%. The inflationary spiral was unprecedented.

Something dramatic had changed in the American economy, Burns conceded. Inflation had become more than periodic; the result of some special set of events such as waging World War II. Now inflation was built into the American economy; it was becoming epidemic, a fact that even Burns had to concede.

“Over the past quarter century, a rather different pattern of wage and price behavior has emerged...The average level of prices, however, hardly ever declines,” Burns said.<sup>17</sup>

Two years later at a commencement speech at Illinois College, in the midst of a now brutal recession that was beginning to look as though the country could lapse into a depression, Burns complained that prices had been rising faster in peacetime than in almost any other period in the nation’s history. The United States could become another Weimar Republic, he warned.

“If past experience is any guide, the future of our country is in jeopardy. No country has been able to maintain widespread economic prosperity once inflation got out of hand,” Burns said.<sup>18</sup>

---

<sup>15</sup>From *Monetary Policy and the Great Inflation in the United States. The Federal Reserve and the Failure of Macroeconomic Policy, 1965-1979*. Thomas Mayer, p 71, (Edward Elgar, Cheltenham, United Kingdom, 1999).

<sup>16</sup>See *Reflections of an Economic Policy Maker*, by Arthur Burns, (American Enterprise Institute, Washington, D.C., 1978), especially “The Problem of Inflation,” pp 143-159.

<sup>17</sup> See Burns’ “The Menace of Inflation” from the same volume, pp 161-168.

<sup>18</sup> Ibid.

Besides a disastrous expansion of the money supply, which by the mid-1970s would give the country double-digit inflation, Burns was part of an administration economic team that constantly eschewed market forces. Burns, along with Treasury Secretary John Connally (a man with no economic qualifications, but who impressed Nixon as a wheeler dealer) also advocated and persuaded the administration to go ahead with an incomes policy as well as wage and price controls, all policies that were as bad as his easy monetary policies.

Said Ehrlichman of these policies: “When Arthur Burns and others persuaded the President to adopt an incomes policy and impose wage and price controls, it was from inception to fadeout as much PR as it was substantive.”<sup>19</sup> If these men were *laissez-faire* theorists, then one must count Herbert Hoover—who ran huge deficits in the midst of the Great Depression<sup>20</sup>—as another so-called advocate of free markets.

Burns, in his memoirs, complained that huge deficits were to blame for inflation, conveniently forgetting the role he played in the great monetary expansion of 1971 and 1972 and not mentioning the failure of wage and price controls. All these policies, which had the one common theme of greater government meddling in the economy, were failures.

Under Nixon, a popular president until the Watergate scandal broke, the federal government, by the early 1970s, was running huge deficits. Nixon announced that he was now a Keynesian in economics and proved it by severing the country’s currency from its last connection to the gold standard. He devalued the dollar, and, at the same time, imposed wage and price controls.<sup>21</sup>

The dollar had been under attack because many foreigners were losing confidence in it as the reserve currency that was supposedly as “good as gold.” Many foreigners holding big dollar accounts wanted gold. Nixon, also using a kind of *Merchant of Venice* reasoning, blamed the problems of the dollar on “foreign speculators.”<sup>22</sup> But the problem had nothing to do with speculation. The United States government, pursuing grandiose dreams of huge social welfare and military spending plans, was overspending, many of the world’s investors believed.

Nixon continued to fund the expensive Vietnam War even after “peace was at hand.” Despite Republican election rhetoric, he didn’t dismantle Lyndon Johnson’s huge Great Society programs. And, in a measure that would be as disastrous on the fiscal side as his monetary policies, Nixon, with bi-partisan support, greatly expanded Social Security in the midst of the aforementioned 1972 election.<sup>23</sup> He added a big election year Social Security benefit increase as well as indexing benefits to inflation.

---

<sup>19</sup> Ehrlichman, page 276,

<sup>20</sup> See Murray N. Rothbard’s *America’s Great Depression*, Los Angeles, Nash Publishing, 1972

<sup>21</sup> See *The Power of Gold . The History of an Obsession*, by L. Peter Bernstein, pp 348-350, (John Wiley & Sons, New York, 2000).

<sup>22</sup> Ibid, p 351.

<sup>23</sup> See my article on Social Security, “The Disastrous Deal of 1972.,” at Mises.com.

These moves were tremendously popular, but would cause the Social Security program to run huge deficits that resulted in big payroll tax increases later in the 1970s as well as in the 1980s and 1990s. The deficits led to further debasement the currency in order to keep these promises, a venal game played by governments and their allies throughout history.<sup>24</sup> However, most people who bore the brunt of those disastrous economic policies---the young people who would pay the high payroll taxes---did not vote in the 1972 election. Although the Social Security program was actually flawed in many ways from its beginnings, the Nixon bi-partisan Social Security policy expedited the problems of social insurance, problems that Americans, many of whom pay more in payroll taxes today than income taxes, face to this day.<sup>25</sup>

This familiar pattern of election-year monetary and fiscal skullduggery has been repeated many times. There is short-term political success and long-term economic disaster as a result of their flawed policies. When the bill for these policies comes due, there is usually comparatively little outrage against the Fed or the policies of big government that required monetary expansion. This is the result, in part, of widespread economic illiteracy as well as the backing of inflationary policies by intellectual elites. They support the policies of inflation because they have an intellectual and economic stake in their continuance.

The persistence of these policies is also, in part, caused by a widespread prejudice that inflation--at least at so-called moderate levels of it--is good for an economy. Keynesians see as a magical formula for beating the business cycle. Indeed, many more socialistically inclined have mistakenly recommended inflation not only as an economic stimulant, but as a backdoor method of redistributing income.<sup>26</sup>

Few people at the beginning of the political business cycle see inflation for it what it is: It is a hidden tax that is always the result of central bank and the policies of its favored banks.<sup>27</sup> Who today remembers Arthur Burns' role in the great inflation of the 1970s? Richard Nixon today is despised for Watergate or for continuing the useless immoral Vietnam War. Few even understand how his re-election hurt their wallets. For them, it

---

<sup>24</sup> For more on how modern governments over-promise on social insurance programs in order to win elections, see the chapter on Social Security in F.A. Hayek's *The Constitution of Liberty*, (University of Chicago Press, 1960).

<sup>25</sup> Ibid, All the problems of modern Social Security systems were predicted in that same prescient chapter.

<sup>26</sup> Greider in "Secrets of the Temple" is frank in advocating this Keynesian method of robbing Peter to pay Paul method. Greider actually eulogizes the 1970s inflation as a good thing: "Inflation particularly benefited the broad middle class of families that owned their own homes, depended on wages for their income, not on interest and dividends from financial assets." There's lots more on this theme of inflation as a wonderful thing. See pages 41-45. Of course, Greider ignores the dangers of inflation---once one unleashes it, it is very difficult to control. As F.A. Hayek has written, inflation is like riding a tiger and it is hard to jump off.

<sup>27</sup> Wrote Ludwig von Mises: "It is important...not to confuse the consequences of credit expansion proper and those of government made fiat money inflation." See *Human Action. A Treatise on Economics*, p571, (The Foundation for Economic Education, Irvington-on-Hudson, New York, 1996).

was all the fault of the Arabs or of President Charles DeGaulle and the French. They sold dollars and complained that they were not as good as gold.

Millions of Americans believed inflation was caused by speculators or greedy rich people who spent money too fast, or the fault of Arab sheiks. That's even though it was Arabs and others holding petrodollars who had been hurt by the devaluation of the dollar. *The Wall Street Journal* declined to buy into the bogeyman theory of American inflation: "OPEC got all the credit for what the U.S. had mainly done to itself."<sup>28</sup>

Have Americans---who overwhelmingly re-elected Richard Nixon as president in 1972 because they were seduced, in part, by his monetary and fiscal legerdemain that appeared to have produced a strong economy--- learned the lesson of politicized monetary and fiscal policies?

There have been proposals to limit the dangers of a central bank. Economist Milton Friedman has argued in favor of an automatic pilot, a computer that would be responsible for picking the exact amount of money creation to keep politics out of the formula.<sup>29</sup> Of course, this sort of reform begins with an immediate shortcoming---in an electronic age one must ask how does even measure what is money?

More important it is, I believe, for the average citizen to realize that, as economist Vera Smith<sup>30</sup> has written, a central bank is an artificial creation. It is an imposition of politicians often working in concert with politically oriented business people. The latter believe their success will come, not from initiatives in the marketplace, but from favors provided by pols with itchy palms. When Nixon wanted more money he wasn't only speaking of campaign contributions. A central bank is bestowed with such dangerous powers and favors that its potential to impose damage on the economy---from misreading the economic data to the out and out distortion of economic data—is huge.

Before any reforms should be entertained, Americans must study the record of these dangerous and ant-democratic institutions called central banks. Those who proclaim their belief in liberty should understand that, just as our military industrial complex is inimical to our liberties, so, too, a central bank is as much a threat to our economic liberty as a Cromwell is to a nation's political liberties.

Gregory Bresiger is a writer and editor with *Traders Magazine*. He who holds a graduate degree in history, and has also written for the *Journal of Libertarian Studies* as well as *the Freeman* and the *New York Post*.

---

<sup>28</sup> *The Wall Street Journal*, January 30, 1986.

<sup>29</sup> See *Money Mischief. Episodes in Monetary History*, by Milton Friedman (Harcourt Brace Jovanovich, Orlando, Florida, 1992).

<sup>30</sup> "A central bank is not a natural product of banking development. It is imposed from outside or comes into being as the result of Government favours." See *The Rationale of Central Banking and the Free Banking Alternative*, by Vera C. Smith, p 169, (Liberty Fund, Indianapolis, 1990)

