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[*Fed Watching for Fun and Profit*](#)

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Chapter 3 **Arthur Burns and G. William Miller: The Hapless Inflators**

Fueling the Great Inflation

Arthur Burns served as Fed chair from February 1, 1970 to January 31, 1978 under Presidents Richard Nixon, Gerald Ford, and Jimmy Carter. Burns was an academic, and the first PhD macroeconomist to head the Fed. He taught economics at both Rutgers University (starting in 1927) and Columbia University (1945), having earned his PhD at the latter.

As a doctoral student at Columbia, Burns studied under Wesley Clair Mitchell, a founder of the National Bureau of Economic Research (NBER) and its chief researcher. Mitchell brought Burns into the NBER, where Burns began his lifelong research into the business cycle. Together, in 1946, they published *Measuring Business Cycles*, which introduced the characteristic NBER methods of analyzing business cycles empirically.³² It was Burns who started the NBER's academic tradition of determining recessions—a role that has been continued by the organization's Business Cycle Dating Committee. The NBER remains the preeminent authority on dating recessions.^[33]

Burns served as president and chair of the NBER at points throughout his teaching career. He also chaired the Council of Economic Advisers (CEA) from 1953 to 1956 under President Dwight Eisenhower. The CEA was established by the Employment Act of 1946, which stated that it is the responsibility of the federal government to create “conditions under which there will be afforded useful employment for those able, willing, and seeking work, and to promote maximum employment, production, and purchasing power.” The CEA was created to help President Eisenhower and successive Presidents make sure another Great Depression would never happen. The CEA provides the President with objective economic analysis and advice on the development and implementation of a wide range of domestic and international economic policy issues.

The council's chairman is nominated by the President of the United States and approved by the US Senate. The CEA members are also appointed by the President. The staff of the council includes about 20 academic economists, plus three permanent economic statisticians.

The council is one of the most prestigious destinations in Washington for academic macroeconomists to spend a couple of years as policymakers. An even more prestigious perch is the Board of Governors of the Federal Reserve System. Sometimes, the top CEA job leads to an even more powerful post, chair of the Fed. Arthur Burns, Alan Greenspan, Ben Bernanke, and Janet Yellen all had served as chairs of the CEA before becoming Fed chair. (See Appendix 3, Chairs of the Council of Economic Advisers, 1946–Present.)

When Nixon was elected President in 1968, he persuaded Burns to become his White House counselor, with the understanding that Burns would be appointed chair of the Fed when William McChesney Martin's term ended in early 1970.[34]

Burns assumed leadership of the Federal Reserve in the middle of what would later become known as the "Great Inflation," which lasted from 1965 to 1982 (Fig. 3).[35] During this period, the inflation rate, based on the year-over-year percent change in the consumer price index (CPI), rose from 1.0% in January 1965 to peak at a record high of 14.8% during March 1980. Over the next three years, it subsided remarkably quickly, to 2.5% in July 1983, thanks to the unprecedented moves by Burns' successor, Paul Volcker.

Many Americans who lived through the Great Inflation remember the worst of it as a time of gasoline rationing and long lines at the gas pumps. Paychecks didn't stretch nearly as far at the grocery store as they had before. It seemed to many that the inflation genie wreaking economic havoc could never be put back into the bottle.

Let's take a look at some of the reasons that US inflation spiraled out of control:

- **The dissolution of the Bretton Woods system of international currency management caused an immediate inflationary shock to the US economy in 1971.** On August 15, 1971, Nixon suspended the convertibility of the dollar into gold, which ended the Bretton Woods system that had kept the dollar's value at a constant \$35 per ounce of gold since the system was established in 1944. All other currencies were pegged to the dollar, so other countries could present their dollars to the United States and receive gold in exchange.

By the summer of 1971, this system was no longer viable because other countries collectively had three times more dollars than the United States held in gold. Theoretically, if they all had chosen to redeem their dollars at once, the United States would not have been able to come up with enough gold. That's because the United States was running a mounting balance-of-payments deficit.

Facing a crisis of confidence within the global financial system, the United States simply closed the gold window, refusing to exchange the foreign central banks' dollars for gold. Foreign currencies were no longer pegged to the dollar or to gold. It was a free market. The value of the dollar in foreign exchange markets suddenly plummeted, causing spikes in import prices as well as the prices of most commodities priced in dollars (Fig. 4). Gold is such a commodity, and its price soared (Fig. 5).

- **Nixon's price-control measures were ineffective solutions.** 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, he imposed the first and only peacetime wage and price controls in US history. Nixon's stunning reversal was driven by political considerations as the 1972 presidential election was approaching. A 90-day freeze was followed by nearly 1,000 days of measures executed in four phases. Price controls were applied almost entirely to the biggest corporations and labor unions, which were deemed to have price-setting power. However, when these companies and unions requested price increases, most of them were granted. The controls were lifted in 1973.
- **There were food, oil, and labor price shocks.** During the 1970s, several price shocks exacerbated inflation. During 1972 and 1973, for the first time since the Korean War, farm and food prices began to contribute substantially to inflationary pressures in the economy. Also, there was a major oil price shock during 1973 and again in 1979.

On October 19, 1973, immediately following Nixon's request for Congress to make available emergency aid to Israel for the conflict known as the "Yom Kippur War," the Organization of Arab Petroleum Exporting Countries (OAPEC) embargoed oil sales to the United States. On January 16, 1979, the Shah of Iran was forced to leave his country. He was replaced as leader soon after by Ayatollah Khomeini. The country's oil output plunged, and inflation soared around the world along with oil prices.

Together, the two oil price shocks of the 1970s caused the price of a barrel of West Texas crude oil to soar 11-fold from \$3.56 during July 1973 to a peak of \$39.50 during mid-1980, using available monthly data (Fig. 6). As a result, the CPI inflation rate soared from 2.7% during June 1972 to a record high of 14.8% during March 1980. Even the core inflation rate (i.e., the rate excluding food and energy) jumped from 3.0% to 13.0% over this period as higher energy costs led to faster wage gains, which were passed through into prices economy-wide. During the 1970s, strong labor unions in the private sector succeeded in quickly boosting wages through cost-of-living clauses in their contracts. The result was an inflationary wage-price spiral (Fig. 7).

- **The Fed's monetary response under Burns was inadequate too.** Monetary policy during this period helped spur a surge in inflation and inflation expectations. The Fed did raise interest rates, but the rate hikes were widely viewed as too little, too late to stop higher prices from spiraling into higher wages. The Fed was increasingly criticized for being behind the curve.

According to *The Economists' Hour* (2019) by Binyamin Appelbaum, "Burns told Congress he doubted the Fed had the power to control inflation, which he blamed on the excessive wage demands of labor unions." He also kowtowed to Nixon, who told Burns during one Oval Office meeting, "Err toward inflation." [36]

Under Burns, the Fed responded to the first oil price shock by raising the federal funds rate from a low of 3.18% during the week of March 1, 1972, to a then-high of 13.55% during the week of July 3, 1974 (Fig. 8). The discount rate, at which commercial banks could borrow funds from the Fed, was also raised to a then-record high of 8.00% on April 25, 1974 (Fig. 9). The prime rate offered by banks to their most creditworthy borrowers peaked at a then-record high of 12.00% on July 5, 1974 (Fig. 10). The result was a severe recession from November 1973 to March 1975 that caused the Fed to reverse course, lowering the discount rate from 8.00% to 7.75% on December 9, 1974. The discount rate was cut six more times to 5.25% by November 22, 1976. The federal funds rate fell from 9.00% to 4.75% over this same period.

At the end of his second term, late in 1977, Burns asked to be reappointed for another four years, but no such luck. I think President Carter didn't much like the Fed chair, maybe because he came across as an arrogant, pipe-smoking professor. Instead, Carter appointed G. William Miller, the chief executive of Textron Corporation.

Setting the Stage for Volcker

By some accounts, Arthur Burns poured gasoline on inflation, while G. William Miller lit the match. Miller succeeded Burns as Fed chair on March 8, 1978 but served only 17 months, until August 6, 1979. Inflation was accelerating again as the economy recovered from the first oil price shock. The second oil price shock hit the economy in early 1979, putting the wage-price spiral in overdrive. Miller remained eerily laid back, believing that the inflation spiral was a transient phenomenon, so he resisted raising interest rates. The trade-weighted dollar dropped 5.4% during Miller's brief tenure (Fig. 11). In late 1978, the Carter administration responded with a "dollar rescue package" that included emergency sales from the US gold stock, executed by borrowing from the International Monetary Fund (IMF), as well as auctions of Treasury securities denominated in foreign currencies.[37]

Miller lacked the experience and the skills for his new job. Most observers were shocked that a few months after taking charge, Miller voted with the minority on the FOMC against raising interest rates. That quickly destroyed confidence in his leadership. The situation only got worse after he gave several interviews the day before the April 1979 FOMC meeting, expressing his view that there was no need to raise interest rates. Press leaks revealed that Miller's dovish stance against inflation was opposed by key administration officials who wanted the Fed to raise interest rates, including Treasury Secretary W. Michael Blumenthal and Charles Schultze, the chair of the CEA.

In any event, during Miller's brief tenure, the FOMC did raise the federal funds rate target from 6 3/4% to 10 5/8%. But that also was widely viewed as too little too late, as inflation continued to move higher while economic growth remained weak. The term "stagflation" was increasingly used by economists and the press to describe the economy's poor performance. The widespread view was that the United States was stuck with an intractable inflation problem.

On July 15, 1979, President Carter responded to the decline in his popularity with his famous "malaise" speech, in which he lamented that the country had not come together to solve its problems. Carter never actually used the word "malaise," but he did use the phrase "crisis of confidence," which was the title of the speech. Carter bemoaned, "The erosion of our confidence in the future is threatening to destroy the social and the political fabric of America."

In his speech, Carter never even intimated that monetary policy had allowed the inflationary price shocks of the 1970s to spiral into wages, which then spiraled back into prices. Instead, he blamed Americans for having become too dependent on foreign sources of oil:

In little more than two decades we've gone from a position of energy independence to one in which almost half the oil we use comes from foreign countries, at prices that are going through the roof. Our excessive dependence on OPEC [Organization of the Petroleum Exporting Countries] has already taken a tremendous toll on our economy and our people. This is the direct cause of the long lines which have made millions of you spend aggravating hours waiting for gasoline. It's a cause of the increased inflation and unemployment that we now face. This intolerable dependence on foreign oil threatens our economic independence and the very security of our nation. The energy crisis is real. It is worldwide. It is a clear and present danger to our nation. These are facts and we simply must face them.[38]

Carter called on Americans to travel less, to use carpools and public transportation, to obey the speed limit, and to lower their thermostats to save fuel.

While it is still widely believed that Carter delivered one of the most depressing speeches ever given to the nation by a sitting US President, the speech was well received, and Carter's poll ratings rose significantly.[39] Then he blew it just two days later when he fired five Cabinet members, including Blumenthal. Doing so suggested that Carter had lost control of his administration.

Carter convinced G. William Miller to leave the Fed to replace Blumenthal at the Treasury. Carter picked Paul Volcker to replace Miller as the new Fed chair. At 6-foot-7, Volcker was a towering personality, both physically and by reputation. A December 9, 2019 article in *The New York Times* on Volcker's death reported this anecdote: "Meeting Mr. Carter in the Oval Office, Volcker slumped on a couch, a familiar cigar in hand, and gestured at Mr. Miller, who was in the room. 'You have to understand,' Mr. Volcker said he told the president, 'if you appoint me, I favor a tighter policy than that fellow.'"[40]

The President was up for reelection in 1980 and was desperate to calm financial markets, which had responded badly to the White House meltdown. Carter knew that Volcker was highly respected in the investment community and in Washington. Indeed, Volcker was confirmed in the Senate with a unanimous vote.



Endnotes

[32] Arthur F. Burns and Wesley C. Mitchell, [*Measuring Business Cycles*](#) (National Bureau of Economic Research, 1946).

- [33] The NBER's Business Cycle Dating Committee [webpage](#).
- [34] "[Arthur F. Burns Is Dead at 83; A Shaper of Economic Policy](#)," *The New York Times*, June 27, 1987.
- [35] Michael Bryan, "The Great Inflation: 1965–1982," Federal Reserve History webpage.
- [36] Binyamin Appelbaum, [The Economists' Hour](#) (New York: Little, Brown and Company, 2019).
- [37] [FOMC Statement](#), November 21, 1978.
- [38] President Jimmy Carter, "[Crisis of Confidence](#)," July 15, 1979 speech.
- [39] Ezra Klein, "[Jimmy Carter's 'Malaise' Speech Was Popular!](#)" *The Washington Post*, August 9, 2013.
- [40] Binyamin Appelbaum and Robert D. Hershey Jr., "[Paul A. Volcker, Fed Chairman Who Waged War on Inflation, Is Dead at 92](#)," *The New York Times*, December 9, 2019.