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BOOK REVIEWS

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Allan H. Meltzer, **A History of the Federal Reserve**, volume 1: **1913–1951** (University of Chicago Press, 2003, 808 pp., cloth: $86); volume 2, book 1: **1951–1969** (2009, 682 pp., cloth: $75); volume 2, book 2: **1970–1986** (2009, 629 pp., cloth: $75)[1]

The publication in late 2009 of the two books of the second and final volume of *A History of the Federal Reserve* (covering the period 1951–86) completes the most ample study to date not only of the American central bank but of any central bank. If we include the first volume (covering the period 1913-51 and published in 2003), it is now possible to examine the work as a whole and appreciate its conception and originality. Meltzer, a well-known specialist in monetary theory and policy, spent fifteen years writing this work, for which he enlisted the help of some fifteen assistants to sift through the massive archives without which the book could not have been written. The result is more than 2,000 pages filled with details, anecdotes, figures, graphs and invaluable historical analyses that have no parallel for anyone interested in monetary and financial theory or the political history of the United States. With the help of largely unpublished archives, *A History of the Federal Reserve* adds considerably to our understanding of major events in the history of the United States and the world, including, in particular, the Great Depression, the operation of the Bretton Woods system and the 'stagflation' of the 1970s. By examining the transition from a system of semi-autonomous regional banks to one increasingly centralised in Washington, along with relations between the administration, the Congress and the Fed, Meltzer's work also helps us to understand major changes in the federalist structure of the United States and the role of the federal government over the course of the twentieth century.

To see these volumes as merely a historical summa brimming with useful data and interpretations, however, would be to miss Allan Meltzer's principal ambition. *A History of the Federal Reserve* should be seen for what it is: the second great historical

[1] A longer version of this review has been published on the website La Vie des idées/Books and Ideas, Éric Monnet, 'A Monetarist History of the Fed', 11 October 2010, ISSN: 2105-3030 (www.booksandideas.net/A-Monetarist-History-of-the-Fed.html); translated from French by Arthur Goldhammer.

work of monetarism. The first, *A Monetary History of the United States*, published in 1963 by Milton Friedman and Anna Schwartz, provided historical justification for the monetarist theories of Friedman and his disciples. Meltzer would not have written his book had it not been for this example.[2] Indeed, he frequently situates his arguments in relation to those of Friedman and Schwartz yet never refers to classic histories of other central banks, such as those of Richard Sayers and John Clapham for the Bank of England or Alain Plessis for the Bank of France under the Second Empire.[3] Most of all, Meltzer shares Friedman and Schwarz's views and methods, in that the purpose he ascribes to historical analysis is not only to identify long-term trends but above all to formulate judgments of the economic policies that were adopted at various points in time. The goal, in other words, is to derive theoretical and political lessons from history. But if Friedman and Schwartz's main concerns were the monetary mass and the banking and financial system, Meltzer's is rather the decision-making process at the Fed. For him, 'the history of an institution is a record of successes and failures' (vol. 2, book 1, p. 40). And in his view the Fed's history is mainly one of failure, since failure occupies more than 30 of the 73 years studied in the book: the Great Depression of the 1930s and the Great Inflation, which Meltzer, offering an unorthodox and provocative chronology, sees as beginning in 1965. Beside these failures, only the periods 1923–8 and 1952–64 find grace in Meltzer's eyes, because in those periods, price stability – the fundamental tenet of monetarism – was not neglected. The work's essential point is that 'the two principal sources of policy errors resulted from political interferences or pressure and mistaken beliefs' (vol. 2, book 2, p. 1217).

In the best-known chapter of *A Monetary History of the United States* (chapter 7), which remains an essential reference today, Friedman and Schwartz argued that the Great Depression was the result of Fed policy. The first volume of Meltzer's work confirms this hypothesis, while showing, contrary to Friedman and Schwartz, that the errors of the 1930s continued rather than departed from the ideas and practices of the 1920s. The second volume does not refer directly to Friedman and Schwartz, whose study ended in 1960, but rather assumes the monetarist mantle by centring its analysis on the charge that the 'Great Inflation' of the 1970s was also a result of central bank policy, which granted priority to full employment over price stability and relied for guidance on the defective Keynesian theory that was widely accepted at the time.

Some readers may find it irritating that the author so frequently indicts the institution he is studying and constantly reiterates the tenets of monetarism. Nevertheless, the work's theoretical and political claims are also its strength; whether or not one shares the author's positions, they compel him to propound stimulating and iconoclastic arguments and highlight his impressive ability to infuse austere and technically complex subjects with genuine interest. Meltzer's ability to grasp theoretical and political issues in highly technical debates is particularly clear

[2] Monetarist principles are summarised and explained at several points in the work, in particular in chapter 2 of volume 1, and chapters 1 and 8 of volume 2 (vol. 2, book 2, pp. 1014–18).

[3] See Clapham (1944); Sayers (1976); Plessis (1983–7).

in the way in which he relates narrative history and the history of ideas. Once again the goal is always to show that errors of monetary policy were the result of disastrous theories that ignored the basic principles of monetarism. Meltzer thus ascribes a fundamental role to ideas. For instance, another historian would no doubt have chosen to introduce his work by describing the state of the American banking and monetary system prior to the creation of the Federal Reserve System in 1913, focusing in particular on previous attempts to create a central bank in the United States. Meltzer takes an entirely different tack, however: his first chapter is a partial synthesis of nineteenth-century English debates on monetary theory. The next chapter then moves directly to the creation of the Fed in 1913.

Finally, among the strong points of Meltzer's analysis, we must include his scrupulous attention to issues of banking and forms of credit, which stems from the theory of monetary transmission that he developed in collaboration with Karl Brunner in the 1960s.[4] This focus is especially valuable because current theories of monetary policy still tend to neglect these questions. Meltzer shows that bank credits and deposits are fundamental variables of monetary policy closely watched by central bankers (who at times misinterpreted what they saw) and always a target of monetary policy, along with bank regulation.

The monetarist prism through which Meltzer sees the history of monetary policy is also the cause of certain oversights, however. First, the importance that he ascribes to the history of ideas and to political relations between the Fed and the government largely supplants administrative history.[5] For instance, he never mentions the number of people employed by the Fed; little detail is offered about the operation of the twelve regional federal banks; and there is no discussion of the relation between these banks and regional economies. Second, the author does not consider Fed decisions in any framework other than one of simple economic efficiency (which for Meltzer always means price stability). But defining political and democratic legitimacy in terms of economic theory is subject to many caveats that Meltzer seems to neglect or dismiss. The problem becomes apparent in the author's frequent assertions that the reason why monetary policy went wrong in the 1960s and 1970s was that the government pursued a policy of full employment as defined by the Unemployment Act of 1946.

Allan Meltzer shares with Milton Friedman the old monetarist dream of an 'automatic monetary policy' that would simply adhere to a predefined rule. Despite Meltzer's own position on the issue, his absorbing history of more than 70 years of Fed activity reveals the cognitive and political complexity of monetary policy and will convince many readers that such a rule is absolutely impossible to define. The work he has produced is ample enough to allow readers to formulate their own interpretations.

Paris School of Economics ERIC MONNET

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[4] Summarised in Brunner and Meltzer (1993).
[5] For a contrasting approach, see esp. Hennessy (1992).

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Catherine Schenk, **The Decline of Sterling: Managing the Retreat of an International Currency, 1945–1992** (Cambridge: Cambridge University Press, 2010, 437 pp., £60, $99)

The role of sterling and the management of its retreat from an international to a national currency has been a central issue in British postwar history. Politically as well as economically, sterling was important in defining Britain's place in the world. Sterling's place in the international monetary system distinguished Britain from other European countries in the postwar period. Moreover, the decline of sterling was an important development in the international monetary system, especially in the 1960s.

As observed by Schenk, the demise of sterling as an international currency was widely predicted after 1945, but the process took 30 years to complete. Why was this downfall so prolonged? Traditional explanations emphasised British efforts to prolong sterling's role on the grounds that it either increased the capacity to borrow, enhanced prestige or supported London as an international financial centre. Schenk challenges this view. She shows that, as early as the 1950s, many British ministers and officials recognised that the burden of sterling's role in terms of the cost of borrowing and confidence in the exchange rate outweighed the benefits of sterling as an international currency. In her view, sterling's international role was critical for the stability of the international economy (the United States saw sterling as the dollar's first line of defence, a 'domino' which had to be defended). Schenk argues then that sterling's international role was prolonged by the weakness of the international monetary system and by collective global interest in its continuation. This enabled the United Kingdom to attract considerable support for managing sterling's gradual retreat. The demise of sterling as a commercial currency was brought about largely through new exchange controls. These encouraged the use of the dollar in commercial transactions and favoured the offshore Eurodollar market, in which the City would play a leading role. The decline of sterling as a reserve currency took more time. It gradually came about through negotiated management among the developed and developing world rather than through free play of market forces.

The book contains more than 400 pages. It is very much based on detailed archival work in many parts of the world. It is structured into three key chronological periods.