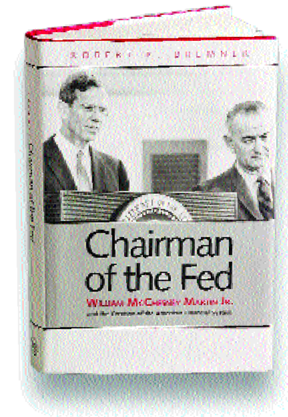
BOOK REVIEWS

Earning independence



Robert P. Bremner

Chairman of the Fed

William McChesney Martin and the Creation of the Modern American Financial System

Yale University Press, New Haven, Connecticut, 2004, 368 pp., $38.00 (cloth).

"The reforms accomplished during the Martin era have stood the test of time, and the NYSE has never experienced a recurrence of the widespread self-dealing that brought Bill Martin into the Exchange presidency." In these words, Robert Bremner summarizes the contributions of William McChesney Martin as he left the New York Stock Exchange in early 1941 because he was drafted at age 34. This biography covers the full career of a remarkable man who always seemed to be in the right place, mostly made the right decisions, and accomplished much for his country and the world.

Bill Martin was not at Fort Dix for long. He was put in charge of the Russian lend-lease program. After the Second World War, he became president of the Export-Import Bank, before moving to the U.S. Treasury as Assistant Secretary for International Affairs. There, in early 1951, he was involved in negotiating the "accord" between the Treasury and the Federal Reserve under which the U.S. central bank recovered its de facto independence in monetary policy to go with its de jure independence. The Federal Reserve was no longer fully obligated to peg interest rates on long-term (or short-term) Treasury debt. Within a month, Martin became chairman of the Federal Reserve Board, where he remained until January 31, 1970.

The rest was not easy. The Martin Federal Reserve had to implement the "accord" and slowly earn its true independence. At the same time, Martin and his colleagues had to deal with the inflation that followed the Korean War in 1954–55 and resurfaced in 1956–57. With two recessions in the late 1950s, Richard Nixon held the Federal Reserve's high interest rates responsible for his loss to John F. Kennedy in 1960.

After Lyndon B. Johnson succeeded JFK, the Vietnam War escalated, and inflation pressure reemerged. Martin wanted fiscal policy to help restrain inflation, but the president resisted. When he finally agreed half-heartedly to propose a tax surcharge, the chairman of the tax-writing House Ways and Means Committee (Wilbur Mills) would not consider it unless the president would also put forward expenditure cuts as well. The president wanted to continue to spend on both guns (the war) and butter (his anti-poverty program). By the time this matter was resolved, the Great Inflation, which accelerated into the early 1980s until the Volcker-led Federal Reserve adopted draconian measures, was under way. Federal Reserve actions under Martin were too little too late, and that continued to be the case under Arthur F. Burns and G. William Miller. Meanwhile, the U.S. dollar and gold reserves came under pressure, sterling was devalued in 1967, and the two-tier gold market was established in 1968, which lasted until Nixon closed the U.S. window for official gold transactions in 1971.

Bremner's account of Martin's life is fascinating and informative. Even those who lived through much of the period will learn a lot. An economist will have a bit of a problem in a few places because the analysis is incomplete or slightly misleading (but then Martin himself was no economist and distrusted economic forecasts). For example, Bremner does not explain that the "deficit" in the U.S. balance of payments that everyone was worried about was not a trade or current account deficit—the United States was in surplus—but the buildup in short-term official external claims against the gold stock.

Bremner does a masterful job of conveying the challenges facing Martin and his operating philosophy: try to work things out and keep the Federal Reserve independent within the government. Martin has been criticized by Allan Meltzer for his efforts to coordinate monetary and fiscal policy, bringing on the Great Inflation. "Political pressure to coordinate policy reinforced widespread beliefs that coordination of fiscal and monetary policies is desirable," Meltzer said in a paper delivered at the Federal Reserve Bank of St. Louis in October 2004. One can, as I do, disagree with Meltzer—it is better to have tried and failed than not to have tried at all—

"A great deal to think about—especially if U.S. fiscal policy continues on its current dangerous trajectory."

and still fault Martin, his colleagues, and their successors for their monetary policies. Readers of Bremner's excellent biography can make up their own minds. He has given them a great deal to think about—especially if U.S. fiscal policy continues on its current dangerous trajectory.

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Laura Wallace, Editor-in-Chief