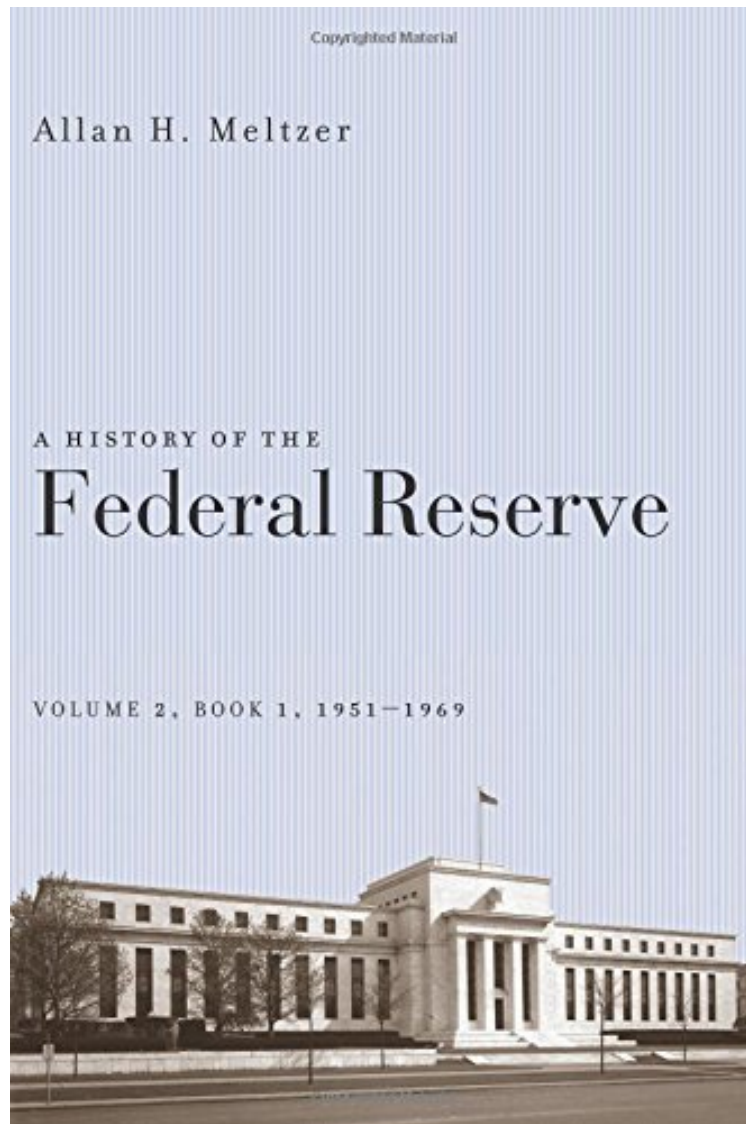


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A History of the Federal Reserve, Volume 2, Book 1, 1951-1969

Allan H. Meltzer

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Allan H. Meltzer : A History of the Federal Reserve, Volume 2, Book 1, 1951-1969 before purchasing it in order to gage whether or not it would be worth my time, and all praised A History of the Federal Reserve, Volume 2, Book 1, 1951-1969:

7 of 9 people found the following review helpful. More Proof Central Planning Does Not WorkBy Suo MarteAfter 2,000 pages of exhaustive scholarship detailing the history of the US Federal Reserve over the past 97 years, it's no wonder Meltzer is quoted as saying "Capitalism w/o failure is like religion w/o sin." However, as Meltzer makes clear throughout Vols 1 2 of this extraordinary book, the Federal Reserve is an agent of Congress w/ a Govt-granted monopoly over the US money supply to achieve specific economic and social outcomes. Literally speaking, by

definition, there's absolutely nothing "capitalist" about the Federal Reserve. Meltzer's magnum opus demonstrates clearly the Federal Reserve is simply a politically motivated central planning bureau whose inherent hubris dooms it to failure, like all other permutations of statist organization. On pg 1217 Meltzer writes: "political interferences or pressure and mistaken beliefs" are the two primary reasons for the Federal Reserve's policy errors. And perhaps nothing demonstrates more starkly the complete unmitigated failure of the Federal Reserve than its two greatest successes; (1) correcting its previous inflationary policy error (Chapter 8 Vol 2, Book 2 "Disinflation" pgs 1008-1131) and (2) the so-called Great Moderation orchestrated by the very same Federal Reserve Chairman (who most believe) is at least partly (if not mostly) responsible for the current US financial mess (Chapter 10 Vol 2, Book 2, particularly pgs 1248-50). Meltzer's bottom line, on pg 1255: "The broader lesson of this experience [our current mess] should be that policy misjudgments by Congress and the Federal Reserve helped to bring on the crisis. Discretionary policy failed in 1929-33, in 1965-80, and now." The ultimate irony is the Govt's Federal Reserve medicine has proven to be worse than the Govt-created National Banking Act illness this medicine was intended to cure 97 years ago. Equally troubling, Meltzer says: "The Federal Reserve should announce and follow a rule for its lender-of-last resort actions." In other words, after almost 100 years of existence, the Federal Reserve cannot fulfill even its most basic function. And some argue it is this fundamental responsibility itself (the "Greenspan Put" in today's parlance) that is the fountainhead of moral hazard. But it is Meltzer's other key conclusion, also on pg 1255: "The lesson should be less discretion and more rule-like behavior" that brings us full circle indeed. What was it again Hayek said about the fatal conceit of central planners? Having said all this, I believe it's important to reiterate Meltzer's point on pg x of the Preface to Vol 2, Book 1 in which he acknowledges "the high level of integrity and purposefulness of the principals and the staffs" and the fact that "More than ninety years passed w/o major scandal" and also that "There are few examples of leaked information." There is no - nor has there ever been a - conspiracy by evildoer "banksters" controlling the Federal Reserve to line their pockets at the expense of the American people. But perhaps the real heroes of this story are Henry Thornton (for correct theory) and Paul Volcker (for correct action). And, to the extent there is a villain, it is the notion that fractional reserve lending managed by a central bank can somehow do more good than harm; that it is somehow the best possible monetary system alternative. W/o saying so, Meltzer proves again what others have penned before: "It is a melancholy fact that each generation must relearn the fundamental principles of money in the bitter school of experience. It is the mismanagement of the monetary mechanism that most of our recent troubles are chiefly ascribable." Clearly, central planning does not work it's a tragedy hundreds of millions (if not billions) of innocent people must suffer the impoverishing consequences of central planning's repeated failures. Considering the ignorance, misrepresentations (blatant lies) told to absolve the Federal Reserve of its responsibility for creating the Great Depression (through its monetary policy errors both before and after Oct 1929), one can only wish pgs 245-414 in Vol 1 will someday become required reading for ALL Americans. Meltzer's done an excellent job describing the Federal Reserve's confused monetary policies and explaining the policy dispute amongst Federal Reserve leaders that plagued it throughout its formative years: the ability of a reserve bank to control the volume of credit or money by limiting discounts to real bills and understanding that the collateral offered to the reserve banks has no fixed or logical connection to the marginal use of bank credit. Meltzer writes: "Strong understood... banks borrow in the most efficient way and lend for the most profitable uses." The fact that real bills doctrine advocates like Miller, other Federal Reserve Board members, and members of Congress such as Carter Glass did not accept Strong's conclusion does not change the fact that Strong was correct. Meltzer's even included testimony from the 1931 Senate Committee on Banking and Currency hearing in which Federal Reserve Governor Harrison explained to Senator Glass why bankers cannot prevent underwriting so-called "speculative" loans, even if they want to. Further, Meltzer's work in Vol 1 exposes the mythology (propagated by DeLong, Eichengreen, Friedman Bernanke) that Federal Reserve policy was influenced by economists such as Hayek. As Meltzer explains on pg 263 Vol 1: "Miller, other Board members, and several reserve bank governors accepted the real bills doctrine as the only correct guide to policy action. The Federal Reserve Act was written by people who accepted "real bills" and the gold standard as proper guides..." (as advocated by Adam Smith). Hayek Mises adamantly opposed the real bills doctrine based on Thornton's reasoning cited by Meltzer in Vol 1. How can so-called "scholars" like DeLong Eichengreen unknowingly conflate the views of Hayek Mises w/ support for the real bills doctrine? And Meltzer's done a wonderful job weaving seemingly arcane technical details (the call money market financing mechanism, for example) into the story. Meltzer points out Strong agreed w/ Warburg that an acceptance market was needed to replace the call loan market for short-term credit which Warburg had publicly campaigned against as early as 1907 and attempted to eliminate in the Aldrich Plan (which was the basis for the Federal Reserve Act). It's also important to highlight the role politics played in the Federal Reserve's actions leading up to the Oct 1929 stock market crash: "Political concerns reinforced the Board's desire to hold the discount rate at 5%. Higher discount rates in the early twenties had been extremely unpopular in Congress and in agricultural areas. Neither the Board nor the reserve banks wanted to repeat that experience. The Board felt the pressure directly from members of Congress, many of whom, like Carter Glass, believed that credit was financing speculation, not commerce and agriculture. Higher rates, they believed, would deprive legitimate users of credit w/o deterring speculators. Miller and other Board members shared this view." Meltzer proves the motivation for

Strong's 1927 discount rate cut (his famous "little coup de whiskey to the stock market") was to help the British specifically the Europeans in general who were suffering the economic consequences of their not following the rules of the interwar gold exchange standard. There is zero evidence Strong or the Federal Reserve Board were "captured" by Wall Street bankers. Other key areas to read are; Vol 1, Book 1 Chapter 2 ("Central Banking Theory and Practice before the Federal Reserve Act"), Vol 2, Book 1 ("Introduction"), Vol 2, Book 1 ("The Great Inflation: Phase 1"), and absolutely every page of Vol 2, Book 2. Chapter 5 Vol 2, Book 2 provides important historical context for the current currency war saber rattling re: China's fixed exchange rate to the US dollar; the quantitative easing by the US Federal Reserve the Bank of Japan; and the threat of imposing capital controls by emerging market Govts to resist the inflationary disruptions fast approaching them in the form of massive liquidity looking for yield, courtesy of the US Federal Reserve. This chapter demonstrates how fixed exchange rates w/in a gold standard environment can work --- PROVIDED countries adjust (increase their money supply when gold inflows increase reduce when gold outflows) in accordance w/ the rules. Meltzer's work throughout Vols 1 2 demonstrates the classical gold standard was successful until it was suspended by WWI. Govts have been unable to return to the monetary discipline the standard requires to function properly; the interwar gold exchange standard (different from the classical gold standard before WWI) between 1924-1933 Bretton Woods are two examples of Govt failure to follow the rules. Meltzer describes in detail how the British (by joining the gold exchange standard at a rate that overvalued its currency), the French (by stabilizing its currency at an undervalued exchange rate, by refusing to hold foreign currency as reserves most significantly by refusing to increase its money supply w/ gold inflows - "sterilization"), and the US (by sterilizing gold inflows like France) did not follow the rules between 1924-1933. On pg 276-7 Vol 1 Meltzer notes France "contributed to the onset and severity of the world depression by sterilizing much of its gold inflow. From June 1928 to Sept 1929, the French bought \$2.6 billion in gold..." and "Greater expansion and less sterilization by the Bank of France would have lessened the severity and scope of the world decline." This conclusion is consistent w/ H Clark Johnson's previous work (1997). On pg 401 Vol 1 Meltzer explains the consequences of the US Federal Reserve's gold sterilization: "If the US had followed the rules, the money stock would have expanded by 14.6% from August 1929 to June 1930... an expansive monetary policy would have prevented at least some of the deflation and recession, so falling prices and fears of collapse would have been absent. The world would have been spared much of what followed." Meltzer demonstrates the Federal Reserve's real bills doctrine mindset, using the "Riefler-Burgess framework," focused the central bank on exactly the wrong signals for determining "loose" and "tight" monetary policy. And it was precisely this policy error --- concentrating on bank reserves above the legal minimum necessary to cover deposits for setting NOMINAL interest rates; instead of concentrating on the quantity of money, available credit and general economic conditions on inflation-adjusted REAL interest rates --- that resulted in its post Oct 1929 policy failure and consequently the impoverishment of millions of Americans. Eichengreen's blaming the gold standard for the Great Depression is simply wrong - he throws the baby out w/ the bath water. Based on this history in Vol 1, no one should be surprised that, by Chapter 5 Vol 2, Book 2, Govts want their cake and to eat it too; they will never follow international monetary rules (for very long) because they believe they cannot remain in power w/in their home country while, at the same time, sustain policies supporting free capital movement, currency convertibility, fixed exchange rates and full employment. As Meltzer says on pg 688: "The choice was never a serious issue for the US; the Johnson and Nixon administrations always chose employment. The Federal Reserve retreated behind the institutional fact that the Treasury and the administration were responsible for international policy." Read Chapter 5 Vol 2, Book 2 and then re-consider the actions today by Chairman Bernanke, Congress the Obama Administration. Moreover, the long standing US current account deficits described in this chapter completely undermine the legitimacy of the Greenspan / Bernanke "Blame the Asian Savers" rationale for causing the current US financial crisis. Understanding how Volcker tamed inflation alone is worth the price of Vol 2, Book 2. Moreover, like Chapter 5, Chapter 8 is also extremely relevant today. It's widely understood the Federal Reserve is about to print another trillion (or so) of money out of thin air (AKA "Quantitative Easing") by purchasing US Govt debt. And it's also widely understood that once this money injection enters global circulation, asset values will inflate and potentially consumer prices (as measured by the CPI) as well. But it's not understood how the Federal Reserve will drain this liquidity w/o further damaging the global economy. This is where Chairman Volcker's outstanding work, detailed in Chapter 8 Vol 2, Book 2, becomes important. Should inflation spike, the Federal Reserve will have to build on the successful Volcker play book to fix the inflationary consequences of its Quantitative Easing. Each of these chapters can be read stand-alone w/o the others; they are complete w/in themselves. Also, Meltzer's told this story in very accessible, plain language the general reader can understand (no algebra or calculus here). As Meltzer quotes Volcker: "People don't need an advanced course in economics to understand that inflation has something to do with too much money." And my favorite Volcker quote is this: "With the best staff in the world and all the computing power we could give them, there could never be any certainty about just the right level of the federal funds rate to keep the money supply on the right path and to regulate economic activity." Everyone interested in the Federal Reserve and/or the practical application of fractional reserve central banking absolutely must read this book. ALL journalists should read all three volumes, not just the Federal Reserve apologists at the WSJ (Wessel, Izzo, etc). And those most urgently in need of absorbing its lessons are the

very economists the media elites shove down our throats every day on television, the internet in print; Krugman, Zandi, Blinder, C Romer, DeLong, Eichengreen even Roubini. This book proves they are either ignorant or merely partisans practicing extreme ideological myopia in order to impose their normative economic visions on the rest of us through Govt coercion. This epic book is the ultimate case for abolishing the Federal Reserve (although I'm confident Meltzer would say this is NOT his intent). If Americans understood the truth, the Federal Reserve would quickly find a comfortable resting spot next to Biddle's 2nd Bank of the United States - in the graveyard of failed monetary ideas. Please purchase all three volumes of this book. You will be richly rewarded. 4 of 6 people found the following review helpful. A Classic of Economic History By Cultured Reader Its not often that one reads a book that you know will be (actually is already) a classic. I've finished Volume one and am into volume two book two of this majestic work. Practically every page has an interesting detail or incident. If you want to know how the Fed was run through most of its history this book will tell you. For every serious student of economic history and for those who's avocation is economics these books are must reading. By the way Professor Meltzer has a postscript at the end of book two of volume two on our current economic difficulties. 0 of 1 people found the following review helpful. Five Stars By James W Butler Jr Excellent series.

Allan H. Meltzer's critically acclaimed history of the Federal Reserve is the most ambitious, most intensive, and most revealing investigation of the subject ever conducted. Its first volume, published to widespread critical acclaim in 2003, spanned the period from the institution's founding in 1913 to the restoration of its independence in 1951. This two-part second volume of the history chronicles the evolution and development of this institution from the Treasury's Federal Reserve accord in 1951 to the mid-1980s, when the great inflation ended. It reveals the inner workings of the Fed during a period of rapid and extensive change. An epilogue discusses the role of the Fed in resolving our current economic crisis and the needed reforms of the financial system. In rich detail, drawing on the Federal Reserve's own documents, Meltzer traces the relation between its decisions and economic and monetary theory, its experience as an institution independent of politics, and its role in tempering inflation. He explains, for example, how the Federal Reserve's independence was often compromised by the active policy-making roles of Congress, the Treasury Department, different presidents, and even White House staff, who often pressured the bank to take a short-term view of its responsibilities. With an eye on the present, Meltzer also offers solutions for improving the Federal Reserve, arguing that as a regulator of financial firms and lender of last resort, it should focus more attention on incentives for reform, medium-term consequences, and rule-like behavior for mitigating financial crises. Less attention should be paid, he contends, to command and control of the markets and the noise of quarterly data. At a time when the United States finds itself in an unprecedented financial crisis, Meltzer's fascinating history will be the source of record for scholars and policy makers navigating an uncertain economic future.

There is no book quite like this one, except for Volume I of this magisterial history. The History of the Federal Reserve, Volume II is a work by a first-rate scholar that ought to be read by all scholarly specialists, central bankers, would-be central bankers, and central bank staffers.