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Review of A History of the Federal Reserve. Volume I (2003) by Allan H. Meltzer ☆

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Abstract

This is a book review of "A History of the Federal Reserve. Volume I (2003) by Allan H. Meltzer.

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1. Introduction

Meltzer's (2003) *A History of the Federal Reserve 1913–1951 Vol. I* is a monumental accomplishment. The volume provides a very detailed history of the Fed in its formative years from its establishment in 1913 to the Federal Reserve Treasury Accord of 1951. The narrative covers the key events of four decades; getting started; war finance in World War I; the 1920–1921 recession; the boom years in the 1920s; the Wall Street crash and the Great Depression; subservience to the Treasury beginning in 1934; World War II finance and the pegging of interest rates; and the 1951 Accord when the Fed regained its independence from the Treasury.

In painstaking detail, Meltzer documents how the Fed grew up to be an adult central bank and what a drawn out and rocky adolescence it suffered through. The narrative in

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Volume I sets the stage for the yet-to-be-completed Volume II which covers the period from the Accord to the beginning of Alan Greenspan's tenure as chairman—the Federal Reserve's far from tranquil adulthood.

The volume complements Milton Friedman and Anna Schwartz's *A Monetary History of the United States: 1867–1960* published in 1963. However, unlike their work, which is a monetary history of the United States, Meltzer's book is a biography of its central bank, portrayed within the broader context of U.S. monetary history. More importantly, because Meltzer had access to a much more complete archived official record than they had (the records of the Federal Reserve Board, the Board of Governors and the minutes of the Federal Reserve Bank of New York's board of directors as well as of the Federal Advisory Council), his interpretation of many of the key episodes in Fed history greatly expands upon and in several episodes, differs considerably from theirs. This is most evident in Volume I's treatment of the Fed's policy failure in the 1920s and 1930s that culminated in the debacle of the Great Depression. Indeed his chapters 4 and 5 are the signature chapters in the book, as of course is Chapter 7 *The Great Contraction, 1929–1933* in Friedman and Schwartz. They are essential reading for any serious student of that disaster.

Section 2 of my essay discusses what I distill to be the seven major themes in *History of Federal Reserve.* A History is an excellent source for any serious student of the Federal Reserve. It is also very detailed and a time-consuming read. Appendix A offers a succinct Readers Guide to the Historical Narrative in Volume I. Section 3 concludes with some critical insights.

2. Major themes

Seven major themes knit the historical narrative together and are the essence of Meltzer's thesis: (1) the Fed followed the wrong model from the beginning and never really got it right even by 1951; (2) as in Friedman and Schwartz, the structure of the Federal Reserve was flawed from the beginning and contributed greatly to its inability to learn; (3) in distinction to Friedman and Schwartz, the effects of adhering to a flawed policy model outweighed the contribution of bright officials, even Benjamin Strong, who may have known better; (4) the interpretation of the Great Depression by Friedman and Schwartz and other scholars such as Bernanke and Eichengreen is wanting; (5) economic forces in the rest of the world are important and the Fed had ongoing problems coming to grips with them; (6) the Fed had a long and protracted struggle in maintaining its independence from the Treasury; (7) Meltzer views the history of the Fed through monetarist glasses.

2.1. The fed followed the wrong model

A theme that determines Meltzer's interpretation of Federal Reserve history is that from its very outset the Federal Reserve Act of 1913, was based on two precepts: the real bills doctrine and the gold standard. These precepts led it on many occasions to follow policies that were detrimental for the U.S. economy. The same point was made by Friedman and Schwartz (1963) and West (1977), but Meltzer takes it much further. His analysis (to be developed further in Appendix A) starts with the problems that the Fed had in operating monetary policy.

Policy in the post-1914 environment was supposed to maintain gold convertibility by the passive rediscounting of self liquidating real (commercial) bills and use of the discount