

Chairman of the Fed: William McChesney Martin Jr. and the Creation of the American Financial System.

By Robert P. Bremner. 2004. New Haven, CT: Yale University Press. Pp 374, \$38.00, hardcover.



William McChesney Martin (1906-98) served as Chairman of the Board of Governors of the Federal Reserve System from April

1951 through January 1970. Martin's tenure, the longest of any Fed Chairman, spanned five presidents and ten Congresses—all of whom, to some degree, sought to influence monetary policymaking. Robert P. Bremner does a masterful job of recounting these and other tensions and crises that Martin faced.

For about a third of the book, Bremner delves into Martin's career both before and after his Fed Chairmanship, periods that are probably less well known to most economists. Early on, we meet Martin's father, William McChesney Martin Sr., who rose to prominence in the St. Louis banking community early in the 20th century and then served as president of the Federal Reserve Bank of St. Louis from 1929 to 1941. At home, the Martin family dinner table included such luminaries as New York Fed president Benjamin Strong, Senator Carter Glass, and Professor H. Parker Willis (the Federal Reserve's first Director of Research). If ever a boy was groomed to be a Fed Chairman, it was Martin Jr.

After graduating from Yale, Martin

Jr. joined the St. Louis investment firm A.G. Edwards in 1928 and had a ring-side seat to the events that would scar the nation for years to come. The 1929 stock market crash and the subsequent Great Depression, coupled with the demise of his grandfather's grain business in the aftermath of the 1893-94 financial panic, helped convince Martin that government policymakers should never stand idly by during boom and bust cycles. Martin's economic views were also shaped to some extent by those who would help formulate government policies to combat the Great Contraction. While taking courses for a Ph.D. in finance at Columbia University, one of Martin's professors was Raymond Moley, who at one time was a key economics adviser to President Franklin Roosevelt. Another of Martin's influential professors at Columbia was Willis, who was a firm believer in the free market system and the self-correcting nature of market forces. Later on, as board member and president of the New York Stock Exchange, Martin, imbuing a synthesis of these views, would battle against the most strident of the reform and anti-reform initiatives sought by FDR's Security and Exchange Commission and the Exchange's "old guard," respectively. According to Bremner, Martin was a firm believer in "flexible" regulation that sought to marry the interests of the governing authorities and private industry.

While serving as president of the New York Stock Exchange, Martin was drafted into the Army as a private (at his insistence) in 1941. He eventually worked for General James Burns, who oversaw the Russian lend-lease program. Burns gave Martin the thankless task of defending the program before Congress. After the war, President Truman

appointed him head of the Export-Import Bank, where he battled, among others, General Marshall over loans to European countries.

Martin then moved to the Treasury Department as Assistant Secretary for International Affairs, where he played the lead role in negotiating the 1951 Treasury-Fed Accord, which officially ended the "peg" and thereby cemented the Fed's independence in designing and implementing monetary policy. In battling the Fed, Truman obtained the resignation of Chairman Thomas McCabe. Despite his misgivings, Truman accepted the recommendation of Treasury Secretary John Snyder to appoint Martin, who then became the Fed's ninth Chairman on April 1, 1951.

Most of the book details Martin's role as Fed Chairman. It is in these pages that we learn the most about his economic philosophy, his approach to central banking, and his battles with five presidents and their economic advisers. First, Martin was a firm believer in the Fed's independence within government, as Alan Sproul, one-time New York Fed president and sometime chief FOMC debater of Martin's, once put it. Second, Martin was a firm believer in capitalism and the self-correcting nature of market economies: "The market's objective measures of the forces of supply and demand give business and government alike a more reliable guide to policy and action than the subjective judgment of any man in government."

Third, Martin believed the Fed had a crucial role to play in stabilization policy. In addition to his famous "punch-bowl" line, Martin said: "Our purpose is to lean against the winds of deflation or inflation, whichever way they are blowing." Fourth, he did not

believe that the Fed should undertake measures that opposed the president outright, nor did he believe it was his role to give advice on policy matters under the purview of the administration. However, this did not prevent him from pushing through an increase in the discount rate in 1965 against the wishes of President Lyndon Johnson—a move that earned him a trip to the woodshed at Johnson's Texas ranch—nor did it preclude him from actively working in tandem with the Johnson Administration to pass the 1968 Tax Surcharge.

Fifth, although the level and sophistication of quantitative analysis took a major leap forward during Martin's tenure, he preferred a less formal approach to policymaking, and often railed against "statisticalitis," his term for an unhealthy reliance on statistical indicators. In his view, a Chairman must be prepared to put in place a policy that today might be termed pre-emptive: "I don't believe in intuitive judgments, but we cannot always wait for statistics."

Finally, Martin was a firm believer in the importance of low inflation: "I believe that economic growth in the long run cannot be soundly brought about except with stability in prices." Yet, Bremner recounts how, in late 1968, Martin quixotically found himself opposed to those FOMC members who wanted to pursue a tighter policy. A year earlier, Martin said that "the horse of inflation is out of the barn and already well down the road." Ever true to his principles, though, Martin wanted to secure the cooperation of the incoming Nixon Administration before launching a full-frontal attack on inflation.

Nearing the end his term in late-January 1970, Fed Chairman William McChesney Martin gathered together his fellow Governors one last time and

privately told them, "I've failed." For the previous few years, Martin had viewed with a sense of foreboding the rise in "inflation psychology" that had infiltrated the markets. (Martin had good reason to worry. After averaging a little less than 1.5 percent per year from 1952 to 1965, CPI inflation had averaged 4.5 percent from 1966 to 1970; in 1969 it had reached an 18-year high of about 5.75 percent. Eventually, inflation would climb even higher, averaging a little more than 8 percent per year from 1971 to 1980.)

In his book *A History of the Federal Reserve* (volume 1), Allan Meltzer argues that, at the end of the day, Martin was of the view that the Federal Reserve could not actively work against a Congress that willingly chose to finance a deficit through debt issuance. In view of the massive Treasury debt issuance that is projected to occur once the baby boomers start to retire and begin collecting on the income and health retirements currently promised to them, one wonders how future Federal Reserve policymakers will react to a similar problem—but one that is several magnitudes larger.

For the most part, Martin refused to comment publicly about the policies pursued by his successors, but he was not shy about jumping into policy matters that did not directly affect the Federal Reserve. Two noteworthy activities in Martin's post-Fed years were a report he agreed to write for the NYSE, who sought out his views about yet another round of financial market reforms, and his 1970 Per Jacobsson lecture, which he argued forcefully for the creation of a world central bank. While such an institution seems unlikely for the foreseeable future—and probably for good reasons—reading of his desire for an institution that could promote "harmonization of the policies of the member states and maintenance of

payments equilibrium among them" certainly rings of the goals of the European Central Bank. For the most part, Martin's views were discounted as impractical.

The lessons to take away from this wonderful book are unmistakable: First, a low inflation economy will not long endure if good policy is not long practiced. Second, the incessant political machinations of monetary policymaking require a forceful Chairman who is willing to man the ramparts in defense of price stability. In his praise of Bremner's book, former Chairman Paul Volcker calls the genial William McChesney Martin "a great man," and "a hero to a generation of central bankers, including me." Regrettably, though, for all his admirable qualities, Martin's tenure puts him in closer proximity to Arthur Burns in the pantheon of Fed Chairmen than to Paul Volcker or Alan Greenspan.

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Restoring Fiscal Sanity, 2005: Meeting the Long Run Challenge

By Alice M. Rivlin and Isabel Sawhill, eds. 2005. Washington, DC: Brookings Institution Press. Pp 146, \$16.95, paperback.



In just three years, the first of the baby boomers will begin to claim early retirement. By the time we (yes, I am one of them) are finished, 77 million of us will cease working and paying wage taxes and begin drawing government benefits instead. We will do so at a rate of

about 10,000 new claimants per day.

In the process, we will put enormous pressure on Social Security, Medicare, Medicaid, civil service retirement, veterans' benefits, and any other federal program that provides benefits for the elderly. Sum it all up, and what we are about to experience is nothing short of a fiscal tsunami. Or, in the words of the contributors to this book, "the nation is headed for a fiscal train wreck."

Almost one-half of non-defense spending (not counting interest) already goes to people sixty-five years of age and over. But, according to the Brookings team, we haven't seen anything yet. Over the next 25 years, the share of national income going to Social Security, Medicare, and Medicaid alone will more than double, unless we change course.

Economists who follow the annual reports of the Social Security and Medicare trustees already know that the forecast for the future is dire. What they may not know is that the trustees' report is not a simple projection of the past into the future. Instead, the trustees assume that future health costs increases are moderated, eventually converging on the rate of growth of wages.

Rivlin and Sawhill, however, are willing to take seriously the possibility that the rate of growth of future health costs will not be moderate and that health costs will continue to grow in the future as they have in the past. They point out that by 2030, total federal spending is likely to be at 25 percent of GDP and rising—mainly because of elderly entitlements, with most of the growth being in health care. Revenues, by contrast, will be below 20 percent of GDP, even assuming the Bush tax cuts are rescinded.

So what are the options? With no change in current policies, we will have soaring debt along with the

mounting cost of servicing that debt. In fact, the Congressional Budget Office puts federal spending (including debt costs) at 50 percent of GDP by mid-century and headed ever upward toward the stratosphere.

If we try to solve the problem by raising taxes, the authors tell us we will need to double the income tax rate and increase payroll taxes two-and-a-half times by 2040. If we choose benefit cuts, we will have to ultimately reduce spending by half.

In analyzing problems and proposing solutions, this book does two interesting things to achieve an ideological balance rarely seen in think-tank publications. First, each chapter has two authors—typically pairing one who is left-leaning with one who is right-leaning. (All are from the Brookings Institution unless otherwise noted.)

For example, a chapter on the budget is written by Rivlin and Rudolph Penner (Urban Institute). The chapter on Social Security combines Peter Orszag and John Shoven (Stanford). The chapter on health pairs Henry Aaron and Jack Meyer. A chapter on tax policy joins William Gale and Eugene Steuerle (Urban Institute). A chapter on the politics of deficit reduction combines Sawhill and Ron Haskins. On each of these pairings, the first author tends to be associated with Democrats, the second with Republicans—though the association is far from perfect.

In another attempt at balance, the book presents a number of reform scenarios designed to appeal to the full ideological spectrum. Solutions include "small government" reforms, "large government" reforms, and one or two scenarios in between. All these solutions involve pain (for small government, read benefit cuts; and for large government, read tax increases); but the reader is free to decide whose ox to gore.

For example, on Social Security, the menu of options includes such benefit cuts as (1) price indexing rather than wage indexing of past wages, (2) progressive price indexing of benefits, (3) increasing the retirement age, (4) increasing the number of years used to calculate benefits, and (5) other benefit formula adjustments. The revenue-raising alternatives include (1) increasing the cap on wages subject to payroll taxes and (2) increasing the payroll tax rate.

Health care is, of course, the biggest part of our problem; and it is here that the authors tell us we "will face a nasty dilemma" that "will likely require health care rationing for all." They project that total health care spending will grow from 13.6 percent of GDP to 35.2 percent by 2040 at current trends. And almost half these costs will be paid by government.

As in the case of Social Security, we get a menu of options. To reduce Medicare spending, they consider (1) raising the eligibility age, (2) increased cost-sharing by patients, (3) enrolling beneficiaries in private health plans, (4) selective purchasing of health care, and (5) other efficiencies. A disappointment is that we don't get to learn more about how health care might be rationed, after being told that it's virtually inevitable.

Overall, this volume is better on analyzing problems than on finding solutions. Readers will get a good rundown of policy options popular with think-tank types. However, most of the recommendations would cause one-time shifts in the spending and revenue paths, but they would not change the rate of growth over time. Thus, the painful remedies they consider don't really solve the long-run problem; they just get us another decade or so down the road.

There is no recognition by the contributors that the problems they write about arise because we have a

chain-letter approach to retirement. Each generation looks to the next generation to pay its benefits instead of saving and paying its own way. Nor is there any recognition that more than 30 countries today have established funded retirement pension systems as an alternative to the pay-as-you-go system we have. The most interesting of these is Singapore, which has structured its entire economy around the belief that each generation should pay its own way, each family should pay its own way, and each individual should pay his or her own way.

Repeatedly, the contributors stress the need to raise national saving and, at one point, bemoan the fact that financial incentives to save do not seem to work. Yet nowhere do they seriously consider forced savings, although they briefly discuss

personal Social Security accounts and give the idea short shrift.

Other countries have eliminated their unfunded liability for elderly entitlements by requiring workers to save for their own retirement benefits. The Brookings Institution needs to give this idea a closer look.

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