Interest in the activities of central banks declined after the Second World War when priority was assigned to fiscal policy, and direct controls were imposed upon the financial system. But as a result of the Great Inflation of the 1970s and 1980s and the deregulation of the financial system there occurred a revival in monetary policy and a renewed interest in central banking. These books will add to the current interest in central banks.

The books differ considerably in their coverage and structure. The first encompasses the history of central banking in Britain and in the United States, while the other concentrates on the US Federal Reserve. The first covers more than three centuries of central-bank history, while the other is confined largely to the second half of the twentieth century. One author is an academic with some experience in the world of central banking; the other was a central banker for most of his career. And yet both authors follow a somewhat similar approach: each relies, for example, on the method of historical narrative to draw conclusions about the nature of central banking, though one of them uses extant literature as his principal source of information while the other draws largely on personal experience. A particular highlight of each of the books is the significance attached to the role of individual central bankers in the formation of monetary policy. Economists — though usually not economic historians or historians of economic thought — often dismiss the importance of the human dimension in the policy process. The authors of these books do not fall into that trap.

John Wood traces the history of central banking in Britain since the formation of the Bank of England at the end of the seventeenth century, and in the United States from the late eighteenth century when the first Bank of the United States was chartered. The origins of the Bank of England are identified in the government’s need to raise revenue to fund military expenditure. The Bank’s
progress is then tracked as it sought to earn profits and remain solvent in its early years; through the suspension of gold convertibility in the 1790s and the restoration of gold payments after the Napoleonic Wars; living with the Bank Charter Act of 1844; the adoption of lender-of-last-resort and financial-stability responsibilities in the second half of the nineteenth century; the return to gold in 1925; and the Great Depression of the 1930s. The book concludes with the Great Inflation of the second half of the twentieth century and the Bank’s independence in 1998.

The origins of the first and second Banks of the United States are similarly attributed to the government’s need to secure revenue to meet its various commitments. Wood then traces the emergence of lender-of-last-resort facilities by the United States Treasury, the Suffolk Bank and the New York Clearing House following the demise of the second Bank of the United States in the 1830s. He goes on to map out the crash of 1907 and the establishment of the Federal Reserve system in 1913; the boom and crash of the 1920s–early 1930s; the erosion of the Fed’s independence in the 1940s and its restoration in the 1950s; and the Fed’s role in helping to create and then combat the Great Inflation of the 1960s and 1970s.

Wood relies heavily on secondary sources, though there are occasional references to primary material. Given the amount of detail involved, the author does well to maintain control of the discussion, which is generally lucid and unpretentious. It is true that the book breaks little new ground. But that is not its aim. Rather, its objective is to provide essential historical information for the purpose of drawing general conclusions about the nature of central banking in two major countries over long periods of time. The book will provide an excellent text for courses in the history of monetary policy and central banking, and a reference for information about the development of central banking in Britain and the United States.

The author of Inside the Fed, Stephen Axilrod, is a former head of the research and monetary affairs divisions of the Federal Reserve Board in Washington D.C. and secretary of the Federal Open Market Committee. He began his career there in the 1950s and served under four chairmen — William McChesney Martin, Arthur Burns, William Miller and Paul Volcker — before retiring in 1986. The book began as a long essay on a number of diverse topics, the author’s aim being to highlight the significant events of his career for the benefit of his family and friends. One of the topics was an extended meditation on the achievements of Arthur Burns (chairman of the Fed from 1970 to 1978) and Paul Volcker (chairman from 1979 to 1987), and the policy disputes at the time over how to deal with the Great Inflation. The essay was subsequently extended to incorporate Bill Martin’s long tenure as chairman (1951–1970) and Alan Greenspan’s chairmanship (1987–2006), with some brief comments on Bill
Miller’s term (1978–1979), the early Bernanke years and the genesis of the Global Financial Crisis (GFC) of 2007–09. Axilrod has written a fine book, based on recollections of his interactions with Fed chairmen and colleagues with whom he worked. It is beautifully written, though readers should be warned that it is easy to be carried away by the quality of the writing and miss the essence of the discussion.

What are some of the conclusions reached by the authors of the two books? Wood contends that central bankers and economists see the world differently. ‘It has always been clear to me’, he says, ‘at first very disappointingly, then less so — that central bankers do not see the world like economists.’ (p.xv) Central bankers, he asserts, have at critical times given excessive ‘attention to the financial markets at the expense of their macroeconomic responsibilities’ (p.4). He endorses the view, once expressed by Allan Meltzer, that the Federal Reserve’s ‘knowledge of the monetary process is woefully inadequate… dominated by extremely short-run, week-to-week, day-to-day, or hour-to-hour events in the money and credit markets. [T]heir viewpoint is frequently that of a banker rather than that of a regulating authority for the monetary system and the economy’ (p.4). Writing before the GFC, Wood highlights the consensus that had been reached in the approach to monetary policy at the end of the twentieth century:

Our monetary system is unprecedented. After decades of instability, central bankers, governments, and economists have reached a consensus that the appropriate role of a central bank in the prevailing fiat-money regime includes: (1) the clear assignment of the responsibility for inflation to the central bank; (2) agreement that inflation should be low and stable; (3) rejection of price controls as a means of controlling inflation; and (4) acceptance of whatever degree of fluctuation is required in interest rates to achieve the inflation objective. This is at once more ambitious and more modest (realistic) than earlier systems. (p.1)

Naturally, one wonders whether the consensus can be retained in the light of recent economic and financial events.

Perhaps the major conclusion reached by Axilrod is ‘the important role in policy played not by pure economic reasoning or understanding, but by personalities and their responses to the political, social and bureaucratic contexts in which they find themselves.’ His experience at the Fed, he states, is:

…that a great leader for monetary policy is differentiated not especially by economic sophistication, but by his or her ability to perceive when
social and political limits can be pushed to make space for a significant, paradigmatic change in the approach to policy should it be required, as well as by the courage and bureaucratic moxie to pull it off. (p.4)

He goes on:

Fed policymakers, being very well aware that they are part of a government established to be democratically representative of the people, are themselves likely to be constrained in the policies that they find it practical to consider by their sense of what is tolerable to the country…I am convinced that such judgments, or perhaps such feelings, whether expressed … or recognized, lie deep within the individual policymaker’s gut. The policymakers are independent, but they are making decisions from within the government and within what they perceive to be certain societal bounds. (p.10)

Axilrod ranks the four chairmen under whom he served, together with Greenspan and Bernanke, according to their performance as heads of the Federal Reserve System. Volcker comes out clearly on top, followed by Martin and then Greenspan. Burns and Miller are at the bottom. He admits that it is too early to assess Bernanke’s performance. He is not impressed with Bernanke’s (and Greenspan’s) failure to raise interest rates quickly enough to dampen subprime borrowing, or with Bernanke’s subsequent failure to adopt expansionary measures rapidly enough to limit the impact of the financial crisis. On the other hand, he is impressed with the scale of the response once the measures were introduced.

Of the Volcker period, which saw the end of the Great Inflation in the United States, Axilrod writes that ‘It was an exciting period…and…it can also be called a glamorous time. …It was…one of the few instances in my opinion where a dramatic shift in policy approach could be attributed to a particular person’s presence rather than mainly to or just to circumstances.’ Volcker, he judges, was:

the essential man for a combination of reasons. He combined great sensitivity to shifting trends in political economy (he could see what the country would now accept) with a willingness to take dramatic action. Moreover, he was technically very competent in the nuts and bolts of monetary policy, which made it much easier for the F[ederal] O[pen] M[arket] C[ommittee] and the chairman himself to feel confident that the new approach, although not risk free, had a reasonably good chance of working. (p.91)

In short, ‘Volcker the actor was in full display. He was totally in command of himself and the subject matter. He spoke with force and conviction. He responded to questions from Congress and the public with certainty…’ (pp.92–3)