

Book Reviews

Edited by Robert Herren

Inside the Fed: Monetary Policy and Its Management, Martin through Greenspan to Bernanke. STEPHEN H. AXILROD. Cambridge, MA: The MIT Press, 2009. Pp. viii, 203, \$24.95

An insider's account of Federal Reserve monetary policy decisions would be of interest to any economist. This is what the author delivers. Stephen Axilrod worked for the Fed in Washington D.C. from 1952-1986 in various capacities close to the federal open market committee (FOMC). He served as the top staff person for monetary policy and was in close contact with the chairmen during that time period. In fact, he played tennis against William McChesney Martin during regular noon doubles matches. Thus, Axilrod is uniquely qualified to offer insight into the workings of the FOMC and its chairmen.

Axilrod divides his book into eight chapters, the first being an overview of monetary policy and the Federal Reserve, the last two summarize the Fed, and the middle five chapters encompass the six chairmen since (and including) William McChesney Martin. Alan Greenspan and Ben Bernanke are dealt with together in one chapter (chapter 6) because Axilrod left the Fed in 1986 to take a job with Nikko Securities. His contact with Alan Greenspan was not day-to-day as it was with the other chairmen. Thus, this chapter is more of Axilrod's interpretation and analysis of Greenspan's and Bernanke's actions rather than his direct experience with them, though he is able to touch on how Greenspan's actions may have contributed to the bubble in housing prices. In contrast, the remaining four chapters (chapters 2 through 5) deal with each of the four chairmen Axilrod had contact with (William McChesney Martin, Arthur Burns, G. William Miller, and Paul Volcker). Axilrod is able to offer insight on both the monetary policy actions that took place under each chairman and what constitutes an effective chairman.

During Martin's time, monetary policy was more of an art, targeting "free reserves", defined as the difference between banks' excess reserves and borrowing from the Fed. Inflation expectations were not on the Fed's radar, and the Fed only began conducting economic forecasts in the late

1960s. Around this time, the Fed began participating in a “quadriad” consisting of it, the Council of Economic Advisors, the Budget Bureau, and the Treasury Department in preparing these forecasts. Throughout the book, Axilrod weaves into the narrative the external and political factors that constrain Fed policy. In this case, Axilrod reports that a problem in the late 1960s was getting accurate data on government spending from the executive branch with regard to spending on the Vietnam War and Great Society. The Johnson Administration often low-balled spending numbers to make the deficit appear smaller. The Johnson Administration also turned Fannie Mae into a quasi-private government sponsored enterprise in order to get its debt off of the government’s books. A result of this low-balling, Axilrod claims, is that it contributed to the Fed’s inaction against inflation, as the 1970s inflation began to take shape in the late 1960s. That is, the Fed would have been more aggressive in taking anti-inflationary measures if it had known the true extent of the government’s spending.

Despite this, Axilrod points out that the public simply did not have the will to fight inflation until it got out-of-hand. A preemptive strike against inflation would have devastated the savings and loan institutions that were borrowing short at variable interest rates and lending long at fixed interest rates. In this sense, he lets Arthur Burns off the hook a bit. Conventional wisdom is that Burns fiddled while inflation burned and perhaps fueled the fire in response to political pressure from the White House. There may be an element of truth to this. Axilrod recounts a story about how after a White House meeting, Nixon aide John Ehrlichman told the assembled Fed staffers “when you gentlemen get up in the morning and look in the mirror while you are shaving, I want you to think carefully about one thing, ‘what can I do today to get the money supply up?’” However, Axilrod is undoubtedly correct that the administration and public would have never tolerated the costs of fighting inflation until the costs of not fighting inflation were widely felt. They would not have tolerated a slew of bankrupt S&Ls in the early 1970s and probably would not have tolerated rising interest rates in general. The same is true for Congress, who ultimately grants the Federal Reserve its authority. Axilrod recalls one instance where Federal Reserve staff had to draft a letter to various Congressmen arguing that the Federal Reserve increasing interest rates did *not* contribute to inflation by increasing borrowing costs for the general public. Axilrod contends that Burns is mainly the victim of bad luck in being appointed the Federal Reserve

chair during the inflationary 1970s.

However, Burns is not left completely off the hook. Axilrod states that Burns was cautious by nature and was not capable to move public opinion in favor of tougher anti-inflationary measures. That is, even if the public were against such measures, Burns did not even attempt to move the needle of public opinion in the other direction. During the Per Jacobsson lecture Burns delivered at the International Monetary Fund just before leaving office, he emphasized that monetary policy was limited by factors (such as political ones) outside of the Fed's control. Burns may also have been too nonchalant with regards to the role money played in causing inflation. Burns had little use for formal economic modeling and instead preferred to look at business cycles as independent events and respond accordingly, probably a throwback to his days studying the business cycle at the National Bureau of Economic Research. He also did not believe money mattered within a broad range of parameters as he believed that changes in the money supply would be offset by changes in velocity, which likely led the Fed to not pay enough attention to the excessive growth in monetary aggregates.

The chair Axilrod clearly admires the most is Paul Volcker, who Axilrod describes as someone who understands the nuts and bolts of monetary policy coupled with an understanding of what the public would accept, and a willingness to take drastic action. However as Axilrod points out, after experiencing the pain of inflation during the 1970s, the public was much more willing to take the anti-inflationary medicine than during Burns' term. Volcker was effective in implementing "practical monetarism" where a target was set for the total amount of reserves under control of the New York Fed's money market manager and allowed the interest rate to fluctuate within a band of plus/minus two points. Volcker also traveled around the country giving "stump speeches" to convince the public that the Fed would stick to the new policy and to lower inflation expectations. The rest, as they say, is history. Inflation was tamed and the Fed abandoned "practical monetarism" in favor of targeting the federal funds rate.

Axilrod discusses the links between fiscal and monetary policy. He believes the recession following the first round of Fed tightening in the early 1980s was more severe than expected because of the credit controls implemented by the Carter Administration. Axilrod believes that the firing of the air traffic controllers helped the Fed bring down inflation by helping break the inflationary expectations underlying the wage-price

spiral. He also believes that the recession following the bursting of the tech bubble was minor because of the expansionary fiscal policy implemented immediately after it. Perhaps the most surprising revelation is that the Reagan supply-side tax cuts made the Fed's life difficult as they worked to offset the Fed's tightening, which may have resulted in the Fed having to tighten more than expected. One wonders what the link between the Fed's actions and the 2009 stimulus were. Hopefully a similar book will come out in the future that answers this question.

There are simply too many interesting nuggets of information to discuss in a short book review. The book is a short, interesting read and is accessible to both professional economists and undergraduate economics students. Highly recommended.

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The Economist's Oath. GEORGE DEMARTINO. New York, NY: Oxford University Press, 2011. Pp 272. \$35.00

Most students in their principles of economics courses often learn the adage, "Economics is the dismal science." After reading this book, readers will come away with a greater understanding of the meaning, "dismal science." Many economists love to present esoteric models and statistics, (skewed) graphs and charts as a means to present the results of their proposed policy or research. However, they often fail to understand any ethical ramifications of these policies. Why? The latter forms the core theme presented in George DeMartino's book, *The Economist's Oath*. In general, DeMartino presents a criticism from within economists' conflicts of interest and general lack of ethical principles. *The Economist's Oath* starts a dialogue among economists about the ethical content of their work. Moreover, DeMartino examines the ethical implications of the immense influence over the lives of others that the economics profession now enjoys and proposes a framework for professional ethics in economics. More importantly, *The Economists Oath* is a well-documented critique from many perspectives and serves as foundation of the increasing critiques of ethical lapses over the past few decades. However, this critique was heightened after the release of the movie "Inside Job" which received an Oscar. This movie revealed the