

Remembering Allan H. Meltzer

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The Federal Reserve System celebrated its 100th anniversary a few years ago. The Fed has been embroiled in many of the economic disruptions that have occurred since its founding in late 1913. Allan H. Meltzer, who recently passed away at the age of 89, was the Fed's most important economic historian. He carefully documented these episodes up until the mid-1980s.

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Meltzer had a long-standing association with the Federal Reserve Bank of St. Louis. He visited the Bank numerous times and participated in several economic policy conferences. He delivered the [Homer Jones Memorial Lecture in 1991](#). To the public and many economists, Meltzer is perhaps best known for his magisterial two-volume work, *A History of the Federal Reserve*. In his introduction to the first volume, former Fed Chairman Alan Greenspan wrote that Meltzer's work was both "stimulating and provocative." We can see Meltzer's penetrating analysis of Fed history and performance from this extended quote in *Volume 1, 1913-1951*, pp. 7-8:

A history of the Federal Reserve is a history of the decisions made and the ideas that prompted them. The chapters that follow allow the participants to explain their actions, and the reasons for them, in their own words. These decisions produced very different results: a steep postwar recession in 1920-21, a period of stability in the 1920s followed by the Great Depression of the 1930s and, much later, the Great Inflation of the 1970s.

The men who made these decisions were not chicanes or evil. They did not directly seek the outcomes that their decisions helped to bring about. They did not fail to stop the depression because they liked the outcome and wanted it to continue. They acted as they did because of the beliefs they held about their responsibilities and about the way their actions affected the economy. Much of this history is about their reasons and their reasoning—what it was and how it changed in response to events and new ideas.

Men and women interpret events using the theories or beliefs learned earlier. The beliefs or theories that guided the Federal Reserve were mostly mainstream beliefs at the time they were held. Individual leaders influenced decisions most effectively by introducing new or different ideas or new interpretations. Benjamin Strong in the 1920s recognized the need to replace the gold standard rules and the commercial loan theory, on which the founders based the Federal Reserve Act. Marriner Eccles believed monetary policy could do nothing in the 1930s when short-term interest rates were low, so he did nothing to lift the economy from the depression. Later he believed that the Federal Reserve did not have the political support to use general monetary policy to prevent inflation after World War II. He proposed selective credit controls to substitute for higher interest rates and slower growth.

Individuals matter most when they are able to lead others to act in ways that do not fit comfortably within the prevailing orthodoxy. Strong led the Federal Reserve to support Britain's return to the gold standard in 1924-25. In 1927 he lowered interest rates and expanded money to help Britain maintain the gold standard. Allan Sproul led the Federal Reserve toward independence from the Treasury in 1950-51.

These and other episodes show that leadership was important at times. Events of this kind are rare. Most policy decisions and actions apply a framework based on prevailing beliefs.

Today, as in many periods in the past, the actions of central bankers in the United States, Europe, and elsewhere are under intense scrutiny. This is as it should be in a democracy, since central banks are not *ex nihilo* creations. But Meltzer's words remind us—or should remind us—that monetary policymaking is difficult. It is difficult because economic theory cannot explain everything and theory is constantly evolving as knowledge about people and institutions improves (that is to say, as new ideas emerge). It is also difficult because Federal Reserve policymakers can never know everything of economic consequence as events unfold in real time. This difficulty stems in part because the models used by central bankers are imperfect, which lend themselves to imperfect judgments and interpretations. As a result, wrote Meltzer, modern central bankers are neither all-knowing savants, nor mad

scientists operating in a Frankenstein-like fashion. They debate and act under the best intentions, with the tools and knowledge at their disposal, and then hope for the best.

Importantly, though, Meltzer wrote that Federal Reserve leaders must be willing to break from conventional wisdom. Again, Meltzer's words are crucial for today's policymakers: "Individual leaders influenced decisions most effectively by introducing new or different ideas or new interpretations." Moreover, "individuals matter most when they are able to lead others to act in ways that do not fit comfortably within the prevailing orthodoxy." ■