The Unbankers

The banker traditionally has led a vicarious life. Even while serving business, he has somehow stood above it. Since the Renaissance, of course, bankers have known risk and coveted profit. Yet a banker's risk is endured from afar; it is the borrower's job to manage, the lender's lot to wait. And profits? American bankers, until quite recently, have pursued them with a circumspection rare in other callings. Banking, like publishing, was an occupation for gentlemen; one did one's best for the stockholders, of course, but profit followed duty. Who was to suggest otherwise? Bank stocks were too thinly traded, too narrowly held to interest Wall Street. "Adventure is the life of commerce, but caution, I almost said timidity, is the life of banking," Walter Bagehot wrote a hundred years ago.

No longer. The change, indeed, has been no less sweeping than this: banks have become businesses, and bankers businessmen. The vicarious strain of the banking life has fallen out of fashion. Even as housewives have refused to live their lives through their children, so bankers have sought firsthand (not, as before, through their customers) the risks and rewards of commerce. The era of bank holding companies dawned with the sixties. Somber men in three-piece woolens took to double-knits; foreign currency trading, real estate management, and leasing became legal, even voguish, banking activities. Bankers' talk turned increasingly to the price of their own stock, to acquisitions and "five-year compound earnings growth." Sagacity overcame wisdom.

Martin Mayer's excellent and exhaustive study, *The Bankers*, is an account of this metamorphosis. To him the change is revolutionary, and it threatens the very roots of American finance. Banking has grown sleeker, more inured to risk, less *bankerly* in recent years. Vast changes have occurred in banking law and practice, he writes—the widespread use of short-term, volatile borrowings to finance longer-term loans, the seemingly limitless diversification of banking companies, the maze of regulatory responsibility. Technology has pressed forward, blurring the lines between savings and checking balances, speeding the velocity of money. All the while, he concludes, banking has become less stable: "The banking structure that is now building can collapse; the longer the regulatory apparatus permits it to grow, the more catastrophic the collapse will be."

Fortunately for us all, Mayer is not alone in these concerns. Late last year (the year of the demise of Franklin National and U.S. National Bank of San Diego), the Chairman of the Federal Reserve Board, Arthur Burns, declared that "commercial banking has been undergoing a profound change for well over a decade." Burns found much in this change to applaud. "Deposit instruments have been tailored to meet the special needs of customers," he told the annual convention of the American Bankers Association in Honolulu. "New types of lending arrangements to serve business and institutional borrowers have proliferated." Despite the recent failure of two major banks, he noted, not a cent in depositors' money had been lost.

And yet, he went on, the very pace of innovation had fostered disturbing trends. (Here, one imagines, the sound was heard of scraping chairs and coughing bankers.) "The most significant of these trends are: first, the attenuation of the banking system's base of equity capital; second, greater reliance on funds of a potentially volatile character; third, heavy loan commitments in relation to resources [more scraping]; fourth, some deterioration of assets; and fifth, increased exposure of the larger banks to risks entailed in foreign exchange transactions."

The Bankers

by Martin Mayer
Weybright and Talley $15.00

In other words, bankers are trying to do too much with too little money; they are borrowing "hot" money in order to lend it out again—convinced, evidently, that they can borrow short-term indefinitely. Moreover, they are lending to unstable borrowers and speculating in foreign currency. Burns might well have drawn his speech from the proofs of Mayer's as yet unpublished book, or from a *Barron's* article—published in April 1974—that questioned the financing and management of many bank holding companies. "Beautiful Balloon?" the headline read. "Bank holding companies embark on frantic expansion. Pay big premiums to diversify, push leverage to the hilt, lend with a ready hand."

The Bankers, however, goes beyond the mere listing of our present troubles. A man of conservative judgment, Mayer has joined sound instincts with reading and observation. He suggests, correctly, that banks have had much to do with inflation. Banks, after all, create money through the very act of lending it, and herein lies the significance of the bankers' revolution: banks not only husband society's stock of capital; they *manufacture* much of it, hastening or slowing the pace of business, stimulating or depressing prices. Investment must equal savings over the long run, Mayer reminds us. But at the hands of commercial bankers, the two sides of the equation have become estranged. The volume of lending, and therefore the quantity of real investment, is determined, not by the levels of savings, but, rather irrelevantly, by bank liquidity—the existing balance between loans and reserves.

Mayer is suspicious of proposals, such as those put forward by the Treasury Department in 1973, to dissolve the legal barriers that separate thrift institutions from commercial banks. Savings banks serve a useful purpose, he writes, one that commercial banks, preoccupied with the glamour of "management," might well shun in their absence. The argument is provocative, though weaker for the author's apparent lack of familiarity with the work of Friedrich A. Hayek and Ludwig von Mises. Long before the age of holding companies, the "Austrian School" saw in the fractional-reserve banking system an unfailing engine of instability. (Bankers lent too much or too little, rarely what the supply of savings, balanced against the demand for investment, should have dictated.)

The Bankers, of course, is not a treatise on the theory of money and banking. It is, in the best sense of the word, a journalist's book and its first aim is description. The markets for Eurodollars and Federal Funds, the Federal Reserve System, the mechanics of making loans—these and other financial arcana Mayer consistently illuminates. Indeed, his diligence is sometimes blinding. For the better part of thirty pages, for example, he describes the odyssey of a single check as it wends its way through the banking system: "In November 1973," he begins, "I purchased 42.7 gallons of gasoline and 33.6 gallons of fuel oil from Piccozzi's Service Station on Route 114 in Shelter Island, N.Y., and on December 1, promptly, Jake Piccozzi sent me a bill for $27.33. He got my check...." Mayer is unrelenting. The facts and descriptive narrative roll on, taxing the patience, one is certain, of everyone but the author's immediate family.

The book, at 566 pages, is far too long, and this is its major weakness. There are things in life that it is better not to know. It is better not to know, for example, that Walter Denbeck, a driver for the American Purolator Company, drove his own car (a station wagon) while delivering checks on the night of December 5, 1973. Flailing one's way through passages like this one, it is hard to recall that Mayer is writing about a revolution.

On the other hand, *The Bankers* boasts pages of intriguing detail. Especially recommended is an inside account of how a rickety loan to Iotron, a small

Boston electronics company, was finally righted. The book is filled with people, which makes it at once lengthy and readable. (Could it be that Mayer mentioned sources simply to thank them for help?) The result, at any rate, is a very thorough, and, at least according to Citibank, which is quoted throughout, a very accurate book.

What of the banking system itself? There are signs that moderation has won a new following. It is important to remember, moreover, that not all bankers have joined the revolt from convention. Tradition, the banker's inherent distrust of financial vogue, still reigns—though not without rivals—in Baltimore, and perhaps in other cities like it. Not long ago, the Bank of America, largest of the nation's 14,000 banks, announced it is slowing its rate of growth. Its decision evidently came at the prodding of the Federal Reserve System. John J. Balles, president of the San Francisco Fed, was quoted at the same time as saying that "the cult of performance" must be put aside: "Now is the time to look primarily at the soundness of earnings and the quality of earnings." Certainly, the economy itself will have much to say about the strength of American banking. And one cannot help but wish, with Martin Mayer, that bankers would become a bit more like bankers. □

ERRATUM

In our August/September review of Paul Eidelberg's *A Discourse on Statesmanship*, Dr. Eidelberg was incorrectly identified as Research Professor of Political Science at the University of Dallas. Dr. Eidelberg now teaches at Claremont Men's College.

EDITORIAL

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one take this tireless socialist, his eye forever on the infinite of egalitarianism even while his body soaks in the luxurious ambience of Gstaad and glides down the slopes with the world's most trivial and boring people, the beautiful people? One should take him as seriously as one takes the local Ford salesman. Anyone with the economic intelligence of an orangutan realizes that Galbraith's economic nostrums would actually increase inequality while leading us to economic catastrophe, but I submit that if his economic nostrums would lead to anything other than catastrophe he would not be thumping his podium for them. It is precisely because these economic prescriptions are so malefic that he roars for them. Their obvious destructiveness is what allows him to show his defiance for society, a defiance that is a direct function of his hubris. In *The Poetics* Aristotle adjudged hubris a terrible flaw. He was correct, of course; and in America today many of those who urge us to the certain destruction that would follow were we to abscond from our responsibilities are people crippled by the terrible flaw of hubris.

Personally, of all my hypotheses explaining the abominable and illogical enthusiasms of the left *cognoscenti* I find hubris most fetching. There is a terrible arrogance in their line on Israel, a destructive insolence in their animus against business and the conditions of liberty, and a downright suicidal passion in their vehemence against intelligence operations, defense spending, and, in brief, the very survival of democratic institutions.

Finally, though we may debate the source of their perversity, we must remember that their enthusiasms are destructive in the extreme. The destructiveness of these enthusiasms may appear, on first glance, to place the United States in grave peril, and it has become very fashionable to bewail America's dismal prospects. Actually it seems to me that Moscow, Peking, and the Third World are also in deep trouble because of these ruinous enthusiasms. Even the average Ivan snoring away in the Politburo must realize that the same vanities that lead Senator Frank Church to disregard the security of America might lead him to disregard the safety of the whole world. What if some lunatic subscriber to the *New York Review of Books* became President and decided the only way to really reform the world would be through worldwide nuclear holocaust? Nothing would stand against his zeal, and in no time Moscow, Peking, and Washington would be turned into cinders. Surely such premonitory musings are not new to the Kremlin. Everyone by now knows that Moscow was as interested in McGoo's 1972 defeat as the Committee to Re-Elect the President; not even Mr. Brezhnev's craftiest Americanologists could guess what crazy George might do.

Admittedly this is a startling new perspective on world politics. What I suggest is that if those Americans who seem so intent on destroying America gain much more influence, the *Bolsheviki* and their Chinese cousins may join forces with the American Legion. Old Brezhnev realizes that hubris knows no bounds; those who would destroy America might also, if given the chance, incinerate the whole globe. It is a scenario to contemplate. □

The Intelligible World of Harry Johnson

Books by economists on social policy must be approached with a certain caution, if not dread. On the one hand, there are the "factual" books, in which information, assumptions, and rhetoric are jumbled together and policy positions tacked on, in the outward form of logical conclusions. John Kenneth Galbraith's books are perhaps the best examples of this genre. On the other hand, there are the "theoretical" books in which rarefied "models" and high-powered mathematical techniques rigorously prove conclusions already implicit in the arbitrary assumptions and value judgments of the authors. There is no single outstanding example of this genre, for this has become the common pattern of modern policy economics. However, one is entitled to hope for something different from someone as unconventional as Professor Harry G. Johnson, who is in the remarkable position of being simultaneously on the faculty of the University of Chicago and of the London School of Economics, as well as being celebrated for making wood carvings during conferences on economics. That hope is not disappointed in this volume of Professor Johnson's essays, *On Economics and Society*, though it is disquieting to realize that the unconventional aspects of this book are sobriety, balance, and intelligence.

Three broad topics dominate these essays—economic policy, economic theory, and the role of intellectuals. These are more connected than they might seem to be at first, for economists are a special interest group like other intellectuals, and their own self-serving vision of the world affects both their theory and the policy derived from it. Intellectuals are constantly discovering urgent social problems whose solutions invariably require an increase in the demand for intellectuals. Moreover, as Johnson bluntly puts it, their "solutions" involve "seeking to create a society more deferential to people like themselves," so that they profit psychically as well as financially—and all in the name of the poor or of democracy. Thus, for example, an ever-popular solution to the poverty problem is "forcing the children of the poor to stay in school" (consuming the products of teachers, writers, administrators, and researchers, at the taxpayer's expense), even past the point of diminishing returns, to the point of actual psychic damage to the child. The damage to the "student" who has come to hate school ultimately becomes damage to society, because his antisocial reactions to continued educational force-feeding have "the effect of inculcating irresponsible habits and antagonistic attitudes toward authority" which plague him and society for years to come. It is no answer to say that education is "necessary" in a modern complex society; many chemicals are absolutely essential to human life and yet become harmful or even fatal when increased beyond a certain proportion.

The general problem of poverty and income inequality is one on which Harry Johnson has a lot of sound things to say which are usually *not* said on this subject, but his impatience and disgust at the "naive and basically infantile" ideas common in this area make him less thorough than he could be in exploring *why* so many arguments are "emotional rather than rational," and why "superficial and irrelevant statistics" are the norm in discussions of income distribution. For example, much of the statistical "inequality" is between young people just starting to work and their middle-aged parents with decades of work and earnings behind them. But most young people will eventually become middle-aged parents themselves—without any revolutionary new social theories or any massive government programs.

> *On Economics and Society*
>
> by Harry G. Johnson
> University of Chicago $12.95

Real poverty is something we can all be concerned about, but the whole point is that there is a vast difference between real poverty and the statistical inequalities which the shrill voices are always pointing to. That *x* percent of the people receive *y* percent of the income or wealth tells us very little about poverty or about real inequality in any meaningful sense of people whose whole lifetimes are constrained within different socioeconomic conditions. Real poverty is what we usually have in mind when we think about inequality or when we set up social programs. But the fatal flaw in much thinking and in many governmental programs is the lack of correspondence between the kind of people we have in mind and the segment of the population defined by the laws and measured by the statistics. Thus we end up with such absurdities as graduate students with very high earnings potential receiving food stamps paid for by taxpayers with far less rosy prospects.

Harry Johnson is perhaps at his best in tracing the emergence and dominance of "Keynesian" economics, and its recent political and intellectual vicissitudes. He exposes its central implicit assumption—that the episodic economic problems of the 1930s were somehow typical or inevitable in capitalism, rather than being disastrous effects of particular governmental decisions at particular crucial points. Indeed, he points out that for England these catastrophic decisions occurred in the 1920s, when an overvalued pound sterling brought chronic deflation and mass unemployment. In the United States, severe monetary contractions after 1929 brought on the greatest depression in history, spreading a shock wave of depressions around the world because of international financial linkages. It is refreshing to see the 1930s portrayed as a peculiar decade, rather than seeing virtually all the *rest* of modern economic history portrayed as unusual periods during which special circumstances (the frontier, mass immigration, etc.) "postponed" this "inevitable" occurrence, which would now be the norm except for providential salvation via Keynesian economics.

The technical aspects of Keynesian theory and of monetary economics generally are summarized in as lucid and straightforward a way as their intricate complexities will permit. Still, this part of the book will not be light reading for anyone but professional economists (and not even all of them). The basic guts of the difference between the Keynesians and the "Chicago school" monetary economists is the question whether government spending is needed to maintain "full employment" or some approximation of full employment politically defined by some corresponding level of "acceptable" inflation. The Chicago economists argue that it is illusory to think that a given set of unemployment rates corresponds to a particular set of inflation rates, because only *ever-increasing* inflation can maintain artificially high levels of employment. Inflation "works" only by fooling people, and you cannot fool all the people all the time with a fixed rate of inflation, which they will eventually adjust to and plan for. But if the Chicago economists do not accept the Keynesian "solution," they also reject the Keynesian problem. Mass unemployment is not the "normal" state of unregulated capitalism, nor is governmental "fine tuning" necessary to keep the economy on an even keel. Indeed, many doubt that the government can get the right channel, much less engage in fine tuning.

The intellectual history of the "Keynesian revolution" and its aftermath is almost as fascinating as its economic and political impact. Johnson depicts the meteoric rise of Keynesianism as due both to an obvious socioeconomic problem of massive dimensions—the depression—and to characteristics of the theory which allowed ambitious younger scholars with mathematical training to upstage and bypass their elders in the economics profession. In short, the enthusiasm with which Keynesian economics was received was due partly to a de-