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by William McChesney Martin, 1956

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Julius Hirsch, Chairman

It's a very real privilege for me to be here today. Whenever I accept an invitation like this, I always like to ask myself why I did it, because I really don't enjoy speaking, whether it's appropriate for me to be present at the occasion, and what, if anything, I can contribute to the meeting. In this case it wasn't very difficult. I knew I would be right at home if I came here to the New School. I have kept a diary - sometimes I think it's a mistake to keep a diary - but I have kept one through the years; and in going back over it the other night I found the origin of my introduction to the New School. In 1931 I came to New York from St. Louis; I joined the New York Stock Exchange, and I was looking around for something to do in the evenings. And I visited with an official of the Federal Reserve Bank of New York, who is now my associate as Under-Secretary of the Treasury, Dr. W. Randolph Burgess, and I asked Dr. Burgess what I ought to do with my evenings. And he suggested New York University, Columbia University, and thumbing through some notes on his desk, he said, "And at the New School an old friend of mine, Dr. Kemmerer, is going to give a course on the gold standard, and I think you might enjoy that. The result was that I came up here and signed up for a course in the gold standard given by Dr. Kemmerer, and from there on, if you look through my diary, you will find evening after evening where I have noted, "Evening spent at the New School. Walked home." And on one entry that I noted particularly and that is appropriate to mention today is, it said, "Walked home with A. Wilfred May. Argued about economics with him. Am not sure whether I won or he did, but we both had a good time." (Laughter)

I also am very pleased to be here to pay tribute to Dr. Johnson. He's a man that wears well, as all of you know; he's a man who has contributed a great deal to my intellectual stimulus; he's a man that I've found always to be provocative, stimulating, constructive, and - most important of all - never dull. Never have I attended a meeting that Dr. Johnson has presided over where in any sense of the word you could describe it as dull. So that I'm very honored to be in his presence again. I always think of him as one of my mentors and teachers.

Now that in itself is not enough for coming to a meeting of this sort. What, it seems to me, is more important is to understand that it is through assemblies, convocations, meetings, discussions, and more discussions that we propel and maintain our form of life and our democratic means of expression, which is really the important thing in a country such as this. I know sometimes we get tired of going to meetings; but it is only through discussion and through constant evaluation and reassessment of the position that we're in that we can hope to safeguard the values which are useful to us.

Now when I look back and think of the last 25 years in New York, I can't help but realize more than I've ever realized before what is meant when you hear that oft-repeated phrase that the truly educated man is one who has a grasp, an understanding, a knowledge, of what his intellectual inheritance is. There's nothing new in that; there's nothing particularly striking in it, but to really appreciate it requires a lifetime of study, and steady and constant humility with respect to the current state of one's own thinking or the current state of the knowledge with which we're dealing.

Now I always like to think of history - I happen to be one that doesn't believe that history repeats itself. I think that there are guides in history to general principles, to general forces, which can be extremely valuable in meeting new situations, and that perhaps we don't gain as much as we should by experience. I doubt if any two situations are ever similar, but it does seem to me that you have to keep the perspective of this heritage that I'm talking about in mind if you want to build, at all times. The year 1856, a hundred years ago, gives me the starting point for my remarks today. Franklin Pierce was President of the United States in 1856. Before the year was out James Buchanan was to be President. The Dred Scott decision was in the making. Kansas was bleeding. And a rising young political figure in the state of Illinois received 110 votes in a political convention for Vice President of the United States, Abraham Lincoln. But none of these events, although they mirrored what was to happen in the next hundred years, and in a financial sense it was centered in the Congress and debates upon the independent Treasury bill, was of particular importance to my theme today except that in late December of that year Woodrow Wilson was born. And the instrument which we now have, the American central banking system was developed and organized under Woodrow Wilson's leadership in 1913, only 42 years ago, so you can see what a relatively new institution it is. This is the centennial of Woodrow Wilson's birth.

It is at that starting-point that I want to take off, because I think that too few of us realize how important or how clearly the roots of our money and credit were imbedded in the soil of our American democracy. Nothing I am saying is intended to imply that I believe the Federal Reserve System to be perfect, or to be the final fruition of the achievements that this country can make in developing a sound system of money and credit. But I think we have to recognize in the roots the evolution of the Federal Reserve, the progress and change that has been made in adapting to a changing world, and the essence of what we're talking about today, new horizons in money and banking, must go back to this heritage. If you will study the Federalist papers, or try to review the documents of the time in terms of money and credit, I think you will see very clearly that you were not rationalizing or developing a thesis when it is indicated that our forefathers were particularly apprehensive of abuse of money and credit. After all, they had come from abuse, they understood what tyranny and despotism was, they knew what "Clipping the coin" was - to put it in a loose phrase - and therefore they were extremely apprehensive of permitting government to in any way get to a position to "clip their coin" or to depreciate their currency. And therefore, in the early days of our country, you see every effort being made, no matter what the consequences, to prevent public governmental interference in the affairs of money and credit. When the first Bank of the United States was formed in 1791, after long debate it was decided that no government official could serve even as a director of the bank. By the time we got to the second Bank of the United States, in 1811, progress had been made to the point that it was stated that at least five government officials could serve on the Board of Directors, but they could not participate in giving the Secretary of the Treasury reports of what transpired at the meetings which they attended. That was carefully stipulated in the debate. By 1840, in the debates that were going on on the continuation, coming into the 1856 period that I described, there was this constant determination to prevent public governmental interference, even if it meant panics and disaster. And that was carried all through the 70's and the 80's until, in 1907, we had a public evolution in the direction of governmental intervention that laid the groundwork for the Federal Reserve System.

Now it's no news to anybody in this room that, generally speaking, business and banking opposed the establishment of the Federal Reserve. I think we can be quite superficial in saying, "Well, that shows that business and banking was blind." Quite the reverse. It seems to me it shows that business and banking were aware of the fact that a great deal of power was now being given to a government body - that we were embarking upon a managed currency, something that strikes right at the roots and heart of our way of life and, if mismanaged, would produce all of the dangers and difficulties - perhaps worse - of the money panics which we had been witnessing. But we had reached a point, with the panic of 1907, where the decisions of the market-place were considered to be so blind, and the difficulties with the evaporation and disappearance of money when it was most needed, and its abundance when it was least needed, had struck through to the consciousness of the American people to such an extent that they were willing to risk the hazards of a managed currency and a full-blown governmental central banking system. But they were not willing to go all out in it, and that's where the structure of the system is important. After long debate, and some of it the usual foolishness that goes on in debates in a free society, we came up with a regional system of central banking. We came up with 12 banks, 24 branches, coordinated in Washington by a governing body that was supposed to have only the minimum of power to make effective national policy. The Board in Washington was to be independent within the government but not independent of the government. It was to be a part of the government, whereas the instrumentalities, such as the Federal Reserve Bank of New York, were to be quasi-government. The stockholders were to be the banks of the country, but the purchase of stock by the banks of the country was in no sense - and as the system has evolved it has become clear - was in no sense to be proprietorship, but to be only a means of participation through the democratic process in the operations and development of policy of the system. A great many bankers, even at the present time, think that it should be proprietorship, and I think have misinterpreted or misunderstood, what the real framework and purpose of the Federal Reserve Act was.

Now I stress at all times the important word in our title. The important word is not "Federal", it is not "Reserve", it is "System". Two hundred and fifty directors bringing to bear, through this process, the grass-roots thinking of the country upon the management of our money and credit. And it seems to me that when we make changes, as we made of a limited sort in the Banking Act of 1935, giving more centralization of power, in accord with the changes of the time, to the governing body in Washington, we should only make those changes with an understanding of the direction in which we are moving and how they should be used.

Now this system that we have has worked reasonably effectively. It certainly hasn't worked perfectly, but it is the body, the only body in the government that is charged full time with responsibility for the purchasing power of the dollar, and must always be thought of in that light if we're to think of it in its proper perspective. I am very fond of quoting from Mr. Disraeli. I have always found him extremely interesting and stimulating, and he said repeatedly that individuals may form communities, but it is institutions alone that make a nation. Such an institution is our Federal Reserve System, and it does constitute today one of the primary bulwarks of our free enterprise system. Because unless you have flexible money and credit policy you cannot have free enterprise in the sense that we so often use the word.

So much for the institution which we have to manage the money supply, to regulate the money supply. Now in so far as there is a major change in thinking out of this evolutionary pattern which I have sketched for you, it comes to the fact that in the twentieth century, for the first time we see general acceptance of the responsibility of government to use all of its resources to minimize economic gyration and to accept responsibility for preventing, in so far as it can, major disturbances. I think that this is largely a product of the twentieth century. I don't mean to be all-embracing in that, or to rule it out in earlier comments, but it seems to me that a study of the Federal Reserve Act alone demonstrates that, because there's no reference to this broader purpose in the preamble of the Federal Reserve Act. There's only a minor reference to it in the preamble to the Banking Act of 1935. But you see its final fruition, in an inchoate way, I think, in the Employment Act of 1946.

Now this evolutionary direction, and the instrument that we have to operate, are essentially what we're dealing with today when we talk about money and credit policy in the broad sense.

I want to switch - having given you the background of the institutional framework within which we're working, I want to switch and put it a little bit in terms of the science or art - I doubt if science is the correct word - that has developed, of how we can exercise effective and useful regulation of the money supply. What are we talking about? I fear that we get too technical at times. All of us really understand that the money we have in our pocket, and deposit money, your checking account at the bank - that's what we're talking about in the money supply, and I think of it, that flow of that money and credit, as I do of a river or stream or a brook - that is, gradually winding its way through the fields of business and commerce. Our purpose in trying to see that this brook, this stream, has a little bit of gurgle on top of it, a little bit of ripple, is to see that it doesn't overflow its banks and flood the fields on either side, and to recognize that irrigation and drainage is required from time to time, and that we want the volume of water in that stream to increase, but not unless the roadbed in which the stream is operating can absorb it and hold it, that people don't just get rich by sitting on the side of the bank and dabbling their fingers in the water - that we do have such things as raw materials and initiative and energy, and that this money stream is just a means to an end - In our approach to it money should always be thought of as our servant and not our master - that we should not get enamoured of the gold standard or other automatic means of regulating it, because what we are essentially dealing with, and what we must recognize as the fundamental problem, is human nature and human things, and no one has yet devised any system of levers, or any formulas or devices by which you can regulate human nature or human beings. Now that is the really basic thing that we're dealing with in trying to regulate the money supply.

I'm going to divide the balance of my remarks into two parts, because I think it will bring to you most clearly an insight into what I conceive to be the concept upon which we are working in the Federal Reserve System today, and will give you perhaps a little insight into the modus operandi by which the Open Market Committee endeavors to arrive at its policy decisions, and also give you some of the essential framework, the essential concepts that have naturally grown out of the approach to money and banking which has been developed in this country - not unique in this country, but in its institutional form certainly different from any other country in the world. I might say its adaptation is a strictly American adaptation to the hazards of managed currency.

Now let's take the general theory of restraint and inflation. I think all of us recognize that you can be more effective in restraining than you can be in galvanizing. It is easier to supply money when business is bad, it's easier on a deflationary base to supply money in an endless stream, but no one's going to borrow that money unless they think they can make a profit out of it - unless you're giving them the money. Therefore we have had the illustration of pushing the string and pulling the string, and it is certainly more difficult to fight deflation as such than it is to fight inflation as such with the tools at our disposal. But having said that, I might point out that the human nature aspect of this problem is such that it is more difficult to get people to restrain once things are going well, even though those restraints will be effective, than it is to work in the opposite direction. It requires a great deal more political courage, it requires a great deal more sensitiveness to the fear psychology, where people say, "Ah, you may be inducing a collapse. You may be leading to ruination, and it will all fall on your shoulders. You will be the one that will be blamed". Well, of course that is a complete misconception of the role of money and credit, because it isn't that important or that powerful in the economy, but nevertheless that's the easy political catchword approach to this problem. Now when you take the elements of restraint, the politics of restraint is found, I think, in the fact that most people who have studied this field recognize that the reason we are against inflation is because we know it leads to deflation. If it were not for the aftermath no one would care about inflation. I don't mind conceding to this audience, or any other audience, that my social philosophy is such that if I really thought inflation would really create jobs and sustain them I would be an inflationist. The only difference between me and some of my critics in the Congress is that we have different methods of pushing for the same end. My own view is that by and large, in terms of employment, which is what we're working for, what we're working for, what we're trying to pursue, is that there will be two people unemployed after inflation has run its course, whereas there would only have been one unemployed in the resulting adjustment, if there had not been the preceding inflation, and that that is the reason we have to do everything we can to restrain inflation.

Now the politics of this is that you can restrain a man before he goes too far and he will forgive you, but if he goes headlong on his course and after he has gotten in trouble you come along and punish him, not only will he not forgive you but I doubt very much whether you can restore him to a working status. I just put that in a general, simple sense so that you can follow the general point of view that I have on this picture.

Now I want to take, in order to illustrate this, a period where it's been obvious, because I don't want to prolong this too far - I want to take the period when we knew that that inventory recession of 1953-54 was over, and that we were embarked upon an expansion in this country and that we were going to have relatively better times. Now when I say that I am fully aware that not every place in the United States has been equally prosperous. I am fully aware of the fact that farm income has declined, that some of the price stability that we've had in the past year has been due to the fact that there's been a $3\frac{1}{2}$ to 5 percent increase since the summer in industrial prices offset by a corresponding decline in farm prices. But nevertheless, by the latter part of 1954 it was fairly clear that we had arrived at certain inevitable corrections that have to be made if we're to develop and expand the unlimited resources that this country still has at its disposal.

A word about corrections, because it seems to me that that's where we miss the point completely. There are people, probably some in this room, who honestly believe that if it hadn't been for the miscalculations of the

Treasury and the Federal Reserve in 1953 with respect to the issuance of a long-term bond and a so-called hard money policy, that there wouldn't have been any correction. There are some people who honestly believe that and that we would just have gone on a steady upward spiral. Now I'm not going to comment on that in a technical sense, but I'm merely going to try to emphasize that anyone who's going through any period and relates this to human nature knows that when times are good or we go on a binge, such as we did in the post-Korean period, that there are elements which human nature brings into any picture that have to be corrected, and those elements are waste, extravagance, incompetence, inefficiency, and all the byproducts of exuberance, enthusiasm, and ability to take advantage of a situation - I'm not talking about taking advantage of it dishonestly, but take advantage of a situation created by shortages The inevitable aftermath of all war is inflation. That's perhaps the worst phase of war, but it's the one that's the least understood by people because it's usually latent. During the war you have patriotism that can control the latent inflation, and after the war the patriotism disappears and the attitude of people changes, and it's there. Now I'm not trying to wriggle out from under a certain amount of responsibility for misinterpreting or misgauging the psychology of the Spring of 1953 in money and credit policy. I have admitted in the Congress and I have admitted publicly that I don't think we handled the situation as well as we might have. But having said that, I emphasized that the place where the error was primarily made, aside from details, was that in '52 we were letting money get too easy and we were not permitting the adjustment to be made in the market that would have to be made.

Let me just illustrate one simple case. When it was apparent that business was declining, and declining rapidly, in late 1953, I had a meeting here in New York with a very intelligent group of individuals whose business was suffering. After the meeting they had some questions, and one of the men there called on another individual and said, "Joe, tell us why your business is so bad. I'm sure Mr. Martin would like to know." I'll never forget this man. He got up and he looked at me and he said, "I can't tell Mr. Martin why my business is so bad. I'd be ashamed to tell him that. Until I've done the things that I know ought to be done in my business, I don't know whether my business is really bad or not." And then he explained to me what had happened in his business. And it was a very revealing portrait, and illustrates the point I'm making. He said, "My daughter married a fellow who, in my judgment is completely incompetent, but he's in the family, so I gave him a job." He said, "I've got twenty people working here that I don't need, but business has been so good that there was no particular incentive for me to correct any of these situations in this shop, and honestly, there are so many things wrong with my business that I know about at the moment that I've been postponing doing, that I'm going to say to Mr. Martin, 'I'd like to talk to you a year from now about how my business is, and if it's bad then I'll start crying, but not before.'" I thought that was an extremely revealing illustration of the point that I'm trying to make.

We go through that period, we eliminate - you must remember that this economy of ours is not only a profit economy but it's a loss economy. A great many of these buildings that we see around us in New York - I love to walk around the streets of New York - have been built out of losses, not out of profits. It's been a long time since any of us recall that, but I once held a few bonds on a building that's now selling at par, and I bought them for five bucks in the open market. Those losses are normal in a free society, they're part of the rewards and profits of business. Business is not always a one-way street. If it were, there's be no judgment in it. And the only point I make in finalizing this part of my talk is, that if it were possible by inflation, or by conscious government policy toward inflation, to continuously have good times, we would have discovered that a long time ago, and there would never have been any changes (inaudible) .... the government would have just propelled by inflation itself into office continuously. It seems to me that that's the rock bottom problem there.

Now I want to go to the period where it's perfectly obvious that we had to change our emphasis and ride herd on credit. This was not a period where we were facilitating the corrections that I illustrated by this story of this individual who wanted to correct the things that were wrong in his business; this was a period in 1955 when it was obvious that certain formations were developing in the economy that could lead us to disaster. What were they? By the Spring of 1955 it was perfectly clear that there was a wage-cost push. We are all familiar with the guaranteed annual wage, or supplementary unemployment compensation, whatever you want to call it. That was the dramatic aspect of it, perhaps, but I don't think that's as important in your thinking as the minimum wage law itself and the areas of the country where that minimum wage law is now about to come into play. That was with us. You had on the whole high levels of employment everyplace. Now employment is a difficult thing to talk about, because none of us want to see anyone unemployed. I certainly don't. And we run into people who try to make political demagoguery out of unemployment. I would do anything in the wide world to help anyone who's unemployed and in a bona fide way wants a job. But we had high levels of employment here; we had a movement that was indicating that we were approaching full employment in the early Spring - not in every area of the country, there were technological changes in the coal regions and other regions - I just cite that - where mobility of labor requires certain changes -

that's the essence of a free economy. But we did not have employment as such working against us in terms of money and credit policy.

Now we come to the thing that has to be watched the most carefully of all. - - - our inventories, Having been through one inventory recession I don't want to go through another if I can help it. Inventories, by and large, people were saying, are in pretty good shape. Figures were being evidenced that they were. I'm not sure about it. When the head of a company tells me that he's trying to build up inventory - and don't forget that inventory figures are the poorest figures we have - and he doesn't build inventory, then I know that his sales are exceeding his expectations, and the first time that his sales don't exceed his expectations, the inventory is going to go like that - and that's the thing you've got to worry about.

Now we have high and increasing levels of consumer credit and mortgage credit. I'm not going to say that they're too high. I'm not going to say what the terms are. I don't believe that I know. I don't know enough about it, but I merely call attention to the fact that we have them and that they should be watched to the extent to which easy terms, whether in real estate or in consumer purchases, are being used when they're not needed, to borrow the market from the future, they're not contributing at that particular point to stability. I'm not saying that they may not have been contributing to stability - I'm simply citing that they were at record levels and growing and that there was a tendency to loosen terms whenever there was the slightest decline in sales, and that we have been riding, in one sense, a toboggan - that unless there is a record at the cash register the first of every month, something's wrong. That in itself is something that has to be watched, I think, pretty carefully.

Now the crowning thing that came to our attention and grew through the summer and was re-enunciated after the President's illness, are the plans for plant and equipment expenditure. It looks like 1956 is going to be a pretty good year for plant and equipment expenditures. Now take all those together, and you've got a situation that has to be watched - has to be analyzed. And it seems to me that if we have any balance at all that we should lean against the wind and let money and credit operate in terms of supply and demand, which are these basic guiding principles that I've been talking about, and which cannot be completely eliminated no matter how much you'd like to eliminate them.

Now here I want to make a few comments about the free market. It's become very popular - it was even popular in my early days at the New School - to hear it said that there was no such thing as a free market. And I believe all these things are relative. I don't believe that the concepts that we have, whether they're in private property or free competitive enterprise or with the profit motive or with the free market, are the same today as they were when the Pilgrims landed on Plymouth Rock. All of them have been modified through the years but that doesn't mean they've been eliminated. And there is no more effective equilibrating force than these time-honored - some people call them, in a deprecatory way, classical devices for gauging and guessing what the equilibrating forces are. Now I went through a period in Washington when it was very popular to say that because of the large public debt, because of the great progress that we've made and because of the current situation, exchange rates would never make any difference any more, interest rates would never have any importance any more because to be effective they'd have to be adjusted so violently that you'd have long lines of unemployment around the country; that the international price mechanism could never work again, that tariffs really didn't make any difference, that there was no point in being a free trader because a protectionist system could be built up - after all, hadn't Hitler showed the way on it, and were we ever going to get to a freer market?

It seems to me that the most striking thing, perhaps, of the last ten years has been a recognition that with modifications these things are still with us just as is the law of gravity. That doesn't mean that you have to be a slave - it doesn't mean that you have to accept, any more than the public intended to go on accepting the money panics which preceded the Federal Reserve Act. It doesn't mean that, but it means that you have to understand them, and if you want to eliminate them or avoid them or minimize them or change them there is a price to be paid. There are advantages and disadvantages which must be weighed in the public mind.

Let me illustrate this in terms of what I conceive to be the politics of money, stripped of technicalities. In this past summer I had a political officer in a small community - it's not a large one, so I don't think anyone will guess it here, or I wouldn't cite this - call and tell me that I should be removed from office because a sewer issue that he was planning was being held up. I was quite interested in this particular picture. I happened to know this individual quite well, and I said, "This is a free society and you have a perfect right to try to remove me from office. I don't have the slightest complaint about that, but what is the situation? Is there no money available at all for the sewer issue in the community, because I think that's a good thing. The last thing we want to do in the central bank is prevent sewer issues from being floated". (Laughter)

Well, an investigation was made, and I think my facts would be borne out by any honest appraisal, that the money was available in the community - not quite the way that this individual wanted it, but it was going to cost about one-eighth to one-quarter percent more than the last time they had floated a similar issue. And now the demands for money were great in all the surrounding area, and they couldn't, with the policy that was being pursued, induce their bankers to come down. So this fellow was in a frenzy. And I told him what I believed to be the politics of this picture. I said, "I don't know whether they'll want to throw me out - perhaps they will. But I think you ought to tell the voters of your community, so that they have a conscious choice, whether they should pay 2-7/8 percent for this sewer issue - which they can get - or whether they would rather have the purchasing power of their currency depreciated just a little bit, regardless of what happens to this particular sewer issue. Stripped of technicalities, that is essentially the problem that you are dealing with, and that's where you have to come to in the free market."

Now the decision to unpeg the government securities market was a decision to return to the market some of the forces that had been precluded from it by government policy for a period of nearly ten years. Despite people saying that there were other factors at work, and I admit all those factors, it seems to me that the record demonstrates that the credit mechanism, once that unpegging occurred, began to function once again as one of the flywheels, one of the governors on the flywheel of the economy, and that people who had been buying mortgages by the bushel basket load had to take the process of evaluation again and determine whether they wanted to sell this government security at a loss in order to make this mortgage loan at a higher rate. There's no reason why they shouldn't make the choice, but they ought to have a choice. They should not have government securities interest-bearing money, so that there's no business choice involved. That, in essence, is what you're dealing with.

Now what, in essence, is the framework of our Federal Reserve Act today? There are very few of you in this room who probably ever read the Federal Reserve Act, and you may think that I'm stretching my analogies a good distance when I return to the concept that I like the best, which is the concept of trusteeship, because it's clearest to me. Seems to me that what Congress was doing in the Federal Reserve Act - and it can amend and change the Federal Reserve Act any time it wants - it may do it this session of Congress or next session of Congress, so we stand at the bar of public opinion - but it was turning over the management of the people's money - and as Walter Bagehot has said repeatedly, money will not manage itself - it was turning over the management of the people's money to a trusteeship. The Federal Reserve System, acting under a trust indenture, the Federal Reserve Act over which if the Congress had control, it would recognize that it could not spend the day-to-day time and energy in administration that is required.

Now it is with that that we are working today. But when I talk about this free market concept and the inter-relationship of these forces, I am still talking about a free society. And although there may be many in this room who will think that I'm begging the issue or that I'm talking in loose terms when I say that so far in this country neither the Treasury nor the Federal Reserve are strong enough to dictate what the money market should be, I believe it to be the truth. If there had not been these forces of the market, apart from the Treasury and the Federal Reserve, you would have had no Treasury-Federal Reserve accord in 1951. These market forces come up still in this country from the grass-roots, and when we talk about our problems in the Open Market Committee, each time we have a meeting we have four factors to deal with.

The first and most important thing that we have to consider are the requirements of the United States Treasury. Now when we talk about independence of the Federal Reserve System we're not talking about making it difficult for the Treasury to borrow money. We must work together with the Treasury. The

Congress appropriates the funds. Nobody has given the Federal Reserve the authority to tell the Congress what appropriations it should make, and the Treasury financing must always be a major consideration of our policy. But that does not mean that either the Treasury or the Federal Reserve can ignore the market and dictate what the rates should be. They have to go out into that market and assess it and evaluate it and determine it as best they can in accord with these market forces, limited or unlimited as they may be by government policy and by other factors.

Now the next thing that we have to consider when we sit down as an Open Market Committee after the Treasury financing, we have to consider the seasonal requirements of business. That's why we're in existence. And we want to see that those are met. In my thinking a central bank has failed in its task whenever money becomes completely unavailable. The purpose is to let the forces of the market have some play, reflected in interest rates, but money should not become unavailable. It may for limited periods, because this is a broad country, be less available in one area than another, but it is our job to see that the seasonal requirements of business are met.

The third factor that we have to deal with is the growth factor in the economy. And this stream that I've been talking about earlier - we want the volume of money, the volume of water in the stream, to dig a roadbed that it can maintain - must grow with the growing population. Some people think it ought to grow at the rate of 3%, some people 5%. I don't know what the figure ought to be. I am very gun shy of precise figures on anything of this sort, but that it should be growing is as obvious as that population is growing; and also that when business declines the same volume of money has less effect because of the velocity factor of money than when business expands and is improving. In other words, you can have an increase in the money supply when a business is declining with velocity also declining, that will not have as much in terms of this ripple or gurgle on this stream that I'm talking about as when business is booming or business is gravitating upward and you have a volume of money that is lesser in amount, but the velocity of money, the turnover of money is increasing and the plans of businessmen are going forward. So that in these measurements you have to be extremely careful.

Now the fourth factor that we have to deal with at each of these meetings is the psychology; and that there is no way of measuring. I confess freely that in 1953 our technical measurements of the money supply I think were almost perfect. I don't believe there were any errors made either by the Treasury or the Federal Reserve of any importance during that period. But our estimate of the psychological nature of the expectations of the community because of what we were doing were completely wrong, and the only credit at all that I take for the Federal Reserve in that period is that we reversed as quickly as we could when we saw what those miscalculations were. And all I would say about the usefulness or adaptation of policy at that particular point is that with human nature and human beings and an inability to develop a precise formula, you've got to be prepared to roll within certain areas. You cannot expect to hit it right on the nose. Some people may think we should have eased two months earlier, some people may think two months later. But if you get within a range you're doing about as well as I think you can expect.

In a general way I've covered what I wanted to talk to you about today, and leave with you. But I would be missing the whole point of what I've tried to get across if I failed to emphasize that the problem that we're facing today, in 1956 is again the problem of whether the community can develop sufficient statesmanship, sufficient leadership - having talked about private enterprise, and having sometimes talked about irresponsibility in one group or another, whether labor or business-not to let itself be carried down the road of a new era. Now I have seen disquieting signs, the last few months, and I would not talk freely in an open meeting if I really thought we were on the verge of a collapse - but I have seen disquieting signs of people believing that we're a lot smarter than we were the last time. And I have studied the records of the Federal Reserve, because they're available to me today, of the 1920's and I must say I find them very disquieting. I find a great deal of brains and a great deal of intelligence revealed in those records, and I'm by no means convinced that the present Federal Reserve and the present Treasury, or the present business leadership, is going to be any more equal to the situation than it was before. But in so far as it may be, it depends upon the community sharing in an understanding of the responsibility of everybody to pull their weight.

I know this sounds like Pollyanna stuff. I know this sounds to business men perhaps at times like, "Oh, you don't understand the competitive forces; you don't understand I'll lose this account across the street if I say no". The basic point I want to leave here with you is that it's in a period like this that the real test of free enterprise comes.

I close with the most interesting and to me revealing thing that's happened. Having painted my disquietude about some of the indications that seem to me the starting development of the "new era" philosophy again, of the belief that consumer credit, for example, will be rental credit from now on, and that nobody will ever be out of debt again - they'll just have automobiles on a rent basis, etc., or something of that sort, which may or may not be so -

I happened to be in New York around November 18. We had just raised the discount rate I was rather discouraged, because it seemed to me that the problems were a little bit over my head, generally speaking, and the New York Times had a little item on the front page about the increase in rate. I went to an entrepreneur where I have visited for the last twenty five years and enjoy sitting around and bulling with the people that are there, and to my surprise they were reading the New York Times. One of these fellows turned to me and he said, "Mr.Martin, I see you raised the discount rate yesterday." And I said, "Yes, Joe, what do you think of it?" "Oh, we've been having quite a discussion here, quite a discussion. You know, we've had the best business in this little shop that we've had in the last twenty years. We never had anything like it. And you know what Ed said, over here? He said, 'You're doing the right thing. You're trying to prevent another 1929, aren't you?'" And I was extremely encouraged. It may be just a straw in the wind, but I said, "This fellow has some glimmer of what the operation is and of what we're trying to do."

Now that in a general way is all I want to leave with you today. Thank you very much. (Applause)

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