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**Stenographic Transcript of Remarks of  
Wm. McC. Martin, Jr., Chairman  
Board of Governors of the Federal Reserve System  
before the Annual Convention of the  
Investment Bankers Association of America  
Hollywood, Florida, December 2, 1952.**

Feeling as I do that groups like the Investment Bankers Association are really the essence of our democracy, I should like to open by telling you about an incident which I think illustrates the contribution that a group like this can make to our society today.

The incident concerns a conversation of mine with a Senator, and I tell it with his permission. I am not going to name him, but I can say he is a Democratic Senator of considerable influence in Washington -- a man who believes in the same things that you and I believe in.

On learning that I was to attend your convention, the Senator said to me: "Why do you waste your time going down to the Investment Bankers Association? They don't have any real political influence, and, after all, what do they do -- just play around?"

The question, whatever its demerits, did give me the opportunity to tell him -- and I repeat that he is one of the most constructive men in the Senate -- of the work of your group during the time I have been on the Federal Reserve Board.

I explained the voluntary credit program to him; how halting it might have been -- without disillusion to me, because I started it as a skeptic -- and how helpful it actually turned out to be. I told him how the Investment Bankers Association, participating in the program with others as we gathered together a large collection of managerial and business resources,

had helped in the attempt to educate the borrower as well as the lender as to the true meaning of credit and finance, so that we could handle a situation that was rapidly getting out of hand.

The Senator was impressed. Then I told him about something some of you in this room will recall; the time we brought the Governor of West Virginia to Washington in connection with a proposed soldiers' bonus bond issue by his State.

The Governor was in the Federal Reserve building, surrounded by investment bankers and other bankers and businessmen, and one by one they explained to him why it would not be wise under current conditions to have the West Virginia bonus issue.

The Governor had brought with him a banker who was part of this educational process, and when it was apparent that the group was adamant against the bonus issue, the Governor -- and I must say he is a charming individual -- turned to his banker for help. The banker, having heard the remarks around the table too, looked at me and said, "I don't know what all this fuss about inflation is."

"After all," he continued, "this isn't really inflationary. There are only a few thousand people in the State of West Virginia that will benefit by it. There is only \$300 apiece involved for each of these individuals, and we have made a study of what they will do with this money."

He paused a moment, then added: "It is perfectly apparent it isn't inflationary. They are going to spend a hundred dollars of each bonus on

liquor, a hundred of it on women, and the other hundred they are going to waste."

His insight into economics -- and perhaps into human nature -- might be doubted but the unconscious humor was to the point. It recalled to me an experience I had here in Florida in the Spring of 1949.

That was when I was a neophyte as Assistant Secretary of the Treasury and when some people, looking at clouds of recession and readjustment, thought they saw a depression on the horizon. The Secretary asked if I would come to Florida in his place and make a little talk to the Florida Bankers Association over in Miami.

I consented, and on the plane en route, began to think over what I might say. I must have taken myself and everything else considerably more seriously than I should have, for it seemed to me that the problems the country was facing were virtually insuperable, for I couldn't see the answers, and it naturally disturbed me.

Then I recalled a course in public speaking I took years ago in which one of the lectures dealt with what a responsible Government official should say to a group of worried businessmen. The lecture went about like this: You should always start by saying, these are the most difficult and perilous times the country has ever faced; never in the history of the country has the ship of state been so close to the rocks. Then, by the clarity and exactness and sharpness of your proposed solutions, you would lead your audience, subconsciously, to feel that after all the ship of state was in good hands and might survive.

Well, when I addressed this group in Miami, I embarked on something just about as pompous as that, and I thought I had carried through on the formula in pretty good style. But after it was over, a fellow came rushing up to me -- I can see him still -- pulled me aside, and said: "Young fellow, when I came here I was pretty upset. But after listening to you, I am just scared to death."

I don't want to frighten anyone this morning. Indeed it seems to me now that while the clouds that were on the horizon in 1949 are not out of the way, there are rays of sunshine that were not apparent at that time.

It seemed to me then, as it does now in retrospect, that the business community as well as the Government showed little fortitude with respect to making the adjustments which are essential and necessary and a vital part of a free competitive economy. In those darker days, all the pressures in Washington -- and I can speak with some feeling on this because I was in the Treasury at the time -- were in the direction of: Don't permit any downward move! Don't permit this thing to gather any headway! Don't have any adjustments whatever! We shouldn't inflate our way out of it, but we can't permit the adjustments that have to be made! We may face a period like that again. That is the reason I recall it. But all I want to do this morning is to talk a little about what I consider to be the basic principles of propulsion of our economic machinery and of the present competitive enterprise system, which we talk about glibly but not always with understanding.

We are once again, not only in this country but in the entire Western World, returning to a recognition of the principles upon which our strength rests. Within the framework of human nature -- of which you may or may not approve -- the maximum benefits for all of us flow from utilizing private property, free enterprise, and the profit motive in accordance with the dictates of the market place -- something that has been almost forgotten for a period of years.

The heritage of all wars is inflation. And inflation can be just as serious an enemy, just as serious a threat to the vitality and the vigor of an economy and a country as can an enemy from without its borders. It is subtle. It is insidious. It creates the conditions which produce controls and regimentation, and it permits the excuse that after all, we have to move in this or that direction because Stalin makes it impossible to move in another way. There is always a grain of truth in that, and there is always some palliative that can be suggested as a temporary expedient. But the essentials, the basic ingredients of the decision of the market place, have been the foundation and the cornerstone of the American economy and of the economy of the Western World. That is one of the reasons why we have been able to achieve current high levels of employment and of production, a record expansion, and a defense program -- which is now rolling -- without serious inflationary consequences. At the risk of appearing too confident, I might say that I think the inflation

situation today is very much like the foam on the waves that you see out there in the sea -- that this inflationary swing is at the tail end and we have caught it where, if we handle ourselves wisely and intelligently, we can prevent the reforming of another wave that will roll on and endanger our structure.

Now this process of returning to acceptance and use of the market place is slow, painful and hard. It is not achieved because people necessarily like it; it is achieved because alternative ways don't work -- and that has been found out in most of Western Europe since the war. In struggling with the problem of inflation, most of Western Europe has gravitated around the Marshall Plan, a program that was in its initial stages not only desirable but intelligently conceived and intelligently planned -- not as a perpetual handout or perpetual dole, but as a means of helping people to help themselves in a period of hospitalization, making it possible for the patient to get the strength to earn his own way when he left the hospital. We have seen the countries of Europe that struggled along with Marshall Plan aid return to the earning process, one by one, and do it the hard way. We have seen monetary policy put to work in Belgium and in Italy. We have seen it move from Italy up to the Netherlands, on to Denmark, and on to Britain. For the last year Britain has been taking measures running somewhat parallel to ours.

I certainly don't intend to imply that monetary policy, alone, is responsible for restraining inflation. Monetary policy is just one ingredient -- one weapon or one test -- but it is a part of the general method by which we let the forces of the market reassert themselves. Other tools should be used, of course, but if we did not use monetary policy, too, we would be turning away not only from the traditional way but also from the purposeful experience of the past. It seems to me that the record of the last few months, and I might say the period since the Treasury-Federal Reserve Accord in 1951, has shown that monetary policy, if properly used in cooperation with debt management, can and does have a tangible, beneficial effect.

During the past year, under the authority of the Federal Open Market Committee, an ad hoc sub-committee has been reviewing our operations in the Government securities market with a view to determining what might be done to develop and improve those operations under the changed conditions.

I want to take this opportunity to pay tribute to your members who have so greatly aided us in this task. I had the privilege of spending three full days, three working days, with your Government Securities Division. I have never seen more interested, intelligent, devoted individuals; it contributed a great deal to our understanding that we have been able to have the benefit of their experience and their guidance. When we were unpegging the Government bond market we had a whole



new field to explore. It was most encouraging to find that there were some groups that had been thinking about this problem, realizing that the latent inflation must not go on, and that at some point you had to put a restraining influence on it. I thought I might be able to give you today something tangible, but at the moment, I can only report, as Mr. Miller did this morning, that we have made "progress".

Still, I would like to share with you a bit of the experience we had with the unpegging of the Government market because from it you can see how you get frozen or straight-jacketed into concepts which require a great deal of thoughtful, patient work to shake off if you are to permit the forces of the market to reassert themselves.

After ten years of the pegged market, and the obvious desirability even during that time of minimizing monetization of the debt, we found that once the market was freed a little bit, all of the devices and techniques we had been using to prevent monetization of the debt now worked in reverse. We found that the dealers, the brokers, the individuals -- that composite that makes up the market -- thought of the Federal Reserve System much in the same way (to draw on my experience on the floor of the stock exchange) that some of the traders felt with respect to a pool operator in the days when pool operations were permitted in the early 30's. Naturally, they were much more interested in finding out what the Federal planned to do and how the Federal was going

to operate than they were in making judgments for themselves. Also, we started this program of freeing the market under the obvious difficulty that people were talking about collapse and panic and despair and disaster; some said that once Government bonds went below par the credit of the United States would be destroyed.

By now I rather enjoy recalling the first three or four months of my experience in the Federal under an unpegged market, but at that time it certainly wasn't a period of pleasure. I used to get calls at midnight, as my wife can testify, from people who saw disaster, panic and collapse on the horizon merely because there had been a movement of a few thirty-seconds in the Government securities market. The word "stability" had come to mean "stagnation" and "frozen prices." Yet today, after 18 months with an unpegged market, there is still too much uncertainty and unawareness of the desirability of letting the market forces reassert themselves, too little understanding of the part the Federal should and must play in supplying reserves to the market or absorbing reserves from the market. Against that background, it is our purpose to try to develop and write some ground rules which will give those of you who participate in the market, and those of you who have contacts in the market, an understanding of how the Federal may intervene, when it will intervene, and for what purpose it will intervene; also, an understanding that the intervening will always be at a minimum and not at a maximum.

We had the problem of the concept of "maintaining an orderly market." I tried before several committees of the Congress to define "orderly market". I don't think I was very successful, but I do think that gradually our emphasis has been shifting toward a realization that we should not be the judges of what an orderly market is; that our efforts should be directed more toward preventing disorderly conditions -- if you can see the shade of difference in emphasis -- and that even there, we ought to be extremely careful about attempting to intervene unduly and in determining in the Open Market Committee what is a sound or unsound Government securities market. The direction in which we are trying to move is, we believe, the right way to maintain the fundamental credit of the United States. However, a very good friend who had some Government securities was terribly distressed when his bonds went down. He had no understanding whatever of what a marketable security was, and he started out by telling me that the credit of the United States had been destroyed--that it had been debauched, and that I was partly responsible. I listened as patiently as I could and tried to explain to him that the credit of the United States hadn't been debauched; that the credit of the United States was stronger than it had ever been; that we were trying to get at the root of the matter, the purchasing power of the dollar, and see that the integrity of the currency is such that when those bonds come due and when interest on your bond comes due, you will have something you

didn't have before. After two and a half hours I hadn't made any progress, but it was interesting to me for this reason: he was showing me a statement from his broker when I happened to notice that on one of his sales he had sold several Government securities at 103-1/2. So I asked, "What did you pay for those securities?" It turned out that he had gotten them at par. As he put it, "I got those on subscription, through my banker." Then I asked him, "Did you send the Treasury a check for those 3-1/2 points you made?" It was the only thing that made an impression on him.

In my early experience in finance, I was trained in the view that there is no risk in Government securities. Certainly in a government like the United States, there is no risk whatever. You can depend on that completely. The only risk is in currency depreciation. That risk, we are confident, will be minimized by molding our thinking, within the framework of logic, to reliance on the forces of the market.

Let me give you just one illustration which supports that view. The year 1951 was largely a year of clearing away the debris in the Government bond market and reestablishing some of the forces that make for a freer market. The Federal attempted to move away from several things: from mothering the market, and from the so-called open mouth policy. Of course when you have a bond account of the size of the Federal's bond account, it is very easy to move in the other direction; very easy to say, "Why don't we make the market -- we will make it what it ought to be. We will be the judge of whether it ought to go up this amount or down that amount."

That is a very natural temptation for one who gets control of a large block of securities, as I learned years ago while watching some of the people who made markets on the floor of the stock exchange. I remember standing in a General Motors crowd one day on the floor of the exchange when it was rumored that an important executive of the company had unloaded his stock and the company, therefore, so far as the traders were concerned, was absolutely worthless. I happened to have 50 shares of General Motors at the time, and I thought, "There is no hope for this company, so I had better rush over there and sell my 50 shares."

Right then, a little trader for whom I had great respect and with whom I talked a great deal came up to me on the floor and said something like this: "You know, that is a great company; it is going places; it doesn't make any difference whether a big executive has sold all his holdings in it or not -- the company, the automobile business, is still there, and if they haven't got the right management now, they can get a new management." Those words encouraged me very much. I held my 50 shares, and later sold them for a small profit.

That case, to me, demonstrates something fundamental. We don't really have to worry about the credit of the United States if we handle our fiscal, monetary and debt management problems properly. Both the Treasury and the Federal Reserve -- jointly -- are deeply and sincerely interested in restraining inflation and maintaining the integrity of the

dollar; none could be more interested than is the Treasury of the United States, or the Secretary of the Treasury with whom I have had the privilege of working. Let me remind you that during the Patman Committee hearings he came out clearly and explicitly for the independence of the Federal Reserve System.

I would like to give you one more experience in clearing away the debris. In 1951, and extending into 1952, came deficit finance. Now I was greatly disturbed when I saw it loom late in 1951, because I thought, maybe that is the spark that will really ignite the fuel that is lying around. But we had a very interesting experience, and I would say that the deficit financing we have had to date has been largely non-inflationary. When the Treasury put out a 2-3/8 per cent, six-year issue in the early part of the summer, it was widely misconstrued as inflationary. It impressed me very much that even some of the financial publications didn't seem to understand what the reserve process was, so they said -- just automatically -- this is inflationary. I was asked to answer one article, but I said no, it is not worthwhile; give them six weeks, and the answer will appear on its own power. And so it went. When the 2-3/8 per cent issue came out it was attractive to banks all right, but it wasn't available to them because nonbank investors took it up under the subscription technique. Now I won't say this was handled either badly or well; that isn't the point of my illustration. You have to learn step by step how to do some of these things, relearn some of the processes that you knew very well

at one time, only that time was years ago. This issue was oversubscribed, heavily oversubscribed. We had high level activity for a period of several weeks and everyone said: "Oh, this is inflationary!" But what happened? Banks found they weren't getting reserves from the Federal Reserve System, so they began to reappraise their portfolios. Then the short-term rate began to go up and, as it did, corporation treasurers who had idle deposits began to think that investing might be worthwhile, and began to buy bills. That in turn took care of the banks, for they proceeded to sell bills to get the reserves they hadn't gotten from the Reserve System.

I was quite impressed at the end of the eight-week period. Mind you, one swallow doesn't make a summer, but what happened in that eight-week period certainly is indicative of the effectiveness of the free interplay of market forces. The Treasury raised over \$4,200,000,000 at the beginning of the period and refunded \$2,000,000,000 of maturing certificates of indebtedness before its close. That the banks found the new issue attractive was shown by the fact that, at the end of the eight weeks, they held \$1,400,000,000 of the \$4,200,000,000 in new securities. And yet, during the same period, there was a decline of nearly \$600,000,000 in total holdings of Government securities--including the new issue--and in loans by banks against Government securities. So instead of more inflation, we had a touch of credit restraint, by virtue of the market attracting corporate deposits into bills. I know some of you will say, oh

that is short term; it will just come back. But the very fact that it happened at all shows that the process of reappraisal and readjustment is going on. Other things show it too. There was the period when mortgages were being picked up right and left. An insurance executive told me that when the Government market was unpegged he sat down to look at some of those mortgages he had been getting and found quite a number of commitments he wished he hadn't made. Here again was the market, bringing into play penalty and reward.

People say to you, "Well you can't measure monetary policy." No, I don't think you can, and I understand the plight of newsmen who come to me from time to time and say there is no news in monetary policy. No, there can't be, because monetary policy doesn't work all in a single afternoon, so it doesn't make spot news. Yet it is a process that goes on quietly, with a general effect on the economy, although it isn't measurable in precise terms.

That brings to mind a talk I had some time ago with a very brilliant economist who didn't believe that monetary policy had any effectiveness whatever. He has had doubts recently as to how correct his convictions were. He remarked that he couldn't see that an interest rate adjustment of an eighth of one per cent has any effect whatever on the economy. I replied that I couldn't prove to him that our policy had been effective but that, after all, we had been having stability at high levels in this country -- with some forces of inflation and some forces of deflation, but equilibrium in the main for a period of many months.



At this point, an associate of mine on the Board, who has a very nice way of putting things, suggested that the comments of our friend the economist about the effect of monetary policy on inflation -- or rather its lack of effect -- reminded him of the time when Max Baer was fighting Joe Louis. Baer had taken a pretty bad drubbing. When the seventh round ended, he had blood over one eye and sweat was oozing from his brow. His handlers were doing everything they could to make him not only able but willing to get back in the ring with Louis, so they said: "Maxie, he isn't hitting you at all -- he isn't touching you. Just get in there and sock him in the jaw." Just as the bell was about to ring, and as they mopped his brow for the last time, Maxie turned around, rather peevishly, and said: "If he isn't hitting me, you fellows better keep an eye on the referee, because somebody in that ring is knocking the hell out of me."

That may be about the only sort of measurement you can apply to the effect of monetary policy.

I want to reiterate what to me is the crux of the matter: that we should be seeking solutions for today's problems as energetically and as intelligently as we can so as to make sure that we preserve freedom of action and choice in the market place. The reason is that the decisions, the judgments of the market place by and large will be sounder than those of any public administrators or any group of super men or any super staff that you are likely to have in Washington or in your own business. For

this applies to our private business as well as to the Government. From it, you will get the framework that will support free democratic institutions.

One of those institutions is our Federal Reserve System. I have been impressed with how effectively the defects revealed in our monetary system in the period of 1906-1907 have been overcome by the successful working of the Federal Reserve System. True, the Federal Reserve System must change its course and must adapt itself to changing times and progress like any other organization, but the adjustments that should be made must be made in accordance with fundamental principles. And I insist that the basic principles of propulsion center around the market place, not distortions of the market place either by pool operators or by a Federal Reserve committee with a large amount of Government securities.

You will recall that in 1907 we had a money panic and that the people who struggled with the solution for that panic, realizing it must not happen again, founded our present Federal Reserve System. Before that, money had a tendency to appear when it was least needed and disappear when it was most needed. Today we have no shortages of currency -- except temporarily when demand for small coins gets ahead of the coinage -- and we hardly realize there once were problems in terms of elasticity or inelasticity of our currency. But it was also found that bank reserves had a way of scattering or disappearing when they were most needed, and also of starting a sad chain of events. So the Federal

Reserve System was given power to expand and contract reserves -- a power that goes to the heart of our money system.

Thus the money system is directly and fundamentally related to letting the adjustments be made by the market place. If we ever let political expediencies or selfish private interests obscure the fundamental principle that the currency belongs to the people, then we will have destroyed the fundamental ingredient of a sound business economy and swept away the base of the free enterprise system. Because the Federal Reserve System upholds the fundamental principle and stands against forces that might destroy it, the System frequently is called the primary bulwark of the free enterprise system.

Considerable study has been given, in the Patman Committee hearings particularly, to the role of debt management in achieving price stability and high level employment -- two things that you all realize are mutually contradictory in one sense, however desirable they are socially. I am glad that price stability was given the same consideration as high level employment because we had been hearing for a long time that prices didn't make any difference, exchange rates didn't make any difference, and interest rates didn't make any difference. Well, once again we are realizing that they do; realizing that the productive capacity of American business is such that you will have to reduce prices in order to sustain volume on the scale needed for high level employment, or else that in order to keep prices up, you will have to reduce the number of units -- and that will mean some

unemployment. We should never again in this country permit the misery and suffering that existed as a result of the unemployment following the '29 collapse. But let's not have our social security or our welfare work impair the fundamental working of the system that has made us great and made us strong.

I'd like to conclude by reciting an experience I had in Moscow in 1943 when I went there on a lend-lease mission. Our group was having dinner with the Russian equivalent of our Secretary of Commerce and Secretary of Defense, all rolled into one. In the course of the evening, he expounded at length on the Russian system. Then he began questioning me, because he thought I would know something about American business and finance. I told him things don't work in our country as they do in his, that we depend upon the market place to make decisions. Oh, he said, we couldn't permit that over here -- you just couldn't have it. Then he went on to tell about the marvels of American products and how he simply couldn't understand how the jeeps we were sending over there seemed to roll in an unending stream. Yet, in the end, he went back to the initial argument, ending up on this note: "That is fine, this matter of freedom, but we just couldn't permit it."

Well, I said, that may be so, but I just want to point out to you that we in the United States can't permit it not to be, because that is the process by which our strength has been created. We are free men because

we are strong, and our strength comes from the working of the market place in accordance with proper incentives -- from realization that in making our adjustments we are not impairing the fundamental structure. Yes, whether it is the New Capitalism of Theodore Roosevelt or the New Freedom of Woodrow Wilson or even the New Deal of Franklin D. Roosevelt, the adjustment itself must be made within the framework of the solid, fundamental concept that there will be a minimum of intervention in the market place, and that we will depend on the composite of decisions as the basis of free, strong, democratic institutions.

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