

ADDRESS - THE HONORABLE WILLIAM McCHESNEY MARTIN, JR.

President Piper, President Leach, members of the Maryland Bankers Association, honored guests, ladies and gentlemen: It gives me a great deal of pleasure to be here today, and the first thing I want to do is to express to all of you the appreciation Mrs. Martin and I feel for the friendly cordiality the Maryland Bankers Association has extended to us on this trip.

We have thoroughly enjoyed every minute of it and I want to let you in on a little colloquy Mrs. Martin and I had in our cabin this morning which I think will demonstrate how thoroughly we have enjoyed it.

When I got up this morning I turned to my wife and said, "Well, I've got to go back to work again." She looked at me scornfully and replied, "The work you've got to do today isn't very difficult. These Maryland bankers are such nice people that they'll probably be polite enough to come out to hear you even in the midst of this fine weather!"

So--properly deflated--may I say that it is a particular pleasure for me to be here today. The Federal Reserve System is not a one man body, it's not the Board of Governors, it's not the banks, it is the people of the United States represented through the banks.

The President of your Association, Charlie Piper, since 1950 has been a faithful, conscientious, and enlightened director of the Federal

Reserve System. We have with us on board today a man who has unstintedly given me his advice and counsel since I've been in my present position--Charlie McCormick, Chairman of the Board of the Federal Reserve Bank of Richmond in the Fifth Federal Reserve District, who has been serving with the System for more than fifteen years. We have also drawn from your group a number of influential and useful directors, so that this is a real opportunity for me to have a chance to know you and for you to have a chance to know me.

Now, thinking of what I might say this morning I couldn't help getting a little reminiscent. My mind went back to the time, about two years ago, when the Treasury-Federal Reserve accord had been worked out and it was indicated that my name would go up to succeed Mr. McCabe as Chairman of the Board of the Federal Reserve System.

There had been a slight disagreement between the Treasury and the Federal Reserve, there were some strained feelings, and I had some qualms about the appointment. A certain individual came to me and said, "Well, now, I think you've got a fair chance of being confirmed if your name goes up. Some people," he went on, "will think you're a stooge for the Treasury, but I think you've got a fair chance of being confirmed."

Well, that didn't encourage me very much. That afternoon, a hoard of newspaper men came pounding in to see me to know what this was all about and to gain some enlightenment on the Treasury-Federal Reserve accord, which was the one thing I couldn't talk about.

At the end of a most unsatisfactory press conference, one of the fellows came up to me and said, "Martin, I've got to do a piece on you for the Sunday paper and I've been searching in vain to find what your qualifications are for this job. I'd appreciate it very much if you'd tell me."

Well, I wasn't smart enough at that time to give him the proper answer--you seldom have the right words at the tip of your tongue. But later that evening I had a call from a friend of mine who was acquainted with an influential Senator. This friend said, "I think you're going to have some difficulty getting confirmed and I wish you'd put down on one sheet of paper just what your qualifications are for this office."

Well, if you want to be truly humbled, just try to sit down and write in a short space of time what your qualifications are for anything. I can assure you that I had a very difficult and unhappy time about it, but as I worked on that statement I gathered a little confidence, because the more I thought about it the more I thought that, since I had been in and around and on the fringes of the problem of money and banking for a good many years, the only real qualification I had was that I knew enough about the subject to know how little I really knew about it. If I could continue to steer my course along that line, I decided, I would be all right.

Now, it seems to me that at a meeting of this sort more benefit, perhaps, is derived from just a few observations than from a polished, formal address, and I would like this morning to make just a few general comments to give you an indication of what my thinking is and of the

course I think we've been travelling in the last two or three years in this country.

There is no more controversial or interesting field than the field of money and none, it seems to me, which is less understood in its basic outline. I had the privilege of knowing Lord Keynes reasonably well, and at the time of the Savannah meeting of the Bretton Woods Conference I had a long talk with him. I asked Lord Keynes what he would do over again if he were rewriting his treatise on money.

He looked rather thoughtful and said, "Well, I would try to relate it more to the course of human events and less to the abstractions of humanity."

I think I know what he meant by that statement, because it seems to me that we have to seek for some principles, some guiding method of determining what our course will be. At the same time, we must recognize the dangers in money management, the limitations of money management, and the heritage we have with relation to money, because it is fundamental to this thing we all treasure and which we can't define, this concept we call the American way of life.

Now, the heritage Harold Brenton referred to in the Constitution of the United States, and in the prohibitions which the founders of our country surrounded our government with are very evident with respect to money. From time to time, I can't help going back and reading the discussions about the first Bank of the United States back in 1791. I

can't help seeing very specifically in terms of the present what Alexander Hamilton meant, despite the fact that the first Bank of the United States provided only for a general liaison between the Secretary of the Treasury and the Bank and some mild reports by the Bank to the Secretary of the Treasury.

I can see what Mr. Hamilton meant when he said it would be a miracle indeed if the credit of this institution should be opened to the Government, if in time it would not end in calamitous abuse.

By 1811, our country had matured a little, and we had the Second Bank of the United States. We had provided in the directorate of the Bank that there would be five directors appointed by the Government. There was a recognition that the public interest was larger in this Bank, but nevertheless it should be carefully circumscribed. Those of you who are familiar with the debates of the Treasury Bank of 1830, which never materialized, or with the debates around our National Bank Act, realize how frequently it was recognized as a part of our heritage to avoid the abuses that would come and the tyranny that would be wielded over people by abuse of the currency.

Napoleon recognized this clearly when, in terms of the morale of his men, he wanted the Bank of France to see to it that there was stable currency with a sound value. From the earliest days of the Bank of England it has been recognized as a requisite of a growing and a progressive country. In this country, we have always shunned central-

ization, authoritarian power, so that when the time came for us to bridge the gap between private and public banking, as all maturing countries do when they are faced with the problem of reserve banking or central banking in highly developed, industrialized, progressive societies, we were very wary that we would be losing this heritage. While there are many in this group who remember the opposition there was to the Federal Reserve System by the bankers at the time it was established--and I can see their misgivings and I think they were somewhat warranted--but the framers of the Federal Reserve Act fully understood this heritage and therefore they endeavored, though embracing the combination of public and private authority as a necessity, to circumscribe it by establishing a decentralized, central bank consisting of twelve regional banks--now twenty-four branches and some 250 directors throughout the country coordinated by a central governing body in Washington.

But that governing body in Washington in the original Act was more circumscribed than it has been since the Banking Act of 1935, when, under the force of centralization in the early days of the New Deal, some of the authority of the individual Reserve banks and the individual branches was dissipated in legislation which provided the Banking Act of 1935.

And I think it is important for us as bankers and as people interested in this field to appreciate that fact, because from time to time I hear of individuals and meet individuals who think their services as directors of a branch or of a regional bank are not really important

enough, that their duties don't warrant the responsibility. They don't seem to appreciate what the trusteeship is--the trusteeship over money that is embodied in the Federal Reserve System and which is essential to a stable and a growing country.

Let me illustrate it concretely with respect to the Banking Act of 1935. One director of a Federal Reserve Bank told me that he didn't feel that he had any real service to render to the institution today, that he didn't feel that he pulled his weight. In the course of discussion with him, when I was trying to point out to him how important this trusteeship is, I asked him where he was when the Banking Act of 1935 was passed.

Mind you, I'm not attacking the Banking Act of 1935, I'm not making judgment on that, I'm just raising it as an issue, as a progression of power. This gentleman told me that he was in Florida fishing at the time the Banking Act of 1935 was passed.

"Well," I said, "it is in that way, if I may say so, that we lose our trusteeship and our prerogatives." That brings very forcefully to mind the point President Brenton made the other day when he pointed out that Benjamin Franklin said that we establish a Republic, but it's up to us to keep it.

I would like now to speak about the functions of monetary management, because monetary management is like the functions of the Judiciary. It depends for its effective performance upon impartial, objective,

unbiased, careful judgment of the situation. It requires insulation from public pressures on the one side, and from private pressures on the other side.

But at the same time it doesn't mean that it should be so insulated or isolated that the body politic cannot attack it at any time that it wishes to and bring to bear the force of public opinion on it in such a way that the heritage of money and banking can be preserved.

The Federal Reserve System today is a primary bulwark of the free enterprise system, and that is why it is important to all of you, why it is worth while to me to be working in it, why it is desirable for all of us from time to time to assess its purpose and its progress.

Now, the Federal Reserve System was obviously born at a time of money panic and its primary purpose, which we say is to regulate the money supply, is not just to regulate the money supply but to provide a climate in which we can have a higher standard of living--and the American people will always be seeking a higher standard of living, and always deserve a higher standard of living.

If that climate cannot be created by the Federal Reserve System, then some other system will supplant it. The Federal Reserve System is not there to create higher interest rates. The Federal Reserve System is not interested in higher interest rates per se. What it is interested in is the lowest interest rates it is possible to have--because the formation of



capital will probably be enhanced thereby--without inducing inflationary pressures.

And why do we restrain inflation, the heritage of all wars? We endeavor to restrain inflation because we know that unbridled inflation always leads to disastrous deflation. We know that there's a cause and effect sequence and unless we guard against that cause and effect sequence we will inevitably reap the whirlwind.

We have been experiencing throughout the western world, the free world, a return to what I have frequently alluded to in talks as the free market, that is, we have shifted a little bit from the left to the right. I want to make clear to this group that this shift from the left to the right is not because people like the right any more than they did before, any more than they did the left. That shift from the left to the right is because the left wasn't working--it's because in terms of preserving freedom and developing a high-level economy and high levels of employment, it was recognized clearly that we have to have more reliance upon the market place and less reliance upon the decisions of the Board of Directors, upon super men or super staffs, upon bodies like the Federal Reserve Board.

With all due respect to us, we don't have all the wisdom that we should have to regulate the money of this country--and it's not likely in a country of this sort that we ever will have. If we can perform our

function satisfactorily by channelling into Washington the best intelligence we can get in the monetary field, I think those of you who are really students will recognize that monetary science or art or craft is sufficiently limited in its scope that even though we were omnipotent and omniscient we couldn't through monetary policy alone achieve the goals that we are endeavoring to attain. We have fiscal policy, we have debt management policy, we have all the technology, all of the creative authority of a progressive and a dynamic people, but the dynamism of our economy is no small measure related to the free market.

Now, "free market" is a relative term. I recently delivered an address in which I discussed what I called the transition to free markets, referring to government securities. At the time that address was prepared I wanted to title it, "The Transition to Freer Markets," but others persuaded me that the "er" ought to come off because, after all, these concepts can't be narrowed so succinctly.

I wrote that talk very carefully as a result of two years of work and some experimentation in the government securities market and carefully analyzed the point that I was trying to make--I was trying very clearly to point out that we would supply reserves and absorb reserves, we would not abrogate our authority as money managers in terms of the market alone, but that we would undertake to supply or absorb these reserves through the nearest equivalent to money that there is--the short term end of the market--thereby giving to the

market, insofar as it wished to have them, the tools of judgment, the essential requisites, for making up its mind on the extent to which market forces would prevail.

The decision to unpeg the government securities market was, in essence, a decision to return to the marketplace some of the forces of supply and demand, as exemplified in the price mechanism, in such a way that we would once again have the credit mechanism acting as a governor on the flywheel of the economy.

I believe that credit mechanism is now operating again today. How satisfactorily, only time will tell, but the mechanism is again operating after ten years of government policy which pre-empted any use of the market as a device for levelling off, so that reserves by bankers, so that decisions by business men, could be made without relation to the forces of the market, to the forces of supply and demand, to the basic concepts upon which the dynamism of the free economy rests.

Now all of these concepts are modified and changed. The concept of private property, free competitive enterprise, the profit motive, have altered substantially since the Pilgrims landed on Plymouth Rock. It would be carrying coals to Newcastle for me even to sketch the ways in which they have been modified, but the thesis upon which we've been endeavoring to mold monetary policy, in terms of our basic heritage, has been on the assumption that under our governmental institutions and under our system of economy these concepts of private property, of

free competitive enterprise, of the profit motive, would produce the greatest good for the greatest number in the community as a whole, if they act in terms of the decisions of the marketplace in preference to the decisions of men per se.

Therefore, we have tried not to lead the market, not to determine what the market ought to be, but to recognize that the forces of the market are things that, like the tide that King Canute commanded to fall back, cannot be brushed aside; the law of supply and demand can be dammed up only for a while, as it was during the war.

We all recognize that we financed a large portion of our wartime expenses through inflation, and while we had patriotism and price and wage controls, which is a part of patriotism, and the discipline of a free people operating with the primary objective of winning the war, we were able to dam that inflation in a fairly satisfactory way, despite the fact that the savings and life insurance policies and the other elements of a free economy were to an extent being undermined. We were able to dam it up until we came through the war and those forces began to dissipate and with a free people those controls began to break down.

Anyone who has been in Washington during the time of the early stages of the Defense Mobilization Board following Korea recognizes how difficult it is to regulate and to control an economy as large and as vast as ours and what it does to the fabric of that economy, and so gradually we faced facts, in terms of government finance and in terms of the money market--and let us not forget that free capital and free money markets

are essential to free markets for everything. That's the thing that too few people have recognized.

A number of years ago when I was in the Treasury I spent much of my time in foreign finance exclusively. It has been extremely interesting to me to see how gradually it began to be realized, from the Netherlands, from Belgium, which started it, in Italy, back to the Scandinavian countries, now to Britain, each in turn realized that the forces of the market can only be dammed up for a limited period of time and that exchange rates, interest rates, prices, do count. They can't just be eliminated and wiped away unless they are wiped away by sheer totalitarianism in which you have an entirely different system of government, an entirely different system of management.

Commenting on that one point, I'd like to say that a number of years ago I was in Russia and I discussed with this with a rather distinguished Russian economist, if I can call him an economist, who pointed out to me that so far as their system was concerned the operation of the forces of the market was a luxury which they could not permit, a luxury which it was impossible for them to have under their system because they couldn't control it.

I tried to make the point to him that over here this is not a luxury but a necessity. Over here, this is the basis of the dynamism of the economy of the western world. This is why the long line of jeeps which was coming over to Russia under lend-lease was something he had

such admiration for and why he wondered that the Russian people, having created their capital in the shortest possible time by the liquidation of the Kulaks, were nevertheless unable to produce these items in the same way, with the same speed, and with the same technological development existing in the United States.

To me, that is the heart and the crux of the problem we've been wrestling with. It doesn't mean that markets are not made and developed. All life is made and developed, and that's why I pointed out the limitations on free markets. I would like to give you a light insight, perhaps, into some of my thinking with respect to this.

Over a period of years, because I've come back to what the fundamentals of a free society are and to differentiating between those who dislike the way the fruits of production are used and those who would undermine the process by which production is achieved, because I am convinced that this thing we call the American way of life--which has the glory of the fact that we can't define it precisely--is the inherent thing which has made possible the growth and development of this great and glorious country we have.

In the early part of the 1930's, I went on the floor of the New York Stock Exchange, and I was struggling then with one of these adaptations, modifications, that come through our structure and our society, because the New York Stock Exchange then purported to be a free market, and in point of fact it was a free market. What I am saying is not in any

sense to be construed as an attack on the New York Stock Exchange, which I think has done a very good job, on the whole. But the thing that distressed me was that, as I got on the floor of the Exchange, I found that the forces of the market, the test of the market, was practically minimized by pool operators, by big operators, by banking concessions, by individuals who were trying to do what the individual in Mr. Norris' book, "The Pit," had done to the grain market.

They were trying to get a toe-hold in a given security and thereby obviate the forces of the free market in order to make a profit-- a big profit. Therefore, in my rambles around the floor of the New York Stock Exchange, looking for a casual stock to buy here and there, I was distressed to find that the important thing was to find out when Joe Zilch was going to buy and when Joe Palooka was going to sell. It wasn't to evaluate the worth and the usefulness of the securities per se.

Now in large measure over a period of years, through regulations, through the Securities and Exchange Commission, you have had that situation virtually eliminated. I don't suppose in human institutions that anything is ever completely eliminated, but today you have pretty close to an opportunity for the forces of the free market to express themselves on the floor of the New York Stock Exchange.

Twenty years later I found myself, along with my associates, in charge of the largest bond account in the world. It took me back to those early days on the floor of the Stock Exchange, because I could see

that no one was really interested in the worth of these government securities, nobody wanted to evaluate them in any way, shape, or form--they just wanted to know whether I was going to help buy and sell. They just wanted to know what the last tipster said about the 2-3/8's.

I seemed to feel that I had gone back twenty years, recognizing, of course, that no analogy is perfectly accurate. But, in terms of the forces of the market, we have in the government securities market this same desire to shoot ducks on the ground, to catch fish in a barrel. No longer were any of the forces of the market really operating, and as we attempted to free the government securities market we found that the devices and the techniques which had developed during the period we were under a pegged market while we were trying to prevent monetization of the debt now worked in reverse and tended to increase monetization of the debt.

And so we started the slow, painful process of unraveling a market which had been tied into a knot, letting the forces of demand and supply have a play. As we did that we were fully aware of the fact that we can do something about the supply of funds, but we can do very little about the demand for money.

Let none of us have any illusion about the extent to which the Federal Reserve System, or any other system, can create the demand for money when people don't see any opportunity to profit by it. We are now approaching a period in our economy when common sense--and I'm



making no predictions today--when common sense requires us to evaluate where we are on the road we're travelling and how we're going to move toward this higher standard of living.

We can't always have what I call an overtime economy. We've been operating under forced draft. The average hours of work per week are something like 41.2, where a normal workweek would be 40 hours. We've gotten into a habit, politically, of thinking that we have to have a new record at the cash register every week or we've lost ground. We've got a business community that, in large measure, has been trained during a hot and a cold war on a perpetual sellers' market and having rising costs covered by inflation.

We can, of course, lack the courage to go forward along the course we're going, and we can arrest at any given point the progress that we are making and restore once again the '40 market, once again postpone the painful decisions which have to be made. But we've gotten in the habit of magnifying words. We now talk about, we now have our thinking dominated by, the fear of another depression like 1929, and if anybody even breathes the thought that we might have a slight setback in business, they are supposed to be virtually traitors.

All during the early days of the unpegging of the government securities market I worked through a very interesting period in Washington, where many business men, many bankers, perhaps even some of you, called into the Secretary of the Treasury, called into me,

and said, "Chaos," "collapse," "The country's ruined, we're gone." It wasn't always easy to resist some of that, and yet we've had the highest level of sustained prosperity on the whole without inflation that we've seen in decades--and we haven't yet had chaos.

There's no reason why we should have chaos if we stick to the fundamentals of what the credit of the United States is. I don't mind saying in this gathering, as I have said a number of times, that as long as this country is constituted as it is, in my judgment neither the Treasury nor the Federal Reserve System is strong enough to destroy the credit of the United States. The credit of the United States can only be destroyed at the grass roots. We can play a lot of havoc with it, and it's up to you gentlemen to keep us from playing that havoc with it.

But we've got to keep this thing in perspective, and one of the things about money, one of the things about the gold standard, one of the things about the field of economics that's always distressed me as a minor student in it--and I am not an economist, I am sorry to say--has been that people get a gleam in their eyes from time to time about economic panaceas. They think that a return to the old fashioned gold standard will solve all of our problems. They think that just a little different management of our currency will eliminate all of the difficulties of the modern world. They lose their perspective and their balance completely.

I myself have done it, so I'm not attacking them. I once wrote a paper of two thousand pages on what could be done by the discount rate.

Recently, I was asked by a gentleman if this could be published. I said, "For goodness sake, no. Get hold of all the copies and tear them up."

I illustrate my point here by saying that just recently a very eminent, a very able, a very competent individual came in to see me in Washington. As he sat down, I could see that he had something on his mind. He's a delightful man and he makes a lot of sense--up to the point when he looked at me and said, "You know, Martin, civilization depends upon the decisions you make in the next few months. Civilization is at the crossroads," he continued, "and I want you to realize the responsibility you have."

A great big smile broke out on my face--up to that point I had been listening very attentively to him--I smiled as broadly as I could, looked at him and said, "Nuts--and you know it."

Civilization doesn't depend on me or on any one man per se. What is really important here is that we keep things in perspective and balance and that we don't get drawn away from the basic principles. Certain adjustments will have to be made--we can't expect to have "forced draft" all the time nor can we expect to have the government bail us out every time we get into trouble.

We may, of course, have another atom bomb fall; we may, of course, have another war incident which will turn on the forced draft again. But that just delays the time when we've got to return to saner principles, more fundamental principles, and I think we've been making some progress in moving in that direction. We haven't been perfect in what we've been doing, some of it has been trial and error.

I can point to at least a half dozen mistakes that I know I personally have made in my judgments on what ought to be done with the government securities market. But that we have been on the path of accepting the decisions of the market place, that we are giving more play to the market, less play to individual judgments, that we recognize the basic importance of maintaining our currency in terms of savings accounts and insurance policies and the other elements of what to me are the essential parts of a free society, that is, savings and investment-- these things we can aver without question.

You all know several countries in the world today where the process of saving and investment is virtually gone. I know of nothing in our life time that can restore these qualities, because these countries have tampered with their currencies so long that the process of saving and investment has gone by the board. I think we are in another struggle at the present time. When the going gets tough, when it gets painful, when it gets hard, there are always voices raised--they should be raised, properly and critically--but there are voices that say, "Let's have just a little bit more of the needle--let's have just a little bit more of the drink."

I'm not quarreling with those people, but by and large I think that, while you can't do everything over night and you shouldn't go any faster, perhaps, than things will permit, you nevertheless must not turn back on the course of supply and demand and the basic dynamism of the American economy.