BUSINESS WEEK

April 22, 1967

Fifty cents

A McGraw-Hill publication

The markets that Rome still rules

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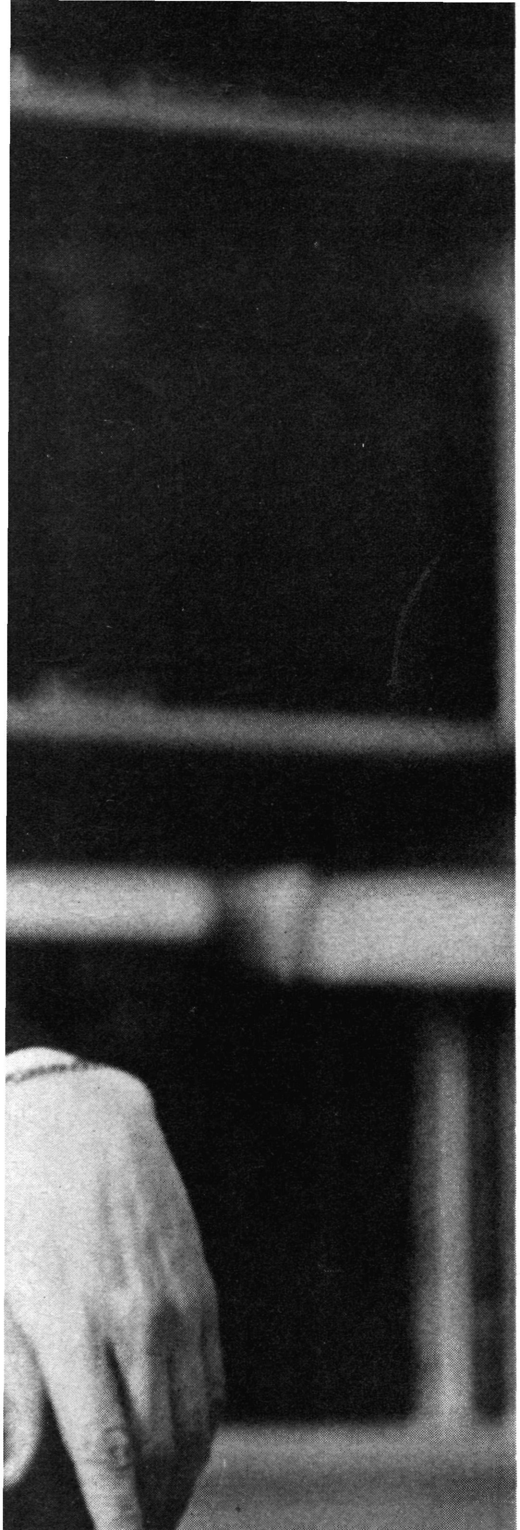
Below: William McC. Martin, Jr., has never faced a more tricky time for monetary management in 16 years at the Fed [Finance]

Soft-spoken William McChesney Martin, Jr., has fought for the Fed's freedom to apply policy as the economy demands.

FINANCE

Inflation's arch-enemy at the Fed

William McC. Martin has drawn plenty of fire in his 16 years as chief of the Federal Reserve Board. Now he thinks his team is doing well at its main job—ensuring a sound dollar



For the man who has weathered some monumental storms in his 16 years as chairman of the Board of Governors of the Federal Reserve, everything has been breaking just right lately.

President Johnson has asked William McChesney Martin, Jr., to stay on as chairman for three years more (he must retire in 1970 when his current 14-year term as a Fed governor runs out). And there is widespread agreement that this time the Fed has been applying monetary policy with perfect timing.

The Fed swung toward easier money last fall—"A well-conceived, moderate easing of credit," says Martin. Now—weeks earlier than expected—there is considerable evidence that the economy is perking up.

Hard test ahead. Not all Martin's critics have been silenced, of course. A good many economists still rank him as far too conservative a money manager, and blame the sluggish economy of the late 1950s and this year's economic pause on excessive restraint by the Fed. Last year's bout with tight money—when interest rates were the highest in 40 years—irked the President and brought demands for Martin's scalp—not only from his perennial foe, Representative Wright Patman (D-Tex.), but also from so potent a Congressional kingpin as Senator Russell Long (D-La.), chairman of the Senate Finance Committee.

There could be conflict again. Renewed inflation later in the year—a distinct possibility now that the economy is looking better and defense spending keeps going up—could well force the Fed to turn away from ease sooner than the White House or Congress would like.

Yet, despite past disagreements and future headaches, the President asked Martin to stay. And the chairman, who six months ago had all but decided to say no, finally agreed. No one who has watched Martin through the years was really surprised when his reappointment was announced.

Symbol. Martin came to the Fed (he was first appointed by President Truman) in 1951, as it was emerging from the doldrums. That year, the Fed-Treasury accord again freed the Fed to apply its own policies instead of merely supporting those of the Treasury, which wartime necessity had forced it to do since 1941. Martin more than anyone forged monetary policy into the potent economic weapon it is today.

To the Fed itself, he has given a stature, at home and abroad, that is unmatched in the central bank's 52-year history—far removed from partisan politics, and with its independence from Administration interference still intact. No less important is what Martin has become—a symbol of orthodox money management to businessmen and bankers in the U. S. and overseas.

Soundness. He is not quite the flinty champion of tight money and high interest rates his critics make him out to be. "I want rates as low as possible without having inflation," he says.

He followed an easy money line through the early 1960s, and in 1965 he held off pushing for a higher discount rate until months after he thought one was due. Last year, he nudged the Fed toward modest ease in October and toward open ease in November.

However, he does worry about inflation, the soundness of the dollar, and budget deficits, with a moral fervor that is nearly evangelical. Prosperity cannot be maintained, he insists, unless inflation is kept in check and the currency kept sound. "Here, I'm antiquated," he says. "But if you run perpetual deficits you will undermine your currency."

Integrity. The process of keeping the economy on an even keel is sometimes painful, he concedes—but he believes that it is unavoidable. "We are always looking for some way to avoid pain—but we haven't found the answer, either for the physical body or for the economic body."

His views are controversial even within his own seven-man board, packed as it is these days with activist economists who mostly tend to be monetary liberals. Certainly these views get little support from the Administration's crop of economists or from Johnson himself, who tends to be an easy money man.

Yet if Martin's views are out of step with those of the Administration, they are presented with an old-fashioned honesty and an integrity that is perhaps unmatched these days in official Washington. The Administration's pronouncements about the economy and the dollar may be greeted with some degree of skepticism; Martin's are not. He is blunt, candid, painfully honest. When he speaks, people—and financial markets—listen.

I. Grasping the reins

It is no easy task separating Martin the man from Martin the legend. The legend has been around for a very long time.

He was born in St. Louis 60 years ago, the son of the longtime president of the Federal Reserve Bank of St. Louis (but the grandson, he concedes, of a populist). Educated at Yale, he came to Wall Street as a stockbroker in 1931. By 1938—when he was only 31—he was the $48,000-a-year president of the New York Stock Exchange, charged with cleaning up the mess left by predecessor Richard Whitney, who went to jail for embezzling the funds of customers and exchange members.

He was drafted into the Army in 1941—swapping the NYSE presidency for the $21 a month of a buck private. By war's end, though, he was a full colonel—and Harry Truman's choice to head the Export-Import Bank.

He stayed at Ex-Im until 1949—then took another pay cut to become Assistant Treasury Secretary for International Affairs. At the Treasury, he played the central role in working out that department's 1951 accord with the Fed. When Fed Chairman Thomas McCabe quit in April, 1951, the job went to Martin.

Individual. He began at once rebuilding the Fed, and he hasn't stopped since. The Fed of 1951 was a dowdy operation. For a decade, it had done little more than support the price of Treasury securities in the open market. Moreover, control of the Fed—and the policy-shaping Federal Open Market Committee—was divided between Washington and the powerful Federal Reserve Bank of New York, which conducts the Fed's all-important securities dealings in the open market. Opposing newcomer Martin was the New York bank's president, Allan Sproul, then rated the nation's most skilled and experienced central banker.

But Martin quickly won the fight with New York for control (Sproul retired in 1956), and he just as quickly turned monetary policy from a passive into an active tool.

For all this, Martin is a world apart from his best-known predecessor, Marriner Eccles, who was chairman from 1936 to 1948. Martin's approach, both he and associates agree, is low-key. Where Eccles spoke first at meetings, then literally dared associates to disagree, Martin listens carefully to the views of others and then speaks his own mind. "Everyone speaks his piece," he says. "I want to be convinced before I take the plunge. The man I distrust is the man who is certain he knows the answer."

Once everyone has had his say, explains one aide, "the chairman conciliates and pacifies. He tries to separate issues and find the common denominator. He influences the board, of course—but he doesn't drive it."

Unorthodox. It is questionable whether any Fed chairman could drive his board, considering the degree of independence a 14-year term gives to a member. Even the extent to which Martin can influence the members is open to some question today, now that the board includes such economic activists as George W. Mitchell and J. Dewey Daane (both picked by President Kennedy), and Sherman J. Maisel and Andrew F. Brimmer (both picked by Johnson). So far as it is possible to attach labels, Daane has proved to be something of a monetary conservative; the other three—along with Fed Vice-Chairman J. L. Robertson—are, at most times, ranked as liberals.

And policy last year was less orthodox and more innovative than ever before. Not only was there a change in the discount rate and tightening in the open market, there was also more imaginative application of the Fed's ability to change the level of reserves that banks must keep against deposits, and more imaginative use of the Fed's ability to screen borrowers at its discount window.

Impressed. Things are much smoother today; there was unanimous backing for each of last year's moves toward restraint, and broad support for the current policy of ease. "At the moment," says Martin, "I feel quite comfortable with the board."

The board and the staff may not always agree with Martin's views; but they are impressed with his fine sense of timing, his intuitive feel for financial markets. Staff people are particularly delighted with the unquestioning support they get from the chairman as they delve more deeply into the mysteries of monetary theory—as distinct from the information-gathering and analysis that makes up the bulk of Fed economics. "He is no economist," says one staff aide, "but he has been the most active supporter of this change."

Yet Martin plainly would feel easier with a more balanced board—fewer economists and more businessmen or bankers. "I have not sought men who would follow me slavishly," he says, "but you don't want to turn the entire decision-making process over to one area. We are overbalanced toward professional economists." And while the chairman doesn't have the final say on appointments to the board, it is widely assumed in Washington that President Johnson won't name an economist to replace Governor Charles N. Shepardson who retires Apr. 30.

II. Standing fast

Martin — tall, spare, peering through gold-rimmed glasses—looks more like a folksy, small-town businessman than the boss of the world's most powerful central bank. He hoists his legs onto a marble table when he chats with visitors. He speaks softly, smiles often, and sprinkles his conversation with anecdotes.

Once good enough to play tournament tennis at Forest Hills, he still tries to slip away for a daily game—often with Vice-Chairman Robertson—in the courts across from the Federal Reserve Building on Washington's Constitution Avenue. He neither smokes nor drinks, and he manages to avoid most of the capital's hectic social life.

Unyielding. But those who misjudge the amount of iron in Martin quickly find they are wrong. "He is so quiet," says one veteran Fed-watcher, "that you don't realize how strong he is. He doesn't have to yell or throw his weight around. In a mild, unobtrusive way, he is a very strong personality."

One visitor stepped away from the chairman's office and observed: "That man exudes power."

Martin has doggedly defended the Fed against the persistent efforts of Wright Patman and others to limit its independence—and won every round. The Administration, he insists, must never be allowed to gain control of monetary policy. "The man who pays the bills," he says, "ought not to have indiscriminate power over the right to print money." This independence has brought Martin into conflict with every President under whom he has served—but always Martin has made his policy moves stick.

The discount-rate increase of December, 1965, angered the President. Johnson then was playing down both the amount of money it would take to fight the Vietnam war and the degree of inflation the economy faced in 1966. He summoned Martin to the LBJ ranch. But when Martin left, the discount rate was still at 4½% and it stayed there until three weeks ago.

Martin's only regret now is that the move toward restraint didn't come earlier in 1965—a delay caused in large measure by the lack of information from the White House on defense spending. "If I had been wise enough to put on the brakes in the first quarter of 1965," he says, "we could have had a totally different picture."

On good terms. Relations between the Fed and the Administration are not perpetually strained. The fuss over the 1965 rate hike died down quickly (inflation did become a major problem in 1966, as Martin said it would). Martin lately has been a sturdy champion of the President's proposal for a 6% surtax—partly because he fears inflation later in the year, partly because he worries about the massive deficit that might result if the tax plan isn't approved.

Martin and the President, in fact, get along quite well together. They have met personally on many occasions—twice in March when the chairman's reappointment was under discussion—and they chat by phone at least twice a month. Beyond this, they get together at the President's periodic meetings with the "quadriad"—Martin, Treasury Secretary Fowler, Budget Director Schultze, and Chairman Ackley of the Council of Economic Advisers.

III. At war with inflation

Martin sees the role of monetary policy this way: "We have a moving stream—the money stream. We want the money in the stream to grow as the river bank can hold it. We don't want it to overflow the banks."

But the stream has overflowed time and again in the postwar years and so forced the Fed to keep applying restraint. (John Maynard Keynes, says Martin, long ago warned him that the biggest problem of the postwar world would be coping with inflation.)

It is a particularly knotty problem now because of the Vietnam war—and not merely the dollar cost of the war. "It is the economic disruption war brings that wrecks you," says Martin.

Lots to learn. So Martin is by no means convinced that the current pause in the economy isn't about to give way to another bout of inflation—one important reason why he still wants Congress to pass the 6% surtax now, even though it wouldn't take effect until midyear. As it is, he sees the economy leveling off now—and not very likely about to turn up again.

Nor does he believe that an end to the war will simplify matters much. "We have a lot to learn about the economics of prosperity, of full employment," he says. "That will be the big problem of the next decade."

Trade-off. Martin concedes he has a strong bias against inflation. "It is a cruel process," he says. "I wouldn't be wasting my time here if I didn't believe that inflation is the bane of the little man."

But neither is he insensitive to complaints that he is too quick to react to hints of inflation—even at the risk of stifling economic growth. "I would rather have inflation than unemployment," he says. "You can't ever be for unemployment. The question is the trade off." To the chairman, a 4% level of unemployment "is a very good figure, though 5% might be better."

He doesn't claim a perfect track record for monetary policy through the years—he doubts policy will ever be error-free. "People," he says, "always talk as if policy could be applied perfectly. You can't apply policy with mathematical precision."

One nagging problem, in Martin's view, is that monetary policy too often has been asked to do too much. Monetary policy, he points out, is only one of the tools at a government's command—the others being fiscal, budget, and wage-cost-price policies. Usually, though, it is the Fed that is called on "to be the chaperone at the party who must take away the punch."

This certainly was true in 1966, when the White House left most of the job of cooling the economy to the Fed—ignoring Martin's frequent calls for additional fiscal restraint, for a better policy mix. Lately, Fed and Administration policies have been in exceptionally close harmony—both very stimulative—and Martin finds this somewhat reassuring for the future.

Slow change. Meanwhile, Martin thinks, the Fed keeps getting better at its job. "I'm biased," he concedes. "I look at it from my point of view."

And he is pushing for more change—better statistics, more research into the basic workings of monetary policy. He is dead against the line of University of Chicago Professor Milton Friedman, who argues that the Fed should stop leaning against the economic winds and simply pay attention to keeping the stock of money in the economy growing at a steady rate.

But Martin is no revolutionary and changes will come slowly at the central bank. It took years of prodding before the Fed, in 1961, again began dealing in securities other than Treasury bills—and so began affecting a broader slice of the financial system than simply short-term securities.

For evolution. There were more innovations in policy last year, to be sure—but Martin sees that more as a necessary reaction to "a situation that had almost gotten out of hand" than to a fundamental change in the Fed's approach to policy. "I am not sure the things we were driven to were the wisest," he says.

As he explains it: "I prefer evolution, not revolution. People take bold and dramatic steps when it isn't their own money they are dealing with. You can't have bold and dramatic moves without disturbing the basic component of money, which is confidence."

And the very last thing in the world Martin wants is to have confidence in the dollar shaken. **End**