

Address of William McChesney Martin, Jr.,
Chairman of the Federal Reserve Board, before members of
The Bond Club of New York, Bankers Club, December 15, 1954.

MR. WILLIAM MCCHESENEY MARTIN: Mr. President, Mr.
Leffingwell, Members of the Bond Club:

When one feels at home, it isn't necessary to make the sort of opening remarks one makes to strangers, and I can truthfully say that I feel at home in this group. Also, this is the Christmas season, and one feels a little sense of nostalgia at the Christmas season, although I admit that I said to myself on the way coming down this morning, "Why in the world did you ever accept that invitation?" Nevertheless, I am glad to be here, and I thought I would just talk to you very simply and directly, and from the heart. I am sure you will not be surprised if you find I talk a little bit about money and credit policy.

I know that this group will indulge me a little bit if I start my remarks with a personal reminiscence, particularly because I am feeling good and I think you are feeling good at this Christmas season--you have had a good year, and I am inclined to think all of us have had a good year in 1954.

I am rather fond of recalling the time when my name went up to the Senate for confirmation to the post which I now occupy. I thought at the time the job was a responsibility to take on, but it wasn't until after my name had actually gone up that the seriousness of it hit me hard. A Senator with whom I was acquainted called me late in the afternoon and

said: "There may be some opposition to your confirmation. After all, there has been a disagreement between the Treasury and the Federal Reserve. You have been in the Treasury. Some people will think you are a stooge for the Treasury, and I would like you to jot down on a piece of paper what your qualifications are for this post which you are assuming, because I would like to be prepared to answer your critics in the morning." And I lightly said, "Well, I'll go to work on it."

I had written up a good many promotions for people in the Army, so I knew how it was done, and I started to write my qualifications. And, gentlemen, if you ever want to feel humble, just start writing your qualifications to regulate the money supply of this great country of ours. I can assure you that whatever attainments have been mine in this life seemed to be extremely inadequate for the task which I was assuming. I was just about at my wits' end when something came to me that has stood me in good stead ever since. It was this thought: "I have been in, around and on the fringes of money, banking, credit, stocks and bonds for getting onto 25 years, and the only thing I have learned is how very little any of us knows about money."

Recognizing my own ignorance may not have qualified me for the job, but it did bring me to the point traditionally considered the beginning of wisdom. Anyone entering upon the task of monetary management ought to have progressed at least to that point. For if he feels within himself that his judgment is always better than the judgments of others, he will have no hesitation about substituting his judgment for theirs,

though they will suffer the consequences if his judgment is wrong. In this sense, I would say that research, painstaking study and experience are all vital requirements of sound monetary management, but in the forefront of them all I would place humility. I believe that without that characteristic we can be easily led toward a fool's paradise in the field of money and banking and credit.

I recognize that it is dangerous to talk about "humility." People who talk about humility are seldom humble, from my experience. I am also certain that humility alone would be of little avail in the cross-currents and cross-inconsistencies of the complex economy that we have to deal with. Other qualities are needed as well. For our problems are at times so bewildering as to threaten to overcome us in confusion. Unless one has some basic principles, one is going to be tossed about on this tempestuous sea without any course that can be followed. It is my conviction that there are certain principles that can act as guideposts, and that those principles should be carefully weighed in all the decisions, and in all the efforts of us all, including you of the financial community. To know where we stand, and where we are headed, it is essential, I think, that we have some understanding of the foundation and of the framework and the structure of this economy in which we are working and making our living.

I would like to talk a moment about the institutional aspect of the Federal Reserve System, which I have the privilege to represent today. Too few of us, I think, realize clearly how the roots of the Federal

Reserve System are imbedded in the soil of our American democracy, and how securely they were planted deep in understanding that the abuse of the money power can be a tyranny which can destroy all liberty and freedom.

I am not going to give you a discourse on the early history of this country and the evolution of the Federal Reserve: Mr. Leffingwell, I am sure, knows far more about it than I do. But I am confident that one reason we took this major step of instituting a managed currency--because that is what we have today--was that the money panics of the 80's, and more particularly the panic of 1907, brought about a recognition on the part of the public that the decisions of the money and credit market, as then constituted, were too severe to be accepted. With fear and trembling in some quarters, and with a good deal of vision in others, we therefore set up an instrumentality to exert a measure of control over needless and erratic swings in the money supply.

In the preamble of the act creating that instrumentality, only three things were talked about: Providing facilities for discounting commercial paper; providing an elastic currency; and improving supervision of banking. There wasn't anything about creating stable conditions throughout the economy, or developing an organization which would share responsibility for economic or price stability, and look to a higher standard of living and high standards of consumption, production, and distribution in this country of ours.

Yet, gradually, as the Federal Reserve has evolved, its very nature, and the development of this country, have directed it inexorably to these tacit but clear objectives and purposes. I believe that this is generally understood and accepted today, even though it is also recognized that there are definite limitations to what money and credit alone can do toward achieving these objectives.

What we are endeavoring to do about the money supply in this country can be described in simple terms: We want the flow of money and credit to be like a stream, or a river. That stream or river is flowing through the fields of business and commerce. We don't want the water overflowing the banks of the stream and flooding the field on either side, for we don't believe that you can just sit on the banks of this river and get rich by dipping into the stream that is going by. Neither do we want the stream to dry up, and leave the fields parched. We understand that there has to be irrigation and drainage. But we do see the flow of money and credit as something which must be related and adjusted to the business economy in such a way that there will be an adequate supply without inducing inflationary pressures. That is the basis upon which this institution, the Federal Reserve, is established.

That is a rather large undertaking. Looking back into history, no one can be surprised if there was a good deal of trepidation in seeing this movement from private to public control over money. Back in the time of the First Bank of the United States, a little stock ownership by

the Government and permission for statements to be made to the Secretary of the Treasury was all that the Congress would permit of public influence in the structure of that organization, because it was feared that abuse of the public credit might result. But by the time we had the Federal Reserve Act, we had a clear mandate from the people that the Congress exercise its power over money. In doing so, the Congress recognized that it could not administer this power as a political body with several hundred members, and that the power should be administered by some group that would be free in its administration, as is the judiciary, to make its decisions objectively: free on the one side of private pressures, and on the other side of political pressures. It was recognized that ultimately, of course, its decisions would have to stand at the bar of public opinion, as does everything in a democracy.

And so there was set up in the Federal Reserve Act a trusteeship over money. I like that concept, because I think we all understand it. The trust indenture of that trusteeship was the Federal Reserve Act. Instead of having a single bank with many branches, we established under that act a regional system, which is now 12 banks, 24 branches, a Federal Advisory Council, and some 250 directors throughout the country. In addition, the composite of that group was brought to bear in a single coordinating agency whose primary task is coordination and centralization of policy, so that policy can work effectively: the Board of Governors of

the Federal Reserve System in Washington. I think you can see the purpose of having a regional system of that nature.

A lot of misunderstanding seems to me to develop because people feel that the Federal Reserve System is "neither fish, flesh, nor fowl." It is quasi-public. The Board in Washington is clearly Government, and when we talk about its independence, we mean independence within the Government. The banks, the Federal Reserve Banks, are quasi-private. I like that in preference to quasi-public. The member banks select six directors of the nine on the directorate of each of the 12 Reserve Banks. The Board in Washington appoints three. Each Reserve Bank thus has nine directors. These regional Reserve Banks do not belong to the member banks who are their stockholders. The ownership of stock in a Federal Reserve Bank is not proprietorship. It is a device for participation in the management. I think it is important that you gentlemen realize what your heritage is in this system, in being permitted to bring the views of business to bear upon our problems through these directorates. This is a right that should be zealously guarded. But so much for the instrumentality, and for the basis upon which it rests.

Now I want to direct my concluding remarks to the concept of the free market. It has become very popular, I might say in the last ten years, to more or less make fun of the concept of the free market. I have been through a period in Washington--now over a decade--in which I have seen that trend develop, and I am glad to say I think it is being

reversed at the present time.

In the broad sense, what we are talking about when we talk of free markets is permitting the forces of the market--the forces of demand and supply--to have some play. Under wartime conditions, of course, the concept of free markets went almost entirely out the window. The decision taken in March of 1951 to unpeg the Government securities market was a decision to restore to the market some of the influence--not all of the influence, but some of it--which had been denied it by Government policy for a period of nearly ten years. With that decision, Government securities ceased to be interest-bearing money. The processes of the market place began to operate again, and the credit mechanism began to function once again as it should, as one of the governors on the fly-wheel of the economy, and many people were amazed at the influence and the effect that it unquestionably had, along with other factors, in slowing the inflation that was then going on.

I would like to stand here and tell you that that decision, the so-called Treasury-Federal Reserve accord, was an act of statesmanship. I couldn't truthfully say that because necessity is frequently the mother of invention, and necessity has a way of driving us back to first principles at some point. The essence of what I am trying to say in these brief remarks today is that there still are principles that remain with us, just as surely as the law of gravity in the realm of nature. And one of those principles, gentlemen, is the law of supply and demand.

We went through a period when we were told that exchange rates didn't make any difference. We had wartime controls that would take care of them. We were told that prices didn't make any difference. We were told that tariffs didn't make any difference. We were told that interest rates might have some effect, but after all, they were no longer a major factor; only classical economists thought in those terms. But we came face to face with the law of supply and demand despite all that. The time came when the volume of Government securities pressing for sale in the market was so great that the Treasury and the Federal Reserve approached the problem as a man might approach the walk under Niagara Falls with only an umbrella to keep him from getting wet. It was not a case at that point of buying a few million Government securities; it was a case of buying billions of Government securities, if we were to maintain a rate of 2-1/2 per cent on those securities.

Now there is a fiction--I believe it a fiction--that the Federal Reserve can control interest rates completely. I happen to be one of those who still believe that the credit and money basis of this country is formed at the grass roots, and I know a great many of you will understand me in what I am saying. I honestly believe that the composite judgments which come up through groups in various towns and hamlets throughout this great country have more to do with the credit basis of this country than has the influence of the Treasury and the Federal Reserve put together, although damaging effects may be felt if we in the Federal Reserve miscast our policy at a given time.

What I want to leave with you today is that this concept of the free market is not a shibboleth. By "free market" I mean, of course, relatively free--we are talking about a matter of degree, and not the kind of pure freedom that can exist only in theory. Having this relative freedom is of practical importance: Neither the Treasury nor the Federal Reserve, in my judgment, can afford to ignore the dictates of the market, because we have seen, through a period of time, that by and large the composite judgments of the market place are better than those produced by the board of directors of any given company, or any Secretary of the Treasury or any Federal Reserve Board. Modifications there must always be, but what we are dealing with is the concept out of which our liberty was cradled, and on which our economy was built. Our free way of life depends upon maintenance of a system in which private property, free competitive enterprise and the profit motive are permitted to operate around the broad modifying principle of the greatest good for the greatest number. There isn't anyone who thinks that the concept of private property is the same today as it was at the time the Pilgrims landed on Plymouth Rock. But, by and large, it still holds that, under our democratic institutions, and with our form of government, the greatest good for the greatest number will be achieved by having, to the maximum extent possible, a free, open market where the price mechanism can register its reflections of the interplay of supply and demand.

That, simply stated, is the philosophy upon which our money management rests today. In every situation that we face, it emerges not in dramatic strokes but as a developing and a fluid operation. I know that people would like to have us make striking pronouncements. People would like to have us say that at a given point policy was turned. I say that fashioning policy by this fluid and flexible system of money and credit management is like tailoring a garment to fit the outline of a dim and obscure future. Many fittings may be required to get everything right. And even then you have to take the garment and reshape it and remodel it from time to time, or even to reverse it if necessity appears over a day-to-day, week-to-week, month-to-month watch.

In my opinion, monetary policy should be conducted, as far as possible, so as to have a minimum of Government intervention, rather than maximum Government intervention. If we follow those principles, I believe our economy will bring results that will put to shame those other economies of the world which ignore these same principles.

Let me just say, in conclusion, that at some point I know from my experience that economics, like theology, becomes a matter of faith. Many years ago, as some of you have heard me recount, I came under the influence of a very brilliant and a very able professor, who loved to make fun of what he called "that parrot phrase, 'the American way of life.'"

He said, "that's just for 4th of July orations; you cannot even define it." His statements used to worry the life out of me during college days. I used to go back to my room and sit down and try to put

together various facets, but it remained a puzzle. I have the greatest respect for the individual I am talking about, but it wasn't until I had been ten years down in this community that it came to me as a deep-seated conviction how wrong he was. Perhaps it is a matter of faith. Without meaning for one moment to indulge in any corn, I will tell you that it seems to me that the glory of the American way of life is that it cannot be defined. It is a way of life that is modified and attuned to the times we are living in. It is a way of life shaped by these basic concepts I have been talking about. If we forget these basic concepts, we will have undermined the whole foundation of that way of life.

And so I want to leave with you today the thought that having money and credit policy on a flexible basis--having an instrument like the Federal Reserve System, which must itself be modified from time to time, because it is certainly not held forth by me as a perfect institution--is a part of the very basis of our economy. If we will adhere to principles, and have some understanding of what flexible money and credit policy means to our way of life, and to our livelihood, we will have nothing to fear for the future.

Thank you for letting me speak to you.

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