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Address of
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Chairman, Board of Governors of the Federal Reserve System
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More than a generation ago, President Wilson explained that his passionate belief in democracy stemmed from the reason that this form of social organization, with its emphasis on freedom and opportunity for the individual, "releases the energies of every human being."

As this occasion falls in the year when the memory of Woodrow Wilson is being honored on the 100th anniversary of his birth, it seems fitting to recall that remark--especially so for one who serves in the Federal Reserve System, which President Wilson helped to establish.

It seems to me that Mr. Wilson's observation helps to explain a great deal about American history in the interval since he made the remark: How we have survived great military perils and moved to higher rank among the nations of the globe; also, how we have survived great economic perils and moved to a higher standard of living here at home.

Other countries have staked their welfare upon systems whereby a ruling few decide what's best for the many, and then harness the energies of their citizens to achieve the pre-determined goals. Our country has put its faith in a completely different way of life: of having the government responsible for providing a climate of opportunity, and then relying for progress upon the enterprise

and energy of free people striving for better things for themselves, their families and their communities.

It is obvious that our country has far outstripped all others in material progress, and this without doing more thus far than scratch the surface of its potential. But for all that, its choice of the way of life to follow is still a matter of faith. And of course there are degrees of faith. All of us know people, admirably devoted to liberty, who say democracy is less efficient than other systems, but still worth having because inefficiency is the price of liberty. Woodrow Wilson had a stronger faith in democracy than that. He expressed it in these words: "The highest and best form of efficiency is the spontaneous cooperation of a free people."

In our country the responsibility of the government is to provide a climate of opportunity that will encourage our people to apply their enterprise and energy in bettering the lot of themselves, their families, and their communities, and thus promote the general welfare of the country as a whole.

That responsibility is one in which the Federal Reserve System shares. What I should like to talk about with you today is how the System views its responsibility, and how it goes about discharging it.

Our responsibility, at all times, is to assure monetary and credit conditions that will foster high levels of business and employment, maintain the stability of the dollar, and promote

sustainable growth in the economy. By doing so, we can make a substantial contribution to raising the living standards of the people as a whole. But we cannot do the whole job: business and employment do not live on credit alone.

How we go about discharging our responsibility is somewhat more difficult to describe--and, one gathers, infinitely more difficult to understand, if the explanation is couched in technical terms and extended into the fine points of central banking techniques, which, experience has taught me, are deadly bores to all save full-time central bankers. I'll try to bear that in mind, and be sparing of your patience.

It does seem to me, however, that it is not only possible but easy for anyone to understand the task and operations of the Federal Reserve System, and I rather think that the man-in-the-street does understand them in terms of his own experience.

In those terms, what the Federal Reserve is undertaking to do, at any time and in any action it takes, is to provide in the sphere of credit much the same thing that a modern heating and cooling plant undertakes to provide in the home: an atmosphere conducive to health, and comfortable for all--except, perhaps, those who are frozen or feverish.

Just as it would be unrealistic to expect universal agreement among 167 million Americans on what is an ideal home temperature, or what is the perfect climate, so it would be unrealistic to

expect complete agreement on what are ideal credit conditions. In each instance, there are some who like things hot and some who like them cold.

Perhaps it is not unreasonable, however, to expect a rather general agreement on a fundamental point that seems applicable for the individual household and the economy alike: moderate temperatures, in a fairly even range, are preferable, and healthier for almost everyone concerned, rather than sharp swings to the respective extremes.

That, at any rate, is the point of view from which the Federal Reserve System approaches its task of keeping credit conditions adjusted to changes in the economic climate.

It may help to explain, in terms we all understand, why the System exerts in the credit field a counter-force against deflationary chills and inflationary fevers alike. The System follows the logic of the homeowner who uses his heating equipment to moderate winter's excessive cold and his cooling equipment to moderate summer's excessive heat. Of course it shares the homeowner's delight in those periods when it is unnecessary to use either, as well as his aversion to running the furnace during a heat wave or running the cooler during a freeze.

In the domain of economic matters, including monetary affairs, there is, however, no exact counterpart of the thermometer

to provide an instantaneous and indisputable record of the current temperature and trend. Nor is there a thermostat to provide an automatic response, in proper direction and degree, to changes in economic conditions.

Monetary policy can never be an exact science because what it deals with, in the ultimate sense, is people rather than things. Like most matters of an economic character, it involves, among other things, sociology and psychology: it has to do with the reactions of a multitude of individuals--with human factors. I don't think monetary policy is cut out for automation. For no one has yet devised any system of levers or any formulas or devices by which you can regulate human nature. I think this is something we have to keep in mind in dealing with problems of high level employment and the satisfaction of the needs and wants of the community.

Clearly, the framers of the Federal Reserve Act were aware that monetary policy would inevitably require an element of judgment. For they took what seem to me some very wise precautions to see that the required judgments would be, insofar as human capacities permit, impartial, informed, and in the interest of the country as a whole.

As anyone can read them in full in the Act, I will take time here for only a couple of observations. One is that great care was taken, when Congress entrusted the power of money management to

the Federal Reserve System during President Wilson's administration in 1913, to safeguard that power from becoming a device that could be controlled either by private interests, on the one hand, or political interests on the other. Another is that the framework of the System was designed to reflect in the best American tradition a blending of the public interest and private enterprise, and also to accord recognition to the wide areas of the United States and the local and regional problems that arise out of peculiarly American conditions.

Thus we have in the Federal Reserve something different from the Bank of England or European central banks, where authority is centralized in a single bank with numerous branches. Instead, we have under the Federal Reserve Act a regional system which is now made up of 12 great regional Reserve Banks with 24 branches, and some 260 directors. In addition, the Board of Governors, in Washington, was given the responsibility and primary task of coordinating and directing policy so that it can work effectively.

Thus public and private participation is merged. The Reserve Board in Washington is, itself, clearly Government, and when we talk about its independence we mean independence within the Government, somewhat analagous to the independence of the judiciary. The regional Reserve Banks may be described as quasi-private. These regional banks, however, are subject to the regulations of the Reserve Board. The member banks select six directors

of the nine who serve on the directorate of each of the 12 Reserve Banks. The Board of Governors in Washington appoints the other three, including a Chairman and a Deputy Chairman.

The directors, in certain matters such as establishing discount rates and appointing the chief officers of the Reserve Banks, have a joint responsibility with the Board: the initiation of action rests with them, the necessary approval rests with the Board. All this is well known, and I do not need to dwell on it, although I do want to say this: the Federal Reserve has been fortunate in the caliber of men who have given so much of their time and effort to its service, which means the service of the general public; they merit the gratitude of the System, of their communities, and of the nation.

What I do wish to mention is something about the services of our directors over the nation that is not so generally recognized. And that is that they are most helpful in keeping the Board speedily posted on economic developments at the grass roots. I don't need to tell you that, of necessity, there is a time lag in much of the statistical type of information on which monetary and credit policy decisions must in part be based. No matter how good the data may be or how much effort goes into gathering it promptly, the fact remains that trends or changes in the direction of the economy usually begin to develop weeks or months before the statistical material can begin to reflect them. In bridging that time gap, the

assistance of 260 intelligent, experienced, and well-posted men located strategically over the face of the nation can be invaluable. They provide the Federal Reserve System with not just ears and eyes but also, in the realm of economic intelligence, the nearest equivalent of a radar network.

That is an important as well as a unique advantage of the System, as becomes evident when we consider what is required in formulating a program to provide credit and money conditions properly attuned to the economic needs of today, and of tomorrow as well. The first requirement is a painstaking search for all the relevant facts that may bear upon the economic and financial outlook. The next is interpretation and appraisal of those facts.

There are of course other requirements, less tangible but not less essential. One is consciousness of certain principles that underlie and sustain the American system. Another is humility--or perhaps I should say an awareness that no man can unerringly foresee the future, and therefore he will do well not to act as if he could.

To me, one of the basic principles that underlie and sustain our economy and our private, competitive system is embraced in the concept of the free market, where balance is achieved by the interplay of demand and supply.

By "free" I mean of course "relatively free," since all freedoms--even our cherished freedom of speech--are necessarily relative, rather than absolute. The idea of an absolutely free

money market, if ever it existed on other than a purely theoretical plane, must itself have been altered when passage of the Federal Reserve Act conferred on the Federal Reserve System authority to influence the money supply. But that authority was conferred for the purpose of providing a money supply in harmony with economic needs--not for arbitrary juggling of the money supply to fix some particular level of interest rates, either high or low.

Regulating the money supply to fit economic needs is one thing, and fixing interest rates is another. To fix an artificially low rate, you would have to pump money into the economy in inflationary doses; to fix an artificially high rate, you would have to starve the economy for money. There is no such thing as a simple choice between high or low interest rates. The fundamental requisite is to see that the volume of bank reserves is appropriate to high level stability in the economy and then to let interest rates be determined in the market place where they can rise or fall in response to supply and demand.

All these matters are part of the background of monetary policy decisions. Perhaps I should mention as well some basic considerations that enter into making the decisions themselves. The first consideration is to estimate the financial needs of the general economy--the private sector, as represented by industry, commerce, agriculture, consumers, and so on, and the public or governmental sector, of which the United States Treasury is representative. The

needs of these two sectors are intertwined, but they can be separated for purposes of discussion.

The Treasury, of course, has the task of raising the money needed to pay for the expenditures which are authorized by Congress, and of managing the governmental debt accumulated in that process. The Federal Reserve's task of managing the money supply must be conducted with recognition of the Treasury's requirements, for two reasons: One, the Federal Reserve has a duty to prevent financial panics, and a panic surely would follow if the Government, which represents the people as a whole, could not pay its bills; Second, it would be the height of absurdity if the Federal Reserve were to say in effect that it didn't think Congress was acting properly in authorizing expenditures, and therefore it wouldn't help enable the Treasury to finance them. So Treasury financing must always be a major consideration of monetary policy.

When we talk about independence of the Federal Reserve we're not talking about making it difficult for the Treasury to borrow money. On the other hand, there is a reciprocal obligation on the part of the Treasury to conduct its operations with recognition of the Federal Reserve's responsibility for contributing to stability of the economy and stability of the dollar.

The Treasury obviously would not expect the Federal Reserve to inflate the money supply, thereby putting the entire economy in jeopardy, so that the Treasury can get money at an

artificially low rate. So, with complementary responsibilities, the Federal Reserve and the Treasury must work together. Neither can ignore the forces of supply and demand that are reflected in the market place by dictating what interest rates should be. Instead, both must assess market place forces and determine their policies accordingly.

Now as to the needs of the private sector of the economy: business--including agricultural--needs for credit characteristically expand at certain seasons, and it is always the job of the Federal Reserve to see that those seasonal needs are met. The Federal Reserve has always done so, and will keep on doing so. It is one thing for interest rates to rise under the pressures of a heavy demand for credit, and another thing for money to become completely unavailable. The forces of the market must be allowed to operate, as reflected in interest rates, but it would be preposterous to stifle the economy by making money unavailable. Because this is a vast country, money may be less available in one area than another for limited periods, but it is up to the Federal Reserve to see that the seasonal requirements of business are met.

A third factor that requires consideration in determining monetary policy is that of growth. The volume of money must grow with the growing population and the growing scale of economic activity. How much growth there should be is more difficult to say.

Some people think the money supply ought to grow at the rate of 3 per cent a year, while others may say 2 per cent or 5 per cent; I do not profess to know what the figure ought to be, and I doubt that a precise figure can be set as desirable for year-in-and-year-out purposes.

In the matter of growth measurements, one needs to be extremely careful. Growth in the money supply must be regulated according to the country's real needs. If borrowers crowd banks with loan demands on a scale much greater than average normal growth, they can expect the result to be some rise in interest rates. If that rise does occur, it merely signals continuance of the Federal Reserve policy of letting the supply and demand for credit be reflected in market rates of interest. Certainly it does not signal a policy of choking off the flow of credit and forcing rates artificially higher, for there is not any such policy and there is not going to be one of that kind.

A fourth factor that we have to deal with is psychology-- and no reliable yardstick has yet been devised to measure what people may be thinking. What things really are may count most in the long run, but what often counts in the short run is what things seem to be--what people think they are. I recall a brief period some three years ago when we were proceeding on technical measurements of the money supply that, even in retrospect, seem to me pretty close to perfect. But even if they were right in fact, they were wrong in the scales of psychology. And what counted was not what the facts

were, but what people thought they were.

Well, the earth has been round since, presumably, the beginning of its existence, and yet for age after age men insisted it was flat, with the practical consequence that the discovery of America, among other things, was retarded by a few centuries.

In the case I cited of a Federal Reserve misjudgment of psychology, the only feasible thing we could do was to adjust to the situation as soon as we saw it. All I can say about our adaptation of policy at that particular point is that it illustrates something we talked about earlier; since monetary policy deals with human nature and human beings, it can't operate on a formula basis. You've got to be prepared to respond quickly to developments as they occur. You cannot expect to foresee future needs perfectly and hit them right on the nose. If you get within a reasonable range, you're doing about as well as is likely in an imperfect world.

Of course we also have to consider the factor of the business cycle, but I think it has been evident through all I have said that we do our utmost at all times to stay alert to the dangers of both inflation and deflation, and to counteract either with equal vigor.

We fight inflation partly because it is the forerunner of deflation. If I thought inflation would create jobs and prosperity, I might be for it. But I am convinced that, apart from transitory effects, the result of inflation is the destruction of jobs and prosperity. I know there are some who think differently--who believe that "a little inflation"--say a price rise of about 3 per cent a year--

is a good thing, especially for "the little man." It seems to me they owe it to owners of savings bonds, pension rights, savings deposits, building and loan shares, life insurance policies, and so on to explain just how a "little inflation" is going to help them.

I promised not to weary you with talk about the techniques of central banking, but I ask your indulgence for a brief comment on the mechanism through which monetary policy is effected. Open market operations, discount rate changes, and reserve requirement changes are the closely inter-related parts of that mechanism. Confusion often arises because we are apt to talk about this mechanism as if it offered a choice between three separate means of easing or tightening credit. All three must operate together--the supply of reserves being basic. Open market operations and discount rates affect that base. It is therefore misleading to think of the three components as if they were alternatives to be used independently of each other.

The use of one component rather than another at a particular moment is explained by the fact that, by its nature, each has a different impact. Reserve requirements are the bluntest of the three, having by their nature the heaviest impact because they necessarily release or absorb very large sums. Accordingly changes in reserve requirements are best suited to broad basic adjustments.

Open market operations are impersonal, pervasive, and best suited to day to day adjustments, for they can be used to

release or impound small or large sums in reserves in accordance with current conditions.

Discount rate changes, in respect to frequency of use, fall in between the others: they were revised downward twice in 1954, during a comparatively short and mild business downturn, and they have been revised upward five times over the last 12 or 13 months as the economy rose toward its capacity and demand for borrowed money strained the limits of supply.

It is worth noting, I think, that for some five years monetary policy, released from wartime and early postwar shackles, has been characterized by flexibility and by prompt adaptation to the ever changing needs of a thriving economy. The test of the policies pursued is not the direction they have taken--toward expansion or restraint--but whether they were appropriate to the times and conditions in which they are applied.

Monetary policy, as I have had occasion to say before, must be tailored to fit the shape of a future visible only in dim outline. Occasions are rare when the meaning of developing events is so clear that those who bear the responsibility can say, "As of today, our policy should be changed from ease to restraint"--or from restraint to ease, as the case may be. What is true of a change in policy is also true of a shift in policy emphasis: it is rarely decided upon in a single day. More typically, as is evidenced by open market

operations, the outline of a shift in policy emphasis, like the outline of the future, emerges gradually from a succession of market developments and administrative decisions. It is a poor subject for the photo-flash camera to capture as a clearly defined still life, or for a news story to etch in spectacular outline. Getting a perfect garment for the future may require several fittings.

Let me emphasize again that the Federal Reserve's authority to combat excesses in the field of money and credit enables it to help in moderating swings in the business cycle, but it cannot do the whole job. If we depend upon the Federal Reserve or the Government to protect us from our own excesses then, by the very nature of our free economy, we are doomed to difficulty and distress.

If businessmen, bankers, your contemporaries in the business and financial world, stay on the sidelines, concerned only with making profits, letting the Government bear all the responsibility and weight of guidance of the economy, we shall surely fail. In an economy so closely interwoven as ours, there is need for a larger vision, on the part of us all.

I should like to close, as I began, with some words of Woodrow Wilson:

"We claim to be the greatest democratic people in the world, and democracy means first of all that we can govern ourselves. If

'our men have not self-control, then they are not capable of that great thing which we call democratic government. "

Those words are as pertinent today as when President Wilson uttered them in November, 1917.