

I have here an interesting letter from Prof. Milton Friedman, of the University of Chicago. It is a brief letter and because we have had the defense, so to speak, of the new proposal made by Mr. Mitchell, and as I understand you gentlemen are quite favorably disposed, it might be helpful if I read this brief critical letter into the record and you might keep it in mind during the discussion period following your presentations for comment.

This was mailed from Oslo, Norway, September 13, 1968.

"Dear Senator Proxmire:

I understand that the Joint Economic Committee is holding hearings on September 17 about the Federal Reserve System's proposed redesign of its discount mechanism. On the assumption that this is correct, I am taking the liberty of submitting to you some comments for the record since I shall still be in Europe on that date.

"The proposed redesign (as outlined in *Reappraisal of the Federal Reserve Discount Mechanism*," *Report of a System Committee*, July 1968), seems to me a major step backwards.

"It is urgent that, at the least, there be a full congressional investigation by the appropriate congressional committees before the proposed plan is put into effect.

"The present rediscount mechanism is an anachronistic survival of an earlier day. Its initial function was to assure that pressures on any one bank could be relieved before spreading doubt and distrust about other, entirely sound, banks and so causing general monetary difficulties. It was not properly used in the early 1930's for this purpose, with the result that Federal Deposit Insurance was enacted. Such insurance now performs effectively the function discounting was supposed to but did not perform. The difficulties of any one bank do not give depositors of other banks any reason to fear for the safety of their deposits. Hence, since FDIC there have been no serious runs on significant groups of banks. Rediscounting, therefore, has no important remaining function to perform. It only adds a disturbing element to the monetary system that renders the Federal Reserve's major task of monetary control more difficult and erratic. For this reason, I have long favored the essential elimination of rediscounting as a tool of monetary management.

"The Federal Reserve proposals go even farther back—to the disastrous attempts by Secretary of the Treasury Shaw in 1905 (if my memory serves me right) to use Treasury balances for precisely the purposes for which the Federal Reserve proposes to rediscounting—to ease seasonal and exceptional pressures on individual banks or groups of banks. This policy was an important factor paving the way for the Banking Panic of 1907 by encouraging to keep unduly small reserve balances in the expectation—which the pinch came was disappointed—that the Treasury would bail out. As I read the Federal Reserve's present report, I could hear echoes of Secretary Shaw's confident pronouncements more than 60 years earlier and the whole analysis was pervaded by the same that marred his project—the failure to allow for the reflex of the existence of the new mechanism on the policy of the themselves.

"The Federal Reserve System has ever since its inception had very different functions: monetary policy—control over the