

that did not behave itself, all combined to drain confidence from financial markets in general and from the banking system in particular.

I am not saying that the Federal Reserve should not have imposed tight monetary conditions in 1966. What I am saying is that the means it employed to do so were clumsy and hazardous: closing all avenues to liquidity simultaneously—and threatening to do so is virtually tantamount to actually doing so—is almost sure to create apprehension throughout the financial community and seriously impair the functioning of financial markets. Some safety valves must be left open, and market participants need assurance that they will continue to be left open, to avoid financial strangulation. That is no less true today than it was when Bagehot was writing Lombard Street almost a century ago.

It is for this very reason that the central bank has traditionally been called “the lender of last resort.” It is the function of the central bank, surely on a par with any of its other functions, to stand by at all times as the ultimate supplier of liquidity in time of need. Such marginal liquidity may be made more or less costly, by varying the discount rate, but to make it more or less accessible is likely to invite grave repercussions throughout financial markets.

The proposed “New Look” in discount policy indicates that the Federal Reserve has learned a lesson from the 1966 experience. Within the total instrument mix of monetary policy, the discount mechanism is the instrument that is best able to provide a safety valve—to furnish injections of liquidity where needed—when over-all pressures become severe. The System Committee’s Report makes it likely that the discount mechanism will perform that function more adequately in the future than it has in the past. Since that should be the primary function of the discount mechanism, within the over-all mix of monetary policy instruments, the Board’s proposal is a good one. Its adoption should enhance the effectiveness of monetary policy by making the central bank more responsive to the rapid alleviation of excessive pressure precisely at those points where and at those times when relief is most needed.

The “New Look” will further that end (1) by making member banks less fearful of approaching the discount window, given that the “basic borrowing” line is now more accessible than formerly; (2) by providing that “other adjustment credit” applications are to be expected as more or less a matter of course; and finally, (3) by establishing a category of “emergency credit” which I assume banks will be informed would not have been specified in such detail if the central bank did not expect it to be utilized from time to time. This emergency accommodation will also evidently be available to non-member banks and other financial institutions. If I were to disagree with any aspect of the proposal it would be to question why emergency credit to other than member banks needs to carry a rate “significantly higher” than the prevailing discount rate.

This “New Look” by itself will not by any means guarantee that the discount window will fully serve the lender of last resort function better in the future than it has in the past. It is a step in the right direction, however, and the new discount machinery should facilitate the attainment of that end.