

care of this. Also, it provides a nationally determined rate automatically. Further, if we assume a realistic relationship between the discount rate and its market counterpart, the fear of an inordinate increase in the money supply through discounting is lessened. In brief, market forces are allowed to play a greater role in determining the amount of borrowing.

There are problems present, of course, such as what market rate to use, whether the discount rate should be at a "penalty" level relative to market rates, whether nonprice criteria should also be used in determining borrower eligibility, et cetera. We need not discuss these at this time. While important, their detailed treatment now is incidental to the concepts being developed and would be better left for later analysis.

CONCLUSIONS

The preceding comments have touched on concepts and basic relationships which I consider important in evaluating the proposed reforms. Based on this, my overall conclusion is that these reforms are not totally acceptable in their present form.

First, they could weaken the competitive position of small member banks. While seasonal borrowing privileges might help their position, the overall resources of large banks could enable the latter to maintain their "share" of the market and probably increase it. This assumes large member banks readjust past propensities to avoid the discount window, and further that they are not thwarted at the discount window in favor of smaller member banks. The feeling among supporters of the reforms is that if the opportunity to borrow at the discount window for member banks is made to be more economically feasible, this tendency for avoidance in the past will fade away, albeit slowly. Further, the limitation of quotas in favor of small banks is obviously an unreasonable form of nonprice bias and, therefore, unacceptable in principle.

A second objection deals with the indirect lending of emergency funds to nonmember financial institutions. The Federal Reserve should make no commitment to support any individual sector of the economy. Perhaps if a particular rate were clearly out of line, the System may be justified in stepping into that market temporarily, but the border between a temporary and a fundamental trend is always hazy. Assistance to one segment of the market sets a precedent for increasing numbers of requests for such assistance.

Again, may I thank you for the privilege of appearing before this committee. I hope these comments may be of some benefit in your final evaluation of the proposed changes.

Chairman PROXMIRE. Well, gentlemen, thank you very much. These are competent and thoughtful papers and I appreciate the work that you put into them.

Mr. Ritter, you had a chance to glance—unfortunately, you did not have a chance to read in any detail the letter from Mr. Friedman. Just before you came in I read it into the record, so that both Mr. Robertson and Mr. Gies have had a chance to hear it.

I would like to ask each of you gentlemen to comment on it along these lines.

First, how do you answer the Friedman argument that discounting is pretty much an anachronism now, that its purpose has been taken