

Chairman PROXMIRE. Is not No. 1 correct, that it complicates the making of Federal Reserve monetary policy?

Mr. GIES. I do not believe it really is.

Chairman PROXMIRE. Why not?

Mr. GIES. The people at the Federal Reserve would not seem to support that view. None of them if we are to believe the statements that have been prepared for us, feel that their executive skills are tested and seriously complicated by the availability of this.

Chairman PROXMIRE. But what they say is that they can easily compensate for the increase of between \$2.5 to \$3.8 billion, whatever it is, maybe three at the extreme, they can easily compensate by engaging in open-market operations and the answer, of course, as I indicated here is that one continuous objection to this is that what this does is to push up the rates higher. Even though it is easier for the banks to accommodate to it, it is harder for the savings and loan, which is of some importance. Of greater importance, it is much more difficult for the housing industry to meet this kind of a situation, an industry which is already disadvantaged by our present monetary arrangements.

Mr. GIES. I think he could have made a better point and one which you might have appreciated. That is that the Fed could set the overall funds for availability of credit and the cost of credit via their open-market operation. They have adequate ammunition. It is an adequate instrument to accomplish that.

If in the course of doing this a little imprecision enters, a little uncertainty and variability in the impact of these controls on that part of the institutional apparatus that feels the immediate impact; namely, the commercial banks, then we give them a little leeway via the discount mechanism.

It is similar to the principle that you can drive your car faster if it has a good set of brakes. If you are about to bump an obstacle you can veer away from it, perhaps is a better analogy.

In any case, the discount window is in effect a safety valve. I do not think that this is the only safety valve that the American economy provides. The Federal Funds Market has developed into an extremely effective market. Not only do the large banks have access to it but since I am involved in the management of a number of small banks I can attest to the fact that small banks have ready access to the Federal Funds Market and have been using it. It has depth, it has breadth, it has reasonably good stability.

Friedman, I should think, might have pointed out something else, however, with regard to the discount mechanism. I should think he might have argued for its preservation on grounds of allocation of resources. It seems to me that once you have decided approximately what the overall amount of credit should be and have implemented this through the open-market operation, then one might be concerned to assure the most advantageous use of the funds, the most fruitful investment of capital. Maybe it is housing. Maybe it is plant and equipment. Maybe it is something else. But whatever is the most important use for credit at the margin should not be denied and we can insure perhaps via a penalty system in the discount mechanism at those projects which are able to pay the penalty rate, which means