

perhaps \$2 billion. Assuming some increase in the banking membership of the Federal Reserve and use of the maximum allowable lending by the Fed, this figure might be in the neighborhood of \$4 billion. Specific information from the Fed as to the magnitudes involved would aid in the consideration of this proposed action.

The conservative \$2 billion may be enough to seriously disrupt money markets and interfere with mortgage lending, nonbank financial intermediaries. Mr. Martin, Chairman of the Federal Reserve System, when testifying on H.R. 16092 in June of 1968 pointed out the changes to housing involved in providing special credit which must be offset by open market operations. Mr. Martin states:

"If the Federal Reserve sold Treasury bills to offset purchase of this magnitude, borrowing costs would rise sharply for the Treasury and for other nonmortgage borrowers. We have recently seen how rapidly Treasury bill rates can climb merely under the apprehension that financial markets would be subject to considerable additional future pressure * * *. Such upward interest rate pressures would, in turn, divert flows of savings from the depository institutions directly to the market. This diversion would magnify the effects of tight money on the availability of mortgage credit from nonbank intermediaries. It would affect particularly adversely the savings and loan associations and mutual savings banks that specialize in residential mortgage lending."⁶

If Mr. Martin's statements are a valid criticism of providing direct credit to mortgage lenders caught in a monetary squeeze, they would seem to have even greater application concerning the provision of credit to commercial banks, essentially nonmortgage lenders. All of the perverse effects would seem to be involved without the redeeming quality of providing direct credit for mortgage financing.

AN ALTERNATIVE PROPOSAL

Many of the threats involved for mortgage lending and the operation of nonbank financial intermediaries could be avoided by a simple modification in the proposals. If the Federal Reserve were to couple its wider provision of discounts with a proscription against providing such discounts at below alternative market rates, all of the proposed benefits could be obtained with few of the threats to other existing economic activities. The Fed does not argue that Federal funds are too expensive for the small bank; rather, it argues that they are not available. Thus, making them available at a rate equal to or minimally above some benchmark market rate would make funds available while not providing misleading price signals. The provision of funds at market rates would largely remove the need for the Federal Reserve to engage in the offsetting open market operations discussed earlier. On a national basis this is so because no net incentive to borrow from the Fed would exist.

A possible reason why the Fed has not suggested the use of market rates or a minimal penalty rate for all borrowers is that they wish to combine the stated objectives of the discount amendment with a subsidy to member banks. The reason for such a subsidy would be to stem

⁶ Wm. McChesney Martin, hearings before the Committee on Banking and Currency, House of Representatives, on H.R. 16092, June 1968, p. 103.