of the responsibility for accommodating these short-run reser[illegible] thus allowing such operations to be undertaken with increased [illegible] tion to the longer run concerns.

I recognize that one other effect of the proposed new discou[illegible] anism would probably be some lowering of the levels of liquidi[illegible] tained by certain groups of banks as they are able to rely on the [illegible] Reserve for increased credit to meet temporary unforeseen or [illegible] ring needs. However, this effect is expected to be concentrated [illegible] smaller rural banks which, because of anticipated need and lack [illegible] access to the central money market, presently maintain an [illegible] sarily high portion of their resources in highly liquid but low-[illegible] assets such as U.S. Government securities, or, in a surprising [illegible] of cases, in nonearning excess reserves. This tendency on the [illegible] some country banks can, of course, result in the credit needs of [illegible] communities they serve being less than fully met.

On the other hand, the proposed redesign is not likely to [illegible] significant impact on the liquidity of the larger city banks [illegible] already have convenient access to market sources of funds. In [illegible] the supervisory function of the Federal Reserve and that of th[illegible] troller of the Currency will continue to operate to insure that [illegible] vidual member banks maintain adequate liquidity.

Professor Friedman's characterization of the discount window [illegible] conveying a subsidy to member banks must be based on some [illegible] ing of the proposal. The rate charged on borrowing under the [illegible] discount arrangements would not, as Professor Friedman sp[illegible] average 2 percentage points below market rates, but on the [illegible] trary would be kept in reasonably close alinement with mar[illegible] This is a clearly stated aspect of the proposal, and it assures t[illegible] will be no significant subsidy to banks or cost to the U.S. t[illegible] Moreover, access to the window is normally limited to memb[illegible] and the value of this privilege ought to be weighed in light of [illegible] requirement that these banks maintain a portion of their dep[illegible] in nonearning capacity as reserve.

I am grateful for this opportunity to express my views on [illegible] Friedman's comments. As you know, the Board is actively [illegible] reactions from all sources on the proposals for redesign of the [illegible] mechanism and is endeavoring to give full and open consideration [illegible] all comments received. I feel that this process should includ[illegible] opposing views when, as in the present case, it is felt that i[illegible] misconceptions are involved in those comments. I would appreciate [illegible] if you would include this letter in the record of your hearings on [illegible] discount mechanism.

Sincerely,

George W. Mitchell.